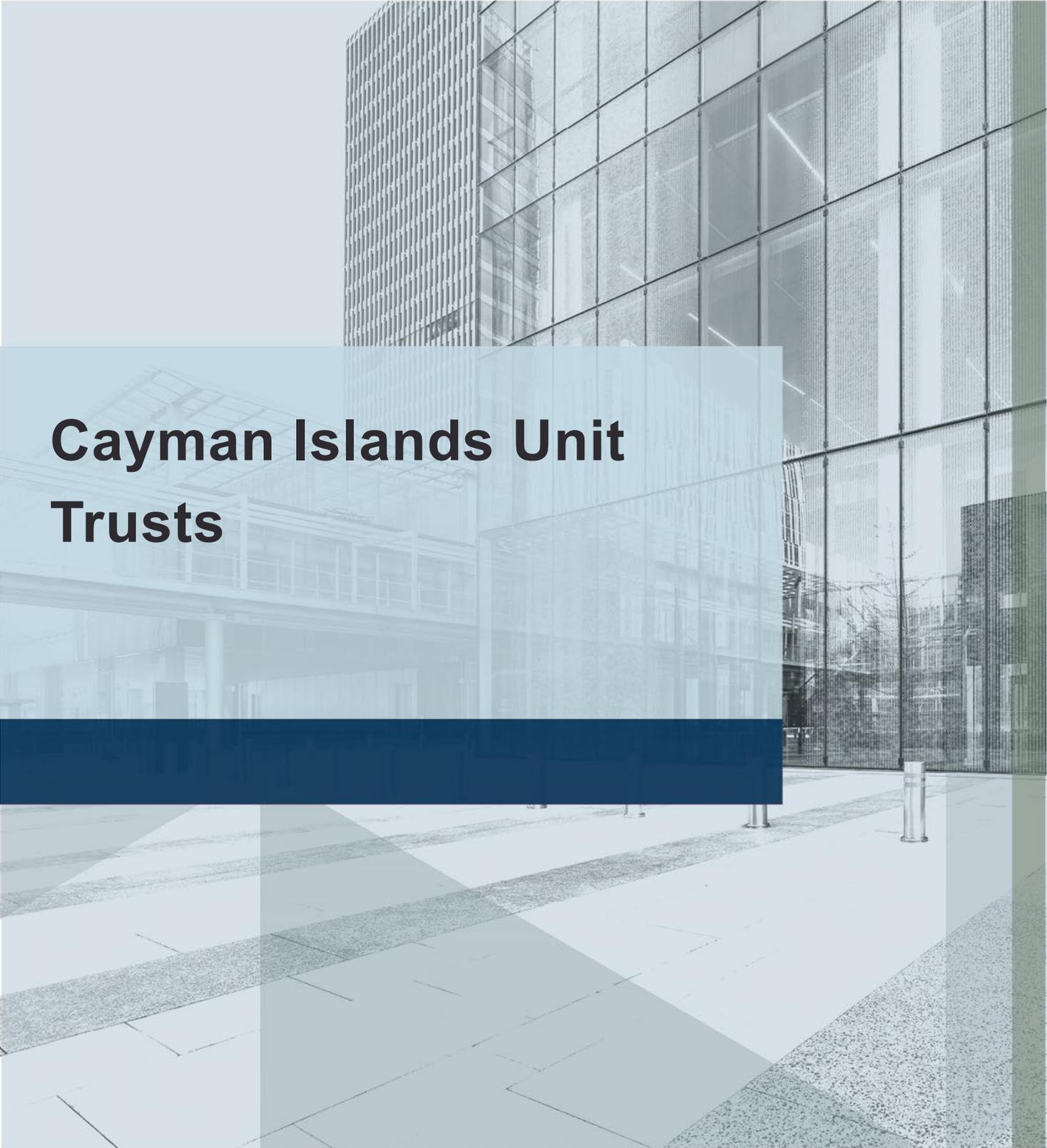


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A photograph of a modern glass skyscraper with a grid-like facade, viewed from a low angle. The building is partially obscured by a semi-transparent blue overlay. The foreground shows a paved plaza with a pattern of light and dark tiles. A dark blue horizontal bar is positioned below the text.

