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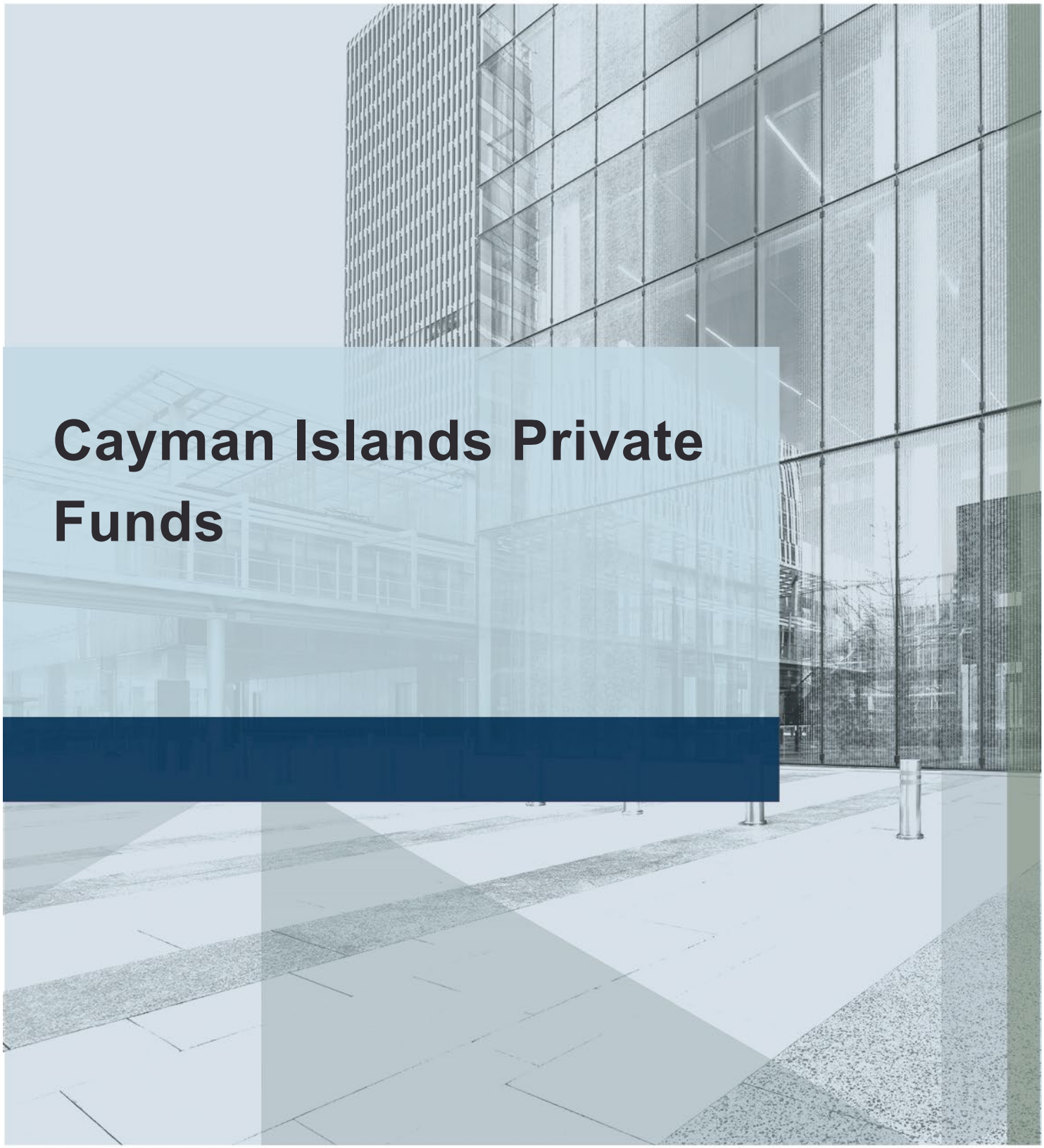

Cayman Islands Private Funds

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Preface

This publication has been prepared for the assistance of those who are considering the formation of a private fund in the Cayman Islands. It deals in broad terms with the requirements of Cayman Islands law for the establishment and operation of such entities. It is not intended to be exhaustive but merely to provide brief details and information which we hope will be of use to our clients. We recommend that our clients seek legal advice in the Cayman Islands on their specific proposals before taking steps to implement them.

