

## Cayman Islands investment funds

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### Introduction

Over the past 25 years, the Cayman Islands has become a pre-eminent jurisdiction for the formation of alternative investment funds, with around 13,000 regulated open-ended funds and 16,000 regulated closed-ended funds. The reasons for Cayman's popularity include its tax neutrality, its proximity to the U.S. and its bespoke fund legislation and regulatory regime that have continuously evolved to meet market demands; as well as the jurisdiction's fundamental appeal as a stable British dependency with a judicial system underpinned by English common law.

### Cayman fund vehicles

The Cayman Islands has the following range of vehicles that are typically used as investment funds:

- Exempted company
- Segregated portfolio company
- Limited liability company
- Exempted limited partnership
- Unit trust

Exempted companies and segregated portfolio companies are commonly used as open-ended funds, while closed-ended funds are typically structured as exempted limited partnerships. Limited liability companies are a relatively recent innovation, ideal for parallel funds that wish to replicate the terms of a U.S. LLC; while unit trusts are primarily used for

investors in particular jurisdictions where other types of vehicle suffer tax or regulatory disadvantages.

### Cayman fund regulation

Cayman Islands investment funds are generally regulated by the Cayman Islands Monetary Authority (CIMA) under the Mutual Funds Act (as revised) (**Mutual Funds Act**) if they are open-ended (which would include most hedge funds) or the Private Funds Act (as revised) (**Private Funds Act**) if they are closed-ended (which would include most private equity, venture capital, real estate, infrastructure and other funds investing in illiquid assets). The exceptions to this rule include single investor vehicles, proprietary investment vehicles and pension funds.

Regulatory applications and filings are made through CIMA's secure Regulatory Enhanced Electronic Forms Submission (REEFS) web portal, which is only accessible to authorised service providers, such as Carey Olsen.

### Mutual Funds Act

#### Categories of mutual fund

Open-ended Cayman funds are regulated under the Mutual Funds Act. A fund is open-ended if it issues participating equity interests (whether shares, interests or units) that are redeemable by investors on a specified period of notice. There are four categories of regulation under the Mutual Funds Act:

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- Licensed mutual funds
- Administered mutual funds
- Registered mutual funds (including master funds)
- Limited investor mutual funds

#### Licensed mutual funds

Licensed mutual funds are subject to full regulation by CIMA and are largely confined to funds marketed locally in the Cayman Islands and funds that comply with regulations designed specifically for the Japanese retail market. Applications for a mutual fund licence take approximately 8-12 weeks and require submission of the following:

- Application form (APP-101-22)
- Certificate of incorporation/registration
- Completed personal questionnaires, 3 references and police clearances (or affidavits of no convictions only if the jurisdiction does not provide police clearances) from all directors, general partner's directors, trustees (as applicable)
- Consent letters from an approved local auditor and an administrator
- Offering document
- Affidavit authorising the fund's agent to make electronic filings with CIMA
- MLRO application form (MLO-154-99)
- Application and licence fees

To approve a licence application, CIMA must be satisfied that each promoter of the fund is of sound reputation, that it will be administered by persons with sufficient expertise, of sound reputation and who are fit and proper to be in their respective positions and that the fund's business and any offering of its interests will be carried out in a proper way.

#### Administered mutual funds

Administered mutual funds are similar to licensed funds, except that a licensed Cayman Islands mutual fund administrator must provide the fund with its principal office and certify to CIMA that it believes the fund's promoter to be of sound reputation and that the fund will be properly managed and administered. Applications for registration as an administered fund take approximately 2-4 weeks and require submission of the following:

- Application form (APP-101-22)
- Certificate of incorporation/registration
- Consent letters from an approved local auditor and the administrator
- Offering document
- Affidavit authorising the fund's agent to make electronic filings with CIMA
- MLRO application form (MLO-154-99)
- Application and registration fees

The administrator providing the fund with its principal office must be satisfied that each promoter of the fund is of sound reputation, that it will be administered by persons with sufficient expertise, of sound reputation and who are fit and proper to be in their respective positions and that the fund's business and any offering of its interests will be carried out in a proper way. On an ongoing basis the administrator is required to notify CIMA immediately if it knows or believes the fund or any of its promoters or operators to be insolvent, in breach of any law or carrying on business in a manner that is or is likely to be prejudicial to the fund's investors or creditors.

