

Private Funds in the Cayman Islands

The Cayman Islands is the leading jurisdiction for the offshore investment funds industry due to its combination of flexible and appropriate regulation, an approachable and effective regulator, professional service provider expertise, high reputation among investors and a tax neutral regime.

Overview

Investment funds established in the Cayman Islands fall into two broad categories: open-ended funds and closed-ended funds.

Open-ended funds provide investors with voluntary redemption or repurchase rights and closed-ended funds do not provide investors with those rights. Typically open-ended funds will invest in liquid assets which can be readily realised to satisfy redemptions (eg listed, liquid, tradable securities) and closed-ended funds will invest in non-liquid assets requiring time to liquidate/realise value (eg real estate, unlisted growth companies).

This guide sets out a summary of the regulatory regime that governs closed-ended investment funds, known as private funds, which is supervised by the Cayman Islands Monetary Authority (**CIMA**).

For an overview of the regulatory regime that governs open-ended investment funds please see our [Guide to Investment Funds in the Cayman Islands](#).

Fund vehicle options

Exempted limited partnerships

An exempted limited partnership (**ELP**) is the most common vehicle for closed-ended funds including private equity, venture capital and real estate funds. An ELP has many similarities to its Delaware equivalent vehicle but an ELP is not a separate legal person and for this reason, it is popular with managers and investors in a number of jurisdictions. An ELP is operated and managed by its general partner. Please see our [Guide to ELPs](#) for more details.

Limited liability companies

Limited liability companies (**LLCs**) can be incorporated in the Cayman Islands in a form closely aligned to the Delaware LLC. LLCs may be used in investment fund structures where

a flexible structure similar to a limited partnership is required, but where the vehicle needs to be established as a body corporate distinct from its members. LLCs are regulated by their LLC agreement and the Limited Liability Companies Law. Please see our [Guide to LLCs](#) for more details.

Companies

Exempted companies limited by shares are also used for the establishment of closed-ended investment funds, with an investor's liability being limited to the amount paid or agreed to be paid in respect of their shares. Please see our [Guide to Exempted Companies](#) for more details.

Segregated portfolio companies

An exempted company may register as a segregated portfolio company (**SPC**), which is similar to a segregated cell company in many other jurisdictions.

An SPC may establish any number of segregated portfolios. Assets and liabilities attributed to a particular segregated portfolio are legally separated from the assets and liabilities attributed to any other segregated portfolio. A creditor who is party to a contract involving a particular segregated portfolio will have restricted recourse and will be entitled to recover only against assets attributed and credited to the specific segregated portfolio to which the contract is also attributed.

SPCs can be useful as multi-strategy vehicles and platform vehicles. Savings by using multi-strategy SPCs are often not as great as anticipated however and SPCs with multiple segregated portfolios do require a greater degree of care to ensure assets are properly segregated, contracts are entered into on behalf of the correct segregated portfolio and inadvertent cross-collateralisation does not occur. Please see our [Guide to Segregated Portfolio Companies](#) for more details.

Unit trusts

Cayman Islands unit trusts are established under and governed by the Cayman Islands Trusts Law and, save as modified under that law, generally applicable principles of English trust law. Under a unit trust investors contribute funds to a trustee which holds those funds on trust for the investors and each investor is directly entitled to a pro rata share in the trust's assets, its unit. Unit trusts are constituted under a trust deed that provides the terms on which the trustee holds the trust's assets for unit holders. The use of Cayman Islands unit trusts is particularly popular in Japan for domestic tax purposes.

General

Establishment

All of the above entities can be established on an express basis and no governmental or regulatory approvals are required.

Taxation of vehicles

All of the above vehicles are exempted from any Cayman Islands income or gains taxes and can obtain a tax undertaking certificate from the Cayman Islands government guaranteeing no change in their tax status for 20 years for exempted companies and 50 years for exempted limited partnerships and limited liability companies (*LLCs*).

Liability of investors

All of these vehicles issue equity interests which typically limit investor liability to the amount paid or agreed to be paid in respect of their investment.

Management of entities

An exempted company's management rests with its board of directors, an exempted limited partnership's with its general partner (typically a Cayman Islands exempted company and so ultimately with that entity's board) and an LLC's with its manager, and these are all referred to as 'operators'. Typically investment management authority is delegated to an investment manager or adviser although the relevant operator will always be required under generally applicable law to maintain oversight of the investment manager's functions.

