The Asset Management Review

Tenth Edition

Editor
Paul Dickson

The LawReviews

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Tenth Edition

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This article was first published in September 2021
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Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34–35 Farringdon Street, London, EC4A 4HL, UK
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www.TheLawReviews.co.uk

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Enquiries concerning editorial content should be directed
to the Publisher – clare.bolton@lbresearch.com

ISBN 978-1-83862-758-4

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ABOU JAOUDE & ASSOCIATES LAW FIRM

ADVOKATFIRMAET BAHR AS

ARTHUR COX

CHRYSSES DEMETRIADES & CO LLC

DEYNECOURT

HAN KUN LAW OFFICES

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TRILEGAL

URÍA MENÉNDEZ

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PREFACE

Last year we reflected on how 2020 might primarily be remembered as the year of the novel covid-19 pandemic. A few events of global significance punctured covid-19's monopoly of economic news: the Democrats winning the White House; an eleventh-hour 'deal' being reached between the European Union and the United Kingdom a mere week before the end of the transition period; and a wrong turn in the Suez canal. However, a year on and the pandemic continues to dominate the global geopolitical landscape and remains a source of significant uncertainty. While it is clear that 2021 will also be overshadowed by the pandemic, successful vaccination campaigns appear to be providing fragile grounds for economic optimism in the near future. Yet unprecedented levels of government spending combined with labour shortages and supply chain disruption mean any recovery will have to grapple with rising inflationary pressures. In the asset management world, it is clear that the sector has faced one of its greatest and most sustained tests in recent history. The need for the industry to remain adaptable and resilient has perhaps never been greater.

Leaving all of this aside though, the importance of the asset management industry continues to grow. Nowhere is this truer than in the context of pensions, as the global population becomes larger, older and richer, and government initiatives to encourage independent pension provision continue. Both industry bodies and legislators are also increasingly interested in pursuing environmental, social and governance (ESG) goals through private sector finance. This should not be a surprise: lack of shareholder engagement has been identified as one of the key issues that contributed to the governance shortcomings during the financial crisis. Given the importance of the asset management industry in investing vast amounts on behalf of clients, the sector is the natural focus of regulatory and governmental initiatives to promote effective stewardship and take the lead in instilling a corporate cultural focus on sustainability and ESG initiatives.

The activities of the financial services industry remain squarely in the public and regulatory eye, and the consequences of this focus are manifest in ongoing regulatory attention around the globe. Regulators are continuing to seek to address perceived systemic risks and preserve market stability through regulation. Operational resilience – a concept focused on ensuring asset managers' holistic preparedness against any risk event, particularly significant operational risks – continues to be a significant focus point for global regulators.

It is not only regulators who continue to place additional demands on the financial services industry: the need to rebuild trust has led investors to call for greater transparency around investments and risk management from those managing their funds. Senior managers at investment firms are, through changes to regulatory requirements and expectations as to firm culture, increasingly being seen as individually accountable within their spheres of

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responsibility. Industry bodies have also noted further moves away from active management into passive strategies, illustrating the ongoing pressure on management costs. This may, in itself, be storing up issues for years to come.

The rise of fintech and other technological developments, including cryptocurrencies, data analytics and automated (or 'robo') advice services, is also starting to have an impact on the sector, with asset managers looking to invest in new technologies, seeking strategies to minimise disruption by new entrants, or both. While regulators are open to the development of fintech in the asset management sector, they also want to ensure that consumers do not suffer harm as a consequence of innovations. Regulators across various jurisdictions launched the Global Financial Innovation Network (GFIN), which aims to facilitate collaboration and communication between regulators regarding financial innovation and to create a cross-border sandbox in which firms can test their new technologies. This continues to be a period of change and uncertainty for the asset management industry, as funds and managers act to comply with regulatory developments and investor requirements, and adapt to the changing geopolitical landscape and respond to the ongoing uncertainties brought about by the global pandemic. Although the challenges of regulatory scrutiny and difficult market conditions remain, a return of risk appetite has also evidenced itself, and the global value of assets under management continues to increase year-on-year. The industry is not in the clear, but, prone as it is to innovation and ingenuity, it seems well placed to navigate this challenging and rapidly shifting environment.

The publication of the tenth edition of *The Asset Management Review* is a significant achievement, which would not have been possible without the involvement of the many lawyers and law firms who have contributed their time, knowledge and experience to the book. I would also like to thank the team at Law Business Research for all their efforts in bringing this edition into being.

The world of asset management is increasingly complex, but it is hoped that this edition of *The Asset Management Review* will be a useful and practical companion as we face the challenges and opportunities of the coming year.

Paul Dickson

Slaughter and May
London
August 2021

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Chapter 4

CAYMAN ISLANDS

Tim Coak, Malachi Sweetman and Michael Richardson[1]

I OVERVIEW OF RECENT ACTIVITY

Asset management vehicles established in the Cayman Islands can generally be divided into two distinct groups: open-ended funds (predominantly hedge funds), for which there is an abundant supply of publicly available statistical information (although it lags behind the market, as is inevitably the case for information compiled by a regulator); and other asset management vehicles (including closed-ended and private equity funds), for which the available data is currently more limited.

A cornerstone to the success of the Cayman Islands' financial services sector is its strong legal and regulatory system, which equally benefits managers and institutional or other sophisticated investors. The jurisdiction is attentive and responsive to developing international trends, continually evolving to ensure it meets the requirements of finance sector participants, including government and regulatory authorities. Against this background, there have been a number of noteworthy developments in recent years, which are discussed in more detail below.