#### Registered mutual funds

This is by far the most popular type of regulated mutual fund, comprising around 97% of all such funds. To qualify as a registered mutual fund, a fund must require a minimum initial investment of at least US\$100,000 (or its equivalent in any other currency) or have its interests listed on an approved stock exchange. A registered mutual fund can commence trading upon submitting the following, and can expect to receive its registration certificate within 2-4 weeks:

- Application form (APP-102-22, or for master funds, APP-101-53)
- Certificate of incorporation/registration
- Consent letters from an approved local auditor and an administrator
- Offering document
- Affidavit authorising the fund's agent to make electronic filings with CIMA
- MLRO application form (MLO-154-99)
- Application and registration fees

Note that a corporate fund must ensure its directors are registered with CIMA under the Directors Registration and Licensing Act, 2014 (as amended) prior to the fund submitting its registration application. Each director must register via [CIMA's web portal](#).

If the fund is a limited partnership, the directors of its general partner are not required to separately register, but certain identifying information must be submitted along with the registration application.

#### Limited investor mutual funds

This previously unregulated category of mutual funds has been required to register with CIMA since August 2020. These funds are similar to registered mutual funds, except that they have no minimum investment requirement; the trade-off being that the fund cannot admit more than 15 investors and the investors must have the right to appoint and remove the fund's directors, general partners or trustees (as applicable) by majority vote. A limited investor mutual fund can commence trading upon submitting the following, and can expect to receive its registration certificate within 2-4 weeks:

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- Application form (APP-101-78, or for limited investor master funds, APP-101-79)
- Certificate of incorporation/registration
- Consent letters from an approved local auditor and an administrator (if applicable)
- Offering document, summary of terms or other marketing materials (as applicable)
- Confirmation that investors have power to appoint and remove the operator by majority vote (e.g. constitutional documents, offering document or resolutions)
- Application and registration fees
- Dividend/distribution policy
- Material risks and any proposed borrowing
- Remuneration of the operator, administrator, manager/ adviser, custodian, prime broker, auditors, legal counsel and any other service providers to the fund
- Powers to enter into side letters
- Accounting principles to be adopted and frequency of reporting to investors
- Biographies of the directors/managers/principals of the fund, its general partner or trustee (as applicable) and its manager/adviser
- Description of potential conflicts of interest
- Summary of material contracts
- Summary of material laws and regulations
- Place where fund documents and periodic reports may be inspected and obtained

### Master funds

A master fund is defined in the Mutual Funds Act as a mutual fund that has one or more regulated mutual funds acting as its feeder fund (meaning that the feeder fund conducts more than 51% of its investing through the master fund, directly or indirectly) and which holds investments and conducts trading activities to implement the funder fund's investment strategy. Master funds are required to register with CIMA as a sub-category of registered mutual funds. Note that a limited investor mutual fund which meets the foregoing definition of a master fund, must register as a registered mutual fund and not as a limited investor mutual fund.

Certain mutual funds that act as master funds, but do not meet the definition above (perhaps because their feeder funds are all non-Cayman funds) would register under the applicable category of mutual fund listed above (which in most cases is likely to be as a limited investor mutual fund).

### Mutual fund offering documents

The Mutual Funds Act requires a mutual fund's offering document to describe the interests it offers to investors in all material respects and to contain such other information as is necessary to enable a prospective investor to make an informed decision whether or not to invest. The mutual fund and/or its promoters or officers could also incur liability in respect of any offering document that contains misrepresentations of fact (made intentionally or negligently), so should take steps to ensure that any factual statements are correct and not misleading.

