

Mutual funds in the Cayman Islands

The Cayman Islands is the leading jurisdiction for the offshore investment funds industry due to its combination of flexible and appropriate regulation, an approachable and effective regulator, professional service provider expertise, high reputation among investors and a tax neutral fiscal regime.

Overview

Investment funds established in the Cayman Islands fall into two broad categories: open-ended funds and closed-ended funds.

Open-ended funds provide investors with voluntary redemption or repurchase rights and closed-ended funds do not provide investors with those rights. Typically, open-ended funds will invest in liquid assets which can be readily realised to fund redemptions (eg listed, liquid, tradable securities) and closed-ended funds will invest in non-liquid assets requiring time to liquidate/realise value (eg real estate, unlisted growth companies).

This guide sets a summary of the regulatory regime of open-ended investment funds, which is supervised by the Cayman Islands Monetary Authority (**CIMA**).

For an overview of the regulatory regime that governs private funds please see [Guide to Private Funds in the Cayman Islands](#).

Fund vehicle options

Companies

Exempted companies limited by shares are the most common form of entity used for the establishment of open-ended investment funds, with an investor's liability being limited to the amount paid or agreed to be paid in respect of their shares. Please see our [Guide to Exempted Companies](#) for more details.

Segregated portfolio companies

An exempted company may register as a segregated portfolio company (**SPC**), which is similar to a segregated cell company in many other jurisdictions.

An SPC may establish any number of segregated portfolios. Assets and liabilities attributed to a particular segregated portfolio are legally separated from the assets and liabilities attributed to any other segregated portfolio. A creditor who is party to a contract involving a particular segregated portfolio will have restricted recourse and will be entitled to recover only against assets attributed and credited to the specific segregated portfolio to which the contract is also attributed.

SPCs can be useful as multi-strategy vehicles and platform vehicles. Savings by using multi-strategy SPCs are often not as great as anticipated however and SPCs with multiple segregated portfolios do require a greater degree of care to ensure assets are properly segregated, contracts are entered into on behalf of the correct segregated portfolio and inadvertent cross-collateralisation does not occur. Please see our [Guide to Segregated Portfolio Companies](#) for more details.

Limited liability companies

Limited liability companies (**LLCs**) can be incorporated in the Cayman Islands in a form closely aligned to the Delaware LLC. LLCs may be used in investment fund structures where a flexible structure similar to a limited partnership is required, but

where the vehicle needs to be established as a body corporate distinct from its members. LLCs are regulated by their LLC agreement and the Limited Liability Companies Act. Please see our [Guide to LLCs](#) for more details.

Exempted limited partnerships

While an exempted limited partnership (**ELP**) is the most common vehicle for closed-ended funds including private equity, venture capital and real estate funds, they are also used for open-ended funds. An ELP has many similarities to its Delaware equivalent vehicle but an ELP is not a separate legal person and for this reason, it is popular with managers and investors in a number of jurisdictions. An ELP is managed by its general partner. Please see our [Guide to ELPs](#) for more details.

Unit trusts

Cayman Islands unit trusts are established under and governed by the Cayman Islands Trusts Act and, save as modified under that law, generally applicable principles of English trust law. Under a unit trust investors contribute funds to a trustee which holds those funds on trust for the investors and each investor is directly entitled to a pro rata share in the trust's assets, its unit. Unit trusts are constituted under a trust deed that provides the terms on which the trustee holds the trust's assets for unit holders. The use of Cayman Islands unit trusts is particularly popular in Japan for domestic tax purposes.

General

Establishment

All of the above entities can be established on an express basis and no governmental or regulatory approvals are required.

Taxation of vehicles

All of the above vehicles are exempted from any Cayman Islands income or gains taxes and can obtain a tax undertaking certificate from the Cayman Islands government guaranteeing no change in their tax status for 20 years or more.

Liability of investors

All of the above vehicles issue equity interests which typically limit investor liability to the amount paid or agreed to be paid in respect of their investment.