The Cayman Islands continues to maintain its position as the leading jurisdiction for the registration of mutual funds, with 11,896 funds regulated under the Mutual Funds Act (2021 Revision) (the Mutual Funds Act) at the end of 2020 and 12,225 at the end of the first quarter of 2021.[2] This consistent growth was expected following amendments in 2020 to the Mutual Funds Act, which removed an exemption from registration for more closely held open-ended funds.[3] The industry's strength is reflected in the Cayman Islands Monetary Authority's (CIMA) statistical digest for 2019, which shows the net asset value of reporting funds at US$4.229 trillion.[4]

It is currently more difficult to obtain an accurate overview of the state of the Cayman Islands' asset management industry as a whole, which would necessarily include looking at the level of managed account activity and closed-ended fund activity. Until February 2020,[5] closed-ended funds (i.e., funds that do not afford investors the option to withdraw all or part of their investment prior to the winding-up of the fund) and funds known as Section 4(4)

1 Tim Coak and Michael Richardson are partners and Malachi Sweetman is an associate at Maples and Calder, the Maples Group's law firm.

2 Figures taken from the Investment Fund Statistics section of the CIMA website: www.cimoney.com.ky.

3 Changes made pursuant to the Mutual Funds (Amendment) Act, 2020.

4 CIMA: Investments Statistical Digest 2019.

5 The Private Funds Act (2021 Revision) and the Mutual Funds (Amendment) Act 2020 introduced a registration regime for closed-ended funds and Section 4(4) funds, respectively. This is discussed further in Section II.

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funds, which are open-ended investment funds that pool the funds of 15 or fewer investors, a majority of whom are given the power to appoint and remove the fund's directors, managers (in the case of a limited liability company (LLC)), general partner or trustee, as applicable, were not required to be registered with CIMA. It may be a few years before CIMA is able to provide meaningful statistics covering all registered funds in the jurisdiction, although CIMA has confirmed unofficially that 12,695 private funds were registered by 7 August 2020.

Accordingly, to date the most useful indicator of the level of closed-ended fund activity (which generally includes funds investing in illiquid asset classes, such as private equity, real estate or infrastructure projects) is the number of registrations of Cayman Islands exempted limited partnerships (ELPs) and, more recently, LLCs. However, this is only a rough indicator based upon practitioners' experience that the majority of closed-ended fund structures are formed as ELPs. By contrast, CIMA's statistical digests show that a minority of open-ended funds are formed as ELPs, highlighting that they are most prominent in the closed-ended sector. Figures released by the Cayman Islands Registrar of Exempted Limited Partnerships show that at the end of 2020 there were a total of 31,733 ELPs registered in the Cayman Islands. The past decade has generally seen a consistent increase in the number of annual ELP registrations. At the end of May 2020, the figures for registered LLCs stood at 3,118.

ELPs are utilised for a variety of purposes within closed-ended structures. An ELP may well be the primary closed-ended fund vehicle, but often ELPs will also serve other purposes (e.g., ELPs may be used as a feeder into an onshore fund, an alternative investment vehicle, a parallel fund or a co-investment vehicle). Similarly, while still a relatively new vehicle in the Cayman Islands, experience has shown that LLCs are increasingly being used as general partners as well as feeder, blocker and aggregator vehicles in closed-ended fund structures. Changes in the rate of formation of ELPs and LLCs could, therefore, indicate fluctuations in the rate of new fundraising, but are just as likely to point to variations in the level of transactional activity by established closed-ended funds themselves.

II GENERAL INTRODUCTION TO THE REGULATORY FRAMEWORK

The primary statute regulating Cayman Islands open-ended pooled investment funds is the Mutual Funds Act. A Cayman Islands investment fund qualifies as a mutual fund and is, therefore, required to be regulated under the Mutual Funds Act if:

a it is a company, LLC, partnership (including ELPs) or unit trust;

b it issues equity interests to investors (i.e., shares, partnership and LLC interests or trust units that carry an entitlement to participate in profits or gains, and which may be redeemed or withdrawn at the option of those investors prior to winding-up); and

c its purpose or effect is the pooling of investor funds with the aim of spreading investment risks and enabling investors to receive profits or gains from investments.

The key distinction between such an open-ended mutual fund and a closed-ended fund is the ability of investors to voluntarily redeem or withdraw some or all of their investment prior to winding-up, whether at will or on a specified period of notice. Where shares, partnership and LLC interests or trust units are subject to a lock-up period, Cayman Islands practitioners and CIMA generally consider that the lock-up period should be at least five years for an investment fund to be regarded as closed-ended at the outset.

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Open-ended master funds are also potentially subject to registration with CIMA. A master fund in a multilevel fund structure will be deemed a mutual fund for the purposes of the Mutual Funds Act and, accordingly, will be required to be registered with CIMA, if it:

a is a Cayman Islands company, LLC, partnership (including ELPs) or unit trust;
b issues equity interests;
c holds investments and conducts trading activities for the principal purpose of implementing the overall investment strategy of a CIMA-regulated feeder fund; and
d has at least one CIMA-regulated feeder fund that conducts more than 50 per cent of its investment activity through the master fund, whether directly or indirectly via an intermediate entity.

