



Establishing Investment Funds in the Cayman Islands

Key Considerations

May 2018

Foreword

We are pleased to present our 2018 guide to establishing investment funds in the Cayman Islands.

The Cayman Islands continues to be the leading jurisdiction for fund formation. Cayman's commitment to maintain a balanced regulatory framework coupled with the long established and sophisticated accounting and legal frameworks have continued to solidify this top position among the global investment community.

Local stakeholders have continued to adapt to the demands of investors and regulators resulting in a number of industry developments over the past year. Anti-money laundering legislation has been revised, a new legal structure has been introduced - the exempted limited liability partnership - and a pragmatic solution to further collaborate with international bodies in handling beneficial ownership information requests is now in place. These events and additional guidance on the regulatory requirements for anti-money laundering procedures, the beneficial ownership regime and technical accounting and disclosure updates remain outside of the scope of this document. We would be happy to discuss these industry developments with you further.

We hope that you find this publication helpful. As always, we encourage you to contact your local Deloitte firm or the Deloitte Cayman Islands office for additional information or assistance.

Best,



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Introduction

Cayman Islands Mutual Funds

The Cayman Islands is a British Overseas Territory and is the leading jurisdiction for establishing offshore mutual funds globally. As of March 31, 2018, the Cayman Islands Monetary Authority (CIMA), the primary regulator of the Cayman Islands' financial services industry, reported that the total number of regulated funds was 10,500, comprised of 7,291 registered funds, 2,810 master funds, 319 administered funds and 80 licensed funds. In comparison, the next largest offshore jurisdictions, by number of latest reported funds of each respective jurisdiction, were Ireland's with 2,583¹ funds, the British Virgin Islands with 1,496² funds and Jersey with 1,104³ funds.

CIMA issues an annual statistical digest that presents aggregate statistics on funds it regulates. In making structuring decisions, it may be useful to understand what is most commonly used by the global asset management community.

Certain relevant statistics are presented in the following table:

CIMA – Investments Statistical Digest	2016 ⁴
Location of Investment Managers by ending net assets	United States 70%
	Europe 16%
	Asia 7%
	Other 6%
Primary location for NAV calculation services (by NAV)	Cayman Islands 35%
	United States 32%
	Ireland 19%
	Other 15%
Primary location for Registrar and Transfer Agent services	Cayman Islands 38%
	United States 26%
	Ireland 19%
	Other 17%
Legal structure	Exempted Company 68%
	Exempted Trust 12%
	Exempted Partnership 10%
	Exempted SPC 9%
	Other 1%
Operating structure of all regulated mutual funds	Master/Feeder 54%
	Stand-Alone 31%
Funds requiring minimum \$1 M initial investment (%)	Fund of funds 15%
	Master Funds 41%
	Registered Funds 32%

¹ Central Bank of Ireland, March 30, 2018; www.irishfunds.ie/facts-figures, alternative investment funds (aifs)

² 2017 BVI FSC Quarterly Statistical Bulletin, Quarter 3 2017 (page 4); www.fsc.gov.bb

³ Summary of statistical survey of funds, December 31, 2017; www.jerseyfsc.org

⁴ 2016 Investments Statistical Digest; www.cimoney.com.ky

Key characteristics

Certain key characteristics of an investment fund will drive the choice of structure, legal entity and operations of the fund, as follows:

Investment fund characteristics	
Investor’s domicile	Domestic/Global
Investment strategies	No Cayman Islands imposed restrictions
Liquidity	Daily/Monthly/Weekly/Quarterly or closed-ended
Transparency	No Cayman Islands imposed restrictions
Leverage	No Cayman Islands imposed restrictions
Investment restrictions	No Cayman Islands imposed restrictions
Investment Management fees	Commonly 1-2% of net assets
Performance fees or allocation	Commonly 10-20% of profits
AUM at launch	Minimum subscription for certain regulated fund categories
Service providers	Residency restrictions for certain key service provider roles

Fund Management will determine the most appropriate organizational structure and type of legal entity most appropriate in order to satisfy the nature of investments and anticipated fund terms noted above. Once the appropriate structure and vehicle is determined, the investment manager will, with the assistance of its legal counsel and advisers, complete a series of steps. See Appendix A for the related estimated timeline. The steps to launch a Cayman Islands exempted company are as follows:

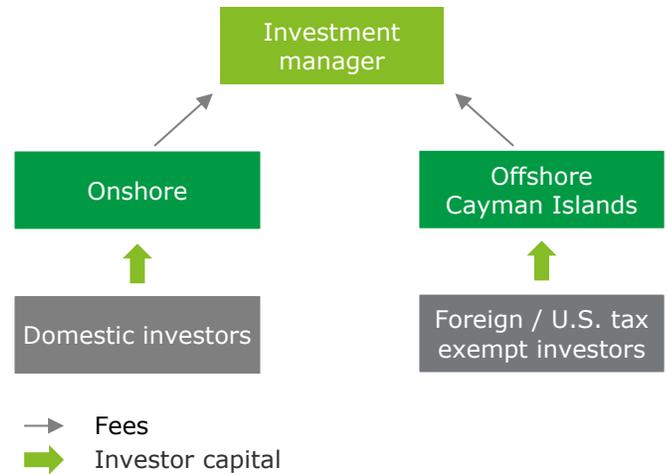
1. Incorporate and form the fund vehicle.
2. Appoint a minimum of one director, if applicable.
3. Prepare the fund’s constitutional documents (such as the memorandum and articles of association, offering memorandum, share subscription agreement, board resolutions).
4. Prepare service provider agreements (such as the investment management/advisory agreement(s), the administration agreement, brokerage agreement(s)).
5. If CIMA registration is required (see Section: Regulatory Regime), prepare application for registration under the Mutual Funds Law of the Cayman Islands.

Organizational Structure

A. Side-by-Side structure

Organizational structure

The side-by-side structure contemplates an investment manager making trades for the onshore and offshore funds according to an identical investment strategy. While the positions held are the same, each fund has its distinct brokerage accounts and trades are executed for each separately. Accordingly, the investors would expect to receive a same or similar investment return.

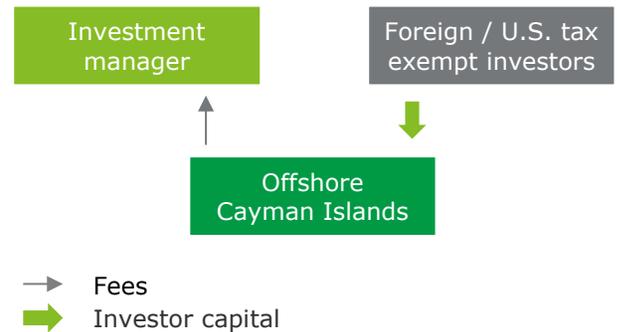


B. Stand-Alone fund

Organizational structure

A stand-alone fund operates as a single vehicle and is typically used by managers that seek to operate a single strategy. Structurally, each vehicle in a side-by-side arrangement is a stand-alone fund.

