COLLAS CRILL

Private Funds Law 2020

MARCH 2020

Read January update

Read July update

We previously published an article detailing draft legislation named the Private Funds Bill which was published on 8 January 2020 (the "**Bill**"). The Bill was approved by the Cayman Islands Government on 31 January 2020 and enacted into law as the Private Funds Law 2020 on 7 February 2020 (the "**Law**"). By way of reminder, the Law sets out requirements for the registration of closed ended funds with the Cayman Islands Monetary Authority ("**CIMA**"), bringing closed ended funds within the scope of a regulatory regime for the first time in this jurisdiction.

Timings

The commencement date of the Law is 7 February 2020 (the "**Commencement Date**").

A set of transitioning regulations named the Private Funds (Savings and Transitional Provisions) Regulations, 2020 (the "**Transitional Regulations**") were published alongside the Law.

Under the Transitional Regulations, Private Funds have until 7 August 2020 to register with CIMA and comply with the Law (the "**Transitional Period**").

Accordingly, clients with existing Private Funds and those who are establishing, or thinking of establishing, new Private Funds, should speak to us as soon as possible so that we can ensure registration and compliance well before 7 August 2020.

CIMA Guidance

We expect that CIMA will imminently publish guidance and rules which will set the parameters as to how, exactly, the Law will be implemented. CIMA currently have the following draft rules in connection with the Law out for consultation with the private sector and industry stakeholders:

1. Rule on the calculation of Asset Values;
2. Rule on Segregation of Assets; and
3. Rule on Contents of Marketing Materials.

We will keep you informed of any updates in respect of the Law's implementation.

Key Features of the Law

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The key features of the Law are largely the same as those which were set out under the Bill. We summarise these below.

Which Funds come under the scope of the Law?

The majority of closed ended funds with more than one investor come within the scope of the Law. Specifically, the Law applies to **'Private Funds'**. A fund is a Private Fund if:

1. it has been structured as a Cayman Islands company, unit trust or partnership;
2. its principal business is offering and issuing investment interests, the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risk and enabling investors to receive profits or gains from the fund's acquisition, holding, management or disposal of investments;
3. its investment interests are not redeemable at the option of the investor;
4. its investors do not have day to day control over the acquisition, holding, management or disposal of the fund's investments;
5. its investments are managed as a whole by or on behalf of its operator, directly or indirectly, for reward based on the assets, profits or gains of the fund.

Non Cayman Islands Private Funds are also captured by the Law, if they invite the public in the Cayman Islands to subscribe for investment interests.

Restricted Scope Private Funds

A set of regulations named the Private Funds Regulations, 2020 were published alongside the Law (the "**Regulations**"). The Regulations defines **'Restricted Scope Private Funds'** as a Private Fund -

1. that is an exempted limited partnership;
2. that is managed or advised by a person who is licenced or registered by CIMA or authorised or registered by a recognised overseas regulatory authority; and
3. in which all of the investors are non-retail, being either high net worth or sophisticated persons.

Under the Law a Private Fund which meets this definition may choose to register with CIMA as a Restricted Scope Private Fund. It is unclear right now what requirements a Restricted Scope Private Fund will need to meet under the Law but we suspect that they will be less onerous than those of a Private Fund. We expect CIMA to publish clarifying guidelines shortly.

Carve Outs

The Law helpfully excludes several 'non fund' arrangements from its scope. An example of some of the 'non fund' arrangements which are specifically excluded from the Law are:

- securitization special purpose vehicles;
- joint ventures;

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- proprietary vehicles;
- holding vehicles;
- individual investment management arrangements;
- debt issuing vehicles;
- structured finance vehicles;
- employee incentive schemes (or similar);
- sovereign wealth funds; and
- single family offices.

A full list of the 'non fund' arrangements is set out in the schedule to the Law, which can be found here.

