

HONG KONG TRUSTEES' ASSOCIATION

TRUST TRAINING COURSE PART B

22 April 2021

UNIT 19

Collective Investment Schemes - Part 1 Private Arrangements

MODULE 28

Collective Investment Schemes – Part 1 Private Arrangements

Part I

Collective Investment Schemes

Collective Investment Schemes (Introduction)

1. What is a collective investment scheme (“CIS”)?

- Describes an arrangement where there is the **pooling of monies** by investors so that their **combined assets can be invested** by a professional **investment manager** in accordance with a **disclosed investment strategy**
- A variety of market terms used to describe CIS (mutual fund, hedge fund, collective investment vehicle, etc.)
- CIS can take a **variety of forms**, using existing legal concepts and structures
- The definition of a “**collective investment scheme**” under Hong Kong law is found in Schedule 1 to the *Securities and Futures Ordinance (Cap 571)* (**SFO**)

Collective Investment Schemes (Introduction)

2. What law applies to CISs?

- SFO definition of collective investment scheme **does not mandate the legal form or structure** that must be used
- **focuses on the people, property and purpose** of a CIS
- In addition to the law applicable to the CIS **entity form** and **jurisdiction**, there is also investor protection **regulation**.

Collective Investment Schemes (Introduction)

3. “Open-ended” and “Closed-ended” CIS

- An **open-ended CIS** provides investors with **voluntary redemption rights**
 - Typically invest in liquid assets
 - In HK, generally in the form of a **unit trust** (although **company form** now also possible)
- A **closed-ended CIS** is a collective investment vehicle that **does not** provide investors with **voluntary redemption rights**
 - Typically invest in illiquid assets
 - Often structured as offshore **limited partnerships**

Part II

Hong Kong Collective Investment Schemes

(i) Unit Trusts

Why are unit trusts popular in Hong Kong?

- Unit trusts are the **most popular** form of fund vehicle in Hong Kong
- Historically, the unit trust has been used as a fund vehicle rather than a company due to **restrictions on the reduction of share capital** for companies with limited liability
- The investing public in Hong Kong is **familiar** with the use of the unit trust as a collective investment scheme

(i) Unit Trusts

A. How is a unit trust different from an ordinary trust?

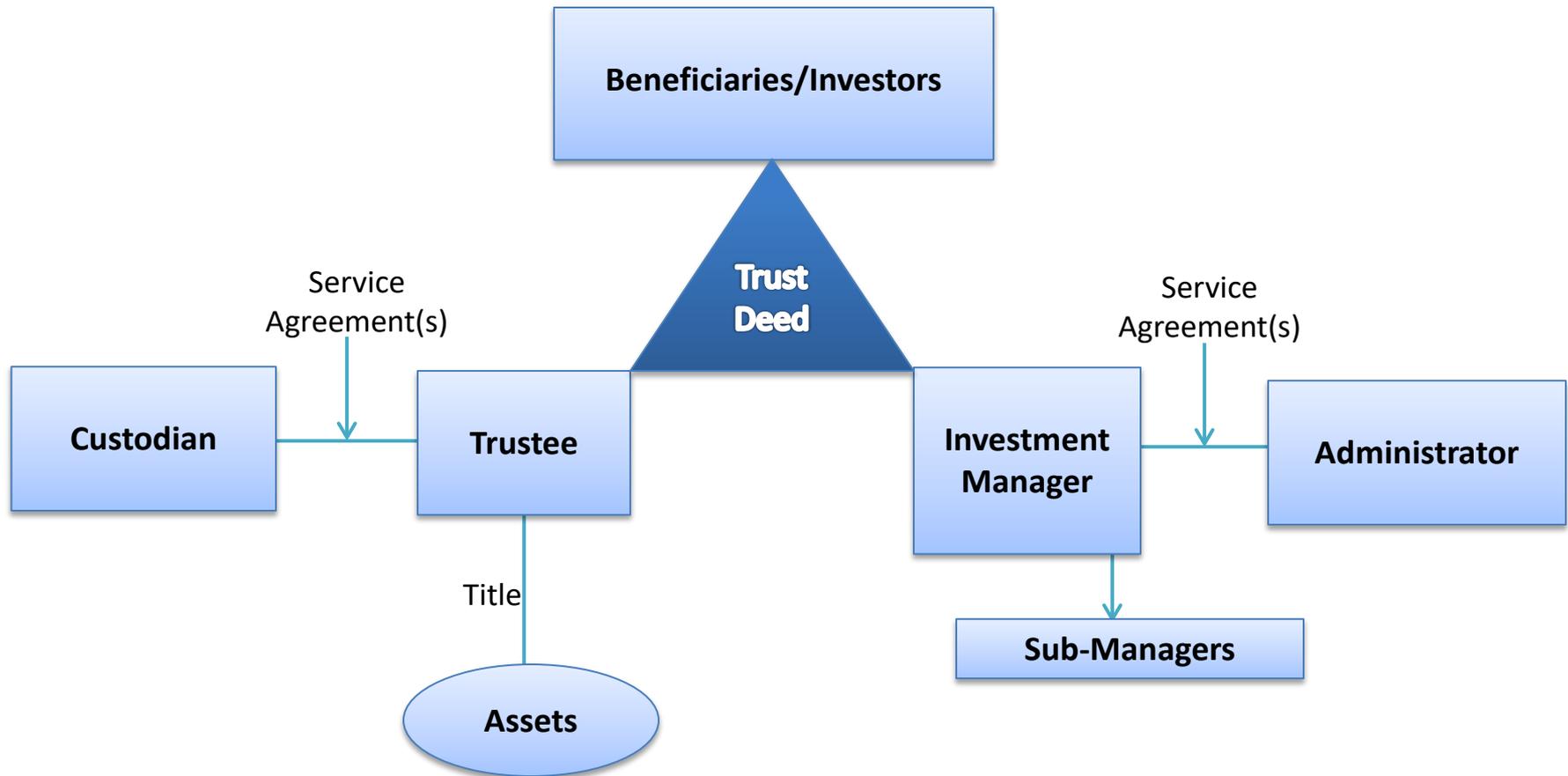
- Remember - **it is still a trust!** All the basic principles of trust law apply (e.g. the “three certainties”, lack of separate legal personality, fiduciary relationship)
- But there are important differences:
 - **Unitization of beneficial interest**
 - Separation of trustee and investment function and two party trust deeds
 - Use of professional trust company

