HARNEYS

Segregated portfolio companies in the Cayman Islands

Any Cayman Islands exempted company (the most common Cayman corporate vehicle limited by shares) may be registered as a segregated portfolio company (an ***SPC***) under the Cayman Islands Companies Act (***Companies Act***). The concept of an SPC is that the company, which remains a single legal entity, may create separate segregated portfolios (each, a ***Portfolio***) with the assets and liabilities of each Portfolio being statutorily ring-fenced from the assets and liabilities of each other Portfolio and the general assets and liabilities of the company. Income and other property of an SPC that is not attributable to any Portfolio constitute the general assets of the company.

Benefits of SPCs

The main benefit of using an SPC for establishing segregation of assets and liabilities, rather than alternative methods such as contractual limited recourse wording, is that the ring-fencing is embedded in statute rather than contract and so has the benefit of statutory recognition in the Cayman Islands.

The other important benefit of the SPC regime is that as a statutory regime under the Companies Act, it also binds non-consensual third parties and so extends the ring-fencing concept to parties who would otherwise not be covered by contractual ring-fencing.

Uses of SPCs

Standard offshore fund structures, such as multi-class hedge funds, umbrella funds, master-feeder structures and managed account platforms, can benefit from the ability to set up statutory ring-fencing to protect against cross liability issues between assets and liabilities of different classes with separate equity and debt profiles. Please see our guide to mutual funds in the Cayman Islands and guide to private funds in the Cayman Islands for further details.

Insurance vehicles, in particular captives, may be set up to provide that individual insurance or product lines are segregated in different Portfolios, to protect them from losses arising from the other categories of business written by the insurer.

Other uses of SPCs include the creation of multiple tranche debt issuing vehicles where an additional level of statutory ring- fencing is preferred to add another level of protection to the usual provision of separate security and/or limited recourse wording.

Establishment of an SPC

Registration

Registration as an SPC can be made either on incorporation of the company or subsequently. Please see our guide to Cayman Islands exempted companies or contact your usual Harney’s representative for details on setting up exempted companies in the Cayman Islands.

Name

The name of an SPC must include the words/letters “Segregated Portfolio Company” or “SPC”.

Conversion to an SPC

Any exempted company in good standing with the Registrar can apply to convert into an SPC.

The company will, along with other formalities, require the consent of its shareholders by a special resolution and the consent of the Cayman Islands Monetary Authority (***CIMA***) if the company is regulated. The company will also require either (i) the consent of all of its creditors; or (ii) to have given adequate notice of the proposal to all creditors and have received the consent of at least 95 per cent by value of all creditors of the company.

Features of an SPC

Satisfaction of liabilities

The liabilities of any specific Portfolio may not be met out of the assets of any other Portfolio. The general liabilities of an SPC may not be satisfied out of the assets attributable to any Portfolio. The general assets of an SPC can however be applied to the liabilities of any Portfolio to the extent that the assets attributable to that Portfolio are insufficient to meet Portfolio liabilities, unless the articles of association (***Articles***) of the SPC expressly prohibit such an application of general assets. It is usual for the Articles to create such a prohibition to prevent the failure of a Portfolio from having any adverse effect on the general assets of the SPC.

Portfolio shares, dividends and distributions

One or more classes of shares may be designated to each Portfolio and the proceeds of issue of those shares are allocable to that same Portfolio alone.

Principles relating to the payment of dividends or other distributions, and the payment of the redemption price of shares, are applied to each Portfolio in isolation as if each Portfolio were a separate legal entity. As such, payments of dividends, distributions and for redemptions of shares may only be funded out of the assets of the Portfolio in respect of which the relevant shares were issued and account only needs to be taken of the balance sheet of the Portfolio that is paying the dividend, distribution or redemption.

Segregation of assets/Entering into of contracts

Directors are required to establish and maintain the segregation both of the general assets of an SPC and the assets of each Portfolio, although the directors are entitled under the Companies Act to move assets between segregated portfolios and between a segregated portfolio and the general assets of the SPC at full value. Each contract or agreement to be entered into on behalf of each Portfolio must also specify on its face that it is entered into by or on behalf of the directors and on behalf of such Portfolio.

Recognition and contractual protection

There has not yet been a case in which a foreign court has specifically ruled on the validity of the segregation of assets and liabilities of a Cayman Islands SPC, although a similar statutory segregation of assets and liabilities is found in an increasing number of jurisdictions. Where assets are located outside of the Cayman Islands it is common to add a level of contractual protection in the relevant transaction documents to provide that recourse is limited to the specific Portfolio assets and also remove grounds for any potential claim of a counterparty raised on the basis that they were unaware of the nature of the statutory restrictions in respect of incurred liabilities.

