This country-specific Q&A provides an overview of alternative investment funds laws and regulations applicable in Cayman Islands.

For a full list of jurisdictional Q&As visit [here](#).
1. What are the principal legal structures used for Alternative Investment Funds?

Under Cayman Islands law or regulation, there is no restriction on the investment strategy of an open or closed-ended fund. In consequence, Cayman Islands funds are used for the full range of alternative strategies, including hedge, private equity, venture capital, infrastructure, real estate and private debt, as well as traditional long-only investing. Cayman Islands structures are also used to establish managed account arrangements, family offices, incentive compensation vehicles and co-investment structures.

A Cayman Islands fund is typically formed as an exempted company, an exempted limited partnership or a unit trust.

The exempted company is used for the open-ended fund and broadly follows the English corporate form, with some modifications. Thus, the exempted company has separate corporate personality and is managed by its directors, who may delegate one or more functions. The corporate regime is extremely flexible – for example, there is no requirement for local resident directors, and redeemable, fractional, partly paid and treasury shares are permitted. Segregated portfolio companies may be formed, which create separate portfolios of assets and liabilities with the benefit of statutory segregation, thus ‘ring fencing’ creditor claims to the relevant portfolio.

The exempted limited partnership is more typically used for private equity and is based on the Delaware model save that whilst a legal entity, it is without separate legal personality. The general partner has control of the partnership, is liable for its debts and engages service providers as necessary. At least one general partner, who may be an individual, must be resident, formed or, if formed elsewhere, registered in the Cayman Islands.

A unit trust is an investment vehicle organised as a common law trust. As in the United Kingdom, the trustee of the trust has legal ownership and control of the trust assets, although powers may be reserved and it will typically delegate functions to service providers. The trust, as a creature of common law, provides a structure that is flexible. A unit trust will typically, for reasons relating to conflict of laws, have a licensed and regulated trust company as trustee based in the Cayman Islands.

2. Does a structure provide limited liability to the sponsor and/or manager vis-a-vis investors?

The usual English law principles of limitation of liability apply to the shareholders in an exempted company. By the Exempted Limited Partnership law, the limited partners have their liability limited to their capital commitment to the exempted limited partnership provided they comply with the restrictions set out in the law limiting their involvement in the conduct of the business of the partnership. The trustee of a unit trust assumes the liability to third parties with which it contracts on behalf of the trust although there may exist express or implied indemnity from unit holders in respect of the liabilities of the trustee in certain
circumstances. The foregoing principles normally limit the liability of investors in the fund to their contribution. The liability of a sponsor to investors is distinct and will usually arise if there is a breach of representations made by it in the offering document on which an investor has relied. An investment manager acting in breach of the specific provisions of the Investment Management Agreement by which it is appointed may incur liability to the fund but any such liability would have to be enforced for and on behalf of the directors of the fund or its liquidator and not by investors directly.

More extensive provisions are available under Cayman Islands law to directors of a fund, by way of indemnity and exculpation than under English law.

3. **Is there a market preference and/or most preferred structure? Does it depend on asset class?**

Given the inherent flexibility available in the constitutional documents of the exempted company, the exempted limited partnership or the unit trust, the choice of form and structure of the fund is invariably driven by the onshore legal, tax, regulatory and marketing requirements as determined by the fund promoter, and is usually a function of the location of the target investors or the investments or a combination of these considerations. In broad terms, the commercial and economic features of any fund structure can be established with equal flexibility in an exempted company, an exempted limited partnership or a unit trust. Needless to say, long term mainly illiquid investment classes including venture capital, buyout, mezzanine and distressed funds typically adopt a closed-end partnership structure with capital drawdowns in tranches.

4. **Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity vs. hedge)) and, if so, how?**

The primary distinction under Cayman Islands law and regulation is between the open-ended and the closed-ended fund. The Cayman Islands regulatory regime does not distinguish between different types of investment strategies. The Mutual Funds Law regulates open-ended funds and their associated master funds. An open-ended fund is a fund which issues shares, interests or units redeemable at the option of an investor. There are three methods of regulation:

- Fast-track registration method: Here the minimum investment level is at least US$100,000 per investor (unless the interests are listed or there are fewer than 15 investors with power to change the directors or general partner). Registration is achieved upon filing the relevant forms, consent letters, placement memorandum and supporting documentation, and paying the relevant fees. Registration is automatic and without review or approval by CIMA. This is the typical method of registration.
- Local administrator registration method: Here regulation is achieved by appointing a local licensed and regulated administrator as the fund’s ‘principal office’, filing similar documentation and paying the fees. Under this method, the local administrator assumes
a degree of supervisory responsibility over the fund. This route is less common, though it has the advantage of there being no minimum investment level.