(i) Unit Trusts

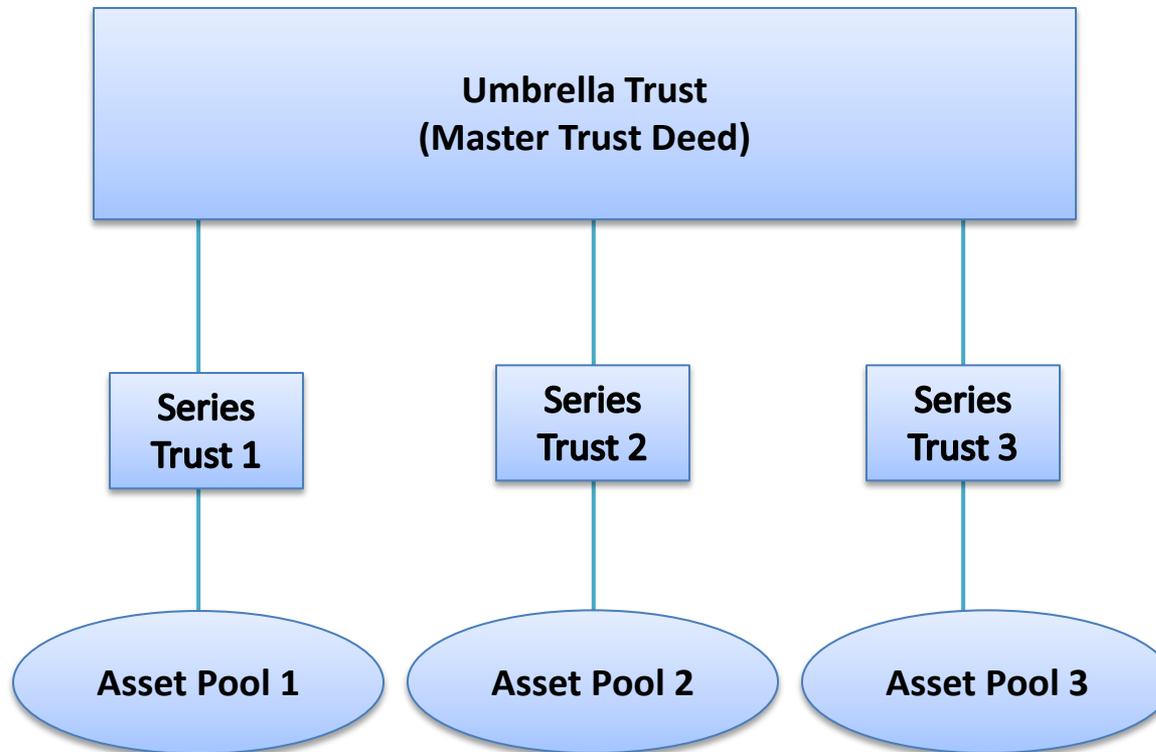
A. How is a unit trust different from an ordinary trust (cont.)?

- But there are important differences (cont.):
 - Appointment of a custodian
 - Appointment of additional professional service providers (e.g. registrar, transfer agent, administrator, NAV calculation agent)
 - Stand-alone and Umbrella trusts

(i) Unit Trusts Standalone Unit Trust Diagram



(i) Unit Trusts Umbrella Unit Trust Diagram



(i) Unit Trusts

B. Unit trusts: Roles, Responsibilities and Relationships

1. The Trustee

- Duty to take into its custody or control all trust property
- Duty to adhere to the trust deed
- Duty to act impartially between unitholders
- Duty to monitor trust property
- Duty to act personally
- Duty to avoid conflicts and secret profits

(i) Unit Trusts

B. Unit trusts: Roles, Responsibilities and Relationships

2. The Investment Manager

- Key responsibility is to invest trust property with the aim of achieving the investment objective in accordance with the investment strategy
- The Investment Manager is a co-fiduciary (not a co-trustee) and will owe fiduciary duties to the investors as a whole

(i) Unit Trusts

B. Unit trusts: Roles, Responsibilities and Relationships (cont.)

3. Relationships in and with a unit trust

- Relationship between the Trustee and Investment Manager
 - The issue of agency
- Relationship of “the Trust” with Third Parties
 - The importance of contractual limited recourse language to protect the trustee

(i) Unit Trusts

C. Unit trusts: What legal documentation is involved?

- **Trust Deed**
 - Remember – it's a contract! The unitholders will be deemed to be party to this contract
- **Private Placement Memorandum**
 - This is a disclosure document
- **Subscription Agreement**
 - This is where the investor offers to subscribe for units

(ii) OFCs

A. OFCs - Introduction

Legislative framework for OFCs

- Background
- The **OFC** was introduced as a limited liability company with **variable share capital**
- The OFC legislative framework is established under the *Securities and Futures (Amendment) Ordinance, 2016* (**SF Amendment Ordinance**)
 - OFC Rules, OFC Code
- SFC as principal regulator for OFCs; Registrar of Companies handles many administrative filings of OFCs
- **SFC Consultation** feedback in September 2020

(ii) OFCs

A. OFCs – Introduction (cont.)

Capital structure flexibility of OFCs

- **Instrument of Incorporation** as governing document
- Paid up share capital = OFC NAV
- Shares in an OFC:
 - limit the liability of shareholders in an OFC
 - can be issued in **more than one class**
 - have **no nominal / par value**
 - title **evidenced by the register of shareholders**
- Property of the OFC **belongs to the OFC** and **no shareholder of the OFC has an interest** in that scheme property

