

Client Alert

Private Funds (Amendment) Law, 2020



Disclaimer: The information provided does not, and is not intended to, constitute legal advice, instead, the information herein is for general informational purposes only. Please contact your usual Cayman counsel for specific legal advice on any of the matters outlined below.

PRIVATE FUNDS (AMENDMENT) LAW 2020

The Private Funds Law, 2020 (PF Law) was recently amended to clarify the position for certain entity types and to broaden the definition of “private fund” to extend to additional entities.

The PF Law was passed earlier this year to enhance the oversight of investment funds in response to the evolution of global regulations and recommendations and drive towards tax neutrality and to fulfill the Cayman Islands’ commitments regarding the EU’s list of non-cooperative jurisdictions in tax matters.

The PF Law came into force on 7 February 2020 with the effect of bringing in certain closed-ended entities, including most private equity, infrastructure and real estate fund structures within the scope of a regulatory regime in the Cayman Islands for the first time. Private funds have 6 months (7 August 2020) to register with CIMA and comply with the new Law.

The Ministry of Finance (Ministry) recently published an industry advisory summarizing the key changes to the definition of a “private fund” under the PF Law and the rationale behind the changes:

- **Amendment of the element of "offering and issuing" of investment interests to refer instead to vehicles that "offer or issue" investment interests.** Because a narrow interpretation of the term "offering" may result in some fund vehicles that are not engaging in a sales process that amounts to the offering of investment interests falling outside the definition of a private fund, the definition has been amended to include a vehicle that offers or issues investment interests.
- **Amendment of the issuing element to bring in scope entities that have "issued" investment interests (in the past), as well as those that "issue" investment interests.** The PF Law is intended to capture all private funds, including those existing funds that have in the past issued investment interests but no longer do so. The definition has been amended to remove any ambiguity in this regard.
- **Deletion of the "principal business" element.** The definition has been amended to delete the "principal business" aspect of the definition. Removing this element removes the need for

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private fund operators to take a view on what the current principal business of the vehicle e.g. is the principal business of the vehicle issuing interests or making investments or managing assets. This deletion also aligns with the addition of the past tense "has issued" language. The Schedule of Non-Fund Arrangements carves out arrangements not operated "by way of business" from the definition, so the Ministry does not consider that this amendment risks bringing non-commercial activities in scope of the PF Law.

- **Deletion of the "spreading investment risks" element.** The Ministry understands that there has been uncertainty whether a fund falls outside the scope of the definition where it invests only in one asset, or even one type of asset, as this could be said not to constitute the "spreading" of investment risks. The definition has been amended to delete this element to prevent these kinds of vehicles from automatically falling outside the scope of the PF Law (though some of them may, of course, then be exempted by virtue of the Schedule of Non-Fund Arrangements).
- **Deletion of the element that investments are managed "for reward based on the assets, profits or gains of the company, unit trust or partnership".** The Ministry understands that this language is creating uncertainty as to whether all vehicles in a multi-fund investment structure are required to register, where manager fees are generally charged only at one level. The argument made is that investments at the other level are therefore not managed "for reward". Indirect reward, where the payment is made at the other fund level, should in the Ministry's view have been caught under the existing definition, but the Ministry believes the amendment should put the matter beyond doubt.

If your Cayman entities have been previously considered for registration, and have been deemed out of scope, it may be necessary for your entities to be reconsidered by your usual Cayman legal counsel as a result of the new amendment. The deadline for all private funds to be registered with the Cayman Islands Monetary Authority (CIMA) is 7 August 2020.

CIMA's previously published FAQ on the PF Law can be found [here](#).

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‘Four Eyes’ Principle: Applicable to Private Funds

CIMA has confirmed that the ‘four eyes’ principle (applicable to open-ended funds) shall apply to Private Funds.

This means that:

- a minimum of two (2) directors are required for applicants that are companies; and
- the minimum of two (2) director test will also apply to the general partner or corporate director, requiring that a minimum of two (2) natural persons be named in respect of a general partner or corporate director of a Private Fund.

There is currently no requirement that the individual directors be CIMA registered directors, however, we are seeing growing interest by many large investment managers and institutional investors for independent oversight on private funds by professional directors. Whilst investor demand has traditionally been a key driver for independent oversight, investment managers are seeing the benefits of using experienced directors with knowledge of Cayman laws and regulations, who can help them navigate the rapidly evolving legal and regulatory landscape. This also comes as CIMA’s powers to administer fines are extended to the Private Funds Law 2020 (as revised).

As a reminder CIMA has the power to impose administrative fines for breaches committed by individuals and entities, under various laws (and associated regulations and rules), including, but not limited to, the Anti-Money Laundering Regulations (2020 revision), the Directors Registration and Licensing law, 2014 (as revised), the Mutual Funds Law (2020 Revision) and the Private Funds law, 2020 (as revised). The Monetary Authority (Administrative Fine) Regulations, 2019 (as revised), sets out both the criteria and procedure for administering such fines, which can range from (approx.) US\$6,098 up to (approx.) US\$1,219,512 depending on the seriousness of the breach and whether such breach was committed by an individual or an entity.

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