

Developments in the Cayman Islands private funds regime

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Introduction

In February 2020, the Cayman Islands enacted the Private Funds Act, 2020 (PFA), which has introduced a new regulatory regime for closed-ended Cayman Islands funds (**private funds**). See [our guide](#) for more information on the PFA. All private funds established prior to 7 August 2020, were required to register with the Cayman Islands Monetary Authority (CIMA) by that date. The pace of registrations was initially lower than expected, resulting in a clarifying amendment to the PFA in July that expanded the scope of the private fund definition; this eventually led to approximately 13,000 private funds being registered by the deadline.

July amendment

In July 2020, the following changes were made to the private fund definition:

Private fund means a company, unit trust or partnership whose principal business is the offering and issuing of its **that offers or issues or has issued** investment interests, the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risks and 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, for reward based on the assets, profits or gains of the company, unit trust or partnership,

but does not include:

- i. a person licensed under the *Banks and Trust Companies Law (2020 Revision)* or the *Insurance Law 2010*;
- ii. a person registered under the *Building Societies Law (2020 Revision)* or the *Friendly Societies Law (1998 Revision)*; or
- iii. any non-fund arrangements.

The effect of these changes was to expand the types of fund vehicles required to be regulated, as follows:

- There is no requirement to be carrying on business as a fund, so funds in liquidation are in scope.
- “Offers or issues” rather than “offering and issuing” brings into scope fund vehicles that have not made a separate offering, such as AIVs and some co-invest vehicles.
- “Has issued” means funds are in scope even when they are no longer open to new investors.
- There is no requirement for any spreading of investment risks, so funds with a single investment are in scope.
- Removing the requirement for any reward brings into scope fund vehicles that are not charging fees, such as certain co-invest or friends and family vehicles.

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CIMA guidance

In the period between February and March 2020, CIMA published an evolving series of FAQs, intended to clarify certain issues around the registration process and requirements; and from March onwards, they also began to publish regulatory guidance and rules dealing with specific areas of the PFA.

Contents of marketing materials

While there is no requirement for a private fund to prepare any marketing materials, if it does so, it must comply with this rule. Any such marketing materials must be filed with CIMA, and must contain a description of the fund's structure, investment strategy, operators, service providers, material risks and so on.

Exemption from audit requirement

This regulatory policy sets out the circumstances in which CIMA will consider waiving a private fund's obligation to have its financial statements audited in respect of a particular financial period. Grounds for an exemption include, not having launched, having raised insufficient capital to be sustainable and being in liquidation.

Exemption from valuation requirement

This regulatory policy sets out the circumstances in which CIMA will consider waiving a private fund's obligation to have its assets valued at least annually. Absolute exemptions are only available where a fund's assets are subject to a court order; but conditional exemptions of up to a year are available in similar circumstances to audit waivers. Under a conditional waiver, constitutional documents must be amended to prevent the admission of new investors and the right to request an audit exemption must be waived.

Segregation of assets

This rule requires investor funds and a fund's investment assets to be segregated from any assets of the fund's manager, operator or person responsible for safekeeping of the fund's assets.

Valuation of assets

This rule on the calculation of net asset values, expands on the basic requirement in the PFA to appoint a person responsible for valuations and to conduct valuations at least annually. There are a number of requirements that all private funds should note; in particular, the requirement to establish a written valuation policy that is disclosed to investors, either in the fund's marketing materials, its constitutional documents or through an investor update. The valuation policy should define the roles and responsibilities of the responsible person, establish price sources for each investment type, pricing models for hard to value securities and disclose to investors the inherent limitations in the policy along with any potential

conflicts of interest. In addition to conducting valuations annually, the fund's operator should review the valuation policy and any pricing models at least annually.

Non-fund arrangements

The private fund definition carves out all non-fund arrangements, as listed in a schedule to the PFA. These include entities that are fairly obviously outside the definition already, such as debt issuing vehicles, but also vehicles such as joint ventures and holding vehicles, which can be difficult to distinguish. CIMA's recent guidance on non-fund arrangements assists with establishing the distinguishing features. Generally, a vehicle will be a joint venture of holding vehicle if established with proprietary capital for investment in a commercial business to contribute to its long-term value and not to generate returns through divestment of its subsidiaries.

Other developments

Administrative fines regime

In June 2020 the Monetary Authority (Administrative Fines) Regulations were amended to expand CIMA's powers to impose administrative fines. Prior to this, CIMA was only able to impose administrative fines for breaches of the Anti-Money Laundering Regulations, but now has the same power across the regulatory spectrum, including in respect of the PFA. Failure to comply with the PFA could now result in the following penalties:

- For minor breaches, a fixed penalty of CI\$5,000 (US\$6,100), which can be imposed repeatedly for ongoing breaches, up to a maximum of CI\$20,000 (US\$24,400).
- For serious breaches, a discretionary penalty of up to CI\$50,000 (US\$61,000) for individuals and CI\$100,000 (US\$122,000) for corporate entities.
- For very serious breaches, a discretionary penalty of up to CI\$100,000 (US\$122,000) for individuals and CI\$1,000,000 (US\$1,220,000) for corporate entities.

Breaches are generally categorised as minor, serious or very serious on the following basis:

- Minor breaches: these include late payment of annual fees and late filing of the fund annual return.
- Serious breaches: these include breaches of the operational requirements (i.e. those relating to preparation and filing of audited financial statements, annual valuations, safekeeping of fund assets and cash monitoring) and failures to update CIMA of any material changes to information previously filed.
- Very serious breaches: these include failures to register as a private fund when required to do so and conducting activities, such as receipt of capital contributions, that require prior registration.

Continued

Virtual asset services regime

The Virtual Asset (Service Providers) Act (**VASP**) was enacted earlier in 2020, but has only begun a phased introduction from October. There is now a registration regime for entities providing virtual asset services, which includes the issuance of virtual assets to the public, as well as services connected with virtual assets, such as virtual asset custody and exchanging virtual assets for fiat or other virtual assets.

The interest points to note in a private funds context are:

- The definition of “investment interest” in the PFA has not been amended, as it has in the Mutual Funds Law, to include virtual representations of such interests. This means that an entity will not fall within the scope of the PFA (and require registration as a private fund) merely by raising funds through a digital token offering.
- Private token offerings (where virtual assets are not advertised for purchase and can only be purchase by a limited number of persons selected prior to the sale by private agreement) are outside the scope of regulation under the VASP regime.



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