Cayman Islands Unit Trusts

Preface

This publication has been prepared for the assistance of those who are considering the formation of unit trusts in the Cayman Islands (“**Cayman**”). It is not intended to be exhaustive nor a substitute for proper legal advice but provides a basic guide to the unit trust concept and an outline of trust law and unit trust administration in Cayman for clients of Conyers.

Clients are advised that they should consider the implications in their home jurisdiction of establishing a Cayman unit trust and should consult with their own legal, financial and other professional advisers as appropriate.

We also recommend that our clients seek legal advice in Cayman on their specific proposals for a unit trust before taking steps to implement them.

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1. TRUST INSTRUMENT

A unit trust is constituted by a trust instrument either in the form of a declaration of trust made by the trustee alone or in the form of a trust deed executed by both the trustee and the manager.

The trust instrument will contain a declaration by the trustee that it holds the trust fund for the benefit of the unitholders and will administer that property according to the terms of the trust instrument.

In a declaration of trust, all the powers and duties of the trustee regarding the administration of the trust are specified in the declaration. The trustee will then enter into an agreement with the manager for the provision of investment management services, under which the trustee delegates certain of its powers, primarily the investment decisions regarding the trust fund, to the manager.

In a trust deed the responsibilities of each of the trustee and the manager are set out.

Unlike a company, a unit trust has no separate legal personality and the trustee as holder of legal title to the trust fund would be the party which sues or is sued in relation to the trust fund.

2. FORMS OF UNIT TRUST

Unit trusts are suitable for a variety of investment structures including the stand-alone trust and the umbrella trust.

2.1. Stand-Alone Unit Trusts

A “stand-alone” trust will be used where the trust intends to pursue a single investment objective and strategy. Such trusts may issue a single class of units to investors, or a number of classes within the same unit trust. In the latter type of “multi-class” unit trust, each class of units will have different rights and terms, such as different fees and expenses and may also be used where the offering of units distinguishes between different types of investors, such as institutional and retail investors. However, the trust fund will be invested as a single portfolio and each unit of any class will participate equally in that portfolio relative to the total net asset value.

2.2. Umbrella Unit Trusts

An “umbrella” unit trust is a flexible structure whereby the trustee holds different pools of investments allocated to different “sub-trusts” and where investors subscribe for units (of one or more classes) attributable to a particular sub-trust. Whilst there is no statutory segregation of assets and liabilities of unit trusts in Cayman, the trust instrument would allow the trustee (and the manager in the case of a dual-party trust deed) to create “sub-trusts”, each of which may have a different investment objective and strategies and/or different types of investors.

The trust instrument will state that a sub-trust is established as a “separate and distinct trust” but it should be noted that this only goes to the terms of the relationship between the unitholders of the relevant sub-trust and the trustee (and the manager in the case of a dual-party trust deed) in respect of their participation in the wider umbrella trust arrangement established under the trust instrument. In the absence of separate limitations being included in any contractual arrangement with third parties, such

persons will not be bound by the segregation envisioned in the “umbrella” unit trust in their dealings with a particular sub-trust.

The trust instrument for an umbrella trust can be structured in a number of ways, including providing that the trustee will have the power to establish each sub-trust by trustee resolution or by a supplemental trust deed.

Where a sub-trust is established by supplemental trust deed, the principal deed should itself establish a “head” trust by settlement of property on the trustee. That settlement may be made by the manager or the trustee itself and may be of a nominal amount. In the absence of such settlement there will not be a valid trust because a trust cannot exist without there being property owned by a person who has obligations as a trustee. Accordingly, unless the “head” trust is established by the principal deed, there will be no valid trust until the first sub-trust is established.

