

CONYERS

Guide

Establishing Hedge Funds in the Cayman Islands

Investment Funds

The Cayman Islands is a world leader in the establishment of offshore hedge funds. Its tax-neutral platform, stable economy, sophisticated banking sector, confidentiality and professional financial service industry are just some of the reasons the location is attractive to hedge fund managers the world over.

To help fund managers decide whether the Cayman Islands is the right home for their fund, we have outlined some important factors to consider when setting up a hedge fund, as well as provided an overview of relevant documentation and regulations.

Key Considerations

1. What Fund Structure Should You Use?

A hedge fund is typically open-ended, that is investors can make periodic redemptions. Accordingly there must always be enough cash or liquid assets in the fund to meet such redemption demands.

Fund managers should also consider whether to impose a lock-in period on their open-ended funds, during which investors cannot sell shares. A lock-in period allows the fund manager to invest all of the subscriptions during the early life of the fund without having to meet redemption requests. It is important, however, to ensure the lock-in period is not so long that the fund effectively becomes a closed-ended fund.

2. Exempted Companies/Segregated Portfolio Companies

Cayman Islands hedge funds are typically structured as exempted companies. However, the particular needs or preferences of different types of investor, whether to reflect market convention, taxation or other considerations, may determine the actual fund vehicle or vehicles used.

Segregated Portfolio Companies may be considered a suitable option for Asian fund managers. Under Cayman legislation for SPCs, assets and liabilities can be separated into distinct pools amongst its segregated portfolios. This avoids the expense of incorporating individual companies to obtain the same effect. With SPCs, it is possible to create single-investor held portfolios that discreetly meet specific needs of each relevant investor.

3. Limited Liability Company

An alternative is to set up the fund as a limited liability company ("LLC"). A LLC combines many of the features of a company with the flexibility of a partnership. A LLC may be formed by a single member. Each member will receive one LLC interest, representing, for example, its right to capital voting rights and its right to receive dividends. For hedge funds that attract US investors, an LLC may be a good choice as a feeder vehicle within a master-feeder structure.

4. Share Classes

The fund, where structured as an exempted company for example, will usually issue two kinds of shares: voting and non-voting. Voting shares (management shares) are non-redeemable, do not have economic rights but carry significant shareholder voting rights and are held by the fund sponsor or manager. Non-voting shares (participating shares) are held by the investors and will only give them the right to participate in the fund's profits.

Regulations

An open-ended fund will be a mutual fund for the purposes of the Mutual Funds Act of the Cayman Islands ("MFA") and will be regulated by the Cayman Islands Monetary Authority ("CIMA"). For hedge funds, this usually means being regulated as a "registered" fund on the basis that the minimum initial subscription by an investor is not less than CI\$80,000 (approximately US\$100,000). An open-ended fund with 15 investors or fewer, who have the power to appoint and remove the directors, will also be subject to regulation by CIMA under the MFA.

Cayman Islands' master funds, being open-ended funds that hold investments and conduct trading to fulfill the investment strategy of a regulated feeder fund, are also regulated under the MFA. A registered fund must appoint a fund administrator, an auditor, a custodian/broker and at least two directors (who do not need to be resident in the Cayman Islands).

Incorporation

The fund must have a registered office in the Cayman Islands. Our affiliated service provider, Conyers Client Services, can provide this.

Conyers Client Services will be able to assist with the incorporation and organisation of the fund as a Cayman Islands exempted company. Incorporation is usually finalised within 48 hours of submission to the Cayman Registrar. However, copies of the certificate of incorporation and the memorandum and article of association, may take up to 7-10 working days unless the available expedited procedure is used.

Fund Documentation

The documents typically required for the hedge fund offering will include:

- The memorandum and articles of association ("M&A") would be our standard M&A for an exempted company incorporated in the Cayman Islands. They would later be amended to include the provisions of the fund's offering and other applicable amendments.
- The private placement memorandum ("PPM") provides all relevant details about the participating shares, so prospective investors can make an informed decision about subscribing, it including the investment objectives and applicable risk factors.
- Mutual Fund Application Form which sets out details prescribed by CIMA for registration as a regulated mutual fund.
- The various service provider agreements such as a management agreement between the fund and the manager, where appointed, an advisory agreement between the manager and the adviser and the fund administration agreement and the prime broker/custodian agreement.
- A subscription form (for investors subscribing for participating shares) and a redemption form (for when investors want to redeem shares).
- A CIMACONnect affidavit, which relates to electronic document filings with CIMA.
- The directors' and shareholders' written resolutions for the fund, which cover adoption of the fund's M&A, the PPM, the service provider agreement amongst other matters.

Finally, the Cayman Islands Directors Registration and Licensing Act requires the directors of any regulated mutual fund under the MFA to register with CIMA.

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