

# Cayman Islands – Segregated Portfolio Companies

## Introduction

Part XIV of the Companies Law (2016 Revision) (the "**Companies Law**") permits any exempted company to apply to the Registrar of Companies (the "**Registrar**") to be registered as a segregated portfolio company ("**SPC**").

Once registered as a SPC, an exempted company can create and operate one or more segregated portfolios with the benefit of statutory segregation of assets and liabilities between portfolios.

## Application and structural benefits of SPCs

The provisions of the Companies Law permitting exempted companies to register as SPCs have created opportunities for the introduction of innovative legal structures across a wide range of business areas. Mutual funds in particular have benefited from the use of SPCs.

Standard mutual fund structures such as multi-class hedge funds, umbrella funds and master-feeder structures benefit from the ability to set up a statutory "ring-fence" to protect against cross liability issues relating to the assets and liabilities of the various segregated portfolios within a SPC. Furthermore, the use of a SPC facilitates a more streamlined offering structure for certain mutual funds.

This closely follows the use of SPCs by insurers where individual insurance or product lines are segregated in different segregated portfolios thus protecting each from losses arising from the other categories of business written by the insurer.

Examples of other uses include multiple tranche debt issue vehicles, property development companies, ship or other fleet owning companies, securitisation and derivative transactions.

The advantages over traditional methods of creating legal divisions between accounts (such as setting up underlying special purpose vehicles and negotiating limited recourse provisions with third parties) include reduced complexity and possible cost savings.

## Cost of setting up SPCs

<b>Fee (where authorised share capital does not exceed CI\$42,000 (approximately US\$51,000))</b>	<b>CI\$</b>	<b>US\$</b>
SPC registration fee	\$1,100	\$1,342
SPC annual fee	\$2,700	\$3,293
Fee for each additional segregated portfolio	\$300 (Maximum of \$1,500)	\$366 (Maximum of \$1,829)

## Key features of SPCs

### Multiple portfolios

A SPC may create one or more segregated portfolios in order to segregate its assets and liabilities. Please note that an annual notice stating the name of each segregated portfolio must be filed by the SPC with the Registrar at the same time as the SPC pays its annual fee (section 213(6)).

### Name

A segregated portfolio company must include the letters "SPC" or the words "Segregated Portfolio Company" in its name (section 215). A segregated portfolio's name must include the words "Segregated Portfolio" or "SP" or "S.P." (section 216(3)).

### No separate legal personality

Although a segregated portfolio must be separately identified, it will not be a separate legal entity from the SPC (section 216(2)).

Section 218(1) of the Companies Law provides that "any act, matter, deed, agreement, contract, instrument under seal or other instrument or arrangement" which is to be binding on or enure to the benefit of a segregated portfolio shall be executed by the SPC on behalf of the relevant segregated portfolio. The SPC must identify the relevant segregated portfolio(s) and state that it is acting "in the name of, or by, or for the account of" the particular named segregated portfolio(s). The capacity in which the SPC contracts and the name(s) of the relevant segregated portfolio(s) must be set out in writing in the relevant transaction documentation.

If a document is executed by a SPC that incorrectly refers to no segregated portfolio or the wrong segregated portfolio, the Companies Law provides a mechanism for the correction of the error. Section 218(2) provides that the directors of the SPC must make enquiries to determine the correct segregated portfolio to which the document should be attributed, make the attribution, and notify all of the relevant parties, including any person who may be adversely affected. There is then an opportunity for such persons to apply to court if they object.

### Segregated assets

Assets of a SPC are either segregated portfolio assets or general assets. The directors of a SPC have a duty to establish and maintain the segregation of each segregated portfolio's assets from those of other segregated portfolios and also from the general assets of the SPC (section 219(6)).

## Issue of shares

Shares may be created and issued in respect of a particular segregated portfolio, the proceeds of which are included in the assets of such segregated portfolio and such shares may carry the right to receive distributions from that segregated portfolio (section 217).

## Rights of creditors and shareholders

A creditor will only have recourse to assets from segregated portfolios with which it has contracted, and a shareholder will only have recourse to assets from segregated portfolios to which its shares relate (section 220(a)). Thereafter, unless specifically prohibited by the articles of association of the SPC, the general assets of the SPC would be available to meet liabilities (section 221(1)(a)). Creditors and shareholders will have no recourse to the assets of other segregated portfolios of the SPC which are protected under the Companies Law (section 220(b) and section 221(1)(b)).