(ii) OFCs

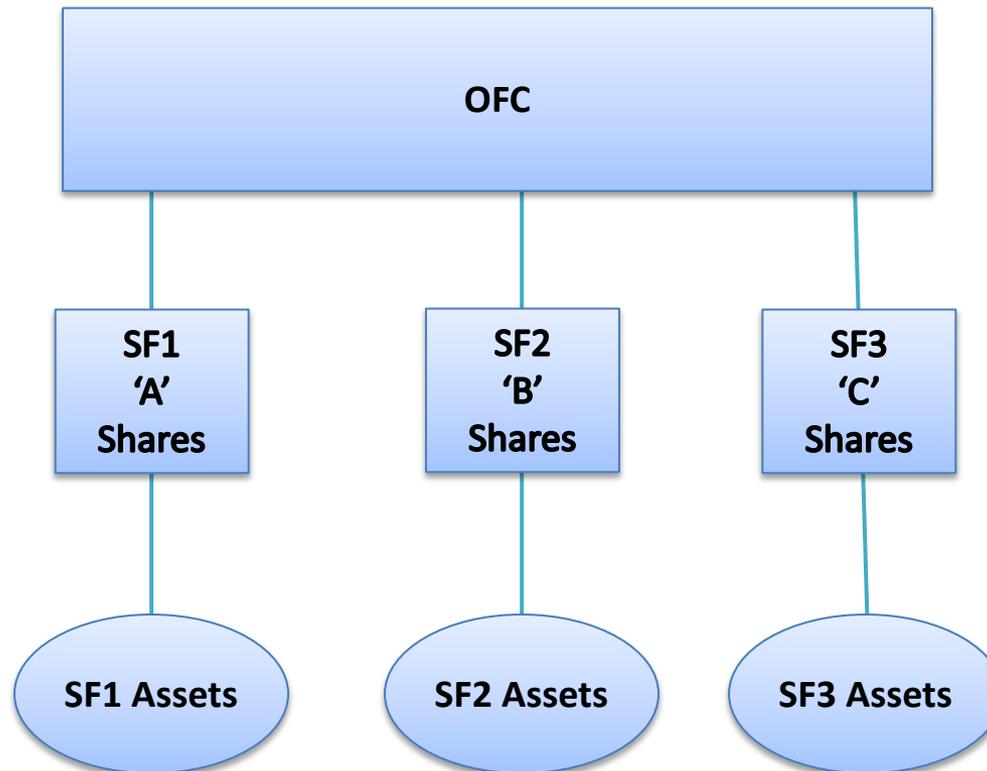
A. OFCs – Introduction (cont.)

Umbrella structure and segregation of sub-funds

- Governed by **instrument of incorporation** and **SF Amendment Ordinance**
- Although **a sub-fund is not a separate legal person:**
 - Assets may be subject to orders of a court as if it were
 - may **sue or be sued** in respect of any of its sub-funds
- **OFC Rule 158** also seeks to limit recourse.
- Overseas enforceability?

(ii) OFCs

Umbrella structure and segregation of sub-funds



(ii) OFCs

B. OFCs: Roles, Responsibilities & Relationships

1. OFC itself: Board of Directors

- Minimum of **two directors**, one of whom is required to be an **independent director**
- Directors must be **approved by the SFC**, and **appointment/resignation/removals notified to the Registrar of Companies**
- A company cannot be appointed as a director of an OFC
- **Qualification requirements** and **fiduciary duties** to the OFC

(ii) OFCs

B. OFCs: Roles, Responsibilities & Relationships (cont.)

2. OFC itself: Meetings of shareholders

- General meetings (except adjourned meetings) require 14 days' notice (or longer if specified in instrument of incorporation)
- Directors have the power to call a general meeting, and must do so if requested by shareholders holding at least 10% of the total voting rights of all shareholders entitled to vote
- Certain resolutions are required to be **registered** with the Registrar:
 - Winding up resolution
 - Resolution varying any matter in or provision of the instrument of incorporation

(ii) OFCs

B. OFCs: Roles, Responsibilities & Relationships (cont.)

3. Investment Manager

- IM is expressly responsible **for the management of the scheme property** of the OFC
- **Appointed by the directors**, and must be registered and licensed by the SFC for Type 9 (asset management) regulated activity
- **SFC must approve** the IM's appointment
- IM is required to carry out its investment activities for the OFC in accordance with the terms of the **instrument of incorporation and the IMA**
- The SFC template instrument of incorporation includes certain **recommended terms** in an IMA.

B. OFCs: Roles, Responsibilities & Relationships (cont.)

4. Custodian

- **All scheme property** of the OFC must be held by a **custodian**
- **Eligibility requirements** for a private OFC custodian are set out in Chapter 7 of the OFC Code (relaxed in Sept 2020).
- The SFC standard private OFC Instrument of incorporation includes **minimum terms for the appointment of the custodian**
- **Custodian is required to segregate assets** of the OFC from the assets of:
 - The custodian, sub-custodians, investment manager, and other clients of the custodian
 - **Omnibus account** arrangements are permitted.
- Resignation and **Rule 119 statement**.

(ii) OFCs

B. OFCs: Roles, Responsibilities & Relationships (cont.)

5. Auditor

- The directors of an OFC must appoint an auditor for each financial year
- Independent of the investment manager, directors and custodian of the OFC
- Auditor may resign by notice to the OFC or may be removed by ordinary resolution of the OFC
- Resignation and **Rule 144 statement**

Investment Restrictions

- Private OFC's have **no investment restrictions**, but require clear **risk disclosures** in the offering document (Sept 2020 OFC revision).

(iii) Limited Partnership Funds

A. Background: Partnerships and Limited Partnerships

1. Introduction

- **General Partnerships**, regulated under the Partnership Ordinance (Cap. 38), enacted in **1897**
- **Limited Partnerships**, regulated under the Limited Partnerships Ordinance (Cap. 37), enacted in **1912**
- **Limited Partnership Funds**, regulated under the Limited Partnership Fund Ordinance (Cap. 637), which came into effect on 31 August **2020**

(iii) Limited Partnership Funds

2. General Partnerships under the Partnership Ordinance (Cap.38)

Definition:

“Partnership is the relation which subsists between persons carrying on a business in common with a view of profit” s3(1)

Remember:

You don't need to intend to create a partnership for one to exist as a matter of law!