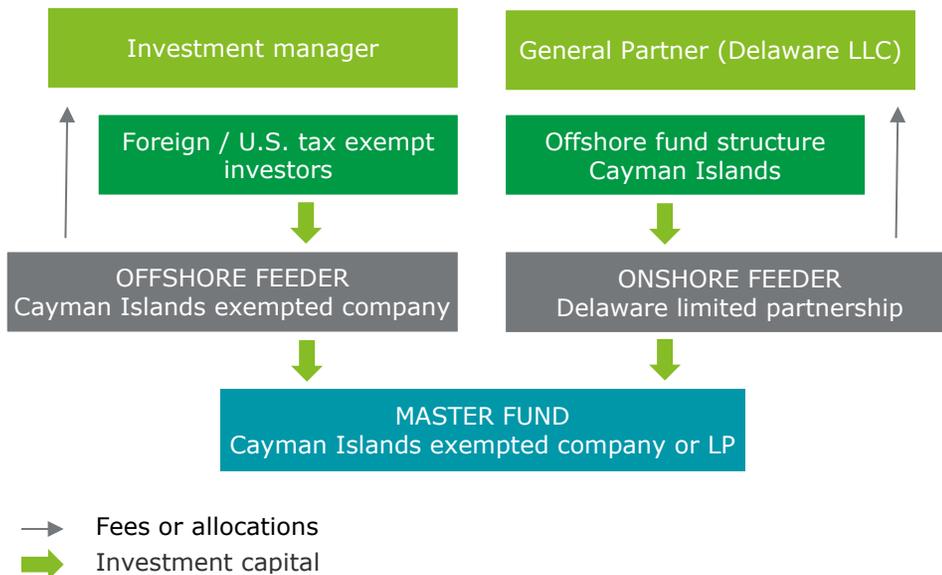
The offshore fund entity may be established using one of the Cayman Islands' legal entities discussed further within the section 'Legal Entities'.



C. Master-Feeder structure

Organizational structure

A Master - Feeder structure is typically utilized in order to allow investors with different tax requirements to participate in the same fund (the Master trading fund). This structure is commonly used by managers in the United States. These managers seek to raise capital from global investors by establishing an offshore feeder vehicle that will invest primarily into the offshore Master trading vehicle, while separately establishing an onshore feeder vehicle to cater to U.S. taxable investors, without having to operate a duplicate trading vehicle, as is required for side-by-side funds. It is therefore both a cost and administratively efficient means of operating and marketing an investment manager's products to both domestic and global investors.



Operations

The domestic feeder accepts contributions from U.S. taxable investors, and the offshore feeder accepts subscriptions from U.S. tax exempt and foreign investors. The feeders in turn generally invest solely into the Master trading vehicle. Typically the Master trading fund does not pay management and performance fees as these are calculated and recorded at the Feeder fund level. The domestic feeder will pay a management fee and a performance allocation to its general partner, while the offshore feeder will pay a

management fee and a performance fee to its investment manager. Given that the character of the fees may influence the investment manager or general partner's U.S. tax treatment, some variances are seen in practice, and therefore consultation with tax advisors is recommended when structuring and drafting the offering memorandum.

Ownership

An incorporated Master Fund typically issues voting, non-participating management shares to the Investment Manager. Non-voting, participating shares of the Feeders. The Feeder in turn invests in participating shares of the Master.

Other tax considerations

If the Master Fund is established as a Cayman Islands corporation, it is critical that the Master Fund make a "check the box" election to be taxed as a Partnership for U.S. tax purposes. It is however increasingly common to structure the Master as a partnership rather than a corporate entity and your alternatives should be discussed with your tax advisers.

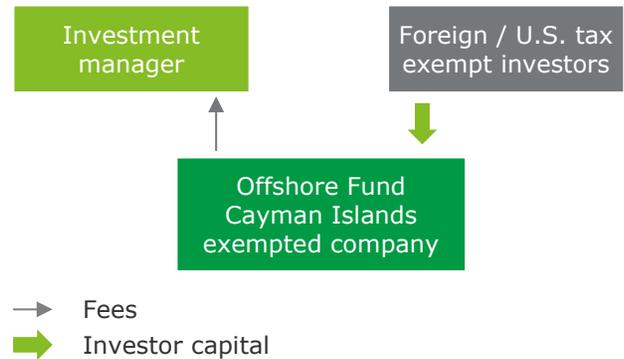
As of March 2018, CIMA reported that 27% of regulated fund structures were Master Funds. The Master-Feeder Fund structure is the most common structure used by U.S. investment managers.

Legal Entities

A. The Cayman Islands Exempted Company

Organizational structure

Exempted companies are formed in accordance with the Companies Law of the Cayman Islands. An exempted company's business activities occur primarily outside of the Cayman Islands. The primary advantage to a company structure is that it limits the shareholders' liability over the debts of the company, however the directors, appointed to manage the company, may be personally liable in the event of breach of duty. The Cayman Islands exempted company is most frequently used by offshore funds as discussed further under the section "Regulatory Regime".



Ownership

The Investment Manager typically owns the voting, non-participating management shares of the Cayman Islands exempted company. Other alternatives such as establishing a charitable trust to own the management shares, or solely issuing voting participating shares may be most appropriate, as determined in consultation with your legal counsel. Non-voting, participating shares are owned by the foreign or U.S tax exempt investors. Multiple share classes can be issued to adapt the fund to varying fee structures or other investor needs.

An exempted company may not raise capital from the public from within the Cayman Islands unless it is listed on the Cayman Islands Stock Exchange.

There is no maximum number of shareholders.

Tax considerations

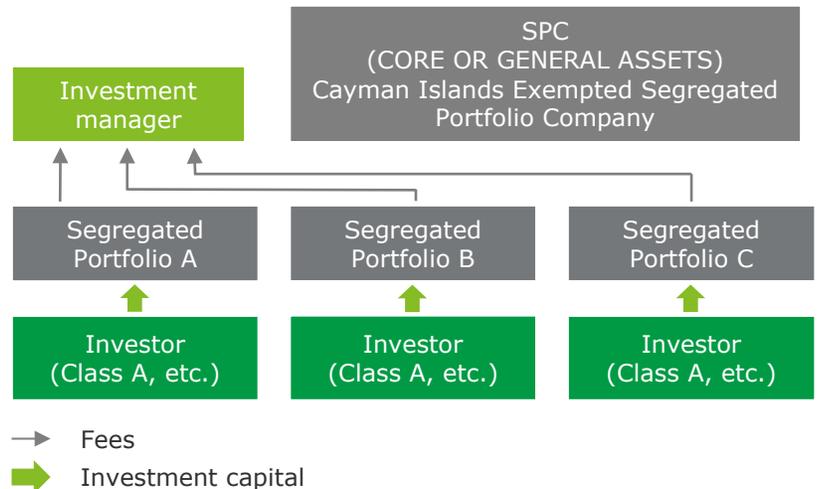
Given there is no taxation on income, profits or capital gains in the Cayman Islands, the corporate structure can accumulate earnings without taxation at the corporate level, while limiting liabilities to the corporation. US tax exempt investors will require information reporting in order to comply with filing tax returns in their home state. The Cayman Islands tax team provides US tax compliance services to funds and to the Investment Managers.

