



Guide to
Investment Funds in the
Cayman Islands

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PREFACE

With several thousand investment funds of various types, representing billions of dollars invested, the Cayman Islands are a leading jurisdiction for funds. The availability of expert professional advice, together with the relative speed and comparatively modest cost of establishing a mutual fund in the Cayman Islands all contribute to the success of the Islands' funds business.

Appleby's experienced investment funds team provides a highly responsive, competitively-priced service for our funds clients. We can advise on requirements for establishing a fund, establish the appropriate vehicle for the fund whether corporate or otherwise, prepare the offering documents and arrange for its registration under the Mutual Funds Law. As Listing Agents for the Cayman Islands Stock Exchange, we can also arrange for the listing of eligible funds. It is now possible to make use of segregated portfolio companies for multi-class funds, and we can advise on and set up fund structures of this type as well as traditional umbrella or master/feeder structures using groups of companies. Increasingly, we are also involved in mergers and acquisitions of funds.

Our private equity funds team advises a broad range of clients including leading private equity firms, asset managers, institutional investors and companies seeking funding. The team is involved in a wide variety of transactions conducted through Cayman Islands companies and exempted limited partnerships. Our lawyers have extensive experience of all the structures used in the private equity sphere and focus on delivering high quality, practical and commercially minded advice. The investment sectors covered are wide-ranging, and include media, manufacturing and technology as well as more traditional hard asset based businesses.

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CAYMAN ISLANDS – JURISDICTION OF CHOICE

Over the years, the Cayman Islands has gained worldwide recognition as a jurisdiction of the highest quality and continues to preserve this status as confirmed by Moody's Investor Services report of June 2009. The rating organization maintained the country's Aa3 foreign currency country ceiling and continues to describe the outlook for the Cayman Islands as stable. The Cayman Islands' respectable rating is largely due to its strong offshore financial services industry, of which investment funds are a cornerstone, and the country's solid macroeconomic fundamentals.

There are many reasons why the Cayman Islands is the jurisdiction of choice for the establishment of both open-ended and closed ended offshore funds.

Leading financial institutions from across the globe, particularly from the Americas, Europe and Asia, have chosen the Cayman Islands as the home for their fund products for many reasons, including the following:

Flexibility in fund structure – Cayman Islands investment funds can be companies, partnerships or unit trusts according to investor requirements, which are often tax related in their home jurisdiction. There are many structures utilised in the Cayman Islands investment fund industry, including stand-alone, side-by-side, master/feeder, multi-class (umbrella) funds and funds-of-funds. A regulated fund must have an offering document which describes its equity interests in all material respects and contains such other information as is necessary to enable a prospective investor to make an informed decision as to whether or not to invest. The form and content of fund offering documents is not prescribed by law.

Speed of establishment – Circumstances permitting, a regulated fund may be launched very quickly. Before the offering commences, the fund must file with the Authority evidence of establishment, its current offering document (and a summary thereof in the prescribed form) and pay the Authority's fees.

No direct taxes – The Cayman Islands have no capital gains, income, profits, corporation or withholding taxes. If the fund vehicle is an exempted company it can obtain an undertaking from the Cayman Islands Government that it will remain tax-free for a 20-year period and if it is an exempted trust or an exempted limited partnership the relevant period is up to 50-years. Investors must always obtain advice on the tax consequences arising in the jurisdiction in which they are tax resident on any investment in a Cayman Islands fund.

Exchange controls – There are no exchange control regulations in the Cayman Islands. As such, money and securities may generally be freely transferred to and from the Islands.

Multi-class (umbrella) funds – A multi-class fund may be established with or without segregated classes. To avoid cross-class liability issues, multi-class unit trusts or exempted segregated portfolio companies may be utilised.

Investment managers and advisers – There are no restrictions on a fund's investment managers and advisers.

Prime brokers and custodians – There are no restrictions on the arrangements a fund may wish to make with respect to its prime brokers and custodians.

Availability of world-class professional services – The Cayman Islands have many lawyers, accountants and fund administrators with considerable expertise.

Administrators – There is no general requirement for a fund to have a local Cayman Islands administrator, unless it is a fund that accepts subscriptions of less than USD100,000 per investor and does not hold the requisite licence.

