



The Cayman Islands Private Funds Act: what you need to know

Overview



How the Private Funds Act affects investment funds

The Private Funds Act, 2020 (the Act), which took effect on 7 February 2020, requires certain Cayman Islands-domiciled, closed-ended investment funds to be regulated by the Cayman Islands Monetary Authority (CIMA). All private funds within the scope of the Act are required to register with CIMA and be subject to its regulation.

To help funds comply with the Act, we offer a variety of services that enable our clients to outsource compliance and other relevant activities. Our deep fund experience, regulatory credibility and leading-edge innovation combine to reduce disruption to your business while addressing requirements related to valuation, audit and more.

CIMA has issued frequently asked questions to clarify certain key aspects of the Act to allow consistent application. We anticipate CIMA as the regulator will continue to update its FAQs to clarify its views and interpretations of the Act.

How does the Act define a private fund?

A private fund is a company, unit trust or partnership that meets the following criteria:

- ▶ It carries on business in or from the Cayman Islands or makes an invitation to the public in the Cayman Islands.
- ▶ It offers or issues or has issued investment interests, the purpose or effect of which is the pooling of investor funds (two or more investors) with the aim of enabling investors to receive profit or gains from such entity's acquisition, holding, management or disposal of investments.
- ▶ Investors do not have day-to-day control over the investments.
- ▶ The investments are managed as a whole by or on behalf of the operator of the private fund, either directly or indirectly.
- ▶ The interests are not redeemable or repurchasable at the option of the investor.

What types of entities are not included within the scope of the Private Funds Act?

- ▶ Non-fund arrangements, which include inter alia holding vehicles, proprietary vehicles, sovereign wealth funds, single family offices and securitization special purpose vehicles
- ▶ Further persons licensed under the Banks and Trust Companies Law (2020 Revision) or Insurance Law, 2010 or persons registered under the Building Societies Law (2020 Revision) or Friendly Societies Law (1998 Revision)

What is a collective investment scheme?

Collective investment schemes have the following characteristics: (1) the undertaking does not have a general commercial or industrial purpose; (2) the undertaking pools together capital raised from its investors with a view to generating a pooled return for those investors; and (3), as a collective group, the unitholders or shareholders do not have day-to-day discretion or control over the private fund.

Such characteristics, if all of them are exhibited by an undertaking, should show that the undertaking is a collective investment scheme that is captured by the definition of a private fund under the Act.

How should investment compartments of a private fund be treated?

Investment compartments, such as a segregated portfolio company, should be considered using the same criteria and characteristics as private funds. If an investment compartment is a separate legal entity and meets the definition of a private fund, it should be registered separately with CIMA as a private fund.

Are alternative investment vehicles (AIVs) required to register with CIMA?

Where a private fund chooses to report its financial statements on a consolidated or combined basis with a Cayman-domiciled AIV, the AIV will be included in the registration of the Cayman-domiciled private fund by including AIV details in the registration form of the fund and is not required to register separately with CIMA. However, the AIV is required to submit a separate annual return to CIMA. Where the main fund is a non-Cayman-domiciled entity, the AIV is required to register with CIMA provided the private fund criteria are met.

Are single investor funds exempt from registration as private funds?

Yes, private funds with a single investor are exempt from registration under the Act provided that the private fund constitution specifies that the private fund has and is intended to only ever have a single investor.

Will CIMA extend the four eyes principle to private funds?

Yes, a minimum of two directors is required for private funds that are registered as companies, and a minimum of two natural persons should be named in respect of a general partner or corporate director of a private fund.



What are the audit requirements for a private fund?

A private fund that meets the criteria for registration under the Act is required to have its accounts audited on an annual basis by a local Cayman auditor approved by CIMA. The private fund is also required to file the audited financial statements and a Fund Annual Return (FAR) with CIMA within six months of its financial year-end. This is applicable for the 2020 financial year and for each financial year-end that follows.

What are the requirements for maintaining identification codes for securities held or traded?

A private fund that regularly trades securities or holds them on a consistent basis is required to maintain a record of the identification codes of the securities it trades and holds.

The identification code maintained should be the International Securities Identification Number, if available. If the International Securities Identification Number is not available, an alternative identification code that conforms to widely adopted international standards or a regional identification code or the legal identifier of the issuer is acceptable.

The private fund is required to make the record of identification codes available to CIMA upon request.

What are the valuation requirements of the Private Funds Act?