CIMA has also issued a Rule on Contents of Offering Documents – Regulated Mutual Funds, which sets out specific information that must be contained in any offering document issued by a mutual fund, including:

- Basic information about the fund's place and date of formation, type of entity, financial year and terms of its equity interests
- Subscription and redemption procedures
- Investment objectives and policy and any investment restrictions
- Valuation methodology

### Ongoing regulatory obligations

The principal ongoing regulatory obligations applicable to all regulated mutual funds are:

- Pay annual registration fees to CIMA by 15 January in each year
- File audited financial statements with CIMA within 6 months of the financial year end, together with a fund annual return
- While its offering of equity interests is ongoing, notify CIMA within 21 days of becoming aware of any change that materially affects the information in its current offering document
- Keep the fund's assets segregated and accounted for separately from the assets of any other person in accordance with CIMA's Rule on Segregation of Assets – Regulated Mutual Funds
- Establish, implement and maintain a written valuation policy in accordance with CIMA's Rule on Calculation of Assets Values – Regulated Mutual Funds
- Comply with the Anti-Money Laundering Regulations, including the requirement to have anti-money laundering officers (see section D. Additional Regulatory Obligations below)
- Comply with FATCA/CRS notification, due diligence and reporting obligations (see section Additional Regulatory Obligations below)

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## Private Funds Act

### Private funds

The Private Funds Act defines a private fund as an entity that offers, issues or has issued equity interests to investors, pooling investor funds with the aim of enabling investors to receive profits or gains from such entity's acquisition, holding, management or disposal of investments, where: (i) investors have no day-to-day control over making, holding or disposing of investments; and (ii) investments are managed by or on behalf of the fund's operator (meaning its directors, general partners or trustees, as applicable). The definition excludes certain licensed banks and insurance companies, along with non-fund arrangements listed in a schedule (such as proprietary vehicles, securitisation vehicles, joint ventures and holding vehicles).

It is not always easy to distinguish between a private fund and a non-fund arrangement, such as a joint venture. CIMA has issued guidance to assist with the analysis, which essentially hinges on whether the vehicle is investing with a view to disposal of the investment at a profit or with a view to long-term appreciation in the value of the underlying business.

### Registration with CIMA

A private fund is required to register with CIMA within 21 days of admitting any investors and in any event prior to accepting any capital contributions from investors. Registration as a private fund requires submission to CIMA of the following:

- Application form (APP-101-77)
- Certificate of incorporation/registration
- Constitutional documents
- Offering memorandum or summary of terms/other marketing materials
- Consent letter from an approved local auditor and, if applicable, an administrator
- Structure chart
- Application and registration fees

Registration will be effective from the date the completed application is filed, but confirmation of registration may take 2-4 weeks to receive.

### Private fund offering documents

The Private Funds Act does not require a private fund to prepare an offering document. However, any offering document or other marketing materials used by the fund for the solicitation of investments in its equity interests must comply with CIMA's Rule on the Contents of Marketing Materials – Registered Private Funds (the **PF Content Rule**). In practice, where no offering document has been prepared (as is often the case for multi-generational funds), a statement of terms satisfying the PF Content Rule will be required for purposes of the fund's registration with CIMA.

The PF Content Rule specifies certain information that must be included in any marketing materials used by a private fund, including:

- Basic information about the fund's place and date of formation, type of entity, financial year and terms of its equity interests
- Subscription and any compulsory redemption or repurchase procedures
- Investment objectives and policy and any investment restrictions
- Valuation methodology
- Dividend/distribution policy
- Material risks and any proposed borrowing
- Remuneration of the operator, administrator, manager/adviser, custodian, prime broker, auditors or any of their delegates responsible for the fund's portfolio or operations
- Powers to enter into side letters
- Accounting principles to be adopted and frequency of reporting to investors
- Names and addresses of the directors/managers/principals of the fund or of its general partner or trustee (as applicable) and of its manager/adviser
- Details of the fund's principal service providers
- Description of potential conflicts of interest
- Summary of material contracts
- Summary of material laws and regulations
- Place where fund documents and periodic reports may be inspected and obtained