Before proceeding with the incorporation of a company or the formation of a unit trust or the establishment of a partnership in the Cayman Islands, persons are advised to consult their tax, legal and other professional advisers in their respective jurisdictions.

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1. INTRODUCTION: PRIVATE FUNDS IN CAYMAN

The Cayman Islands is among the world's most attractive locations for the establishment of private equity funds. The Private Funds Act (2021 Revision) and associated regulations (the "**Act**") provides for the registration of certain closed-ended funds ("**private funds**") with the Cayman Islands Monetary Authority ("**CIMA**").

2. DEFINITION

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."

Excluded from the definition of private fund are persons licensed under the Banks and Trust Companies Act or the Insurance Act; persons registered under the Building Societies Act or Friendly Societies Act and a list of business activities described as "non-fund arrangements". Non-fund arrangements are listed as a Schedule to the Act and include, amongst other things, pension funds, securitisation SPVs, joint ventures, employee incentive schemes, holding vehicles, structured finance vehicles and funds whose investment interests are listed on a stock exchange specified by CIMA. Non-fund arrangements are further defined in the Statement of Guidance on Non-Fund Arrangements issued by CIMA in November 2020.

The Act also provides for **restricted scope private funds** which are private funds that are exempted limited partnerships managed or advised by a person licensed or registered by CIMA or a recognised overseas authority and in which all of the investors are either high net worth or sophisticated persons. It is still to be disclosed how the registration and ongoing requirements will differ for this category of private funds.

It should be noted for the purposes of the private fund definition that:

- "company" also includes foreign companies, "unit trust" includes a foreign unit trust and "partnership" includes foreign partnerships, general or limited, but excludes general partnerships constituted under Cayman Islands law;
- an "investment interest" includes a share, LLC interest, trust unit or partnership interest that carries an entitlement to participate in the profits or gains of the entity and is not redeemable or repurchasable at the option of the investor;
- "investment interest" excludes debt and therefore a fund which only issues debt instruments would not be regarded as a private fund for these purposes;

- there is no statutory definition of “investments”;
- “promoter” is defined as any person whether within or without the Cayman Islands who causes the preparation or distribution of marketing materials in respect of the private fund or proposed mutual fund but does not include a professional adviser acting for or on behalf of such a person; and
- “operator” means, in the case of a unit trust, the trustee of that trust; in the case of a partnership, the general partner in that partnership; or in the case of a company, a director of that company, or in the case of a limited liability company, a manager of the limited liability company.

A private fund must not carry on or attempt to carry on business in or from the Cayman Islands without being registered with CIMA unless it falls within the exemptions provided in the Act.

“To carry on or attempt to carry on business in or from the Cayman Islands” means that the private fund is incorporated or established in the Cayman Islands or, regardless of where it is incorporated or established, a private fund (“**Foreign Fund**”) which makes an invitation to the public in the Cayman Islands to subscribe for its investment interests.

An invitation to any the following persons will not constitute an invitation to the public in the Cayman Islands:

(a) sophisticated persons;

(b) high net worth persons;

(c) the Cayman Islands Stock Exchange, CIMA, the Cayman Islands Government or any public authority created by the Cayman Islands Government;

(d) exempted or ordinary non-resident companies registered under the Companies Act;

(e) foreign companies registered under Part IX of the Companies Act;

(f) limited liability company registered under the Limited Liability Companies Act;

(g) any company listed in (d), (e) or (f) above that acts as general partner to a partnership registered under section 9(1) of the Exempted Limited Partnership Act;

(h) any director or officer of the entities listed in (d),(e), (f) or (g) above acting in such capacity;

(i) an exempted limited partnership;

(j) a limited liability partnership; or

(k) the trustee of any trust capable of registration under section 74 of the Trusts Act acting in such capacity.

