



Regulation of Investment Funds in the Cayman Islands

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Preface

The Mutual Funds Law (Revised) (the “Law”) regulates mutual funds established, administrated or managed in the Cayman Islands. This briefing note provides an overview of key requirements of the Law and is not intended as a substitute for specific legal advice.

Regulatory oversight of mutual funds is vested in the Cayman Islands Monetary Authority (“CIMA”); a corporate body charged with the supervision and regulation of mutual funds and mutual fund administrators.

The Law defines a ‘mutual fund’ as a company, unit trust or partnership;

- which issues shares, trust units or partnership interests respectively;
- that carry an entitlement to participate in the profits or gains of the issuer and are redeemable or re-purchasable at the option of the investor (i.e. that are ‘open ended’) before the commencement of winding up or dissolution of the issuer; and
- with the purpose or effect of pooling investor funds with the aim of spreading investment risks and enabling investors to receive profits or gains from investments.

The definition specifically excludes any person who is licensed under the Banks and Trust Companies Law (Revised) or the Insurance Law (Revised) or who is registered under the Building Societies Law (Revised) or the Friendly Societies Law (Revised).

‘Closed-ended’ investment vehicles, whose equity interests are not redeemable or re-purchasable at the option of the investor before their winding up or dissolution, fall outside of the definition of a mutual fund and, accordingly, are not regulated under the Law.

To comply with the Law, mutual funds must either be ‘licensed’, ‘administered’ or ‘registered’ unless they are ‘exempted’. Further information about these compliance options is set out below.

LICENSED FUNDS

The Law provides that, unless a mutual fund is an administered, registered or an exempted fund, it shall not carry on or attempt to carry on business in or from the Cayman Islands unless it has a mutual fund license and has either a registered office in the Cayman Islands or, in the case of a unit trust, has as its trustee a trust company licensed under the Banks and Trust Companies Law (Revised).

The grant of a mutual fund license is within the

discretion of CIMA. In considering an application for a mutual fund license, CIMA may require such information as it may deem necessary to satisfy itself that each promoter of the applicant fund is of sound reputation, that its administration will be undertaken by persons who are of sound reputation and have sufficient expertise to administer the applicant fund, and that its business and any offer of equity interests in it will be carried out in a proper way. Such an application is to be made in the prescribed form (Form MF3) and must be accompanied by;

- a copy of the current offering document or latest draft;
- a copy of the most recent annual audited accounts (if the applicant is an existing fund);
- where applicable, a certified copy of the certificate of incorporation or registration issued by the Registrar of Companies or evidence of registration or establishment of a partnership or a unit trust;
- completed personal questionnaires, references and police clearance certificates for:- (a) all directors of a corporate mutual fund; or (b) all directors of a corporate trustee of a unit trust mutual fund; or (c) all directors of any corporate general partner of a limited partnership mutual fund;
- a letter of consent from an approved Cayman Islands auditor accepting an appointment as auditor;
- letter(s) of consent from its administrator (and net asset value calculation agent, if applicable); and
- application fee and annual license fee.

A mutual fund license may be granted on terms that it will take effect upon the incorporation of a corporate mutual fund or, in the case of a foreign company, upon its registration as a foreign company under the Companies Law, or on the establishment of any unit trust. A mutual fund license may also be granted subject to such conditions as CIMA may consider appropriate and CIMA may, upon application, waive, vary or revoke any such condition.

ADMINISTERED FUNDS

A mutual fund having more than fifteen investors and not being a licensed or registered mutual fund will be an administered mutual fund if its principal office in the Cayman Islands is provided by a licensed mutual funds administrator.

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In accepting an engagement to provide the principal office of an administered, registered or licensed fund, an administrator is required to satisfy itself, and make a declaration to CIMA, that (a) each promoter of the relevant fund is of sound reputation, (b) the administration of the fund will be undertaken by persons who are of sound reputation and have sufficient expertise to administer the fund, and (c) the fund's business and any offer of equity interests in it will be carried out in a proper way. This declaration must be filed with CIMA (on Forms MF2 and MF2A) as soon as the Administrator starts to provide its principal office, along with the following documentation;

- the fund's current offering document or the latest draft;
- a letter of consent from an approved Cayman Islands auditor);
- a letter of consent from its administrator indicating the name of the fund and giving a summary of the services to be provided. Please note however, that if the fund decides to appoint a separate net asset value calculation agent (other than the administrator) CIMA will require a similar consent letter to be prepared and filed by such entity on behalf of the fund;
- where applicable, a certified copy of the certificate of incorporation or registration issued by the Registrar of Companies or evidence of registration or establishment of a partnership or a unit trust; and
- the first annual administered fund's fee.

