



Cayman Islands - The Private Funds Act

Introduction

This memorandum summarises the key features of the Private Funds Act (as amended) (the "**Act**") and how it affects closed-ended funds and their managers.

Which vehicles does the Act apply to?

Most closed-ended investor-facing fund vehicles, which encompasses the majority of private equity, infrastructure and real estate funds, as well as certain master funds in such structures, are required to register with the Cayman Islands Monetary Authority ("**CIMA**") under the Act and will be subject to the ongoing requirements the Act contains. The Act includes certain exemptions for a series of non-fund arrangements.

The Act applies to 'private funds', which for these purposes are any company (including limited liability companies), unit trust or partnership whose principal business is the offering or issuance of investment interests, the purpose or effect of which is the pooling of investor funds and enabling investors to receive profits or gains from such entity's acquisition, holding, management or disposal of investments, where:

1. the holders of investment interests do not have day-to-day control over the acquisition, holding, management or disposal of the investments; and
2. the investments are managed as a whole by or on behalf of the operator of the private fund, directly or indirectly.

The Act includes a substantial list of 'non-fund arrangements' which are excluded from the definition of private funds and therefore outside of the scope of the Act altogether. In addition, the Act provides that significant aspects of the regime, including the requirements to file audited financial statements, do not apply to alternative investment vehicles ("**AIVs**") of registered private funds where the reporting standards or accounting principles permitted by the Act and used by the fund permit consolidated or combined financial statements (and the fund chooses to report consolidated or combined financial statements).

The list of 'non-fund arrangements' includes the following:

1. securitisation special purpose vehicles;
2. officer, manager or employee incentive, participation or compensation schemes;
3. separately managed accounts;
4. holding vehicles;
5. structured finance vehicles;
6. preferred equity financing vehicles;

7. sovereign wealth funds; or
8. single family offices.

The exact scope of these 'non-fund arrangements' is set out in rules issued by CIMA. Please speak to your usual Walkers contact, or to one of the contacts listed below for further details.

In addition, funds with a single investor will be out of scope of the requirements, as they do not involve pooling of investor funds.

Although the primary focus of the Act is on Cayman Islands vehicles, private funds that are incorporated or established outside of the Cayman Islands but which make an invitation to the public in the Cayman Islands to subscribe for investment interests also fall within the scope of the Act.

The Act does not affect funds registered as 'mutual funds' under the Mutual Funds Act (as amended) (the "**Mutual Funds Act**"), which applies to most open-ended mutual fund structures. The Mutual Funds Act governs the regulation of these structures.

The key features of the Act and their practical impact

The Act requires private funds to register with CIMA, with a registration process similar to the well-established online CIMA registration regime applicable to open-ended mutual funds. Private funds are also subject to requirements in relation to audit (including the requirement to have their audit issued or undertaken by an auditor approved by CIMA, which in practice will generally be the Cayman Islands branch of the fund's auditor), valuation, safekeeping of assets, cash management and the identification of the securities they hold.

Initial registration

A private fund must submit an application for registration with CIMA within 21 days of accepting capital commitments from investors for the purposes of investments or, if earlier, on or before the date that capital contributions are accepted for the purposes of making investments.

The registration application will require the filing of certain prescribed details with CIMA including certain constitutive documents of the fund, a short summary of fund terms, a structure chart, a letter of consent of the fund's auditor and, if an administrator is appointed, a letter of consent of such administrator.

The registration application is now part of the launch process for private funds, and is handled primarily by Walkers as Cayman Islands counsel.

Ongoing obligations: Fees and Filings

Private funds registered under the Act are required to pay an annual fee of US\$4,200 (together with an additional amount of US\$300 in respect of each of the private fund's AIVs up to a maximum of 25 AIVs) by 15 January in each year.

To the extent any of the information submitted in the initial registration changes materially, or if the private fund changes the location of its registered office or principal office, a registered private fund is required to file the details of this change with CIMA within 21 days of the change. These are similar to the obligations on CIMA-registered mutual funds.

Annual fees will be paid to CIMA on the fund's behalf by its registered office in the same way as annual registration fees are currently paid. Updates to CIMA in respect of material changes would generally be handled by Walkers as Cayman Islands counsel to the fund, although there may be situations where registered offices make certain filings.

Ongoing obligations: Audit and Annual Return

Registered private funds are required to have their accounts audited annually by an auditor approved by CIMA. In practice this means that the audit will be issued or undertaken by the Cayman Islands branch of the relevant auditor (though it may well be that the auditor in the home jurisdiction of the manager performs the substantive audit process). The audit

must be filed with CIMA within six months of the end of the financial year to which it relates, unless the fund applies for an extension).

The accounts must be prepared in accordance with the International Financial Reporting Standards or the generally accepted accounting principles of the United States of America, Japan, Switzerland or a non-high risk jurisdiction, and the audit must be carried out in accordance with the International Standards on Auditing or the generally accepted auditing standards of the United States of America, Japan, Switzerland or a non-high risk jurisdiction.

CIMA has the power to issue waivers from the audit requirements on a similar basis to the limited parameters which apply to CIMA-registered mutual funds, for example for funds that register but never admit investors or draw down capital.

In addition, a private fund is required to submit a fund annual return ("**FAR**"), which includes a Related Fund Entities form, each year to CIMA in the prescribed form.

In practice, as most funds are required by their constitutive documents and/or by the legal and regulatory framework applicable to the fund's investment manager to perform an annual audit, the principal additional obligations here relate to the issuance of these audits being by a CIMA-approved auditor (ie one located in the Cayman Islands), and their filing with CIMA. The audited accounts are filed as an attachment to the FAR form. The FAR and audited accounts filings are handled by either the fund auditor, registered office or any other service provider engaged to do so via CIMA's online portal.

