

Cayman Funds investor counsel: Selling the Cayman buy-side

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GLOBALLY, INSTITUTIONAL INVESTORS ALLOCATE BILLIONS OF DOLLARS TO FUNDS REGISTERED IN THE CAYMAN ISLANDS AND YET MANY MAY NEVER HAVE ENGAGED CAYMAN COUNSEL.

SOME KEY QUESTIONS ARE POSED IN THE AMERICAN LAWYER FROM AN INVESTOR PERSPECTIVE AND CONSIDERS SOME COMPELLING FACTORS AS TO WHY CAYMAN BUY-SIDE COUNSEL SHOULD BE (AND INCREASINGLY ARE) ENGAGED.

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JUST TO BE CLEAR - WHAT INSTITUTIONAL INVESTORS ARE WE TALKING ABOUT?

SWFs, pension funds, funds of funds, insurance companies, banks (where domestic legislation permits), foundations, endowments and (increasingly) family offices.

WHY ARE THESE INVESTORS INVESTING INTO CAYMAN FUNDS?

Simply put, because managers setting up offshore funds (across fund types) as either stand-alone funds, parallel funds to domestic funds, AIVs, or feeder and/or master funds continue to choose Cayman as one of their primary offshore fund domiciles.

Managers seeking to attract global pools of capital want to spend their time and resources convincing investors of the merits of their strategy, proprietary deal flow and personnel, not on explaining why they have elected to use a fund jurisdiction outside of that which investors are familiar and comfortable with.

BUT AS A SOPHISTICATED INVESTOR WE HAVE AN INTERNAL LEGAL TEAM AND/OR HAVE ENGAGED INTERNATIONAL ONSHORE LEGAL COUNSEL TO CONDUCT OUR FUND REVIEWS. WHY SHOULD WE ALSO ENGAGE CAYMAN COUNSEL?

Have a think about these highlighted points:

The fund documentation is Cayman law governed – fundamentally the constitutional documents of the fund (the memorandum and articles of association of a company, the limited partnership agreement of a Cayman exempted limited partnership or the LLC agreement of a Cayman LLC) as well as the subscription documentation and any side letters are **all** Cayman law governed. Whilst Cayman has adopted legislation to allow its fund documentation to replicate/dovetail with onshore fund documentation, there remain differences – making a multimillion dollar investment into a Cayman fund without engaging Cayman counsel acting for you (as opposed to acting for the fund itself) to review them, is a risk.

Onshore Counsel Role – onshore investor counsel's primary focus is to assist with analysis and negotiation of fund terms and documentation, a role which they adopt with respect to a Cayman fund. Onshore investor counsel are often very familiar with Cayman law issues, particularly where the firm in question also acts as fund counsel for managers on Cayman fund formations. Onshore counsel are not however Cayman law qualified, typically will not be familiar in detail with the full statutory provisions of

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the relevant Cayman laws and are not based in the Cayman Islands. Consequently, at a particular point in time they may not be familiar with imminent/recent changes to Cayman law or practice, whether statutory or deriving from Cayman case law, or which are driven off local regulator (i.e. with respect to hedge funds, the Cayman Islands Monetary Authority) statements of guidance or approach which may also impact the documentation/investment.

Fiduciary Duties – for institutional investors having fiduciary duties to their stakeholders, not engaging Cayman counsel may run a particular risk in connection with being able to demonstrate satisfying those duties. This has, for example, led to a particular increase in Cayman counsel engagement amongst pension funds and funds of funds. Not engaging Cayman counsel at any level may have duty of care implications.

SO IF IT'S A CAYMAN FUND DO I ALSO NEED ONSHORE COUNSEL?

Yes, **absolutely**. Cayman counsel's primary role is providing Cayman Islands legal advice, not drafting or negotiating fund terms which is the primary role and experience of your onshore counsel.

To coin and somewhat mix a saying, "beware handsome offshore counsel bearing gifts" – investors should be wary of any offshore firm that claims it can do everything (presumably for less money) that an onshore counsel review team would do.