CIMA has provided guidance on best practice for fund governance which should be followed by operators of all funds. See our [Guide to Duties and Obligations of a Director of a Cayman Islands Fund](#) for further details.

Private Fund and Securities Regulation

The Private Funds Law is the main legislation regulating closed-ended investment funds in the Cayman Islands. Investment managers, broker dealers and others carrying on

securities investment business from the Cayman Islands must comply with the Securities Investment Business Law (*SIBL*). All investment funds, investment managers and their service providers must comply with anti-money laundering and automatic exchange of information laws and regulations.

What is a 'private fund'?

To be categorised as a private fund under the Private Funds Law:

- the fund must be offering, issuing or have issued, investment interests and not debt or contractual interests, in other words, shares, limited partnership interests, LLC interests or trust units
- the investment interests cannot be redeemable at the option of the investor
- the fund must be a collective investment vehicle effecting the pooling of investor funds
- the holders of investment interests must not have day-to-day control over the acquisition, holding, management or disposal of the investments
- the investments are managed as a whole by or on behalf of the operator of the private fund, directly or indirectly
- the fund must be established in the Cayman Islands or be a foreign fund and seek to make an offer or invitation to the public in the Cayman Islands to subscribe for its investment interests

Exclusions or exemptions from regulation for certain funds?

Certain 'non-fund arrangements' are deemed not to be private funds, such as a single family office, pension fund, securitisation special purpose vehicle, sovereign wealth fund and any fund whose investment interests are listed on a recognised stock exchange. Accordingly these vehicles are not required to register with CIMA under the Private Funds Law.

A private fund that is not incorporated or established in the Cayman Islands and which makes an invitation to the public in the Cayman Islands to subscribe for the fund's investment interests through a person licensed under SIBL, and those interests are either listed on a stock exchange specified by CIMA, or the private fund is regulated by a regulator approved by CIMA, is not required to register with CIMA.

Single investor funds are not private funds, as there is no 'pooling' of investor funds and open-ended funds which permit the redemption or repurchase of investor equity are not private funds.

Valuation and cash monitoring

All private funds will need to conduct an asset valuation. The valuation must be done on an appropriate and consistent basis, which must be at least annually, and in accordance with CIMA's valuation rules for private funds.

All private funds must monitor cash flows, cash account receipts and payments to investors.

Custody

A private fund must appoint a custodian:

- to hold assets which are capable of physical delivery or capable of registration in a custodial account (except where that is neither practical nor proportionate given the nature of the private fund and the type of asset held), and
- to verify title to, and maintain records of, assets.

The custodian must be authorised in an approved jurisdiction to provide custody services and not have a control relationship with the manager or operator of the private fund.

Where it is not practical nor proportionate to appoint a custodian the private fund must still ensure that title verification is performed.

Valuation, custody and cash monitoring service providers

For each of valuation, custody (where not practical nor proportionate) and cash monitoring, these functions must be performed by an independent provider, administrator, or the manager or operator of the private fund subject to appropriate operational independence (ie the same people at the investment manager cannot perform portfolio management and valuation tasks, for example) and disclosure, management and monitoring of the potential conflicts of interest to investors.

An administrator must be authorised in an approved jurisdiction to provide administration services and not have a control relationship with the manager or operator of the private fund. Where there is a control relationship there must be appropriate operational independence and disclosure, management and monitoring of the potential conflicts of interest to investors.

Where the asset valuation, custody or cash monitoring is not performed by an independent provider CIMA has the power to require that the valuations be verified by an auditor or independent third party.

Identification of securities

For those private funds that regularly trade securities or hold them on a consistent basis, they must maintain records of the identification codes (eg ISIN or LEI) of the relevant securities.

Auditor

All private funds must appoint an auditor from a list of firms approved by CIMA (and the local Cayman office will need to sign off on audits).

Investment manager

There is no restriction on the location of the investment manager of a private fund if the investment management is not carried out by its general partner (for an exempted limited partnership) and many managers decide to set up a Cayman Islands vehicle as the investment manager or adviser to the fund.

SIBL regulates the advisory and management services of investment managers and investment advisers incorporated, registered or with a place of business in the Cayman Islands.

Further details on investment managers and advisers and SIBL can be found in our [Guide to the Securities Investment Business Law](#).

Location of service providers

Save for the local auditor sign off requirement, there is no requirement that a fund's service providers be based in the Cayman Islands or in any prescribed jurisdiction.