Owing to the definition of master fund under the Mutual Funds Act, an open-ended master entity in a structure having only one investor (i.e., where there is, strictly speaking, no pooling element at the level of the master fund) will, nevertheless, constitute a mutual fund. The exact fund structure will, in each case, determine whether registration of a master entity, or any other entity, is necessary, although there are certain structural approaches that may allow such an entity to fall outside the scope of the master fund registration regime under the Mutual Funds Act. Where an open-ended fund is eligible for registration both as a feeder fund and as a master fund, CIMA has suggested that funds should generally opt for registration as a master fund, although there are certain circumstances in which this may not be appropriate.

Funds registered under Section 4(3) of the Mutual Funds Act account for over 92 per cent of all regulated open-ended investment funds in the Cayman Islands as of 31 December 2020.[6] The straightforward requirements for registration and the absence of a pre-approval process contribute to this popularity. The basic requirements for registration under Section 4(3) (for both traditional mutual funds and master funds) are that the minimum initial investment per investor is at least US$100,000 (or its equivalent in another currency) (the Minimum Investment Requirement), or that the equity interests are listed on a recognised stock exchange. Registration involves completion of an online application form by a licensed corporate services provider in the Cayman Islands, together with the online filing of the fund's offering document and consent letters from its administrator and its Cayman Islands auditor. A separate offering document is not required for a regulated master fund. On an ongoing basis, the fund must file an amended offering document within 21 days of any material change that occurs while it is still offering its equity interests. It must also file annual audited accounts, a key data elements form and a fund annual return (all submitted electronically by the fund's auditor) with CIMA within six months of the end of each financial year.

Few investment funds are fully licensed under the Mutual Funds Act, since this is generally only applicable to retail funds, while the majority of investment funds formed in the Cayman Islands are intended for institutional or high-net-worth investors. Of the total number of 11,896 regulated investment funds at the end of 2020, only 59 were fully licensed by CIMA under the Mutual Funds Act.[7]

6 Op. cit. 2.
7 ibid.

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An alternative to obtaining a full licence under Section 4(1)(a) of the Mutual Funds Act is to be regulated as an administered fund under Section 4(1)(b) of the Mutual Funds Act. As of 31 December 2020, there were only 294 administered funds.[8]

Administered funds have steadily declined in popularity in recent years (from 408 in 2012 to 294 in 2020),[9] perhaps because the administrators who originally saw them as a source of higher fees came to realise that the higher fees were counterbalanced by higher risks. Registration as an administered fund is achieved by designating a Cayman Islands-licensed mutual fund administrator as the fund's principal office. The administrator must satisfy itself that the promoters of the fund are of sound reputation, that the fund's administration will be undertaken by persons with sufficient expertise who are also of sound reputation, and that the fund's business and its offering of equity interests will be carried out in a proper manner. The administrator is obliged to report to CIMA any suspected infringements by the fund of the Mutual Funds Act (or any other law), or any suspicion that the fund may be insolvent or may otherwise be acting in any manner prejudicial to its creditors or investors. This imposes a role of quasi-regulator and compliance monitor on the administrator themselves, potentially a burdensome task to carry out effectively.

i Limited investor funds

What were previously referred to as Section 4(4) funds (now designated as limited investor funds (LIFs)) are required to register with CIMA and no longer benefit from an exemption from registration. A LIF is required to be registered with CIMA prior to the acceptance of investors and making investments. The registration requirements are similar to those of a mutual fund registered under Section 4(3) of the Mutual Funds Act, except that a LIF may file its offering document or marketing materials or a summary of its terms, as well as certified evidence of the operator removal right. LIFs must comply with CIMA's 'four-eyes' principle that requires them to have at least two natural persons in management roles. In addition, each director or manager of a LIF structured as a Cayman Islands exempted company or LLC will need to register under the Directors Registration and Licensing Act 2014 (the DRL Act), if not already registered, prior to the LIF's registration with CIMA.

The key differences between a mutual fund registered under Section 4(3) of the Mutual Funds Act and a LIF are that investors in the former are subject to the Minimum Investment Requirement whereas there is no statutory minimum initial investment amount applicable to investors in a LIF, and a LIF must have 15 or fewer investors, a majority in number of which must be capable of appointing or removing the operator of the LIF.

ii Private funds

The Private Funds Act (2021 Revision) (PFA) and its supporting regulations provide for the registration of certain closed-ended funds (known as private funds) with CIMA. The PFA applies to private funds set up as Cayman Islands partnerships, companies, unit trusts and limited liability companies unless out of scope on the basis set out in the PFA. The PFA also applies to non-Cayman Islands private funds that make an invitation to the public in the Cayman Islands.

8 ibid.

9 ibid.

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A vehicle is a private fund where it offers or issues or has issued investment interests, the purpose or effect of which is the pooling of investor funds with the aim of enabling investors to receive profits or gains from the vehicle's acquisition, holding, management or disposal of investments, where:

a its investment interests are not redeemable or repurchasable at the option of the investor (i.e., are closed-ended);

b the investors do not have day-to-day control over the investments;

c its investments are managed as a whole by or on behalf of the operator, directly or indirectly; and

d it does not constitute a 'non-fund arrangement', as listed in the schedule to the PFA.

Non-fund arrangements include joint ventures, proprietary vehicles, holding vehicles, single family offices, securitisation special purpose vehicles and officer, manager or employee incentive, participation or compensation schemes, and programmes or schemes to similar effect. There is no separate master fund definition for private funds, meaning that each closed-ended vehicle will need to be assessed to determine whether it is within the scope of the PFA.

