Funds in the Sun: The Formation of Mutual Fund Entities in Nevis

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The Caribbean Island of Nevis and its sister Island of Saint Christopher, (which is better known as 'Saint Kitts') form the Federation of Saint Kitts-Nevis (the 'Federation'). The two Islands, which were governed for centuries by the United Kingdom, received their independence in 1983. Under the Federation's current Constitutional arrangement, Nevis (the 'Island') has its own Legislature. This body has the right to draft, enact and administer laws for the promotion and development of the Island's commercial, fiscal and corporate arenas.

A popular vacation destination, approximately 250,000 visitors from around the World flock annually to Nevis' intimate thirty-six square miles to enjoy its sun, sand and shores. In addition to its robust and vibrant tourism industry, the offshore financial services sector comprises an ever-expanding portion of the Island's economy. Since independence, the Legislature has enacted severalbusiness-friendly laws, which have encouraged and enabled the development of the financial services sector.

Some of these offshore business laws include:

- *Nevis Business Corporation Ordinance 1984, as Amended* (the 'NBCO')
- *Nevis International Exempt Trust Ordinance 1994, as Amended* (the 'NIETO')
- *Nevis Limited Liability Company Ordinance 1995, as Amended* (the 'NLLCO')

and

- *Nevis International Insurance Ordinance 2004, as Amended.*

In an effort to enable the Island to compete with other jurisdictions, both onshore and offshore, the Legislature recently enacted the *Nevis International Mutual Funds Ordinance 2004* (the 'IMFO'), which allows the establishment of mutual funds.

A mutual fund is an investment entity that pools assets from several investors and invests that money in a diversified portfolio of stocks, bonds and other securities. The overall value of a share of the mutual fund is known as the *net asset value* and is calculated periodically, based on the total value of the fund divided by the number of shares held by investors. A mutual fund can make a profit for its investors in two ways: the assets that it owns can pay dividends or earn interest, or the assets can appreciate in value.

The first mutual fund, *Massachusetts Investors Trust,* which still exists today, was founded in the United States in 1924. The Great Depression slowed the growth of the industry, but by the end of the 1950s, there were 155 mutual funds with US $15.8billion in assets. Today, there are 8,606 funds listed in the United States, with combined assets of over US $9.2trillion. Offshore, the industry leader in mutual fund registration are the Cayman Islands, which are estimated to be home to three-quarters of the World's hedge funds and half of US $1.1trillion in assets which are held offshore.[1]

The IMFO defines the term 'mutual fund' or 'fund' as follows:

> *'[A] company incorporated, a partnership formed, a unit trust organized or other similar body formed or organized under the laws of Nevis or... any other... jurisdiction which pools investor funds for the purpose of collective investment and issues shares...: that entitle the holder to receive or demand... an account computed by reference to the value of a proportionate in the whole or in a part of the net assets of the company... partnership or unit trust...'*[2]

The IMFO includes in its definition of mutual fund an 'umbrella fund', whose shares are split into a number of different class funds or sub-funds.[3]

The IMFO restricts the use of the words *'mutual fund'* or *'fund'* in English or any other language by any legal entity registered or recognized under the laws of Nevis, unless prior written approval is received from the Registrar of Mutual Funds (the 'Registrar'). The Registrar's duties under the IMFO include ensuring the due and proper administration of any funds registered under the Ordinance and the supervision of mutual funds and their functionaries.[4]

1 *Institutional Investor*, 5 April, 2006
2 *IMFO 2004*, Section 2
3 *IMFO 2004*, Section 2
4 *IMFO 2004*, Section 2

The IMFO provides for three types of funds: private funds, professional funds and public funds. A private fund is one which has no more than fifty investors and is designated as a private fund by its regulations and organizing documents. Any invitation to purchase shares must be done to specified persons by reason of a private or business connection between the offeror and investor.[5] All Nevis funds are exempted from local tax; however, the investors in the fund may be subject to taxes in their home jurisdictions.

