

# Cayman Islands Investment Funds Private Funds Act, 2020 compliance overview

January 2021



# Overview

On February 7, 2020 the Cayman Islands enacted new legislation for collective investment vehicles. This legislation included the passage of a new Private Funds Act (“PFA”) for closed ended funds. Further, on July 7, 2020 the Private Funds (Amendment) Act, 2020 was enacted in order to clarify the intended scope of the PFA (together, the “Act”). The Act seeks to strengthen investor confidence in Cayman Islands investment fund vehicles and ensure that the Cayman Islands remains a preeminent jurisdiction for investment fund formation. The Act also seeks to address EU suggestions for investment fund oversight as set forth in a report dated May 27, 2019, from the EU Code of Conduct Group (Business Taxation).

In addition to the passage of the Act, the Cayman Islands Monetary Authority (“CIMA”) has issued several notices, rules and FAQs to clarify some of the operating requirements under the Act. This publication seeks to summarize these requirements.\*

## **Private Funds Act, 2020 including the Private Funds (Amendment) Act, 2020**

The PFA (renamed from the Private Funds Law, 2020 in December 2020) establishes a framework to monitor closed-ended funds (“private funds”), which are currently beyond the scope of the existing Mutual Funds Act:

- All vehicles falling within the scope of the private funds definition and section 3(1) of the PFA must register with CIMA and will be subject to regulatory obligations.
- Exemptions from registration exist for certain non-fund arrangements and the PFA also includes provisions that relieve the alternative investment vehicles of registered private funds from certain provisions.
- Private funds must provide CIMA with information upon registration, pay an annual registration fee, comply with annual audit and return requirements and retain accessible records. Annual audits must be issued or undertaken by a CIMA-approved local auditor.
- A registered private fund must also comply with certain ongoing obligations in relation to valuation of fund assets, safekeeping of fund assets, cash monitoring and identification of securities. Flexibility as to appointing service providers, including the manager, operator or administrator, to perform the valuation, safekeeping and cash monitoring functions is permitted, provided that conflicts of interest are identified, managed, monitored and disclosed.

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# Registration and Fees

## Requirements to register:

Private funds launched after August 7, 2020 must register with CIMA (and comply with the PFA) within 21 days of accepting capital commitments from investors and, in any event, before accepting capital contributions from investors.

Private funds can be registered electronically through CIMA's secured Regulatory Enhanced Electronic Forms Submission (REEFS) web portal by an authorized service provider.

## The following documents are required to be uploaded

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REEFS Application Form

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Certificate of registration/incorporation (as applicable)

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Constitutive documents (Memo/Articles of Association/Trust Deed/ Declaration of Partnership(as applicable)

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Offering Memorandum/Summary of Terms/Marketing Material  
(as applicable)

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Auditors letter of consent

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Administrators letter of consent (if applicable)

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Structure chart

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Application fee (CI\$300)

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## Fees

Private funds registering subsequent to August 7, 2020 will pay the annual registration fee of CI\$3,500 (USD\$4,268.29) and the CI\$300 (USD\$365.85) application fee.

After registration, all private funds are required to pay an Annual Fee of CI\$3,500 (USD\$4,268.29) and an additional amount of CI\$250 (USD\$304.88) in respect of each of the private funds registered Alternative Investment Vehicle up to a maximum of 25 investment vehicles. This fee is payable on or before the 15<sup>th</sup> of January each year. The late filing fee imposed by CIMA for Annual Fees not paid by the 15<sup>th</sup> of January is equal to 1/12<sup>th</sup> of the owed fee for each month or part of month the fee remains unpaid.

CIMA also maintains a list of Sundry fees imposed for various administrative matters which are included on their website [here](#).

# Practical implications for Cayman Islands Closed ended funds

## Key requirements of the PFA

The operational areas covered under the PFA include valuation, custody, cash monitoring, security identification and audit which are explained further below:

**Valuation** - Valuations of the assets of a private fund shall be performed at least annually by one or more of the following:

- an independent third party that is appropriately professionally qualified to conduct valuations in a non-high risk jurisdiction;
- an administrator; or
- the manager or operator of the private fund (provided that 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 private fund).

