

New Registration Requirements for Unregulated Investment Funds

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On 7 February 2020, the Cayman Islands Government enacted the Private Funds Law 2020 (**PF Law**) and an amendment to the Mutual Funds Law (2020 Revision) (**MFL Amendment**). The legislation is a result of certain EU and other international recommendations and has been developed to align the Cayman Islands investment fund regulatory regime with other jurisdictions.

This advisory summarises key features of the PF Law and the MFL Amendment.

Private Funds Law, 2020

Which entities are covered by the PF Law?

The PF Law applies to any Cayman Islands closed-ended fund. If such a fund falls within the definition of a "private fund", the PF Law provides for its registration with, and its regulation by, the Cayman Islands Monetary Authority (**CIMA**). "Mutual funds" such as open-ended hedge funds are not caught by the PF Law and continue to be regulated by the Mutual Funds Law.

The definition of "**private fund**" captures any company, unit trust or partnership that offers or issues or has issued to investors its participating, 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 a vehicle's investment activity, where (a) the holders of investment interests do not have day-to-day control over the vehicle's investment activities; and (b) the investments are managed as a whole by or on behalf of the fund operator directly or indirectly.

Vehicles that only issue debt or prescribed alternative financial instruments are not deemed to be issuing investment interests and so do not fall within scope of the PF Law. The PF Law also expressly exempts "non-fund arrangements" including securitisation special purpose vehicles, joint ventures, proprietary vehicles, holding vehicles, preferred equity financing vehicles, sovereign wealth funds and single family offices.

"Funds" which are established for only one investor will be outside the scope of a "private fund" given the "pooling of investor funds" requirement.

Is there a transitional period for private fund registration?

The PF Law provides that private funds covered by the legislation must be registered by 7 August 2020. This applies both to private funds which were carrying on business on the date of the commencement of the PF Law (being 7 February 2020) and private funds which commence business within the six month transitional period from 7 February 2020 to 7 August 2020. Private funds that launch on or after 7 August 2020 will need to comply with the registration timing requirements contained in the PF Law, as summarised below.

At what stage in the launch process must a private fund register?

The PF Law expressly permits a private fund to enter into agreements (which we understand would include subscription agreements, side letters and a partnership agreement) with investors and accept capital commitments from investors for the purpose of making investments before submitting its registration application to CIMA.

Subject to the transitional period referred to above, a private fund must submit an application for registration to CIMA within 21 days of its acceptance of capital commitments. Again subject to the transitional period, in all cases, a private fund must register with CIMA before accepting capital contributions from investors in respect of investments.

Does registration involve filing an offering document?

CIMA have confirmed that a copy of the marketing materials, summary of terms or offering document will be required to be filed upon registration. It is expected that in practice a summary of terms may often be most efficient and appropriate.

What operating requirements apply?

The PF Law seeks to ensure that there is transparency and a proper papering of a private fund's core operations and processes. The PF Law achieves this through audit, valuation, custody, cash monitoring and securities identification requirements that will align with most private funds' current procedures:

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 expressly permits a private fund to prepare and file financial accounts that are combined or consolidated with an alternative investment vehicle.

Valuation – valuations of the assets of a private fund must be carried out at a frequency that is appropriate to the assets held by the private fund. Generally, valuations will be required on at least an annual basis, however, the PF Law expressly empowers CIMA to waive the valuation requirements, either absolutely or subject to such conditions as it deems appropriate. To the extent valuations are not performed by an appropriately qualified independent third party, the valuation function established by the manager or operator (eg, general partner) of the private fund must be independent from the portfolio management function or the potential conflicts of interest must be properly identified and disclosed to investors.

Custody – a custodian must be appointed to: custody, in segregated accounts, the custodial fund assets; verify that the private fund holds title to any other fund assets; and maintain a record of those other fund assets. A private fund shall not be required to appoint a custodian if it has notified CIMA and it is neither practical nor proportionate to do so, having regard to the nature of the private fund and the type of assets it holds. In such circumstances, a private fund must appoint a person to carry out title verification. To the extent such verification is not performed by an independent third party, the verification function established by the manager or operator of the private fund must be independent from the portfolio management function or the potential conflicts of interest must be properly identified and disclosed to investors.

