Cayman Islands Segregated Portfolio Companies

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Preface

This memorandum sets out a brief summary of segregated portfolio companies in the Cayman Islands. For further information please contact the investment funds department at Higgs & Johnson.

GUIDE

The segregated portfolio company ("SPC"), a variant of the exempted company, was first introduced in the Cayman Islands in 1998 by an amendment to the Companies Law (Revised). The concept of an SPC is that a company, which remains a single legal entity, may create segregated portfolios (each, a "Portfolio") such that the assets and liabilities of each Portfolio are legally separate from the assets and liabilities of any other Portfolios.

The segregated portfolio concept also exists in various other jurisdictions (such as Delaware, BVI and the Channel Islands) and has become increasingly well understood and recognized. The Companies Law (Revised) initially restricted the use of SPCs to certain licensed insurers, but refinements to the Companies Law in 2002 and 2003 have extended the use of SPCs to allow any Cayman Islands exempted company to apply to the Registrar of Companies (the "Registrar") to be registered as an SPC.

This memorandum provides a summary of the key features of an SPC as provided by the Companies Law (Revised) and looks at the use of the SPC as a popular vehicle for multi-class investment funds, insurance companies writing different lines of business, and multi-issuer structured finance vehicles.

ESTABLISHING AN SPC

Any Cayman Islands exempted company may apply to the Registrar to be registered as an SPC. However, where the SPC will engage in regulated business (e.g. a regulated mutual fund or an insurance company) then the approval of the Cayman Islands Monetary Authority ("CIMA") will be required for its registration, and CIMA will determine the company's eligibility to be registered or licensed by CIMA in the usual way). The initial and annual fees payable by an SPC are set out at the end of this memorandum.

CONTRACTS ON BEHALF OF SPCs

The Companies Law requires that any transaction or arrangement entered into by an SPC on behalf of one or more of its Portfolios must be executed by the SPC on behalf of, or for the account of a Portfolio, which must be identified in the relevant documents.

If the SPC fails to meet this requirement, then (notwithstanding any provisions to the contrary in the SPC's Articles of Association or in any contract) its directors incur personal liability for the liabilities of the SPC and the relevant Portfolio(s) under the relevant contract or arrangement. The Cayman Islands courts may relieve a director of all or part of his personal liability if satisfied that: (a) he was not aware of the circumstances giving rise to his liability and in being unaware was not fraudulent, reckless or negligent, and did not act in bad faith; or (b) he expressly objected and exercised his rights as a director to try to prevent the circumstances giving rise to the liability.

STRUCTURAL FEATURES

The Memorandum and Articles of Association of an SPC will need to take note of and give effect to certain key structural provisions, as follows:

- Name- a segregated portfolio company must include the letters "SPC" or the words "Segregated Portfolio Company" in its name;
- Designation of Portfolios- an SPC may create one or more Portfolios in order to segregate the assets and liabilities held by the SPC on behalf of one Portfolio from the assets and liabilities held on behalf of any other Portfolio and from the general assets and liabilities of the SPC. One or more classes or series of shares may be designated to each Portfolio and the proceeds of issue of any shares so designated must be included in the assets of the relevant Portfolio. Each Portfolio is required to be separately identified and to include in its identification the words "Segregated Portfolio";
- Distributions and Redemptions- principles relating to the payment of dividends or other distributions, and the payment of the redemption or repurchase price of shares are applied to each Portfolio in isolation, so that an SPC may pay a dividend or other distribution in respect of Portfolio shares of any class or series regardless of whether a dividend or distribution would be permitted to be paid in respect of any other Portfolio. Payments in respect of dividends, distributions and redemptions of shares may only be paid out of the assets of the Portfolio in respect of which the relevant shares were issued;
- Segregation of Assets - the assets of an SPC are either Portfolio assets or general assets and it is the duty of the directors to establish and maintain the segregation both of the general assets from the Portfolio assets and of the assets of each Portfolio from those of each other Portfolio. The general assets of an SPC comprise those assets of the SPC which are not assets of any Portfolio. The assets of a Portfolio comprise the share capital and reserves attributable to the Portfolio and all other assets held within the Portfolio.

    i) segregated portfolio assets- are only available to meet liabilities to creditors of the SPC who are creditors in respect of the relevant Portfolio; and

    ii) are protected from and are not available to creditors of the SPC who are not creditors in respect of that Portfolio.

