



Segregated portfolio companies in the Cayman Islands

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The purpose of this memorandum, which has been prepared for the assistance of anyone who is considering establishing a segregated portfolio company in the Cayman Islands, is to provide a summary of its key features and to examine some of its potential uses.

This memorandum is intended to provide a general summary of the position under Cayman Islands law as at the date shown on the cover; it is not to be taken as specific legal advice applicable to particular issues or circumstances. Anyone considering establishing a segregated portfolio company should contact one of the Ogier partners listed here.

Introduction

A segregated portfolio company (**SPC**) is a type of exempted company, first introduced in the Cayman Islands in May 1998 by an amendment to the Companies Act (Revised) (**Companies Act**). The concept of an SPC is that a company, which remains a single legal entity, may create segregated portfolios (**Portfolios**) such that the assets and liabilities of each Portfolio are legally separate from the assets and liabilities of any other Portfolio and from the SPC's general assets and liabilities. This is known as the segregation principle.

The central tenets of the segregation principle, as prescribed by the Companies Act, are these:

As regards each Portfolio's assets:

- those assets are only available and may only be used to meet liabilities to the creditors and shareholders of the SPC who are, respectively, creditors in respect of that Portfolio or holders of shares attributable to that Portfolio and are entitled to recourse to those assets for that purpose

- those assets are not available and may not be used to meet liabilities to creditors of the SPC who are not creditors in respect of that Portfolio or liabilities to shareholders of the SPC who are not holders of shares attributable to that Portfolio

As regards each Portfolio's liabilities (being liabilities in respect of or attributable to that Portfolio):

- each such liability extends only to, and the person in respect of that liability is entitled to have recourse only to:
 - firstly, that Portfolio's assets
 - secondly, unless the SPC's articles specifically prohibit, the SPC's general assets to the extent that Portfolio's assets are insufficient to meet the liability (and to extent that the SPC's general assets exceed any minimum capital amount lawfully required by a regulatory body in the Cayman Islands)
- each such liability does not extend to, and the person in respect of that liability is not entitled to have recourse to, any other Portfolio's assets

The segregated-portfolio concept also exists in various other jurisdictions (such as Delaware, Bermuda, British Virgin Islands, Guernsey and Jersey) and has become increasingly well understood and recognised. In May 2012, the Cayman Islands Court of Appeal, in *ABC Company (SPC) v J & Co. Ltd* (this was the first Cayman case to consider the SPC provisions), acknowledged the separateness of segregated portfolios while emphasising that the SPC's status as a single legal entity. This decision is considered below in more detail.

At first, the Companies Act restricted the use of SPCs to certain licensed insurers, but refinements in 2002 and 2003 progressively lifted the restrictions, culminating in the present-day position that allows any Cayman Islands exempted company to apply to the Registrar of Companies (**Registrar**) to be registered as an SPC.

Establishment of an SPC

Any Cayman Islands exempted company may apply to the Registrar to be registered as an SPC.

Contracts on behalf of a Portfolio of an SPC

The Companies Act requires that any transaction or arrangement which is to be binding on or to enure to the benefit of a Portfolio shall be executed by the SPC on behalf of that Portfolio, which must be identified or specified, and such execution must specify that it is in the name of, by, or for the account of, that Portfolio.

If the SPC breaches this requirement then, immediately upon becoming aware of the breach, directors must:

- make any necessary enquiries to determine the correct Portfolio to which the relevant transaction or arrangement should be attributed
- make the correct attribution
- notify in writing all persons which are party to the transaction or arrangement that was executed, or which may be adversely affected by any such attribution, of that attribution and the parties' rights under subsection (3)

Subsection (3) provides that any person so notified (or who should have been so notified) who objects to such attribution by the directors may, within 30 days of receiving written notice in the case of persons who received such notice, apply to the Grand Court of the Cayman Islands by petition for a re-attribution; and the Court may, upon hearing the petition and taking account of the intention of the parties and such other factors as are deemed relevant by it, order that the transaction or arrangement be deemed to be attributable to a particular Portfolio or Portfolios or to the general assets (if applicable in particular proportions or on a particular basis) and may make such ancillary orders as may be just and equitable in the case.

Structural features of an SPC

The SPC's memorandum and articles of association need to take note of, and the SPC needs to give effect to, the following key structural features that characterise an SPC:

Name

A segregated portfolio company must include the letters 'SPC' or the words 'Segregated Portfolio Company' in its name.

Designation of portfolios

An SPC may create one or more Portfolios in order to segregate the assets and liabilities held by the SPC on behalf of one Portfolio from the assets and liabilities held on behalf of any other Portfolio and from the SPC's general assets and liabilities. One or more classes or series of shares may be designated to each Portfolio, and the proceeds of issue of any shares so designated must be included in the assets of the relevant Portfolio. Each Portfolio is required to be separately identified and to include in its identification the words 'Segregated Portfolio' or 'SP' or 'S.P.'.