A company may apply for a Tax Exemption Certificate to obtain an undertaking from the Governor in Cabinet that no income, profit or capital gains taxes will be imposed on the company for a period up to 20 years from the date of such undertaking (a further 10 year extension is then available). The certificate is to protect the fund in the unlikely event that a direct tax is imposed in the future.

US taxable investors will require information reporting in order to comply with filing tax returns in their home state. The Cayman Islands tax team provides US tax compliance services to funds and Investment Managers.

B. The Segregated Portfolio Company

An SPC is an exempted company, organized under the Companies Law of the Cayman Islands (the Companies Law), which seeks to segregate separate pools of assets and liabilities to specified shareholders or creditors. Such segregation protects investors and creditors from assuming losses incurred by a separate share class or investor group. An investor may otherwise be exposed to the liabilities of other classes when, for example, a fund enters into side arrangements on behalf of another investor, or when individual cells have different levels of risk.



An SPC is designed so that a creditor or investor will only have recourse to the assets attributable to the specific segregated portfolio, or "cell" with which it is a creditor or investor. To the extent that such assets are insufficient to satisfy the obligation, and unless prohibited by its articles of association, the creditor or investor may seek settlement from the balance of the SPC's general assets less any minimum capital amount lawfully required. The creditor or investor may not look to the assets of any other segregated portfolio to satisfy its obligations, as is the case in a multi-class fund, or an umbrella trust.

Ownership

SPCs follow the same share structure as an exempted company under the Companies Law. Management shares, typically owned by the Investment Manager, and participating shares are both authorized and issued at the SPC level. The SPC will then re-designate portions of its authorized participating share capital to the segregated portfolios.

Benefits and Shortcomings of the SPC

The primary benefit is that there is no cross-liability between segregated portfolios as is the case for a multi-class fund or umbrella trust structure.

An SPC is a single legal entity, as specified under the Companies Law. Therefore in order for a segregated portfolio to achieve the advantage of maintaining its separate legal status in liquidation, it is crucial that the assets and liabilities are legally segregated between segregated portfolios. This may be achieved through the SPC entering into contracts for and on behalf of a specific identified portfolio and not in the name of the SPC, which includes establishing separate bank, custody and brokerage accounts, derivative contracts, loan agreements, service provider agreements, etc. If not separately identifiable, the assets and liabilities may be considered general assets of the SPC and may not be available to settle obligations of creditors of the intended portfolio when called upon to do so.

The SPC appeals to investors seeking to protect themselves from other share classes that have different risk parameters (such as leveraged share classes).

A summary of benefits and shortcomings of the SPC is detailed below:

Benefits of the SPC

- There is no cross-liability between segregated portfolios as is the case for a multi-class fund or umbrella trust structure.
- Ability to create customized products with minimal cost and in a timely manner.
 - New segregated portfolios are established by a Board resolution that re-designates its share capital and authorizes a new portfolio.
- An SPC may have an unlimited number of segregated portfolios.
- If CIMA registered, only the SPC is registered with CIMA; segregated portfolios are not individually registered⁵.

Shortcomings of the SPC

- Complexities and operational requirements not always well understood by service providers and errors can be commonplace.
- The Companies Law with respect to SPCs has not been tested in court. Accordingly, some question both the strength of the product's features in the event of litigation, and the validity of isolating litigation to one cell without tainting the SPC as a whole.
- The structure may fail to provide the protection it was created to provide if a creditor, shareholder or third-party enters into a contract with the SPC rather than a specific portfolio.
- The SPC Law explicitly holds a director responsible for proper application of the structure therefore there is increased risk to a director given the increased complexity to operate the structure.

⁵ The Fund must furnish to the Registrar of Companies an annual notice containing the names of each segregated portfolio created. The Fund must furnish a separate FAR for each segregated portfolio.

C. The Exempted Limited Partnership (ELP)

Organizational structure

Partnerships are not entities with separate legal personality and as such all contracts are entered into by the General Partner (GP) on behalf of the partnership. In the event that the partnership becomes insolvent, the GP is liable for all the debts of the partnership. U.S. investors prefer the partnership structure as it acts as a pass through entity for tax purposes, whereby the character of income is passed to the end investor.

The Cayman Islands limited partnership is most commonly used by private equity funds while onshore feeder funds within a master-feeder vehicle commonly use a Delaware partnership structure.

Ownership

A partnership is formed by one or more GPs and one or more LPs entering into an exempted limited partnership agreement (“LPA”). The general partner may hold an allocation of capital in addition to the limited partners. Any performance fees are treated as equity allocations to the general partner rather than recorded as expenses on the statement of income.

A Cayman Islands partnership may not accept contributions from the public within the Cayman Islands.

There is no maximum number of limited partners.

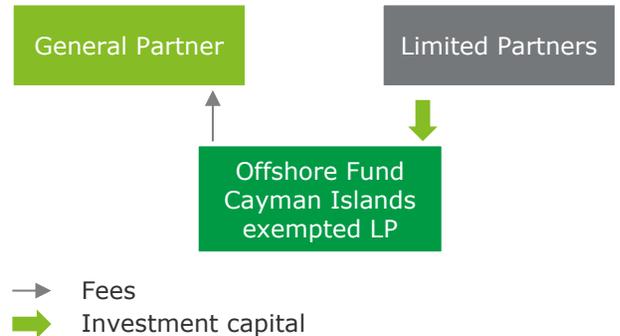
Tax considerations

Partnerships are treated as a conduit and are, therefore, not subject to taxation. The character of income earned by the partnership is preserved when flowed-through to the partners and are reported on their personal income tax returns. The tax benefit associated with the partnership being a pass through entity is a key benefit to this vehicle.

A Cayman Islands partnership may apply for a Tax Exemption Certificate to obtain an undertaking from the Governor in Cabinet that no income, profit or capital gains taxes will be imposed on the partnership for a period up to a maximum of 50 years from the date of such undertaking. The certificate is to protect the fund in the unlikely event that a direct tax is imposed in the future.

Other

The terms of an exempted limited partnership are set out in the LPA and are registered with the Registrar of Exempted Limited Partnerships. See section Other General Requirements, Residency Restrictions for additional requirements.



D. The Exempted Trust

Organizational structure

The exempted trust is established under a trust deed and management agreement between the Trustee and the investment manager. A unit trust has no separate legal personality and therefore the Trustee typically holds legal title to the unit trust structure and its assets, and acts on behalf of the trust in all contracts unless otherwise delegated to the manager. Legal liability therefore largely rests with the Trustee.

A unit trust may be stand-alone or establish various sub-trusts or classes as an umbrella trust. Umbrella trusts are used to offer differing investment strategies and objectives in order to tailor to an investor's needs. Sub-trusts are established by issuing supplemental trust deeds.

Unlike a segregated portfolio however, a unit sub-trust may be exposed to the liabilities of another insolvent sub-trust. The unit trust is most commonly favoured by Asian investors for domestic tax purposes (e.g. Japan).

A CIMA regulated trust must appoint a Cayman Islands Trustee licensed under the Banks and Trusts Law. Minimum capital requirements are set for Restricted (US\$24k) and Unrestricted (US\$480k) Trust licences.

