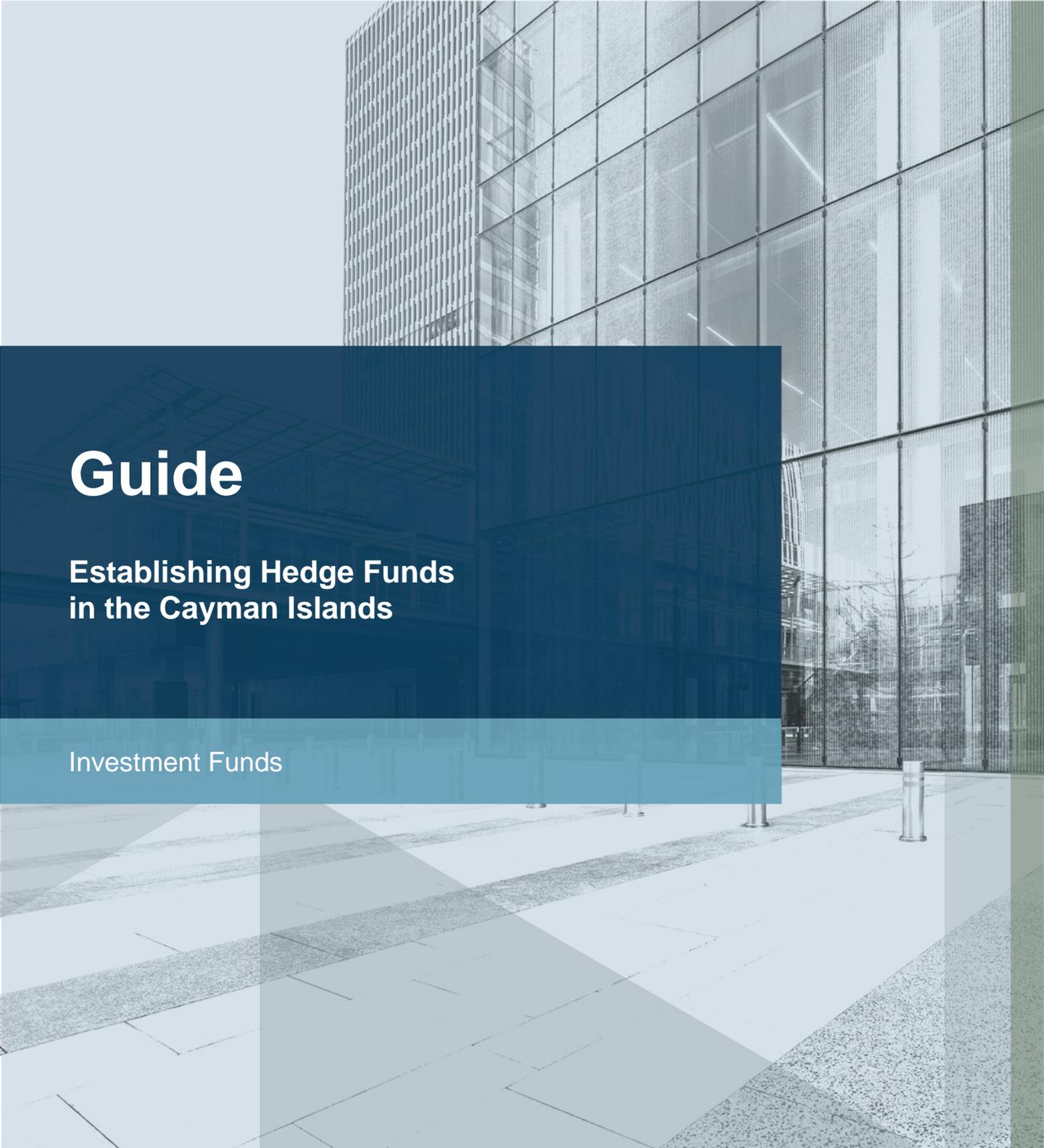


CONYERS



Guide

Establishing Hedge Funds in the Cayman Islands

Investment Funds

The Cayman Islands is a world leader in the establishment of offshore hedge funds. Its tax-neutral platform, stable economy, sophisticated banking sector, confidentiality and professional financial service industry are just some of the reasons the location is attractive to hedge fund managers the world over.

To help fund managers decide whether the Cayman Islands is the right home for their fund, we have outlined some important factors to consider when setting up a hedge fund, as well as provided an overview of relevant documentation and regulations.

Structural Considerations

A hedge fund is typically open-ended, that is investors can make periodic redemptions. Accordingly there must always be enough cash or liquid assets in the fund to meet such redemption demands.

Fund managers should also consider whether to impose a lock-in period on their open-ended funds, during which investors cannot sell shares. A lock-in period allows the fund manager to invest all of the subscriptions during the early life of the fund without having to meet redemption requests. It is important, however, to ensure the lock-in period is not so long that the fund effectively becomes a closed-ended fund.

While hedge funds are typically structured as Cayman Islands exempted companies, the particular needs or preferences of different types of investor, whether due to market convention, taxation or other considerations, may determine the actual fund vehicle or vehicles used.