(iii) Limited Partnership Funds

3. What are the legal consequences of being in a General Partnership?

- Relationship of **mutual agency**
- **Mutual fiduciary** duties
- No conflict/secret profits and obligation to account for profits
- Equal share of profits and losses, regardless of contributions
- **Joint and several liability for wrongs**
- Notice to one partner is deemed notice to all
- Automatic termination if any one partner terminates

(iii) Limited Partnership Funds

4. Limited Partnerships under the Limited Partnerships Ordinance (Cap.37)

*“A limited partnership must consist of one or more persons called **“general partners”**, who shall be **liable for all debts and obligations of the firm**, and one or more persons to be called **“limited partners”**, who shall at the time of entering into such partnership contribute thereto a sum or sums as capital or property valued at a stated amount, and who **shall not be liable for the debts or obligations of the firm beyond the amount so contributed.**” section 3(2)*

(iii) Limited Partnership Funds

4. Limited Partnerships under the Limited Partnerships Ordinance (Cap.37) (cont.)

The trade-off:

“A limited partner shall not take part in the management of the partnership business, and shall not have power to bind the firm . . . If a limited partner takes part in the management of the partnership business, he shall be liable for all debts and obligations of the firm incurred while he so takes part in the management as though he were a general partner.” ss5(1) and 5(2)

(iii) Limited Partnership Funds

4. Limited Partnerships under the Limited Partnerships Ordinance (Cap.37) (cont.)

- You must **register a limited partnership with the HK Registrar of Companies**, otherwise it is a general partnership
- You must file **a registration statement** containing:
 - Name of partnership and general nature of business
 - Principal place of business and full name of each partner
 - Term of the partnership
 - Statement that liability of limited partners is limited
 - Sum contributed by each limited partner and whether paid in cash or otherwise (if otherwise, must specify)

(iii) Limited Partnership Funds

4. Limited Partnerships under the Limited Partnerships Ordinance (Cap.37) (cont.)

- All of the information in the registration statement of a limited partnership is a **matter of public record**
- Any **change** to the details in the registration statement must be filed within **7 days**
- **Certain changes** (e.g. if a GP becomes an LP or if an LP assigns his/her interest to someone else) must be advertised in the government **Gazette**

(iii) Limited Partnership Funds

B. Limited Partnership Fund (“LPF”) Regime

1. Why was the LPF regime needed?

Particularly suited to private equity and venture capital funds, which are closed-ended.

2. What is a LPF?

A LPF is a “fund” constituted as a limited partnership by a Limited Partnership Agreement (“**LPA**”) and registered as an LPF with the HK Registrar of Companies

(iii) Limited Partnership Funds

2. What is a LPF? (cont.)

An arrangement in respect of any property is a **fund** if:

- the property is managed as a whole by, or on behalf of, the persons operating the arrangement and the contributions of the persons participating in the arrangement are pooled;
- the participating persons do not have day-to-day control over the management of the property; and
- the purpose or effect of the arrangement is to enable the operating and participating persons to share in profits, income, gains or other returns which arise, or are expected to arise, from the acquisition, holding, management or disposal of all or any part of the property

(iii) Limited Partnership Funds

2. What is a LPF? (cont.)

The LPF must:

- have one general partner and at least one limited partner
- contain in its name the words “Limited Partnership Fund” or “LPF” or, if in Chinese, the characters “有限合夥基金”
- have a registered office in Hong Kong
- not be set up for an unlawful purpose
- not have all of the partners comprised only of corporations in the same group of companies

(iii) Limited Partnership Funds

3. Role of the GP and the LPs in an LPF

The **GP** has unlimited liability for all debts / obligations of the LPF and is responsible for the management and control of the LPF

The **LPs**:

- participate economically (i.e. share in profits) in the fund but have no right to participate in the day-to-day management (or have control over the assets) of the LPF
- have no liability for the debts and obligations of the LPF beyond the amount of their agreed **capital contributions** **unless** they participate in management of the LPF, in which case the LP becomes **jointly and severally** liable for the debts and obligations of the LPF
- **Schedule 2** to the LPF Ordinance lists “safe” activities for LPs

(iii) Limited Partnership Funds

3. Role of the GP and the LPs in an LPF (cont.)

Wide **freedom of contract** applies to the LPA, including as to the following topics:

- The admission, withdrawal and transfer rights of partners;
- The organization, management structure, governance and decision making procedures
- scope of the fiduciary duties of the general partner and remedies for breach or default
- The investment scope and strategy of the fund
- The financial arrangements among the partners in the fund, such as capital contributions to the fund (including timing of contributions), withdrawal of capital, right to participate in follow-on investments etc.

(iii) Limited Partnership Funds

4. Service Providers to a LPF

The GP must ensure the fund has persons appointed to the following roles

- **Investment Manager** – must be operating in HK, which means the Investment Manager will need to be licensed to engage in relevant regulated activities under the SFO (can be the GP)
- **Responsible Person for AML** (can be the GP) to carry out measures in Schedule 2 AML/CTF Ordinance (Cap. 615)
- Proper **Custody** Arrangements
- Independent **auditor**

(iii) Limited Partnership Funds

5. Incentives to Grow the Private Equity Fund Industry in Hong Kong

- Favourable tax treatment of “**carried interest**”
- Simplified and expedited regime by which offshore funds can be **re-domiciled** to Hong Kong

(iii) Limited Partnership Funds

Tax treatment of “carried interest”

The right of the investment manager to share in the gains realized from the sale of assets of the LPF is called “**carried interest**” because the investment manager is treated as having a notional interest in the underlying property, even though they haven’t contributed any capital to the partnership – thus the rest of the investors “carry” the notional interest of the investment manager

Partners in the LPF	Capital Contribution	Share of Investment
		Gains
LP #1	\$250,000	20%
LP #2	\$250,000	20%
LP #3	\$250,000	20%
LP #4	\$250,000	20%
GP	\$0	20%
Total	\$1 million	100%

(iii) Limited Partnership Funds

Tax treatment of “carried interest” (cont.)

Assume LPF realizes \$2 million, which will be distributed as follows:

- **First**, each of the 4 limited partners gets back their capital contributions (i.e. \$1 million is repaid to the limited partners who each receive back \$250,000);
- **Second**, each of the limited partners and the general partner get to share equally in the remaining \$1 million that represents the gain made on the real estate development (i.e. the 4 limited partners and the general partner each receive \$200,000).

(iii) Limited Partnership Funds

Tax treatment of “carried interest” (cont.)

Under the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Bill 2021 “eligible carried interest” distributions to “qualified persons” will be taxed at a 0% rate

Note:

- the LPF must be certified by the Hong Kong Monetary Authority as being in scope for this concession
- carried interest recipients must demonstrate they are undertaking “core income generating activities” in Hong Kong

(iii) Limited Partnership Funds

Re-domiciliation of Offshore Funds to Hong Kong

- **“domicile”** = a legal person’s permanent home
- **“re-domiciliation”** = the legal process by which a “person” that was established in one jurisdiction (say, the Cayman Islands) migrates into a different jurisdiction (say, Hong Kong). It is also referred to as a “transfer by way of continuation”

(iii) Limited Partnership Funds

Re-domiciliation of Offshore Funds to Hong Kong (cont.)