CIMA has issued a Calculation of Net Asset Values Rule (“CIMA NAV calculation rule”) which is available on their website [here](#) and requires that a private fund establish and maintain a ‘NAV Calculation Policy’ to ensure the private fund’s NAV is fair, reliable, complete, neutral, free from material error and is verifiable. The policy should:

- be calculated in accordance with the accounting principles used to prepare the private funds audited financial statements and state which principles these are;
- be written and disclosed in the private funds constitutional documents/marketing material or other form of Investor communication;
- describe the private funds practical and workable pricing and valuation policies, practices and procedures;
- define the role and responsibilities of the person performing the valuation function;
- identify the price sources for each investment type and a practical escalation of resolution procedure for the management of exceptions; and
- incorporate internal controls that are appropriate to the size, complexity and nature of the private fund’s operations;

The CIMA NAV calculation rule also requires that for hard to value securities a private fund must, to the extent appropriate, calibrate pricing models, by verifying the inputs used in the model and testing whether the model reflects current market conditions, for example, by applying the model and inputs to a similar instrument for which pricing information is available or other appropriate means. In estimating the Fair Value for an investment, the private fund should apply a technique or techniques that are appropriate considering the nature, facts and circumstances of the investment.

Any deviations from the Policy require a satisfactory reason and must be disclosed in the private fund’s marketing materials as well as to the investors and agreed by the Operators in advance if they are likely to have an effect on the reported NAV. The private funds operator(s) have ultimate responsibility for oversight of the entire net asset valuation process, and must approve, and review, at least annually, the NAV calculation policy and any pricing models.

**Identification of securities** – A private fund shall maintain a record of the identification codes of the securities it trades and holds. Identification codes can include the securities ISIN number, if available, an alternative identification code that conforms to widely adopted international standards, or, if also not available, a regional identification code or the legal entity identifier of the issuer.

# Practical implications for Cayman Islands Closed ended funds (continued)

## Key requirements of the PFA (continued)

**Custody** - A private fund shall appoint a custodian for the safekeeping of a private funds assets unless certain conditions are met. 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 this case, the private fund shall appoint one of the following persons to carry out the title verification;

- an administrator;
- another independent third party; or
- the manager or operator (provided that 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 private fund).

CIMA has issued a Segregation of Assets Rule which is available on their website [here](#) and requires that the portfolio of the private fund must be segregated and accounted for separately from any assets of the Manager or Operator or person carrying out the title verification role. The purpose of this rule is to ensure the Portfolio of the private fund is not used by those parties to finance their own or any other operations.

The Segregation of Assets Rule outlines common instances where traditional operations would not be in violation of the rule and CIMA has also issued guidance to clarify that the Segregation of Assets Rule does not prohibit prime brokerage/custody arrangements that allow, in accordance with established and accepted industry practice, a custodian/sub-custodian to hold all client assets in a commingled client omnibus account along with the assets of other clients nor is the rule meant to disallow rehypothecation. The Segregation of Assets Rule also requires that the Operator(s) of the private fund establish, implement, and maintain strategies, policies, controls and procedures to ensure compliance with the rule appropriate for the size, complexity and nature of the private fund's activities and Investors.

**Cash monitoring** - A private fund shall appoint one of the following to perform the cash monitoring duties of the private fund:

- an administrator, custodian, other independent third party; or
- the manager or operator of the private fund (provided that the cash monitoring function is independent from the portfolio management function or potential conflicts of interest are properly identified and disclosed to the investors of the private fund).

The person appointed shall monitor the cash flows, ensure 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 ensure that all payments made by investors to the private fund in respect of investment interests have been received.

**Contents of marketing material** – Due to the various forms of marketing material used by private funds, CIMA have issued a rule outlining the required contents for private funds registered under the PFA. For further details refer to publication [here](#). Any private fund preparing marketing material should be aware of the requirements and review their compliance.

We expect that most entities would already be compliant with the above rules and guidance and have existing policies and controls that address these requirements. We do recommend however, that an evaluation is undertaken to assess whether existing arrangements/policies need to be supplemented or modified to ensure compliance.

# Practical implications for Cayman Islands funds (continued)

## Key requirements of the PFA (continued)

**Audit** – All private funds, that have not obtained an audit exemption (see below for further details), will need to be audited by a CIMA-approved auditor, with the Annual Financial Statements submitted to CIMA within 6 months of the year end. Financial Statements must be prepared in accordance with International Financial Reporting Standards or the generally accepted accounting principles of the US, Japan, Switzerland or any other non-high risk jurisdiction. If an entity is using different accounting principles than those listed, such as a special purpose reporting framework, the entity should be considering opening a dialogue with CIMA on the continued acceptability of their chosen reporting framework or look to align their reporting model to the requirements of the PFA and NAV calculation rule. The private fund is also required to submit an Annual Return to CIMA. As of drafting of this update, the format of the Annual Return has not been released however, it is expected to be similar to the Annual Return required under the Mutual Funds Act, but with some additional requirements and a simplified filing model for associated Alternative Investment Funds and sub-fund arrangements.

