

CONYERS

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 containing text. The foreground shows a paved plaza with geometric patterns and a few stanchions.

Cayman Islands Segregated Portfolio Companies

Preface

This publication has been prepared for the assistance of anyone who is considering establishing a segregated portfolio company in the Cayman Islands. It deals in broad terms with the requirements of Cayman Islands law. It is not intended to be exhaustive but merely to provide general information to our clients and their professional advisers.

We recommend that our clients seek legal advice in the Cayman Islands on their specific proposals before taking any steps to implement them.

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1. INTRODUCTION

Part XIV of the Companies Law of the Cayman Islands provides for the establishment of a Cayman Islands exempted company as a “segregated portfolio company” (“**SPC**”), with protected cells or portfolios.

An SPC is a single legal entity whose assets and liabilities can be allocated to different cells or segregated portfolios within the company. Where assets have been allocated to a particular segregated portfolio, those assets are held as a separate fund which is not part of the general assets of the company itself. Such segregated portfolios are held exclusively for the benefit of the owners of those segregated portfolios and any counterparty to a transaction linked to those segregated portfolios. Only persons who have entered into transactions with a segregated portfolio, or who otherwise have become creditors of the segregated portfolio concerned, will have recourse to that segregated portfolio’s assets. Any asset which attaches to a particular segregated portfolio is not available to meet liabilities of the SPC or any of the other segregated portfolios.

Segregated portfolio assets comprise the proceeds of any segregated portfolio share capital and any other assets attributable to or held within to the relevant portfolio, including profits, retained earnings, capital reserves and share premiums. All assets held by an SPC not allocated to individual portfolios are regarded as general assets.

2. RATIONALE FOR ESTABLISHING A SEGREGATED PORTFOLIO COMPANY

2.1. Segregation of Assets and Liabilities

Part XIV of the Companies Law came into force in 1998 in response to strong demand, particularly from the insurance sector of the international financial community. The main purpose of the legislation is to provide a means for different groups to protect their interests when carrying on business with different risks through a single legal entity. In effect, each segregated portfolio or cell operates like a separate limited liability company but is actually a segregated part of a single company. Whilst the assets and liabilities of a segregated portfolio are ring fenced from the assets and liabilities of other segregated portfolios within an SPC, each segregated portfolio of or within an SPC does not constitute a legal entity that is separate from the SPC. The provisions of Part XVI of the Companies Law therefore enable a statutory segregation of accounts within a single company that could otherwise only be achieved by incorporating subsidiaries.

An SPC is permitted to create segregated portfolios. Any asset or liability linked to a particular segregated portfolio is deemed to be separate from the assets or liabilities of other segregated portfolios and from the SPC at large. Such assets or liabilities are held exclusively for the benefit or burden of the owners of that segregated portfolio and any counterparty to a transaction linked to that segregated portfolio. SPCs can thereby contract with a creditor or shareholder so that assets injected by that person are held by the SPC in respect of a particular segregated portfolio are insulated from any claims of the creditors of other segregated portfolios and of the general creditors of the SPC.

Within the investment funds industry the ability to use a SPC is particularly beneficial for fund managers wishing to establish master-feeder fund structures, structures providing for multiple classes of shares or any structure where the statutory segregation of assets is desired. For example, an SPC can issue

shares and declare dividends on its own account, as well as with respect to each individual portfolio. This can be a very useful device, particularly in the case of umbrella funds and fund of funds structures.

The SPC has obvious practical application to the captive insurance and reinsurance industries as it allows insured persons to better assess and handle the risks of the insurer by focusing only on the sufficiency of reserves of the relevant segregated portfolio as opposed to conducting an assessment of the business and reserves of the company as a whole. From the insurer's point of view, the SPC offers advantages over traditional methods of legal separation of accounts including reduced administrative expenses and relative simplicity of the structure. Companies incorporated to hold significant assets (for example, aircraft or ships) may also find it beneficial to have each asset attributed to a separate portfolio. Other types of companies may also benefit from the segregated portfolio structure and specific advice should be sought to determine whether on the facts of each case an SPC is the best available option.

2.2. Flexibility

An SPC can be tailored to best serve the interests of the individual portfolio owners and the company at large. In particular, SPCs can be designed to streamline and simplify administration for investment funds, insurance companies, asset-holding companies and companies carrying on separate and distinct business ventures.

2.3. Cost

The annual government fees for Cayman companies are set on a sliding scale calculated on the basis of the company's authorised share capital. Annual government fees for exempted companies presently range from US\$854 (CI\$700) to US\$3,133 (CI\$2,569) per company. Additionally, the fee to establish an SPC is US\$610 (CI\$500), with annual fees of US\$2,440 (CI\$2,000) for the SPC and US\$366 (CI\$300) per segregated portfolio, subject to a maximum of US\$1,830 (CI\$1,500). Regulated mutual funds that are segregated portfolio companies pay an additional fee. Taking into account the legal incorporation fees and annual secretarial fees, which are usually payable per company, the cost benefit in setting up one company with minimal authorised capital but administering a number of segregated portfolios is likely to be significant.

