HFMWEEK

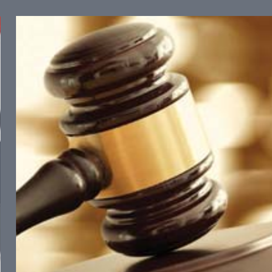
SPECIAL REPORT

CAYMAN 2016

TRANSPARENCY
A long-standing supporter of accountability

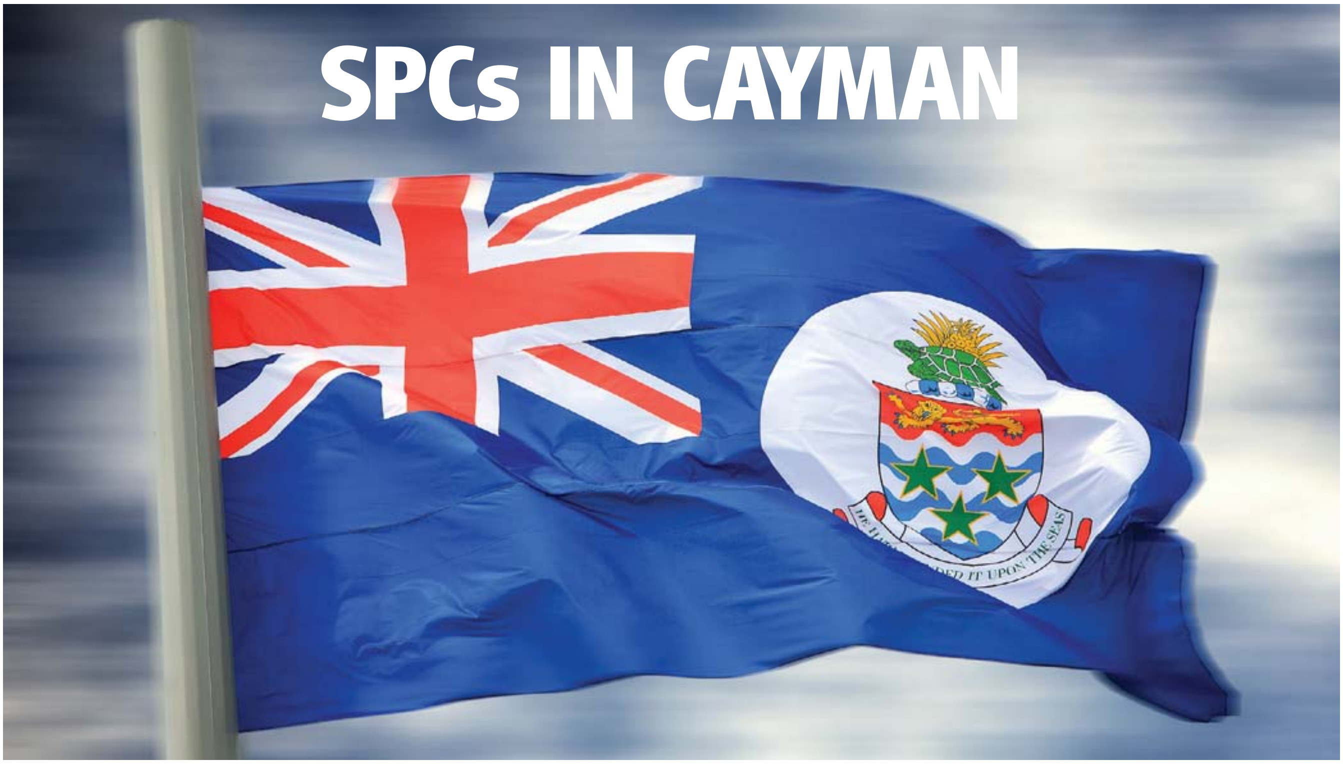
REGULATION
Compliance with new rules and amendments

VISION
An ambition to remain the market-leader

FEATURING Dillon Eustace // Elian // Harbour // Harney Westwood & Riegels // Higgs & Johnson // International Management Services Ltd. // KB Associates (Cayman) Ltd // Loeb Smith // PwC Cayman Islands // Stuarts Walker Hersant Humphries

SPCs IN CAYMAN



GARY SMITH, PARTNER AT LOEB SMITH'S CORPORATE TEAM, TALKS TO *HFMWEEK* ABOUT SPCs AND WHY THEY ARE THRIVING IN CAYMAN

Gary Smith is a partner in Loeb Smith's corporate team advising principally on offshore investment funds, IPOs and M&A. Gary has given expert evidence in the United States Bankruptcy Courts relating to Cayman Islands investment funds and has also authored various publications on issues pertaining to Cayman Islands funds.