Management of entities

An exempted company's or SPC's management rests with its board of directors, a unit trust's with its trustee, an LLC's with its members or a separate manager or managers and an ELP's with its general partner, and these are all referred to as 'operators'. Typically, investment management authority is delegated to an investment manager or adviser although the relevant operator will always be required under generally applicable law to maintain oversight of the investment manager's functions.

CIMA has provided guidance on best practice for fund governance which should be followed by operators of all funds. See our [Guide to Duties and Obligations of a Director of a Cayman Islands Fund](#) for further details.

Mutual fund and securities regulation

The Mutual Funds Act (**MF Act**) is the main legislation regulating open-ended investment funds in the Cayman Islands. Investment managers, broker dealers and others carrying on securities investment business from the Cayman Islands must comply with the Securities Investment Business Act (**SIB Act**). All investment funds, investment managers and their service providers must comply with anti-money laundering and automatic exchange of information laws and regulations.

What is a 'mutual fund'?

To be categorised as a mutual fund under the MF Act:

- the fund must be issuing equity and not debt or contractual interests, in other words, shares, limited partnership interests, LLC interests or trust units
- the fund must be a collective investment vehicle effecting the pooling of investor funds
- the fund must issue equity interests which are redeemable or repurchasable at the option of the investors, so those funds where the fund operators have discretion to consent to redemptions or repurchases are exempt. However, funds with an initial but limited no redemption lock-up period (usually from six months to three years) are considered mutual funds for the purposes of the MF Act
- the fund must be established in the Cayman Islands or be a foreign fund and seek to make an offer or invitation to the public in the Cayman Islands to subscribe for its equity interests

Exclusions or exemptions from regulation for funds?

Some funds are not considered mutual funds under the MF Act and therefore are not required to be registered with, or licensed by, CIMA under that law:

- single investor funds (which are not master funds) are not mutual funds, as there is no 'pooling' of investor funds
- closed-ended funds which do not permit the redemption or repurchase of investor equity, for example private equity funds, are not mutual funds (however please see our private funds guide referred to above as a private fund may need to be registered with CIMA under the Private Funds Act)
- listed or otherwise regulated funds which are not incorporated or established in the Cayman Islands and which make invitations to the public in the Cayman Islands to subscribe for the fund's equity interests through a person licensed under the SIB Act, provided that the fund in question must be either:
 - listed on a stock exchange recognised for the purpose by CIMA
 - regulated in a category and by a regulator recognised for the purpose by CIMA

Regulated mutual funds

There are four categories of regulated mutual funds:

- registered funds (which includes master funds required to register)
- limited investor funds
- administered funds
- licensed funds

Registered funds

This is the most common category of regulation under the MF Act, with approximately 68 per cent of Cayman Islands mutual funds registered with CIMA coming under this category as at the end of Q1 2023. To qualify for registration as a registered fund, a mutual fund must have either:

- a minimum initial subscription amount of US\$100,000, or its equivalent in any other currency (by far the most common), or
- its equity interests listed on a recognised stock exchange approved by CIMA

Master funds

Master funds are a sub-category of registered funds. Approximately 25 per cent of Cayman Islands mutual funds registered with CIMA are master funds as at the end of Q1 2023.

A master fund is a vehicle that facilitates the investment by feeder funds located in the Cayman Islands or elsewhere. Typically a master fund is used when different types of investor are going to be investing in a similar investment strategy but they cannot be commingled in one vehicle.

A Cayman Islands entity into which a CIMA regulated feeder fund (which is a mutual fund regulated by CIMA that conducts more than 51 per cent of its investing through a master fund) invests is classified as a 'master fund' under the MF Act. A master fund does not benefit from the single investor exemption or fall within the limited investor fund classification (15 or fewer investors).

For example, a typical master/feeder structure may involve a Cayman Islands feeder fund and a US feeder fund being set up to invest in a Cayman Islands master fund. If the Cayman Islands feeder fund were registered or licenced by CIMA then the master fund would have to register. However, if the Cayman Islands feeder fund is not required to register with CIMA (for example, because it is a single investor fund) and the only other investor is the US feeder fund, the master fund would instead be classified as a standard mutual fund and would likely register as a registered mutual fund with CIMA.

