

# Cayman Islands Economic Substance Requirements – Relevant Activity of Fund Management Business

For general background on The International Tax Co-operation (Economic Substance) Law (2020 Revision) (the "Economic Substance Law"), the related Guidance on Economic Substance for Geographically Mobile Activities (the "Guidance") and for the meaning of 'relevant entity', please refer to our main update<sup>1</sup>.

This update assumes that an entity has already been determined to be a relevant entity under the Economic Substance Law and that the relevant entity is now considering whether it is carrying on one of the nine categories of geographically mobile relevant activities - in particular, under the 'fund management business' category.

## What is fund management business?

Fund management business in the Economic Substance Law is defined as "*the business of managing securities as set out in paragraph 3 of Schedule 2 to the Securities Investment Business Law (2020 Revision) ("SIBL") carried on by a relevant entity licensed or otherwise authorised to conduct business under that Law for an investment fund.*"

The relevant definition of "managing securities" in SIBL is "*managing securities belonging to another person in circumstances involving the exercise of discretion*".

The reference in the Economic Substance Law to persons "*otherwise authorised to conduct business*" includes entities that are registered under SIBL as Registered Persons, or licensees, with the Cayman Islands Monetary Authority ("CIMA"), under SIBL.

## Economic Substance Test

If a relevant entity carries on the relevant activity of fund management business it will be subject to the economic substance test set out in the Economic Substance Law (unless it has no relevant income in respect of that relevant activity, in which case only notification and reporting obligations will apply). The economic substance test ("ES Test") can be satisfied in relation to that fund management business if the relevant entity:

- (a) conducts core income generating activities in the Cayman Islands;
- (b) is directed and managed in an appropriate manner in the Cayman Islands; and

---

<sup>1</sup><https://maples.com/Knowledge-Centre/Industry-Updates/2020/09/Cayman-Islands-Update-Economic-Substance-Guidance-Notes-v3-Issued>

- (c) has adequate operating expenditure, physical presence and personnel in the Cayman Islands.

### Core Income Generating Activities

The relevant core income generating activities ("CIGA") in the context of fund management businesses include:

- (a) taking decisions on the holding and selling of investments;
- (b) calculating risk and reserves;
- (c) taking decisions on currency or interest fluctuations and hedging positions; and
- (d) preparing reports or returns, or both, to investors or CIMA, or both.

### The Guidance on Fund Management Business

The Guidance contains a sector specific section on fund management business, which elaborates on each limb of CIGA, and provides indications of measures which are unlikely to satisfy each limb.

For example, in terms of the decision taking CIGA, the Guidance provides "*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.*"

### Guidance on Outsourcing

While outsourcing of CIGA is permitted within the Cayman Islands, subject to certain conditions, for outsourcing outside the Cayman Islands, the Guidance explains "*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.*"

Outsourcing of non-CIGA to foreign service providers is permitted and does not impact the ES Test.

### Notification and Reporting

In light of the revised registration regime under the SIBL, Registered Persons conducting fund management business can regard 2020 as the first year of conducting relevant financial business.

Accordingly, any notification made to the DITC in 2020 should have reflected that the entity had not conducted a relevant activity in 2019. The notification to be made in 2021 will reflect the fund management activity in 2020.

As ES Returns must be made by relevant entities conducting relevant activity in the prior year, there is no obligation for Registered Persons to submit an ES Return in 2020, but they will need to submit an ES Return in 2021, in relation to 2020 relevant activity.

### What should a relevant entity carrying on the relevant activity of fund management business do?

Careful consideration as to the individual circumstances of any relevant entity carrying on fund management business is required, as they may be relevant in determining the 'adequacy' or 'appropriateness' of certain factors. We recommend relevant entities carrying on the relevant activity of fund management business seek legal advice with respect to compliance with the ES Test.

It is worth noting that there are a range of consequences for breaches of the Economic Substance Law (including financial penalties and potential striking-off).

If you have any questions in relation to a relevant entity conducting fund management business or on this update please reach out to your usual Maples Group contact or to:

**Chris Capewell**

+1 345 814 5666

chris.capewell@maples.com

**Martin Livingston**

+1 345 814 5243

martin.livingston@maples.com

**October 2020**

**© MAPLES GROUP**

This update is intended to provide only general information for the clients and professional contacts of Maples Group. It does not purport to be comprehensive or to render legal advice.