The Financial Services and the Treasury Bureau will introduce a bill to LegCo in Q2 2021 to encourage re-domiciliation of offshore funds to HK by clarifying that this process **will not**:

- create a new legal entity;
- prejudice or affect the identity or continuity of the fund as previously incorporated or registered before its re-registration in Hong Kong;
- affect any contract made, resolution passed or any other act or thing done in relation to the fund before its re-registration in Hong Kong;
- affect the rights, functions, liabilities or obligations, and property of the fund before its re-registration in Hong Kong; or
- render defective any previous legal proceedings by or against the fund.

(iv) Private Placement of Collective Investment Schemes in Hong Kong

A. When is an offer of securities a private placement?

- Section 103 of the SFO makes it an **offence to issue an invitation to the public to enter into (or offer to enter into) an agreement to acquire or subscribe for securities unless the issue is authorised** by the SFC.
- **“Securities”** is defined broadly in Schedule 1 of the SFO, and **includes interests in any CIS**;
- **“public”** means the public of Hong Kong (or any class of the public of Hong Kong)
- However, there is a safe harbour under the SFO for invitations made only to **“professional investors”**
- Accordingly, **private placements in Hong Kong are typically targeted to professional investors**

(iv) Private Placement of Collective Investment Schemes in Hong Kong

A. When is an offer of securities a private placement? (cont.)

- The SFO also provides that an offering will **not be a public offer** where, if it is a corporate fund, it is only offered:
 - To **professional investors** (unlimited number)
 - To **no more than 50 people**
 - Subject to a **minimum investment** of not less than HKD\$500,000 per investor
- For collective investment schemes which are not structured as a corporate fund (such as **unit trusts**), the SFO also provides that an offer will **not be a public offer** where it is only offered:
 - To **professional investors** (unlimited number)
 - To **no more than 50 people**

(iv) Private Placement of Collective Investment Schemes in Hong Kong

B. Regulation of Persons in HK associated with the private placement of CISs

- Collective investment schemes that are not offered to the public are **not subject to any local domicile or local qualification** requirements – i.e. private Hong Kong and non-Hong Kong funds are treated the same way
- The SFO **does not distinguish between Hong Kong or offshore funds** in its regulation of offers of securities or conduct of regulated activities
- But:
 - is the CIS offered to the Hong Kong public (in which case, the fund must be authorised under the SFO)?
 - Does a party engage in SFC regulated activity?

Part III

Cayman Islands Collective Investment Schemes

(i) Introduction to the Cayman Islands

Legal framework

- The **British Overseas Territory** of the Cayman Islands is the leading jurisdiction for offshore funds (followed by the British Virgin Islands, then Jersey)
- As a British colony, it is a **common law** jurisdiction (similar to Australia, Hong Kong and Singapore)
- It is known as a **tax haven jurisdiction**, because the Cayman Islands does not levy any taxes on income, capital, capital gains or sales
- The term “collective investment scheme” does not exist as a defined legal term in Cayman law and there is no single equivalent term. Under Cayman law there are “**mutual funds**” and “**private funds**”

(i) Introduction to the Cayman Islands

Mutual Funds

- A **mutual fund** is defined under Section 2 of the *Mutual Funds Act (2021 Revision)* as:

*“a company, unit trust or partnership that issues **equity interests**, the purpose or effect of which is the **pooling** of investor funds with the aim of spreading investment risks and enabling investors in the mutual fund to receive profits or gains from the acquisition, holding, management or disposal of investments”*
- An **equity interest** means a share, trust unit or partnership interest that:
 - Carries an entitlement to participate in the profits or gains of the company, unit trust or partnership; and
 - Is redeemable or repurchasable at the option of the investor....before the commencement of winding up or the dissolution of the company, unit trust or partnership
- All mutual funds are **open-ended funds**

(i) Introduction to the Cayman Islands

Private Funds

A **private fund** is defined under Section 2 of the *Private Funds Act (2021 Revision)* as:

a company, unit trust or partnership that offers or issues or has issued **investment interests**, the purpose or effect of which is the pooling of investor funds with the aim of enabling investors to receive profits or gains from such entity's acquisition, holding, management or disposal of investments, where:

- (a) the holders of investment interests do not have day-to-day control over the acquisition, holding, management or disposal of the investments; and
- (b) the investments are managed as a whole by or on behalf of the operator of the private fund, directly or indirectly, [subject to certain exclusions];

(i) Introduction to the Cayman Islands

Private Funds (cont.)

The equivalent term to an “equity interest” for a private fund is an “investment interest”, which is defined as follows:

“**investment interest**” means a share, LLC interest, trust unit or partnership interest that:

- (a) carries an entitlement to participate in the profits or gains of the company, unit trust or partnership; and
- (b) is not redeemable or repurchasable at the option of the investor

(ii) Cayman Islands Exempted Companies

A. Introduction

1. Key Features

- Most common type of open-ended fund
- Section 37 of the Companies Act (2021 Revision)

2. Registration as an Exempted Company

- A company may apply to be registered as an **exempted company** if the purposes for which the company was established are to be conducted **mainly outside the Cayman Islands**
- Satisfaction of this criterion is by a filing a declaration from a subscriber which states that the operations of the proposed exempted company will be conducted mainly outside the Cayman Islands with the application for registration

(ii) Cayman Islands Exempted Companies

2. Registration as an Exempted Company (cont.)

- **Key characteristics** of an exempted company:
 - The shares must be non-negotiable and transferred only on the books of the company (i.e. no bearer shares)
 - No trading in the Cayman Islands except in furthering the business of the company **outside the Cayman Islands**
 - An exempted company that is **not listed** on the Cayman Islands Stock Exchange is **prohibited from making any invitation to the public** of the Cayman Islands to subscribe for any of its securities

(ii) Cayman Islands Exempted Companies

2. Registration as an Exempted Company (cont.)

- **Advantages** of an exempted company:
 - Tax concessions undertaking that no tax will be imposed for 20 years (i.e. comfort re tax exempt status)
 - **Only one shareholder required** (although more permitted)
 - **Names of shareholders are not required to be filed** with the Registrar of Companies. The only public information available is company type (exempted), date of incorporation, company number, status (active or dissolved) and location of registered office
 - **Minimal annual reporting** requirements
 - Exemption from requirement to hold annual general meetings
 - Can apply to be registered as a **segregated portfolio company**