Whilst a structure in which a “head” trust is not established may be intended to emphasize the “separate and distinct trust” concept for each sub-trust, in the absence of a “head” trust, the power to create a sub-trust (or, more accurately, a trust) is not derived from the principal deed, but rather from the supplemental trust deed itself which, upon execution, incorporates such powers of the principal deed by reference. Accordingly, the provisions of the principal deed are not effective until the execution of the first supplemental trust deed and then only in respect of the sub-trust established by such supplemental trust deed. The principal deed would therefore simply amount to contractual terms incorporated into the terms of a trust relationship only upon the establishment of each sub-trust. This may undermine the intended “umbrella” nature of the structure because a separate series of trusts will be created by supplemental trust deed without them necessarily having any trust relationship to each other.

3. POWERS, DUTIES AND TRUST ADMINISTRATION

3.1. The General Law of Trusts

Under Cayman trusts law, a number of general fiduciary duties are imposed on trustees. Whilst these duties apply generally to unit trusts, unlike a private trust where the investment and trust administration functions are vested only in the trustee, a unit trust will have a manager and a trustee, both of whom are responsible for such functions in the unit trust.

3.2. Contractual Arrangements

A unit trust is not a separate legal entity from the trustee and thus it is not possible to enter a contractual arrangement on behalf of the trust itself. Where a trustee enters into a contract pursuant to a power under the trust instrument, the trustee can be sued by another party to that contract (the “**third party**”) under the law of contract and, under the law of trusts, any other trustee must administer the trust in order to meet any liabilities under the contract. However, the third party will only have a claim directly in contract against the other trustee(s) of the trust if the trustee had authority to act as agent for those other trustee(s) when contracting with the third party.

The manager of a unit trust has a fiduciary role with some of the same duties as those of the trustee.

It is possible for the unit trust deed to provide that the decision-making functions for contracts with third parties may be given to the manager under the trust instrument, in which case any contract will only bind the trustee under the law of contract if either the trustee is a party to the contract or the manager is authorised to enter the contract as agent for and on behalf of the trustee.

Even though the third party may only have a claim against the manager, if the manager is sued under the contract it would claim against the trustee. The trustee would be required to administer the trust fund in accordance with the trust instrument. Accordingly, the manager would need to ensure that the trust instrument specifies it has the power to enter into contractual arrangements.

3.3. Security interests

The fact that the third party does not have a direct claim against the trustee because only the manager entered the contract, may place the third party at a disadvantage. For example, a security interest in favour of a third party may not be fully effective unless the trustee as legal owner of the trust fund, or the manager as agent appointed by the trustee, enters into the security document. In such circumstances, the manager may be regarded as creating a security interest over the trust fund which it had no right to do as the trustee holds the legal title to the investments of the trust fund.

Accordingly, where the security interest is created pursuant to an express power of the manager provided in the trust instrument, if the third party wishes to have direct contractual recourse against the trustee as holder of the legal title of the trust fund in order for a charge or other security to be granted over the trust fund, the trustee should also be a party to the contract or the manager should be authorised as agent of the trustee to enter into the relevant contract.

4. APPOINTMENT OF SERVICES PROVIDERS

Where a separate custodian or sub-custodian is appointed it will typically be a company in the trustee's group and thus appointed by the trustee. Where a sub-custodian in a particular jurisdiction falls outside the global network of custodians in the trustee's group of companies, such sub-custodian may also be appointed by the trustee, albeit that the applicable supervisory and liability threshold of the trustee may then be different.

However, where a prime broker is appointed, the trust instrument may provide that it is the manager who effects such appointment, in consultation with the trustee. The usual rationale for this is that, as the manager instructs the prime broker, the prime broker should be appointed by the manager.

In the absence of an express provision in the trust instrument, the trustee should not allow the manager to appoint any prime broker (or indeed a custodian) without, as a minimum, consultation with the trustee regarding such appointment.

Where (part of) the trust fund is in the safe-keeping of another person on the instructions of the manager, the trust instrument should include a provision to the effect that the trustee will not be responsible for the (part of the) trust fund placed with that person.

5. TRUSTEES' LIABILITIES

Under the general law, the level of care which a trustee is obliged to show in performing its duties is that of an "ordinary prudent man of business in managing his own affairs", but in the case of professional corporate trustees, there is a higher test of "special care and skill". In addition, a paid trustee is expected to exercise a higher standard of diligence and knowledge than an unpaid trustee.

