

BRIEFING NOTE

Overview of Cayman Islands law governing mutual funds – Q&A

1. What is a mutual fund?

The primary legislation regulating mutual funds in the Cayman Islands is the Mutual Funds Law (2015 Revision) (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. The term “mutual fund” applies for Cayman Islands law purposes to all open-ended investment funds irrespective of whether they are hedge funds or other fund with multiple strategies.

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 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,..."

Accordingly, 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 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 with any asset class which satisfies the definition of "*equity interests*" above. For present purposes we will refer to these funds as "**Open-ended Funds**".

1. Types of Open-ended Funds

According to the Funds Law, certain categories of Open-ended Funds are required to subject themselves to regulation by the Monetary Authority. The three types of Open-ended Funds which are regulated by the Monetary Authority are:

- i. licensed mutual funds;
- ii. administered mutual funds; and
- iii. registered mutual funds.

Licensed mutual funds

Licensed mutual funds are covered under section 4(1)(a) of the Funds Law and must apply for and obtain a license from the Monetary Authority to undertake

business. This is the least common type of regulated mutual fund owing in no small part to the burdensome approval process for a license.

Administered mutual funds

Administered mutual funds are covered under section 4(1)(b) of the Funds Law and must have appointed a licensed mutual fund administrator which is licensed with the Monetary Authority in the Cayman Islands. The licensed mutual fund administrator must also provide the Fund's principal office in the Cayman Islands. This type of mutual fund is commonly referred to as a "retail fund" in that it allows an investment manager to establish a fund that permits each investor to have a minimum initial subscription that is lower than US\$100,000. An administered mutual fund is the only type of regulated mutual fund which must appoint a mutual fund administrator based in the Cayman Islands. Licensed mutual funds (discussed above) and registered mutual funds (discussed below) may appoint an administrator based in any jurisdiction.

Registered mutual funds

Registered mutual funds are covered under section 4(3) of the Funds Law. This is the most common type of investment fund registered with the Monetary Authority. Registered mutual funds are exempt from the requirement to be licensed under section 4(1)(a) of the Funds Law or administered 4(1)(b) of the Funds Law on the basis that either (i) each investor must invest a minimum initial subscription of no lower than US\$100,000 (or its equivalent in any other currency) or (ii) the *equity interests* of the fund are listed on a stock exchange recognised by the Monetary Authority.

Exemption from Registration for Section 4(4) Funds

Under section 4(4) of the Funds Law, 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.

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

The following procedures apply to mutual fund registration:

- i. If the minimum aggregate equity interest purchasable by a prospective investor is at least US\$100,000 (or its equivalent in any other currency) or the equity interests are listed on a recognised stock exchange, including the Cayman Islands Stock Exchange, then the registration application requires filing of the following documents with the Monetary Authority:
 - a) 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);
 - b) 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);
 - c) a current offering document (for example, a private placement memorandum);
 - d) a consent letter from the fund's administrator and a consent letter from the Cayman Islands auditor, approved by the Monetary Authority;
 - e) a registration fee, which is currently US\$4,269 (approximately).
- ii. In the case of an administered fund where the 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 the following documents with the Monetary Authority:

- a) Forms MF2 and MF2A, completed by the administrator and the investment fund (including similar particulars to the Form MF1) (*see above*);
- b) the same documents (except the Form MF1) and registration fee as above.

These are filing registration requirements. The Monetary Authority will not perform a substantive review of the filing. Generally, the mutual fund can accept subscription monies once the filing is made.

Fund's offering document must:

- i. describe the equity interests in all material respects.
- ii. contain such other information as is necessary to enable a prospective investor in the fund to make an informed decision about whether to subscribe for or purchase the equity interests.

The fund is required under the Funds Law to file its current offering document with the Monetary Authority within 21 days of becoming aware of any change that materially affects any information in the offering document filed with the Monetary Authority or in the prescribed details of the offering document filed with the Monetary Authority.

This Briefing Note is not intended to be a substitute for specific legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and general guidance only. For more specific advice on the laws relating to Cayman Islands investment funds, please contact:

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