Alternative Investment Vehicles

The Private Funds Law creates a category of private fund known as an "alternative investment vehicle" (**AIV**), which is a company, unit trust, partnership or other similar vehicle 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.

An AIV needs to register with CIMA

Where IFRS or GAAP of an approved jurisdiction permits consolidated or combined financial account reporting and a private fund chooses to report consolidated or combined financial statements with its AIV then the AIV is not required to appoint a custodian or an auditor, conduct asset valuation, monitor cash flows or identify securities.

Registration

To register a private fund with CIMA, the following documents must be filed via CIMA's online registration system:

- the online application form including details of the fund, its service providers and its anti-money laundering and compliance officers
- a summary of the fund's offering terms
- consent letters from the fund's administrator (if applicable) and auditor (confirming that they act as such on behalf of the fund)
- the fund's certificate of incorporation, registration or trust deed
- structure chart
- the Electronic Transactions Law affidavit, and
- payment of the relevant application fee

Prior to the filing of a registration application with CIMA, a private fund, or any person authorised to act on behalf of a private fund, may engage in oral or written communications and enter into any agreements with high net worth persons or sophisticated persons who may have an interest in subscribing for or purchasing investment interests in the private fund. However a private fund must not accept capital contributions from investors, in respect of investments, until it is registered with CIMA.

General provisions affecting ongoing operation of Cayman Islands private funds

The following sets out the key continuing obligations for a private fund, for further details see our [Guide to Continuing Obligations of a Cayman Islands Private Fund](#).

Private Funds Law requirements

As set out above all private funds must conduct asset valuations at least annually and ensure the custody requirements are being fulfilled. They must also ensure that cash monitoring is being satisfactorily conducted and that all securities are being identified (where applicable).

All private funds must, within 21 days, file details with CIMA of any change that materially affects any information previously filed with CIMA, including a change of registered office.

All private funds must submit audited financial statements to CIMA within six months of the end of the fund's financial year, in electronic format together with a fund annual return form.

All private funds must pay the applicable annual CIMA fee (currently US\$4,268) by 15 January of each year. If the annual fee is not paid by 15 January of each year, a penalty of 1/12 of the annual fee will be payable for each month or

part of a month during which the annual fee and any penalty remains unpaid.

A fee of US\$300 is payable each year in respect of each AIV, up to a maximum of 25 vehicles.

No Director registration

The directors (or managers of LLCs) of private funds (or directors of the GP of a private fund) are not required to be registered under the Director Registration and Licensing Law.

Registered office

All Cayman Islands exempted companies, exempted limited partnerships, LLCs and exempted unit trusts must have a registered office in the Cayman Islands provided by a person licensed under the Companies Management Law or the Banks and Trust Companies Law.

AML compliance

Cayman Islands investment funds, including mutual funds, are obliged to comply with Cayman Islands anti-money laundering, proliferation financing and terrorist financing (**AML**) legislation, including assessing and applying a risk-based approach to money laundering, proliferation financing and terrorist financing risks and compliance. Funds must designate natural persons to the roles of AML compliance officer, money laundering reporting officer and deputy money laundering reporting officer, after which performance of these functions can be delegated or outsourced.

Typically funds delegate performance of certain AML functions by appointing an administrator based and regulated in an equivalent jurisdiction¹ approved by the Government's Anti-Money Laundering Steering Group (previously referred to as Schedule 3 countries) to undertake its AML compliance function. Ultimate responsibility for maintaining and implementing satisfactory AML procedures remains with the fund however. It should be noted that many US based administrators, although located in an equivalent jurisdiction, will not be subject to US AML regulations. As such, specific provisions will need to be included in agreements with US based administrators.

Under the Guidance Notes on the Prevention and Detection of Money Laundering and Terrorist Financing in the Cayman Islands such outsourcing by the fund to its administrator is acceptable if :

- details of the administration agreement and written evidence of the suitability of the administrator (or its employees) to perform the relevant functions on behalf of the mutual fund are available to CIMA on request
- there is a clear understanding between the administrator and the mutual fund of the functions to be performed by the administrator and documentation of the reliance by the fund on the administrator to perform such functions

- the relevant customer information is readily available to CIMA on request and to the Financial Reporting Unit and other law enforcement authorities

As a result it is crucial for the relevant administration agreement to contain provisions to this effect. CIMA's Statement of Guidance on Outsourcing issued in 2015 also provides guidance to funds on the establishment of outsourcing arrangements and the outsourcing of material functions or activities, including AML compliance functions. CIMA's Notice in April 2018 also includes guidance for funds where reliance is placed on others to perform AML functions.

