

The Cayman Islands: Still the Preferred Jurisdiction for Asian Fund Promoters and Investors

In recent years, several jurisdictions in Asia have made concerted efforts to increase the attractiveness of their funds platform in a bid to win a greater share of the global investment funds market. Notwithstanding such efforts, the Cayman Islands is still the preferred investment funds jurisdiction for Asian fund promoters, managers and investors. In this article, Nick Harrold highlights some of the reasons behind this continued pre-eminence.

Promoter, Manager and Investor Familiarity

The ubiquitous nature of Cayman Islands funds, and the resulting investor familiarity, continue to be drivers for promoters, managers and investors to select the Cayman Islands as their investment funds jurisdiction of choice. Cayman Islands funds are used for investment by institutional investors across the globe, including financial institutions, pension funds, charitable foundations, and university endowments. They are also used by governments, government agencies, and international bodies such as the World Bank, lending credibility to the jurisdiction.

Investor familiarity, and confidence in the jurisdiction, means promoters and managers can focus their attention on marketing themselves and their investment strategy, rather than addressing investor queries and concerns relating to the less well-known funds jurisdictions.

Flexibility and Freedom to Determine the Commercial Structure

A further attraction of the Cayman Islands is the freedom that fund promoters, managers and investors have to determine the commercial features of fund structures, including the number of investors, the type of investments the fund will make, and the investment objectives and policies of the fund, without restriction. Promoters and managers of Cayman Islands funds are also able to appoint the service providers of their choice – there is only a requirement to appoint a local Cayman Islands auditor to sign off on the fund's existing accounts if the investment fund is regulated by the Cayman Islands Monetary Authority ("CIMA").

The legal and regulatory framework in some of the Asian fund jurisdictions can be less straightforward and ultimately less flexible. For instance, managers are often required to obtain a license from the local regulatory authority (the "Manager Licensing Requirement") before a fund is eligible for registration in the jurisdiction. Likewise, in the Cayman Islands there is no requirement for a minimum number of investors, i.e. it is possible to establish a fund-of-one which effectively operates as a separately managed account, and there are no requirements that investors must be 'third-party' investors, whereas these are sometimes conditions to registration of funds established in Asian fund jurisdictions.

Simplicity, Speed to Market and Cost

The simplicity of establishing Cayman Islands funds, as well as the speed to market, both continue to play a role in influencing the decision of promoters and managers in using the jurisdiction. There are typically no pre-launch approvals required by CIMA. This contrasts with some Asian fund jurisdictions where the Manager Licensing Requirement must be satisfied before a fund can launch.

In terms of cost, one argument that is sometimes put forward by Asian fund jurisdictions is that establishing a fund in their jurisdiction can help to reduce fund establishment costs as there is only a need to appoint local 'onshore' counsel in that jurisdiction, with no need to also appoint offshore counsel, thereby reducing legal spend. In practice, this cost-saving can be illusory, since the more prescriptive nature of the fund structure, the additional regulatory compliance burden (which can in some cases include a requirement for substance in the relevant jurisdiction), as well as the inherent uncertainty in the tax position (described below), can all increase structuring, advisory and ongoing compliance costs, as compared with the more well-trodden path of establishing funds in the Cayman Islands.

Tax Treatment

Another reason why fund promoters, managers and investors choose the Cayman Islands to establish investment funds relates to the tax treatment. Cayman Islands funds provide a tax-neutral platform to prevent additional layers of foreign taxation to investors from multiple jurisdictions over and above (the investors') home country tax. A similar approach is taken concerning promoters, managers and advisers with no Cayman Islands taxes levied in respect of amounts returned to them in addition to their home country tax. In this regard, it should be noted that the OECD's Forum on Harmful Tax

Practices has given the Cayman Islands its highest rating of "not harmful"¹.

Recently, some Asian fund jurisdictions have begun to offer tax concessions that seek to more clearly exempt investment fund level incentive fees and / or the return of such incentive fees to fund parties in the form of carried interest from certain onshore taxes that would otherwise apply. In practice, the criteria and conditions to be satisfied to qualify for such concessions are often complex. For example, investment fund incentive fees are often only exempt from taxes if a fund is a qualifying investment fund and invests in certain approved asset classes. Likewise, the carried interest exemption: (i) may only be available to certain qualifying recipients who are providing services to qualifying investment funds; (ii) is often only applicable to certain types of payments; and (iii) is only available if the payment relates to returns on investment made in respect of certain asset classes.

Whereas the default position in the Cayman Islands is there are no additional local taxes imposed, in most Asian fund jurisdictions, the default position is tax is payable and the burden is invariably on the fund parties to establish that an available exemption applies. This can lead to uncertainty for promoters, managers and investors and it can also lead to increased lawyer, auditor and tax adviser costs in obtaining advice on an ongoing basis (from the relevant advisers). Assuming the attraction of tax concessions is that they can lower the overall tax burden for fund promoters, managers and related parties who are located in and receiving monies in such Asian jurisdictions, it is worthwhile noting that in many cases the onshore tax concessions are equally available to Cayman Islands investment funds, and their related parties, often without material cost or additional compliance (apart from the appointment of an authorised local representative).

¹ <https://www.oecd.org/tax/beps/harmful-tax-practices-peer-review-results-on-preferential-regimes.pdf>

Certainty and Legal Stability

The Cayman Islands have an English-based legal system, established and independent judiciary, and a final court of appeal in the form of the UK Privy Council in London. This helps to provide comfort for fund promoters, managers and investors alike.

About the Author

Nick Harrold is a partner of the Hong Kong Funds & Investment Management team at Maples and Calder, the Maples Group's law firm. He specialises in all aspects of investment funds, advising an international client base, with a particular focus on advising clients who wish to target the Japanese market. Nick is recommended by Legal 500 Asia Pacific as a standout funds specialist who has the "ability to quickly understand very complicated structures" and whose "strength lies in his ability to apply legal principles to some of the most complex, novel and challenging commercial issues". He is also recognised as "client-friendly, innovative and commercial" and having an "in-depth knowledge" of the Japanese market.

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