Limited Investor funds

Limited investor funds are those mutual funds of which the equity interests are held by not more than 15 investors, a majority of whom (in number and without reference to the number of shares or other equity interests held by each investor) are capable of appointing or removing the operator of the fund. The limited investor fund classification excludes master funds.

This category of fund was previously known as a "section 4(4) fund" or "exempt fund" because it was not required to be registered with CIMA. However changes to the mutual funds registration regime in 2020 mean that all such funds are to be registered with CIMA.

As at the end of Q1 2023, approximately 5 per cent of mutual funds are registered as limited investor funds. This is mainly down to the fact that a limited investor fund and a registered mutual fund are subject to identical regulatory oversight so there are now no benefits to being a limited investor fund in the Cayman Islands.

Administered funds

Administered funds make up approximately 2 per cent of mutual funds that are registered with CIMA as at the end of Q1 2023.

Administered funds will generally be used if the promoter does not want to have a minimum initial investment amount for its investors. The mutual fund must designate a principal office in the Cayman Islands at the office of a Cayman Islands based licensed mutual fund administrator. The key difference to registered funds is that responsibility for regulatory oversight for administered funds is largely delegated to the licensed mutual fund administrator and therefore the administrator providing the fund's principal office must be satisfied that:

- each promoter of the fund is of sound reputation
- the fund's administration will be undertaken by persons with sufficient expertise to administer the mutual fund and who are of sound reputation
- the fund's business and any offering of its equity interests will be carried out in a proper way

On an ongoing basis, the licensed fund administrator must notify CIMA if it has reason to believe that a fund for which it provides the principal office is acting in breach of the MF Act, is insolvent or is otherwise acting in a manner that is prejudicial to its creditors or investors. There are also specific on-going obligations applicable to licensed mutual fund administrators.

Licensed funds

This is the rarest category of Cayman Islands funds with fewer than 1 per cent of regulated mutual funds falling under this category of regulation as at the end of Q1 2023.

Unless a mutual fund falls within one of the other categories described above, it must obtain a mutual fund licence. A fund promoter manager would usually choose to licence a fund under the MF Act if the fund is intended to be a retail fund offered generally to the public outside the Cayman Islands, with its administrator and/or manager and other key service providers located outside the Cayman Islands.

Licensed funds are rarely encountered in practice as retail investment funds are normally set up as onshore funds in accordance with the regulatory requirements of their relevant home jurisdiction. However, one of the main exceptions to this practice has been in Japan, where the use of licensed funds structured as Cayman Islands exempted unit trusts has been popular. This type of category is usually only chosen by well-known financial institutions.

EU connected funds

The Cayman Islands Government passed legislation which introduces the concept of 'EU Connected Funds' to enable Cayman Islands funds to take advantage of the passport regime under the Alternative Investment Fund Managers Directive¹ as and when it becomes available to Cayman Islands investment funds. Further secondary legislation sets out in detail how EU Connected Funds will be regulated. The EU Connected Fund regime under the MF Act will allow both open-ended and closed-ended funds to apply to be registered or licensed with CIMA as EU Connected Funds and therefore enable them to benefit from the EU passport regime.

Service providers

Auditor

All regulated mutual funds must appoint an auditor from a list of firms approved by CIMA (and the local Cayman office of that audit firm will need to sign off on the audited financial statements).

Administrator

Although not a MF Act requirement, in practice regulated mutual funds will generally appoint an independent administrator whose function will be to handle all of the day to day fund accounting, net asset value calculations and investor due diligence and reporting.

Investment manager

There is no restriction on the location or regulation of the investment manager of a regulated mutual fund and managers may wish to set up a Cayman Islands vehicle as the investment manager or adviser to the fund.

The SIB Act regulates the advisory and management services of investment managers and investment advisers incorporated, registered or with a place of business in the Cayman Islands.

Further details on investment managers and advisors and the SIB Act can be found in our [Guide to Securities Investment Business](#).