A professional fund may only offer shares to professional investors and its organizing documents must designate it as such. The initial investment in the fund for each of the majority of the investors must be US $100,000 or greater. This requirement does not apply to any investment which is made by the Manager, Administrator, Promoter or Underwriter of the fund.[6] A professional investor is an individual who either alone or with his or her spouse has a net worth of greater than US $1,000,000. His or her ordinary business must involve the acquisition and disposal of fund-owned property. He or she must consent to be treated as a professional investor and his or her ordinary business must involve the acquisition and sale of fund assets.[7] A public fund is one which is not recognized or classified as either a private fund or a professional fund.[8]

Any private and professional fund seeking to obtain recognition must send an application to the Registrar which states that it is either private or professional within the meaning of the IMFO and that it is lawfully constituted and is not adverse to the laws of Nevis. The application must also detail the nature and scope of the business of the fund.[9] Despite this application requirement, a professional fund may administer its affairs from within Nevis for up to fourteen days without the Registrar's recognition.[10] After this probationary period, if recognition has not yet been granted by the Registrar, the fund must cease operations.

If there has been a change in either the management of the private or professional fund or in the underlying assets of more than twenty per cent of the ownership of the fund, the Registrar must be notified of such changes within fourteen days thereof.[11] Unlike a public fund, there is no requirement under the IMFO that a private or professional fund file a prospectus before selling shares or retain an auditor to provide financial statements to investors.

To be granted registration in Nevis, a public fund must submit an application to the Registrar, which in turn must be forwarded to the Minister of Finance (the 'Minister').[12] The application must describe the nature and scope of the business of the fund and must contain a statement which declares that the applicant or promoter is lawfully constituted under the laws of Nevis or any other jurisdiction. Nothing in the fund's constitutional documents must be adverse to the laws of Nevis.[13]

On application to form a public fund, the Minister's consent, if granted, is only valid for a three-month probationary period.[14] Upon the expiration of the probationary period, the Minister may grant an approval for renewal, subject to there being no material changes in the fund's organizing documents.[15] The Minister may refuse the application of an existing or proposed public fund. However, if the Minister refuses an existing public fund's application, a written decision which details the reason for the denial must be provided.[16]

The criteria that the Minister may use in denying the application include: the name is undesirable or misleading; the fund does not have a Custodian that is independent of the Administrator or Manager; or the Minister determines that the registration or consent of the fund would be contrary to the laws or the public interest of Nevis.[17] While the aforementioned standards are utilized to approve or disapprove an application, the Minister shall not be required to reveal the reason for refusing to allow the registration or consent of a proposed public fund. This decision is not subject to an appeal and may not be reviewed by the High Court.[18]

The three types of entities which may be utilized in the formation of Nevis mutual funds are; Corporations, unit trusts and partnerships. If they are formed under the laws of Nevis, a mutual fund could be a Corporation which was incorporated under the NBCO or a unit trust under the NIETO. A fund may also be organized as a partnership under the *Limited Partnerships Act 1996* (the 'LPA') or under the NLLCO. The mutual fund entity may also be established under the laws of any jurisdiction and then registered under the laws of Nevis.

The most common and flexible vehicle used to establish a fund is a Nevis Business Corporation incorporated under the NBCO. The investors in the fund are shareholders of the Nevis registered company. These entities have the ability to issue several classes of shares with different rights and benefits.[19] There are many reasons why a corporate fund may wish to create separate share classes. The fund may wish to distinguish directors from its investors. The holders of management shares would control the selection of professional advisors and have voting

5 *IMFO 2004*, Section 2
6 *IMFO 2004*, Section 2
7 *IMFO 2004*, Section 2
8 *IMFO 2004*, Section 19
9 *IMFO 2004*, Section 18 (2)
10 *IMFO 2004*, Section 22
11 *IMFO 2004*, Section 9 (3)
12 *IMFO 2004*, Section 9 (2)
13 *IMFO 2004*, Section 10 (4)
14 *IMFO 2004*, Section 10 (5)
15 *IMFO 2004*, Section 36
16 *IMFO 2004*, Section 11 (2)
17 *IMFO 2004*, Section 11 (3)
18 *NBCO 1984, as Amended*, Section 31; *NLLCO 1995, as Amended*, Section 39
19 *NIETO 1994 as Amended*, Section 2

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rights, but will have no participation in the dividends, distribution or redemption of the fund. The fund may wish to distinguish between different types of assets in which the fund invests to allow investors to customize their portfolios. Finally, the fund may seek to distinguish between different investors, to enable the fund to tailor its asset holding to maximize the desired returns for each individual investor.