Further, Foreign Funds will not need to be registered in the Cayman Islands in the event that they are making an offer of investment interests to the public in the Cayman Islands where they do so:

(a) by or through an entity licensed under the Securities Investment Business Act; and

(i) the interests are listed on a stock exchange specified by CIMA by notice in the Gazette; or

(ii) the Foreign Fund is regulated by a recognised overseas regulatory authority approved by CIMA.

3. PRIVATE FUND REGISTRATION

3.1. Requirements for Private Funds

Applications are submitted electronically through CIMA's secured regulatory enhanced electronic forms submission ("**REEFS**") web portal, including the following:

- **Prescribed particulars**: a regulated private fund is required to file an application for registration (REEFS Application form APP-101-77) together with

(a) a certificate of incorporation/registration,

(b) constitutional documents,

(c) offering memorandum/summary of terms or marketing materials,

(d) auditor letter of consent,

(e) administrator letter of consent,

(f) structure chart,

(g) application fee of CI$300/US$366, and

(h) registration fee of CI$3,500/US$4,269 (and then annually thereafter by 15 January)

within 21 days after its acceptance of capital commitments and before accepting capital contributions. Details of any change that materially affects any information submitted to CIMA must be filed with CIMA within 21 days.

The date that all required documentation and payment have been received by CIMA will be the date reflected on the private fund's registration certificate.

3.2. Regulatory Powers

The Act confers regulatory powers on CIMA, the Cabinet and the Court. Regulated private funds must comply with any orders or directions given in exercise of these powers. These powers are designed to enable both investigation and remedy including, if need be, reorganisation or winding-up of the relevant fund. CIMA also has access to the Grand Court for orders to protect the interests of investors and creditors of the fund.

There is a right of appeal to the Executive Council against any decision of the Inspector. Hindrance of CIMA is an offence.

Certain principal regulatory powers conferred on CIMA by the Act in relation to private funds are briefly as follows:

- **Name of Fund**: CIMA may direct any private fund to change its name if the existing name is regarded as confusing or misleading or suggests falsely that the private fund has a special status in relation to or derived from the Government or the Crown.
- **Special Audit**: CIMA may at any time direct a private fund to have a special audit and to submit the audited accounts to CIMA within a specified period.
- **Provision of Information and Documents**: CIMA may direct any promoter or operator of a private fund to provide information or an explanation concerning the fund and to provide access to records relating to the fund. CIMA has similar powers to obtain information, an explanation and access to documents from private fund administrators.
- **Power to cancel or revoke registration**: CIMA has the power to de-register a private fund where it is satisfied of certain matters, including those listed below.
- **Miscellaneous Powers**: The Act gives CIMA extensive powers in relation to any regulated private fund which:

    (i) is or is likely to become unable to meet its obligations as they fall due;

    (ii) is carrying on business fraudulently or otherwise in a manner detrimental to the public interest or to the interests of its investors or creditors; or

    (iii) is carrying on or attempting to carry on business or is winding-up its business voluntarily in a manner that is prejudicial to its investors or creditors; or

    (iv) has contravened any provision of the Act or the Anti-Money Laundering Regulations; or

    (v) is carrying on or attempting to carry on business without complying with any condition of its registration; or

    (vi) has not been managed or directed in a fit and proper manner; or

    (vii) has as a director, manager or officer a person who is not fit and proper to hold the respective position.

CIMA has additional remedial powers with respect to private funds, as well as general duties and powers to maintain a review of the private fund business in the Cayman Islands.

4. THE ESTABLISHMENT OF A FUND

Once it has been determined what type of private fund is to be established, then setting up the private fund will be done in accordance with the instructions relevant to either a company, partnership or unit trust. For further information please see our publications on Cayman Exempted Companies, Segregated Portfolio Companies, Cayman Limited Liability Companies, Cayman Exempted Limited Partnerships and Cayman Unit Trusts, as well as our application forms in each case, available upon request.

Typically the constitutional documents of the entity will outline the regulation of the affairs of the entity, terms of issue of interests, meetings of the operators, voting rights and other key matters.