Location of service providers

Save for administered funds and the local auditor sign-off requirement, there is no requirement that a mutual fund's service providers be based in the Cayman Islands or in any prescribed jurisdiction.

Registration

To register a registered fund with CIMA, the following documents must be filed via CIMA's online registration system:

- the online application form including details of the fund, its service providers and its anti-money laundering and compliance officers
- the fund's offering document
- consent letters from the fund's administrator and auditor (confirming that they act as such on behalf of the fund)
- the fund's certificate of incorporation, registration or trust deed
- the Electronic Transactions Act affidavit or declaration, and
- payment of the relevant application fee

General provisions affecting ongoing operation of Cayman Islands funds

The Cayman Islands open-ended fund model requires transparency and full disclosure in the offering document, an audit firm that has been vetted and approved by CIMA and regular reporting. It is a model that emphasises disclosure over arbitrary prescription and so there are no requirements as to leverage or asset allocation or investment strategies. The model has proved popular and has changed little over the years, giving investors and managers a certain platform for their agreements.

The following sets out the key continuing obligations for a registered fund, and for further details see our [Guide to Continuing Obligations of a Cayman Islands Registered Mutual Fund](#).

MF Act requirements

All regulated mutual funds (other than master funds) must have a current offering document which describes the equity interests in all material respects and contains such other information as is necessary to enable a prospective investor in the mutual fund to make an informed decision as to whether or not to subscribe for or purchase the equity interests.

All regulated mutual funds (other than a master fund which has no offering document) must file their offering document with CIMA on registration or licensing together with certain prescribed particulars.

All regulated mutual funds, as long as there is a continuing offering of equity, must inform CIMA of any change that materially affects any information in the offering document (or prescribed details of a master fund, where applicable) and must file with CIMA an amended offering document and the relevant CIMA form incorporating such changes within 21 days.

All regulated mutual funds must submit audited financial statements to CIMA within six months of the end of the fund's financial year, in electronic format together with a fund annual return form.

All regulated mutual funds must pay the applicable annual CIMA fee (currently US\$4,268 and US\$3,048 for master funds) by 15 January of each year. If the annual fee is not paid by 15 January of each year, a penalty of 1/12 of the annual fee will be payable for each month or part of a month during which the annual fee and any penalty remains unpaid.

Director registration

Under the Director Registration and Licensing Act (**DRL Act**), all directors and managers of LLCs, whether natural persons or corporate directors and whether resident in the Cayman Islands or elsewhere, who act as directors of regulated mutual funds (or manager where the regulated mutual fund is an LLC) must also be registered with, or in certain circumstances be licensed by, CIMA. An application fee is payable to CIMA together with annual fees, which must be paid by 15 January of each year. There are heavy penalties for non-compliance with the DRL Act, including significant fines and imprisonment.

Registered office

All Cayman Islands exempted companies, exempted limited partnerships, LLCs and exempted unit trusts must have a registered office in the Cayman Islands provided by a person licensed under the Companies Management Act or the Banks and Trust Companies Act.

AML compliance

Cayman Islands investment funds, including mutual funds, are obliged to comply with Cayman Islands anti-money laundering, proliferation financing and terrorist financing (**AML**) legislation, including assessing and applying a risk-based approach to money laundering, proliferation financing and terrorist financing risks and compliance. Funds must designate natural persons to the roles of AML compliance officer, money laundering reporting officer and deputy money laundering reporting officer, after which performance of these functions can be delegated or outsourced.

Typically funds delegate performance of certain AML functions by appointing an administrator based a jurisdiction that is not considered a high-risk jurisdiction for AML purposes to undertake its AML compliance function (eg Cayman Islands, US, Ireland or Bermuda). Ultimate responsibility for maintaining and implementing satisfactory AML procedures remains with the fund and its operators. Typically the fund administrator will need to agree to undertake the AML work for the fund in accordance with Cayman Islands rules. If they do not, then the fund's operators will need to undertake a gap analysis and ensure that any differences are addressed.