HFMWeek (HFM): How versatile are SPCs? What makes them this way?

Gary Smith (GS): Under Cayman Companies Law, a segregated portfolio company (SPC) is an exempted company which has been registered as a segregated portfolio company. It has full capacity to undertake any object or purpose, subject to any restrictions imposed on the SPC in its Memorandum of Association. The Memorandum of Association of an SPC usually gives the SPC full capacity to pursue very broad objects. Once registered under the Cayman Islands Companies Law, an SPC can operate segregated portfolios (SPs) with the benefit of statutory segregation of assets and liabilities between portfolios.

The appeal of SPCs extends beyond investment funds and is often used in capital markets and securitisation transactions. In the investment funds context, SPCs greatly enhance the versatility and efficiency of Cayman Islands fund structures. It allows investors to access different trading strategies or investments, different markets or different managers through a single corporate vehicle whilst simultaneously providing the segregation of assets and liabilities through each SP. This feature is unlike, for example, a 'multi-class' fund where there is typically a single legal entity offering various classes of shares designated according to the portfolio investment. The statutory ring-fence of assets and liabilities of an SP affords the SPC structure the ability to avoid cross class liability issues which could arise with 'multi-class' funds.

Cayman Islands Companies Law permits an SPC to create one or more SPs in order to segregate the assets and liabilities of the SPC held within one SP from the assets and liabilities of the SPC held within another SP of the SPC. The general assets and general liabilities of the SPC (i.e. assets and liabilities which cannot be properly attributed to a particular SP) are held within a separate general account rather than in any of the SP accounts. Each SP should have, as appropriate, its own bank account, brokerage account, and other accounts to hold its assets to avoid co-mingling with the assets of other SPs.

The Companies Law requires that segregated portfolio assets must only be available and used to meet liabilities to the creditors of the SPC who are creditors in respect of that SP, and who will, as a consequence, be entitled to have recourse to the segregated portfolio assets attributable to that SP for such purposes. Segregated portfolio assets of an SP should not be available or used to meet liabilities to, and shall be absolutely protected from, the creditors of the SPC who are not creditors in respect of that SP, and who accordingly will not be entitled to have recourse to the segregated portfolio assets attributable to that SP.

Accordingly, a creditor will only have recourse to assets from SPs with which it has contracted and creditors will have no recourse to the assets of other SPs of the SPC which are protected under the Companies Law. This statutory protection afforded under the Companies Law to the assets of each SP is one of the key feature and benefit of the SPC structure.

HFM: Why are SPCs flourishing in the Cayman Islands?

GS: The Cayman Islands continue to be the leading offshore jurisdiction for the establishment of hedge funds, private equity funds, real estate funds and other asset classes. The SPC structure has flourished as the Cayman Islands investment funds industry has flourished. Its versatility and efficiency in terms of the ability effectively to 'ring-fence' certain assets and their related liabilities under the same entity has made it increasingly attractive. Like a standard exempted company:

- There are no residency restrictions on directors or shareholders of an SPC
- The annual government fees for an SP is 50% less than the annual government fees for an exempted company
- There are no exchange control restrictions applicable in the Cayman Islands
- There are no Cayman Islands taxes on the SPC or its shareholders.