5. SEGREGATED PORTFOLIO COMPANIES

The Companies Act, which is of general application to companies incorporated in the Cayman Islands, including funds, makes provision for the incorporation of companies as segregated portfolio companies ("**SPCs**").

The most significant aspect of an SPC is that any asset which is linked to a particular segregated portfolio is held as a separate fund which is not part of the general assets of the company itself. Such segregated portfolios are held exclusively for the benefit of the account owner of that segregated portfolio and any counterparty to a transaction linked to that segregated portfolio. Any asset which attaches to a particular segregated portfolio is not available to meet liabilities of the company (subject to any agreement to the contrary in the governing instrument) or any of the other segregated portfolios.

Once established, a segregated portfolio company constitutes a single legal entity; each segregated portfolio does not. The company can issue shares and declare dividends on its own account, as well as with respect to each individual segregated portfolio. This can be a very useful device, particularly in the case of umbrella funds and fund of funds structures.

By notice dated 22 March 2023, CIMA advised that it would no longer be collecting annual registration fees on behalf of segregated portfolios of private fund SPCs. Any fees paid from 2020 to date will be reimbursed.

6. OPERATION OF A PRIVATE FUND COMPANY

In a private fund, investors cannot redeem or exit from the fund until it is wound up. Private funds will typically only accept investors for a set period such that the number of investors is fixed at the closing of the subscription deadline. As investors will wish to know how long their capital will be invested in the private fund, private funds will usually have a set finite lifespan. Private funds that have not received capital contributions from their investors are not legally required to file audited accounts or annual returns, however, they must follow the notification process prescribed in the Private Funds (Amendment) Regulations (2022 Revision). In these circumstances, operators are required to submit a declaration within six months after the end of the private fund's financial year.

Once a regulated private fund is in receipt of capital contributions, the Act requires:

- **Audit**: The Act requires an annual audit of the accounts of every regulated private fund by an auditor approved by CIMA. The audited accounts must be filed with CIMA within six months of

the end of the fund's financial year, although CIMA may allow an extension of time. Technology has been implemented by CIMA which allows for audited accounts to be filed electronically. CIMA has the discretion to either absolutely or conditionally exempt a private fund from filing audited accounts. This discretion will only be exercised where the private fund has a valid reason not to file audited accounts. CIMA'S Regulatory Policy concerning Exemptions from Audit Requirements for Private Funds dated March 2022 addresses circumstances where an audit waiver or extension may be needed and applications for such are considered on a case-by-case basis. It should be noted that CIMA may consider extending a private fund's first audit period for a maximum of 18 months from the date of registration and may also extend the fund's last audit period for a maximum of 18 months from the date of the last financial year end for which an audit has been filed. The audited accounts are to be submitted with the fund annual return ("**FAR**") and operator declaration (see below).

- **Annual filing**: A regulated private fund must file a FAR with CIMA in the form prescribed in the Private Funds (Annual Return) Regulations, 2021 (the "**Private Funds Regulations**"), along with an annual fee and operator declaration. The annual return is usually submitted through the auditor together with the audited accounts and includes general information about the fund, operational information such as the nature of the investments held as well as financial information about the fund. Submission is required via REEFS using form PFR-049-77. A maximum of three one month extensions may be requested from CIMA with a fee of CI$500/US$610 for each request. Please refer to the FAR Completion Guide for further guidance on the filing process.

- **Related fund entity filing**: The Private Fund Regulations require that certain information is reported in respect of a private fund's related entities. Consequently, a private fund must submit a related fund entity form ("**RFE**") with the FAR to satisfy the reporting requirements prescribed in the Private Funds Regulations. The RFE (RFE-050-77) is available, along with the relevant completion guidance, on CIMA's website.

- **Operator declaration**: The operator declaration confirms that a private fund has complied with sections 16 (valuation), 17 (safekeeping of assets) and 18 (cash monitoring) of the Act.

- **Valuation:** A private fund is required to have proper valuations of its assets at appropriate frequencies (at least annually) unless the requirement is waived by CIMA. To the extent valuations are not performed by an appropriately qualified third party, the valuation function conducted by the manager or operator should be independent from the portfolio management function or the potential conflicts of interest should be properly identified and disclosed to investors.