Distributions and redemptions

Principles relating to the payment of dividends or other distributions, and the payment of the

redemption or repurchase price of shares, are applied to each Portfolio in isolation, so that an SPC may pay a dividend or other distribution in respect of Portfolio shares of any class or series regardless of whether a dividend or distribution would be permitted to be paid in respect of any other Portfolio. Payments in respect of dividends, distributions and redemptions of shares may only be paid out of the assets of the Portfolio in respect of which the relevant shares were issued.

Segregation of assets

The assets of an SPC are either general assets or Portfolio assets. The general assets of an SPC comprise those assets of the SPC that are not assets of any Portfolio. The assets of a Portfolio comprise the share capital and reserves attributable to the Portfolio and all other assets attributable to the Portfolio.

To give effect to the segregation principle described above, it is the duty of the directors to establish and to maintain the segregation of the following: (i) of the general assets from Portfolio assets, and (ii) of the assets of each Portfolio from those of any other Portfolio and from the general assets.

To recap, there are two elements of the segregation principle as regards the assets of a Portfolio:

- The positive element is that such assets may be used to meet liabilities to the creditors and shareholders of the SPC who are, respectively, creditors in respect of that Portfolio or holders of shares attributable to that Portfolio, but for no other purpose.
- The negative element is that such assets must not be used to meet liabilities to creditors of the SPC who are not creditors in respect of that Portfolio or liabilities to shareholders of the SPC who are not holders of shares attributable to that Portfolio.

Segregation of liabilities

To recap on the segregation principle as regards the liabilities of an SPC in respect of, or attributable to, a particular Portfolio, it similarly has two elements:

- The positive element is that the person in respect of each such liability of that Portfolio may have recourse to (but only to):
 - firstly, that Portfolio's assets
 - secondly, unless the SPC's articles specifically prohibit, the SPC's general assets to the extent that Portfolio's assets are insufficient to meet the liability (and to extent that the SPC's general assets exceed any minimum capital amount lawfully required by a regulatory body in the Cayman Islands)
- The negative element is that the person in respect of each such liability is not entitled to have

recourse to any other Portfolio's assets.

One should note that it is possible for the SPC's articles to provide that there will be no overspill of a liability from an insolvent Portfolio to the SPC's general assets.

General assets and liabilities

Income and other property and rights of an SPC not attributable to any Portfolio must be applied to, and are comprised in, the company's general assets. Liabilities of an SPC not attributable to any of its Portfolios may only be discharged from the company's general assets.

Inability to invest across Portfolio

As a Portfolio is not a separate legal entity, distinct from the SPC itself or from any other Portfolio, the general case law stipulating that a company may not purchase shares in itself applies so that a Portfolio it is not able to invest into another Portfolio of the same SPC.

This position has been tailored for insurance companies. Following an amendment to the Insurance Act effected by the Insurance (Amendment) Act 2013, insurers that are registered as SPC's are able to incorporate one or more of their cells as 'portfolio insurance companies' (PICs). Each PIC is a subsidiary of the SPC, with the shares of the subsidiary being held by the SPC attributable to a particular Portfolio. A PIC is a separate legal entity that is able to contract with others in its own right, including other PICs in the same SPC.

Inability to enter into binding agreement across Portfolios

One of the limitations of an SPC is that a Portfolio cannot enter into a binding agreement with another Portfolio, as they do not constitute two separate contracting parties.

As noted above, in the case of insurance companies established as SPC's, an insurer registered as an SPC is able to incorporate each of its 'cells' as a 'portfolio insurance company' (PIC); each PIC is a subsidiary of the SPC, and the shares in a PIC are held by the SPC attributable to a particular Portfolio.

Limitation of directors' indemnity

Any indemnity given by an SPC in favour of a director in respect of a liability incurred by the director on behalf of a Portfolio is enforceable only against the assets of the Portfolio in respect of which the liability arose.

Conversion of a 'standard' exempted company to an SPC

A company may convert from a 'standard' exempted company into an SPC by:

- filing with the Registrar a declaration made by at least two directors setting out an accurate statement of certain prescribed matters, such as: the company's assets and liabilities, the assets and liabilities it proposes to transfer to each of its segregated portfolios, the requisite consent of creditors, and the fact that the company as a whole and each segregated portfolio will be solvent
- passing a special resolution of its shareholders authorising the transfer of assets and liabilities into segregated portfolios
- where the company is licensed, obtaining the consent of the Cayman Islands Monetary Authority (CIMA)

Implications of cross-border contracts

A risk of an SPC entering into cross-border transactions is that, if proceedings were brought in a jurisdiction outside the Cayman Islands, the courts of that foreign jurisdiction may not recognise and give effect to the segregation principle that prevents the assets of one Portfolio being applied to meet the liabilities of another Portfolio.

As the assets of Portfolios are likely to be held outside the Cayman Islands, it is recommended that, where possible, contracts entered into by an SPC on behalf of a Portfolio be governed by Cayman Islands' law and be subject to the exclusive jurisdiction of the Cayman Islands' courts.

