

The Cayman Islands' investment funds industry

Chris Humphries of Stuarts Walker Hersant Humphries, discusses the current position of funds in the Cayman Islands

The Cayman Islands remains the offshore jurisdiction of choice for hedge funds and mutual funds. It maintains this prestigious status by continuing to employ innovative legislature and providing a sensible regulatory regime in a tax-free environment.

In recent months, the Cayman Islands has seen significant changes to the regulatory framework for the funds industry. This is a good time to restate the current position.

Mutual fund definition

The Mutual Funds Law (2020 Revision) applies to all open-ended funds – funds in which the investors have the right to redeem their interests at their option – except those specifically excluded from regulation.



Chris Humphries
Stuarts Walker Hersant Humphries

Chris Humphries is the managing director and one of the founding directors of Stuarts. He is a recognised leader in his field by Chambers & Partners and Legal 500. He has registered several hundred mutual funds with the Cayman Islands Monetary Authority and frequently advises on regulatory and compliance issues involving funds, investment managers and fund administrators. For further details, please get in touch at www.stuartslaw.com, or email us at info@stuartslaw.com

Types of regulated mutual funds

There are essentially four types of mutual funds that are subject to regulation and supervision under the Mutual Funds Law by the Cayman Islands Monetary Authority (CIMA):

- **Registered mutual funds:** streamlined registration procedures are available for mutual funds where:
 - the initial minimum equity interest purchasable by an investor is US\$100,000; or
 - whose equity interests are

listed on an approved stock exchange such as the Cayman Stock Exchange.

Registration requires filing the appropriate forms with CIMA together with a copy of the current offering document, consent letters from the auditors and the administrators and payment of the registration fee. Where the fund is not a registered mutual fund and is not excluded from regulation, it must either apply for a mutual fund licence or apply to be regulated as an administered mutual fund.

- **Licensed mutual funds:** a mutual funds licence is suitable for retail funds with a large and reputable promoter who does not intend to appoint a

Cayman Islands administrator. In order to obtain a mutual fund licence, the fund is required to:

- file and keep on file with CIMA a current copy of the fund's offering document;
 - maintain a registered office in the Cayman Islands (or if a trust, a licensed trust company acting as trustee);
 - appoint a reputable administrator which need not be a Cayman Islands administrator;
 - submit evidence to CIMA showing the soundness of the promoter, the expertise of the administrator and that the directors are fit and proper persons.
- **Administered mutual funds:** to be regulated as an administered mutual fund, the fund must appoint a Cayman Islands licensed Mutual Fund Administrator to provide its principal office in the Cayman Islands.
 - **Non-Cayman Islands funds:** funds that are established or incorporated outside of the Cayman Islands but whose management or administration is provided in the Cayman Islands, may be required to be registered in the Cayman Islands. If a corporate mutual fund is subject to regulation under the Mutual Funds Law, it must first register as a foreign company under the Companies Law (as Revised) to be licensed or registered as a mutual fund.

Regulated mutual funds requirements

All regulated mutual funds are required to:

- Submit to CIMA a current copy of the fund offering document. The offering document must describe the equity interests offered to investors in all material respects and must contain such information as is necessary to enable a prospective investor to make an informed decision as to whether or not to purchase the equity interests.

- Submit to an annual audit and file accounts within six months of the end of the fund's financial year. This will involve appointing an auditor in the Cayman Islands. All of the major accounting firms are represented on the Island and we would be pleased to provide you with recommendations.
- Pay a prescribed annual registration fee.

Master fund registration

Which master funds must register? The master funds that are incorporated or established in the Cayman Islands that hold investments and conduct trading activity and have one or more regulated feeder funds. This definition includes mutual funds which issue equitable interests that are redeemable at the option of the feeder fund.

A private fund is not required to appoint a custodian if it notifies CIMA that it is neither practical nor proportionate to do so

Registration and continuing obligations

The registration process involves the filing of a certificate of incorporation and an MF4 registration form as well as the payment of an annual fee. No separate offering document is required for the master fund and where the auditor and administrator of the master fund are the same as for the corresponding regulated feeder fund, a separate letter of consent is not required. Master funds are required to file with CIMA audited financial statements, signed off by a local auditor, within six months of its financial year end.

Limited investor funds registration

The Mutual Funds (Amendment) Law 2020 (the 'Amendment Law') amends the Mutual Funds Law. The primary effect of the Amendment Law is to bring within the scope of

CIMA's regulation, funds with 15 or fewer investors who have the ability to appoint or remove the operator of the fund. These funds were previously referred to as 'exempted funds' and are now referred to as 'limited investor funds'.