Ownership

The trust issues participating, non-voting units to investors, redeemable at net asset value per unit.

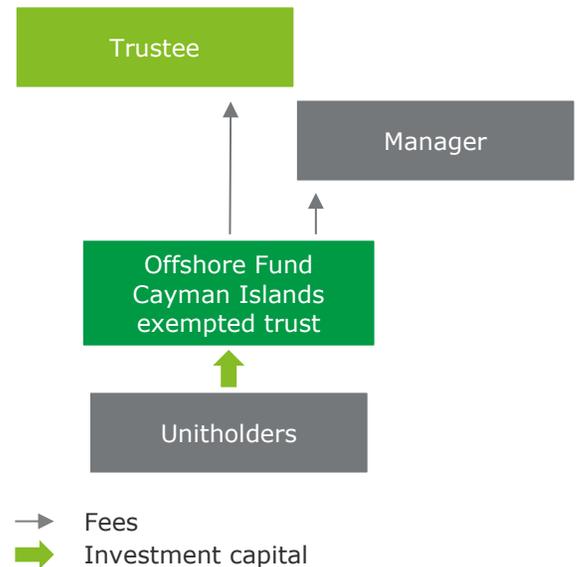
A Cayman Islands trust may not accept contributions from the public within the Cayman Islands.

There is no maximum number of unitholders.

Tax considerations

Trusts are not separate legal entities and therefore treated as a conduit similar to partnerships. Compliance reporting is driven by unitholder needs and should be discussed with onshore and offshore tax advisors.

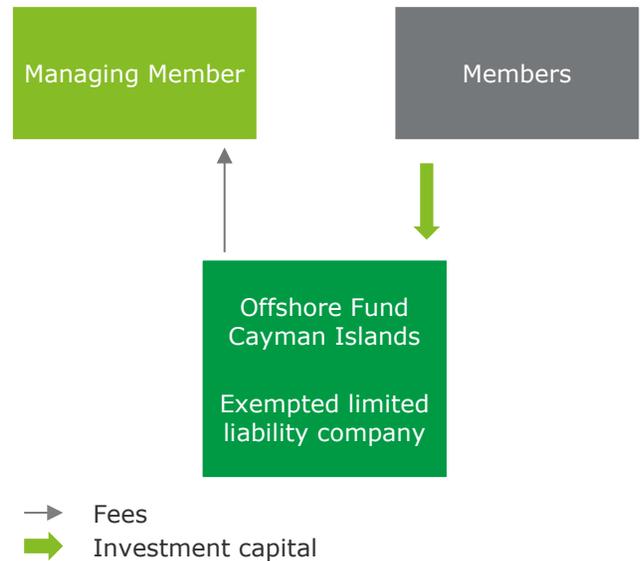
A Cayman Islands trust may apply for a Tax Exemption Certificate to obtain an undertaking from the Governor in Cabinet that no income, profit or capital gains taxes will be imposed on the trust for a period up to a maximum of 50 years from the date of such undertaking. The certificate is to protect the trust in the unlikely event that a direct tax is imposed in the future.



E. The Exempted Limited Liability Company (LLC)

Organizational structure

The exempted limited liability company came into law in June 2016. It is formed by one or more members in accordance with the terms of the limited liability company (LLC) agreement. A managing member may be appointed to manage the affairs of the LLC, or the entity may be managed by the members themselves or another contracted party. The LLC was introduced in order to offer a product familiar to those most comfortable with the Delaware LLC, and it provides for flexibility of terms when drafting the LLC agreement. This could include for example, flexibility to limit the manager’s fiduciary duties other than a duty of good faith, and therefore limits its liability. Given the LLC’s infancy, the latter has not been tested in Cayman Islands courts to date, however such allowances within the LLC agreement may lend themselves most appropriately to family offices, private equity and venture capital structures.



The LLC is said to be a hybrid between an exempted company and exempted limited partnership. While it acts as a separate legal entity, it does not issue share capital and therefore is accounted for similar to a partnership whereby income and expenses are allocated to member interests in the manner agreed and documented in the LLC agreement.

One significant difference when compared to a Delaware LLC, is that the Cayman LLC does not initially provide for separate series with segregated assets and liabilities (a popularly used feature of Delaware LLCs). Fund managers needing this level of separation will still need to utilize the Segregated Portfolio Company (SPC) structure or establish separate legal entities.

Ownership

An LLC is divided into member interests similar to a partnership’s capital accounts however each member’s liability is limited to its capital account as stipulated in the LLC agreement. Voting interests are allocated in accordance with the LLC agreement and may be weighted to certain members. Typically a managing member’s performance remuneration is treated as an equity allocation to the managing member rather than recorded as an expense on the statement of income.

A Cayman Islands LLC may not accept contributions from the public within the Cayman Islands.

There is no maximum number of members.

Tax considerations

A Cayman LLC is permitted to elect its classification for U.S. tax purposes. It is therefore expected to be treated as a partnership unless it otherwise elected to be taxed as a corporation. If no election is made, we expect it would default as a partnership however for the avoidance of doubt, it is recommended that an election be filed.

An LLC may apply for a Tax Exemption Certificate to obtain an undertaking from the Governor in Cabinet that no income, profit or capital gains taxes will be imposed on the partnership for a period up to a maximum of 50 years from the date of such undertaking. The certificate is to protect the fund in the unlikely event that a direct tax is imposed in the future.

Regulatory Regime –

The Cayman Islands Monetary Authority

Mutual Fund categories

The Cayman Islands Monetary Authority (CIMA) regulates mutual funds in accordance with the Mutual Funds Law of the Cayman Islands (“MFL”). If a Cayman Islands fund meets the definition of a mutual fund and the established criteria for registration within the MFL, it will be regulated by CIMA under one of the regulated mutual fund categories outlined below:

Category	MFL	Description
Registered Fund	Section 4(3)	A fund that meets criteria under Section 4(3) of the MFL, and does not qualify for exemption under Section 4(4) of the MFL, described below.
Licensed Fund	Section 4(1) a	A fund that has a Mutual Fund License. The provisions benefit large, well known and reputable institutions and are similar to retail funds.
Administered Fund	Section 4(1) b	A fund that has a CIMA-licensed administrator providing its principal office. The regulatory responsibility for the administered fund, which has more than 15 investors, is placed largely in the hands of a licensed Mutual Fund Administrator.
Master Fund	MFL (Amendment), 2011	A fund that has one or more Regulated Feeder Funds. A Regulated Feeder Fund is registered with CIMA and conducts 51% or more of its investing activities through another mutual fund.
EU Connected Fund	MFL (Amendment), 2015	A registered fund or a fund that has elected to be registered, and that is offering the fund to investors domiciled in an EU member state.

Figure 1

The Registered Fund category is most commonly used to structure funds in the Cayman Islands. In 2016, CIMA reported 7,654 Registered Funds, representing 70% of the total 10,940 funds under its regulatory regime, while Master Funds totaled 2,805 (26%) (see Figure 2).

Registered Mutual Funds - Section 4(3) of the Mutual Funds Law

Open ended mutual funds established in the Cayman Islands may require registration with CIMA unless they qualify for an exemption under section 4(4) of the Mutual Funds Law.