Stock exchange listing – A significant number of funds are listed on the Cayman Islands Stock Exchange which has been recognised by the London Stock Exchange as an “approved organisation”. Cayman Islands funds are also often listed in Ireland and Hong Kong.

Trustworthy and reliable legal system – Cayman Islands law, derived from English common law and supplemented by local legislation, ensures that Cayman Islands’ funds are structured as internationally accepted vehicles. The Cayman Islands court system is well developed with appeals ultimately going to the Privy Council in London.

Anti-money laundering culture – The Cayman Islands has long committed to implementing best international practice and is fully compliant with the requirements of the Organisation of Economic Cooperation and Development (OECD) and Financial Action Task Force (FATF).

Stable and business oriented government – The Cayman Islands are a British Overseas Territory and have a history of stable government, committed to promoting the financial services industry.

The Cayman Islands Monetary Authority (“Authority”) – The Authority’s mission is to regulate and supervise the financial services industry in order to maintain a first class financial system. The Authority has regard to international standards, the need for operational freedom by financial industry service providers and the need to maintain a dynamic and competitive industry.

These advantages make the Cayman Islands the premier jurisdiction for the establishment of offshore funds.

Tax Information Exchange Agreements (“TIEAs”)

The international media has frequently reported on the Organisation for Economic Co-operation and Development (“OECD”), TIEAs and lists of countries that have been categorized as “black”, “grey” or “white”. For the Cayman Islands, these reports culminated in a positive announcement on 13 August 2009 when the Islands were elevated to the OECD white list. The OECD places a jurisdiction on the white list if it has entered into a minimum of 12 bilateral agreements to exchange tax information with foreign governments. The TIEAs provide for the type of information to be exchanged, the timing and route of information, the protection of individual and corporate rights under the laws of each jurisdiction and extensive safeguards to protect the confidentiality of the information exchanged.

In actively implementing the TIEAs and continuing to engage in international economic dialogue, the Cayman Islands demonstrates its status as a well-regulated, forward-looking and leading offshore financial jurisdiction. Its white list status is but one example of the Cayman Islands’ willingness to be at the forefront of compliance and transparency standards. The Cayman Islands has entered into more than 19 TIEAs.

INVESTMENT FUNDS

In 1993, the Cayman Islands enacted the Mutual Funds Law. The law covers both funds themselves and certain persons having control over a fund's assets.

When does a common Investment Vehicle become a Mutual Fund?

A “mutual fund” is a common investment vehicle which issues “equity interests” that allow participation amongst a pool of investors in the profits or gains of such vehicle's investments. The common investment vehicles employed are companies, unit trusts or limited partnerships, which may be formed under either Cayman Islands law or the laws of another jurisdiction.

An “equity interest” means a share in a company, a unit in a trust or an interest in a partnership that carries an entitlement to participate in profits or gains (usually at net asset value) and which is redeemable or repurchaseable at the option of the investor. Accordingly, closed-end investment vehicles, whose equity interests are not repurchasable or redeemable at the option of the investor, are not required to comply with the Mutual Funds Law.

Different Categories of Mutual Funds

There are four types of mutual funds:-

- exempted mutual funds
- registered mutual funds
- administered mutual funds
- licensed mutual funds

Unless a mutual fund fits within one of these categories it is prohibited from carrying on (or attempting to carry on) business in or from the Cayman Islands. In general terms, a mutual fund will be carrying on business in or from the Cayman Islands if:-

- It is incorporated or established in the Cayman Islands; or
- It is managed or administered in the Cayman Islands, regardless of its place of incorporation or establishment.

Exempted Mutual Funds

Funds will be exempted from compliance with the Mutual Funds Law if the equity interests are held by not more than 15 investors, the majority, in number, of whom are capable of appointing or removing the operator of the mutual fund (i.e. the directors of a company, the trustee of a unit trust or the general partner of a partnership).

Registered Mutual Funds

Registered funds are the most common form of mutual funds regulated under the Mutual Funds Law. A mutual fund will be a registered mutual fund if:

- the minimum subscription per investor is at least USD100,000 (or equivalent); or
- the equity interests are listed on a stock exchange approved by the Authority.

A registered mutual fund is not required to be licensed. Instead, it is only required to register its offering memorandum and certain prescribed details relating to the offering of its equity interests with the Authority. Fees are payable to the Authority on registration and thereafter on or before 15 January each year. Penalties apply if fees are unpaid.