Registration of a private fund involves completion of an online application form, together with a structure chart, certain constitutional documents, the fund's offering document or its marketing materials or a summary of its terms, and consent letters from its administrator and its Cayman Islands auditor. On an ongoing basis, a private fund must inform CIMA if it makes a change, or becomes aware of any change, that materially affects any information submitted to CIMA in connection with the fund, within 21 days of the change or the fund becoming aware of the change. Like mutual funds registered under the Mutual Funds Act, a private fund must also file annual audited accounts, a key data elements form and a fund annual return (all submitted electronically by the fund's auditor) with CIMA within six months of the end of each financial year.

Private funds are also subject to certain operational requirements relating to valuation of its assets, safekeeping of its assets, cash monitoring and identification of securities. These functions can be carried out by the fund itself or by an appropriate service provider appointed by the fund.

There are no local service provider requirements for CIMA-registered investment funds, except that they are required to appoint an approved local auditor and, in the case of an administered fund, a Cayman Islands-licensed mutual fund administrator.

CIMA issued a Statement of Guidance on Corporate Governance for Regulated Mutual Funds (SOG) on 13 January 2014. The SOG is relevant to all CIMA-registered and licensed mutual funds, their individual operators and their governing bodies. It does not extend to the banking and insurance sector. The purpose of the SOG is to provide individual operators and governing bodies of funds with guidance on CIMA's minimum expectations for the sound and prudent governance of mutual funds. While the SOG is not intended to be exhaustive and is not directly enforceable by CIMA, CIMA may look to the SOG should it need to consider whether the direction and management of a CIMA-registered and licensed mutual fund has been conducted in a 'fit and proper manner'.

The DRL Act requires the directors (or, in the case of LLCs, the managers) of mutual funds registered with CIMA under the Mutual Funds Act and companies registered with CIMA as 'registered persons' under certain heads of the Securities Investment Business Act (2020 Revision) (together, covered entities) to be, themselves, registered with or licensed

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by CIMA, and allows CIMA to regulate 'professional directors' and 'corporate directors' of covered entities. The DRL Act will be relevant to any person who is, or who intends to become, a director of a company (or a manager of an LLC) that is or will be a covered entity, whether that person is resident in the Cayman Islands or elsewhere. Under the DRL Act, it is unlawful to be appointed as a director (or, in the case of an LLC, as a manager) of a covered entity without first being registered or licensed with CIMA.

The Cayman Islands has signed an intergovernmental agreement to improve international tax compliance and the exchange of information with the United States (US IGA). The Cayman Islands has also signed, along with over 100 other countries, a multilateral competent authority agreement to implement the Organisation for Economic Co-operation and Development (OECD) Standard for Automatic Exchange of Financial Account Information – Common Reporting Standard (CRS). Cayman Islands regulations have been issued to give effect to the US IGA and CRS (collectively, the AEOI Regulations). Pursuant to the AEOI Regulations, the Cayman Islands Tax Information Authority (TIA) has published guidance notes on the application of the US and CRS. These developments are supported by a network of bilateral tax information exchange agreements (according to the OECD, there are over 4,200 bilateral exchange relationships activated with respect to more than 100 jurisdictions committed to the CRS, with the next exchanges between these jurisdictions set to take place at the end of September 2021), and adherence to multilateral conventions such as the OECD and Council of Europe Convention on Mutual Administrative Assistance in Tax Matters.

These initiatives further strengthen Cayman's regulatory reputation on cooperation matters and align its regulatory framework with a trend towards automatic exchange of information on tax.

III COMMON ASSET MANAGEMENT STRUCTURES

Three types of vehicle are most commonly utilised by Cayman Islands investment funds: exempted companies, ELPs and exempted unit trusts. Essentially, exempted vehicles are not permitted to carry on business within the Cayman Islands or must conduct their business mainly outside the Cayman Islands unless they have a licence to carry on business in the Cayman Islands. LLCs are not yet commonplace as investor-facing vehicles but are becoming increasingly common in overall fund structures, and are also eligible to apply for a 50-year tax undertaking.

Exempted companies limited by shares are the most commonly used vehicle for open-ended funds. In 2014, 77 per cent of CIMA-regulated mutual funds were exempted companies (including segregated portfolio companies),[10] and while this particular statistic was not included in the most recent CIMA statistical digests, practitioner experience suggests that this trend continues.

As previously noted, closed-ended funds established in the Cayman Islands are most commonly established as ELPs. Most jurisdictions with managers of, or investors in, such funds have become comfortable with the limited partnership structure prevalent in the United States, which is replicated to a significant degree in the Cayman Islands ELP structure. It is expected that the use of LLCs within fund structures will continue to increase over the coming years because of the substantial similarities between the Cayman Islands LLC and

10 CIMA: Investments Statistical Digest 2014.

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the popular United States limited liability company vehicles. While exempted companies are extremely flexible with regard to the extent to which voting and economic rights can be mixed among different classes of shares, companies with share capital have, by their very nature, certain structural and legal limitations that may not apply to ELPs or LLCs.

There are, for example, fewer statutory rules governing approval processes within ELPs and LLCs. For instance, general partners of ELPs or the managers of an LLC can be, and usually are, delegated a certain degree of unilateral authority to amend the constitutional documents of an ELP or an LLC, while such powers cannot be delegated to the directors of an exempted company in relation to its memorandum and articles of association (which can only be amended by special resolution of its shareholders). However, the key reasons for the use of ELPs (and now LLCs) for closed-ended funds relate to distributions. While the directors of a company are restricted by statutory and common law maintenance of capital rules, the general partners of an ELP or the managers of an LLC are generally limited only by basic solvency requirements and the agreed terms of the limited partnership or LLC agreement, as applicable, when considering which sources of funds to utilise. Even more significant, however, is the ability of partners or LLC members to directly enforce the constitutional documents against one another; and the fact that the terms of investment can easily be expressed to survive a partner's or member's withdrawal (whereas a shareholder in a company ceases to be subject to its articles of association when he or she no longer holds any shares).

