Marbury Client and Friend Memo
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Cayman Islands

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Segregated portfolio companies in the Cayman Islands

What is an SPC

Segregated Portfolio Company or Protected Cell legislation exists in the laws of several countries. The most commonly used jurisdictions are the Cayman Islands, British Virgin Islands and Bermuda (all of which are offered within the Marbury group). This memo deals specifically with the Cayman Islands, although concepts are mostly valid across all three jurisdictions.

Any Cayman Islands exempted company limited by shares is capable of being registered, either on incorporation or subsequently, as a segregated portfolio company (an **SPC**) under the Cayman Islands Companies Law (Revised) (**Companies Law**). The concept of an SPC is that the relevant company, which remains a single legal entity, may create separate segregated portfolios (each, an **SP**) very much in the same way that any company may create classes or series of shares. The key distinction is that the assets and liabilities of each SP are statutorily ring-fenced from the assets and liabilities of each other SP as well as from the general assets and liabilities of the SPC.

Assets or liabilities not allocated by the directors or attributable to any specific SP will form a part of the general assets of the SPC.

SPs themselves do not acquire legal personality and all acts of an SP must be authorised and approved by the SPC for and on behalf of that SP.

Introduction to SPCs

Legislative vs Contractual Segregation

Rather than segregating classes by resorting to limited recourse language in contract, for SPCs the Companies Law recognises ring-fencing of assets and liabilities between SPs. Amongst the many practical and legal benefits,

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statutory segregation binds non-consensual third parties and so extends the ring-fencing concept to parties who would otherwise not be covered by contractual ring-fencing.

Satisfaction of liabilities

Each SP meets its own liabilities out of its own assets. The general liabilities of an SPC may not be satisfied out of the assets of any SP. However, general assets of an SPC can be applied to the liabilities of any SP to the extent that the assets attributable to that SP are not sufficient to meet SP liabilities, unless the articles of association of the SPC expressly prohibit it.

General characteristics of SP shares

SPs can create one or more classes of shares or series, and issue shares to each of these classes and series within the SP.

Principles relating to the payment of dividends (or other distributions) and the payment of the redemption price of shares, are applied to each SP in isolation as if each SP were a separate legal entity. Accordingly, distributions and redemptions must only be funded out of the assets of the SP in respect of which the relevant shares were issued and proceeds taken off the balance sheet of the SP that is paying out the distribution or redemption.

Segregation of assets / contracts of agreement

Directors are required to establish and maintain the segregation both of the general assets of an SPC and the assets of each SP, although the directors are entitled under the Companies Law to move assets between segregated portfolios and between a segregated portfolio and the general assets of the SPC at full value.

In order to ensure proper segregation, directors need to ensure that all agreements on behalf of an SP must also specify on its face that it is entered into by or on behalf of the directors and for or on behalf of that SP.

Directors' duties and liabilities

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

A director is however appointed to the SPC and not to each individual SP. This means that the principal duties of directors derived from English common law apply. For completeness, these duties are 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.

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

Cayman Islands SPCs

Legal recognition and contractual protection

No specific legal proceeding in a foreign court has ruled on the validity of the segregation of assets and liabilities of a Cayman Islands SPC. The principle in international law regarding these matters however directs foreign courts to apply the law of the jurisdiction of incorporation when dealing with company laws. It is also notable that 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 relevant transaction documents to provide that recourse is limited to the specific SP assets, and also remove grounds for any potential claim of a counterparty on the basis that it was unaware of the nature of the statutory restrictions in respect of incurred liabilities (estoppel).

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.

Uses of SPCs

Originally the concept of SPCs was directed toward the insurance industry, in particular captives. The benefit here is that each individual insurance or product line can be ring-fenced in a separate SP, to protect the insured from losses arising from the other categories of business written by the insurer. It also provides the insurer with greater flexibility and cuts risk from cross contamination.

More widely applied to offshore fund structures these days, standard or complex fund structures benefit from the ability to statutorily ring-fence assets and liabilities of what would ordinarily be different classes with separate equity and debt profiles to protect against the risk of cross default or other liability issues. It can reduce cost if properly used and while administration is different and requires some careful attention, vehicles can be quickly and efficiently created with little of the usual regulatory fuss.

Incorporation and ongoing requirements

Fees are payable to the Registrar of Companies in the Cayman Islands (**Registrar**) on incorporation of an SPC and annually, including fees for each additional segregated portfolio established.

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 have either (i) obtained the consent of all of its creditors; or (ii) 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.

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 SPs 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 SP assets from other SP assets and the general assets of the SPC. The liquidator must only discharge SP creditors' claims from the assets of the relevant SP. If the creditor has only a claim against the general assets of the SPC it has no right to claim against the assets attributable to any SP.

For further information on any aspect of this guide please contact your usual Marbury advisor.

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