### Ongoing regulatory obligations

The principal ongoing regulatory obligations for private funds are:

- Pay annual registration fees to CIMA by 15 January in each year
- File audited financial statements with CIMA within 6 months of the financial year end, together with a fund annual return
- Comply with the operating requirements in the Private Funds Act relating to: (i) valuations; (ii) title verification; and (iii) cash monitoring
- Keep a record of the identification codes of any securities traded or held by the fund
- Keep the fund's assets segregated and accounted for separately from the assets of any other person in accordance with CIMA's Rule on Segregation of Assets – Registered Private Funds
- Establish, implement and maintain a written valuation policy in accordance with CIMA's Rule on Calculation of Assets Values – Registered Funds (see Valuation Requirements below)

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- Update CIMA within 21 days of becoming aware of any material change to any information provided to CIMA upon registration or otherwise
- Comply with the Anti-Money Laundering Regulations, including the requirement to have anti-money laundering officers (see Additional Regulatory Obligations below)
- Comply with FATCA/CRS notification, due diligence and reporting obligations (see Additional Regulatory Obligations below)

### Valuation requirements

Private funds must adopt appropriate and consistent procedures for proper valuation of assets, with valuations to be carried out at least annually in accordance with the accounting standards adopted by the fund.

Valuations can be carried out by:

- the fund's administrator or another appropriately qualified independent third party; or
- the fund's manager or operator, provided: (i) the valuation function is independent of the portfolio management function; or (ii) potential conflicts of interest are properly identified, managed, monitored and disclosed to investors.

The fund's written valuation policy, including details of the person responsible for valuations must be disclosed to investors. Further details of the requirements are set out in CIMA's Rule on Calculation of Net Asset Values – Registered Private Funds.

Where valuations are not carried out by an independent third party, CIMA may require the fund to have its valuations verified by an auditor or other independent third party.

### Title verification

Private funds are required to appoint a custodian for their assets, except where it is neither practical nor proportionate to do so. In practice, this is often the case, except where the private fund is trading publicly listed securities.

In respect of any assets of a private fund not held by a custodian, the private fund is required to appoint one of the following to perform title verification:

- the fund's administrator or another independent third party; or
- the fund's manager or operator, provided: (i) the title verification function is independent of the portfolio management function; or (ii) potential conflicts of interest are properly identified, managed, monitored and disclosed to investors.

Where title verification not carried out by an independent third party, CIMA may require the fund to have its title verification verified by an appropriately qualified independent third party.

### Cash monitoring

Private funds must appoint a person to monitor cash flows, ensure cash has been booked in appropriate cash accounts and ensure all payments made by investors have been received. The appointed person may be:

- the fund's administrator, custodian or another independent third party; or
- the fund's manager or operator, provided: (i) the cash monitoring function is independent of the portfolio management function; or (ii) potential conflicts of interest are properly identified, managed, monitored and disclosed to investors.

Where cash monitoring is not carried out by an independent third party, CIMA may require the fund to have its cash monitoring verified by an independent third party.

## Additional regulatory obligations

### Anti-Money Laundering (AML)

Cayman Islands investment funds are required to comply with the anti-money laundering, countering the financing of terrorism and countering proliferation financing regime contained primarily in:

- Proceeds of Crime Act (as revised)
- Misuse of Drugs Act (as revised)
- Terrorism Act (as revised)
- Proliferation Financing (Prohibition) Act (as revised)
- Anti-Money Laundering Regulations (as revised) (**AML Regulations**)

CIMA has issued Guidance Notes on the Prevention and Detection of Money Laundering and Terrorist Financing in the Cayman Islands (**CIMA Guidance Notes**). Although the CIMA Guidance Notes do not themselves have the force of law, a Court will take them into account when determining if a fund has breached any of the primary laws or the AML Regulations listed above.