Closed-ended funds generally make distributions on a waterfall basis, most commonly by paying distributions first to investors until all capital contributions have been returned and a certain level of return obtained, then to the manager or general partner until it has received a specified percentage of the aggregate amount of all distributions, and then to investors and the manager or general partner in specified percentages. These distributions are often subject to clawback at the end of the fund's life if, once all distributions have been made, the manager or general partner has received a higher proportion of the aggregate distributions than intended, or, in some cases, from investors to fund indemnity payments. Utilising a company in this situation would generally require these obligations to be set out in a separate shareholders' or subscription agreement that is also signed by the company to ensure that the obligations survive a shareholder's withdrawal, and can be directly enforced by each investor and the company as against each other. Such considerations are also critical prior to the drawdown of funds from investors in a closed-ended vehicle, who may be bound by a limited partnership agreement or an LLC agreement prior to funding, but will generally not be bound by the articles of a company until such time as they actually subscribe for and are issued with shares.

Investment funds structured as unit trusts are primarily formed in the Cayman Islands for distribution in Japan, where the demand is generated by familiarity with the unit trust structure and historical local tax benefits relating to unit trusts as opposed to company shares or limited partnership interests. The Cayman Islands also has specific regulations[11] that such investment funds can elect to comply with when applying for a licence under the Mutual Funds Act, which, under current guidelines set by the Japan Securities Dealers Association, permit them to be marketed to the public in Japan. Although companies and limited partnerships are also eligible to use this regime, the popularity of unit trusts with Japanese investors means that funds regulated under this regime are usually unit trusts.

11 The Retail Mutual Funds (Japan) Regulations (2018 Revision).

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IV MAIN SOURCES OF INVESTMENT

The current disparity of available information between open-ended and closed-ended investment funds in the Cayman Islands is evident when analysing the source and value of investments in such funds. CIMA's published statistics[12] provide a useful indication of the scale of the open-ended industry, with the net asset value of reporting funds in 2019 being over US$4 trillion. The actual figures for open-ended funds alone will exceed these amounts, because CIMA's figures are based only on the 82 per cent of regulated funds as at December 2019 that had actually filed their fund annual returns for 2018, and do not as yet capture LIFs.

We can speculate that the size of the closed-ended fund industry in the Cayman Islands is of a similar order. However, as previously noted, the exact number of closed-ended fund vehicles is currently difficult to establish, and the details of equity holders in those vehicles and the size of their investments is not publicly available information. Therefore, this is, at best, an educated guess, although we expect to see more meaningful figures emerging from CIMA in the course of the next few years.

V KEY TRENDS[13]

The Cayman Islands has consistently adapted its regulatory and legal system to meet the demands of the finance sector and align it with international best practice. As a jurisdiction, it has proven to be highly responsive to the needs of the global financial industry through industry consultation projects, statutory amendments and new legislation, and through the growth and development of a commercially sophisticated judicial system.

Increasingly, the majority of inflows to hedge funds are from institutional investors. Institutional money has typically favoured larger managers, and this trend, together with recent positive industry performance, is reflected in the increasing total assets under management (AUM) figure for the industry, which is currently estimated to be over US$4 trillion.

Approximately 53 per cent of new funds were launched by managers with over US$1 billion AUM at the time of launch (whether from pre-existing funds in the market or because of a launch that exceeded US$1 billion). On the other hand, approximately 25 per cent of new funds were launched by managers with under US$100 million AUM at the time of launch, showing that there are a significant number of new start-ups in existence despite the increased regulatory burden and other challenges faced by emerging managers in the current environment.

Over the past six years, the proportion of specific Employee Retirement Income Security Act of 1974 (ERISA) funds, and the funds allowing ERISA investors on the traditional limited basis, has remained fairly constant and was at 77 per cent in 2019.

Equity long-short funds have consistently constituted the highest proportion of funds launched since 2013. Other strategies such as managed futures and fixed income have fluctuated in popularity, while more recently multi-strategy funds have become more popular, perhaps reflecting the current economic uncertainty in the global markets.

12 Op. cit. 4.

13 The following trends and statistics are based upon our own client and transaction experience to the end of 2019.

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Since 2013, there has, unsurprisingly, been a steady increase in the number of regulated managers. This is undoubtedly driven by the Dodd-Frank Wall Street Reform and Consumer Protection Act, which removed certain exemptions to registration with US regulatory bodies. For 2019, however, the general upward trend in the number of regulated managers dropped slightly, with 88 per cent of new funds being launched by regulated managers.

Both investors and regulators have pushed for greater transparency and accountability, which has led to changes in board composition. While the use of independent directors has generally increased over the years, a segment of the launch market prefers split boards consisting of independent directors appointed from more than one service provider as well as a manager-affiliated director. This trend has been more marked for funds with promoters in the US than other regions. Independent directors are now regarded as significant to the overall structuring of a fund, as a robust board can be critical to the fund's success, and significant decisions in crisis situations (such as gating and suspending redemptions) can rest with the board. Investor due diligence on board members is now standard practice, and institutional investors in particular now often require independent directors on the board of funds in which they invest. There has also been an increase in the use of independent advisory committees or independent directors on the boards of general partners where funds – particularly master funds – are structured as ELPs. Additionally, there has been a significant shift in the manner in which directors engage with a fund, its service providers and investors. The institutionalisation of the industry and the impact of new regulatory initiatives aimed at protecting investors has led to a much greater degree of scrutiny on corporate governance, resulting in more proactive and engaged directors than ever before.