Section 4(4) states that a Cayman Islands mutual fund, other than a Master Fund, is exempt from registration if the number of investors in the Fund is fifteen (15) or less, the majority of whom are capable of appointing or removing the directors of the Fund.

The EU Connected Fund was introduced in 2017 in response to the European Union's (EU) Alternative Investment Fund Manager Directive (AIFMD) requirements that are triggered when a non EU fund is marketed to EU investors. This category enables a fund that is otherwise exempt from CIMA registration to register voluntarily and allow the EU member states to rely on Cayman's regulatory regime in satisfaction of AIFMD. The EU Connected Fund is obliged to reconfirm annually, within six months of its yearend, that there has been no changes to the information in its original notification, and submit an annual declaration that the fund is being marketed in each EU member state in accordance with the applicable laws.

Registered Fund regulatory requirements

Some of the primary statutory obligations for a Registered Fund, including a Registered Master Fund, are as follow:

- a. Minimum capital requirements** - A Registered Fund or Registered Master Fund requires a minimum of US\$100,000 initial investment by each investor unless the fund is listed on a recognized stock exchange. **The Cayman Islands Stock Exchange (CSX)** is a CIMA recognized stock exchange and therefore would not require any minimum capital. See Stock Exchange section below for a discussion on listing with the CSX.
- b. Annual Audit requirement** - A Registered Fund must submit audited financial statements annually. The appointed auditor must be CIMA approved and have a local presence.
 - Audited financial statements must be filed with CIMA within six months of the fund's financial year end.
- c. Fund Operator and annual return:** The Fund must appoint an Operator who is charged with validating the Fund Annual Return (FAR), which is filed electronically together with the annual audited financial statements.
 - The Fund Operator is typically a Director of the fund (or Trustee or General Partner).
 - The Fund Annual Return may be compiled by another party such as the Fund Administrator but must be (a) signed by the Operator (b) filed electronically by the Fund's auditors of record.
- d. CIMA registration:** The Fund's Operator will submit a completed form MF1 for a Registered Fund, MF3 for a Licensed Fund, or MF4 for a Registered Master Fund, together with the following documents: Certificate of Incorporation, Fund Offering Memorandum, Fund Administrators' Consent letter, Fund Auditors' Consent Letter and Registration fee. The Fund's offshore legal counsel typically coordinates, reviews and submits the registration application to CIMA.

SEC Registered Investment Adviser

Implications to the financial reporting process

Offshore funds managed by an investment adviser that is registered with the Securities and Exchange Commission's (SEC) must comply with the SEC's Custody Rule. A fund may elect to distribute the audited financial statements to investors in order to satisfy certain provisions of the Custody Rule. Reliance on the audited financial statements for this purpose will trigger the following:

- The audited financial statements must be distributed within 120 days of its financial year end (180 days for fund of funds).
- First year stub period audits are mandatory for the SEC. In comparison, CIMA may allow a maximum 18 month period for first year financial statements from the date of registration to the fund's financial year end.
- Financial statements must be prepared using Generally Accepted Accounting Principles in the United States (US GAAP), or International Financial Reporting Standards that include US GAAP required disclosures in the notes to the financial statements.

Investment Advisers that are registered with the SEC must appoint an auditor that is registered with and subject to inspection by the PCAOB.

Deloitte Cayman Islands is both registered and inspected by the PCAOB.

Corporate Governance Overview

General

In accordance with the Companies Law, a Cayman Islands exempted company must appoint at least two directors and CIMA issued guidance that sets out expectations that boards of directors hold at least two meetings a year. There is no requirement to appoint an independent, non-executive director and there are no restrictions on residency of the directors.

Demand for independent directors has been increasing, however whether funds choose to include independent directors remains a decision of the fund.

The Directors Registration and Licensing Law

The Directors Registration and Licensing Law, 2014 (DRLL) applies to directors of companies that are registered under the Mutual Funds Law of the Cayman Islands as a regulated mutual fund or under the Securities Investment Business Law (SIBL) Excluded Person as an investment manager (each a “Covered Entity”). The DRLL does not apply to trustees (that are regulated under the Banks and Trust Companies Law) or partners of partnerships.

Category	Application
Registered Director	A Registered Director is a natural person acting as director on 19 or fewer covered entities, as defined. Registered directors do not need to apply for a license.
Professional Director	A Professional Director is a natural person acting as director on 20 or more covered entities, as defined. Some exemptions apply. A Professional director must, among other requirements: <ul style="list-style-type: none"> · apply for a professional director’s license · maintain D&O insurance from a reputable insurer
Corporate Director	Corporate Directors are permitted and must, among other requirements: <ul style="list-style-type: none"> · Apply for a license as a Corporate Director. Companies holding a companies management license or a fund administration license are exempted.

See Appendix A for processing times to register and/or license a director of a Covered Entity. Directors pay annual registration and/or licensing fees by January 15 of each year and at that time reconfirm information provided the previous year.

CIMA issued Statements of Guidance (SOG) to provide Operators of regulated mutual funds guidance on key corporate governance principles in order for the Board and the funds Operators may effectively carry out their duties.

CIMA will respond to inquiries on Directors’ fees at directorsfees@cimoney.com.ky and all other questions at DirectorsRegistration@cimoney.com.ky

Alternative Investment Fund Manager Directive (AIFMD)

The Alternative Investment Fund Managers Directive (AIFMD or the “Directive”) provides an EU framework for the regulation and oversight of alternative investment fund managers (AIFMs). The Directive and the detailed “Level 2” Regulations require EU AIFMs to comply with its provisions and submit an application for authorization as an EU AIFM. The AIFMD makes provision for a passport, enabling the AIFM to market its fund across the EU while registering with only one EU member state. This passport is currently only available to EU AIFMs and certain non EU Alternative Investment Funds (AIFs). While the passport is not available to Cayman funds to date, any investment manager that intends to market its Cayman Islands fund in the EU must consider the AIFMD provisions.

Third country provisions

Currently, the national placement regimes (NPRs) of each EU Member State is the only marketing and distribution channel available to non-EU AIFMs. Similarly, EU AIFMs intending to market non-EU AIFs in the EU may only do so at the discretion of the regulator of the EU country of distribution, having first submitted the appropriate filings and received authorization. An EU country reserves the right to refuse access under private placement.

The Directive stipulates an overriding requirement for supervisory cooperation arrangements to be in place between the home state regulator of the EU country of distribution and the supervisory authority of the third country where the non-EU AIFM and/or non-EU AIF are established. To date, the CIMA has signed Memoranda of Understanding (MOUs) and the respective cooperation agreements with over 30 EU member states.

Under the NPR, the Directive permits each member state to introduce rules beyond the AIFMD minimum requirements. Therefore, each member state regulator is able to define its own “gold plating rules” to permit marketing by non-EU AIFMs, or marketing of non-EU AIFs by EU AIFMs, in their jurisdiction. As part of these requirements, many jurisdictions may require a declaration or confirmation that the Cayman AIF is subject to regulation in its home country. The overriding requirement for cooperation agreements to be in place implicitly suggests that the non-EU AIF would need to be subject to regulation in its home jurisdiction. Under the regulatory regime of the Cayman Islands, only those funds registered as mutual funds are subject to regulation by CIMA pursuant to the Mutual Funds Law.