(ii) Cayman Islands Exempted Companies

3. Constituent documents: Memorandum & Articles

- **Memorandum of Association** must cover the following:
 - **Company name** – cannot be identical / deceptively similar to an existing name; must not contain sensitive words (e.g. “bank”, “trust”, “insurance”, “royal”), which may require additional consent or not be permitted at all
 - **Registered office** – must have a registered office located in the Cayman Islands
 - Objects / **Purpose and powers** of the company – can be limited to a specific list, but more commonly drafted in general, unrestricted terms
 - **Limited liability** of shareholders
 - **Authorised share** capital (and whether divided into management versus participating shares)

(ii) Cayman Islands Exempted Companies

3. Constituent documents: Memorandum & Articles (cont.)

- **Articles of Association** cover the following kinds of topics:
 - **Shares** – issue, transfer and redemption of shares, including ability to issue shares in different classes and series
 - **Voting rights** and members' meetings
 - Calculation of **net asset value**
 - How **directors and officers** are appointed, and their meetings, powers and rights of indemnification
 - Payment of **dividends**
 - **Winding up** provisions

(ii) Cayman Islands Exempted Companies

3. Constituent documents: Memorandum & Articles (cont.)

- The Companies Act (2021 Revision) contains a form of template Articles of Association known as “Table A”, in Schedule 1; companies may adopt any, all or none of the template Articles of Association
- The Memorandum and the Articles of Association must be made available to every shareholder upon request. The Companies Act provides they have the effect of a **binding contract between the shareholders and the company**

(ii) Cayman Islands Exempted Companies

4. Procedure for incorporating a company in the Cayman Islands

It is quick and easy! You must submit the following to the Registrar of Companies:

- **Original Memorandum & Articles of Association**, signed by an initial subscriber for shares
- **Incorporation fee** (tiered rate based on value of the company's authorised share capital)
- Declaration that operations / business of the company will be principally conducted **outside the Cayman Islands**
- Typically takes **3-5 days for registration; 1-2 days for express** registration
- Can register with 'generic' Memorandum & Articles, and then file '**amended and restated**' version once investment needs of fund defined

(ii) Cayman Islands Exempted Companies

5. Offering document of an open-ended exempted company

- An “**offering document**” (variously described as a Private Placement Memorandum, Offering Memorandum etc.) is the document(s) by which investors are invited to subscribe for shares in the company
- Under section 4(6) of the Mutual Funds Act (2021 Revision), the offering document must **describe the equity interests** in all respects; and contain **such other information as is necessary** to enable a prospective investor in the mutual fund **to make an informed decision** as to whether or not to subscribe for or purchase the equity interests
- Note that in 2020 for the first time the Cayman Islands Monetary Authority exercised its rule making power under the Monetary Authority Act (2020 Revision) to prescribe **detailed contents requirements** for offering documents

(ii) Cayman Islands Exempted Companies

6. Directors and Officers of an Exempted Company

- If the company is regulated under the Mutual Funds Act (2021 Revision) it must have **at least two** directors
- No independent director(s) are required
- Responsible for the management of the company
- Directors owe **fiduciary duties** to the company, including duty:
 - Of loyalty and to **act in the best interests** of the company
 - To act for a **proper purpose**
 - Not to fetter the future exercise of the director's discretion
 - To avoid **conflicts of interest** with the company

(ii) Cayman Islands Exempted Companies

6. Directors and Officers of an Exempted Company (cont.)

- **Fiduciary duties** owed by directors to the company (cont.):
 - **Not to make secret profits** from the director's position as a director
 - To **act fairly** as between different shareholders
 - To act with **due skill and care**
- Directors must be either **registered or licensed by CIMA**

(ii) Cayman Islands Exempted Companies

6. Directors and Officers of an Exempted Company (cont.)

- **Fiduciary duties** owed by directors to the company (cont.):
 - **Not to make secret profits** from the director's position as a director
 - To **act fairly** as between different shareholders
 - To act with **due skill and care**
- Directors must be either **registered or licensed by CIMA**
- These duties are **owed to the company** itself, and **not** generally to shareholders per se

(ii) Cayman Islands Exempted Companies

7. Service providers to an Exempted Company

- In general, no particular service providers are required (including **no requirement to appoint a custodian**), but every exempted company that is regulated as mutual fund must appoint an Anti-Money Laundering Reporting Officer (plus a deputy) and an Anti-Money Laundering Compliance Officer
- Must have a **local registered office**
- CIMA-approved auditor for exempted companies that are regulated as mutual funds

(ii) Cayman Islands Exempted Companies

B. Comparison with Hong Kong OFCs

	Hong Kong OFC	Cayman Exempted Company
Constituent Documents	Instrument of Incorporation <ul style="list-style-type: none"> SFC prescribes certain provisions (e.g. kinds of investment assets) Material changes require SFC approval 	Memorandum & Articles of Association <ul style="list-style-type: none"> No prescribed terms No requirement for CIMA approval for changes
Company name	<ul style="list-style-type: none"> Must end with “OFC” or “Open-ended Fund Company” Must not be misleading or undesirable in SFC view Changes subject to SFC approval 	<ul style="list-style-type: none"> May choose not to include “Limited” or “Ltd” Must not be same name as existing company Must not contain sensitive words No approval for changes

(ii) Cayman Islands Exempted Companies

B. Comparison with Hong Kong OFCs

	Hong Kong OFC	Cayman Exempted Company
Directors	<ul style="list-style-type: none"> • Minimum of two • One director independent of custodian • Qualification requirements • SFC approval for appointment 	<ul style="list-style-type: none"> • Minimum of two • No independent directors • Registration for directors of fewer than 20 companies, but no approval process • No qualification requirements
Custodian	<ul style="list-style-type: none"> • Required to be appointed, although eligibility requirements have been relaxed, so prime brokers can now be used • Required to be approved by SFC 	<ul style="list-style-type: none"> • Not required for Cayman fund sold in Hong Kong unless seeks SFC authorisation for public sale • Prime brokers often appointed