- CIMA licensing method: Here regulation can be achieved by direct licensing from CIMA. In this case, there is no minimum investment level and CIMA will conduct a substantive assessment of the fund, each of the promotors and certain service providers to the fund. Given the flexibility of the fast-track method, this method is seldom used. CIMA may apply conditions on grant of the licence.

The recently enacted Private Funds Law brings closed-ended funds under a registration regime with effect from 7 August 2020. An in-scope closed-ended fund must apply to register with CIMA within 21 days of accepting capital commitments from investors and must complete the registration process prior to accepting capital contributions. Registration is similar to fast-track registration under the Mutual Funds Law; however, there is no minimum investment level for investors and no need to file a full placement memorandum (and see question 2.2).

5. **Are there any limits on the manager’s ability to restrict redemptions? What factors determine the degree of liquidity that a manager offers investor of an Alternative Investment Fund?**

There are no limits on the manager’s ability to restrict redemptions contained in Cayman Islands law or regulation. The restrictions, if any, will therefore be contractual and must be contained in the constitutional documents or side letter. Evidently, in the open-ended fund context, a manager must give ongoing consideration to liquidity in relation to potential redemption requests. The constitutional documents may contain gating, suspension, or other restrictive provisions limiting redemptions usually by percentage of redemption requests on any given redemption day and may provide for side pocket structures. A mutual fund administrator and its auditor providing a principal office for a regulated fund in addition to the operators of a fund must give CIMA notice if the fund is likely to become unable to meet its obligations as they fall due, it is carrying on business otherwise and in accordance with the law or is carrying on business in a manner which is likely to be prejudicial to the investors or creditors of the fund.

6. **What are potential tools that a manager may use to manage illiquidity risks regarding the portfolio of its Alternative Investment Fund?**

   See above at Answer 5.

7. **Are there any restrictions on transfers of investors’ interests?**

   The terms and restrictions applicable to the issue, redemption and transfer of interests in a fund are entirely matters to be decided by the sponsors when preparing the fund’s constitutional and offering documents. It is typical for a fund to have a restrictive share transfer or limited partnership transfer regime.
8. **Are there any other limitations on a manager’s ability to manage its funds (e.g., diversification requirements)?**

There are no diversification requirements under Cayman Islands law for open or closed-ended funds. The manager’s ability to manage the funds will be limited to the investment objectives and restrictions contained in the offering document and the investment management agreement.

9. **What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds? Does the tax treatment of the target investment dictate the structure of the Alternative Investment Fund?**

The Cayman Islands does not have a direct taxation regime.

Accordingly, no taxes are imposed under Cayman Islands law on the profits, income, gains or appreciations of Cayman Islands funds; and there is no withholding in respect of any dividend, distribution or interest payment by a Cayman Islands fund. Nominal stamp duties apply to documents executed or brought into the Cayman Islands. There are no exchange or currency controls in the Cayman Islands.

A Cayman Islands fund formed as an exempted company that desires additional comfort on this matter may obtain an undertaking certificate that, for a period of 20 years from the date of the certificate, no laws of the Cayman Islands imposing any tax on profits, income, gains or appreciation shall apply to the fund and that no tax in the nature of estate duty or inheritance tax shall be payable on the equity interests of the fund. An exempted limited partnership fund may obtain a similar undertaking for a period of 50 years. A unit trust fund may also obtain a similar undertaking for a period of 50 years, provided that it excludes investors resident or domiciled in the Cayman Islands (other than Cayman Islands exempted companies and non-resident companies).

Cayman Islands fund structures are generally subject to the Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS) reporting regimes of the Cayman Islands.

No taxes are imposed under Cayman Islands law on the profits, income, gains or appreciations of Cayman Islands fund managers or advisers. A fund manager or adviser formed as an exempted company, limited liability company or exempted limited partnership may obtain a tax exemption certificate for a period of 20, 50 and 50 years respectively.

10. **What rights do investors typically have with respect to the management or operations of the Alternative Investment Fund?**
Cayman Islands law and regulation is silent on the issue of the commercial and economic terms of investor’s rights in a fund which are governed entirely by the deal terms and the constitutional documents of the fund as a matter of contract. It is not uncommon for investors to be granted participating non-voting shares in a corporate open-ended fund and for the sponsor to retain the non-participating voting shares. By the governing statute, limited partners in an exempted limited partnership should not be involved in the conduct of the business of an exempted limited partnership at the risk of losing limited liability. The trust law of the Cayman Islands is sufficiently flexible to allow reserved powers to investors but that would require specific provisions to be included within the unit trust documentation and is by no means typical.

11. Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

The Securities Investment Business Law regulates, among other things, the activities of discretionary management of, provision of advice in relation to and arrangement of deals in securities by a person formed or otherwise with a place of business in the Cayman Islands. The ‘managing’ and ‘advising upon’ activities capture traditional asset and risk management decisions; whereas ‘arranging deals’ covers private negotiation of investments and the distribution or placement of equity interests in the fund itself. ‘Securities’ are defined under the Securities Investment Business Law to include a wide range of equity, debt, commodities, futures, options and similar instruments. Accordingly, the vast majority of Cayman Islands based fund managers or fund advisors must be registered with or licensed by the Cayman Islands Monetary Authority (CIMA).

Until the passage of the Virtual Asset (Service Providers) Law 2020, real estate and cryptographic tokens/coins fell outside the definition of ‘securities’. However, this new law now includes within the definition of “security” any crypto representing a security or a derivative on a security. Thus, general crypto, for example, coins and service token remain outside of the definition of security but a crypto that tracks a share or its value is caught. Accordingly, a manager or adviser to a security backed crypto will now be regulated under the Securities Investment Business Law in its current form. However, a fund manager not otherwise regulated may require licensing by CIMA under the Companies Management Law as a company manager or under the Mutual Funds Law as a mutual fund administrator, depending on the particular structure or under the Virtual Asset (Service Providers) Law 2020 upon its formal implementation.

In addition, the Anti-Money Laundering Regulations, the Foreign Account Tax Compliance Act and the Common Reporting Standard Regulations, various sanctions orders and the Data Protection Law apply to all fund managers and advisers, although their incremental impact is limited relative to ordinary compliance processes. Directors to managers or advisers regulated under the Securities Investment Business Law must be registered or licensed by CIMA under the Director Registration and Licensing Law.
Distinct from the position with regard to Cayman Islands funds and their operators and investment advisers, Cayman Islands fund managers are within the scope of the recent International Tax Cooperation (Economic Substance) Law. Cayman Islands fund managers to securities funds which managers are formed as legal persons and licensed or registered under the Securities Investment Business Law are subject to the regime. In scope fund managers must:

- conduct core income-generating activities within the Cayman Islands (e.g., asset management, risk, reserve and hedging assessment and regulatory and performance reporting);
- be appropriately directed and managed from within the Cayman Islands; and
- have adequate operating expense, physical presence and staff in the Cayman Islands.

In order to meet the economic substance requirements, we envisage that a number of managers will:

- look to add local directors and locally licensed delegate managers to assist in establishing activity in the Cayman Islands;
- narrow the roles of the manager to reduce the impact of the requirements; or
- move to restructure their business so that the manager is no longer in scope for the regime.

12. Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

The principal law regulating Cayman Islands open-ended funds is the Mutual Funds Law, which dates from 1993. The Mutual Funds Law requires that Cayman Islands funds (and their associated master funds) which offer redeemable equity interests, whether formed as companies, limited partnerships or unit trusts, to be regulated by the Cayman Islands Monetary Authority (CIMA) (see further question 1.4). In addition, under the newly enacted Private Funds Law, many closed-ended funds now fall to be regulated by CIMA.

Open-ended funds are required to register under the Mutual Funds Law and closed-ended funds are required to register under the Private Funds Law.

Question 1.4 summarises the three methods of regulation for open-ended funds under the Mutual Funds Law. In addition to annual fee obligations, the obligations under the law include:

- appointing a local auditor;
- filing audited accounts (and certain specified additional information) with the Cayman Islands Monetary Authority (CIMA) annually;
- maintaining a minimum of two directors (or a corporate director) who are licensed or registered with CIMA; and
In respect of closed-ended funds registered under the Private Funds Law, in addition to annual fee obligations, the obligations under the law include:

- appointing a local auditor;
- filing audited accounts (and certain specified additional information) with CIMA annually;
- maintaining a minimum of two directors or a corporate director (though currently the directors are not required to be licensed or registered with CIMA);
- maintaining appropriate valuation procedures no less than annually;
- appointing a custodian to hold title to the fund’s assets (or as appropriate, to verify title to those assets);
- appointing a service provider to monitor the fund’s cash flows;
- where the fund trades securities, regularly maintaining a record of securities identification codes; and
- maintaining with CIMA up-to-date filed versions of any summary of fund terms, offering document or constitutional documents which may have been filed as part of the original application to CIMA.