NPR minimum requirements (allowed at minimum until 2018):

Reporting/disclosure rules	Additional rules may exist by EU country.
EU cooperation arrangements with U.S./Cayman Islands	✓ Cayman is compliant
U.S./Cayman Islands not listed as “non-cooperative” by Financial Action Task Force (FATF)	✓ Cayman is compliant

Under the NPR, an AIFM must register with each member state in which it is marketing its funds. The definition of marketing adopted by each member state varies, and therefore an AIFM must evaluate the requirements of each EU country. Registration under the NPR requires the AIFM to comply with transparency rules, comprised of regulatory reporting and investor disclosures.

AIFMD passport extension to the Cayman Islands

In principle, the phasing out of NPR is due for consideration by ESMA and the European Commission in 2018. When the NPR is phased out, all investment managers will have to comply in full with the AIFMD requirements in order to access the EU market.

ESMA advised in 2016 that there are no significant obstacles impeding the application of the AIFMD passport to the Cayman Islands, however deferred its recommendation pending completion of the following:

1. Introduction of AIFMD-like regime - the current framework applicable in Cayman Islands is significantly different from the AIFMD, especially regarding the depositary and the remuneration provisions. A number of Cayman Islands service providers now offer full depositary and/or depositary lite solutions in satisfaction of this requirement.
2. Development and implementation of a macro-prudential policy framework which is expected to enhance CIMA's current systemic risk monitoring. Amendments to the Mutual Funds Law provide for an EU Connected Fund Regime, which now allows Cayman fund and fund managers to opt-in to CIMA's regulatory framework.
3. Implementation of legislative amendment which will give CIMA power to impose administrative fines for breaches of regulatory laws, regulations and rules. This legislation was enacted within the Cayman Islands Anti-Money Laundering Regulations, 2017.

Registration under the Mutual Funds Law to achieve compliance

In the event that the regulator of the EU member state(s) in which the Cayman fund is marketed explicitly requires the AIF to be regulated in its local jurisdiction, the fund would comply with this rule by virtue of its CIMA registration. Non-regulated open-ended and closed-ended AIFs may opt-in to CIMA's regulatory regime as a 'Regulated EU Connected Fund', as discussed within the Regulatory Regime section of this document.

Compliance with AIFMD provisions

Where full AIFMD compliance is necessary, its provisions include a long list of operational, reporting and transparency requirements. The remuneration provisions in particular are subject to a great deal of discussion and therefore highlighted briefly in this document.

Structure Alternative upon full compliance (AIFMD Passport)

AIFMD's remuneration principles involves the AIFM adopting a detailed remuneration policy and governance structure. For example, there must be an appropriate balance between fixed and variable remuneration, at least 50% of variable remuneration should consist of shares of the AIF or equivalent, at least 40% to 60% of variable remuneration should be deferred over a minimum period of 3 to 5 years and vest no faster than on a pro-rata basis, and other requirements.

In addition to the above requirements, the AIFM must disclose the split between variable and fixed remuneration and, on an aggregated basis, amounts broken down by senior management and members of staff of the AIFM whose actions have a material impact on the risk profile of the AIF. As a result of this disclosure requirement, one structuring alternative to limit the disclosure to remuneration earned solely from EU investors, is to establish an EU offshore feeder to accept subscriptions from EU investors. The EU offshore feeder would invest solely into the Cayman master fund, however would pay any management fees directly to an intermediate Non-EU AIFM, which would act as the investment adviser to the EU offshore feeder.

Foreign Account Tax Compliance Act (FATCA)

Compliance for Cayman Islands Financial Institutions (FIs)

The United States ("US") legislation related to the Foreign Account Tax Compliance Act ("FATCA") and similar United Kingdom ("UK") legislation (also known as "UK-CDOT") are aimed at improving international tax compliance and preventing perceived tax abuse by US and UK persons through the use of offshore accounts. Together these regulations are referred to as FATCA throughout this report. Mutual funds established in the Cayman Islands are expected to fall within the scope of FATCA reporting requirements as Foreign Financial Institutions ("FFIs").

Under the provisions of respective FATCA legislations and Intergovernmental Agreements ("IGAs"), FFIs are required to identify accounts of certain US and UK persons and report prescribed information to the local authorities (for Model 1 jurisdictions, such as the Cayman Islands). The requirements for US FATCA impose due diligence requirements relate to account holder documentation, information reporting and withholding obligations for FFIs, which are further clarified in the final regulations, in addition to subsequent notices released by the IRS.

Appendix C summarizes key FATCA compliance milestones in the Cayman Islands.

Compliance requirements - US FATCA

- Establish a Compliance Program
 - Includes policies, procedures, and processes sufficient for the participating FI to satisfy regulatory requirements.
- Registration with the IRS
 - FI will receive its Global Intermediary Identification Number (GIIN).
- Appointment of a principal point of contact
 - Financial Institution (FI) will provide contact details of principal point of contact at time of notification to the Cayman Islands Department of International Tax Cooperation.
- Reporting requirements: As part of new client on-boarding, FIs will need to collect self-certification forms from investors, in addition to relevant US tax documentation.
- Methods to Ease the Registration Burden
 - Sponsored FI –Sponsoring FI registers on behalf of the FIs within its affiliated group
 - Notification and reporting via the Cayman Automated Exchange of Information ("AEOI") Portal.
Under the Regulations, notifications are due by April 30th and reporting is due by May 31st of the relevant calendar year.

Compliance requirements - US and UK FATCA

- Documentation of US and UK Reportable Accounts
- If the self-certification establishes that the Account Holder is resident in the US or UK for tax purposes, the fund should:
 - Treat the account as a US or UK Reportable Account; and
 - Obtain a self-certification that includes the Account Holder's US TIN (which may be an IRS Form W-9 or other similar agreed form) or UK NIN and date of birth.
 - In 2016, the UK and all of the Crown Dependencies and Overseas Territories adopted the Common Reporting Standard (CRS) developed by the Organisation for Economic Co-Operation and Development.

Common Reporting Standard (CRS)

Compliance for Cayman Islands Reporting Financial Institutions (RFIs)

The Common Reporting Standard (CRS) was developed by the Organisation for Economic Co-operation and Development ("OECD") on the mandate of the G20 to develop a global standard for automatic exchange of financial account information for tax purposes. As a measure to counter tax evasion, the CRS builds on the intergovernmental approach adopted by many jurisdictions for the implementation of the United States Foreign Account Tax Compliance Act (FATCA) as well as the implementation of the reporting for the UK Crown Dependencies and Overseas Territories ("UK-CDOT") and is designed to maximise efficiency and minimise costs.