(ii) Cayman Islands Exempted Companies B. Comparison with Hong Kong OFCs

	Hong Kong OFC	Cayman Exempted Company
Investment manager	<ul style="list-style-type: none"> • Must be appointed • Must be hold Type 9 licence • SFC approval required • Fit and proper criteria 	<ul style="list-style-type: none"> • No prescriptive requirements, although in practice, the investment manager will be regulated in its jurisdiction of domicile
Ongoing compliance	<ul style="list-style-type: none"> • OFC Rules and Code contemplate various post-registration compliance requirements • For private OFCs, material changes require shareholder approval and, if to Memorandum & Articles, SFC approval 	<ul style="list-style-type: none"> • Limited annual reporting requirements

(ii) Cayman Islands Exempted Companies B. Comparison with Hong Kong OFCs

	Hong Kong OFC	Cayman Exempted Company
Termination	<ul style="list-style-type: none"> Submission of proposal to SFC 	<ul style="list-style-type: none"> No vetting process by CIMA Simple to return capital to shareholders and apply to Registrar for company to be struck off register
Tax	<ul style="list-style-type: none"> Transfers of OFC shares subject to stamp duty Exempt from profits tax 	<ul style="list-style-type: none"> Not subject to tax Not subject to Hong Kong stamp duty

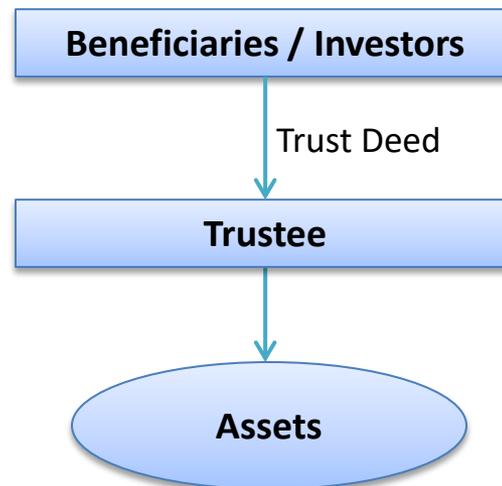
(iii) Cayman Islands Exempted Unit Trusts

- English **common law** applies, so **similar body of trust law to Australia, Hong Kong and Singapore**
- A **unit trust** is defined in the Mutual Funds Act as:
“a trust established by a trustee which, for valuable consideration, issues trust units in profits or gains arising from the acquisition, holding, management or disposal of investments by the trustee of the trust, the proper law of which is the law of the Cayman Islands or the law of any other jurisdiction.”
- Trustee of a Cayman Islands unit trust typically **licensed as a trust company or a mutual fund administrator** in the Cayman Islands, and will therefore be regulated by CIMA

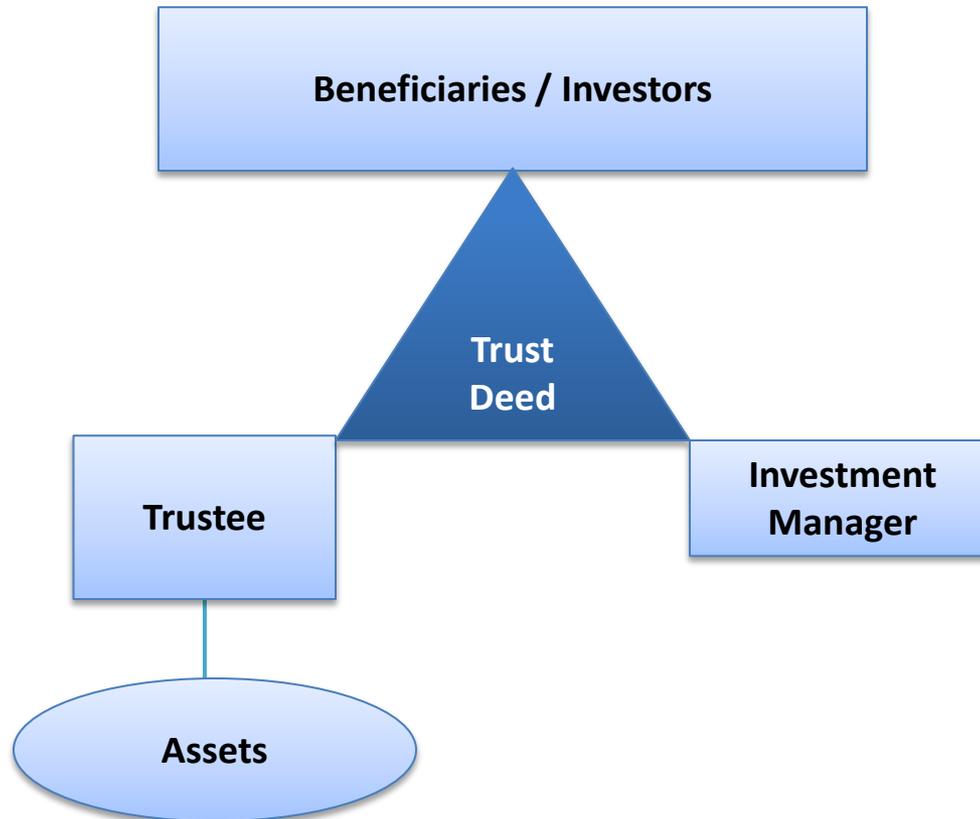
(iii) Cayman Islands Exempted Unit Trusts

Single versus dual party trust deeds

- Trust deed can be a **single party** trust deed or a **dual party** trust deed
- Regardless of whether they are a party to the trust deed, or separately appointed by the trustee, the **manager** is likely to owe a **fiduciary duty** to the unitholders (as well as the trustee owing such duty)



(iii) Cayman Islands Exempted Unit Trusts



(iii) Cayman Islands Exempted Unit Trusts

3. Registration of a unit trust as an Exempted Trust

- Registration with the Registrar of Trusts as an **exempted trust** on the basis that its beneficiaries are not, and will not include at any time, a person resident or domiciled in the Cayman Islands
- The trust **does not lose its exemption** if a unitholder becomes resident or domiciled in the Cayman Islands
- Once registered as an exempted unit trust, the trustee must file all documents recording the trusts and all **subsequent amendments** (i.e. trust deed and amendments etc.)

