

Alert

The Private Funds Bill 2020 and Mutual Funds (Amendment) Bill 2020

On 8 January, after a period of industry consultation, the Cayman Islands Government issued the Private Funds Bill 2020 (the “Private Funds Bill”) and the Mutual Funds (Amendment) Bill 2020 (the “Mutual Funds Bill” and together with the Private Funds Bill, the “Bills”). The Bills are not yet law and will be considered for enactment at the 30 January 2020 meeting of the Cayman Islands Legislative Assembly.

The aim of the Bills is to bring within the scope of regulation closed-ended and private funds which are currently beyond the scope of the Mutual Funds Law (2019 Revision) (the “Mutual Funds Law”) and to modernise the regulation of both open-ended and closed-ended funds. The intended result is to align the Cayman Islands’ funds regulatory regime with best international market practice and to ensure compliance with enhanced anti-money laundering and other applicable local and international regulatory standards. Several key features of the Bills are to be confirmed in regulations or guidelines yet to be published by the Cayman Islands Government. We will supplement this Alert with such additional details as they become available.

The Private Funds Bill 2020

The Private Funds Bill provides for the registration and regulation of most closed-ended funds formed in the Cayman Islands and sets out the supervisory and enforcement powers of the Cayman Islands Monetary Authority (CIMA) in relation to such funds. The Private Funds Bill does not impact open-ended funds which have already been registered with CIMA under the Mutual Funds Law.

Definition of a Private Fund

The Private Funds Bill defines a “private fund” as 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 or investments, where –

- a) the holders of investment interests do not have day-to-day control over the acquisition, holding, management or disposal of 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 reward based on the assets, profits or gains of the company, unit trust or partnership

but does not include –

- (i) a person licensed under the Banks and Trust Companies Law (2018 Revision) or the Insurance Law 2010;
- (ii) a person registered under the Building Societies Law (2014 Revision) or the Friendly Societies Law (1998 Revision); or
- (iii) any non-fund arrangements.

The Private Funds Bill details various “non-fund arrangements” which will fall outside of its scope. Among the arrangements which will be considered “non-fund arrangements” are (i) securitisation SPVs; (ii) officer, manager or employee incentive, participation or compensation schemes; (iii) holding vehicles; (iv) individual investment management arrangements; (v) debt issues and debt issuing vehicles; (vi) structured finance vehicles; (vii) a fund whose investment interests are listed on a stock exchange; (viii) sovereign wealth funds; and (ix) single family offices.

The Private Funds Bill also provides for a category of “restricted scope private funds” that may elect to be registered as such. The precise meaning of such term will be prescribed in due course.

It should be noted that any non-Cayman Islands formed closed-ended funds that make an invitation to the public in the Cayman Islands will also fall within the scope of the Private Funds Bill.

Registration, timing and ongoing obligations

Under the Private Funds Bill, private funds must register with CIMA by filing certain prescribed details and paying a registration fee.

The Private Funds Bill makes it clear that new private funds which are required to register with CIMA will nonetheless be able to engage in oral or written communications or enter into agreements with high net worth persons or sophisticated investors prior to making a registration application. A registration application must however be submitted to CIMA within 21 days of its acceptance of capital commitments and a new private fund will not be permitted to accept capital contributions from investors prior to the completion of its registration with CIMA.

This new application process will involve co-ordination between fund managers and Cayman Islands counsel and consideration should be given as to how this might impact any timeline for launching Cayman Islands private funds. It is not expected that any special form of offering memorandum or offering document will be required to support the registration; we will however provide further details on the intended application procedures and timelines as more details become available.

For existing private funds required to register, there will be a transitional period within which to comply. It is also expected that regulations will be issued to provide additional guidance on registration procedures and ongoing regulatory requirements.

Once registered, a private fund, similar to existing open-ended funds regulated under the Mutual Funds Law, will be required to pay an annual registration fee, submit annual audited accounts audited by a Cayman Islands based auditor and annual returns, inform CIMA of material changes to the information submitted as part of its registration application and retain appropriate accessible records.

Operating conditions

The Private Funds Bill also contains requirements for valuation of fund assets, safekeeping of fund assets and cash monitoring, in each case by independent third parties. Where such functions are not undertaken by an independent third party but by someone with a “control relationship” with the manager of the private fund, either such functions must be independent from the portfolio management function or any potential conflicts of interest must be properly identified, managed, monitored and disclosed to the investors of the private fund. Private funds trading or holding securities on a consistent basis are also obliged to keep records of the identification codes of such securities and to make such records available to CIMA on request. Such records will include the ISINs for the relevant securities or similar codes used to identify the securities.

It should be noted that alternative investment vehicles (a term to be defined in regulation or guidance in due course) will not be required to comply with the annual audit, valuation, safekeeping, cash monitoring or securities identification requirements which may not be appropriate for such structures.

CIMA’s powers, supervision and enforcement

CIMA has a broad range of prudential powers under the Private Funds Bill. If CIMA is satisfied that, amongst other things, a private fund does not or is unlikely to meet its obligations as they become due, is carrying on business fraudulently or in a manner detrimental to the public interest, investors or creditors, it may take action including: cancelling the private fund’s registration, imposing conditions or further conditions on its registration, requiring the substitution of any promoter or operator, appointing an advisor in respect of the proper conduct of the private fund’s affairs or appointing a person to assume control of the affairs of the private fund (including, if necessary, termination of the business of the private fund). Where considered necessary or appropriate and where practical to do so, CIMA will inform the investors of any action it intends to take.

The Mutual Funds (Amendment) Bill 2020

The key proposed change of the Mutual Funds Bill is to bring within the scope of regulation funds with 15 or fewer investors who have the ability to appoint or remove the operator of the fund; these funds are often referred to in the Cayman Islands as “exempted funds” or “section 4(4) funds”.

Unless an exemption is granted by CIMA, upon the enactment of the Mutual Funds Bill, such 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 Islands based auditor and annual returns, inform CIMA of material changes to the information submitted as part of its registration application and

retain appropriate accessible records. Going forward, regulated mutual funds and funds which will now be required to register under section 4(4)(a) of the Mutual Funds Law will be required to prepare their audited accounts in accordance with International Financial Reporting Standards (meaning the accounting and reporting standards developed and issued by the International Accounting Standards Board) or the generally accepted account principles of the United States of America, Japan or Switzerland or any non-high risk jurisdiction (namely one that is not on the list of high risk jurisdictions issued by the Financial Action Task Force).

Funds with mutual fund administrators providing their principal office will also be required to comply with all registration and ongoing requirements.

Once the Mutual Funds Bill becomes law, funds that had been carrying on business in reliance on the former section 4(4) exemption will have six months within which to comply with the registration requirements.

Further guidance is expected to be provided as to the scope of the Mutual Funds Bill, including as to circumstances in which exemptions may be available. We will provide updates to this Alert as further details become available.

For further information on the Bills, please contact any of the contacts below or your usual Conyers attorney.

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