## Termination and reinstatement of a segregated portfolio

A segregated portfolio that has no assets or liabilities can be terminated by a resolution of the directors (or other approval as set out in the SPC's articles of association), and reinstated in the same way (section 228A). The SPC should file a notification of a segregated portfolio's termination or reinstatement with the Registrar.

## Receivership and liquidation

### Making a receivership order

The Grand Court of the Cayman Islands (the "**Grand Court**") may make a receivership order, and appoint a receiver over a segregated portfolio's assets, if the Grand Court is satisfied that:

1. the assets attributable to any particular segregated portfolio are or are likely to be insufficient to discharge the claims of the creditors of that segregated portfolio; and
2. a receivership order would achieve (i) an orderly winding down of the business of or attributable to that segregated portfolio; and (ii) the distribution of assets attributable to such segregated portfolio to those entitled to have recourse to them (section 224(1)).

An application for a receivership order in respect of a segregated portfolio of a SPC may be made by:

1. the SPC itself;
2. the SPC's directors;
3. any creditor of that segregated portfolio;
4. the holder of any segregated portfolio shares in respect of that segregated portfolio; or
5. the Cayman Islands Monetary Authority ("**CIMA**") (if the SPC carries on a regulated business) (section 225(1)).

### Effect of a receivership order

The receiver of a segregated portfolio may do all such things as may be necessary in order to complete an orderly wind down of the business of, or attributable to, that segregated portfolio and distribute the assets of that segregated portfolio to those entitled to have recourse to them (section 226(1)). The receiver shall have all the functions and powers of the directors in respect of the business and the assets of or attributable to the segregated portfolio in taking such steps (section 226(1)(b)). The receiver may apply to the Grand Court for directions as to the extent or

exercise of any function or power (section 226(2)) and may be granted the same powers as would be granted to a liquidator of a company (*In the matter of JP SPC 1 and JP SPC 4* [2013 (1) CILR 330]). The receiver is deemed to act as the agent of the SPC and does not incur personal liability unless he is fraudulent, reckless, negligent or acts in bad faith (section 226(3)). Following the making of an application for a receivership order, and for so long as a receivership order is in place, no suit, action or other proceedings may be instituted against the SPC in relation to that segregated portfolio or its assets without the leave of the Grand Court (section 226(5)). Further, once a receivership order has been made, the powers of the SPC's directors cease in respect of the business of or attributable to the segregated portfolio in respect of which the order was made (section 226(6)(a)).

### Effect of liquidation on a receivership

The Grand Court cannot make a receivership order if the SPC is in winding up, and any receivership order made ceases to be of effect upon the commencement of any winding up of the SPC (section 224(4)). A voluntary winding up of a SPC may not be commenced by resolution of its shareholders without leave of the Grand Court if any of its segregated portfolios are the subject of a receivership order (section 224(5)). The remuneration and expenses of a receiver are met, in priority to all other claims, from the assets of the specific segregated portfolio in respect of which the receiver was appointed (section 228).

### Winding up or liquidation

A SPC may be wound up or liquidated in the same manner as any other company incorporated under the Companies Law (save that, as explained above, leave of the Grand Court is required to voluntarily wind up a SPC where a segregated portfolio is subject to a receivership order). Notably, a petition seeking the winding up of a SPC on the 'just and equitable' ground can be presented by a shareholder whose shares have been issued in respect of a single segregated portfolio; the holder of segregated portfolio shares is not confined, under the Companies Law, to seeking the appointment of a receiver for the segregated portfolio in respect of which the shares have been issued (*ABC Company (SPC) v J & Company Limited* [2012 (1) CILR 300]). However, the liquidator may only discharge claims of specific segregated portfolio creditors' and distribute any surplus to holders of segregated portfolio shares from (i) assets attributable to such segregated portfolio; and (ii) unless specifically prohibited by the articles of association, the SPC's general assets (to the extent that the assets attributable to the relevant segregated portfolio are insufficient to satisfy its liabilities, and the assets of the SPC exceed any minimum capital requirements for the SPC). If a creditor has a claim against the SPC, or a shareholder holds shares in the SPC, that is not attributable to any of its segregated portfolios, the liquidator must discharge those claims out of the general assets of the SPC only (section 222(1)). Any liquidator appointed must therefore continue to maintain procedures to segregate and keep segregated particular portfolio assets from other portfolio assets and the general assets of the SPC (section 223(1)).