Whilst the trustee's duties require active participation in the administration of the trust, the extent of its responsibilities will be determined by the trust deed. For example, the trust deed will usually make it clear that the manager alone has the right and the duty to make investment decisions. In such circumstances, the trustee's function is not to assess the investments decisions of the manager, provided that the investments themselves are in line with the investment parameters of the trust and the custody requirements of the trust instrument. Accordingly, whatever the level of care which may be required of the trustee under the general law, the duty to which it applies is only that set out in the trust deed.

The Trusts Act contains relieving provisions in respect of liability for the acts of third parties. Section 47(1) of the Trusts Act provides that the trustee should be accountable only for its own acts and not for those of third parties unless the same happens through its own wilful default. In the context of an exclusion clause such as Section 47(1) of the Trusts Act, the term 'wilful default' means a deliberate breach of trust.

Section 29 of the Trusts Act, provides that trustees may act through agents and shall not be responsible for the default by any agent employed in good faith. However, caution should be applied in relying on this provision as its terms may be construed strictly against a trustee, particularly for professional corporate trustees. It is also the case that the trustee must exercise proper care in the selection of an agent and review the agent's performance at periodic intervals.

6. REGISTRATION UNDER THE TRUSTS ACT

A unit trust will typically be registered in Cayman with the Registrar of Trusts as an "exempted" trust pursuant to Section 74 of the Trusts Act and thus obtain a tax undertaking from the Governor in Cabinet pursuant to Section 81 of the Trusts Act.

In the case of an umbrella unit trust, on the basis that it is structured with a "head" trust being established prior to any sub-trust, the Registrar of Trusts will register that "head" trust as the "exempted" trust and the Governor in Cabinet will provide a tax undertaking in respect of the "head" trust only.

7. LICENSING REQUIREMENTS

A unit trust which falls within the definition of "mutual fund" in the Mutual Funds Act of Cayman will need to be regulated under that Act.

In the context of a stand-alone unit trust or an umbrella unit trust whose sub-trusts are not established by supplemental trust deed, application for regulation as a mutual fund with CIMA will be made following the execution of the declaration of trust or trust deed. For an umbrella fund where its sub-

trusts are established by supplemental deed, application may be made to CIMA for registration of each sub-trust rather than the “head” trust.

8. POWER OF ATTORNEY GIVEN BY TRUSTEE

Under the general rule, trustees have no implied power to appoint an attorney to carry out their functions, subject to statutory exceptions to this rule and the ability to delegate purely administrative functions, not involving the exercise of a discretion. They may, however, be expressly authorised to delegate their powers, or certain of them, under the terms of the trust instruments.

Under the Powers of Attorney Act a trustee may, by power of attorney, delegate the execution or exercise of all or any of the trusts, powers and discretions vested in it for a period not exceeding twelve months (Section 7(1) of the Powers of Attorney Act). If a trustee is executing a power of attorney pursuant to the Powers of Attorney Act, the trustee, as the donor of the power, must give written notice of it to each other trustee, if applicable, and any person who has power under the trust instrument to appoint a new trustee, if applicable. Such notice must specify the date on which the power comes into operation, its duration, the identity of the donee of the power, the reason why the power is given and, where some only are delegated, the trusts, powers and discretions delegated. Failure to comply with these notice provisions of the Powers of Attorney Act does not invalidate any act done or instrument executed by the donee of the power in favour of a third party.

A power of attorney granted by a trustee under Section 7 of the Powers of Attorney Act must be attested by at least one witness.

In the absence of any express provision, the duration of a power will be for a period of twelve months commencing on the date of execution of the power of attorney. However, the power can expressly provide for a shorter, but not longer, period and can provide for that period to commence at a later specified date. The power may not be granted to the only other co-trustee of the donor of the power unless that co-trustee is a “trust corporation” within the meaning of the Trusts Act.

If a power of attorney is given under the power to delegate under the trust instrument, the power should refer to the express power of delegation contained in the trust instrument.

This publication should not be construed as legal advice and is not intended to be relied upon in relation to any specific matter. It deals in broad terms only and is intended merely to provide a brief overview and give general information.

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