Cash monitoring – a private fund must appoint a person 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. To the extent such 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 must be independent from the portfolio management function or the potential conflicts of interest must be properly identified and disclosed to investors.

Securities identification – a private fund that regularly trades securities or holds them on a consistent basis must maintain a record of the identification codes of the securities it trades and holds and shall make this record available to CIMA upon request.

Although not contemplated in the PF Law, CIMA has separately confirmed that it will require all private funds to have at least two natural persons acting as, or for, the operator (board of directors, general partner etc) of the private fund.

All operating conditions and procedures need to be appropriate and proportionate given the scale and operations of a private fund. Where independent third parties are not engaged to carry out the above functions, CIMA may require that third party verification be undertaken. The PF Law provides that CIMA's supervision and monitoring of private funds, including the above operating conditions, is risk-based.

The PF Law provides that alternative investment vehicles will not have to comply with these operating requirements. An alternative investment vehicle is defined as a vehicle that is formed in accordance with the constitutional documents of a private fund for the purposes of making, holding and disposing of one or more investments wholly or mainly related to the business of that private fund and only has as its members, partners or trust beneficiaries, persons that are members, partners or trust beneficiaries of the private fund.

What are the registration and ongoing annual fees for registered private funds?

A private fund will be required to submit an initial application for registration in the prescribed form accompanied by a fee of US \$366. Private funds are subject to an annual registration fee of US \$4,268, however private funds registering during the transitional period of six months, shall not pay such annual registration fee for 2020 and the first annual registration fee shall fall due in January 2021. Any private fund registering on or after 8 August 2020 will be required to pay annual registration fees for 2020. In addition, any private fund required to pay an annual registration fee will be required to pay US \$305 in respect of each of the private fund's alternative investment vehicles up to a maximum of 25 investment vehicles.

Mutual Funds (Amendment) Law, 2020

Who is affected?

The MFL Amendment will affect open-ended funds carrying on business in or from the Cayman Islands that were previously exempt from CIMA regulation under section 4(4) of the Mutual Funds Law (**s4(4) Funds**) by virtue of the fact that the equity interests of the mutual fund were held by not more than fifteen investors, a majority of whom are capable of appointing or removing the operator of the fund.

What is required of affected funds?

Pursuant to the MFL Amendment, a s4(4) Fund will be required to register with CIMA by:

- (i) filing a certified copy of their constitutive documents which specify that a majority of investors in number are capable of appointing or removing the operator of the fund;
- (ii) filing such other information as may be required in the prescribed form; and
- (iii) payment of the prescribed registration fee.

An s4(4) Fund registered under the MFL Amendment shall not be required to have a prescribed minimum initial investment amount nor is there any requirement to have or file an offering

document.

Pursuant to the MFL Amendment s4(4) Funds will be required to have at least two natural persons acting as, or for, the operator (board of directors, general partner etc.), and that these persons will be required to register under the Directors Registration and Licensing Law (Revised).

What are the registration and ongoing requirements of the AML Amendment?

The MFL Amendment came into force on 7 February 2020 and provides a six-month transitional period (to 7 August 2020) for compliance for those s4(4) Funds in existence on 7 February 2020. A s4(4) Fund will be required to submit an initial application for registration accompanied by a fee of US \$366. S4(4) Funds are subject to an annual registration fee of US \$4,268, however such s4(4) Funds registering during the six-month transitional period, shall not pay such annual registration fee for 2020 and the first annual registration fee shall fall due in January 2021. Any s4(4) Fund registering on or after 8 August 2020 will be required to pay an annual registration fee of US \$4,268 for 2020. For a detailed overview of ongoing obligations, please refer to our Briefing Note: [Operating a Cayman Islands Open-Ended Fund](#)

Will there be any audit requirements for s4(4) Funds?

An s4(4) Fund will be required to have its accounts audited annually by an auditor approved by CIMA. The MFL Amendment requires that the accounts be prepared and audited in accordance with International Financial Reporting Standards or US, Japanese or Swiss GAAP or GAAP of a non-high risk jurisdiction.

For further information or to discuss specific structures, please contact your regular Ogier contact or a member of the Investment Funds Regulatory team listed.

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