  According to CIMA's Rule on Calculation of Net Asset Values – Registered Private Funds, funds are required to establish, implement and maintain a NAV calculation policy that ensures a fund's NAV is fair, reliable, complete, neutral and free from material error and is verifiable. Such policy must be calculated in accordance with the International Financial Reporting Standards or generally accepted accounting principles of the United States of America, Japan or Switzerland or a non-high risk jurisdiction. The Rule requires, amongst other things, that the policy must be written and disclosed in the fund's constitutional documents or marketing materials or other form of investor communication typically used by the fund.

- **Safekeeping:** Unless not practical nor proportionate to do so, a private fund is required to appoint a custodian to hold the custodial fund assets and verify that the private fund holds title to fund assets and maintain a copy of the same.

- **Cash monitoring:** Private funds are required to appoint a person to monitor the private fund's cash flows, ensure the cash has been booked in cash accounts opened in the name or for the account of the private fund and ensure that payments made by investors in respect of investment interests have been received. To the extent the cash monitoring functions are not performed by an administrator, custodian or other independent third party, the cash monitoring function conducted by the manager or operator should be independent from the portfolio management function or the potential conflicts of interest should be properly identified and disclosed to investors.

- **Identification of securities:** Private funds that regularly trade securities or hold them on a consistent basis must maintain a record of the identification codes (International Securities Identification Number) and make such information available to CIMA upon request.

- **Segregation of Assets:** Pursuant to CIMA's Rule on the Segregation of Assets – Registered Private Funds all financial assets and liabilities (the "**portfolio**") of a fund must be segregated and accounted for separately from any assets of the manager, operator or person appointed by the fund to hold custody[1] of the fund assets. The aim of this rule is to ensure that such persons do not use the portfolio to finance their own or any other operations. The operators of the fund must establish, implement and maintain (or oversee the same) strategies, policies, controls and procedures to ensure compliance with CIMA's rules, consistent with the fund's marketing materials and appropriate for the size, complexity, and nature of the fund's activities and investors.

The above operational requirements will not apply to an alternative investment vehicle ("**AIV**") (other than the annual filing requirements) where International Financial Reporting Standards or the generally accepted accounting principles of the United States of America, Japan, Switzerland or a non-high risk jurisdiction permit consolidated or combined financial account reporting and a private fund chooses to report consolidated or combined financial statements with such AIV. AIV means a company, unit trust, partnership of similar 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. The annual registration fee in respect of each AIV is CI$250/US$305 up to a maximum of twenty-five AIVs.

The offering of the interests of a private fund in jurisdictions outside the Cayman Islands is, of course, subject to the laws of those jurisdictions. It should be noted that a Cayman AIV of a non-Cayman main fund will, if it meets the definition of a private fund, be required to register as a stand alone private fund under the Act and will be required to have its accounts audited annually by a CIMA-approved auditor and

[1] Per CIMA Notice of 21 July 2020, this does not prohibit prime brokerage/custody arrangements that allow a custodian/sub-custodian to hold all client assets in a commingled client omnibus account along with the assets of other clients.

submit its audited accounts and fund annual return to CIMA within six months of the end of each financial year.[2]

7. ECONOMIC SUBSTANCE

Investment funds are excluded from the definition of "Relevant Entity" and therefore are not required to report on their activities under the International Tax Co-operation (Economic Substance) Act (2021 Revision). However, all Cayman Islands entities (including partnerships) must notify the Cayman Islands Tax Information Authority ("**TIA**") of, amongst other things, whether or not they are carrying on a "relevant activity" and, if so, whether or not it is a "relevant entity".

The notification to the TIA is by way of an annual Economic Substance Notification ("**ESN**") which must be filed prior to an entity filing its annual return with the General Registry's Corporate Administration Portal ("**CAP**"). As general partnerships are not registered through CAP, the Department of International Tax Compliance (the "**DITC**") has advised that general partnerships must file an ESN in the form of a spreadsheet to registered office service providers for submission to the DITC's Economic Substance Team at DITC.EScompliance@gov.ky[3].

