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## IN THIS ISSUE

- The risks of back-dating Cayman Islands law governed documents
- Overview of Cayman Islands law governing hedge funds – Q&A
- FATCA Update - Cayman Islands agree Model 1 IGA with the United States
- FATCA Update - Cayman Islands agree FATCA Type IGA with the UK

### The risks of back-dating Cayman Islands law governed documents

If the parties to an agreement governed by Cayman Islands law would like the agreement to take effect from a date earlier than the date upon which the agreement is signed and entered into, the parties should expressly state in the document that it is intended to be effective from a date earlier than the date on which the parties entered into the agreement. It should be made clear in the document that notwithstanding it being entered into on the date of execution by the parties, it is to take effect from an earlier date.

Stating that the agreement will be effective from an earlier date will, however, only be effective, as a matter of Cayman Islands law, as between or among the parties to the agreement. It will not affect those parties' obligations under the terms of the agreement with regard to third parties who are not parties to the agreement. The obligations to third parties will almost invariably be based on the date that the agreement was fully executed, subject to any applicable special circumstances.

Whilst parties signing a Cayman Islands law governed agreement may expressly state that the agreement is effective from an earlier date, the parties should not “back-date” the date of execution (for example, by signing the agreement today but dating it with an earlier date, thereby making the document seem as if it was also signed on some earlier date). The document should be dated with the

date on which it is signed and entered into. Back-dating agreements has a number risks for the parties thereto, including the risk of civil and/or criminal sanctions being brought by, for example, tax authorities and regulatory authorities in jurisdictions where the document is required to be filed or produced. Depending on, among other things, the nature and subject matter of the agreement, the parties risk facing claims of false accounting or false statements by directors, or even conspiracy to defraud, if they "back-date" the agreement in order to give the impression that the agreement was entered into on some earlier date.

## Overview of Cayman Islands law governing hedge funds – Q&A


### 1. What are the key statutes and regulations that govern hedge funds in the Cayman Islands? Which regulatory bodies regulate hedge funds?

The primary legislation regulating hedge funds in the Cayman Islands is the Mutual Funds Law (As Revised) (the "**Funds Law**") and accompanying regulations, including the Retail Mutual Funds (Japan) Regulations (2007 Revision, as amended) which generally apply to investment funds licensed under the Funds Law (licensed funds) where the securities are marketed to the public in Japan.

#### What is a "mutual fund"?

The Funds Law defines a "mutual fund" as follows (emphasis added):

*"a company, unit trust or partnership that issues equity interests, the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risks and enabling investors in the mutual fund to receive profits or gains from the acquisition, holding, management or disposal of investments but does not include a person licensed under the Banks and Trust Companies Law (2009 Revision) or the Insurance Law (2008 Revision), or a person registered under the Building Societies Law (2010 Revision) or the Friendly Societies Law (1998 Revision)".*



Accordingly investment funds which are established for a sole investor and do not involve the pooling of investor funds fall outside the regulatory framework of the Funds Law. Nonetheless, a single investor hedge fund can apply for voluntary registration to, among other things, benefit from the status of being a fund registered with and regulated by Cayman Islands Monetary Authority (the “**Monetary Authority**”).

### **Will the mutual fund issue “equity interests”?**

As can be seen from the definition of “mutual fund” above, the Funds Law applies only to investment funds which issue “*equity interests*”. Equity interests are defined in the Funds Law as:

*“a share, trust unit or partnership interest that-*

*(a) carries an entitlement to participate in the profits or gains of the company, unit trust or partnership; and*

*(b) is redeemable or repurchasable at the option of the investor.... before the commencement of winding-up or the dissolution of the company, unit trust or partnership, but does not include debt,...”*

The Funds Law makes it clear that debt-issuance vehicles do not (unless they also issue relevant equity interests) fall within its scope. The vast majority of Cayman Islands' hedge funds are regulated under the Funds Law.

Investment funds investing in private equity, real estate, bankruptcies, re-organisations, liquidations and other distressed securities which do not give investors the right to redeem their shares, units or interests from the fund at the investor’s option do not fall within the scope of the provisions of the Funds Law.

The law as set out herein therefore applies only in respect of investment funds of any asset class which satisfies the definition of “*equity interests*” above. For present purposes we will refer to these funds as “**Open-ended Funds**”.



## Registration

Open-ended Funds are, subject to the exemption noted below, required to be registered with the Monetary Authority.


## Exemption from Registration

Open-ended Funds in which the “*equity interests*” are held by not more than fifteen (15) investors, a majority of whom are capable of appointing or removing the “operator” of the fund are not required to be registered with the Monetary Authority. In the case of an investment fund structured as a company, the operator would be the fund’s Directors. In the case of an investment fund structured as a limited partnership, the operator would be the fund’s general partner(s). In the case of an investment fund structured as a unit trust, the operator would be the fund’s trustee(s).