There are, however, some distinct differences between FATCA and the CRS, in particular:

- **CRS is based on tax residency** - FATCA reporting is on the basis of the US citizenship and the scope includes US accounts only, while CRS is based on tax residency and will include accounts held by tax residents in any of the 100+ participating jurisdictions. RFIs must establish a way to record and track tax residency information, the definition of which may differ from jurisdiction to jurisdiction.
- **CRS does not impose withholding tax** - FATCA imposes 30% withholding tax on US-source income and other US-related payments made to or by a non-participating foreign financial institution in the event of non-compliance. On the other hand, CRS has penalties for non-compliance specified under the Tax Information Authority Law that are enforced by the jurisdiction where the RFI is a resident.
- **CRS has no de minimis thresholds applicable**, with the exception of pre-existing entity accounts. Therefore, every new entity or individual account opened on or after January 1, 2016 requires self-certification be obtained and validated against the RFI's records.

Compliance requirements

Under the CRS, jurisdictions obtain specified financial account information from their financial institutions and automatically exchange that information with the partner jurisdictions on an annual basis. Notification and reporting for the CRS is conducted through the Cayman AEOI Portal. By December 31, 2017 all individual and entity account remediation must have been completed.

Similar to FATCA, the CRS requires Cayman Islands resident entities that are RFIs, which includes most Cayman Islands domiciled investment funds, to:

- Identify each jurisdiction in which an account holder (or controlling person) is resident for income tax or corporation tax purposes;
- Apply the due diligence procedures as set out in the CRS; and
- Ensure that any information obtained in accordance with the CRS or a record of the steps taken in respect of a financial account is kept for six years.

As an early adopter of the CRS, a Cayman Islands RFI's first reporting year for the CRS is the calendar year 2016 and the RFI shall submit a return on or before May 31st of the year following the calendar year to which the return relates.

The UK CDOT reporting requirements are fully replaced. While some additional information was required to be reported in 2017 for UK CDOT purposes, there will be no need for duplicate reporting.

“Comparing key milestones for FATCA, UK-CDOT, and CRS” simplifies tracking important filing and other deadlines across FATCA, UK-CDOT and CRS, and can be found at www2.deloitte.com.

Other General Requirements

Registered office

Funds must have a registered office situated in the Cayman Islands to which all notices and communications may be addressed. The registered office may coordinate the annual fee payable to the Registrar of Companies or the ELP Registrar, as applicable, and file the annual return by January 31 of each year.

Material changes to corporate documents

The Registrar of Companies must be notified of certain material changes to the fund’s constitutional documents. Failure to do so will incur penalties to the fund. These include:

- Amendments to the Memorandum and Articles of Association or name change within 15 days.
- Changes to the directors and officers of the fund within 30 days.
- CIMA must also be notified of material changes to the fund’s constitutional documents including any change of registered or principal office.
- This includes: changes to the fund’s offering memorandum by filing the revised document within 21 days.

Residency restrictions⁶

No Cayman Islands residency restrictions on:

Cayman Islands residency restrictions on:

☐	☐
☐ Fund management	☐ Registered office
☐ Fund administration	☐ Auditors of record (Mutual Funds Law)
☐ Official books & records	☐ ELP General Partner ⁵
☐ Appointed directors	
☐ Transfer agent services	
☐ Bank and custodial accounts	

⁶ A GP of an exempted limited partnership must have at least one GP that is either:

- a. An individual resident in the Cayman Islands
- b. A company incorporated or registered as a foreign company in the Cayman Islands, or
- c. Be a partnership itself

Cost Considerations

Cayman Islands fund fee structure

Fund Management will need to estimate a number of fixed and variable cost drivers when establishing and operating the new fund structure.

Appendix B lists the primary expenses incurred within a typical stand-alone Cayman Islands exempted company, and highlights which expenses are fixed, partially variable and mainly variable with the level of assets and transactions (volume and nature) undertaken by the fund. An offshore fund’s most significant operating expenses include the investment adviser’s management and performance fees, fund administration, tax and audit, and transactional type costs such as brokerage trading commissions and interest.



Increasingly common as a Fund expense :

- Research costs
- Middle office support
- Directors’ and officer’s (D&O) insurance
- Indemnifications – including directors extraordinary fees (legal) and out of pocket expenses.

Fund expense requirements

There are no regulations in the Cayman Islands on the amount or nature of operating fees. All fees contemplated to be charged by the fund must be disclosed in the fund’s offering memorandum. The amount and basis of charging operating expenses are typically disclosed in the notes to the fund’s financial statements to ensure investors have been provided full transparency over the fund’s expense policy.

Fund expense policy

Allocating costs between the Investment Adviser and the Fund

An important consideration in setting up a fund is determining which expenses should be borne by the fund versus the investment adviser. There are no formal standards for what may or may not be passed on to investors as a fund expense and therefore policies vary in practice. CIMA nor the SEC have issued any related guidance. Generally, smaller and less established fund managers will outsource a number of middle office and other support functions and seek to allocate such costs to the funds. Given the expected limitations of the operations and resources available to smaller fund managers, this may be considered reasonable and appropriate by their investors. Generally, larger fund managers tend to absorb many of these expenses as part of their investment management services.

Costs incurred by the investment adviser span activities related to investment management, investment support and operations and technology as summarized in the figure below:

Investment Management	Investment Support	Operations & Technology
Portfolio management Related travel Research & analytics D&O, E&O insurance	Marketing Investor relations Risk & compliance outsourcing	Middle office support Technology support Compliance consultants

Industry practice

An investment manager can generally expect to cover expenses incurred in connection with its overhead and operational expenditures such as personnel, rent, professional services fees, travel, marketing and presentation expenses, fixtures, equipment, among others. While less common, there are instances where investors agree to reimburse the manager for all such costs as an expense to the fund.

Some funds may cover portfolio support fees including middle office accounting and reconciliation services, operational support such as investment research or similar information and data services used by the investment manager to manage the funds.

Due diligence professionals have a certain target expense ratio in mind therefore understanding your prospective investor's maximum threshold may assist in early expense allocation decisions. In order to keep the expenses at a reasonable level, it is not uncommon for managers to provide for a fee cap in relation to such expenses and reimburse amounts above a set threshold.

Given the potential for conflicts of interest, regulators are focusing on these expense allocations more closely during reviews. The primary concern is that investors be treated fairly irrespective of materiality levels, and that the expense policy be applied in a manner that is consistent with representations made to investors in the offering memorandum.

It is advisable that the fund's policy with respect to reimbursement of such costs be disclosed clearly and in sufficient detail within the offering memorandum or partnership agreements to avoid any future conflicts. Additionally, to the extent any such operating expenses are incurred for the benefit of several of funds within a complex, or for both the funds and the investment manager, the funds' allocation policy to allocate such expenses (e.g. pro rata based on assets of the funds) should be described in the offering memorandum.

Redemption charges

Many funds allow early-redemption fees for redemptions prior to a minimum holding period. Generally speaking, such charges are in the 1% range and must be disclosed in the fund's offering memorandum or in subscription documentation. As most funds domiciled in the Cayman Islands have relatively large minimum subscription amounts, such charges are typically insignificant relative to the capital contribution and often waived by management of the fund.

US GAAP and IFRS require that all organizational and set up costs be expensed as incurred. It is however industry practice to disclose to investors within the offering memorandum that the fund's policy is to amortize such costs over 5 years so that initial investors do not carry the burden of the fund's set up costs. Auditors will in turn evaluate the materiality of such non-compliance with accounting standards and the impact to the audit opinion, if any.