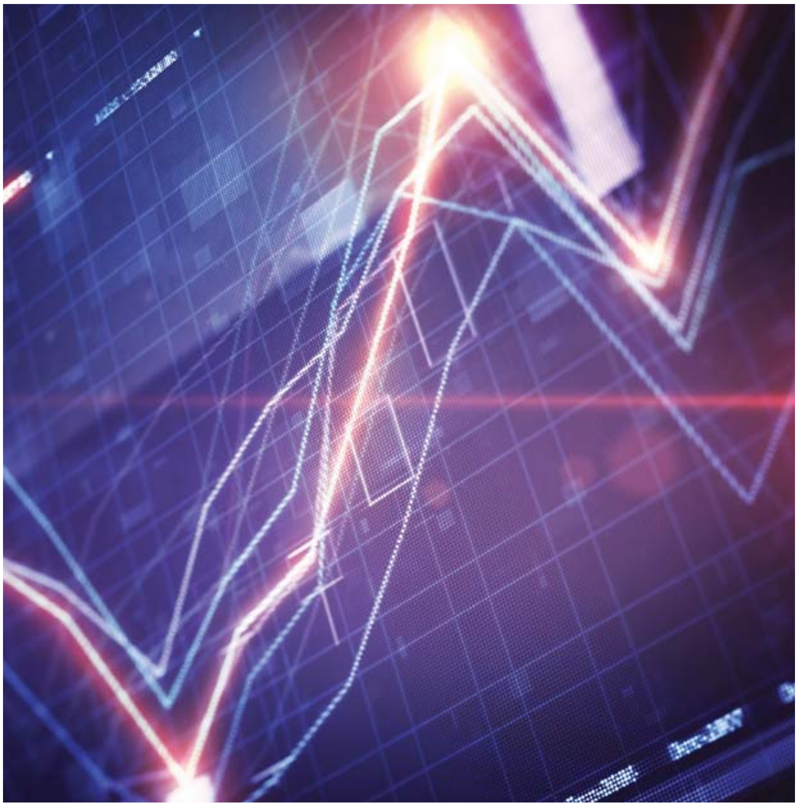
HFM: What are the main attractions of an SPC for a manager?

GS: The SPC corporate structure allows a fund manager to employ different trading strategies, and/or establish different investment platforms, and/or provide access to different markets, and/or different trading advisers through a single corporate vehicle while simultaneously providing the segregation of assets and liabilities through each SP. Fund managers are able to market an SPC fund to potential investors as being able to provide a statutory 'ring-fence' to protect against cross liability issues relating to the assets and liabilities of the various SPs within the SPC.

The SPC structure is increasingly being used as an investment platform on which investors can use different SPs to hold varying asset classes (e.g. real estate, intellectual property, stocks and shares, and distressed assets) and have their investments managed separately from other investments held by other SPs on the same SPC platform. We have seen an increase in the use of SPCs by fund managers as investment platforms for pursuing different strategies for the same pool of investors, managing investments in different geographical regions (e.g. China and emerging markets in Asia and Africa) and investing in different sectors (clean technology and offshore oil drilling).

The SPC will have a board of directors. In addition, each SP can have its own segregated portfolio directorate or investment or management committee which effectively controls and manages the operations of the relevant SP. The segregated portfolio directorate, investment or management committee would obtain its powers through powers delegated to it by the board of directors of the SPC.

The liabilities to a person arising from a matter imposed on, or attributable to, a particular SP, only entitle that person to have recourse to that particular SP in the first instance and then to the general assets of the SPC, unless the Articles of Association of the SPC prohibits payments from the general assets of the SPC, in which case there is no recourse to the general assets.



"THE APPEAL OF SPCs EXTENDS BEYOND INVESTMENT FUNDS AND IS OFTEN USED IN CAPITAL MARKETS AND SECURITISATION TRANSACTIONS"

HFM: Are there any misconceptions about SPCs? What are they?

GS:

- Can assets be transferred between SPs? The Companies Law requires the directors of the SPC to ensure that assets and liabilities are transferred between SPs at full value.
- Does an SP have separate legal personality? While the SPC is a company and therefore a corporate entity with separate legal personality, an SP does not have separate legal personality. Accordingly, the Companies Law requires that when contracting on behalf of a particular SP, it should be made clear which SP of the SPC is contracting on behalf. Each SP can have its own investment manager, trading advisor, and other service providers but it should be made clear in the agreements which SP of the SPC has engaged them for their services.
- Can an SP be liquidated without liquidating the entire SPC? An application can be made to the Cayman Court for a receivership order where a particular SP of the SPC is insolvent and other SPs within the SPC are operating on a solvent basis. ■