All registered mutual funds must be audited by an approved Cayman Islands auditor and the annual audited accounts of the fund must be filed with the Authority within 6 months of its year end.

Administered Mutual Funds

A mutual fund will be an administered mutual fund if its principal office in the Cayman Islands is provided by a licensed mutual fund administrator. Administered mutual funds must file an appropriate offering document and certain other relevant details with the Authority, together with all changes and supplements thereto.

Annual accounts audited by approved Cayman Islands based auditors must be filed within 6 months of the relevant financial year-end.

Fees must be paid to the Authority on registration and on or before 15 January each year thereafter. Penalties apply if fees are unpaid.

Licensed Mutual Funds

Licensed mutual funds are the rarest form of mutual funds regulated under the Mutual Funds Law.

A licensed mutual fund is a mutual fund that is licensed under the Mutual Funds Law. Unless a mutual fund falls within one of the above three categories, it must obtain a mutual fund licence.

All licensed mutual funds must have a registered office in the Cayman Islands or, in the case of a unit trust, have a trustee licensed under the Banks and Trust Companies Law.

Unless otherwise exempted by the Authority, the current offering document must be filed with the Authority and audited accounts must be filed within 6 months of each financial year end. The auditors must be Cayman Islands based and approved by the Authority.

The proposed name of a licensed mutual fund must also be approved.

A licensed mutual fund will be subject to fees which must be paid to the Authority initially with the licence application and then annually thereafter on or before 15 January. Penalties apply if fees are unpaid.

An exempted mutual fund, a registered mutual fund or an administered mutual fund can voluntarily choose to be licensed.

An application for a mutual fund licence requires the following to be submitted to the Authority:

- an application containing the prescribed information;
- the current offering document or, if one has not yet been finalised, the latest draft of such offering document, together with a synopsis of that document;
- details of the mutual fund's registered office or, in the case of a unit trust, its trustee or, as the case may be, its licensed mutual fund administrator;
- evidence that each promoter is of sound reputation. (A promoter means the person responsible for the preparation or distribution of the relevant offering document but does not include a professional adviser acting for the promoter.);
- evidence that the administration of the licensed mutual fund will be undertaken by a person with sufficient expertise and of sound reputation; and
- Evidence that the business of the licensed mutual fund and any offer of its equity interests will be carried out in a proper way.

FUND MANAGERS AND ADVISERS

The Securities Investment Business Law regulates the advisory and management services of investment managers and investment advisers incorporated, registered or with a place of business in the Cayman Islands. Unless an investment manager or adviser falls within one of the exemptions provided by the legislation a securities investment business licence will be required and licencees must comply with statutory obligations.

The most likely exemption available to investment managers and advisers exists where such activities are carried on exclusively for one or more of the following classes of person:

- Sophisticated Persons;
- High Net Worth Persons; or
- companies, partnerships or trusts of which the shareholders, unitholders or limited partners are Sophisticated Persons or High Net Worth Persons.

“Sophisticated Persons” are: (i) persons regulated by the Authority or a recognised overseas regulatory authority; (ii) persons whose securities are listed on a recognised securities exchange; or (iii) persons who by reason of their knowledge and experience in financial and business matters, can reasonably be regarded as capable of evaluating the merits of a proposed transaction (which in each case must involve a monetary amount of at least USD100,000).

“High Net Worth Persons” are individuals whose net worth is at least USD1,000,000 or who have total assets of at least USD5,000,000.

Investment managers and advisers established or carrying on business in the Cayman Islands appointed by Cayman funds should be able to qualify for the above exemption from licensing because a mutual fund that is registered or licensed in the Cayman Islands under the Mutual Funds Law (including a fund that is regulated by virtue of its administration by a Cayman licensed administrator) is considered a Sophisticated Person. Other exemptions from the requirement for licensing under The Securities Investment Business Law may also apply if the fund is not so registered or licensed.

Investment managers and advisers who are exempt from the requirement to be licensed under The Securities Investment Business Law must, however, file an annual declaration with the Authority to confirm their exempt status and pay the prescribed exemption fee.

SUPERVISION AND ENFORCEMENT

The Authority can require a special audit of a regulated mutual fund or licensee and each operator of a regulated mutual fund must ensure that such special audit is carried out.