Registration with CIMA

Under the Law, newly established Private Funds will be required to submit an application to register with CIMA within 21 days after it accepts capital commitments from investors and in any event, may not accept capital contributions from investors until the Private Fund is registered by CIMA.

After the Transition Period, a Private Fund may not accept capital contributions from investors until it is registered by CIMA.

However, quite helpfully, a Private Fund may engage in oral or written communications and enter into agreements with potential investors who are high net worth persons or sophisticated persons prior to the submission of its registration application to CIMA.

Applications for registration of Private Funds will need to be submitted electronically through CIMA's REEFS web portal.

In order to apply to be registered with CIMA, as part of its electronic application submission, a Private Fund will need to submit a copy of its certificate of incorporation/registration (as applicable), constitutive documents, offering memorandum/summary of terms/marketing materials (as applicable), auditor's letter of consent, administrator's letter of consent (if applicable) and a structure chart for the entity, together with payment of the prescribed registration fee to CIMA. Private Funds which register by 7 August 2020 will be liable to payment of a registration fee of US$365.85 while Private Funds which register following 7 August 2020 will be liable to payment of a registration fee of US$4,634.14.

Based on the draft 'Rule on Contents of Marketing Materials' which is currently under consultation, we suspect that all Private Funds, save for **'Alternative Investment Vehicles'**, will be obliged to include certain information in their marketing materials. 'Marketing materials' are defined as any document which is used to solicit investors to invest in a fund. We suspect that most, if not all, Private Funds have or will publish marketing materials.

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We will confirm the information which must be published within marketing materials as soon as the Rule is finalised. The draft Rule currently excludes Alternative Investment Vehicles from the obligation to publish marketing materials with specific information. Under the Regulations, an Alternative Investment Vehicle is defined as a company, unit trust, partnership or other similar vehicle which –

1. 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
2. only has as its members, partners or trust beneficiaries, persons that are members, partners or trust beneficiaries of the Private Fund.

Once CIMA receives a complete application from a Private Fund, it will consider the application and register the Private Fund once satisfied. The Law sets out that CIMA will communicate its decision to register a fund as soon as reasonably practicable after its review of the application and the registration date of the Private Fund will be the date of submission of the complete application for registration to CIMA.

Ongoing Obligations

A summary of the ongoing obligations of a registered Private Fund are set out below:

- Directors: Private Funds must have a minimum of two (2) directors for applicants that are companies. In the case of general partners or corporate directors of a Private Fund, a minimum of two (2) natural persons must be named in respect of the general partner or corporate director.
- Valuations: Private Funds must have appropriate and consistent procedures for the proper valuation of its assets. Valuations must be carried out at least once a year. Valuations must be carried out by an independent third party, an administrator or the manager or operator of the fund provided the valuation function is independent of the management function or that potential conflicts of interest are properly identified, managed, monitored and disclosed to investors. under the draft 'Rule on the calculation of Asset Values', currently under consultation. Private Funds must disclose their valuation policy within their constitutional documents, marketing materials or other form of investor communication. CIMA may exempt a Private Fund from this valuations requirement, either absolutely or subject to such conditions as CIMA may determine.
- Safekeeping: Private Funds must appoint a custodian to hold the custodial fund assets. The custodian must verify that the fund holds title to any other fund assets and maintain a record of those assets. A fund may notify CIMA that it is neither practical nor proportionate to appoint a custodian having regard to the nature of the assets which it holds. In this case, the fund must appoint an independent third party or the manager or operator of the fund to carry out the title verification function. If this function is carried out by the manager or operator, it must be independent from the portfolio management function and potential conflicts of interest must be properly identified, managed, monitored and disclosed to investors.
- Cash Monitoring: Private Funds must appoint a person to monitor its cash flow, ensure all cash has been booked in cash accounts opened in the name, or for the account of, the fund and ensure that all payments made by investors have been received. An independent third party may be appointed to perform this role.