If a contract entered into by an SPC on behalf of a Portfolio is neither governed by Cayman Islands' law nor subject to the exclusive jurisdiction of the Cayman Islands' courts, then specific provisions should be inserted into the contract limiting the recourse of the counterparty to the assets of the relevant Portfolio. Particular care should be taken with respect to bank accounts to ensure that rights of set off are not accidentally granted (by use of a bank's standard documentation) over all accounts maintained by an SPC regardless of the different Portfolios to which they relate.

Annual requirements

Every exempted company (including an SPC) must file an annual return, together with the appropriate annual filing fee, with the Registrar in January of each year. The annual return confirms that the requirements of the Companies Act in relation to an exempted company have been complied with since the date of incorporation or, as the case may be, since the previous annual return. The annual return filing will usually be dealt with by the service provider which maintains the registered office of the company in the Cayman Islands.

In addition to the annual return, an SPC must file a notice with the Registrar containing the names of each Portfolio that it has created, and pay additional fees. If the SPC is regulated by CIMA, for

example, if it is a mutual fund or insurance company, then it also needs to make filings with CIMA.

Winding up and receivership

An SPC, like any other Cayman Islands company, may be wound up voluntarily or by the court. But as the Court of Appeal explained in *ABC Company (SPC) v J & Co. Ltd*, such liquidation is only available with respect to the SPC as a whole; liquidation of an individual Portfolio is not possible. By contrast, it is possible for the court to make a receivership order in respect of an individual Portfolio, but (as the Court of Appeal also explained) it may only make such an order on the ground that the assets attributable to that Portfolio are or are likely to be insufficient to discharge the claims of creditors in respect of that Portfolio; there is no jurisdiction to make such an order on any other ground, such as the just and equitable ground. A receivership order may be made on application by the SPC, its directors, any creditor of the SPC in respect of the relevant Portfolio, any holder of shares issued by the relevant Portfolio, or by CIMA where the SPC is licensed or regulated by CIMA. However, such an order cannot be made if the SPC is being wound up.

Once a receivership order has been made in respect of a Portfolio, the powers of the SPC's directors cease in respect of the business and assets attributable to that Portfolio. When an application has been made for a receivership order in respect of a Portfolio, and for so long as that receivership continues, there is a stay of proceedings against the SPC in relation to the Portfolio that is the subject of the order - no suit, action or other proceedings may be instituted against the SPC in respect of that Portfolio without the leave of the court. However, the 'stay in proceedings' does not prevent a secured creditor from enforcing its security against assets of the Portfolio notwithstanding the making of a receivership order.

Whether an SPC is being wound up, or a receiver has been appointed to the assets of one or more Portfolios, the liquidator or receiver, as the case may be, must give effect to the segregation principle.

Some potential uses of an SPC

Investment funds

Cayman SPC's are a popular vehicle for use by investment funds, particularly in the context of multi-class funds in which one or more portfolios uses, as part of its investment strategy, leverage, short sales and other tools that potentially create substantial liabilities to third parties. Multi-class funds have historically sought to prevent liabilities spilling over from one class to another by creating trading subsidiaries through which the assets of the class (akin to a segregated portfolio in an SPC) engaging in such a strategy would be invested. However, there are various risks associated with this approach, (for example, a court might deem the trading subsidiary to be a mere agent of the multi-class fund and thus prejudice the containment of liabilities at the trading-subsubsidiary level), and the creation of trading subsidiaries results in a high cost of rolling out additional

portfolios. The relatively low cost of rolling out new portfolios and the statutory segregation between portfolios may make an SPC a preferable structure.

An Ogier partner can advise on the pros and cons of an SPC and the alternatives.

Captive insurers

The SPC was first used in the Cayman Islands by captive insurers, and it continues to be a popular structure as it allows an insurer to add additional participants in a reinsurance programme without risk of cross liability.

It is a significant benefit to participants in a 'rent-a-captive' programme whereby those wishing to organise their own insurance or reinsurance can become shareholders in a Portfolio of an existing SPC, managed by an experienced insurance manager. There are savings in time and cost in creating a new Portfolio as opposed to creating a new company or limiting recourse contractually. The participants in a captive programme contribute premiums to the Portfolio through which their business is placed and are entitled to distributions solely from that Portfolio. On completion of a particular programme, the relevant Portfolio is wound up and the shares issued by that Portfolio held by the participant are redeemed and cancelled.

Structured-finance vehicles

Cayman exempted companies are widely used as bankruptcy-remote vehicles in structured-finance and capital-markets transactions. The SPC structure allows a single company to act as multi-issuer structured-finance vehicle, and the legal structure of an SPC is recognised by the leading rating agencies as meeting the legal criteria required of a bankruptcy-remote special-purpose company.

About Ogier

Ogier is a professional services firm with the knowledge and expertise to handle the most demanding and complex transactions and provide expert, efficient and cost-effective services to all our clients. We regularly win awards for the quality of our client service, our work and our people.

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Regulatory information can be found under [Legal Notice](#)

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