

## Cayman Islands private funds regime

Service area / [Investment Funds](#)

Location / [Cayman Islands](#)

Date / [February 2020](#)

The Cayman Islands has on 7 February 2020 enacted the Private Funds Law, 2020 (PF Law) which establishes a regime for the registration and ongoing regulation of closed-ended funds (private funds).

The Cayman Islands continues to be at the forefront of adoption of global best practices in the funds industry. The regulation of closed-ended funds reflects the Cayman Islands' commitment to implementing governance principles laid out by the EU, the OECD and other international organisations.

Other international financial centres such as Bermuda, the British Virgin Islands, Guernsey, Jersey, Ireland and Luxembourg also have in place registration regimes for closed-ended funds.

### Scope of the PF Law

#### General

Subject to certain exclusions, discussed below, the PF Law applies to any private fund; which includes any company, unit trust or partnership whose principal business is the offering and issuance of 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:

- the holders of investment interests do not have day-to-day control over the acquisition, holding, management or disposal of the investments; and
- 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.

Private funds include both Cayman Islands entities and entities established outside the Cayman Islands that offer their investment interests to the public in the Cayman Islands.

For purposes of the private fund definition, investment interest means a share, LLC interest, trust unit or partnership interest that: (a) carries an entitlement to participate in the profits or gains of the company, unit trust or partnership; and (b) is not redeemable or repurchaseable at the option of the investor, but does not include debt, or certain transferable debt instruments.

### Out of scope entities

The following are out of scope of the PF Law:

- Certain prescribed non-fund arrangements including, among others, structured finance, securitisation and debt issuance vehicles, joint ventures, proprietary vehicles, employee incentive schemes, holding vehicles, preferred equity financing vehicles, certain listed funds, sovereign wealth and pension funds and single family offices;

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- Certain Cayman Islands licensed entities;
- Regulated Cayman Islands mutual funds; and
- Single-investor funds, formed without the purpose of pooling investor funds.

## Registration

A private fund must submit its registration application to the Cayman Islands Monetary Authority (CIMA) within 21 days after acceptance of capital commitments from investors and pay an annual registration fee.

The PF Law prescribes a period of six months until 7 August 2020 for new and existing private funds to comply with the PF Law; please refer to the section headed “Timing and transition – registration of new and existing private funds” below for further information.

The PF Law expressly permits private funds to enter into binding subscription agreements with certain high net worth and sophisticated persons (as defined) before submitting a registration application to CIMA, however capital contributions may not be accepted prior to registration.

The application process for private funds will involve filing an application form with CIMA through its online portal, containing key details on the fund and its service providers. This process will be undertaken by the fund’s Cayman Islands counsel in the ordinary course of the fund launch process.

Notably, the PF Law does not introduce a requirement for private funds to prepare a detailed offering document, meaning private funds may (where relevant) continue to offer investment interests on the basis of a term sheet or limited partnership agreement.

## Operational requirements

The PF Law codifies a number of investor friendly operational requirements which are consistent with the EU’s guidance on investment funds, and which in practice, will not be new to sophisticated operators in the global funds industry. To avoid duplication, there is an exemption from these requirements for any alternative investment vehicle (AIV) of a private fund which, where permitted by the applicable accounting standards, reports its accounts on a consolidated or combined basis with its AIV. A summary of the ongoing obligations is set out below.

### Audit

- Audited financial statements signed-off by a Cayman Islands auditor must be submitted to CIMA within six months of a private fund’s financial year end. The PF Law provides broad scope for private funds to select the accounting standards to be applied in the preparation of their financial statements.
- Private funds will also be required to submit an annual return to CIMA.

## Valuation

- Private funds must adopt appropriate and consistent procedures for proper valuation of assets, with valuations to be carried out at least annually.
- Valuations must be carried out by:
  - a. an appropriately qualified independent third party,
  - b. the manager or operator of the fund, provided the valuation function is independent of the management function or that potential conflicts of interest are properly identified and disclosed to investors, or
  - c. a fund administrator.
- Where valuations are not carried out by an independent third party, CIMA may require the private fund to have its valuations verified by an auditor or independent third party.

## Custody

- Unless it is neither practical nor proportionate to do so (having regard to the nature of the fund and its assets), private funds must appoint a custodian to hold custodial fund assets, and undertake title verification of other fund assets.
- If a private fund notifies CIMA of its intention not to appoint a custodian, it must appoint one of the following to perform title verification:
  - a. an administrator or other independent third party; or
  - b. the manager or operator of the fund, provided this function is independent of the portfolio management function or that potential conflicts of interest are properly identified and disclosed to investors.
- Where title verification is not carried out by a custodian, administrator or another independent third party, CIMA may require the private fund to have its title verification verified by an appropriately qualified independent third party.

## Cash monitoring

- Private funds must appoint a person to monitor cash flows, ensure cash has been booked in appropriate cash accounts, and ensure all payments made by investors have been received.
- The appointed person may be:
  - a. an administrator, a custodian, or another independent third party; or
  - b. manager or operator of the fund, provided the cash monitoring function is independent of the portfolio management function or that potential conflicts of interest are properly identified and disclosed to investors.
- Where cash monitoring is not performed by an administrator, custodian or another independent third party, CIMA may require the private fund to have its cash monitoring verified by an independent third party.

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## Identification of securities

Private funds that regularly trade or hold securities on a consistent basis, must maintain a record of the identification codes of the securities traded or held, and must make this record available to CIMA on request.

## Timing and transition – registration of new and existing private funds

The PF Law and related regulations provide a transitional period until 7 August 2020 (or such longer period permitted by CIMA) for both existing and newly formed private funds to comply with the PF Law. This will allow private funds that were (i) carrying on business at 7 February 2020, and (ii) launched on or after 7 February 2020, until 7 August 2020 to implement the necessary operational procedures and register under the PF Law.

## Penalties

Failure to register a private fund in accordance with the PF Law constitutes an offence and carries a fine on conviction of CI\$100,000. The same penalty applies to a person not registered as a private fund that holds itself out as a registered private fund. CIMA also has the ability to impose administrative penalties.

## Commercial benefits

The regime introduced under the PF Law seeks to modernise regulation of closed-ended funds in the Cayman Islands. The changes will provide additional surety and transparency for investors and managers of Cayman Islands investment funds, while better aligning with best market practices, enhanced anti-money laundering and other global regulatory standards.

In addition, the regulation of closed-ended funds in the Cayman Islands is expected to be beneficial from the perspective of raising capital from investors in the EU and the Middle East, which have a general preference (largely driven by domestic regulation) to invest into regulated fund products.



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