A fund may also be established as a unit trust under the NIETO. In such a structure, the investors in the fund or unit holders are named as the beneficiaries of the trust, while the Manager acts as the settlor. The trustee must be a licensee under NIETO or a Nevis Business Corporation.[20] The trustee prepares a trust deed, which is executed by the Manager as settlor, who in turn settles the assets in the unit trust. The trust deed provides the manner in which the unit trust will be administered, the rights of the unit holders, the trustee's duties, investment powers and provisions for the termination of the structure. The custody of the assets and the calculation of the net asset value are the responsibility of the trustee, although these duties may be delegated. A unit trust follows general trust principles since the trust itself has no legal capacity and action to be brought by or against the fund would have to borne by the trustee.

Under the LPA, a fund may be established as a limited partnership, with at least one general partner and at least one limited partner.[21] To be registered as a partnership, a declaration executed by all of the general partners must be submitted to the Registrar of Limited Partnerships.[22] The declaration must detail the name and address of the partnership, the address of its registered office in Nevis, the names and addresses of the general partners and the nature of the partnership.[23] The documents which govern the partnership do not have to be filed and there is no requirement that the partnership have either general or limited partners resident on the Island. The IMFO also allows a Nevis Limited Liability Company formed under the NLLCO to be considered a partnership.[24]

The IMFO does not compel any Nevis funds to have an Annual General Meeting; however, there are requirements with regard to financial information. Every public fund shall maintain adequate accounting and shall prepare financial statements every fiscal year.[25] These statements must be audited by an auditor in accordance with generally accepted accounting principles.[26] There are no approval requirements for auditors working on private or professional funds, but any auditor that is retained by a public fund must be approved by the Regulator.[27] The position of Regulator is appointed by the Minister.[28]

No public fund may make an invitation to the public to purchase shares unless it first publishes a prospectus.[29] The prospectus must be dated and lodged with the Registrar, must contain the names and addresses of all functionaries associated with the fund, and shall disclose any commissions to be paid.[30] Every prospectus shall contain a summary of investor rights and shall also provide such information as investors would reasonably require in making an informed investment decision.[31] If a public fund publishes a prospectus which contains a misrepresentation, and any person who purchased shares relied on that falsehood, they shall have the right to rescind the purchase or seek damages against the fund or its governing body.[32] No action for misrepresentation may be commenced more than 180 days after the purchaser had knowledge of the misrepresentation or more than one year after the date of purchase.[33]

The IMFO provides for the following five functionaries; Promoter, Manager, Administrator, Custodian and Director. A Promoter is the person who organizes or forms a mutual fund.[34] Every Promoter of any fund shall be either a Manager or an Administrator or a person licensed to promote mutual funds under the laws of Nevis or a recognized jurisdiction.[35]

All funds shall retain the following functionaries; a Custodian, a Manager or an Administrator and two independent local directors.[36] A Custodian is the person who safeguards the fund's assets.[37] A public fund must have a Custodian that is independent of the Manager and Administrator.[38] The IMFO allows a fund to have several Custodians, therefore, a Nevis fund's property may be held by multiple brokers or investment companies. A Manager is the person who provides the fund with management services only or investment advice and administrative services.[39] An Administrator supplies administrative and accounting services.[40] The Administrator maintains the books and records of the fund and determines its net asset value. To ensure diversity in organization of a fund, the IMFO provides that no

20 *LPA 1996*, Section 4
21 *LPA 1996*, Section 5
22 *LPA 1996*, Section 6
23 *IMFO 2004*, Section 2
24 *IMFO 2004*, Section 13 (1)
25 *IMFO 2004*, Section 13 (2)
26 *IMFO 2004* , Section 13 (2) (a)
27 *IMFO 2004*, Section 2
28 *IMFO 2004*, Section 14 (1)
29 *IMFO Regulations 2006*, Section 16 (1) (b)
30 *IMFO 2004*, Section 14 (2)
31 *IMFO 2004*, Section 16
32 *IMFO 2004*, Section 17
33 *IMFO 2004*, Section 2
34 *IMFO Regulations 2006*, Section 10 (4)
35 *IMFO 2004*, Section 31
36 *IMFO 2004*, Section 2
37 *IMFO 2004*, Section 11 (2) (b)
38 *IMFO 2004*, Section 2
39 *IMFO 2004*, Section 2
40 *IMFO 2004*, Section 24 (4)

person may act as both Manager and Administrator of the same fund.[41]