Private fund valuation procedures should be performed in accordance with the private fund's valuation policy. A private fund is required to perform valuations at a frequency that is appropriate to the assets of the private fund and, in any case, on at least an annual basis. CIMA will issue regulations and requirements of valuation policies and procedures.

What are the requirements for the safekeeping of assets?

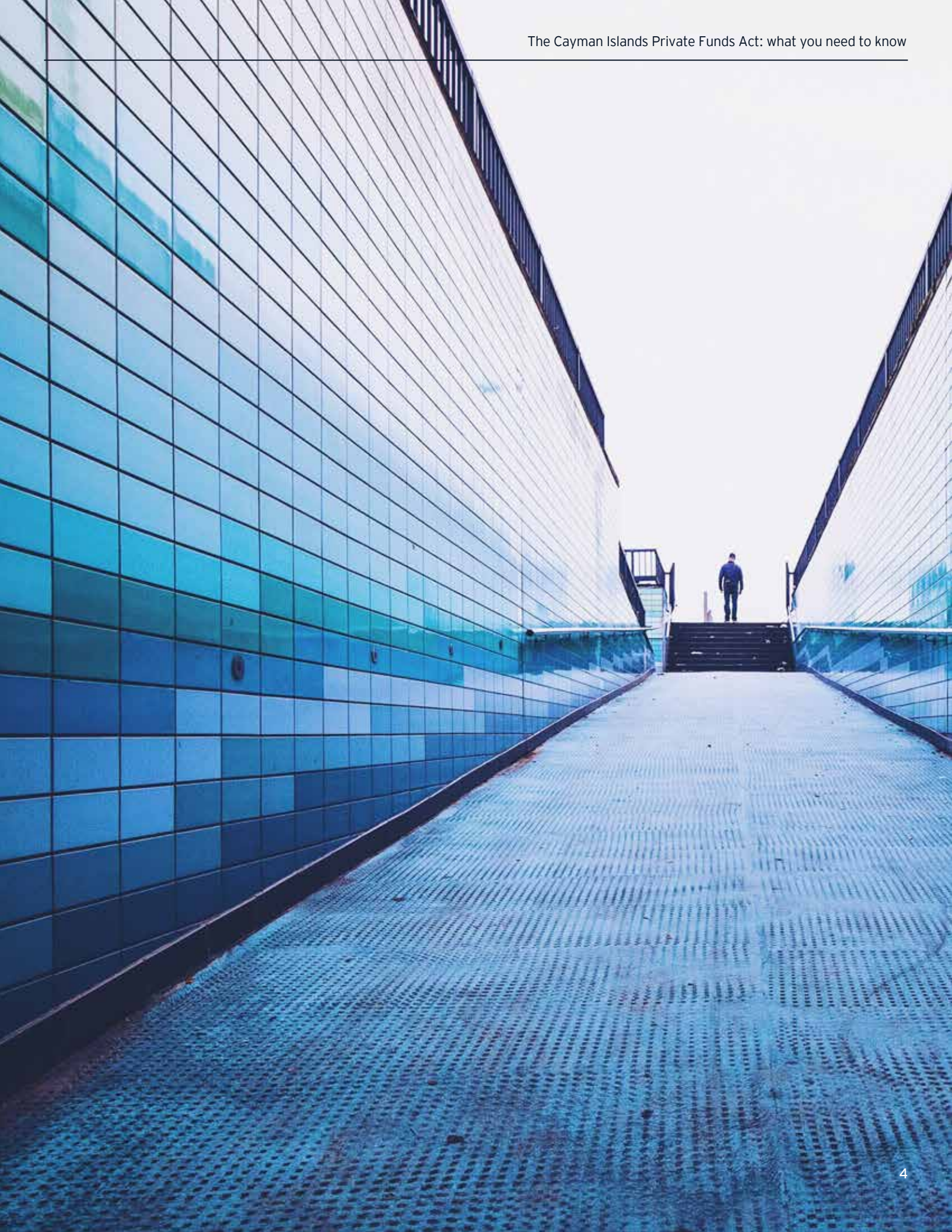
A private fund is required to appoint a custodian to (1) hold the private fund's custodial fund assets in segregated accounts and (2) verify that the private fund holds title to any other fund assets and maintain a record of those other fund assets.

A private fund is not required to appoint a custodian if it is neither practical nor proportionate to do so and has notified CIMA thereof. Where a custodian is not appointed, a private fund is required to appoint an administrator or independent third party to perform the title verification. Alternatively, the manager or operator of the private fund can perform the title verification, provided the title verification function is independent from the portfolio management function or potential conflicts of interest are properly identified, managed, monitored and disclosed to investors.