- Segregation of Liabilities- liabilities of an SPC to a person arising from a matter, or otherwise imposed, in respect of or attributable to a particular Portfolio, extend only to, and may be satisfied only from:

  i) the assets attributable to that Portfolio; and

  ii) unless prohibited by the SPC's Articles of Association, to the general assets of the SPC to the extent that the specific Portfolio's assets were insufficient and to the extent that the SPC's general assets exceed any minimum capital amounts required by CIMA.

There may be no recourse to the segregated assets of any other Portfolio. Therefore, it is possible to provide in the Articles of Association that there will be no overspill of a liability from an insolvent Portfolio to the general assets of the SPC.

- General Assets and Liabilities- income and other property and rights of an SPC not attributable to any Portfolio shall be applied to and comprised in the company's general assets. Liabilities of an SPC not attributable to any of its Portfolios shall be discharged from the company's general assets;
- Limitation of Directors' Indemnity- any indemnity given by an SPC in favor of a director in respect of a liability incurred by such director on behalf of a Portfolio is enforceable only against the assets of the Portfolio in respect of which the liability arose. Any provision in the Articles of Association or any other contract which purports to indemnify directors for failing to meet the requirements regarding contracts on behalf of SPCs (see section 3 above) is void.

CONVERSION TO SPC STATUS

A company may convert from a "standard" exempted company into an SPC by:

- filing with the Registrar a declaration made by at least two directors as to the assets and liabilities of the company and the assets and liabilities it proposes to transfer to its future Portfolios attesting that (i) each creditor has consented to the proposed conversion and (ii) that, on registration as an SPC, the company as a whole and each Portfolio will be solvent;
- passing a special resolution of its shareholders authorizing the transfer of assets and liabilities into Portfolios; and
- where the company is licensed, obtaining the consent of CIMA.

CROSS-BORDER CONTRACTS

The Companies Law provides for statutory segregation between the different Portfolios of an SPC and limits the recourse of a creditor, so that there is no recourse against the assets of one Portfolio to satisfy liabilities of any other Portfolio.

However, it is possible that, if proceedings are brought in a different jurisdiction, the courts of that jurisdiction will not recognize that segregation in giving or enforcing a judgment against the SPC. As the assets of Portfolios are likely to be held outside the Cayman Islands, it is recommended that, where possible, contracts entered into by the SPC on behalf of a Portfolio, are governed by Cayman Islands law and are subject to the exclusive jurisdiction of the Cayman Islands courts.

If a contract entered into by the SPC on behalf of a Portfolio is neither governed by Cayman Islands' law nor subject to the exclusive jurisdiction of the Cayman Islands courts, then specific provisions should be inserted into the contract limiting the recourse of the counterparty to the assets of the relevant Portfolio. Particular care should be taken with respect to bank accounts to ensure that rights of set off are not accidentally granted (by use of a bank's standard documentation) over all accounts maintained by an SPC regardless of the different Portfolios to which they relate.

ANNUAL REQUIREMENTS

Every exempted company must file an annual return, together with the appropriate annual filing fee, with the Registrar in January of each year. The annual return confirms that the requirements of the Companies Law in relation to an exempted company have been complied with since the date of incorporation or, as the case may be, since the previous annual return. The annual return filing will usually be dealt with by the service provider which maintains the registered office of the company in the Cayman Islands.

In addition to that annual return, an SPC must file a notice with the Registrar containing the names of each Portfolio which it has created, and pay additional fees. If the SPC is regulated by CIMA, for example if it is an investment fund or insurance company, then it will also need to make filings with CIMA. Please refer to the firm's memoranda on setting up Cayman Islands companies and investment funds for more information.

WINDING UP & RECEIVERSHIP

An SPC, like any other Cayman Islands company, may be wound up voluntarily or by the court. In either case, the liquidator, in applying the SPC's assets in satisfaction of its liabilities, must deal with those assets and liabilities in accordance with the segregation of assets and liabilities amongst the relevant Portfolios. However, an SPC may not be voluntarily wound up without the leave of the court at any time when a receivership order is in force against any of its Portfolios.

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In addition, a receivership order may be made by the Cayman Islands court in respect of any one or more Portfolios of an SPC, on application by the SPC, its directors, any creditor of the SPC in respect of the relevant Portfolio, any holder of shares issued by the relevant Portfolio, or by CIMA where the SPC is licensed or regulated by CIMA.

A receivership order may not be made if the SPC is being wound up, but will otherwise be made in respect of a Portfolio if the court is satisfied that:

- the assets attributable to that Portfolio (when account is taken of the SPC's general assets unless no creditors are entitled to have recourse to general assets) are or are likely to be insufficient to discharge the claims of creditors in respect of that Portfolio; and
- appointing a receiver would enable the orderly closing down of the business attributable to that Portfolio and the distribution of its assets to those entitled to have recourse to them.