3. SETTING UP A SEGREGATED PORTFOLIO COMPANY

An exempted company may be formed as an SPC or an existing exempted company may be converted into an SPC. Depending on the business that the SPC is being set up to carry on, the prior approval of the Cayman Islands Monetary Authority ("**CIMA**") may be required.

The name of an SPC must include the words "Segregated Portfolio Company" or the letters "SPC". An SPC may create one or more segregated portfolios, each of which must have its own distinct name or designation and must include "Segregated Portfolio" or "SP" or "S.P." in its name.

3.1. Incorporation

Incorporation of an SPC is accomplished by submitting the Memorandum and Articles of Association to the Registrar of Companies together with the prescribed fee, as in the case of the incorporation of an

exempted company. Full particulars of the incorporation process, together with a description of the constitutional documents, local requirements and the ongoing regulation of a Cayman Islands exempted company can be found in our publication entitled “Cayman Islands Exempted Companies,” copies of which are available on our website or on request.

3.2. Registration

To register as a SPC, an application must be made to the Registrar of Companies, with payment of the prescribed application fee. A notice containing the names of each segregated portfolio created must also be furnished to the Registrar at the same time.

The application for the conversion of an existing exempted company into an SPC comprises a declaration made by at least two directors of the company setting out an accurate statement:

- (a) of the assets and liabilities of the company as at a date within three months prior to the date of the declaration;
- (b) of any transaction or event which, as at the date of the declaration, has occurred or is expected to occur between the date of the statement of assets and liabilities prepared pursuant to paragraph (i) above and the date of registration of the company as an SPC which, if it had occurred before the date of the declaration, would have caused material changes to the assets and liabilities disclosed in the declaration;
- (c) that the company intends to operate, and the assets and liabilities which the company proposes to transfer to each of the portfolios;
- (d) that, on registration as an SPC, the company and each segregated portfolio will be solvent; and
- (e) that each creditor has consented in writing to the transfer of assets and liabilities into segregated portfolios or, alternatively, that adequate notice has been given to all creditors of the company and 95% by value of the creditors have consented to that transfer of assets and liabilities into segregated portfolios. For this purpose, adequate notice is deemed to be given if notice in writing is sent to each creditor having a claim against the company exceeding US\$1,220 (CI\$1,000).

Further, the company must pass a special resolution authorising the transfer of assets and liabilities into segregated portfolios and attach a copy of the same to the declaration. In addition, where the company is licensed by CIMA, the written consent of CIMA must also be attached to the declaration.

3.3. Time Frame

An exempted company can usually be incorporated as an SPC, or converted into an SPC, within 5 to 10 full business days of submission to the Registrar of Companies of the relevant documents.

4. ONGOING REQUIREMENTS

4.1. Ongoing Segregation of Assets

The assets of an SPC comprise segregated portfolio assets and general assets. The directors of an SPC are under a duty to establish and maintain procedures to:

- (a) segregate, and keep segregated, portfolio assets separate and separately identifiable from general assets of the SPC;
- (b) segregate, and keep segregated, portfolio assets of each segregated portfolio separate and separately identifiable from segregated portfolio assets of any other segregated portfolio; and
- (c) ensure that assets and liabilities are not transferred between segregated portfolios otherwise than at full value.

It is suggested that proper discharge of the directors' duty to segregate the assets and liabilities will require physical segregation, for example, by way of maintaining separate accounts, and not merely separate accounting for each segregated portfolio.

Assets attributable to a particular segregated portfolio are held by the company as a separate fund. Such assets will only be available and used to meet liabilities to those creditors and shareholders who are creditors or shareholders of a particular portfolio and who are thereby entitled to recourse to that portfolio's assets. Such assets are not available to meet the SPC's general liabilities, and cannot be made available to satisfy the liabilities attributable to other segregated portfolios of the SPC. The directors of a segregated portfolio company are required to establish and maintain procedures to ensure that assets and liabilities are not transferred between segregated portfolio and general assets otherwise than at full value.

Liabilities attributable to a particular segregated portfolio may only extend to, and recourse may only be had to, firstly, the segregated portfolio assets attributable to that particular segregated portfolio and, secondly, unless prohibited by the articles of association of the SPC, the SPC's general assets but only to the extent that the segregated portfolio assets attributable to that particular segregated portfolio are insufficient to satisfy the liability, and to the extent that the general assets exceed any applicable prescribed minimum capital amounts. Such liabilities may not extend to, and recourse may not be had to, the segregated portfolio assets attributable to any other segregated portfolio.