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The manager or operator of the fund may also be appointed provided this function is independent of the management function or that potential conflicts of interest are properly identified, managed, monitored and disclosed to investors. In addition, should this function be performed internally by the manager or operator of the fund, the fund's auditor will be required to confirm that the function was carried on throughout the year when signing off the fund's audited financial statements.

- Identification of Securities: Private Funds which regularly trade securities or hold them on a consistent basis must maintain a record of the identification codes of the securities it trades and holds. This information must be made available to CIMA upon request.
- Annual Fee: an annual fee of US$4,268.29 (together with an additional fee of US$304.88 in respect of each of the Private Fund's alternative investment vehicles up to a maximum of twenty-five (25) vehicles, as applicable) must be paid to CIMA by 15 January of each year.
- Annual Return: a Private Fund will need to submit an annual return to CIMA in respect of each financial year.
- Inform CIMA of Changes: details of any changes to the Private Fund which materially effect the information submitted upon the fund's initial registration must be submitted to CIMA within 21 days; and
- Accounts and Audit: Private Funds will need to prepare annual accounts in accordance with the International Financial Reporting Standards or generally accepted accounting principles of the United States of America, Japan, Switzerland or a non-high risk jurisdiction and an audited set of accounts must be filed with CIMA within six months of the fund's year end. The audit will need to be undertaken by a Cayman Islands auditor approved by CIMA. A Private Fund is required to submit an audit for its 2020 financial year within six (6) months of its financial year end, unless an extension is otherwise granted by CIMA. This means that if a transitioning Private Fund registers with CIMA in August 2020 and has a financial year end of 31 December, it will need to file its audited accounts with CIMA in respect of its financial year ending 31 December 2020.

Possible Exemptions for Alternative Investment Vehicles

Under the Law, where International Financial Reporting Standards or 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 choses to report as such with an Alternative Investment Vehicle, that Alternative Investment Vehicle will not be required to comply with the following requirements (1) audit; (2) valuation; (3) safekeeping; (4) cash monitoring; or (5) identification of securities.

Pre-existing Ongoing Obligations

In addition to the new obligations proposed by the Law, operators Private Funds should be aware of the pre-existing continuing obligations that Private Funds are subject to:

- Anti-money laundering: Private Funds are subject to the requirements of the Anti-Money Laundering Regulations (as amended) and will usually either delegate anti-money laundering functions to a service provider or rely on the manager or administrator to perform the functions. Private Funds are also required

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to appoint natural persons to the roles of Anti-Money Laundering Compliance Officer, Money Laundering Reporting Officer ("**MLRO**") and Deputy MLRO.

- Automatic Exchange of Information: all Private Funds should already be complying with their reporting obligations under the Foreign Account Tax Compliance Act ("**FATCA**") and the Common Reporting Standard ("**CRS**") which requires the collection and reporting of financial account information in relation to investors.
- Data Protection: Private Funds and their functionaries and service providers will be data controllers or data processors under the Data Protection Law, 2017 ("**DPL**") and must ensure that all personal data is handled in accordance with the DPL.

Winding-up of existing Private Funds

An existing Private Fund which is in liquidation / being wound-up or that has commenced the liquidation / wind-up process prior to 7 August 2020, and which submits evidence (in the form of resolutions, auditor confirmations etc.) to CIMA that its liquidation / winding-up will be completed prior to 7 August 2020 will not be required to apply for registration under the Law.

Supervision and Enforcement

The Law provides CIMA with new supervisory and enforcement powers to ensure the requirements of the Law are complied with. For example, if CIMA deems it necessary to comply with its functions under the Law, it may request additional information from a Private Fund, carry out on site inspections, impose additional conditions or apply to Court for an order to take any action it deems necessary to protect the interests of the investors. Failure to comply with the provisions of the Law may result in the imposition of fines on a Private Fund and / or its operators.

Contact

We will make sure to keep you informed of any updates relating to the implementation of the Law.

If you would like any additional information, please get in touch at regulatory@collascrill.com or with your usual Collas Crill contact, who will be happy to speak with you.

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