Any person who wishes to carry on business as an Administrator or a Manager of a mutual fund from within Nevis must be licensed under the IMFO.[42] Persons who are ordinarily resident in Nevis, any Administrator or Manager of a fund in a recognized jurisdiction and any person who has received written permission of the Minister to act as an Administrator or Manager are exempted from the aforementioned licensing requirement.[43]

The directors of the fund have the duty to protect the interest of the investors and may engage legal counsel and auditors.[44] The Custodian, Manager and Administrator must be licensed, either under the laws of Nevis or another jurisdiction. While the Administrator and Manager are usually residents of Nevis, the Custodian tends to be off the Island in a major financial or banking center. If the Custodians are located in Nevis, they would need to be licensed under one of the following acts: the *Banking Act 2004;* the *Nevis Offshore Banking Ordinance 1996, as Amended;* or the *Securities Act 2001.*[45]

Every application for a mutual fund certificate or to be a licensee under the IMFO shall be accompanied by the following information: the applicant's address for service in Nevis; the name of a person who is authorized to represent the applicant and accept service and the address of any other place of business that the applicant has in any other jurisdiction.[46]

The Minister may cancel a certificate or license because of certain actions by the holder: if the holder has ceased to carry on business from within Nevis; has been convicted of a serious criminal offense in any jurisdiction; has knowingly provided false or misleading information; has been declared bankrupt or has been dissolved or is carrying on business in a manner detrimental to the interest of the public or investors. The Minister may also cancel a certificate or license if the holder has contravened any provision of the IMFO or the *Code of Practice.*[47] The *Code of Practice* directs license holders on several matters; including the conduct of business, notification of specified events, custody of client funds and compliance with anti-money laundering, anti-terrorism and organised crime legislation.[48] The Minister may cancel a certificate or license at a fund or licensee's request.[49] Before canceling a certificate or license, the Minister shall give the holder written notice of the proposed cancelation and afford the license holder a hearing within thirty days of receipt of the notice.[50]

The Minister's denial of a certificate for an existing public fund, the refusal to grant a license to an Administrator or Manager or the cancelation of a certificate or license may be appealed to the Financial Services Commission (the 'FSC'). The decision of the FSC can be appealed to the High Court and any judgment made by that body would be final.[51]

An initial fee shall be payable in the years that a fund is granted a certificate or when a license is issued. Annual fees for all funds and licensees are due on or before 31 March of every year.[52] Any unpaid annual fee may be subject to a penalty equal to the amount of the fee.

The *Nevis International Mutual Funds Ordinance 2004* is a regulatory act which ensures that any mutual fund registered in the Island of Nevis is a valuable and attractive investment vehicle. The Ordinance allows the establishment of funds which can be custom-designed to suit the needs of any investor. Depending on the number or type of investors and their regulations, funds may be granted private, public or professional status. The Island of Nevis applies no tax to the establishment or operation of mutual funds.

The legislation focuses on ensuring that qualified and capable functionaries are involved in every aspect of the mutual funds business registered on the Island. The Manager, Administrator and two local directors of the fund must be approved by the Registrar of Mutual Funds. All Custodians need to be licensed, either under the laws of Nevis or their home jurisdictions.

The statute reflects an understanding of modern economic realities and market conditions to allow flexibility in the structure of the funds. A Nevis fund may be established as a corporation under the *Nevis Business Corporation Ordinance 1984, as Amended* or as a unit trust under the *Nevis International Exempt Trust Ordinance 1994, as Amended.* A mutual fund may also be established as a partnership either under the *Nevis Limited Liability Company Ordinance 1995, as Amended* or the *Partnerships Act 1996.* With its flexibility and thorough licensing scheme, investors and investment professionals alike can be assured that a Nevis registered fund is a viable and secure investment alternative.

41 *IMFO 2004*, Section 23 (1)
42 *IMFO 2004*, Section 23 (2)
43 *IMFO 2004*, Section 31
44 *IMFO Regulations 2006*, Section 2
45 *IMFO 2004*, Section 28
46 *IMFO 2004*, Section 33 (b)
47 *IMFO 2004*, Section 27
48 *IMFO 2004*, Section 33 (a)
49 *IMFO 2004*, Section 34
50 *IMFO 2004*, Section 37
51 *IMFO 2004*, Section 32 (2)
52 *IMFO 2004*, Section 32 (3)