The Amendment Law will impose upon limited investor funds many of the same requirements that the Private Funds Law will impose upon private funds. Limited investor funds will be required to register with CIMA in the prescribed form, pay an annual registration fee, submit annual audited accounts audited by a Cayman Island-based auditor (and prepared in the same manner as those required under the Private Funds Law) and annual returns, inform CIMA of material changes to the information submitted as part of its registration application and retain appropriate accessible records. In addition, limited investor funds will be required to have at least two natural persons acting as, or for, the operator (for example the board of directors or general partner). The natural persons will be required to register with CIMA under the Directors Registration and Licensing Law (Revised).

A certified copy of an extract of the limited investor fund's constitutional documents will need to be filed with CIMA showing that a majority in number of its investors are capable of appointing or removing the operator of the limited investor fund.

Registration under the private funds law

The Cayman Islands has passed the Private Funds Law, 2020, which requires closed ended private funds to register with CIMA. The Private Funds Law impose extended administrative and operational requirements upon previously exempted closed-ended funds.

The private funds are defined in the Private Funds Law as follows:

- A 'private fund' means a company, unit trust or partnership whose principal business is the offering and issuing of its 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

The Private Funds Law also provides for 'alternative investment vehicles' and 'restricted scope private funds' which are beyond the scope of this article.

Private Funds do not include entities which constitute 'non-fund arrangements' as set out in the Private Funds Law.

All private funds (including newly set-up private funds) will need to register with CIMA by 7 August 2020. The Private Funds Law sets out a registration process for private funds which involves the filing of prescribed details with CIMA and payment of an annual fee.

The Private Funds Law does not require the filing of a full offering memorandum (or similar) in relation to a private fund or impose any requirements on the contents of a private fund's offering materials (if any). Where a private fund (a) makes any changes, or becomes aware of any changes, that materially affects any information submitted to CIMA under the provisions of the Private Funds Law; or (b) changes its registered office or the location of its principal office, the private fund shall within twenty-one days after making the change or becoming aware of the change, as the case may be, file with CIMA the details of the changes.

Operating conditions for private funds

The Private Funds Law requires a private fund to ensure it has certain ongoing operating provisions in

place relating to annual audits, annual returns, retention of records, valuation of assets, safekeeping of fund assets, cash monitoring and identification of securities which can be summarised as follows:

Annual audit of private fund

A private fund shall have its accounts audited annually by an auditor approved by CIMA. Accounts will need to be prepared in accordance with International Financial Reporting Standards or the generally accepted accounting principles of the United States of America, Japan or Switzerland or any non-high-risk jurisdiction.

Annual return

A private fund will, in respect of each financial year of the private fund, be required to submit an annual return in the prescribed form.

The Cayman Islands has passed the Private Funds Law, 2020, which requires closed ended private funds to register with CIMA

Retention of records

A private fund shall maintain its records in an accessible manner and in accordance with rules, statements of principle and guidance issued by CIMA under section 34 of the Monetary Authority Law (2018 Revision). This requirement includes an obligation to maintain a record of the identification codes of any securities regularly traded or held on a consistent basis.

Valuation

A private fund shall have appropriate and consistent procedures for the purposes of proper valuations of its assets, which shall ensure that valuations are conducted in accordance with the requirements in the Private Funds Law. Valuations of the assets of a private fund shall be carried out at a frequency that is appropriate to the assets held by the private fund and, in any case, on at least an annual basis.

Valuations of the assets of a private fund shall be performed by (a) an independent third party that is appropriately professionally qualified to conduct valuations in a non-high-risk jurisdiction or (b) the manager or operator of the private fund, or a person who has a 'control relationship' with the manager of the private fund. If the valuation is undertaken by the latter, then it must be independent from the portfolio management function and potential conflicts of interest must be properly identified, managed and disclosed to investors. Alternatively, the valuation function could be undertaken by an administrator not falling under option (a) and appointed by the private fund.

Safekeeping of fund assets

A private fund shall appoint a custodian to hold in custody, in segregated accounts opened in the name, or for the account, of the private fund, the custodial fund assets and verify, that the private fund holds title to any other fund assets and maintain a record of those other fund assets.

A private fund is not required to appoint a custodian if it notifies CIMA that 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 scenario, the private fund shall appoint either an administrator or independent third party, manager, operator, or person with a control relationship with the manager of the private fund, provided the verification function is kept separate and conflicts of interest are identified and managed in the same way the valuation function is administered.

Cash monitoring

The Private Funds Law requires that monitoring of cashflows and checking of cash accounts and receipt of investor payments be carried out by any of the manager or operator of the private fund (obviously subject to functional independence or conflicts management requirements), an independent administrator, independent custodian or any other independent third party. HFM