Each promoter or operator of a regulated mutual fund or licensee must give the Authority such information and access to such records as the Authority requires.

The Authority may apply to court to preserve the assets of a regulated mutual fund.

The Authority has power in relation to a regulated mutual fund or a licensee to revoke the relevant licence, impose conditions on the licensee, require the substitution of a promoter or operator, appoint advisers or persons to assume control of the affairs of the mutual fund or the licensee or require the reorganisation or winding up of the mutual fund or the licensee.

The auditor of a regulated mutual fund or licensee must immediately give written notice to the Authority if the licensee or mutual fund is, or is likely to become, unable to meet its obligations as they fall due, is carrying on or attempting to carry on business in a manner prejudicial to investors or creditors or is maintaining insufficient accounting records to allow its accounts to be properly audited.

Neither the Cayman Islands Government nor the Authority is liable for actions taken in relation to the Mutual Funds Law, except in the case of bad faith.

INVESTMENT FUNDS STRUCTURES

Cayman Islands investment funds are established utilising a range of fund vehicles and structures depending on the needs of fund promoters and proposed investors. Considerations when deciding on the form of Cayman Islands fund vehicles or structures include tax and cultural considerations along with the equally important consideration of choosing a vehicle or structure with which potential investors are already familiar and therefore comfortable investing in.

Stand-alone Funds – The simplest structure is a stand-alone fund vehicle. Under this structure investors simply purchase investment interests in a single vehicle.

Multi-class (Umbrella) Funds – Multi-class funds have shares or units split into a number of different classes, each with different investment objectives and pools of underlying investments. Such funds are often established as exempted segregated portfolio companies (see below).

Side-by-side Funds – Side-by-side fund structures usually involve the establishment of a stand-alone on-shore fund and a stand-alone Cayman Islands fund. Under this structure the on-shore and the Cayman Islands fund will each individually make identical investments in assets managed by the same investment manager.

Master/Feeder Funds – Master/feeder structures typically involve three fund vehicles, an on-shore feeder, an off-shore (Cayman Islands) feeder and an off-shore (Cayman Islands) master fund. Under this structure the on-shore and off-shore feeders invest in the master fund, which utilises the proceeds of such investments to acquire a pool of assets. Usually such structures are established to allow U.S. investors to invest in the off-shore master fund via the on-shore feeder. In some cases only two fund vehicles are used, in which case U.S. investors will invest in the on-shore feeder and U.S. tax exempt and non-U.S. investors will invest directly into the off-shore master fund.

Funds-of-Funds – This is more descriptive of investment objectives rather than structure. A fund-of-funds has the investment objective of investing its investment capital in other funds.

INVESTMENT FUND VEHICLES

Investment funds may be established utilising any of the following vehicles:

Exempted Companies

Exempted companies are established under the Companies Law and are the most common form of entity used for the establishment of investment funds. An exempted company, although prohibited from trading in the Cayman Islands, may enter into and conclude contracts in the Cayman Islands and exercise all its powers for the purpose of carrying on business outside the Cayman Islands.

An exempted company is incorporated by filing with the Registrar in the Cayman Islands the memorandum and articles of association together with the appropriate incorporation fee. The company can conduct business activities from the date of its incorporation and pre-incorporation contracts made on behalf of the exempted company may be ratified.

An undertaking from the Cayman Islands Government may be obtained which confirms that for a 20 year period, in the event of imposition of income, capital gains or inheritance taxes, the company and its shareholders will not be taxed in the Cayman Islands.

The authorised share capital of an exempted company is generally divided into shares of a fixed par value amount which may be expressed in foreign currencies. The registration fee and the annual return fee are computed on the basis of the company's authorised share capital.

There are only a few requirements for exempted companies to satisfy. An exempted company must have at least one shareholder of record; details of directors and officers must be furnished to the Registrar (details of shareholders and directors are kept confidential) and each year a return must be filed which confirms that the company has conducted its business activities outside the Cayman Islands.

Exempted companies must maintain their registered office in the Cayman Islands. There is no requirement for the directors of an exempted company to meet in the Cayman Islands and there are no restrictions on the nationality or place of residence of the directors or shareholders of such companies.

