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LEGAL ANALYSIS

Cayman Islands - the new regulatory regime for Private Funds

The Private Funds Law, 2020 (the "**Law**") came into force on 7th February 2020 and introduced a requirement for the registration of closed-ended funds (typically, investment funds which do not grant investors with a right or entitlement to withdraw or redeem their shares or interests from the fund upon notice) with the Cayman Islands Monetary Authority ("**CIMA**"). The Law refers to these closed-ended funds as "Private Funds". Mutual funds (e.g. open-ended hedge funds) are not caught by the Law and continue to be regulated by the Mutual Funds Law (2020 Revision) as amended. Accordingly, there is now a regulatory regime in the Cayman Islands for all mutual funds and a separate regulatory regime for "private funds" covered by the Law.

What is a "Private Fund"?

A "Private Fund" means a company, unit trust or partnership that offers or issues or has issued its non-redeemable investment interests, the purpose or effect of which is the pooling of investor funds with the aim of enabling investors to receive profits or gains from such entity's acquisition, holding, management or disposal of investments, where (a) the holders of investment interests do not have day-to-day control over the acquisition, holding, management or disposal of the investments; and (b) the investments are managed as a whole by or on behalf of the operator of the private fund directly or indirectly.

A list of "*non-fund arrangements*" including (i) securitisation special purpose vehicles, (ii) joint ventures, (iii) proprietary vehicles, (iv) holding vehicles, (v) preferred equity financing vehicles, (vi) sovereign wealth funds, (vii) structured finance vehicles, and (viii) single family offices are listed in the Schedule to the Law and are excluded from the scope of the Law.

Single investor Private Funds will be outside the scope of the Law as there would be no pooling of investor funds in this case.

Which Funds will fall within the scope of the Private Funds Law?

The Law applies to private equity funds, real estate funds, and other types of closed-ended funds set up as Cayman Islands limited partnerships, companies (including SPCs), unit trusts and limited liability companies.

The Law also applies to non-Cayman Islands private funds carrying on business or attempting to carry on business in or from the Cayman Islands. As stated above, there is a separate registration regime for mutual funds under the Mutual Funds Law (2020 Revision) as amended and the Law does not apply to a regulated mutual fund or a regulated EU Connected Fund.

Registration Process - What documentation is required to register with CIMA?

Section 5 of the Law states that a Private Fund is required to:



- (a) submit an application for registration to CIMA within twenty-one (21) days after its acceptance of capital commitments from investors for the purposes of investments;
- (b) file prescribed details in respect to the Private Fund with CIMA;
- (c) pay a prescribed annual registration fee to CIMA in respect of the Private Fund;
- (d) comply with any conditions of its registration imposed by CIMA; and
- (e) comply with the provisions of the Law.

In terms of documentation to be filed with CIMA, the Law refers to the filing of “prescribed details” in respect of the Private Fund but there is no requirement to file an offering memorandum or any other offering document but where marketing materials (e.g. an Offering Memorandum) are filed with CIMA, there is a Rule setting out certain requirements on the contents of the Private Fund's offering document, if any.

Timing of Registration

Section 5 of the Law indicates that a new Private Fund falling within the scope of the Law will be required to:

- (a) submit its registration application to CIMA within 21 days after its acceptance of capital commitments from investors for the purposes of investments; and
- (b) be registered by CIMA before it accepts capital contributions from investors in respect of investments.

Accordingly, the timing of registration with CIMA will be somewhat different from that applicable to mutual funds.

Private Funds are required to register via the CIMA REEFS portal with Form PFC 166-77.

Requirement to register changes with CIMA

A Private Fund is required under the Law to notify CIMA:

- (a) of any change that materially affects any information submitted to CIMA;
- (b) of any change of its registered office or the location of its principal office.

The Private Fund will have twenty-one (21) days after making the change or becoming aware of the change to file details of the change with CIMA.

Fees

The registration fee payable to CIMA in respect of registration of Private Funds is US\$4,268.29.

Regulatory Requirements for Private Funds

The Law requires that Private Funds that are subject to the Law have in place certain mechanisms and safeguards relating to audit, valuation of assets, safekeeping of fund assets, cash monitoring, and identification of securities.