REGISTERED FUNDS

As a further alternative to obtaining a mutual fund license or appointing an administrator to provide its principal office in the Cayman Islands, section 4(3) of the Law provides that a mutual fund may carry on or attempt to carry on business in or from the Cayman Islands if;

- the minimum equity interest purchasable by a prospective investor in that mutual fund is US \$100,000 or its equivalent in any other currency;
- if its equity interests are listed on a stock exchange recognised by CIMA (including an over-the-counter market); A recognised exchange for this purpose is one that is either:

- a US licensed exchange; or
- an EU licensed exchange; or
- a Canadian licensed exchange; or
- a full member of the World Federation of Exchanges that is located in a Schedule 3 country; or
- the Cayman Islands Stock Exchange; or
- it is a master fund that meets the criteria in (i) or (ii) above.

Such a fund may apply for a certificate of registration from CIMA by filing the prescribed details (on Form MF1) in respect of its current offering document or the latest draft (unless it is a master fund and does not have one) which should be accompanied by;

- letter(s) of consent from its administrator (and net asset value calculation agent, if applicable);
- where applicable, a certified copy of the certificate of its incorporation or registration issued by the Registrar of Companies or evidence of registration or establishment of a partnership or a unit trust; and
- the first annual Registered Fund's fee.

The lighter regulatory touch which is applied to registered funds is premised on the assumption that investors who are in a position to invest the minimum subscription amount of US\$100,000 are likely to be sophisticated investors who can assess for themselves or afford professional advice on the risks associated with an investment in the fund or, alternatively, that listed funds will be subject to effective regulation by the relevant stock exchange. Registered funds are the most common category of mutual fund regulated under the Law.

EXEMPTED FUNDS

The Law permits two categories of funds to carry on or attempt to carry on business in or from the Cayman Islands without any filing whatsoever with CIMA:

Firstly, under section 4(4)(a) of the Law exempt status is available only to those funds in which the equity interests are held by not more than 15 investors, the majority in number of whom are capable of appointing or removing the trustees of a unit trust mutual fund, the general partners of a limited partnership mutual fund or

the directors of a corporate mutual fund, as the case may be. Note that, in order to meet this requirement, the power to appoint and remove directors etc. must be vested in a majority in number of the investors, rather than a majority in terms of the value of equity interests.

Funds which are structured so that the investors are issued with a class of shares which carry participation rights but which do not carry voting rights will not qualify as exempted funds. In considering whether or not a particular fund qualifies as an exempted fund, it should be borne in mind that the Law defines “investor” to mean the legal holder of the equity interest in a fund and does not “look through” to the beneficial or indirect owners.

Second, under section 4(4)(b) of the Law a foreign (non-Cayman) domiciled mutual fund would be exempt from registering with CIMA as long as it is not offering its shares to members of the public in the Cayman Islands (which does not include Cayman Islands exempted or ordinary non-resident companies).

PROCEEDS OF CRIME LAW

Despite the exempt status of such funds under the Law, all law firms, banks, trust companies, fund administrators and other service providers in the Cayman Islands have a responsibility under the Proceeds of Crime Law (Revised) (the “PCL”) to make suitable inquiries before providing services to any client in order to prevent their services being used in connection with the proceeds of criminal conduct. The PCL contains provisions for such service providers to report any suspicious activity to the relevant authority.

CONTINUING OBLIGATIONS FOR REGULATED MUTUAL FUNDS

Under the Law, the requirement that licensed funds and administered funds have their current offering documents filed with CIMA, and that registered funds have prescribed details in respect of their current offering documents filed with CIMA, is not satisfied unless:

- each such offering document describes the equity interests in all material respects, and contains such other information as is necessary to enable a prospective investor to make an informed decision as to whether or not to subscribe for or purchase the equity interests; and
- (where there is a continuing offering of equity interests and any promoter, director, trustee or general partner of the fund becomes aware of any change that materially affects any information in the offering document (or the prescribed details) filed with CIMA), the fund files an amended offering document (or amended prescribed details) incorporating that change within twenty-one days of the promoter or operator becoming so aware.

In addition, every regulated fund is required to file accounts audited by an approved auditor within six months of the end of each financial year. Further, every regulated fund must pay its annual fee to CIMA on or before 15th January in each year.

If you wish to receive further information on establishing, maintaining, restructuring or terminating Cayman Islands mutual funds, please e-mail cayman@higgsjohnson.com.