Under the Guidance Notes on the Prevention and Detection of Money Laundering and Terrorist Financing in the Cayman Islands issued by CIMA such outsourcing by the fund to its administrator is acceptable if :

- details of the administration agreement and written evidence of the suitability of the administrator (or its employees) to perform the relevant functions on behalf of the mutual fund are available to CIMA on request
- there is a clear understanding between the administrator and the mutual fund of the functions to be performed by the administrator and documentation of the reliance by the fund on the administrator to perform such functions
- the relevant customer information is readily available to CIMA on request and to the Financial Reporting Unit and other law enforcement authorities

As a result it is crucial for the relevant administration agreement to contain provisions to this effect. CIMA's Statement of Guidance on Outsourcing also provides guidance to regulated mutual funds on the establishment of outsourcing arrangements and the outsourcing of material functions or activities, including AML compliance functions.

Automatic exchange of information obligations

Cayman Islands funds are not directly subject to the US Foreign Account Tax Compliance Act (**FATCA**), however the Cayman Islands has introduced legislation implementing FATCA requirements for 'financial institutions' to identify and report certain US accounts to the Cayman Islands Tax Information Authority (**TIA**) on an annual basis.

The Cayman Islands has also enacted regulations (**CRS Regulations**) to implement the OECD common reporting standard on automatic exchange of information (**CRS**) into Cayman Islands law. Under the CRS Regulations, Cayman Islands 'reporting financial institutions' have to report information on the holders of 'reportable accounts' which are tax resident in 'reportable jurisdictions'.

Cayman Islands mutual funds will typically fall within the definition of an 'investment entity' and are generally classed as a 'financial institution' for FATCA and CRS purposes. Funds therefore have information gathering and reporting obligations to report the relevant information to the TIA on an annual basis and that information will then be sent automatically to the relevant home tax jurisdiction of the relevant account holders.

For further details of applicable FATCA and CRS requirements, please contact your usual Harneys representative or see our [Guide to Automatic Exchange of Information Obligations for Cayman Islands Investment Funds](#).

Supervision and enforcement

CIMA can require a special audit of a regulated mutual fund. Regulated mutual funds must also provide CIMA with such information and access to such records as CIMA requires from time to time.

CIMA may apply to court to preserve the assets of a regulated mutual fund.

CIMA has the power in relation to a regulated mutual fund to revoke its registration, impose conditions upon it, require the substitution of a promoter or management, appoint advisers or persons to assume control of the affairs of the mutual fund or require the reorganisation or winding up of the mutual fund.

The auditor of a regulated mutual fund must immediately give written notice to CIMA if the mutual fund is, or is likely to become, unable to meet its obligations as they fall due, is carrying on or attempting to carry on business in a manner prejudicial to investors or creditors or is maintaining insufficient accounting records to allow its accounts to be properly audited.

CIMA also has the power under the Monetary Authority Act to impose significant administrative fines of up to CI\$1 million (US\$1.2 million) for each breach of certain provisions of the Anti-Money Laundering Regulations and other Cayman regulatory laws and regulations, including the MF Act and SIB Act. The level of an administrative fine will depend on various factors including whether the breach is committed by an individual or a body corporate and if the breach is classified as minor, serious or very serious.

Economic Substance

The International Tax Co-operation (Economic Substance) Act (the **ES Act**) was introduced in the Cayman Islands in response to OECD's Base Erosion and Profit Shifting framework and related EU initiatives in relation to what are known as 'Geographically Mobile Activities'.

The ES Act is supplemented by the Guidance Notes issued by the Cayman Islands Tax Information Authority (the **TIA**) on Economic Substance for Geographically Mobile Activities.

Under the ES Act any 'relevant entity' which carries on a 'relevant activity' and receives 'relevant income' in a financial period must satisfy the economic substance test in relation to that activity and make an annual filing with the TIA.

Investment funds

Under the ES Act an 'investment fund' is not a 'relevant entity' and therefore the ES Act is not applicable to such entities.

Investment managers

Under the ES Act 'fund management business' is a 'relevant activity' and is the business of discretionary investment management carried on by a relevant entity licensed or otherwise authorised under SIB Act for an investment fund. Accordingly, any relevant entity that carries on fund management business and receives relevant income will need to satisfy the economic substance test and make annual filings with the TIA.