Audit



Each Private Fund is required to (i) have its accounts audited annually by a firm of auditors on the CIMA approved list of auditors and (ii) file such audited accounts with CIMA within six (6) months of the end of each financial year of the Private Fund (along with an Financial Annual Return in CIMA's prescribed form).

Audited accounts are required to be prepared in accordance with the International Financial Reporting Standards or the generally accepted accounting principles of the United States of America, Japan or Switzerland or any non-high risk jurisdiction. The Law defines a "non-high risk jurisdiction" as any jurisdiction that is not on the list of high risk jurisdictions issued by the Financial Action Task Force.

CIMA may, in relation to the whole or part of any financial year of a Private Fund, grant an exemption to the Private Fund from the requirement to submit audited accounts to CIMA either absolutely or subject to such conditions as CIMA may deem appropriate. CIMA has published circumstances in which such an audit exemption may be granted.

Valuation of assets

The Law requires a Private Fund to have appropriate and consistent procedures for the purposes of proper valuations of its assets, which ensures that valuations are conducted in accordance with the requirements in the Law. Valuations of the assets of a Private Fund are required to be carried out at a frequency that is appropriate to the assets held by the Private Fund and, in any case, on at least an annual basis.

Valuations of the Private Fund's assets can be performed by:

- (a) an independent third party that is appropriately professionally qualified to conduct valuations in a non-high risk jurisdiction;
- (b) the manager or operator of the Private Fund, or a person who has a control relationship with the manager of the Private Fund, **provided that**:
 - i. the valuation function is independent from the portfolio management function; or
 - ii. potential conflicts of interest are properly identified and disclosed to the investors of the private fund; or
- (c) an administrator not falling under paragraph (a) above who is appointed by the Private Fund.

Where the valuation of the Private Fund's assets is not performed by an independent third party professionally qualified to conduct valuations in a non-high risk jurisdiction, CIMA may require the Private Fund to have its valuations verified by an auditor or independent third party.

The Law empowers CIMA to waive the valuation requirements, either absolutely or subject to such conditions as CIMA deems appropriate.

Safekeeping of fund assets

The Law requires a custodian (i) to hold the Private Fund's assets which are capable of physical delivery or capable of registration in a custodial account except where that is neither practical nor proportionate given the nature of the Private Fund and the type of assets held; and (ii) to verify title to, and maintain records of, fund assets.

Where having a custodian is neither practical nor proportionate given the nature of the Private Fund and the



type of assets held, title verification can be carried out by any of (i) the manager or operator of the Private Fund (subject to functional independence or conflicts management requirements), (ii) an independent administrator, or (iii) another independent third party.

Where the title verification is not performed by a custodian, an administrator or another independent third party appointed, CIMA may require the Private Fund to have its title verification verified by an appropriately professionally qualified independent third party.

Cash monitoring

The Law requires a Private Fund to appoint an administrator, custodian or another independent third party (or the manager or operator of the Private Fund) to:

- monitor the cash flows of the Private Fund;
- ensure that all cash has been booked in cash accounts opened in the name, or for the account, of the Private Fund; and
- ensure that all payments made by investors in respect of investment interests have been received.

When the cash monitoring function is not performed by an administrator, custodian or another independent third party, the cash management function established by the manager or operator of the Private Fund is required to be independent of the portfolio management function or the potential conflicts of interest must be properly identified and disclosed to investors.

Identification of securities

A Private Fund that regularly trades securities or holds them on a consistent basis must maintain a record of the identification codes (e.g. ISIN codes or CUSIP codes) of the securities that it trades and holds and make this available to CIMA upon request.

Penalty for Non-Compliance

The penalty for failing to comply with Section 5 of the Law is liability on conviction to a fine of CI\$100,000 (approximately US\$122,000). The “operator” (e.g. the board of directors where the Private Fund is structured as a company or a general partner where the Private Fund is structured as a limited partnership) of a Private Fund will be responsible for securing the compliance by that Private Fund with the Law. The operator of a Private Fund that fails to discharge its responsibility for securing the Private Fund’s compliance with the Law commits an offence and is liable on conviction to a fine of CI\$20,000 (approximately US\$24,400).

This publication is intended to merely provide a brief overview and general guidance only and is not intended to be a substitute for specific legal advice or a legal opinion. For more specific advice on the above matters, please contact us at enquiries@hcs offshore.com





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