8. BENEFICIAL OWNERSHIP

Certain companies, limited liability companies and limited liability partnerships are required to maintain beneficial ownership registers at their registered offices and for the information contained therein to be provided to the Cayman competent authority for beneficial ownership, the General Registry. Private funds are exempted from the requirement to keep a beneficial ownership register by virtue of being registered under the Act. However, a private fund must provide its corporate services provider ("**CSP**") with written confirmation of the exemption with prescribed information together with instructions to file the written confirmation with the competent authority. The private fund is required to notify its CSP within one month of becoming aware of any changes to the written confirmation. Although private funds are exempted from the primary obligations of the beneficial ownership regime, penalties may still apply under the Monetary Authority (Administrative Fines) (Amendment) Regulations (2022 Revision) (the "**Administrative Fines Regulations**") if a private fund fails to provide such written confirmation and instructions, or if they incorrectly report that they are an exempted entity. The Administrative Fines Regulations are discussed further below.

9. ADMINISTRATIVE FINES

CIMA has significant powers to impose administrative fines on licensed and regulated individuals and entities. These range from non-discretionary fines of CI$5,000/US$6,100 for a minor breach to CI$1,000,000/US$1,220,000 for a very serious breach. CIMA would be able to impose cumulative fines of up to CI$20,000/US$24,390 for a single minor breach. It is important that private funds take note, as contraventions or failures to act could give rise to fines. The Administrative Fines Regulations contain the prescribed provisions attracting fines, the basis upon which discretion may be exercised, the process for imposing fines, appeals, payment and enforcement. Schedule 1 of the Administrative Fines

[2] Per CIMA Notice of 12 August 2020.

[3] This manual process for general partnerships has been adopted on the basis of advice from the DITC on 29 March 2023.

Regulations sets out the prescribed regulatory act provisions and corresponding breach categories in relation to a wide range of legislation including the Act – these categories range from offences considered to be minor in nature to breaches categorised as very serious.

10. CORPORATE GOVERNANCE

On 14 April 2023 CIMA issued a new Rule – Corporate Governance for Regulated Entities, Rule and Statement of Guidance – Internal Controls for Regulated Entities and a Statement of Guidance – Corporate Governance – Mutual Funds and Private Funds (together the "**new Rules and SOGs**"). The new Rules and SOGs are to come into effect within 6 months of their issue date.

10.1. Monitoring of Acts and Regulations

The operators of a regulated private fund have a positive duty to monitor acts and regulations affecting the funds industry (including anti-money laundering, counter terrorist financing and counter proliferation financing requirements – see section 11) and to request information to ensure that the fund and its service and/or professional providers are complying with these and, where it is not, provide appropriate direction to ensure compliance. The operators should require regular reporting from the investment manager and other service providers to enable it to make informed decisions and to adequately oversee and supervise the fund.

10.2. Operators

CIMA has recognised that the operator of a fund, normally a non-executive director, is not actively administering or operating the fund but rather has a duty to retain sufficient oversight so as to enable the operator to satisfy itself that the fund is efficiently and effectively operated and managed and in accordance with all applicable acts, regulations and rules. While funds often delegate a number of functions to service providers, delegating the function does not abrogate the operator from ultimate responsibility for the delegated functions. An operator must apply his or her mind to directing the fund through actively enquiring into the affairs of the fund on an on-going basis; operators are expected to be proactive rather than reactive.

CIMA requires a minimum of two directors for private fund applicants that are companies and will require a minimum of two natural persons to be named in respect of a general partner or corporate director of a private fund. Directors appointed to private funds are not required to be registered pursuant to the Director Registration and Licensing Act.

The operators must ensure that the fund has a conflict of interest policy and ensure that it is adhered to. The operator should meet at least twice a year and, where necessary, must request the presence of its service providers.

Operators must exercise independent judgment, operate with due skill, care and diligence and act honestly and in good faith. Where appropriate, operators must make relevant enquiries and communicate adequate information to investors.