Cross-class Liability – Cross-class liability issues do, however, arise when using an exempted company as a multi-class fund vehicle. Under a multi-class corporate fund, the redeemable shares offered to investors are issued as designated classes. Each class may have its own investment objectives and all redeemable shares in these classes usually have substantially the same share rights in relation to subscription and redemption procedures. However, such funds are required to maintain separate accounting records for each class and, in most cases, to segregate the assets of each class from those of the other classes.

Although each class is often treated as a separate fund, because each class is merely one class of a single corporate entity, the assets and liabilities attributable to each class are in fact merely part of the assets and liabilities of the company as a whole. A serious issue therefore arises when the liabilities of any one class exceed the assets attributable to that class. This will usually only occur where the investment objectives of the relevant class include the use of leverage and/or speculative derivatives. The issue arises since on the liquidation of the fund, all of the assets of the fund will be available to meet all of its liabilities, such that to the extent the assets of one class are insufficient to meet the liabilities of that class, assets of other classes will be applied against the liabilities of the insolvent class, with a consequent reduction in the net asset value of other classes.

The traditional way of avoiding these difficulties has been to establish separate subsidiaries for each class where the investment objectives of any class may result in a negative position. Each separate subsidiary is likely to be a mirror image of the fund company itself with substantially similar subscription and redemption procedures and net asset value calculation provisions. Subscriptions for each high risk class in the fund will then be channelled down to the subsidiary, usually by way of subscription for redeemable shares in the subsidiary (or perhaps also by way of loan). If the subsidiary trades itself into an insolvent position, this will usually not affect the other classes of the fund since, provided the corporate veil remains intact, the liabilities will be isolated to the subsidiary company.

Exempted Segregated Portfolio Companies

The Cayman Islands' Companies Law permits investment funds to take the form of segregated portfolio companies which provides an attractive alternative corporate structure and enhances the versatility and efficiency of fund structures.

In essence, whilst retaining its corporate existence as a single legal entity, a corporate fund vehicle may be registered as having segregated portfolios of assets, which may be traded independently and which during the life of the company and on liquidation are protected from creditor claims arising with respect to liabilities of other segregated portfolios or the company generally.

The use of segregated portfolio companies provides an attractive alternative to the measures outlined above to address cross-class liability issues for multi-class corporate funds and provides corporate fund vehicles with the ability to operate in a way analogous to a corporate group despite utilising just a single legal entity.

Unit Trusts

Cayman Islands unit trusts are established under and governed by the Trusts Law and English equitable principles. Each unit trust will be constituted under a trust deed that provides the terms on which the trustee holds the trust's assets for unitholders.

Provided the trust deed is properly drafted and the trust property of each separate trust established under the trust deed is properly managed, multi-class unit trusts provide an effective method of establishing multi-class funds without cross-class liability issues arising.

Exempted Unit Trusts – Most unit trusts are registered as exempted trusts. Exempted trusts, like exempted companies, are entitled to a tax undertaking from the Cayman Islands Government. Such tax undertaking provides that for 50 years the trust will not be subject to any laws imposing any tax or duty on income or on capital assets, gains or appreciation or any tax in the nature of estate duty or inheritance tax with respect to any property comprised in or income arising under the trust or to the trustees or the beneficiaries of the trust.

Before a trust can be registered as an exempted trust, the Registrar of Trusts must be satisfied that the beneficiaries under the trust do not and are not likely to include any person resident or domiciled in the Cayman Islands. For the purpose of this requirement, exempted companies and non-resident companies are not considered to be “persons resident or domiciled in the Cayman Islands”.

When making an application to register an exempted trust, all documents recording the trusts, powers and provisions of the trust must be lodged with the Registrar of Trusts. Accordingly, the application for registration is usually made following execution of the trust deed.

Trustee's Powers and Duties – A trustee's powers and duties are defined by the trust deed, the Trusts Law and equitable principles. Accordingly, unless for example, the trust deed expressly extends a trustee's discretionary powers of investment, the trustee's powers of investment will be limited to the conservative investment powers provided to trustees under the Trust Law and the law of equity.