Segregated Portfolio Companies may be considered a suitable option for Asian fund managers. Under Cayman legislation for SPCs, assets and liabilities can be separated into distinct pools amongst its segregated portfolios. This avoids the expense of incorporating individual companies to obtain the same effect. With SPCs, it is possible to create single-investor held portfolios that discreetly meet specific needs of each relevant investor.

Another option is to set up the fund as a limited liability company ("LLC"). A LLC combines many of the features of a company with the flexibility of a partnership. A LLC may be formed by a single member. Each member will receive one LLC interest, representing, for example, its right to capital voting rights and its right to receive dividends. For hedge funds that attract US investors, an LLC may be a good choice as a feeder vehicle within a master-feeder structure.

The fund will usually issue two kinds of shares: voting and non-voting. Voting shares (management shares) are non-redeemable, do not have economic rights but carry significant shareholder voting rights. Non-voting shares (participating shares) are held by the investors and give them the right to participate in the fund's profits.

Regulations

An open-ended fund will be a mutual fund for the purposes of the Mutual Funds Law of the Cayman Islands ("MFL") and will be regulated by the Cayman Islands Monetary Authority ("CIMA"), unless exempted. For hedge funds, this usually means being regulated as a "registered" fund on the basis that the minimum initial subscription by an investor is not less than CI\$80,000 (approximately US\$100,000). An open-ended fund with 15 investors or fewer, who have the power to appoint and remove the directors, may be exempted from regulation by CIMA under the MFL.

Cayman Islands' master funds, being open-ended funds that hold investments and conduct trading to fulfill the investment strategy of a regulated feeder fund, are also regulated under the MFL. A registered fund must appoint a fund administrator, an auditor, a custodian/broker and at least two directors (who do not need to be resident in the Cayman Islands).

The Securities Investment Business Law of the Cayman Islands ("SIBL") regulates certain type of investment business, including the managing of securities by Cayman Islands entities. A Cayman Islands manager would typically obtain an exemption from licensing as an excluded person under the SIBL for any management services it provides to the hedge fund.

Cayman Funds Structures

- Cayman Exempted Company
- Segregated Portfolio Company
- Limited Liability Company

Proposal & Incorporation

In general, for hedge funds we suggest the fund is incorporated as a Cayman Islands exempted company operating as an open-ended fund. An exempted company may also be incorporated as an investment manager in the Cayman Islands and in that case we would assume an investment adviser in an onshore jurisdiction would provide investment advisory services to the manager.

The fund and the manager must each have a registered office in the Cayman Islands. Our affiliated service provider, Conyers Client Services, can provide this.

Conyers Client Services will also be able to assist with the incorporation and organisation of each of the fund and of the manager as a Cayman Islands exempted company. Incorporation is usually finalised within 48 hours of submission to the Cayman Registrar. However, copies of the certificate of incorporation and the memorandum and article of association, may take up to 7-10 working days unless the available expedited procedure is used.

Fund Documentation

The documents typically required for the hedge fund offering will include:

- The memorandum and articles of association (“M&A”) would be our standard M&A for an exempted company incorporated in the Cayman Islands. They would later be amended to include the provisions of the fund’s offering and other applicable amendments.
- The private placement memorandum (“PPM”) provides all relevant details about the participating shares, so prospective investors can make an informed decision about subscribing, it including the investment objectives and applicable risk factors.
- An Application Form which sets out details prescribed by CIMA for registration as a regulated mutual fund.
- The various service provider agreements such as a management agreement between the fund and the manager, an advisory agreement between the manager and the adviser and the fund administration agreement and the prime broker/custodian agreement.
- A subscription form (for investors subscribing for participating shares) and a redemption form (for when investors want to redeem shares).
- A CIMACONnect affidavit, which relates to electronic document filings with CIMA.
- The directors’ and shareholders’ written resolutions for the fund, which cover adoption of the fund’s M&A, the PPM, the service provider agreement amongst other matters.
- The M&A of the manager would also be Conyers’ standard memorandum and articles of association for an exempted company incorporated in the Cayman Islands.
- The Form SIBL which set out details prescribed by CIMA for the manager’s application for exemption status under the SIBL.
- The directors’ written resolutions of the manager covers the application for exemption under the SIBL and the approval of the Management Agreement.

Finally, the Cayman Islands Directors Registration and Licensing Law requires the directors of any regulated mutual fund under the MFL and certain excluded persons under the SIBL (including the manager) to register with CIMA.

Key Contact:

Hong Kong

Piers Alexander
Partner

piers.alexander@conyers.com

+852 2842 9525

Global Contacts:

Cayman Islands

Kevin C. Butler
Partner, Head of Cayman Islands Office

kevin.butler@conyers.com

+1 345 814 7374

London

Linda Martin
Director, Head of London Office

linda.martin@conyers.com

+44(0)20 7562 0353

Singapore

Preetha Pillai
Director, Head of Singapore Office

preetha.pillai@conyers.com

+65 6603 0707

This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

For further information please contact: media@conyers.com

CONYERS DILL & PEARMAN

29th Floor
One Exchange Square
8 Connaught Place
Central
Hong Kong
Tel: +852 2524 7106

conyers.com