As outlined in Appendix 1 and 2 of this update, CIMA has allowed some exemptions to parts of the Act for entities meeting the definition of an Alternative Investment Vehicle. As part of these exemptions CIMA will accept combined or consolidated audited financial statements which may include more than one CIMA regulated entity or other non-CIMA regulated entities to meet the audit requirement as long as the audited financial statements are still in compliance with the relevant accounting principles. This assists private fund groups where combined or consolidated financial statements may have been prepared in the past or where combined presentation is most useful to the users of the financial statements.

CIMA has issued a regulatory policy providing details of when they may exempt a private fund from audit requirements. This is available on the CIMA website [here](#). In general, the circumstances for which an exemption may be provided are quite limited and include such circumstances as when a private fund has not yet launched, when audited accounts are not able to be prepared due to bankruptcy proceedings, legal or regulatory enforcement actions, the private fund is in liquidation and a liquidator has been appointed to review the accounts, the private fund is re-domiciling or is dissolving by way of a merger within six months of its last audited financial statements. Private funds are required to submit an application for waiver to CIMA along with an administrative fee along with the required documents and information outlined in the regulatory policy and each decision will be made on a case by case basis.

**Questions** - CIMA has put together a website with Frequently Asked Questions which clarifies some questions on the new Act which can be found [here](#)





# PwC Cayman's Referred Reporting Process

CIMA introduced a policy in 2002 requiring all Cayman regulated mutual funds and mutual fund administrators to be audited by an approved auditor located in the Cayman Islands. At that time, PwC Cayman formed the Fund Referred Reporting Engagement Group (FRREG) solely dedicated to assisting with compliance with this policy. The new Private Funds Act and amended Mutual Funds Act will leverage the cumulative knowledge and expertise of PwC Cayman's FRREG.

PwC Cayman's market-leading hedge and private fund practice (including the FRREG), audits approximately 26% of all Cayman regulated mutual funds and private funds. Since the FRREG's inception, we have been consistently growing and developing our dedicated FRREG team to serve these clients. The majority of FRREG staff are qualified CPAs or CAs with significant relevant experience in auditing regulated investment funds. We have significantly expanded the group by adding staff at all levels in light of the new PFA. Currently, we perform local auditor sign-off engagements with over 70 PwC offices in 36 territories. Our reach and ability to work with multiple territories is a testament to the diversity and ability of the FRREG. Auditing standards require firms issuing audit opinions under referred reporting engagements to be responsible for the overall direction, supervision, performance and review of the audit. Our specialist group has expert knowledge and experience in performing the appropriate procedures necessary under the applicable auditing standards, while leveraging the work of engagement team members of your local PwC network firm.

We work directly with your local PwC network firm so that you have one primary point of contact with PwC. We are involved in the process from planning to completion to seek to identify issues up front to avoid last minute surprises. We also have a dedicated e-filing team in place to file the completed Annual Return along with the Audited Financial Statements with CIMA through their online portal which is a regulatory requirement.

Our dedicated team leverages the latest technologies, such as robotics, machine learning and artificial intelligence to elements of the audit in order to digitally amplify our ability to accelerate our service delivery times and the insights the PwC team can bring to the engagement.



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# Appendix 1 – Scope of the Private Funds Act

## Entities covered by the PFA:

Under the PFA a private fund is defined as a company, unit trust or partnership 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 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 the purposes of the requirement for registration, a private fund is carrying on or attempting to carry on business in or from the Islands if it is incorporated or established in the Islands, or incorporated or established outside the Islands and makes an invitation to the public in the Islands to subscribe for its investment interests, and it is in receipt of capital contributions from investors for the purposes of investments.

## Entities are exempt from the PFA registration requirement if:

- a. the entity is licensed or registered under the Banks and Trust Companies Act (2020 Revision), the Insurance Act 2010, the Building Societies Act (2020 Revision) or the Friendly Societies Act (1998 Revision); or
- b. the entity is a non-fund arrangement, including but not limited to securitisation special purpose vehicles, joint ventures, holding vehicles, sovereign wealth funds, listed funds and single-family offices as further defined in the Statement of Guidance on Non-Fund Arrangements issued by CIMA in November 2020; or
- c. it is an entity incorporated or established outside the Islands, but who has invited the public in the Islands to subscribe for its investment interests by or through a holder of a licence under the Securities Investment Business Law (2020 Revision), where the investment interests are listed on a stock exchange (including an over the-counter market) specified by CIMA or the private fund is regulated by a recognised overseas regulatory authority, approved by CIMA.