Trustee's who fail to comply with their duties, will be liable to unitholders for losses occasioned by such misfeasance. The duties of trustees include the duty to:

- act in good faith and exercise a reasonable degree of skill and care in managing the trust fund;
- manage the trust fund in the best interests of unitholders;
- act in accordance with the terms of the trust deed;
- ensure the trust property remains segregated and is not co-mingled;
- maintain accurate accounts and records; and
- not to profit from the trust, except to the extent permitted by the trust deed (for example, most trust deeds provide for the trustee to be remunerated for their services).

Most trust deeds for Cayman Islands unit trusts will grant a trustee wide discretionary investment powers in accordance with the investment objectives, permitted investments and investment restrictions specified in the

offering document for the fund. In addition, most trust deeds will expressly permit the trustee to delegate many of their duties to investment managers, custodians and administrators to assist them in fulfilling their trustee's duties.

Extensive indemnification, disclaimer and limitation of recourse provisions are usually included in trust deeds and other trust documentation to, as much as possible, limit a trustee's personal liability. However, such provisions will only be effective to protect the trustee to the extent permitted by law. There is no direct Cayman Islands' authority on the extent to which such provisions will be effective to release a trustee for negligence, misfeasance or default.

Exempted Limited Partnerships

In addition to the liability of limited partners being limited to their partnership interests (unless the limited partners take part in the conduct of the partnership's business), a partnership registered under the Exempted Limited Partnership Law has a number of distinct features which enable it to be used as an effective offshore fund vehicle.

An exempted limited partnership may be formed for any lawful purpose to be carried out or undertaken either in or from within the Islands or elsewhere provided that the limited partnership does not undertake business with the public of the Islands.

An exempted limited partnership must maintain a registered office in the Islands and must have at least one general partner. At least one general partner, if an individual, must be resident in the Cayman Islands or, if a company, be registered under the Companies Law or if, a partnership, be registered under the Exempted Limited Partnership Law.

Whilst a limited partner is precluded from taking part in the general conduct of the partnership business, a number of specific activities, similar to those appearing in U.S. limited partnership laws, are deemed not to offend this principle.

An exempted limited partnership is not dissolved or disrupted by a change in the identity of the partners (although if for any reason an exempted limited partnership loses its general partner, and no substitute is appointed, the partnership will be dissolved). The assignment of limited partnership interests on the death, bankruptcy or incapacity of a limited partner and the rights to assign and to mortgage limited partnership interests are specifically recognised under the Exempted Limited Partnership Law.

An exempted limited partnership is registered by filing with the Registrar a statutory statement signed by the general partner. The general partner has the responsibility for maintaining (or causing to be maintained) a register of partnership interests recording the name and address and contribution of each partner, the amount of any capital returns and the dates thereof. Such register must be maintained at the registered office of the exempted limited partnership. The register is not open to public inspection but only to the limited partners or by any other person with the consent of the general partner and must be kept up to date.

Unless the partnership agreement provides otherwise, a limited partner may demand and shall receive accounts from the general partner, proceedings are instituted by or against the general partners and not by or against limited partners and the return of limited partners' capital contributions will be permissible so

long as the partnership is solvent immediately following such return of capital. However, each limited partner is contingently liable to repay a returned capital contribution if, and to the extent, necessary to settle partnership debts if the return of capital is not justified and took place within six months of the partnership's insolvency.

A partner or creditor can apply to the court for an order for dissolution of an exempted limited partnership on just and equitable principles. The death, bankruptcy or incapacity of the last remaining general partner by law terminates the partnership unless the limited partners take steps to replace such general partner.

As with exempted trusts, the Governor can grant a tax exemption undertaking with respect to an exempted limited partnership and the interests of the partners thereto for a period of fifty years. The general partner is required to make an annual return to the Registrar regarding compliance with the Exempted Limited Partnership Law.

In general, the Exempted Limited Partnership Law goes some distance to bringing to the Cayman Islands a concept of partnership akin to the U.S. Uniform Limited Partnership Act 1987. Certainly some of the features of the Exempted Limited Partnership Law resemble those of its U.S. counterpart.

PERFORMANCE FEES

Most Cayman Islands funds charge a management fee of around 1% of net assets and a performance fee (generally at 20% per annum) on gains in a fund's net asset value. Other fees are also generally payable to administrators, custodians and other service providers of the fund.