THE FUND I AM GOING INTO HAS CAYMAN FUND COUNSEL WHO ARE NAMED IN AND HAVE PREPARED THE FUND DOCUMENTATION - ISN'T THAT SUFFICIENT?

That should be sufficient to ensure the documentation complies with Cayman law but **complying** with Cayman law does not equate to making investors aware of terms arising under Cayman statute and/or which have arisen as a matter of common law in the Cayman courts – various of which may be caught by language in the documentation referring to matters being 'subject to applicable law' or subject to the provisions of a particular Cayman statute. Experienced buy side counsel will highlight the applicable Cayman provisions, providing knowledge and, if necessary, the opportunity to address issues before an investment is made.

WHAT DOES A CAYMAN COUNSEL INVESTOR-SIDE REVIEW TYPICALLY INVOLVE?

Review of the main fund documents – including the PPM, Cayman constitutional documents, subscription documents and any side letter - to ensure compliance with Cayman law and highlight any unusual provisions/other Cayman issues impacting the documentation.

Review of any fund Cayman counsel legal opinions – this may include a Cayman fund counsel 'launch' legal opinion for the fund and a side letter opinion and negotiation of the same from a Cayman law perspective with the fund Cayman counsel.

Cayman Court Searches – potentially conducting Cayman court searches on the fund and any related Cayman entities - for the purposes of identifying if there is any Cayman based litigation against the fund entities and/or any insolvency/winding up proceedings.

Online Cayman Registry and Regulator (Cayman Islands Monetary Authority) checks – checking the fund (and any related entity) is actually registered in the Cayman Islands and (where required) registered with the Cayman Islands Monetary Authority.

Reporting back – Cayman counsel will review and report back to the investor's onshore counsel who will 'quarterback' the review comments, discuss further as necessary with Cayman counsel and their client and determine any matters which need further

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investigation/incorporation into the fund documentation and/or any side letter.

Investor-side Legal Opinion – an investor may also want a separate legal opinion from its Cayman counsel in connection with an investment – for example where a limited partnership agreement includes limited partner rights raising concerns as to the investor’s limited liability protection.

OK, ANYTHING ELSE TO PUSH ME OVER THE LINE?

‘Carrot’ and ‘stick’:

The ‘carrot’ – a number of our investor clients and their onshore counsel view Cayman buy-side counsel (worse case) like an insurance premium – as well as satisfying various fiduciary-type duties the cost/benefit analysis runs that if Cayman counsel do not spot a material issue in nine out of ten investments that is a positive and, ultimately, the one time they do raise something or are available to advise at short notice on an issue that arises, it has paid for the ten times.

The ‘stick’ – hopefully, the rationale provided elsewhere will convince but, ultimately, there is another way of looking at this which we might characterise as the ‘stick’ – if something happens to the investment which is driven off, is a consequence of, or could have been mitigated by, an up-to-date knowledge of Cayman law issues and the investor suffers a loss, will that investor (and potentially its onshore counsel) be comfortable with responding to a question internally/from its own investors or clients as to why it didn’t receive Cayman counsel advice?

ABOUT THE AUTHOR

Joss Morris has been based in the Cayman Islands for over a decade with roughly the first half of that spent with one of the largest Cayman firms representing and regularly advising some of the largest global fund managers on fund formations, secondary investments and (to a lesser extent) institutional investors on their primary investments and the second half spent focusing on advising institutional investors into global funds and on their own fund formations – ‘poacher turned gamekeeper’ as an analogy doesn’t warrant too close an analysis but conveys the point.

Prior to moving offshore, Joss trained and worked with Linklaters for eight years in London and Central and Eastern Europe.

Collas Crill has an established Cayman investor/buy-side practice spanning over 20 years advising some of the world’s largest institutional investors across fund types. The firm also acts as Cayman fund counsel, particularly in the sub US\$1 billion market.

Collas Crill’s investor-side practice also operates across its global jurisdictions in the BVI, Guernsey, Jersey and Asia.

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