As noted above, private equity funds and other closed-ended funds (e.g. real estate funds) which do not give investors the right to redeem their shares, units or interests from the fund at the investor’s option do not issue “equity interests” for the purposes of the Funds Law and therefore would not fall into the registration regime in any event.

Ancillary legislation affecting Cayman Islands Open-ended Funds include the:

- Companies Law (2012 Revision) (“**Companies Law**”).
- Exempted Limited Partnership Law (2012 Revision) (“**ELP Law**”).
- Partnership Law (2002 Revision) (“**Partnership Law**”).
- Trusts Law (2009 Revision) (“**Trusts Law**”).
- Banks and Trust Companies Law (2009 Revision) (“**BTC Law**”).
- Securities Investment Business Law (2011 Revision) (“**SIB Law**”).
- Proceeds of Crime Law 2008 (“**PCL**”).
- Money Laundering Regulations (2010 Revision) (“**ML Regulations**”), enacted pursuant to powers under the PCL.



The PCL, ML Regulations and the guidance notes prepared and issued by the Monetary Authority on the prevention and detection of money laundering in the Cayman Islands to provide guidance to service providers in complying with their obligations under the ML Regulations (Guidance Notes) are together referred to as the AML Laws.


**Regulatory bodies.** The Investment and Securities Division of the Monetary Authority is responsible for the ongoing supervision of Open-ended Funds and fund administrators. The Funds Law is administered by the Monetary Authority.

The Financial Reporting Authority (FRA) is the Cayman Islands' Financial Intelligence Unit with responsibility for receiving, analysing and disseminating disclosures of financial information concerning the proceeds of criminal conduct, money laundering and the financing of terrorism pursuant to the provisions of the PCL. Suspicious activity or transaction reports (that is, reports on financial transactions in which there are reasonable grounds to suspect the transactions are related to the proceeds of criminal conduct (as defined in the PCL) must be submitted to the FRA.

## **2. What are the categories of regulated hedge funds? What are the main legal vehicles used to set up a hedge fund and what are the key advantages and disadvantages of using these structures?**

There are three categories of Open-ended Funds which are subject to regulation under the Funds Law in the Cayman Islands. The distinction between them turns on the manner in which they are regulated under the Funds Law, rather than on the type of vehicle or configuration of vehicles that is/are being regulated. These three categories are as follows:

- **Licensed funds** – these are funds which hold a license under the Funds Law. These Open-ended Funds must have either a registered office in the Cayman Islands or, if a unit trust, a trustee which is licensed under the Banks and Trust Companies Law.



These Open-ended Funds are also subject to a prior approval process, requiring the Monetary Authority to be satisfied with the experience and reputation of the promoter and administrator and to be satisfied that the business of the fund and the offering of its interests will be carried out in a proper way. This category of Open-ended Funds is relatively rare. According to figures published by the Monetary Authority, as of the end of 2012, there were 121 of this category of Open-ended Funds registered in the Cayman Islands.

- **Funds with no minimum investment threshold** – Open-ended Funds with a minimum subscription level of less than US\$100,000 must have a licensed mutual fund administrator providing their principal office in the Cayman Islands (as distinct from funds falling in the third category below which can have an administrator outside the Cayman Islands). This category of Open-ended Funds is also relatively rare. According to figures published by the Monetary Authority, as of the end of 2012, there were 408 of this category of Open-ended Funds registered in the Cayman Islands.
- **Funds with a US\$100,000 minimum investment threshold** – Open-ended Funds where either: (i) the minimum equity interest purchasable by a prospective investor is US\$100,000 or its equivalent in another currency; or (ii) the equity interests are listed on an approved stock exchange or over the counter market, constitute the vast majority of hedge funds established in the Cayman Islands. According to figures published by the Monetary Authority, as of the end of 2012, there were 8,421 of this category of Open-ended Funds registered in the Cayman Islands.

#### **Legal vehicles used to establish Open-ended Funds**

There are three types of vehicle that are used to establish hedge funds in the Cayman Islands:

- **Exempted companies** (including segregated portfolio companies), which offers shares.
- **Exempted limited partnerships**, which offers limited partnership interests.
- **Unit trusts**, which offers units of beneficial interest to investors.

The choice of the structure used is often dictated by some or all of the following factors:

- Market practice.
- Tax.
- The regulatory requirements of the investors in the fund.
- The investors' or investment manager's familiarity or preference of one structure over another.

