

UPDATE

Changes proposed for Cayman funds

Draft legislation has been published in the Cayman Islands which will introduce fundamental changes to the regulation of Cayman Islands investment funds

Background

The Mutual Funds (Amendment) Bill, 2020 and the Private Funds Bill, 2020 (together, the **Bills**) were published on 8 January 2020 and are scheduled to be considered by the Cayman Islands Legislative Assembly on 30 January 2020. Whilst subject to further change, the proposed legislation will impact both private equity and hedge fund structures, which are discussed in turn below.

Private equity funds

The Private Funds Bill, 2020 will require closed-ended Cayman fund vehicles to apply for registration with the Cayman Islands Monetary Authority (**CIMA**) prior to accepting capital contributions from investors.

Which vehicles does the Bill apply to?

The Bill applies to "private funds", which are defined as vehicles whose principal business is the offering and issuance of investment interests¹, 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 the vehicle's investments, where (a) the investors do not have day-to-day control over those investments and (b) the investments are managed by or on behalf of the fund's operator for reward based on the vehicle's profits or gains.

The definition of "private fund" excludes certain "non-fund arrangements". Those non-fund arrangements include pension funds, securitisation SPVs, joint ventures, proprietary vehicles, holding vehicles, individual investment management arrangements, debt issues and debt issuing vehicles, structured finance vehicles, sovereign wealth funds and single family offices.

Restricted scope private funds

The Bill is expected to introduce a category of "restricted scope private funds", to which reduced requirements will apply. Whilst the parameters of this definition are not yet known, we understand that the definition is likely to include typical private equity fund structures (i.e. exempted limited partnerships with managers where the investors are sophisticated or high net worth persons), which are intended to benefit from a measured approach regarding oversight and compliance.

Registration requirements

The requirements of a registration application are unknown at this stage. However, they will likely involve the provision of key details of the fund's structure, assets and service providers, together with payment of a

¹ The current definition of **investment interests** means a share, LLC interest, trust unit or partnership interest that:

- (a) carries an entitlement to participate in the profits or gains of the vehicle; and
- (b) is not redeemable or repurchasable at the option of the investor,

but does not include debt or certain alternative financial instruments. The definition of **investor** also excludes promoters, operators and proprietary investors.

prescribed fee. Additional requirements, such as a certified copy formation certificate and a copy of the fund's marketing prospectus or offering document, will likely also be required.

A private fund will be able to market and solicit investment from certain sophisticated and high net worth investors without having registered with CIMA. However, a registration application must be made within 21 days of accepting capital commitments from investors and the fund must be registered with CIMA prior to accepting any capital contributions.

Timing of implementation

When finalised and approved, the Private Funds Bill will need to be brought into force by Order of Council. The Bill itself does not provide any detail regarding the proposed timing of implementation but it is anticipated that there will be a substantial transition period during which existing closed-ended fund vehicles will be required to become compliant with the new regime. The timing of implementation for existing vehicles will likely differ from the timing applicable to registrations of new private fund vehicles.

Hedge and mutual funds

Removal of section 4(4)(a) exemption

Those familiar with the current Cayman regulatory regime applicable to funds will know that an open-ended fund structure will be subject to regulation in Cayman if it falls within scope of the Mutual Funds Law (2019 Revision). The Mutual Funds Law provides for three categories of regulated fund and also an exemption, commonly referred to as "section 4(4) funds". Under section 4(4)(a) of the Mutual Funds Law, an investment fund which would otherwise fall within-scope is not required to be regulated where:

- the shares or partnership interests in the fund are held by 15 or fewer investors; and
- a majority of those investors have the power to appoint or remove the fund's operator (ie, the directors or general partner).

The Mutual Funds (Amendment) Bill, 2020 proposes to amend section 4(4)(a) and vehicles with 15 or fewer investors who have the right to appoint or remove the operator will, thereafter, be required to:

- register with CIMA;
- pay an annual registration fee; and
- file documentation confirming the ability to appoint/remove the fund's operator.

Timing

The Mutual Funds (Amendment) Bill, 2020 will come into force at the same time as the Private Funds Bill, 2020. Existing vehicles which have taken advantage of the section 4(4) exemption will have a period of time in which to become compliant with the new requirements, currently six months from the date that the Bills come into force.

Ongoing obligations for private funds and mutual funds

The Bills both include the following ongoing obligations to:

- inform CIMA of any material changes to the information submitted in the authorisation application, or of a change in the fund's registered or principal office, within 21 days of making the change;
- pay an annual authorisation fee and filing of an annual return form with CIMA;
- have the fund's accounts audited annually by a CIMA approved auditor, together with an obligation to file audited accounts with CIMA within 6 months of the fund's financial year end; and
- retain records in accordance with CIMA's published rules, guidance and policies.

The Private Funds Bill also imposes requirements regarding asset valuations, safekeeping of assets and title verification, cash monitoring and (where applicable) identification of securities. Asset valuations, safekeeping and cash monitoring are required to be conducted by an independent third party but may also be conducted by the fund's manager or operator, provided that the relevant function is independent from the portfolio management function and that potential conflicts of interest are identified, managed, monitored and disclosed to investors.

Next steps

This update provides a very brief summary of draft legislation, the content of which may change considerably before the legislation is finalised and adopted. We are monitoring these developments closely and will issue further information as the position solidifies.

Please contact your usual Mourant contact with any questions or, alternatively, please get in touch with one of the contacts named below.

Contacts



Alex Last

Partner, Cayman Islands
+1 345 814 9243
alex.last@mourant.com



Catherine Pham

Partner, Cayman Islands
+1 345 814 9247
catherine.pham@mourant.com



Hayden Isbister

Managing Partner, Cayman Islands
+1 345 814 9125
hayden.isbister@mourant.com



Neal Lomax

Partner, Cayman Islands
+1 345 814 9131
neal.lomax@mourant.com



Robert Duggan

Managing Partner, London
+44 20 7796 7622
robert.duggan@mourant.com



Paul Christopher

Managing Partner, Hong Kong
+852 3995 5700
paul.christopher@mourant.com



Sara Galletly

Counsel, Cayman Islands
+1 345 814 9233
sara.galletly@mourant.com

This update is only intended to give a summary and general overview of the subject matter. It is not intended to be comprehensive and does not constitute, and should not be taken to be, legal advice. If you would like legal advice or further information on any issue raised by this update, please get in touch with one of your usual contacts. © 2020 MOURANT OZANNES ALL RIGHTS RESERVED