GUIDE

APPLEBY

GUIDE TO DUTIES AND OBLIGATIONS OF A DIRECTOR OF A CAYMAN ISLANDS FUND

CONTENTS

PREFACE

This Guide is a summary of the duties and obligations of a director of a Cayman Islands Fund.

We recognise that this Guide will not completely answer detailed questions which clients and their advisers may have; it is not intended to be comprehensive. If any such questions arise in relation to the contents, they may be addressed to any member of the team, using the contact information provided at the end of this Guide.

Appleby
Cayman Islands
March 2016

1. INTRODUCTION

The purpose of this Guide is to provide you with an overview of the powers, duties and obligations of a director of an exempted company (**Fund**) incorporated under the Companies Law (as amended) of the Cayman Islands (**Companies Law**) and registered as a regulated fund under the Mutual Funds Law (as amended) of the Cayman Islands (**Mutual Funds Law**).

This summary is limited to the law and practice of the Cayman Islands, and you will need to be aware that other duties, obligations and potential liabilities may arise under foreign law.

2. WHO ARE THE DIRECTORS OF THE FUND?

There is no precise definition of a "director" under Cayman Islands law. Put simply, the directors of the Fund are the persons who are ultimately responsible for the management and conduct of the Fund's affairs. The directors of the Fund may be individuals or corporate bodies.

Directors (whether described as "executive" or "non-executive") should be appointed by the initial subscribers to the Fund or otherwise in accordance with the articles of association of the Fund (**Articles**), and the Register of Directors maintained by the Fund will be *prima facie* evidence as to the identity of the directors from time to time.

A person undertaking the activities of a director without being formally appointed may be found to be acting as a "**de facto director**". In addition, if the duly appointed directors of the Fund are found to be acting in accordance with the directions or instructions of another person then that person may be found to be acting as a "**shadow director**".

Executive directors, non-executive directors, shadow directors and de facto directors are all subject to the duties and obligations set out in this Guide.

3. SHOULD I AGREE TO ACT AS A DIRECTOR OF THE FUND?

When deciding whether or not to act as a director of the Fund, you should take into account the following practical considerations:

- Any other interests you may have in the structure of the Fund and its advisers or service providers. If you are a connected person (for example, a principal of the Fund's investment manager), you may wish to consider either not sitting on the board of the Fund or making sure that you are in a minority position. These measures will reduce the potential for conflicts of interest.
- If you are a connected person, you should also take into account the expectations of the Fund's key investors. They may be comfortable with a board of directors comprised of connected persons or may require the Fund to have one or more directors independent of the Fund's investment manager.
- You need to have sufficient and relevant knowledge and experience to discharge your duties as a director.
- You need to have sufficient time to carry out your duties and this should be reflected in your remuneration.
- It is up to you to acquire and maintain sufficient knowledge to enable you to carry out your role. You should use the Fund's professional advisers to provide advice on any areas or transactions of which you are unsure.

- Even if you are also an employee or principal of the investment manager or any other connected party, your duties as a director of the Fund remain unchanged. You should ensure that you are wearing the right "hat" when turning your mind to the affairs of the Fund and be aware of actual and potential conflicts of interest.

4. WHAT POWERS AND AUTHORITY DO I HAVE AS A DIRECTOR OF THE FUND?

If you agree to act as a director of the Fund, your powers and authority as a director are derived from, and constrained by, the memorandum of association (**Memorandum**) and the Articles. The Memorandum sets out the capacity and powers of the Fund and the Articles prescribe the manner in which the Fund is to be operated.

You will need to ensure that the Fund is operated in accordance with the terms of any prospectus, offering document or private placement memorandum (**Offering Document**) issued by the Fund from time to time. Whilst the terms of the Offering Document do not fetter the powers of the directors of the Fund, the Offering Document constitutes a collateral contract as between the Fund and its shareholders.

In practice, the Articles will almost certainly permit the directors to delegate their powers to service providers. The directors of the Fund will typically appoint an investment manager, an administrator and a custodian/prime broker. In deciding to appoint a service provider the directors will need to be diligent and careful in their selection; as a director, you must form the reasonable opinion that the service provider is competent to carry out the relevant function(s) on behalf of the Fund.