Preserving liquidity continues to be a key priority for investors. There was a significant decrease in funds launching without a gate in 2018, but 2019 saw a return to previous levels at around 64 per cent of funds, with a corresponding reduction in the number of funds launching with fund level gates and investor level gates, being 21 per cent and 15 per cent, respectively.

Requests for liquidity in side letters must be tailored to the asset class, and many investors understand that it is not always preferable to have greater liquidity. It is crucial to provide clear disclosure on any liquidity restrictions and the reasons for them in side letters. Fund promoters frequently consider the importance of balancing investors' desire for liquidity with the need to manage the fund's portfolio in a liquidity crunch.

i Statutory revisions and new legislation

A key strength of the Cayman Islands' funds regime continues to be the ability to combine robust yet flexible laws, which are updated to keep pace with industry needs, with a commercial approach to business. The past few years have been a particularly busy period for Cayman Islands legislation in this regard. Legislation and regulations have been amended when necessary to meet OECD, EU Directive on Alternative Investment Fund Managers (AIFMD) and other European Union initiatives, the US Foreign Account Tax Compliance Act and other external requirements, and this approach can be expected to continue. The Cayman Islands fund industry is focused on, and responsive to, the legal and regulatory changes taking place worldwide, particularly in the US, Europe and Asia.

The Cayman Islands, through the applicable regulatory agencies, continues to engage proactively with counterpart international regulators (such as the Securities and Exchange Commission and the Financial Conduct Authority), and so remains at the forefront of evolving transparency and cooperation initiatives.

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In addition to the recently introduced PFA, amendments to the Mutual Funds Act, the SOG and the DRL Act, there have been a number of other fairly recent legislative updates.

CIMA has issued rules on the contents of offering documents for mutual funds and the contents of marketing materials for private funds. The rules should harmonise material disclosures in the marketing documents of all registered funds, although it is likely that, due to the breadth of the meaning of private fund under the PFA, not all private funds will necessarily have marketing materials. As a case in point, private funds that are alternative investment vehicles are expressly excluded from the rules.

CIMA has also issued new rules that apply to mutual funds regulated under the Mutual Funds Act relating to the segregation of assets and the calculation of asset values. The rules relating to segregation of assets require that a fund's portfolio be segregated and accounted for separately from the assets of any service provider (subject to certain exceptions), that a fund has a service provider in place with regard to ensuring safekeeping of the fund's portfolio, and that service providers do not use a fund's portfolio (as defined in the rules) to finance their own or any other operations. The rules relating to segregation of assets do not apply to funds that are subject to the Retail Mutual Funds (Japan) Regulations (2018 Revision). Such funds are already required to appoint a custodian pursuant to those regulations and the appointed custodian owes direct duties to CIMA.

The rules relating to calculation of asset values require a fund to establish, implement and maintain a written net asset value calculation policy based on generally accepted accounting principles of a non-high risk jurisdiction. These rules set out a number of requirements that the net asset value calculation policy must adhere to, including that the net asset value of a fund be calculated at least quarterly. Deviations are permitted subject to certain conditions being met, including disclosure to investors. Similar asset valuation calculation rules apply to private funds, which must establish, implement and maintain appropriate and consistent pricing and valuation practices, policies and procedures in order to properly value their assets and to ensure that valuations are conducted in accordance with the PFA. Valuations must be carried out at a frequency that is appropriate to the assets held by the private fund and, in any case, on at least an annual basis.

The Cayman Islands has established two 'opt-in' regulatory regimes that are consistent with (and intended to provide equivalency to) the AIFMD. In August 2015, the amendments to the Mutual Funds Act and Securities Investment Business Act required to implement the new regulatory regimes were passed, and in December 2016 the relevant supporting regulations were passed. This regime was brought into force on 1 January 2019, although certain requirements of the regime remain subject to a further order of the government.

The Cayman Islands' anti-money laundering (AML) and countering of terrorist financing (CFT) sanctions and countering of proliferation financing (CPF) regimes implement the FATF Recommendations and global practice. The Anti-Money Laundering Regulations (2020 Revision) (the AML Regulations) apply to entities carrying on 'relevant financial business', which includes all types of Cayman Islands investment vehicles, whether or not registered with CIMA.

All Cayman Islands investment entities must maintain AML/CFT/CPF and sanctions procedures in accordance with the AML Regulations and each investment entity must designate natural persons in the roles of anti-money laundering reporting officer, money laundering reporting officer and deputy money laundering reporting officer (together, AML officers). However, AML compliance functions (including those of AML officers) can be performed by third-party service providers, subject to certain conditions, including the

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requirement for a risk-based assessment and ongoing review of the service provider, and that there is adherence to the prescribed requirements of the AML Regulations. In this regard, the most salient requirement is that beneficial ownership of entity investors is assessed at a minimum 10 per cent ownership or control threshold.

ii Recent case law

In the Cayman Islands court system, commercially significant cases are handled by the Financial Services Division of the Grand Court (FSD), and each proceeding is assigned to one of the FSD's highly experienced commercial judges. Appeals from the Grand Court are to the Cayman Islands Court of Appeal (CICA), with a further potential right of appeal to the Privy Council in London. The courts deal with a wide variety of complex commercial disputes, including disputes between investors and funds that have suspended redemptions or are being wound down.

