



Incubator Funds & Funds Exempt from CIMA Registration

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Preface

Higgs & Johnson frequently advises on the establishment of investment management companies and investment funds in the Cayman Islands. In the case of new investment managers, some of the challenges include a low starting capital (less than USD 30 million), no track record, initial high fees of service providers and difficulty in attracting institutional investors. Two solutions offered by Higgs & Johnson include the incubator fund and the unregulated fund.

Incubator Fund

An incubator fund is a vehicle that allows the investment manager to establish a track record and raise initial capital. The legal structure may take the form of a separate, stand-alone, legal entity or a segregated portfolio of a segregated portfolio company platform. A common trend is to utilize a segregated portfolio company platform. This is described below.

Segregated Portfolio Company Platform

Higgs & Johnson may advise on the structuring of a segregated portfolio platform as follows:

- formation of the segregated portfolio company in the Cayman Islands;
- creation by the directors of multiple segregated portfolios, each with a different investment strategy;
- appointment of a different manager or advisor in respect of each segregated portfolio;
- appointment of a reputable firm of auditors, a fund administrator, prime broker and other service providers in respect of each segregated portfolio;
- registration of segregated portfolio company with the Cayman Islands Monetary Authority (“CIMA”) or it may be unregulated in the manner described under Unregulated Funds below;
- payment by new manager of a nominal set-up fee in order to operate his own segregated portfolio on the segregated portfolio platform;
- commencement of trading and establishment of track record, with exposure to reputable service providers;
- where the vehicle is regulated by CIMA and where reported performance is verified by the firm of auditors appointed in respect of the segregated portfolio, then it may be possible for the manager to attract third party investors, including institutional investors whose investment restrictions may require them to

invest through a regulated structure and whose track record can be verified; and

- once the assets of the segregated portfolio managed by the manager falls within the range of USD 50 – 100 million, Higgs & Johnson can then advise on restructuring from the management of a single segregated portfolio on a segregated portfolio platform to the incorporation of a stand-alone fund regulated by CIMA.

With the appropriate fee structure in place for the relevant service providers and an independently verified track record, the management of a segregated portfolio on a segregated portfolio platform may be a viable option for new managers.

Unregulated Funds

In the Cayman Islands, an unregulated fund is one that is not required to register with CIMA as a mutual fund under the Mutual Funds Law. A fund can be unregulated in two ways- (i) where it falls outside the definition of a “mutual fund” under the Mutual Funds Law or (ii) where it meets the criteria for exemption from CIMA registration.

Mutual Fund Definition

If terms of the fund documentation include any one of the below features, the fund will fall outside the definition of a mutual fund:

- single investor fund (the Mutual Funds Law requires a “pooling” of investor funds and no pooling is deemed to occur where there is a sole investor);
- where shares carry no entitlement to participate in the profits or gains of the fund;
- where shares are not redeemable or repurchasable at the option of an investor (in this case, shares may be redeemable or repurchasable at the option of the fund or the directors); and
- where debt interests are issued and equity interests are not issued

The satisfaction of any of the above criteria means that:-

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- no CIMA registration is required;
- no auditor must be appointed (and therefore, audit fees can be avoided);
- (multiple service providers do not need to be appointed (although the engagement of independent service providers is recommended in order to improve transparency and corporate governance in respect of the structure);
- (the fund will not be subject to regulation in the Cayman Islands; and
- there will be no minimum investment requirement.

Meeting Criteria for CIMA Exemption

Higgs & Johnson also advises on cases where a fund initially falls within the definition of a mutual fund, however, it meets the criteria under the Mutual Funds Law for exemption from CIMA registration.

The fund will satisfy the CIMA registration exemption if:

- the equity interests are held by not more than fifteen investors, a majority of whom are capable of appointing or removing the operator of the fund (the operator is a director in the case

of a corporate fund, a general partner in the case of a partnership and a trustee in the case of a unit trust); or

- it is a fund, not incorporated or established in the Cayman Islands, which makes an invitation to the public in the Cayman Islands to subscribe for its equity interests by or through a person who is the holder of a licence under the Securities Investment Business Law (Revised), for a regulated activity specified by CIMA for the purposes of the forgoing and those interests are listed on a stock exchange (including an over-the-counter-market) specified by CIMA or the fund is regulated in a category, and by an overseas regulatory authority, approved by CIMA for the purposes of this subsection.

Next Steps

As described above, Higgs & Johnson is available to assist investment managers and seed investors in the early capital raising stages where the parties are seeking to minimise start-up fees and to establish a track record.

For further queries regarding the establishment of an incubator fund or further advice on unregulated funds in the Cayman Islands, please contact cayman@higgsjohnson.com.