Once appointed in accordance with the above, you are entitled to trust (to a reasonable extent) the competence and integrity of the service provider in discharging its functions. However, you will remain subject to a continuing duty to supervise and monitor the activities of the service provider on a high-level basis. If you are found to be in breach of this duty, you may be found guilty of wilful neglect or default, potentially vitiating any exculpatory provisions in the Articles.

5. WHAT ARE MY DUTIES AS A DIRECTOR OF THE FUND?

Your duties as a director of the Fund arise as a consequence of the fiduciary relationship as between you (as a director) and the Fund. These duties derive from English case law, as the same has been applied in the courts of the Cayman Islands.

Your duties will ordinarily be owed to the Fund, but can, in particular circumstances, be owed to creditors or individual shareholders.

In the ordinary course of business, the interests of the Fund can be equated to acting in the best interests of the Fund's shareholders as a whole. However, once the Fund becomes insolvent or "doubtfully" solvent you must take into account the Fund's creditors when discharging your duties.

You are also obliged to comply with various statutory obligations regarding the management and operation of the Fund. The principal obligations applicable to the Fund and to the directors arise under the Companies Law, the Mutual Funds Law and the Proceeds of Crime Law (as amended) (**Proceeds of Crime Law**).

Your key duties can be summarised as follows:

5.1 Fiduciary duties

- To act *bona fide* in what you consider to be the best interests of the Fund.

- To exercise your powers under the Articles for the purposes for which they are conferred.
- To avoid conflict between the interests of the Fund and your personal interests and duties or (where such conflicts are permitted by the Articles) making sure that any such conflicts are properly disclosed.
- To exercise your powers as a director independently, without subordinating your powers to the will of others (except to the extent that such powers have been properly delegated).
- Not to make secret profits from acting as a director of the Fund.

5.2 **Duties of skill and care**

- To acquire and maintain a sufficient knowledge of the business of the Fund on a continuing basis.
- To supervise the discharge of functions which have been delegated to advisers and service providers (see paragraph 4 above).

You are obliged to undertake these duties with care, diligence and skill. As noted above, you are subject to a minimum objective standard as a director of the Fund, but the expected standard will be raised if you have more knowledge, skill or experience than would ordinarily be expected of a director in your position.

5.3 **Statutory obligations**

- To maintain the Register of Members, the Register of Directors and Officers and the Register of Mortgages and Charges.
- To maintain proper books of account for the Fund.
- To maintain a registered office in the Cayman Islands for the Fund.
- To comply with the Money Laundering Regulations (as amended) (**AML Regulations**) issued under the Proceeds of Crime Law.
- To ensure that the Offering Document issued by the Fund describes the shares in all material respects, and contains such other information as is necessary to enable a prospective investor in the Fund to make an informed decision whether or not to invest; and to update the Offering Document to take account of any material changes.
- To ensure that the Fund is audited on an annual basis.
- To comply with reporting obligations including, without limitation, notifying the Registrar of Companies (**ROC**) of any changes in the directors, officers or registered office of the Fund, arranging for the filing of the Fund's annual return and exempt company declaration with the ROC and filing of the Offering Document and annual audited financial statements with the Cayman Islands Monetary Authority (**CIMA**).

Full details of the ongoing reporting obligations of the Fund can be found in our briefing note entitled Continuing Obligations of Mutual Funds.

In practice, the maintenance of statutory registers, the establishment of policies and procedures in accordance with the AML Regulations and the compliance with statutory filing obligations will be delegated by the directors to the registered office and/or administrator of the Fund. However, while the directors may be entitled to appoint service providers to take responsibility for particular obligations, as a director of the Fund you are still obliged to supervise the discharge of the delegated functions.

5.4 CIMA Statement of Guidance for Regulated Mutual Funds

In December 2013, CIMA published a concise Statement of Guidance (**SoG**) which applies to investment funds regulated under the Mutual Funds Law. The SoG sets out best practices and establishes certain minimum standards for governing bodies of Funds on the topic of corporate governance.