See Appendix 2 for a Scoping Decision Tree based on the PFA.

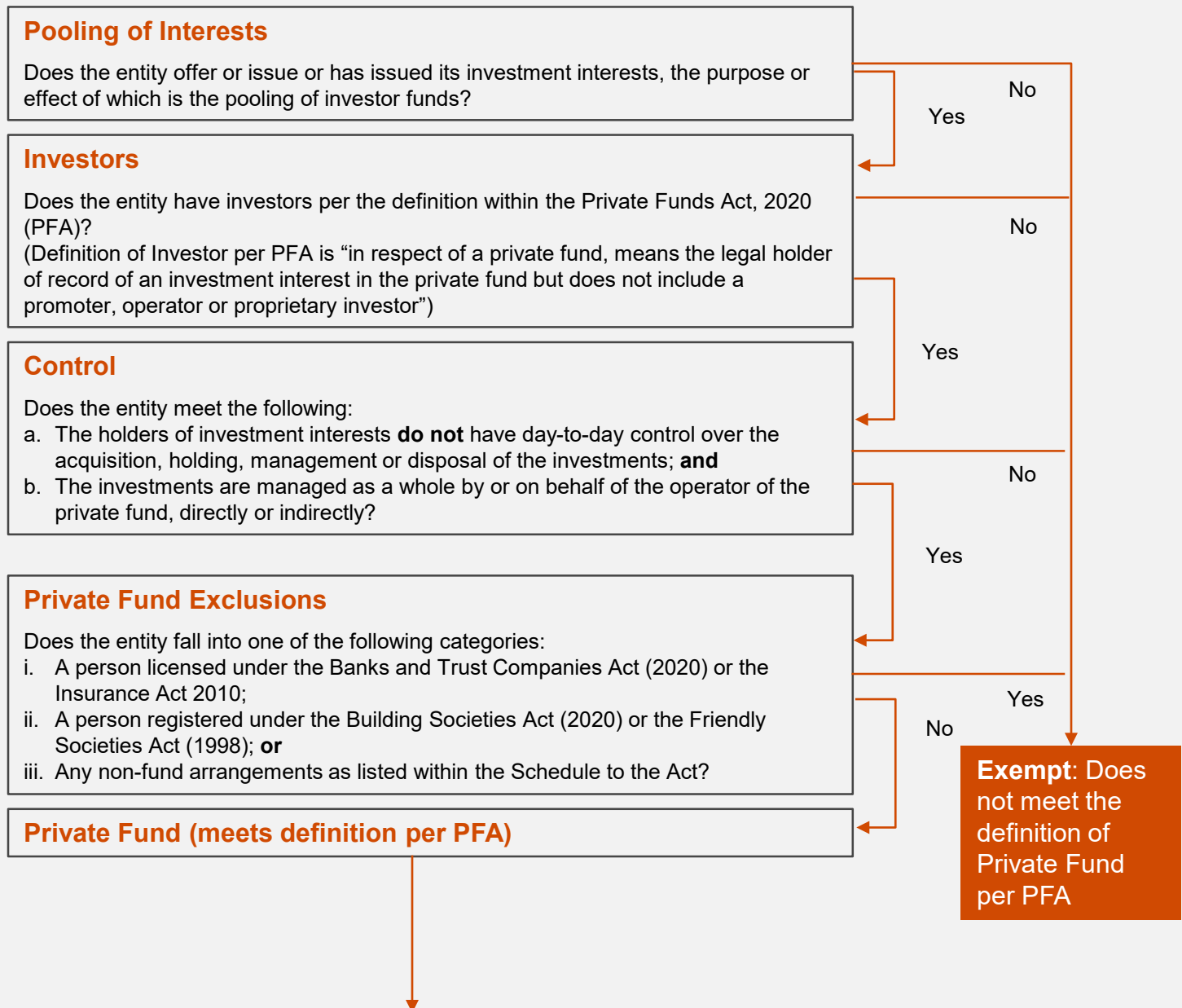
## Alternative Investment Vehicles

A set of regulations named the Private Funds Regulations, 2020 were published alongside the PFA (the "Regulations"). The Regulations define 'Alternative Investment Vehicles' ("AIV") as a company, unit trust, partnership or other similar vehicle that -