The payment of performance fees by Cayman Islands funds requires a balancing of the desire of investment managers and advisers to earn a performance fee based upon the performance of each investment interest sold to investors and the convenience of maintaining a common Net Asset Value ("NAV") per share. Cayman Islands law in relation to corporate funds requires all redeemable shares of the same class offered to investors to have the same NAV per Share because all shares of the same class must have the same share rights. Thus, if any redeemable shares will have a different NAV per share than any other redeemable shares, on each subscription day redeemable shares may have to be issued as separate classes or series even though the only difference in share rights between the classes or series will be a potentially different NAV per Share.

The following are some common methods of calculating performance fees:-

Equalisation Methods – There are a range of equalisation methods available. The advantage of such methods is that they generally result in all shares issued sharing a common NAV. Such methods also attempt to allocate fairly performance fees between investors at the end of each calculation period.

Under the various equalisation methods, shares are automatically issued to investors or redeemed by the fund, as necessary, to ensure that at each subscription and redemption date, all shares issued by the fund have the same NAV and that an identical performance fee is payable with respect to each share. These methods, unlike other methods, allow shares to be issued to new investors at a constant subscription price, irrespective of fund performance, which can sometimes be advantageous from an administrative or marketing standpoint.

Per Share Basis with Conversion to Benchmark Series – This is the most common method of calculating performance fees. Performance fees are calculated on a per share basis and shares are issued in series on each subscription day on which shares are issued. The first series issued is the benchmark series. Subsequent series are issued at the NAV per share of the benchmark series. Whenever the NAV of each subsequent series of shares exceeds any high water mark applicable to the subsequent series and the benchmark series, after payment of the performance fee due on the subsequent series, the shares of the subsequent series are converted to the benchmark series. The conversion is effected by the automatic redemption of shares of the subsequent series and the application of the redemption proceeds to the purchase of shares of the benchmark series at the NAV per share of the benchmark series. The fund can be marketed on the basis of the performance of the benchmark series and the only series of shares outstanding for any length of time (ie. other than during performance fee payment periods) will be those that are below the relevant high water marks. This method is fair to investors and the investment manager and has the marketing advantage of selling fund shares at a common NAV per share. The disadvantage of having more than one series is minimised by the number of series of fund shares being reduced with every conversion to the benchmark series.

Per Share Accrual Basis with Compulsory Redemptions – Under this method, all shares issued on the same day (and sometimes, but not necessarily, also issued to each investor on the same day) are treated as a separate class or series and the performance fee is calculated on the performance of each such class or series on a per share basis. This results, however, in each class or series having a different NAV per Share. For administrative convenience, therefore, at the end of each performance fee payment period, the performance fee is paid by the compulsory redemption of sufficient shares of the relevant class or series as is necessary to fund the performance fee payment due to the investment manager or adviser. This means that, in effect, investors are paying the performance fee by having their shareholding reduced and having the redemption proceeds applied against payment of the performance fee.

Per Share Accrual Basis without Compulsory Redemptions and without Loss Carry Forward – Under this method, the performance fee is calculated on a per share basis and accrued, usually daily, on each valuation of the fund. In the event of a down-turn in the performance of the fund during any performance fee payment period, accruals for performance fees will be reduced accordingly. The difficulty with this otherwise simple method arises from any loss carry forward provisions whereunder no performance fee is earned until the previous "high water mark" is achieved. It is usually necessary when using this method not to have any loss carry forward beyond the current performance fee payment period.

The fact that the "high water mark" does not extend beyond the current performance fee payment period could obviously be adverse to the interests of investors. The adviser will not be entitled to a performance fee in respect of all shares within a performance fee payment period whilst such shares' performance is below a "high water mark". However, a performance fee could otherwise have been earned on interim subscriptions during the performance fee payment period which experience a positive performance but still below the "high water mark". The adviser, in effect, waives its entitlement to a performance fee on such shares issued during a negative performance fee period. If the adviser were entitled to a performance fee on the newly issued shares, this would result in these newly issued shares having a different NAV per Share than the remaining shares, the performance in respect of which has not yet exceeded the "high water mark" and therefore in respect of which there will be no accrued performance fee. It is also necessary when utilising this method that, upon any redemption of shares within a performance fee payment period, the accrual for performance fees in relation to the shares being redeemed is paid on such redemption.