The SoG does not impose a strict or all-encompassing code of conduct on governing bodies or operators of Funds. At a concise eight pages, the SoG establishes an overall framework for good corporate governance within which Funds should operate. The SoG does not contain specific restrictions on investments, risks or strategies, nor does it attempt to direct, prescribe or constrain the management or business activities of Funds.

The SoG includes the following:

(a) **Oversight Function**

Boards of directors are ultimately responsible for overseeing and supervising the activities of the Fund. They should regularly monitor and take steps to ensure that the Fund and its service providers are conducting the affairs of the Fund in compliance with the Fund's defined investment criteria, investment strategy and restrictions as well as with all applicable laws, regulations and other rules. Directors should receive regular reporting from the investment manager and service providers to ensure they are able to make informed decisions and to adequately oversee and supervise the Fund.

(b) **Conflicts of Interest**

Directors of Funds must ensure that the Fund's offering documents adequately and accurately disclose conflicts of interest and ensure that the Fund has adequate measures in place to identify, disclose, monitor and manage any conflicts of interest.

(c) **Meetings**

Fund boards should meet at least twice a year, and more often depending upon the circumstances or size, nature and complexity of the Fund and service providers should also attend. Full, accurate and clear written records must be kept of such meetings.

(d) **Duties**

- Directors of Funds are responsible for the appointment, removal and contract terms of service providers, including notifying investors and CIMA of any changes;
- Board members should communicate adequate information to the Fund's investors, where disclosure is proper;
- Each director must have sufficient capacity to apply his or her mind to overseeing and supervising each Fund in accordance with relevant laws, regulations, rules, statements of principles and the provisions of the SoG; and
- Directors should ensure that the offering contain such information as is necessary to enable a prospective investor to make an informed investment decision.

6. DIRECTOR REGISTRATION AND LICENSING

The Directors Registration and Licensing Law, 2014, as amended, imposes registration obligations on directors of registered mutual funds and certain securities investment businesses (**Covered Entities**). The registration fee is US$854 per director for any person not being a "Professional Director" or a "Corporate

Director". Licences are required for "Professional Directors", being natural persons appointed to the boards of 20 or more Covered Entities and "Corporate Directors" of Covered Entities. Licence fees for Professional and Corporate directors are US$3,660 and US$9,756, respectively.

7. WHAT PRACTICAL CONSIDERATIONS SHOULD I TAKE INTO ACCOUNT DURING THE LIFE OF THE FUND?

In 2011, Jones J of the Grand Court of the Cayman Islands provided a detailed analysis of the scope of an independent director's duties toward an offshore fund in *Weavering Macro Fixed Income Fund (In Liquidation) v. Peterson and Ekstrom*[1]. He determined that the two independent directors of the fund had conducted themselves in a manner which constituted "wilful neglect or default", thus excluding them from access to the indemnity provisions of the fund's articles and leaving them personally liable for an award in damages exceeding US$100 million. The Cayman Islands Court of Appeal subsequently allowed the appeal of the two defendants[2], agreeing with the trial judge that these independent directors had been negligent, but holding that the evidence before the Grand Court did not support a finding of "wilful neglect or default". As a result of their successful appeal, the two directors would be able to rely on the indemnity provisions of the fund's articles (however, the liquidators have indicated they would seek leave to appeal to the Privy Council). As the Court of Appeal did not disagree with the substance of the comments made by the trial judge as to the steps independent directors generally ought to take in order to discharge their duties, those comments continue to serve as a useful guide.

In his analysis of the performance of the directors, Jones J divided the life of a fund into three distinct phases: a) Establishment; b) Ordinary Course of Business and c) Crisis Management. Taking each in turn:

7.1 Establishment

- You must satisfy yourself that the overall structure of the Fund and the terms of service provider contracts (in particular those relating to the determination of net asset value (**NAV**), remuneration, indemnification and limitation of liability) are reasonable and consistent with industry standards and to the extent that they are not, that there are reasonable reasons for the divergence. If the Fund structure or service provider agreements are not standard, then this would definitely be a matter for disclosure in the Offering Document.
- You should find out what service providers will and will not be doing for the Fund and ensure that delegation and the division of responsibilities are appropriate. For example, you will need to ensure that responsibility for calculating NAV, anti-money laundering compliance, maintaining accounts, preparing management accounts and preparing financial statements is split appropriately between the investment manager and the administrator.
- As a practical matter, if your role is limited to that of an independent director then you will not be expected to be involved in detailed negotiations with service providers. However, when taking on a role as independent director, it would be sensible to ask that, before any agreement is signed, the investment manager or whoever is negotiating it lets the counterparty know that you will want to review the agreement and approve it and that you may have comments or questions before doing so.
- The directors of the Fund are collectively responsible for the contents of the Offering Document. Accordingly, you should ensure that the Offering Document is accurate and not misleading on launch and on an ongoing basis. You will need to be satisfied that the Offering Document describes the equity interests (e.g. shares, partnership interests or units) in all material respects and provides

[1] 2011 (2) CILR 203
[2] 2015 (1) CILR 45

such information as is necessary for an investor to make an informed decision on whether or not to purchase the equity interests. You cannot simply rely on the fact that the Offering Document has been prepared by reputable advisers, and you should enquire as to the nature and depth of the verification exercise undertaken in relation to various aspects of the document and satisfy yourself that it has been done properly.

- If the appointment of a service provider is approved in resolutions, you should make sure that the appointment actually happens and ask to review a copy of the appointment letter or service agreement. For example, prime brokers may be appointed periodically and if the making of such appointments has been delegated to the investment manager, the directors should ensure that the terms are consistent with industry practice.
- If an item has been delegated to a single director to approve, for example, a final draft of an agreement or the final draft of the Offering Document, you should be satisfied that there is a process in place to circulate final documents to all of the board members and consider noting this as having been done at a subsequent meeting.
- At the establishment stage, when considering your duties to act in the best interests of the Fund, you should be thinking about potential investors.

7.2 Ordinary Course of Business

- The directors perform a high-level supervisory role. The very nature of an offshore hedge fund means that directors are non-executive and investment management, administration and accounting functions are delegated to third parties. This is acceptable, but in the words of the trial judge in *Weavering*, "they [the directors] are not entitled to assume the posture of automatons". Simply to sit back after delegation of a role to a service provider and assume it is being done properly is not acceptable. You are not absolved from performing your duties and must supervise the discharge of any delegated functions.
- Directors should hold regular board meetings. Board meetings should be held sufficiently frequently so that the board is able to carry out its role effectively. In its SoG, CIMA has stated that Directors of a regulated fund should meet at least twice a year in person or via telephone or video conference. This may or may not be sufficient; the frequency of meetings should depend on the nature of the Fund and the circumstances. If market or other conditions require it, directors should consider meeting on a quarterly basis, and also consider convening an extraordinary meeting if warranted by the circumstances (see paragraph 7.3 below).
- Agendas and associated documents should be circulated before formal meetings with sufficient time for review of both. An agenda should reflect input from the investment manager, administrator, directors and any other relevant party.
- Directors should not approve resolutions or board minutes which refer to documents that they have not reviewed or discussions that have not been had.
- Detailed board minutes should be kept for all board meetings that are held and minute books updated accordingly. These should fairly and accurately record the matters which were considered and the decisions which were made. Discussions do not need to be recorded in detail, but should be summarised, at least to the extent necessary for the reader to understand the basis upon which the decisions were made.
- You should keep evidence of enquiries made to service providers, such as emails or records of telephone conversations that take place outside of board meetings.
- Directors should ensure that a minute book is kept and that copies (at least) are sent to Cayman counsel and the registered office in the Cayman Islands. (**NB**: for funds or directors based in some

jurisdictions, to have the minute book in the Cayman Islands might be important from a tax perspective to avoid the Fund's management being "brought onshore").