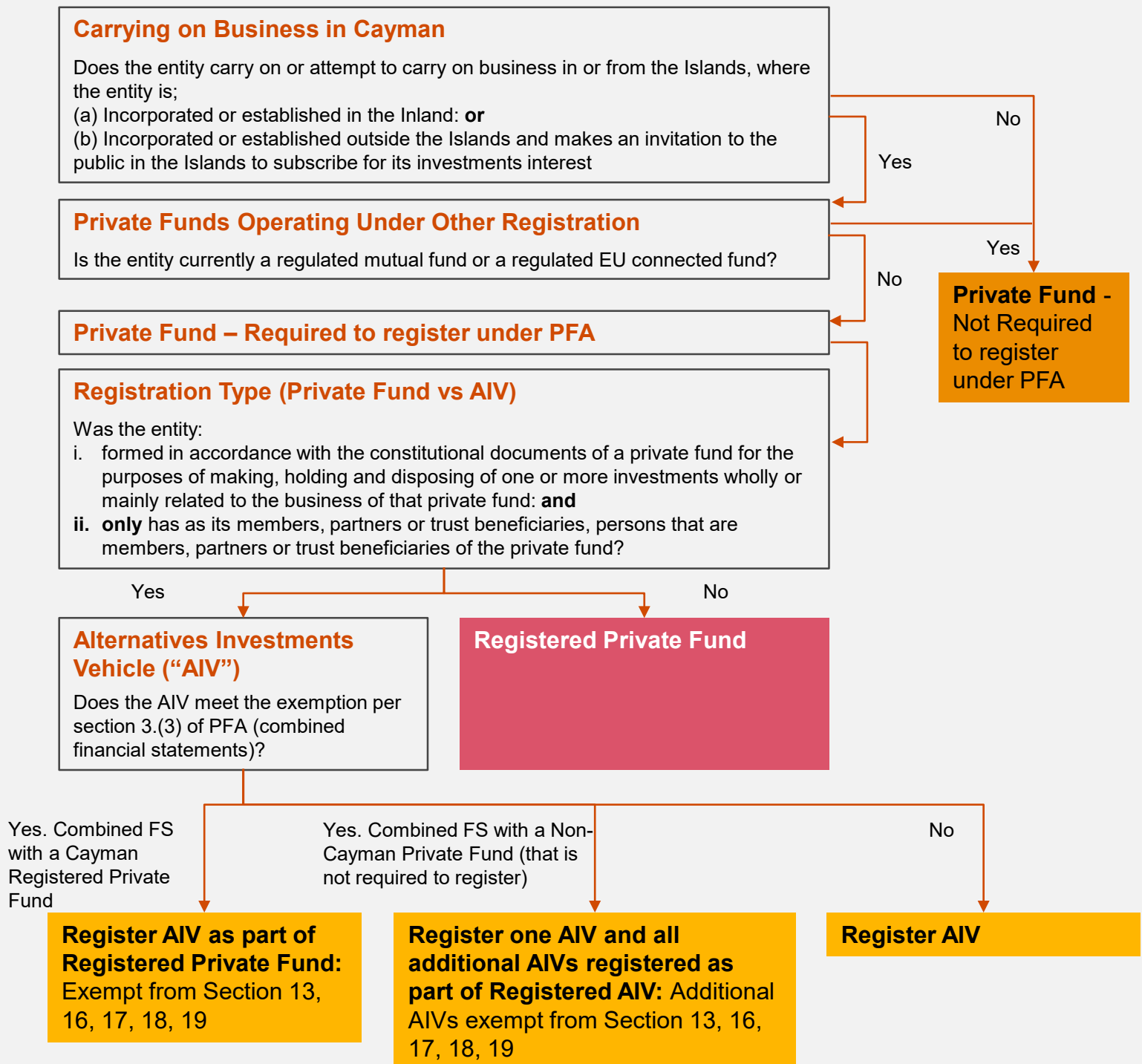
- a. is formed in accordance with the constitutional documents of a private fund for the purposes of making, holding and disposing of one or more investments wholly or mainly related to the business of that private fund; and
- b. only has as its members, partners or trust beneficiaries, persons that are members, partners or trust beneficiaries of the private fund.

Under the PFA where the applicable GAAP permits consolidated or combined financial statements and a private fund chooses to report consolidated or combined financial statements with an AIV, the sections of the PFA relating to annual audit, valuation, safekeeping of fund assets, cash monitoring and identification of securities do not apply to the AIV

# Appendix 2 - PFA Registration Scoping Decision Tree



# Appendix 2 - PFA Registration Scoping Decision Tree (continued)





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