

Fund Management Business

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Relevant Activity – What is a “fund management business”?

“Fund management business” means the business of managing securities as set out in paragraph 3 of Schedule 2 to the Securities Investment Business Act (2020 Revision) carried on by a relevant entity licensed or otherwise authorised to conduct business under that Act for an investment fund.

“[M]anaging securities as set out in paragraph 3 of Schedule 2 to the Securities Investment Business Act (2020 Revision)” means managing securities belonging to another person in circumstances involving the exercise of discretion. This does not extend to other activities such as arranging deals in securities or providing non-binding discretionary advice.

The word “licensed” covers only the small minority of entities that are fully licensed under SIBA and does not extend to entities registered as registered persons under SIBA.

The words “authorised to conduct business” applies to entities that are registered persons under SIBA.

A licensed or registered entity therefore engages in a ‘fund management business’ where it manages securities belonging to an investment fund on a discretionary basis.

For the avoidance of doubt, an entity which is carrying on ‘fund management business’ for the purposes of the International Tax Co-operation (Economic Substance) Act (2021 Revision), as amended (the “**ES Act**”) cannot be classified as an ‘investment fund’ for the purpose of the ES Act.

Source: Cayman Islands Economic Substance Guidance Notes v3.1, page 19

Economic Substance Test

A ‘relevant entity’ that conducts one or more ‘relevant activity’, will need to satisfy the Economic Substance Test (“**ES Test**”) in respect of each relevant activity conducted.

The ES Test requires that a relevant entity:

- (a) conducts ‘Core Income Generating Activities’ (“CIGA”) in relation to its relevant activity(ies);**

‘Core Income Generating Activities’ means activities that are of central importance to the relevant entity in terms of generating relevant income and must be carried on in the Cayman Islands.

A relevant entity will satisfy the ES Test in relation to a relevant activity if its core income generating activities in relation to that relevant activity are conducted by any other person and the relevant entity is able to monitor and control the carrying out of the Cayman Islands core income generating activities by that other person.

(b) is directed and managed in an appropriate manner in the Islands in relation to its relevant activity(ies); and

The ES Act provides that a relevant entity satisfies this limb of the ES Test if in relation to the relevant activity:

- (i) the relevant entity's board of directors, as a whole, has the appropriate knowledge and expertise to discharge its duties as a board of directors in relation to the relevant activity;
- (ii) meetings of the board of directors are held in the Islands at adequate frequencies given the level of decision making required in relation to the relevant activity;
- (iii) during a meeting of the board of directors described in paragraph (ii), there is a quorum of directors present in the Islands;
- (iv) the minutes of the meetings of the board of directors described in paragraph (ii) record the making of strategic decisions of the relevant entity at the meeting; and
- (v) the minutes of all meetings of the board of directors and appropriate records of the relevant entity are kept in the Islands.

(c) having regard to the level of relevant income derived from the relevant activity carried out in the Islands (i) has an adequate amount of operating expenditure incurred in the Islands; (ii) has an adequate physical presence (including maintaining a place of business or plant, property and equipment) in the Islands; and (iii) has an adequate number of full-time employees or other personnel with appropriate qualifications in the Islands.

What is adequate or appropriate for each relevant entity will depend on the particular facts of the relevant entity and its business activity. A relevant entity will have to ensure that it maintains and retains appropriate records to demonstrate the adequacy and appropriateness of the resources utilized and expenditures incurred.

Source: Cayman Islands Economic Substance Guidance Notes v3.1, page 16

CIGA for Fund Management Business

CIGA with respect to every type of relevant activity means activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on in the Islands.

In relation to fund management business, CIGA includes -

(a) Taking decisions on the holding and selling of investments

This head of CIGA is focused on the actual taking of decisions regarding the acquisition, disposal or trading of investments. The decisions would need to be taken in the Islands by an investment committee, board of directors or equivalent. It is necessary for a quorum of directors to be physically present in the Islands in order to treat their decisions as being made in the Islands.

(b) Calculating risk and reserves

A fund manager can satisfy this head of CIGA by assessing its client investment fund's risk as a whole, and calculating the overall risk across the investment fund and the reserves required on a strategic basis. An investment fund's risks typically include market risk, credit risk (where applicable), liquidity risk as well as operational risks.

(c) Taking decisions on currency or interest fluctuations and hedging positions

A fund manager can satisfy this CIGA by taking a strategic approach on risk management of its client investment fund's overall position arising from currency or interest rate fluctuations. For example, the fund manager's CIGA could include conducting FX, interest rate or other hedging functions, or similar, with a view to controlling risks or optimising exposures of the client investment fund.

(d) Preparing reports or returns, or both, to investors or the Cayman Islands Monetary Authority, or both

A fund manager can satisfy this head of CIGA by ensuring that there are systems and processes in place so that the fund manager is able to provide its client investment fund with accurate information on the investment fund's financial position on a timely basis. It is acceptable for the investment fund's administrator or other person to perform the administrative task of compiling the various routine reports and returns for the investment fund to its investors and any regulatory returns to the Cayman Islands Monetary Authority, however the fund manager should ensure that such contractual arrangements are in place so as to allow for appropriate reporting to be available in a timely manner.

Outsourcing outside the Islands

A relevant entity conducting fund management business must satisfy the ES Test for that relevant activity with respect to the particular heads of CIGA for fund management business that it undertakes. If a relevant entity outsources certain aspects of its CIGA to a person within the Islands, that is deemed to remain part of and to satisfy that part of the relevant entity's CIGA to the extent it is supervised appropriately by the relevant entity.

If a relevant entity is not able to satisfy the ES Test for a head of CIGA due to it having outsourced the CIGA to a foreign service provider, (for example an investment manager resident in the US, UK or Hong Kong) then the relevant entity should not receive the relevant income for this activity. In practical terms this means that the [Tax Information Authority](#) (the "**Authority**") would not expect to see the relevant entity having fee income in respect of such head of CIGA.

Source: Cayman Islands Economic Substance Guidance Notes v3.1, pages 61-62

Economic Substance Reporting

Entities that are in-scope under the ES Act (i.e. 'relevant entities' conducting 'relevant activities') will be required to report certain information on their relevant activities in the Cayman Islands, in particular the extent to which core income generating activities are being conducted in the Cayman Islands, on an annual basis to the Authority.

An Economic Substance Return (“**ES Return**”) must be submitted each year within twelve months of the relevant entity’s financial year end. Together with the ES Return, the entity will be required to upload appropriate documents (i.e. financial statements or books of account) that give a true and fair view of the state of the entity’s affairs and to explain its transactions.

Source: Cayman Islands Economic Substance Guidance Notes v3.1, page 28

Contact your Campbells attorney or regulation@campbellslegal.com if you have questions about Economic Substance Reporting.

For more information about Relevant Activity, CIGA, the ES Test and Economic Substance Reporting, please review the *Cayman Islands Economic Substance Guidance Notes v3.1* and additional DITC-issued Resources available [here](#).

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