- If using written resolutions for significant decisions, you should ensure that these detail the scope of enquiry made in relation to a particular issue rather than simply "noting" that something has been done. For example, if the investment manager has provided reports or detailed advice, the directors should provide a summary of the review that they have carried out and if necessary a summary of the advice and append a copy of any reports.
- The directors of the Fund are responsible for ensuring that the financial statements of the Fund give a true and fair view of the Fund's state of affairs at the end of the year. This is not altered by any delegation of account preparation to the administrator or the investment manager.
- As the directors may be required to provide a letter of representation to the auditors, they should review the accounts and may wish to seek similar representations from those to whom they have delegated powers (and consider including this as an obligation in the relevant service contract).
- You should require regular reporting from the investment manager to the board to ensure that investments of the Fund continue to be made within the relevant investment parameters and restrictions set out in the Offering Document and the investment management agreement. This should be done at least at every board meeting and possibly more frequently, for example, in line with redemption frequency.
- The investment manager should be required to provide copies of management accounts at least as frequently as redemption frequency if not monthly.
- You should ensure that the board asks questions of all service providers and requires reports and documents to be provided regularly or in special circumstances. For example, the board should require the administrator to regularly update the board either by report or attendance at a board meeting as to, among other things, anti-money laundering compliance, changes in pricing sources, pricing problems and deviation from standard procedures. In addition to regular management or other accounts and reports, the board should also ask for copies of all documentation that is sent to investors or regulators by the investment manager or the administrator.
- The Fund has at least six months from its financial year end to finalise its audited financial statements and to file them with CIMA. You should ensure that you are provided with the draft financial statements in plenty of time to review them and ask any relevant questions. (**NB**: for a fund of funds, for example, this is particularly important because it might not be possible to finalise the audit until very late in the six-month period).
- Side letters – although these are common, if the Fund is a party undertaking to carry out certain actions, then you should review them and be comfortable with their terms from a commercial perspective. For example, if the side letter imposes extra investment restrictions, can these be carried out, and does agreeing to these impact on the rest of the Fund's strategy as reported to investors? It is not enough to simply know that legally they can be entered into by the Fund. If the investment manager has been given delegated authority to negotiate and execute side letters on behalf of the Fund, this should form part of the regular reporting to the board and the scope of such authority should be agreed.
- Segregated portfolio companies – if the Fund is a segregated portfolio company, then you will have additional duties under the Companies Law. These include:
    - the duty to establish and maintain the segregation of the assets and liabilities attributable to each segregated portfolio from the assets and liabilities attributable to each other segregated portfolio and the general assets and liabilities of the Fund; and

- the duty to ensure that the Fund states the capacity in which it is contracting (i.e. which portfolio it is acting for) when entering into contractual documentation.

Please refer to our "Guide to Segregated Portfolio Companies in the Cayman Islands" for further details.

7.3 Crisis Management

Throughout the life of the Fund, directors should be pro-active in ensuring that the investment manager is required to provide information on an ad hoc basis which might require urgent action by the board. In addition to standard regular reporting requirements, you should be asking the investment manager and any other relevant service providers whether there is anything that should be brought to the attention of the board. The following is a non-exhaustive list of the issues that would fall under this heading:

- Is there is any actual, pending or threatened litigation against the Fund?
- Are there any disputes with investors or counterparties that will fall short of actual litigation?
- Will outstanding redemption requests have a significant impact on NAV at the next dealing day; if so, could such redemptions destabilise the Fund or adversely affect the liquidity of the Fund?
- Will accepting subscriptions in respect of ERISA/pension assets have an impact on existing investors?
- Are market or other conditions having or likely to have a material impact on the trading strategies of the Fund?
- Is there is any significant counterparty risk for "over the counter" transactions to which the Fund is a party?
- Has there been any change to or movement away from the investment strategy, policy or restrictions set out in the Offering Document?
- Has there been any reduction in the investment manager's holding in the Fund?
- Have there been or are there likely to be any material changes of staff at the investment manager (for example, triggering "key-man" events) or at any other service provider?

8. WHAT SHOULD I DO IN THE EVENT OF A CRISIS?

If the Fund finds itself in difficulties, you cannot sit back and assume that other service providers, and in particular the investment manager, will rescue the Fund without significant oversight from you, as a director of the Fund.

As a director, you are entitled to rely on the advice of suitably qualified third parties. In some circumstances you may even be considered negligent if you make a decision without obtaining expert advice on behalf of the Fund.