If required, to reduce exposure to the courts of other jurisdictions, documents evidencing payment obligations can be governed by Cayman Islands law and parties can agree to submit to the exclusive jurisdiction of the Cayman Islands courts in those documents. Care should also be taken with generic set-off and netting provisions found in standard form banking and brokerage documents which will need to be specifically tailored to respect the segregation of assets and liabilities in an SPC structure.

Directors' duties and liabilities

The directors of an SPC have a continuing obligation to make sure that all contracts are entered into in the name of the correct Portfolio and that all assets and liabilities are properly attributed between the general assets and each Portfolio.

The principal duties of directors of all Cayman exempted companies, including SPCs, are derived from English common law. This requires a director of a company to act honestly and in good faith and in what that director believes to be in the best interests of the company. The director must also act for a proper purpose and must not fetter their future discretion.

Please see our guide to directors' duties and obligations under Cayman Islands law for more information on directors' duties.

In addition to the common law duties, the Companies Act provides that any contract or other arrangement which is to be binding on a Portfolio must be executed by or on behalf of the directors on behalf of, and clearly referencing, the relevant Portfolio. The Companies Act also includes a remedial mechanism if an attribution has been incorrectly made, without the directors incurring any personal liability.

Ongoing obligations of an SPC

Please see our guide on continuing obligations of Cayman Islands exempted companies for details on the ongoing requirements of an exempted company.

Winding up, liquidation and receivership

Winding up or liquidation

An SPC may be wound up or liquidated in the same way as any other Cayman Islands exempted company, except when one of its Portfolios is in receivership and leave of the Grand Court is then required for a voluntary winding up. Any liquidator appointed must continue to maintain procedures to segregate and keep segregated Portfolio assets from other Portfolio assets and the general assets of the SPC. The liquidator must only discharge Portfolio creditors' claims from the assets of the relevant Portfolio. If the creditor has only a claim against the general assets of the Company it has no right to claim against the assets attributable to any Portfolio.

Making a receivership order in respect of a particular Portfolio

The Grand Court of the Cayman Islands may make a receivership order and appoint a receiver over a particular Portfolio's assets on the application of the SPC, any director, any creditor or shareholder of a Portfolio or CIMA (for a regulated fund or other regulated entity only).

The Grand Court will make an order if it is satisfied that either:

- the assets attributable to any particular Portfolio are or are likely to be insufficient to discharge the claims of the creditors of that Portfolio, or
- there is a desire for there to be an orderly winding down of the business attributable to any particular Portfolio and it is proposed to distribute the Portfolio's assets to those entitled to have recourse to the Portfolio.

Effect of receivership order

The making of a receivership order by the Grand Court creates a stay of proceedings against the SPC in relation to the Portfolio in respect of which the receivership order is made. No suit, action or other proceedings may be taken or instituted against that Portfolio's assets without the leave of the Grand Court. 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 specific Portfolio's assets.

Effect of general SPC liquidation on a receivership

The Grand Court cannot make a receivership order if the SPC is in liquidation and any receivership order made ceases to be of effect on the commencement of any liquidation of the SPC. An SPC may not commence a voluntary winding up without the prior leave of the Grand Court if any of its Portfolios are the subject of a receivership order. The remuneration and expenses of a receiver are met from the assets of the specific Portfolio in respect of which the receiver was appointed in priority to all other claims.

Termination of a Portfolio

Where a Portfolio has no assets or liabilities attributable to it, the SPC may by resolution of its directors terminate such Portfolio.

Economic Substance

The International Tax Co-operation (Economic Substance) Act (the ***ES Act***) was introduced in the Cayman Islands in response to OECD's Base Erosion and Profit Shifting framework and related EU initiatives in relation to what are known as 'Geographically Mobile Activities'.

The ES Act is supplemented by the Guidance Notes issued by the Cayman Islands Tax Information Authority (the ***TIA***) on Economic Substance for Geographically Mobile Activities.

Under the ES Act any 'relevant entity' which carries on a 'relevant activity' and receives 'relevant income' in a financial period must satisfy the economic substance test in relation to that activity and make an annual filing with the TIA.

Please see our guide to economic substance in the Cayman Islands for further details of the ES Act.

Funds regulation and AML compliance

If an SPC is established as an open-ended investment fund and falls within the definition of a "mutual fund" under the Mutual Funds Act, or if it is a closed ended fund and falls within the definition of a "private fund" under the Private Funds Act, it may be regulated by CIMA and will also have to comply with Cayman Islands anti-money laundering legislation.

Please see our guide to mutual funds in the Cayman Islands and guide to private funds in the Cayman Islands or contact your usual Harneys representative for more information about SPCs which are established as mutual funds or private funds.

For more information and key contacts please visit **harneys.com**