(iii) Cayman Islands Exempted Unit Trusts

B. Comparison between Cayman Islands Exempted Companies and Exempted Trusts

	Exempted Company	Exempted Trust
Tax and perception issues	<ul style="list-style-type: none"> Board of directors often under control of investment manager or affiliate 	<ul style="list-style-type: none"> In some jurisdictions, the trust structure is more familiar and independent trustee preferred

(iii) Cayman Islands Exempted Unit Trusts

B. Comparison between Cayman Islands Exempted Companies and Exempted Trusts (cont.)

	Exempted Company	Exempted Trust
Fiduciary obligations	<ul style="list-style-type: none"> • Similar obligations to trustees, although perception that standard not quite as high • Duties owed to company 	<ul style="list-style-type: none"> • Trustees seen as owing a higher standard of prudence • Duties owed to beneficiaries directly
Regulated status	<ul style="list-style-type: none"> • Directors of exempted companies regulated under the Mutual Funds Act generally required to be registered, regulated or licensed by CIMA 	<ul style="list-style-type: none"> • Trustee will commonly be a corporate trustee • Accordingly, will be licensed as a trust company or as a mutual fund administrator,

(iii) Cayman Islands Exempted Unit Trusts

B. Comparison between Cayman Islands Exempted Companies and Exempted Trusts (cont.)

	Exempted Company	Exempted Trust
Regulated status	<ul style="list-style-type: none"> This requirement does not apply to single investor exempted companies 	<p>whether or not the unit trust is regulated under the Mutual Funds Act</p> <ul style="list-style-type: none"> Therefore the trustee will be regulated and supervised by CIMA

(iii) Cayman Islands Exempted Unit Trusts

B. Comparison between Cayman Islands Exempted Companies and Exempted Trusts

	Exempted Company	Exempted Trust
Indemnification risk	<ul style="list-style-type: none"> Liability of shareholders is limited as a matter of law 	<ul style="list-style-type: none"> At common law, unitholders may become personally liable to the trustee, but note that this is usually excluded in the trust deed
Flexibility and privacy	<ul style="list-style-type: none"> Distributions to shareholders subject to certain restrictions at law Unlimited duration 	<ul style="list-style-type: none"> Trust deed can be tailored Distributions to unitholders unrestricted 150 year perpetuity

(iv) Cayman Islands Exempted Limited Partnerships

A. Key Features

1. Background

- Cayman has the **same English law background** as in Hong Kong. Section 3(1) of the Partnership Act (2013 Revision) defines “partnership” in almost identical terms as the Partnership Ordinance (Cap. 38):

“Partnership is the relation which subsists between persons carrying on a business in common with a view to profit.”

- The formation and regulation of both **general partnerships** and **limited partnerships** is addressed in the Partnership Act (2013 Revision) and is substantively similar to the law in Hong Kong.
- Just as in HK, a Cayman partnership **does not have separate legal personality**

(iv) Cayman Islands Exempted Limited Partnerships

2. Exempted Limited Partnerships (“ELPs”)

An ELP is a Cayman partnership that has been registered with the Registrar of Exempted Limited Partnerships under the **Exempted Limited Partnership Act (2021 Revision)** (“**ELP Act**”) and is defined as follows:

*“An exempted limited partnership shall consist of one or more persons called **general partners** who shall, in the event that the assets of the exempted limited partnership are inadequate, **be liable for all debts and obligations of the exempted limited partnership**, and one or more persons called **limited partners** who shall **not be liable for the debts or obligations of the exempted limited partnership** save as provided in the partnership agreement and to the extent specified in [this Act].”*

(iv) Cayman Islands Exempted Limited Partnerships

2. Exempted Limited Partnerships (cont.)

- Just as is the case in Hong Kong, **all management responsibility is vested in the general partner** and the limited partners are generally excluded from the management of the ELP and will lose the benefit of limited liability to the extent they take part in the conduct of the business of the ELP.
- Section 20(2) of the ELP Act provides certain **“safe harbors”** for a limited partner that do not amount to taking part in the conduct of the business of the ELP (e.g. serving on an advisory board)

(iv) Cayman Islands Exempted Limited Partnerships

3. Formation and Registration of an ELP

- **Entry into LPA** by one or more GPs plus one or more LPs (can be a “short form” LPA”)
- Pay **registration fee** and file **Section 9(1) particulars** with the Registrar of ELPs, which are as follows:
 - the name of the ELP, which must include the words '**Limited Partnership**' or the letters '**L.P.**' or '**LP**'
 - the **general nature of the business** of the ELP and its **term/duration**
 - the **address** in the Cayman Islands of the registered office of the ELP
 - the full **name and address of the GP** and a declaration that the ELP shall not undertake business with the public in the Cayman Islands other than so far as may be necessary for the carrying on of the business of that ELP exterior to the Islands (note: **unlike in HK, the names of LPs are not included**)

(iv) Cayman Islands Exempted Limited Partnerships

3. Formation and Registration of an ELP (cont.)

- Section 9(1) statement is a matter of public record, but the details are very sparse
- An ELP is eligible to obtain a tax undertaking from the Financial Secretary of the Cayman Islands that for a period not exceeding fifty years any law which is enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains or appreciations shall not apply to the ELP or to any partner thereof

(iv) Cayman Islands Exempted Limited Partnerships

4. The Exempted Limited Partnership Agreement

- LPAs tend to be **long and complex**, due to **high degree of flexibility** to tailor the rights and obligations of the partners
- Note that the LPA does not get filed anywhere and is **not a matter of public record**
- **Usual topics** in the LPA include the following:
 - Powers and obligations of the GP
 - Admission, withdrawal of partners and when transfers are permitted
 - Capital contributions, capital calls, what happens if you default
 - Allocation of share in profits, which can be very complex, esp. for the GP (e.g. hurdles, high watermarks etc.)

(iv) Cayman Islands Exempted Limited Partnerships

4. The Exempted Limited Partnership Agreement (cont.)

- Usual topics (cont.)
 - Indemnification of GP (similar to a trust)
 - Role and membership of advisory boards and other committees
 - Broad Power of Attorney in favour of the GP
- But, note that there isn't complete freedom of contract, so the LPA must always be checked against the ELP Act

(iv) Cayman Islands Exempted Limited Partnerships

B. Private Funds Law (2021 Revision)

- Introduced in **February 2020** and made **closed-ended funds** regulated by CIMA for the first time
- Requires private funds to:
 - undertake a fairly simple registration process
 - appoint a local auditor to prepare and file annual financial statements with CIMA
 - comply with certain requirements around valuation of assets, safe-keeping of assets, cash monitoring and securities identification