Per Share Basis with Compulsory Redemptions only for Post-High Water Mark Subscriptions - The disadvantages of short term loss carry forward and waiver by the investment manager or adviser of performance fees on interim issues under the Per Share Accrual Basis above can be avoided by not accruing any performance fee on shares issued at NAV below any relevant "high water mark". Shares (with positive returns) issued after a general downturn in the performance of the fund below any relevant "high water mark" will attract a performance fee on their individual performance. Such performance fee is not brought into and does not affect the overall NAV calculation because the performance fee charged in respect of such shares is, in effect, paid by the individual shareholder not the fund. Such fee is paid by the individual shareholder by a compulsory redemption of the number of that shareholder's shares necessary to pay the performance fees due.

LOCAL AUDITOR SIGN-OFF

Local auditor sign-off is required for Cayman Islands' funds regulated by the Authority. This requirement does not, however, apply to foreign domiciled funds that are administered in the Cayman Islands, but not otherwise registered as foreign companies doing business in the Islands.

This policy seeks to ensure the effective discharge of obligations placed on auditors under the Mutual Funds Law and aims to enable an efficient interface between auditors and the Authority. The level of regulatory comfort provided by the requirement to have local auditors also assists with the timely treatment of licensing and registration applications by new mutual funds, investment managers and advisers.

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM OBLIGATIONS

The Cayman Islands legal system incorporates anti-money laundering and combating the financing of terrorism laws and regulations in accordance with modern international best practice. Appleby and its affiliated companies have always required certain information from our clients in all cases. Beyond that, we are required to obtain and keep on file extensive documentation of the identity of each client for whom certain specified types of business are conducted. In certain cases, it may be possible to rely on an exemption or on client identification carried out by another regulated service provider, and we will do so where appropriate. However, it will often be necessary to ask clients or prospective clients for documentary evidence of their identity, and often also that of related parties, as well as certain references and comprehensive details of the business that they are involved in.

THE CAYMAN ISLANDS STOCK EXCHANGE

With over eleven hundred listings, the Cayman Islands Stock Exchange ("CSX") (www.csx.com.ky) has become one of the world's fastest growing exchanges and an integral part of the Cayman Islands success story.

The CSX was established to provide a listing facility for the specialist products of the Cayman Islands, being mostly offshore mutual funds and specialist debt securities.

The CSX is firmly focused on international capital markets and providing an efficient and sophisticated listing regime. Many of the world's leading financial institutions have listed their products on the exchange. The CSX is recognised and accepted by leading institutions and market players as a "blue chip" listing environment, which assists in providing investors with the necessary degree of comfort to invest in a fund.

The listing rules are sophisticated and tailored to meet the needs of funds and to accommodate the latest structures and products. The rules emphasise the disclosure of all relevant information, without imposing unnecessarily onerous conditions.

When a fund is listed, it is given space to publish its marketing materials on the CSX website. The site can provide hyper-links to the fund's own website or to other sites providing analytical data for the fund. The CSX also automatically updates Bloomberg with any public information given to it.

The CSX has been admitted to membership of the European Securitisation Forum (an independent initiative of The Bond Market Association) and has entered into a working relationship with Euroclear which allows CSX participants access to the Fundsettle system for enhanced transparency and communication with investors. The CSX is also an affiliate of the International Organisation of Securities Comminssions (IOSCO).

Appleby is a listing agent for the Cayman Islands stock exchange and has significant experience in the listing of investment funds on this exchange and numerous other global exchanges.

For more specific advice on Investment Funds in the Cayman Islands, we invite you to contact one of the following:

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Appleby is the leading provider of offshore legal, fiduciary and administration services. With an unparalleled presence in the key offshore jurisdictions of Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey, Isle of Man, Jersey, Mauritius and the Seychelles, the group offers advice on offshore law. We also have offices in the international financial centres of London, Hong Kong, Zurich and Bahrain.

Over 800 lawyers and professional specialists deliver sophisticated, specialised services, primarily in the areas of Corporate and Commercial; Litigation and Insolvency; Private Client and Trusts; and Property. We advise global public and private companies, financial institutions, and high net worth individuals, working with them and their advisers to achieve practical solutions, whether in a single location or across multiple jurisdictions.

This publication is intended only to provide a summary of the subject matter covered. It does not purport to be comprehensive or to provide legal advice. No person should act in reliance on any statement contained in this publication without first obtaining specific professional advice.

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