## Third party dealings with SPCs

When dealing with a SPC, a third party should clearly establish which segregated portfolio of the SPC it is dealing with, and therefore which of the relevant segregated assets it has recourse to.

## International recognition for claims against a SPC assets

The concept of statutory segregation of accounts is now well developed and recognised in jurisdictions such as Delaware, Guernsey and Bermuda. However, where a segregated portfolio's assets are located outside the Cayman Islands, it may be prudent to seek legal advice from an insolvency practitioner in the jurisdiction(s) where such assets are located to confirm, among other things, that the concept of statutory segregation of assets will be respected. Furthermore, to reinforce the legal position, it is advisable that Cayman Islands Law be selected to govern contracts to which a SPC is a party and to ensure that such contracts provide that the Cayman Islands courts shall have jurisdiction to determine any disputes arising therefrom.

## Converting an exempted company to a SPC

Part XIV of the Companies Law specifies the steps that are required to be taken before a company which is already in existence as an "exempted company" for the purposes of the Companies Law can be converted into, and acquire the status of, a SPC.

### Summary of Required Steps

There are three principal actions (other than the payment of the relevant fees, which are in the region of US\$1,000) that an exempted company applying to be registered as a SPC (the "**Applicant**") is required to undertake:

1. file a declaration (the "**Declaration**") with the Registrar;
2. pass a special resolution dealing with certain prescribed matters; and
3. change its name to identify itself as a SPC.

Where an Applicant is licensed by CIMA, there are additional requirements under the Companies Law to obtain permission from CIMA to convert to a SPC.

### The Declaration

The Declaration must be made by at least two directors of the Applicant. It must set out an accurate statement of the following matters (section 214(1)(a)(i)-(v)):

1. Assets and liabilities

The assets and liabilities of the Applicant as at a date (the "**A&L Date**") within three months prior to the date of the Declaration (the "**Declaration Date**").

2. Pending material transactions

Any transaction or event which, as at the Declaration Date, has occurred or is expected to occur between the A&L Date and the date of registration of the Applicant as a SPC which, if it had occurred before the Declaration Date, would have caused material changes to the assets and liabilities disclosed in the Declaration.

3. Applicant's intention to operate as a SPC and segregate assets

That the Applicant, on registration as a SPC, intends to operate as a SPC and details of the assets and liabilities which the Applicant proposes to transfer to each of such SPC's segregated portfolios.

4. Solvency of Applicant and segregated portfolios

That, on registration as a SPC, the Applicant, as so registered, and each of its segregated portfolios will be solvent.

5. Consent of creditors to change of status

That each creditor of the Applicant has consented in writing to the transfer of assets and liabilities into segregated portfolios or, alternatively, that adequate notice has been given to all creditors of the Applicant and that 95% by value of such creditors have consented to that transfer of assets and liabilities into

segregated portfolios. Such notice will be adequate if it is in writing and is sent to each creditor having a claim over CI\$1,000 (approximately US\$1,200).

### False declaration

Any director making a Declaration who does so without having reasonable grounds for the information declared or who knowingly makes a false declaration will be guilty of an offence under the Companies Law. Such offence carries a fine of up to CI\$5,000 (approximately US\$6,100) or imprisonment of one year (section 214(3)).

### Special resolution

In addition to filing the Declaration, the Applicant must pass a special resolution of its shareholders authorising the transfer of assets and liabilities into segregated portfolios and attach a copy of such resolution to the Declaration (section 214(1)(b)). For convenience, the change of name (see below) and adoption of the new memorandum and articles of association that will be required for undertaking business as a SPC may be adopted by the same resolution. These special resolutions must be filed with the Registrar.

### Change of name

In order to qualify as a SPC, the Applicant must change its name so that it includes the letters "SPC" or the words "Segregated Portfolio Company" (section 215).

### Change of status

On satisfactory completion of the matters referred to above, an Applicant which is not regulated by CIMA will become a SPC.

Updated: 20 March 2017

For further information please refer to your usual contact or:

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