Under the AML Regulations and CIMA Guidance Notes, all Cayman funds are required to appoint an AML compliance officer (**AMLCO**), with overall responsibility for the fund's AML compliance, as well as a money laundering reporting officer (**MLRO**) and deputy (**DMLRO**), with specific obligations for reporting suspicions of money laundering to the Cayman authorities. Cayman funds must identify their AMLCO, MLRO and DMLRO to CIMA when they register and notify CIMA of any changes. As most Cayman funds are unstaffed, it is common practice to outsource provision of these officers and AML compliance generally, to third party service providers.

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## FATCA/CRS

Cayman Islands investment funds will be investment entities and therefore generally required to register and report as financial institutions under the Cayman Islands legislation implementing the Foreign Account Tax Compliance Act of the United States (**FATCA**) and the OECD's equivalent scheme, the Common Reporting Standard (**CRS**). These regimes are intended to facilitate onshore tax compliance by requiring the automatic exchange of information for tax purposes (**AEOI**). Exceptions include funds that invest in non-financial assets, such as real estate and certain pension funds.

Cayman funds that are not exempted from AEOI reporting are required to obtain a GIIN for FATCA purposes by registering on the IRS web portal within 30 days of commencing business. They must then register on the web portal of the Department of International Tax Co-operation of the Cayman Islands Government (**DITC**) at DITC Portal ([secure.ky](https://secure.ky)) for FATCA and CRS reporting by the end of April following launch and report on any reportable accounts by the end of July following each calendar year end.

Cayman funds must collect due diligence on investors for purposes of AEOI reporting, which is generally satisfied by requiring investors to provide a self-certification with their subscription, and to update any information that later changes. For CRS purposes, funds must maintain a written compliance policy and file a CRS compliance form with DITC in respect of each reporting year.

For more information on this subject, please refer to our legal guide on Cayman Islands Investment Funds: Tax transparency reporting obligations.

## Penalties

### Criminal

Breaches of the Mutual Funds Act, the Private Funds Act, the anti-money laundering or the AEOI regime of the Cayman Islands will in many cases constitute criminal offences, punishable by terms of imprisonment and/or substantial fines. For example, a failure to register under the Mutual Funds Act or the Private Funds Act when required to do so, is an offence punishable by a fine of up to CI\$100,000 (approx. US\$120,000). Making dishonest or intentionally misleading statements in a Cayman fund's marketing materials could constitute one of several offences under the Penal Code carrying terms of imprisonment of up to ten years.

### Civil

If a Cayman fund breaches the terms of its investment contract with any investors (for example, by breaching agreed investment restrictions) it could be liable to the investor for any resulting losses. Similarly, where a fund's marketing materials contain misstatements or misrepresentations, the fund may be liable for any loss incurred by an investor that invested on the basis of that misstatement or misrepresentation and/or the investor may be entitled to rescind its investment contract.

### Administrative

CIMA has the power under the Monetary Authority (Administrative Fines) Regulations to impose administrative penalties for breaches of regulatory laws, including the Mutual Funds Act, the Private Funds Act and the AML Regulations. These regulations classify breaches of specific sections of the regulatory laws as either minor, serious or very serious. Minor breaches can result in a CI\$5,000 (approx. US\$6,000) fine, while serious and very serious breaches can result in discretionary fines of up to CI\$100,000 (approx. US\$120,000) and CI\$1,000,000 (approx. US\$1,200,000) respectively. A Cayman fund's officers or managers that are complicit in any breach may also be liable to fines of up to CI\$100,000 (approx. US\$120,000). DITC also has the power to impose administrative penalties of up to CI\$50,000 (approx. US\$60,000) plus daily ongoing penalties for breaches of the AEOI regime.

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