Appendix A - Timeline

Time horizon for a Cayman Islands fund launch

On average it will take 6 to 8 weeks to launch a Cayman Islands fund.

The following table summarizes the maximum anticipated processing times and deadlines in order to launch and operate a Cayman Islands fund formed as an exempted company.

Activities	Two days	Less than two weeks	Two to four weeks	Greater than one month
Prepare formation documents ⁷				✓ (6 to 8 wks)
Issuance of Certificate of Incorporation and Memo. & Articles of Association by the Registrar of Companies	✓ (expedited service)	✓ (3-5 days)		
Application for Tax Exemption Certificate			✓ (2-3 wks)	
Request Administrator's and Auditor's Consent letters	✓			
CIMA application submission (Registered fund)	✓ (generally)	✓ (max 1 wk)		
CIMA application submission (Licensed fund)			✓ (4 weeks)	
Directors registration – CIMA (Registered directors)	✓ (48 hours)			
Directors registration – CIMA ⁸ (Professional and Corporate directors)			✓ (4 weeks)	
Audited f/s submission: CIMA (together with FAR) - 180 days post year end SEC - 120 days post year end; 180 days for fund of funds				✓
CSX Listing Initial comments < 5 days Document turnaround < 3 days				✓ (3 to 6 wks)

⁷ Formation of documents include the memorandum & articles of association, offering memorandum, shareholder subscription document, management contract, and board resolutions.

⁸ It is the responsibility of the director to arrange for registration or licensing with CIMA.

Appendix B - Expense Analysis

Exempted Company					
TYPICAL OPERATING COSTS		Cost borne by:	Set up per fund	Annual fees per fund	
Operating costs:			US\$	US\$	
A	Incorporation	Fund	732	854	a
A	Disbursements (stamp duty, seal, filing fees, notarial fees)	Fund	579		
A	Registered office	Fund	2,500	2,500	b
A	Tax exemption certificate application	Fund	1,829		c
A	CIMA registration fee- Registered Mutual Fund	Fund	4,268	4,268	d e
A	CIMA administrative filing fee	Fund	366	366	d e
A	CIMA annual FAR filing	Fund		366	d
C	Fund Administration	Fund			f
B	Financial statement preparation	Fund			g
B	Legal	Fund			h
B	Audit	Fund			i
B	Tax compliance	Fund			i
A	Directors	Fund			j
A	MLRO, DMLRO, AMLCO	Fund			k
Trading costs:					
C	Brokerage commissions	Fund			l
C	Custodian	Fund			l
C	Withholding taxes on dividends	Fund			m
C	Bank charges	Fund			l
B	Research fees	Fund or Manager			l
B	D&O insurance	Fund or Manager			l
C	Management fee	Fund			n
C	Incentive Fee	Fund			n

- A** Fixed, or primarily independent of size
- B** Partially variable based on size/activity
- C** Mainly variable based on size/activity

a Fees for a company with authorized capital not exceeding US\$42,000(\$1,098 pa for \$50,000); fee schedule Jan 2014.

b For exempted companies, this must be provided by a local CIMA licensed company management, law or accountancy practice or trust company.

c While not required, common application for tax exemption certificate which guarantees tax exemption by the Governor in Cabinet for a period of 20 years.

d CIMA fee schedule; updated April 1, 2015. Master Fund annual fees US\$3,049.

e Annual fee due on or before January 15th

f No local fund administrator or transfer agent requirement. Indicative pricing can be requested of various administrators in the Cayman Islands or globally for Fund Accounting and Transfer Agency services. Fees can generally range from 8 - 15 bps of the fund's net asset value and may carry a minimum per fund. May be able to negotiate a lower minimum for multiple funds.

g Financial statement preparation services generally range from US\$5,000 to US\$10,000 per fund.

h Legal fees include incorporating the company, drafting the offering memorandum and subscription documents, memorandum and articles of association, board resolutions, management agreement, etc. May be able to negotiate lower fee with each additional fund set up following drafting of initial constitutional documents. Annual fees contemplate a legal confirmation letter for auditors. Other legal fees will vary depending on the activity of the fund such as new share class offerings, restructuring, regulatory consultations, etc.

i Auditors' fees are fixed fees that are determined primarily based on the complexity of the structure and of the investments held in the investment portfolio. CIMA registered funds must have a local approved auditor audit or issue and file the annual financial statements. Tax compliance fees are incurred to the extent there are U.S. taxable investors in a domestic feeder forming part of a master feeder fund.

j Two directors must be appointed; however, the appointment of independent directors is not required. Corporate directors permitted. Directors' own registration and/or licensing fees are operating costs of the directors and not typically reimbursed by the Fund.

k Cayman Islands entities, both regulated and unregulated, must appoint a natural person to act as their Money Laundering Reporting Officer, Deputy Money Laundering Reporting Officer, and Anti-Money Laundering Compliance Officer. If delegated to a third party, the fund will incur fees that will range depending on the size of the fund complex.

l Broker commissions and other charges based on trading and investment activities; Custodian fees negotiated based on net asset value of the portfolio.

m Generally, withholding taxes on equities range from 0% to 30% of any dividends declared.

n Investment manager's fee is calculated as a percentage of net assets. Commonly between 1%-2% per annum. The performance or incentive fee is commonly between 10%-20% per annum of operating income, including net realized and unrealized gains.

Share capital

Initial and annual registration fees for the exempted company vary depending on the level of authorized capital. The exempted limited partnership set up is higher at US\$1,220 and annual fees of US\$1,464.

The exempted company typically issues US\$50,000 in share capital, comprised of management share capital (voting, non-participating) with a par value of US\$1 to US\$1,000 per share and participating share capital (non-voting, participating) with a par value ranging from US\$0.001 per share to US\$0.01 per share. Management share capital is more commonly owned by the Investment Manager.

Appendix C – Reference Guide

Laws, regulations and guidance

Cayman Islands laws, regulations and guidance available within www.cima.ky

Deloitte resources

Deloitte Tech Brief for Investment Funds vol. 10 - www.deloitte.com.ky

FATCA - Deloitte Thought Leadership - www2.deloitte.com

The Common Reporting Standard (CRS)- Deloitte Thought Leadership - www2.deloitte.com

AIFMD - Deloitte Insights - www2.deloitte.com/lu

Contact Us

Deloitte in the Cayman Islands

Deloitte's Cayman practice started in 1973. Since then, we have grown to be one of the largest professional services firms in the Cayman Islands, offering a full range of investment management industry expertise.

We currently serve some of the world's largest investment funds and have strong relationships with all key industry service providers globally, including fund administrators, law firms and independent directors.

Our team of 16 partners and more than 150 professionals works closely with local regulators, including the Cayman Islands Monetary Authority and the Cayman Islands Institute of Professional Accountants. We are a recognized leader in providing professional services to the investment fund industry.

Internationally, we work with other Deloitte investment fund practitioners and together our depth of resources, be it in the Cayman Islands or across the globe, allows us to assemble a team that is perfectly suited to your needs.

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