Where the title verification is not performed by an independent third party, CIMA may require the private fund to have its title verified by an appropriately professionally qualified independent third party.

What are the requirements for the cash monitoring process?

A private fund is required to have appropriate cash monitoring policies and procedures in place for its investment strategy and types of investments held. CIMA is expected to issue rules and regulations related to establishing a cash monitoring policy. A private fund can choose to conduct the cash monitoring process internally, provided the function is independent from the portfolio management function or potential conflicts of interest are properly identified, managed, monitored and disclosed to investors, or it may outsource this process to an external third party.



Valuation considerations



The Private Funds Act introduces, among other changes, new provisions for the valuation of a private fund's assets that increase the rigor concerning independence in the valuation process.

Under the Act, a private fund shall have appropriate and consistent procedures for the purpose of proper valuations of its assets, which shall establish that valuations are conducted in accordance with the requirements of the Act. For private funds that prepare valuations internally, they will likely need to enhance their internal processes and associated documentation. We also anticipate that CIMA will establish a set of rules in relation to the calculation of net asset values pursuant to the Act.

The Act requires a private fund's valuations to be carried out at least annually and to be performed by:

- ▶ An independent third party professionally qualified to conduct valuations in a non-high-risk jurisdiction

Or

- ▶ The manager or operator of the private fund, or a person who has a control relationship with the manager of the private fund, provided that the valuation function is independent from the portfolio management function or potential conflicts of interest are properly identified, managed, monitored and disclosed to investors

Where the valuation of the assets of a private fund is not performed by an independent third party, CIMA may require the private fund to have its valuations verified by an auditor or independent third party.

Our services

Regionally based EY Valuation, Modeling & Economics professionals perform high-quality valuations of companies and individual assets that recognize the need for transparent and robust valuations that satisfy corporate, regulatory and accounting requirements. Our experience includes performing valuations for privately held portfolio companies and reviewing valuations performed by management and other professionals.

Our people

Our professionals are experienced in accounting, taxation and financial due diligence to help advance your strategic, financial and tax agendas through corporate finance, analytics and economic analyses. We continue to build our existing competencies and aggressively invest in skills that enable you to make better decisions involving transactions, funding capital expansion and optimizing operations.

Scope of service

We offer a variety of scope-of-service options based upon the degree of management involvement and the nature of the conclusion.

	Degree of management involvement			
	GP/sponsor		Company management	Third party
	Internal valuation	Inputs and assumptions aggregation	Interviews and limited access	Complete outsourced process
Full scope valuation opinion (point estimates or range of values)		●	●	●
Limited scope valuation opinion (range of values)	●	●	●	●
Valuation review with corroborative ranges of value	●	●	●	●
Valuation review (positive or negative assurance)	●	●	n/a	n/a

Increasing risk/robustness/exposure

Degree of specialist independence and reliance on management's information

Legend

● Full reliance (>95%)	● Heavy reliance (>75%)	● Involvement preferred if available (50%)	● Limited involvement or reliance if/where applicable (<25%)	n/a No involvement necessary
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Our credentials

As recognized leaders in the valuation profession, several of our senior members have held a variety of leadership roles over the years with standard setters (Financial Accounting Standards Board, The Appraisal Foundation and International Valuation Standards Council), regulators (Securities and Exchange Commission) and the major valuation professional organizations (AICPA, ASA, RICS), as well as their combined efforts with the Certified in Entity and Intangible Valuations (CEIV) designation.

Our team members provide services related to the valuation of business enterprises, equity and debt interests, as well as various intangible assets and intellectual property across a range of sectors and geographies, from startups to established businesses.

Audit considerations



All entities that are registered as private funds under the Act and regulated by CIMA are required to have an audit opinion on their annual financial statements issued by a local audit firm approved by CIMA. With nearly 30 years of alternative assets experience, we provide a more efficient audit as we have an in-depth understanding of strategies, methodologies and investment philosophies. Our extensive experience with the operational, accounting and valuations issues impacting private funds enables us to assemble an experienced team to provide you with industry-focused perspective and insights.

Our focus on quality

Our emphasis on quality and value has been a major contributor to the growth of our fund practice. We are dedicated to providing the highest-quality services and exceptional client service by being connected, responsive and insightful. As your needs evolve, we will coordinate with other EY subject-matter resources to best serve you. With thousands of asset management professionals worldwide, we provide firsthand insight on such matters as local market trends, accounting, tax and regulatory issues.