Automatic exchange of information

Cayman Islands funds are not directly subject to the US Foreign Account Tax Compliance Act (**FATCA**), however the Cayman Islands has introduced legislation implementing FATCA requirements for 'financial institutions' to identify and report certain US accounts to the Cayman Islands Tax Information Authority (**TIA**) on an annual basis.

The Cayman Islands has also enacted regulations (**CRS Regulations**) to implement the OECD common reporting standard on automatic exchange of information (**CRS**) into Cayman Islands law. Under the CRS Regulations, Cayman Islands 'reporting financial institutions' have to report information on the holders of 'reportable accounts' which are tax resident in 'reportable jurisdictions' and all Cayman Islands 'financial institutions' have to register with the TIA via its automatic exchange of information portal.

The majority of Cayman Islands funds fall within the definition of an 'investment entity' and are generally classed as a 'financial institution' for FATCA and CRS purposes. As a result, these funds have information gathering, due diligence and reporting obligations. Ongoing obligations include the requirement to report the relevant information to the TIA on an annual basis. Reported information will then be sent automatically to the relevant home tax jurisdiction of the relevant account holders.

For further details of applicable FATCA and CRS requirements, please see our [Guide to Automatic Exchange of Information Obligations for Cayman Islands Investment Funds](#) or contact your usual Harneys contact who would be happy to assist.

Supervision and enforcement

CIMA can require a special audit of a private fund. Private funds must also provide CIMA with such information and access to such records as CIMA requires.

CIMA may apply to court to preserve the assets of a private fund.

CIMA has the power in relation to a private fund to revoke its registration, impose conditions upon it, require the substitution of a promoter or management, appoint advisers or persons to assume control of the affairs of the private fund or require the reorganisation or winding up of the private fund.

The auditor of a private fund must immediately give written notice to CIMA if the private fund is, or is likely to become, unable to meet its obligations as they fall due, is carrying on or attempting to carry on business in a manner prejudicial to investors or creditors or is maintaining insufficient accounting records to allow its accounts to be properly audited.

CIMA also has the power under the Monetary Authority Law (**MAL**) to impose significant administrative fines of up to CI\$1 million (US\$1.2 million) for each breach of certain provisions of the Anti-Money Laundering Regulations and other Cayman regulatory laws and regulations, including the Private Funds Law and SIBL. The level of an administrative fine will depend on various factors including whether the breach is committed by an individual or a body corporate and if the breach is classified as minor, serious or very serious.

Economic Substance

The International Tax Co-operation (Economic Substance) Law (the **ES Law**) was introduced in the Cayman Islands in response to OECD's Base Erosion and Profit Shifting framework and related EU initiatives in relation to what are known as 'Geographically Mobile Activities'.

The ES Law is supplemented by the Guidance Notes issued by the Cayman Islands Tax Information Authority (the **TIA**) on Economic Substance for Geographically Mobile Activities.

Under the ES Law any 'relevant entity' which carries on a 'relevant activity' and receives 'relevant income' in a financial period must satisfy the economic substance test in relation to that activity and make an annual filing with the TIA.

Investment funds

Under the ES Law an 'investment fund' is not a 'relevant entity' and therefore the ES Law is not applicable to such entities.

Investment managers

Under the ES Law 'fund management business' is a 'relevant activity' and is the business of discretionary investment management carried on by a relevant entity licensed or otherwise authorised under SIBL for an investment fund. Accordingly, any relevant entity that carries on fund management business and receives relevant income will need to satisfy the economic substance test and make annual filings with the TIA.

Please see our Guide to [Economic Substance in the Cayman Islands](#) for further details of the ES Law.



For more information and key contacts please visit harneys.com

ⁱ Current equivalent jurisdictions are Argentina, Australia, Austria, Bahamas, Bahrain, Barbados, Belgium, Bermuda, Brazil, British Virgin Islands, Canada, Curacao, Cyprus, Denmark, Finland, France, Germany, Gibraltar, Greece, Guernsey, Hong Kong, Iceland, India, Ireland, Isle of Man, Israel, Italy, Japan, Jersey, Liechtenstein, Luxembourg, Malta, Netherlands, New Zealand, Norway, People's Republic of China, Portugal, Singapore, Spain, Sweden, Switzerland, United Arab Emirates, United Kingdom and United States of America.

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