The valuation, custodial and cash monitoring processes may be conducted by third parties (including by a fund administrator), though in most cases the functions may be discharged by the fund manager or general partner, subject to appropriate disclosure and conflict review.

13. **Are there local residence or other local qualification or substance requirements?**

There is no requirement for Cayman Islands funds to appoint a Cayman Islands based investment manager or adviser. A Cayman Islands open or closed-ended fund falls outside of the scope as defined in the International Tax Cooperation (Economic Statute) Law. The fund manager or adviser can be located anywhere in the world.

Where a promoter chooses to establish a Cayman Islands based fund manager or adviser, these have typically been formed as Cayman Islands exempted companies or limited liability companies, though there is no prohibition on the use of a Cayman Islands partnership. In addition, a foreign fund management or advisory company may establish a place of business in the Cayman Islands. Fund managers and advisers formed or with a place of business in the Cayman Islands are subject to the requirements of the Securities Investment Business Law (see above at question 2.1).

The International Tax Cooperation (Economic Substance) Law impacts Cayman Islands based managers to securities funds and may require compliance with the provisions of the law (see above at question 2.1).
14. **What service providers are required?**

Cayman Islands law does not mandate the service providers or, if appointed, their jurisdictions of domicile. The Private Funds law now requires satisfactory custodial or safekeeping arrangements are provided for closed-ended funds that are regulated.

15. **Are local resident directors / trustees required?**

Cayman Islands law does not require resident Cayman Islands directors. A Cayman Islands unit trust for reasons relating to conflicts of law and the applicable law on enforcement, will typically have a Cayman Islands licensed and regulated trustee.

16. **What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?**

A non-resident fund manager or advisor providing services to a Cayman Islands fund that has no place of business in the Cayman Islands would not fall to be regulated under Cayman Islands law or regulation. If establishing a branch operation or place of business in the Cayman Islands, to provide such services, it would fall to be regulated in the same manner as a Cayman Islands incorporated entity (see above at question 2.1).

17. **What are common enforcement risks that managers face with respect to the management of their Alternative Investment Funds?**

The Cayman Islands commercial court demonstrates a high level of sophistication and efficiency in dealing with enforcement issues in relation to Cayman Islands funds and applies judicial precedent. The orders of the Cayman Islands court are typically well respected in most common law jurisdictions.

18. **What is the typical level of management fee paid? Does it vary by asset type?**

There is nothing specific under Cayman Islands law and regulation that affects the type or quantum management fees payable which may therefore be typical to the industry.

19. **Is a performance fee typical? If so, does it commonly include a “high water mark”, “hurdle”, “water-fall” or other condition? If so, please explain.**

Again, Cayman Islands law and regulation does not regulate the level of performance fees which are therefore contractual in nature and are typical to the industry and the specific fund promoter. Carried interest fees are typical in the private equity context and performance fees using equalisation or series accounting are typical in open-ended fund structures. Fees can vary from 1/20 to 2/20 but some funds in the crypto space are as high as 4/40. On the other hand, conservative strategies can simply run 2% management fees with no performance fee. In relation to private equity funds, a 2% fee may be typical on committed funds which will
vary on investment to a typical 15-20% performance fee on an 8% hurdle.

20. **Are founder shares (which offer a reduce fee structure for initial investors) typical in raising assets for new fund launches?**

   Founder shares are typical and may be voting and non-participating to retain control for the fund promoter. If voting and participating, founders shares may have lower fees or enhanced returns to encourage early stage investment.

21. **Are management fee “break-points” offered based on investment size?**

   See 3.2 above.

22. **Are first loss programs used as a source of capital (i.e., a managed account into which the manager contributes approximately 10-20% of the account balance and the remainder is furnished by the investor)?**

   See 3.2 above.

23. **What is the typical terms of a seeding / acceleration program?**

   These terms are regarded as highly proprietary.

24. **What industry trends have recently developed regarding management fees and incentive fees?**

   Anecdotally, Cayman Islands is the domicile for over half of the world’s hedge funds and has some 21,000 registered exempted limited partnerships undertaking private equity transactions. There is nothing specific to Cayman Islands law and regulation governing the issues of fees which are generally commercial and are largely driven by the historic and prospective investment performance of the manager.

25. **What restrictions are there on marketing Alternative Investment Funds?**

   Open-ended funds must comply with the Mutual Funds Law prior to commencing business, which includes capital raising. In respect of closed-ended funds, registration under the Private Funds Law is required within 21 days of accepting capital commitments from investors and registration must be completed prior to accepting capital contributions. Thus, in the case of closed-ended funds, registration may be deferred until the end of a successful capital raising process.