Ongoing obligations: Valuation, Safekeeping, Cash Monitoring and Identification of Securities

Private funds will be required to have appropriate and consistent procedures for the purposes of proper valuations of their assets. These valuations must be carried out with such frequency as is appropriate for the assets, and at least annually. The valuation may be carried out by an independent third party or administrator, or by the manager or operator of the fund, provided in the latter case that either the valuation function is independent from the portfolio management function, or potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the fund.

Private funds will be required to appoint a custodian to hold custodial fund assets and verify that the fund holds title to other fund assets, and keep a record of those assets. However, a fund may notify CIMA that it is neither practical nor proportionate to do so, having regard to the nature of the fund and the type of assets it holds, with such notification typically made as part of the registration process. In these circumstances, verification of title may be carried out by an independent third party or administrator, or by the manager or operator of the fund, provided in the latter case that either the title verification function is independent from the portfolio management function, or potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the fund.

Private funds will be required to appoint a person to monitor their cash flows. This includes ensuring that all cash of the private fund has been booked in cash accounts opened in the name, or for the account, of the private fund, and that all payments made by investors to the private fund in respect of investment interests have been received. The fund may appoint an administrator, custodian or another independent third party, or may rely upon the manager or operator of the fund, provided in the latter case that either the cash management function is independent from the portfolio management function, or potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the fund.

CIMA has published rules detailing the scope of the obligations relating to valuations and segregation of assets. CIMA has the power to require funds to have the relevant function verified by an appropriately professionally qualified independent third party.

Private funds that regularly trade securities or hold them on a consistent basis will be required to maintain a record of the identification codes of these securities and shall make this record available to CIMA upon request. The records must include the ISINs where available, or an alternative identification code or legal entity identifier of the issuer of the relevant securities.

Most private equity managers will avail of the ability to conduct these functions internally, to the extent required. Fund offering documents may require additional language to disclose potential conflicts of interest (to the extent not already covered).

Ongoing obligations: Regulatory Requirements

Below is a summary of the regulatory obligations for entities registered as private funds. In each case we would be pleased to provide our more detailed guidance on request.

Automatic Exchange of Information

The majority of registered private funds will be classified as 'Reporting Financial Institutions' for the purposes of the Common Reporting Standard ("CRS") and the United States Foreign Account Tax Compliance Act ("FATCA"), both such tax information exchange regimes having been implemented by the Cayman Islands.

Anti-Money Laundering

As a result of being a private fund, an entity will be conducting "relevant financial business" and will need to comply with the Cayman Islands anti-money laundering, counter-terrorist financing and proliferation financing ("AML") framework. This includes complying with the Anti-Money Laundering Regulations (as amended) which set out the entity's ongoing AML compliance obligations.

Beneficial Ownership

Cayman Islands law requires Cayman Islands companies, limited liability companies, and limited liability partnerships to establish and maintain beneficial ownership registers unless they are exempt. This information is stored on a non-public platform maintained by the Cayman Islands Registrar of Companies (the "**Registrar**"), and can be searched by the Cayman Islands Government only upon a lawful request by specified Cayman Islands or UK law enforcement authorities. The information is not open to public inspection. Entities registered as a private fund can avail of an exemption contained within the Cayman Islands beneficial ownership regime, such that it is not required to maintain a beneficial ownership register for so long as it is a registered private fund under the Act. In the event that the fund ceases to operate as a registered private fund, for example in the event that it only has a single investor, the directors should ensure that the fund still remains outside the scope of the beneficial ownership regime on the basis of another exemption.

Data Privacy

The Cayman Islands Data Protection Act (as amended) ("**DPA**"), came into force on 30 September 2019. A registered private fund (a data controller for the purposes of DPA) must comply with eight data protection principles when processing personal data and to ensure that those principles are complied with in relation to personal data processed on the data controller's behalf (for example, an administrator).

EU Substance

Cayman Islands companies, limited liability companies and partnerships, exempted limited partnerships, general partnerships, limited partnerships, and foreign limited partnerships are obliged to file an annual return even where the entity can claim an exemption from the full obligations by virtue of being an investment fund.

Deregistration as a Private Fund

A private fund is required to deregister with CIMA when liquidating. For further information, please speak to your usual Walkers contact or one of the contacts listed below.

CIMA's additional supervisory and enforcement power

The Act includes a range of powers for CIMA, modelled on CIMA's powers applicable to the mutual funds that it regulates. These include the ability to require funds to provide such information or documents as CIMA may reasonably require

in connection with its functions, and the power to apply to court in respect of such orders as it sees fit in respect of funds operating without the required registrations. Where CIMA considers that a private fund has breached or is at risk of breaching any of its obligations under the Act, it has certain powers to enforce special measures against the fund, including a requirement to perform a special audit or provide such other reporting as CIMA may request. Additionally, CIMA has certain powers where it is satisfied that a private fund is or is likely to become unable to meet its obligations as they fall due, or is carrying on business fraudulently or otherwise in a manner detrimental to the public interest, or to the interests of its investors or its creditors (among other things). These powers include the ability to cancel registrations, impose conditions, or ultimately require the substitution of operators (directors, general partners etc) or to assume control of the affairs of a private fund.

The operative provisions of the Act are supported by penalties on funds and, in some cases, their operators that fail to comply.

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For further information please refer to your usual contact or:

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