Our risk-based approach

The EY global audit methodology guides us in the execution of our audit, but allows the flexibility to take a customized approach that acknowledges and addresses your processes and risks. We begin with our understanding of your organization, strategies and risks and how they affect your business model. This helps us design the audit scope so that it is efficient and avoids duplication, addressing risks and aligning our efforts with your needs and expectations.

We take a risk-based audit approach that focuses on the drivers of your business, the associated risks and the potential effects on financial statement accounts. Our balanced approach is designed to focus comparatively more audit effort on complex, higher-risk areas, particularly investment valuations and capital allocations, than on those assessed as lower risk.

Our integration

The EY Cayman Islands practice is aligned with the EY Americas Financial Services Organization headquartered in New York, offering you direct access to industry leaders from around the globe. Our audit teams are an example of the integration of both local and international professionals to deliver the right approach for your needs.

The integrated structure of EY member firms facilitates seamless services and consistent performance everywhere in the world. This global infrastructure is supported by industry experience, clearly articulated engagement roles and leading-class methodologies. EY uses the same audit methodology worldwide and is linked through an integrated technology platform to provide for instantaneous communication and collaboration.

Tax considerations

EY Tax professionals provide detailed and focused tax assistance tailored to the unique needs of the alternative investment fund industry. They have extensive experience with the varied and specific facets of private equity and private funds taxation, including fund and organizational structuring, tax minimization planning, on-call advice and tax compliance.

Our experience

Our dedication, commitment and experience serving private funds enable us to understand and appreciate your unique needs and challenges. Our experience and proactive approach help in the assessment of tax considerations at the outset and keep you ahead of such issues. We continually seek tax-related efficiency opportunities and place strong emphasis on anticipating potential tax issues before they become problems.

Our services

- ▶ Help to meet complex tax reporting and compliance requirements, including Schedule K-1 presentation and filing of various US federal, state and local tax returns
- ▶ Structure offshore and onshore funds to enhance tax benefits and reduce risks for investors and advisors
- ▶ Provide on-call tax advice and perform tax planning for managing the timing and character of direct investment transactions, including review for tax exposure
- ▶ Assist with management company structuring for compensation arrangements for key employees and other unique considerations
- ▶ Work with managing members' tax advisors on planning and understanding the tax implications of their tax returns



Fund resolution considerations



Do you have funds that are winding down, but the existence of illiquid assets such as distressed/private equity or litigation/class action claims is preventing closure? Are there contingent liabilities such as uncertain tax positions that need to be resolved? Are you considering restructuring operations, such as moving away from third-party investors to a single-family office? Have changing regulations or increased compliance costs impacted longer-term business plans?

The EY Strategy and Transactions team is well positioned to assist you with the wind-down of funds that have reached the end of their operational life while preserving investor value and freeing management time.

Our approach

We structure our engagements around the philosophy of being a trusted business advisor, working with you to develop a collaborative approach to achieve innovative commercial alternatives.

Our approach focuses on practical and pragmatic approaches to liquidations and disputes, learned from working on some of the largest and most complex restructurings internationally.

Our services

- ▶ Assist in identifying the structures suitable for liquidation and recommend the necessary steps to be taken prior to liquidation
- ▶ Manage the realization of illiquid and distressed assets, leveraging vast experience in monetizing all asset types
- ▶ Leverage our extensive network of secondary market contacts to source interested parties for illiquid assets
- ▶ Provide innovative and commercial solutions to allow assets to be moved out of funds to facilitate closure
- ▶ Use our global unclaimed and abandoned property database and proprietary search software designed to locate or identify and recover lost or dormant assets
- ▶ Eliminate residual risk by making sure that all matters are considered and dealt with prior to the conclusion of a liquidation and the dissolution of a fund

Contact us



Jeffrey Short

EY Cayman Country
Managing Partner
EY Cayman Ltd.
jeffrey.short@ky.ey.com



Igal Wizman

Regional Strategy and
Transactions Leader
Turnaround & Restructuring
Strategy
EY Bahamas Ltd.
igal.wizman@parthenon.ey.com



Bill Bailey

Regional Tax Leader
EY Bermuda Ltd.
bill.bailey@bm.ey.com



Tiffany Norris-Pilcher

Regional Wealth & Asset
Management Leader
EY Bahamas Ltd.
tiffany.norris@bs.ey.com



Baron Jacob

Regional Private Equity
Leader
EY Cayman Ltd.
baron.jacob@ky.ey.com



Robert Crockett

Strategy and Transactions
Valuation, Modeling &
Economics
EY Cayman Ltd.
robert.crockett@parthenon.ey.com

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