Once a receivership order has been made in respect of a Portfolio, the powers of the SPC's directors cease in respect of the business and assets attributable to that Portfolio. When an application has been made for a receivership order in respect of a Portfolio, and for so long as that receivership continues, there is a stay of proceedings against the SPC in relation to the Portfolio which is the subject of the order– no suit, action or other proceedings may be instituted against the SPC in respect of that Portfolio without the leave of the court.

However, the 'stay in proceedings' does not prevent a secured creditor from enforcing its security against assets of the Portfolio notwithstanding the making of a receivership order.

APPLICATIONS

(a) Investment Funds

Cayman Islands SPCs have become an increasingly popular vehicle for use by investment funds, particularly in the context of multi-class funds in which one or more portfolios uses, as part of its investment strategy, leverage, short sales and other tools that create potentially substantial liabilities to third parties. Multi-class funds have historically sought to prevent liabilities spilling over from one class to another by creating trading subsidiaries through which the assets of the class (i.e. portfolio) engaging in such a strategy would be invested. However, there are various risks associated with this approach, (for example; a court may deem the trading subsidiary a mere agent of the multi-class fund and thus prejudice the containment of liabilities at the trading subsidiary level), and the creation of trading subsidiaries results in a high cost of rolling out additional portfolios. The relatively low cost of rolling out new portfolios and the statutory segregation between portfolios have made the SPC structure the vehicle of choice for these types of funds.

(b) Captive Insurers

SPCs were first used in the Cayman Islands by captive insurers and continue to be a popular structure as they allow an insurer to add additional participants in a reinsurance program without risk of cross liability. It is a significant benefit to participants in a "rent-a-captive" program whereby those wishing to organize their own insurance or reinsurance can become shareholders in a Portfolio of an existing SPC, managed by an experienced insurance manager. There are savings in terms of time and cost in creating a new Portfolio as opposed to creating a new company or limiting recourse contractually. The participants in a captive program will contribute premiums to the Portfolio through which their business is placed and will be entitled to distributions solely from that Portfolio.

On completion of a particular program the relevant Portfolio will be wound up and the shares issued by that Portfolio held by the participant will be redeemed and cancelled.

(c) Structured Finance Vehicles

Cayman Islands exempted companies are widely used as bankruptcy remote vehicles in structured finance and capital markets transactions. The SPC structure now allows a single company to act as multi-issuer structured finance vehicle and the legal structure of an SPC is recognized by the leading rating agencies as meeting the legal criteria required of a bankruptcy remote special purpose company.

CAYMAN ISLANDS GOVERNMENT FEES

Registrar of Companies Fees based on share capital

Initial Registration Fee / Annual Fee

(i) Authorized share capital not exceeding CI$42,000 (US$50,000)	**US$732**
(ii) Authorized share capital exceeding CI$42,000 (US$50,000) but not exceeding CI$820,000 (US$1,000,000)	**US$1,098**
(iii) Authorized share capital exceeding CI$820,000 (US$1,000,000) but not exceeding CI$1,640,000 (US$2,000,000)	**US$2,298**

(iv) Authorized share capital exceeding CI$1,640,000 (US$2,000,000)	**US$3,010**

SEGREGATED PORTFOLIO COMPANIES

(i) Initial registration fee	**US$1,342**
(ii) Annual registration fee	**US$3,171**
(iii) Annual portfolio fee (per portfolio up to a max of US$1830)	**US$366**

Please note that the segregated portfolio Company fees are payable in addition to the fees based upon the authorized share capital of the exempted company.

LEGAL FEES	**$1,200**

ANNUAL FEES

(i) Registered Office Fees (Non CIMA)	$1,200
(ii) Registered Office Fees (CIMA)	$1,500
(iii) Secretarial Fees (if required)	$400
(iv) Forward/Hold Mail Fees (if require)	$500

OTHER REGULATORY FEES

If the SPC is licensed by CIMA then there will be additional licensing fees (currently, CI$3,000 (or US$3,659) per entity) and annual registration fees (currently US$305 per SPC up to a maximum of 25 SPC). There may be minimum net worth requirements for the fund as well as minimum shareholding requirements for investors. Specific advice on such fees and requirements should be sought.

If you wish to receive further information on establishing a new investment vehicle, or restructuring an existing Cayman Islands fund, please e-mail cayman@higgsjohnson.com.