The use of winding up petitions as a means of debt recovery is a notable feature of litigation in the Cayman Islands, and one that is occurring with greater frequency in the current economic climate. Winding-up petitions are most commonly presented under Section 92(d) of the Companies Act (2021 Revision) (CA), which provides that a winding-up order may be made if the company is unable to pay its debts (as defined in Section 93 of the CA) or under Section 92(e) of the CA, which provides that a winding-up order may be made if the court is of the opinion that it is just and equitable that the company should be wound up.

In *Primus Investments Fund, LP and Mayer Investments Fund, LP*,[14] creditors' winding up petitions under Section 92(d) of the CA on the basis of acts of default under credit agreements were opposed on the ground that there was a bona fide dispute on substantial grounds as to whether the debt was in fact due. The respondent funds argued that as the credit agreements were Hong Kong law governed, and as proceedings were ongoing in Hong Kong to determine the validity of the creditors' notices, the petitions should be dismissed, or alternatively, stayed pending the outcome of those proceedings. Having considered the expert evidence on Hong Kong law presented by both sides, the Grand Court concluded that the creditors were acting in accordance with their contractual rights in seeking to enforce the debts and that the arguments raised by the respondent companies were not sufficiently strong to amount to a bona fide dispute on substantial grounds, and ordered the funds wound up. Similarly, in *Re Grand State Investments Limited*[15] the Grand Court was equally willing to engage with questions of Hong Kong law. This petition to wind up the respondent company was presented on the grounds that it had failed to pay redemption proceeds to investors in accordance with the shareholders' agreement. The respondent company did not dispute that valid redemption requests had been submitted but relied upon a term in the shareholders' agreement that provided that the obligation to pay redemption was subject to the company having adequate funds legally available for that purpose. The Grand Court construed legally available funds as meaning funds owned by the company or funds that the company could obtain by exercising its legal rights and concluded that, on the facts, the company's insolvency had not been established and the dispute was genuinely and substantially disputed. As result, the petition was struck out as an abuse of process. In *Re Adenium Energy Capital Ltd*,[16] the Grand Court ordered the winding up of the respondent company notwithstanding its claims

14 *Primus Investments Fund, LP and Mayer Investments Fund, LP* (Unreported, Grand Court, 16 June 2020).

15 *Re Grand State Investments Limited* (Unreported, Grand Court, 28 April 2021).

16 *Re Adenium Energy Capital Ltd* (Unreported, Grand Court, 29 July 2020).

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that the dispute should be stayed to arbitration and the petitioner lacked standing on the basis that the respondent company's defence – that the petitioner was not a legal entity at the relevant times – was a ruse contrived at a late stage to avoid paying the sums due.

Further to the decision of CICA in *Tianrui (International) Holding v. China Shanshui Cement Group*[17] (where it was held that the jurisdiction of the Court to strike out just and equitable winding-up petitions was more limited than had previously been the case), just and equitable winding-up petitions are presented with some frequency. In *Re Circumference Holdings Ltd*,[18] the Grand Court struck out a just and equitable petition on the basis that the petitioner had in fact an adequate alternative remedy and the petition was being brought for an improper and collateral purposes. The Grand Court found in particular that the events complained of by the petitioner as causing a justifiable loss of confidence were arguably attributable to the petitioner's own actions, and moreover, that the petition was being presented for the purposes of undermining foreign proceedings then ongoing between the parties in respect of the same matters.

A question that frequently arises in the funds context is the information rights of investors in Cayman Islands domiciled funds. The case of *Gulf Investment Corporation & ors v. The Port Fund LP*[19] concerned an application by limited partners for access to true and full information regarding the business and financial condition of the fund, in accordance with Section 22 of the Exempted Limited Partnership Act (2021 Revision) (ELP), which application resulted from allegations of historic financial misconduct in the business. The application was opposed by the directors of the general partner (who were not in any way connected to the allegations of misconduct) on the basis that the information requested might be misused for collateral purposes and might be prompted by ulterior motives other than those stated. The Court found Section 22 of the ELP was a free-standing unqualified provision entitling limited partners to information in accordance with its terms, which in this case had not been materially modified by the terms of the limited partnership agreement. The Court also found that a limited partner did not have to provide reasons for any request and their motives for requesting information were irrelevant, and re-iterated that the general partner could not assert privilege against a limited partner where the privileged material contained advice for the benefit of the partnership (except where the privilege related to a dispute a dispute with that limited partner).

Finally, in a dispute of very specific and historic context, in *Re Ascot Fund Ltd (in Official Liquidation)*[20] the Grand Court was asked to determine whether final distributions from a Madoff-affected funds should be adjusted to take account of payments received by some investors some eight years previously in accordance with a settlement brokered by the New York Attorney General, where those payments were not calculated in accordance with the fund's articles of association, and were not received by all investors. The Court ruled that no adjustment was necessary on the basis that the earlier payments were made in compromise of claims brought by the New York Attorney General, in the public interest, in accordance with New York law and were distributed by others and did not fall therefore to be treated as assets of the fund.

17 *Tianrui (International) Holding Company Limited v. China Shanshui Cement Group Limited* (Unreported, CICA, 6 February 2019).

18 *Re Circumference Holdings Ltd* (Unreported, Grand Court, 3 May 2021).

19 *Gulf Investment Corporation & ors v. The Port Fund LP* (Unreported, Grand Court, 16 June 2020).