   Funds, whether open or closed ended, organised as Cayman Islands exempted companies, unless listed on the Cayman Islands Stock Exchange, and Cayman Islands exempted limited partnerships, are effectively prohibited from making an invitation to the public in the Cayman
Islands to subscribe for their equity interests. The expression ‘public in the Cayman Islands’ is not comprehensively defined and thus would be given its ordinary common law meaning, although it would exclude Cayman Islands exempted companies, exempted limited partnerships, foreign registered companies or partnerships and similar investment vehicles.

Cayman Islands funds organised as unit trusts are not subject to any direct prohibition on the offering of their equity interests to the public in the Cayman Islands; however, they typically exclude investment from persons resident or domiciled in the Cayman Islands (other than Cayman Islands exempted companies or non-resident companies) in order to obtain a tax exemption certificate and on wider investor suitability grounds.

26. **Is the concept of “pre-marketing” (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?**

See 4.3 below. Cayman Islands funds are invariably marketed outside of the Cayman Islands and accordingly, the rules relating to pre-marketing and reverse solicitation are therefore the rules of the jurisdiction in which the securities are marketed not Cayman Islands law or regulation. Cayman Islands funds may be marketed in Europe pursuant to private placement exemptions but the AIFMD passport has not and is unlikely to be extended, with the result that less than 6% of the investors in Cayman Islands funds are EU based. Uniquely, specific regulation exists in Cayman for the marketing of Cayman Funds to retail investors in Japan.

27. **Can Alternative Investment Funds be marketed to retail investors?**

A Cayman Islands corporate fund may offer its shares to the public only if the shares are listed on the Cayman Islands Stock Exchange. A Cayman Islands exempted limited partnership fund is generally prohibited from making public offers. Cayman Islands unit trust funds are not subject to any direct prohibition on offerings to the public in the Cayman Islands, although this is generally avoided.

A foreign fund making a public offer into the Cayman Islands will trigger a registration requirement under the Mutual Funds Law or Private Funds Law (unless the fund is regulated or licensed overseas and appoints a local licensed placing agent or distributor).

Where the fund is required to be regulated under the Mutual Funds Law, it is likely that the ‘fast-track registration’ method would be unsuitable, as a retail offering typically entails investment levels below US$100,000 per investor.

Placing agents and distributors operating in the Cayman Islands must comply with the Securities Investment Business Law. Where a retail offering is envisaged, it is likely that formal licensing will be required, as the registration route for practical purposes extends only to high-net-worth and sophisticated investors and not typical retail investors.
28. **What are the minimum investor qualification requirements?**

An open-ended fund registered under the ‘fast-track registration’ method of the Mutual Funds Law should observe a minimum investment level of US$100,000 per investor, which in practical terms means that the fund is suitable for high-net-worth or institutional investors but otherwise there is no minimum investment for an open-ended fund. A closed-ended fund registered under the Private Funds Law is not required to observe any particular minimum investment level. Uniquely, specific regulations exist to market Cayman Islands funds to retail investors in Japan but otherwise, Cayman Islands funds are typically marketed to high net worth or institutional investors pursuant to private placement gateways or exemptions in the jurisdiction of marketing.

29. **Are there additional restrictions on marketing to government entities or pensions?**

No such restrictions exist under Cayman Islands law and regulation.

30. **Are there any restrictions on the use of intermediaries to assist in the fundraising process?**

No such restrictions exist under Cayman Islands law and regulation.

31. **Is the use of “side letters” restricted?**

There is no restriction on the use of side letters under Cayman Islands law or regulation.

32. **Are there any disclosure requirements with respect to side letters?**

The issue of disclosure in relation to side letters is governed by Cayman Islands regulation which requires the main features of the side letter to be disclosed but broadly in accordance with the common law of disclosure and contract and the overriding obligation of the directors, general partner or trustee of a fund to treat investors of the same class or series equally.

33. **What are the most common side letter terms? What industry trends have recently developed regarding side letter terms?**

The terms of side letters are entirely a function of the investment manager’s requirements for the specific fund but may typically include lock-up periods affecting redemption rights or include a restatement of the principle of equality of treatment for holders of a class or series. Care has to be taken under usual principles of common law contract to ensure that side letters do not contradict the provisions of the Articles of Association or purport to create special class rights exercisable only by certain investors to the prejudice of others of the same class or series.