It is imperative that you seek advice from the Fund's legal advisers as soon as you become aware of any circumstances that could have a material adverse effect on the management and operations of the Fund or the interests of the Fund's investors.

9. WHAT COULD HAPPEN IF I FAIL TO DISCHARGE MY DUTIES AS A DIRECTOR OF THE FUND?

9.1 Breach of statutory duty

As noted above, the Companies Law, the Mutual Funds Law and the Proceeds of Crime Law (among others) impose certain duties upon you as a director of the Fund. Some of these duties are sanctioned by criminal

penalties and, on conviction, are punishable by a fine and (in relation to certain offences) a custodial sentence.

Many of these duties are imposed upon the directors. It is also important to note that if the Fund is in breach of a statutory obligation, the relevant legislation may also impose penalties on any "officer" of the Fund (which includes a director) who is "in default". For these purposes, you will be "in default" if you knowingly and willingly authorise or permit the default, refusal or contravention that constitutes the breach.

9.2 **Breach of fiduciary duty**

If you breach your fiduciary duties to the Fund, you may be found personally liable to the Fund in damages.

9.3 **Negligent misstatement**

In circumstances where you have been negligent in making a statement, for example, in the Offering Document, you may be liable for a claim in damages brought by a person who has suffered loss in reliance on that statement.

9.4 **Deceit**

If you are fraudulent in misrepresenting facts by making a statement in the knowledge that it is false, or by being reckless as to whether or not the statement is true or false (for example, in the Offering Document), you could be found liable in damages to an investor or purchaser who is deceived by the statement.

9.5 **The Penal Code**

If you publish (or concur in publishing) a written statement or account which to your knowledge is or may be misleading, false or deceptive in any material particular, with intent to deceive shareholders or creditors of the Fund about its affairs, then you will be guilty of an offence, punishable on conviction by up to seven years imprisonment[3].

This offence, together with obligations under the Mutual Funds Law, and the heads of liability described at sub-paragraphs 9.3 and 9.4 above, are of particular relevance in relation to statements made in the Offering Document.

9.6 **Contempt of court**

If you are aware that the Fund has been ordered by any court of competent jurisdiction either to do or refrain from doing something, or that the Fund has given an undertaking to the court to do or refrain from doing something, then you are under a duty to take reasonable steps to ensure that the order or undertaking is complied with. If you wilfully fail to do so, with the result that the order or undertaking is breached, you can be punished for contempt of court. If you turn a 'blind eye' to the breach you may still be found liable for contempt, even if you do not actively participate in the breach.

9.7 **Fraud etc. on, or prior to, winding-up**

The Companies Law provides for a range of statutory offences relating to the actions of the directors prior to, or in connection with, the winding-up of the Fund[4].

[3] Section 257 of the Penal Code (2013 Revision), as amended
[4] See, in particular, Sections 134 – 137

9.8 **Ultra Vires**

As noted above, the Memorandum sets out the capacity and powers of the Fund and the Articles prescribe the manner in which the Fund is to be operated.

If the directors of the Fund purport to enter into any transaction that is outside the objects set out in the Memorandum, the transaction will be *ultra vires* and the Fund will be without capacity to enter into the transaction. In similar fashion, if the directors enter into a transaction on behalf of the Fund that is *ultra vires* their powers under the Articles, the directors are without capacity to bind the Fund.

In either circumstance, the Companies Law steps in to ensure that any such transaction with a third party is not rendered invalid by such lack of capacity. However, the Fund may bring a claim against the directors for any loss caused or damage suffered as a consequence of the *ultra vires* act.

NB: actions taken by the directors that are *ultra vires* their powers under the Articles may be capable of ratification by the shareholders. However, actions taken by the directors that are *ultra vires* the objects in the Memorandum are not capable of verification.

For more specific advice on duties and obligations of a director of a Cayman Islands Fund, we invite you to contact:

Cayman Islands
Bryan Hunter
Managing Partner, Cayman Islands
Corporate
+1 345 814 2052
bhunter@applebyglobal.com

For the convenience of clients in other time zones, a list of contacts available in each of our jurisdictions may be found here.