20 *Re Ascot Fund Ltd (in Official Liquidation)* (Unreported, Grand Court, 11 January 2021).

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VI SECTORAL REGULATION

i Insurance

CIMA requires all insurance companies licensed under the Insurance Act 2010 to have a business plan and an investment strategy, the complexity of which is dependent upon the nature of the business underwritten. CIMA's Statement of Guidance: Asset Management & Investment Strategy for Insurance Companies requires insurers, among other things, to ensure that the composition of their asset portfolio is the product of a well-structured investment process with appropriate steps for implementation, to determine asset allocation in terms of the asset mix over the investment categories selected, and, in specific cases (e.g., use of derivative contracts), to seek prior CIMA approval to make certain investments.

ii Pensions

Local pension plans must be registered with the Superintendent of Pensions under the National Pensions Act (2012 Revision), and the administrators of such plans are subject to statutory duties of care, diligence and skill (comprising both objective and subjective tests) in their management of the plan assets. Pension plans established and maintained for the benefit of employees in the Cayman Islands are required to comply with asset management rules under the National Pensions (Pension Fund Investments) Regulations (1998 Revision), which currently restrict investments to certain types of securities.

iii Real property

There are no specific rules that apply to property fund management in the Cayman Islands.

iv Hedge funds

Hedge funds will generally be open-ended vehicles, and therefore need to comply with the provisions of the Mutual Funds Act, as described in Section II.[21]

v Private equity

There are no rules that apply specifically to private equity funds (as opposed to any other type of closed-ended fund) in the Cayman Islands (e.g., private equity funds, like other types of investment entities, are subject to the need for AML officers). Private equity funds will generally be closed-ended vehicles and, therefore, in most cases, will be subject to and will need to comply with the provisions of the PFA, as described in Section II.[22]

VII TAX LAW

The Cayman Islands imposes no taxation on the income or capital gains of investment funds or their investors, and no transfer taxes on the transfer of interests in investment funds. Exempted companies, LLCs, limited partnerships and unit trusts can obtain undertakings from the government that if any such taxation is introduced during a 20-year period

21 See also Section V.i.
22 ibid.

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(companies) or 50-year period (limited partnerships, LLCs and unit trusts),[23] as applicable, from the date of the undertaking (or date of creation of the unit trust), such taxation will not apply to the entity to which the undertaking is given.

The Cayman Islands recently introduced legislation[24] (the Economic Substance Act) in connection with global initiatives in relation to base erosion and profit shifting.

The Economic Substance Act introduces certain reporting and economic substance requirements for 'relevant entities' conducting 'relevant activities'. These entities will be required to report certain information on their relevant activities on an annual basis to the TIA, the first such annual report being due no later than 12 months after the last day of the entity's financial year commencing on or after 1 January 2019.

The definition of 'relevant entity' in the Economic Substance Act recognises that, among other things, an entity that is an 'investment fund' is not within the classification of a 'relevant entity' and, therefore, not subject to the requirements of the Economic Substance Act. The definition of 'investment fund' includes an entity through which an investment fund directly or indirectly invests or operates.

VII OUTLOOK

As evidenced by recent legislative activity, the Cayman Islands continues to respond and adapt to the implementation of new global regulatory and taxation standards and improve the laws relating to the fund vehicles preferred by sponsors and investors alike, and we expect the jurisdiction to remain prevalent and competitive in the hedge, private equity and venture capital fund formation market.

Further, the demand for a tax-neutral and secure method of pooling capital from multiple jurisdictions, and of transmitting that capital to where it can best be employed, remains strong, in a world that is subject to increased regulatory and fiscal scrutiny. The Cayman Islands' secure legal and regulatory framework and level of specialist expertise, combined with a proactive regulator and desire to comply with recognised global standards in the investment fund industry, should enable the Cayman Islands to continue taking advantage of this demand, and to maintain its position as a premier jurisdiction for offshore investment funds.

23 Companies are entitled to a 20-year undertaking under Section 6 of the Tax Concessions Act (2018 Revision), limited partnerships are entitled to a 50-year undertaking under Section 38 of the Exempted Limited Partnership Act (2021 Revision), LLCs are entitled to an undertaking for a period not exceeding 50 years under Section 58 of the Limited Liability Companies Act (2021 Revision) and trusts are entitled to an undertaking under Section 81 of the Trusts Act (2021 Revision).

24 The International Tax Co-operation (Economic Substance) Act (2021 Revision), supplemented by the related Guidance on Economic Substance for Geographically Mobile Activities (as revised from time to time).

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Appendix 1

ABOUT THE AUTHORS

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Maples Group

Tim Coak is a partner in the funds and investment management team at Maples and Calder, the Maples Group's law firm. He specialises in the establishment, launch, ongoing maintenance and restructuring of all types of Cayman Islands investment funds, particularly hedge funds and private equity funds. He advises on commingled funds and managed accounts, and acts for a wide variety of clients, including large financial institutions and investment managers and smaller, start-up investment managers. He also regularly advises clients on a broad range of corporate and commercial transactions.

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Malachi Sweetman is an associate in the dispute resolution and insolvency team at Maples and Calder, the Maples Group's law firm, and has a wide breadth of experience in all forms of commercial litigation and insolvency. He regularly advises clients in the banking, finance and investment fund sectors on litigation-related matters and has appeared in a number of the highest value commercial disputes that have recently come before the Cayman courts.

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ISBN 978-1-83862-758-4

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