**Advantages.** Of the three structures, only the company benefits from separate legal personality distinct from its investors and administrators. Additionally, investors' liabilities are limited to the amount unpaid on their shares, if any. The unit trust and limited partnership structures arguably offer more flexibility than the exempted company structure.

**Disadvantages.** The exempted company structure is subject to company law requirements (for example, capital maintenance restrictions) under the Companies Law and is arguably not as flexible as the limited partnership structure or the unit trust structure. Neither the limited partnership structure nor the unit trust structure has the benefit of separate corporate personality.

### 3. What are the key disclosure or filing requirements (if any) that must be completed by the hedge fund?

The following procedures apply to hedge fund registration:

- If the minimum aggregate equity interest purchasable by a prospective investor is at least US\$100,000 (or its equivalent in another currency) or the equity interests are listed on a recognized stock exchange, including the Cayman Islands Stock Exchange, then the registration application requires filing the following with the Monetary Authority:
  - a certified copy of the Certificate of Incorporation or Certificate of Registration (as applicable and depending on whether the fund is a company, limited partnership or trust);



- Form MF1 (this form includes certain prescribed details of the fund, such as the identity of the operators and service providers and the key terms regarding subscriptions and redemptions);
  - a current offering document (for example, a private placement memorandum);
  - a consent letter from the fund's administrator and a consent letter from the Cayman Islands auditor, approved by the Monetary Authority;
  - a registration fee of approximately US\$3,659.
- If a licensed investment fund's administrator provides the fund's principal office in the Cayman Islands (this may apply in the case of an investment fund that agrees to accept minimum initial investments below the US\$100,000 threshold) then the registration is applied for by filing with the Monetary Authority:
    - Forms MF2 and MF2A, completed by the administrator and the investment fund (including similar particulars to the Form MF1) (*see above*);
    - the same documents (except the Form MF1) and registration fee as above.

## FATCA Update – Cayman Islands agree Model 1 IGA with the United States

Earlier this year we reported that the Cayman Islands Government had announced in March 2013 its intention to adopt a Model 1 intergovernmental agreement (IGA) in response to the US Foreign Account Tax Compliance Act (FATCA).

The Cayman Islands Government has now agreed a Model 1 IGA with, and has entered a new Tax Information Exchange Agreement with, the US government. This new arrangement stands to significantly simplify FATCA compliance for Cayman Islands financial institutions, including for hedge funds, private equity funds, banks, trust companies, structured finance vehicles, and insurance vehicles.

FATCA requires financial institutions to use enhanced due diligence procedures to identify US persons who have invested in either non-US financial accounts or non-US entities. One principal purpose behind FATCA is to deter US persons from hiding income and assets overseas. FATCA requires foreign financial institutions (FFI's) to provide the US Internal Revenue Service (IRS) with information on certain US persons invested in accounts outside of the US and for certain non-US entities to provide information about any US owners. Each FFI risks significant consequences if it fails to enter into an agreement with the IRS by being, among other things, subject to a 30% withholding tax on any "withholdable payment" made to its proprietary account. The signing of the IGA by the Cayman Islands Government means, among other things:

- (a) The US Government will treat the Cayman Islands as having an IGA in effect and the Cayman Islands will, upon signing, be added to the US Treasury's list of jurisdictions that have signed but have not yet brought into force an IGA. The Cayman Islands will be treated as having an IGA in place for FATCA purposes.
- (b) Compliance with FATCA for Cayman Islands financial institutions will be simplified significantly as a result of the agreement reached on the Model 1 IGA. For example, there will now be no need for each Cayman Islands financial institution to enter into an FFI Agreement directly with the IRS.

## FATCA Update – Cayman Islands agree FATCA Type IGA with the UK

Earlier this month, the Cayman Islands Government signed an intergovernmental agreement with the United Kingdom ("**UK IGA**"), to set out the basis for the automatic exchange of financial information relating to UK tax payers who hold accounts in the Cayman Islands. The UK IGA will come into force once the internal procedures for both governments have been completed.

The UK IGA tracks the draft Model IGA that the Cayman Islands has agreed with the US Government in relation to FATCA. Under the UK IGA, Cayman Islands financial institutions will be required to report information annually to the Cayman Islands Tax Information Authority ("**TIA**") on financial accounts that are held by UK individuals or entities controlled by UK persons. The TIA will then forward the UK tax payer information to the UK tax authority, HM Revenue and Customs. Additionally, the UK IGA contains details of the alternative reporting regime for UK resident non-domiciled individuals.

Efforts are being made to set up the legislative and operational framework to implement the UK IGA. The Cayman Islands Government has announced that it intends to issue guidance to assist with the implementation.

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