Please see our [Guide to Economic Substance in the Cayman Islands](#) for further details of the ES Act.



For more information and key contacts
please visit [harneys.com](https://www.harneys.com)

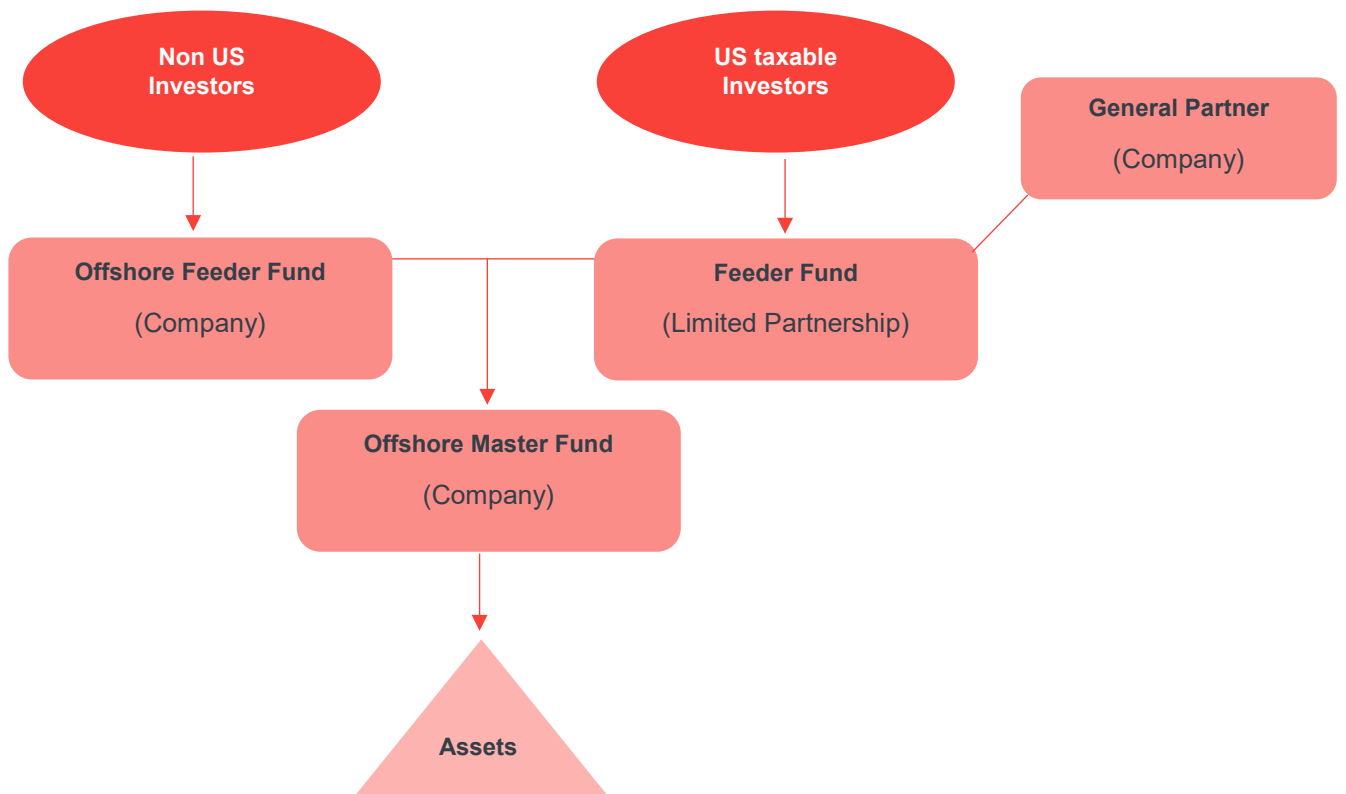
Typical Offshore Fund Structures

Standalone Fund

(No U.S. taxable investors)



Master-Feeder Fund



ⁱ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

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