

# Structuring crypto-focused investment funds and token issuance vehicles

*Richard Spencer, of Campbells, discusses structuring considerations for crypto-focused funds and token issuance vehicles in the Cayman Islands*

A significant number of crypto-focused private investment funds have launched during the first half of 2018, with investment managers continuing to structure many of these through the Cayman Islands. This is unsurprising, as international investors have long regarded the Cayman Islands as the leading offshore investment funds jurisdiction, and the Cayman Islands' investment funds regime is well suited to emerging asset classes. The Cayman Islands are home to more than 10,500 regulated investment funds, with an aggregate net asset value in excess of \$3.5trn.

The Cayman Islands' legal and regulatory landscape also supports the development and monetisation of distributed ledger technology. Having worked with the founders of some of the largest and most exciting projects in this space over



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the past 18 months, we note that many are now choosing to establish a physical presence in the Cayman Islands.

## Investment fund structures

The selection of an appropriate fund structure is largely driven by onshore tax considerations and investor preference. The most common fund structures in this space are standalone funds, parallel funds, master-feeder funds and mini-master funds.

A standalone fund is the simplest structure, with investors subscribing for interests in a single vehicle,

while a parallel fund typically consists of a standalone onshore fund and a standalone Cayman Islands fund, with both funds being managed identically and investing in parallel. A master-feeder fund typically consists of an onshore feeder fund and a Cayman Islands feeder fund that each feed into a Cayman Islands master fund. A mini-master fund consists of a Cayman Islands feeder fund that feeds into an onshore master fund. The choice of jurisdiction for the investment management vehicle is usually determined with reference to the principals' tax considerations and onshore regulatory considerations.

The Exempted Company continues to be the most popular Cayman Islands vehicle for crypto-focused fund structures, with each investor's liability being limited to the amount paid or agreed to be paid in respect of their shares. It is standard

practice to appoint at least one Cayman Islands-based independent director to the company's board, and in many cases a majority of independent directors will be appointed to the board.

Some investment managers prefer to use a Segregated Portfolio Company (SPC), being an Exempted Company that has registered as an SPC. It can be used as a cost-effective "umbrella" fund structure, allowing the manager to offer a range of different crypto-focused investment strategies, with segregation of assets and liabilities between each segregated portfolio. This statutory segregation is particularly important where leverage is used in respect of one strategy and not others.

An Exempted Limited Partnership (ELP) is the vehicle of choice for closed-ended investment funds, and as such it is not typically used in structuring new Cayman Islands crypto-focused funds. Other Cayman Islands fund vehicles include Limited Liability Companies (LLCs) and unit trusts.

### Regulation

Crypto-focused investment funds that are open-ended typically fall within the definition of a "mutual fund" under the Mutual Funds Law (Revised) (the MF Law). Accordingly, most Cayman Islands crypto-focused funds are registered with the Cayman Islands Monetary Authority (Cima) under Section 4(3) of the MF Law, which involves a straightforward online registration process. Such funds are prohibited from accepting initial subscriptions of less than \$100,000 per investor and must appoint an administrator and a Cayman Islands auditor.

Open-ended Cayman Islands investment funds with 15 or fewer investors, the majority of whom are capable of removing the directors, trustee or general partner (as applicable), are not required to register with Cima. In the early days of structuring crypto-focused investment funds, such "exempted fund" structures were popular, principally because it was difficult to find a Cayman Islands auditor to audit investment funds that accepted cryptocurrency from their investors and invested in digital assets. In 2018,

fund managers now have a much better selection of service providers, including a number of audit firms, fund administrators and independent directors.

Cayman Islands investment funds that are closed-ended do not fall within the definition of a "mutual fund" under the MF Law, and as such they are not required to register with Cima. It is relatively uncommon to establish a dedicated closed-ended fund with a cryptocurrency or digital asset strategy; however we have seen a number of managers of existing closed-ended funds revise their investment strategies and restrictions in recent months to permit some exposure to cryptocurrencies and digital assets.

## ***Cayman Islands structures are fast becoming the gold standard in this space***

When structuring tokenised investment funds, additional legal and regulatory considerations may apply, and fund managers should also consider how a secondary market for the tokens will function in practice.

### Service providers

It is important for fund managers to undertake thorough due diligence on prospective service providers, in order to ensure that they have appropriate experience and resources. For example, in respect of funds that are looking to accept cryptocurrencies or digital assets from investors as in specie subscriptions, fund managers will need to identify fund administrators and auditors that are able to implement best practices in this regard.

### Investment strategies

Typically, an offering memorandum issued by a Cayman Islands crypto-focused fund will permit investments in digital assets of any kind, including virtual currencies, tokens and tokenised securities. Such funds may also participate in token pre-sales, purchase equity in private distributed ledger technology companies, and attempt to profit from information asymmetries and

market inefficiencies in this space. It is crucial that the offering memorandum discloses sector-specific risks applicable to investments of this type.

### Crypto SPVs

We are increasingly seeing standalone Cayman Islands entities formed by high-net-worth and family office investors to participate in Simple Agreements for Future Tokens (SAFTs) and token issuances, with management and advisory entities being registered with Cima as "excluded persons" under the Securities Investment Business Law.

### Distributed ledger technology and token-issuance companies

Cayman Islands crypto-focused funds and SPVs often purchase SAFTs and tokens issued by other Cayman Islands entities. These issuers typically fall outside the scope of the MF Law; however it is important to consider the applicability of other Cayman Islands' legislation and regulations on a case-by-case basis, with reference to the rights attached to the underlying tokens and their functionality. A variety of structuring options are available for such vehicles, including Exempted Companies, LLCs and Foundation Companies.

The tax neutrality of the Cayman Islands is a key driver for using Cayman Islands vehicles to hold and develop group intellectual property. Distributed ledger technology groups are also increasingly considering whether to establish a physical presence in the Cayman Islands, benefiting from a fast-track and low-cost trade licensing process in the Special Economic Zone.

### Conclusion

We are delighted to see the continued growth in the number of crypto-focused funds and distributed ledger businesses being established in the Cayman Islands, and we expect this trend to continue throughout the second half of 2018 and into 2019. With positions on each of the active Fintech and digital asset committees in the Cayman Islands, we look forward to contributing to sector-specific regulations and guidance in the coming months. [HEM](#)