Liabilities of an SPC not attributable to any of the segregated portfolios of the SPC are discharged from the SPC's general assets. Similarly, income, receipts and other property or rights of or acquired by an SPC and not otherwise attributable to any particular segregated portfolio are applied to and become part of the SPC's general assets.

4.2. Shares and Dividends

An SPC may create and issue shares in one or more classes or series, including different classes or series relating to the same segregated portfolio, and the proceeds of the issue of such shares must be included in the segregated portfolio assets of the segregated portfolio in respect of which such shares are issued. The proceeds of the issue of any shares other than segregated portfolio shares must be included in the general assets of the SPC.

An SPC may pay a dividend or other distribution in respect of segregated portfolio shares of any class or series and whether or not a dividend or other distribution is declared on any other class or series of segregated portfolio shares or other shares. Dividends or other distributions in respect of segregated portfolio shares must be paid by reference only to the accounts of and out of the segregated portfolio assets and liabilities of the segregated portfolio in respect of which the segregated portfolio shares were issued and otherwise in accordance with the rights of such shares.

4.3. Execution of Contracts for the Benefit of Segregated Portfolios

Any transaction which is to be binding on or is for the benefit of a particular segregated portfolio must be executed by or on behalf of the directors of the SPC and on behalf of that particular segregated portfolio, which must be identified or specified, and it must be indicated that the transaction is in the name of, or by, or for the account of, that particular segregated portfolio.

If the SPC is in breach of this obligation, the directors are obliged forthwith of becoming aware of the breach to make necessary enquiries, remedy the situation and notify all relevant persons of the error.

4.4. Winding-up and Receivership Orders

The liquidator of an SPC is required to deal with the assets of the SPC in accordance with the segregated procedures established by the directors of the company and, in discharging the claims of creditors of the SPC, may only apply the company's assets to those entitled to have recourse, as described above.

The Court may make a receivership order in respect of a segregated portfolio of an SPC if it is satisfied that the segregated portfolio assets attributable to that segregated portfolio (taking into account the SPC's general assets, unless there are no creditors in respect of that segregated portfolio who are entitled to have recourse to the SPC's general assets) are or are likely to be insufficient to discharge the claims of creditors in respect of that segregated portfolio, and that the making of the order would achieve the orderly closing down of the business of that segregated portfolio and the distribution of its assets to those entitled to have recourse thereto.

An application for a receivership order in respect of a segregated portfolio may be made by the SPC, its directors, any of its creditors in respect of that segregated portfolio, any holder of shares in respect of that segregated portfolio and, in relation to any company regulated by CIMA, CIMA.

A receivership order may not be made if the SPC is in winding up and a receivership order will cease to have effect upon the commencement of the winding up of the SPC. It should also be noted that a resolution for the voluntary winding up of an SPC of which any segregated portfolio is subject to a receivership order will only become effective with the leave of the Court. Further, during the period of operation of a receivership order of a segregated portfolio, no suit, action or other proceedings may be instituted against the SPC in relation to the segregated portfolio except with the Court's consent, which may be made subject to conditions.

During the period of operation of a receivership order in respect of a segregated portfolio, the functions and powers of the directors of the SPC will cease in respect of the business and assets of or

attributable to the segregated portfolio, which functions and powers will be vested in the receiver who may apply to the Court for directions as to the extent or exercise of any function or power.

5. SEGREGATED PORTFOLIO COMPANIES AND OTHER JURISDICTIONS

The SPC is becoming a popular and effective vehicle not just in the Cayman Islands but in other jurisdictions as well. Variations on segregated cell legislation exist in an increasing number of jurisdictions, including in several US states.

As the concept becomes commonplace, so too should investor comfort with the effectiveness of such structures. It is, however, possible that in some jurisdictions a SPC may be an unfamiliar structure and its dealings may be construed in a manner which is contrary to the intent of the legislation. More specifically, courts in other jurisdictions may not be prepared to accept that creditors in respect of a particular segregated portfolio are prevented from gaining recourse to the assets of other segregated portfolio, or that general creditors of the SPC as a whole do not have recourse to those assets specifically designated as segregated portfolio assets. Accordingly, where segregated portfolio assets are located outside the Cayman Islands, legal advice from insolvency practitioners in those jurisdictions is highly recommended. Parties may want to consider selecting Cayman Islands law to govern contracts to which an SPC is a party in an effort to ensure that the laws of Cayman Islands will apply and that the courts of the Cayman Islands will have jurisdiction to determine any disputes which may arise.

6. TAXATION

The Cayman Islands has no corporation tax, income tax, capital gains tax, inheritance tax, gift tax, wealth tax, or any other tax applicable to a company conducting off-shore business. Certain documents are subject to stamp duty which is generally nominal. All exempted companies are entitled to receive from the government a “Tax Exemption Undertaking” exempting them from any possible future Cayman taxes for a period of twenty years. Ordinary non-resident companies are not able to take advantage of the Tax Exemption Undertaking.

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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