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Cayman Islands investment funds update Q1 2024

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Removal from Financial Action Task Force Grey List and EU's High-Risk Third Countries List

The Financial Action Task Force ("FATF") leads global action to tackle money laundering, terrorist and proliferation financing, setting international standards to ensure national authorities can effectively clamp down on illicit funds linked to drugs trafficking, the illicit arms trade, cyber fraud and other serious crimes.

FATF holds countries to account if they do not comply with these standards and if a country repeatedly fails to implement these standards then it can be named a 'Jurisdiction under Increased Monitoring' ("grey list") or a High Risk Jurisdiction ("black list").

On 27 October 2023, the Cayman Islands were removed from the FATF grey list, having satisfied all the recommended actions set out in the FATF's action plan; having completed a successful on-site inspection; and as recognition of their significant progress in addressing the strategic anti-money laundering ("AML") and countering of terrorist financing and proliferation financing ("CFT") regime deficiencies previously identified. Accordingly, the Cayman Islands is deemed FATF compliant and no longer subject to the FATF's increased monitoring process.

The European Commission, as a member of FATF, is mandated by the EU to identify high-risk third countries having strategic AML/CFT deficiencies that pose significant threats to the financial system of the European Union ("EU"). Following their removal from the FATF grey list, the Cayman Islands were removed on 7 February 2024 from the EU's list of "high-risk third countries" having strategic deficiencies in their AML/CFT regimes.

These decisions, along with the removal of the Cayman Islands from the United Kingdom's list of high-risk countries for AML/CFT, are welcome recognition of the Cayman Islands robust and effective AML/CFT regimes and commitment to meeting international AML/CFT standards. It is also anticipated that relevant financial institutions subject to the EU AML/CFT regime or UK AML/CFT regime will no longer need to apply enhanced customer due diligence on customers, clients or beneficial owners established or resident in the Cayman Islands.

Cayman Islands Monetary Authority – new corporate governance and internal controls rules

All regulated Cayman Islands investment funds and regulated managers or advisers are reminded of the new governance and internal controls rules issued by the Cayman Islands Monetary Authority ("CIMA").

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The following rules came into force on 14 October 2023:

- Rule on Corporate Governance for Regulated Entities; and
- Rule and Statement of Guidance on Internal Controls for Regulated Entities.

The focus of the new rules is to ensure that regulated entities are not only operationally compliant but also properly documenting that compliance. In many cases, particularly for private funds, this may mean a shift in emphasis towards formal rather than informal meetings of the fund's governing body and a formalised process for receiving and reviewing compliance, legal and service provider reports as well as monitoring and managing the fund's risks and internal controls.

The governing bodies of all regulated Cayman Islands investment funds and regulated managers or advisers should ensure that they meet (if they have not already done so) to review their compliance with the new governance regime and applicable laws, regulations and CIMA rules generally.

We encourage our affected clients to discuss the new requirements with your usual Carey Olsen attorney contact, as we can provide governing bodies with the required annual updates on relevant Cayman Islands legal and regulatory developments, as well as a detailed guide on compliance with the governance regime.

All of CIMA's rules and statements of guidance relevant to regulated Cayman Islands funds can be viewed on CIMA's website.

Beneficial Ownership for CIMA Registered Funds

The Beneficial Ownership Transparency Bill, 2023 ("BoT Bill") was passed by the Cayman Islands Parliament in November 2023. The BoT Bill is not yet in force but is expected to be implemented in phases during 2024.

Currently, investment funds registered under the Mutual Funds Act (as revised) ("MFA") or the Private Funds Act (as revised) ("PFA") benefit from an exemption to maintain a beneficial ownership register under the current beneficial ownership legislation. The BoT Bill removes such exemption but provides an alternative route to compliance.

Such alternative route to compliance will require each registered fund to nominate a licensed administrator or other regulated person in the Cayman Islands that will be responsible for providing beneficial ownership information to the competent authority within 24 hours (or such other time required by the competent authority) of any request.

Any investment entity or other vehicle within a fund structure that is not registered under the MFA or PFA will no longer benefit from an exemption and will be required to maintain a beneficial ownership register when the BoT Bill comes into force.

Single-Investor Vehicles – an attractive structuring option

Single-investor vehicles, often called "funds-of-one", can be very attractive structuring options for institutional investors, including insurance firms, sovereign wealth funds, pension trustees and family offices. With these investors becoming more sophisticated in terms of tailoring their investment needs, investor-dedicated funds using a single-investor vehicle ("SIV") have proven to be effective structuring solutions to cater to their unique investment requirements and risk profiles.

Key features of a Cayman SIV:

- Structured as a Cayman Islands corporate, unit trust or limited partnership structure a SIV, in general, is not required to be regulated as an investment fund under the relevant laws of the Cayman Islands.
- The Cayman Islands do not impose regulatory requirements upon SIVs in relation to their investment objectives, investment strategies, portfolio diversification, liquidity terms or leverage restrictions and permit extensive amendments of these parameters post-closing without regulatory approvals. Investment terms of SIVs can therefore be flexibly negotiated and adjusted as and when required to suit the bespoke needs and risk appetites of specific investors.
- SIVs can also protect key investors against the effect of co-investor redemptions which might otherwise negatively affect the investors' holdings in commingled funds.
- While SIVs permit investor-specific tailored investment arrangements not otherwise attainable in commingled funds, they also provide for statutory limited liability and delegation of management and administration responsibilities. The latter feature is particularly attractive to leading cornerstone investors as it allows the SIVs' operators to work with their investment managers or other service providers to meet their enhanced reporting requirements, which may not be feasible or practical (in the case of multi-investor commingled funds) or would typically need to be undertaken by the investors (in the case of separately managed accounts).

Cayman SIVs are ideal platforms that could provide key investors with a high degree of transparency to allow for effective monitoring of performance, risk and controls. As such, SIVs are increasingly used by asset managers as a useful structuring tool to suit the needs of leading investors that prefer the safety and bespoke nature of fund-of-one structures.

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