LEGAL DEVELOPMENTS AND RECENT TRENDS FOR CAYMAN INVESTMENT FUND STRUCTURES

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What changes have been introduced recently in Cayman Islands law that you believe will enhance the jurisdiction's offering in the investment funds industry?

In June 2016 the Cayman Islands brought into effect The Limited Liability Companies Law, 2016 (the "**LLC Law**") which introduces a new Cayman Islands limited liability company (an "**LLC**"). Since July 2016 there has been an increasing number of LLCs formed and also a large number that have transferred to the Cayman Islands by way of continuation from other jurisdictions. The Cayman Islands LLC structure will be attractive for general partner entities and other carried interest distribution vehicles because while the LLC has the benefit of being (like a Cayman Islands exempted company) a separate corporate entity with limited liability, it does not have the maintenance of capital restrictions applicable to exempted companies and therefore has more flexibility to make distributions of income and capital through the terms of the LLC Agreement. For the same reason, LLCs are also proving attractive for management company entities. We expect that over the next few years LLCs might also prove attractive as a structure for offshore funds in order to align the rights of investors between onshore and offshore investment funds in master/feeder structures.

What are the key features of a Cayman LLC?

The key features are:

- An LLC formed under the LLC Law is similar in structure to the Delaware LLC as the LLC Law is broadly based on the Limited Liability Company Act in the State of Delaware. However the LLC Law has also preserved the broad legal principles applicable to Cayman Islands companies and the rules of equity and common law.
- An LLC is a corporate entity which has separate legal personality to its members.
- Formation of an LLC is straightforward. It requires the filing of a registration statement with the Companies Registry and payment of the requisite Government fee.
- An LLC must have at least one member. It can be member managed (by some or all of its members) or the LLC agreement can provide for the appointment of persons (who need not be members) to manage and operate the LLC.
- The liability of an LLC's members is limited. Members can have capital accounts and can agree amongst themselves (in the LLC agreement) how the profits and losses of the LLC are to be allocated and how and when distributions are to be made (similar to a Cayman Islands exempted limited partnership).
- An LLC may be formed for any lawful business, purpose or activity and it has full power to carry on its business or affairs unless its LLC agreement provides otherwise.
- The following statutory registers are required to be maintained for an LLC but, similarly to the requirement for a Cayman Islands exempted company, only an LLC's register of managers is required to be filed with the Companies Registry:
  a. a register of members;
  b. a register of managers; and
  c. a register of mortgages and charges.

  The register of managers and register of mortgages and charges are required to be maintained in a manner similar to the register of directors and register of mortgages and charges for a Cayman Islands exempted company.
- Subject to any express provisions of an LLC agreement to the contrary, a manager of the LLC will not owe any duty (fiduciary or otherwise) to the LLC or any member or other person in respect of the LLC other than a duty to act in good faith in respect of the rights, authorities or obligations which are exercised or performed or to which such manager is subject in connection with the management of the LLC provided that such duty of good faith may be expanded or restricted by the express provisions of the LLC agreement.

The Segregated Portfolio Company ("SPC") is increasingly being used as a structure for investment funds, what do think explains this increasing popularity?

Under the Cayman Islands Companies Law (the "**Companies Law**"), an SPC is an exempted company which has been registered as a segregated portfolio company. It has full capacity to undertake any object or purpose subject to any restrictions imposed on the SPC in its Memorandum of Association. The Memorandum of Association of an SPC usually gives the SPC full capacity to pursue very broad objects. Once registered under the Companies Law, an SPC can operate segregated portfolios ("**SPs**") with the benefit of statutory segregation of assets and liabilities between portfolios.

The appeal of SPCs extends beyond investment funds and the structure is often used in capital markets and securitisation transactions. In the investment funds context, SPCs greatly enhance the versatility and efficiency of Cayman Islands fund structures. It allows investors to access different trading strategies or investments, different markets or different managers through a single corporate vehicle whilst simultaneously providing the segregation of assets and liabilities through each SP (unlike, for example, a 'multi class' fund where there is typically a single legal entity offering various classes of shares designated according to the designated portfolio investment) and avoiding cross class liability issues which could arise with 'multi class' funds.

The Companies Law permits an SPC to create one or more SPs in order to segregate the assets and liabilities of the SPC held within one SP from the assets and liabilities of the SPC held within another SP of the SPC. The general assets and general liabilities of the SPC (*i.e.* assets and liabilities which cannot be properly attributed to a particular SP) are held within a separate general account rather than in any of the SP accounts. Each SP should have, as appropriate, its own bank account, brokerage account, and other accounts to hold its assets to avoid co-mingling with the assets of other SPs.

The Companies Law requires that segregated portfolio assets must only be available and used to meet liabilities to the creditors of the SPC who are creditors in respect of that SP and who are thereby entitled to have recourse to the segregated portfolio assets attributable to that SP for such purposes. Segregated portfolio assets should not be available or used to meet liabilities to, and must be absolutely protected from, the creditors of the SPC who are not creditors in respect of that SP, and who accordingly are not entitled to have recourse to the segregated portfolio assets attributable to that SP.

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Accordingly, a creditor will only have recourse to assets from SPs with which it has contracted and creditors will have no recourse to the assets of other SPs of the SPC which are protected under the Companies Law. This statutory protection afforded under the Companies Law to the assets of each SP is one of the key feature and benefit of the SPC structure.

Why is the SPC being used increasingly as a fund structure?

The Cayman Islands continue to be one of the leading offshore jurisdictions for the establishment of hedge funds, private equity funds, real estate funds, and other asset classes. The versatility and efficiency of the SPC structure in terms of the ability to effectively 'ring fence' certain assets and liabilities under the same investment portfolio and benefit from statutory recognition of that ring-fencing have made the SPC increasingly attractive in this environment. Like other exempted companies, there are no residency restrictions on Directors or Shareholders of an SPC and there are no Cayman Islands taxes on the SPC or its shareholders.

The SPC corporate structure allows a fund manager to employ different trading strategies, and/or establish different investment platforms, and/or provide access to different markets, and/or different trading advisers through a single corporate vehicle whilst simultaneously providing the segregation of assets and liabilities through each SP. Fund managers are able to market an SPC fund as being able to provide the ability to set up a statutory "*ring-fence*" to protect against cross liability issues relating to the assets and liabilities of the various SPs within the SPC. The SPC structure is being used as an investment platform on which investors can form different SPs to hold varying asset classes (e.g. real estate, intellectual property, stocks and shares, and distressed assets) and have their investments managed separately from other investments held by other SPs on the same SPC platform.

The SPC will have a Board of Directors. In addition, each SP can have its own segregated portfolio directorate or investment or management committee which effectively controls and manages the operations of the relevant SP. The segregated portfolio directorate, investment or management committee obtains its powers through powers delegated to it by the Board of Directors of the SPC.

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