10.3. Additional Noteworthy Principles

- Operators should ensure that they have sufficient time to apply their mind to the overseeing and supervising of the fund.
- Operators should ensure that the fund documents are compliant and up to date, particularly the description of investment strategy and conflicts of interest policy.
- Operators should continually monitor and assess delegates, and specifically the investment manager, on an ongoing basis and verify that they are performing their function(s) in terms of the contracts – noting that the operators retain responsibility for delegated functions.
- The operators should review financial results, net asset valuation policy and calculation of net asset value.
- The operators should monitor compliance with investment strategy, criteria and restrictions.
- Operators are responsible for ensuring that a full, accurate and clear written record is kept of the operator's meetings.
- Operators owe a duty to disclose to CIMA any matter which could materially and adversely affect the financial soundness of the fund and any non-compliance with relevant acts, regulations, rules, statements of principles and statements of guidance, including anti-money laundering, counter terrorist financing and counter proliferation financing requirements.

11. ANTI-MONEY LAUNDERING, COUNTER TERRORIST FINANCING AND COUNTER PROLIFERATION FINANCING COMPLIANCE

Funds are considered to be carrying on "Relevant Financial Business" as defined in the Proceeds of Crime Act (2020 Revision) (the "**POCA**") and are subject to the POCA, the Anti-Money Laundering Regulations (2023 Revision) (the "**AML Regulations**") and the Guidance Notes on the Prevention and Detection of Money Laundering, Terrorist Financing and Proliferation Financing in the Cayman Islands (the "**Guidance Notes**", collectively with the POCA and the AML Regulations, the "**AML Regime**") issued by CIMA.

In March 2022, the Anti-Money Laundering Unit released the Cayman Islands' 2021 National Risk Assessment ("**NRA**") which evaluated the money laundering, terrorist financing and proliferation financing risks faced in the Cayman Islands. Amongst its findings, the NRA concluded that, given the Cayman Islands' status as an international financial centre, the Cayman Islands' greater risk exposure is to proceeds-generating crimes committed overseas, in particular, foreign proceeds of crime ("**FPOC"**) through fraud, corruption and tax evasion. Banks, securities business and investments and funds face the primary exposure to FPOC. The nature and complexity of business, particularly registrar and transfer agency services, the high volume of transactions and the use of non-face to face contact through referrals or introducers have resulted in the investments sector being assigned a medium-high risk rating while exempt companies are the most implicated corporate structure.

Pursuant to the AML Regime, funds are required to have internal reporting procedures in place to (1) identify and report suspicious activity; (2) monitor and ensure internal compliance with laws relating to money laundering; and (3) test that their AML system is consistent with the AML Regulations and the Guidance Notes (the "**Procedures**"). As part of the Procedures, funds are required to:

(a) adopt a risk based approach to identify, assess and understand money laundering, terrorist financing and proliferation financing risks and clearly document or keep a written record of the risk analysis approach taken;

(b) put in place identification and verification procedures to identify customers and undertake ongoing due diligence measures;

(c) have in place record keeping policies and procedures and investor due diligence information and ensure that transaction records should be available without delay upon a request by competent authorities;

(d) have internal systems and controls relating to audit function, outsourcing, employee screening and training which is proportionate to the nature, scale and complexity of its activities;

(e) appoint a Compliance Officer ("**AMLCO**"), to act as compliance officer, who shall have overall responsibility for ensuring compliance by the Fund with the AML Regime; and

(f) appoint a Money Laundering Reporting Officer ("**MLRO**"), to act as MLRO and a Deputy MLRO ("**DMLRO**"), who shall have responsibility for receiving reports of, investigating and reporting suspicious activity to the Reporting Authority in accordance with the Guidance Notes.

While the ultimate responsibility for maintaining and implementing satisfactory Procedures remains with the fund, the obligations may be met by delegating or outsourcing those functions, including to persons who are subject to the anti-money laundering requirements of a country that the fund has assessed and documented as having a low degree of risk of money laundering and terrorist financing. Regulated funds must notify CIMA of their AMLCO, MLRO and DMLRO appointments and any changes thereto. For further information on the AML Regime, please contact your Conyers contact.