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**Fintech Funds In The Cayman
Islands: Rise, Regulations And
Structures**

Contributor

Stuarts Walker Hersant Humphries

Chris Humphries

Managing Director & Head of Funds | chris.humphries@stuartslaw.com

**STUARTS
WALKER
HERSANT
HUMPHRIES**

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FINTECH FUNDS IN THE CAYMAN ISLANDS RISE, REGULATIONS AND STRUCTURES



The Cayman Islands has seen a significant rise in the number of fintech funds being established. This article explores the regulations and preferred structures of these funds.

Rise in Fintech Funds in the Cayman Islands

The Cayman Islands has been the leading offshore jurisdiction for the establishment of mutual funds and private funds for more than 30 years. Its' phenomenal reputation has been due in part to the use of innovative legislation and the absence of taxation and exchange controls. This, together with the presence of sophisticated and professional service providers has resulted in the jurisdiction's reputation for responsible supervision and regulation of funds. In addition, the Cayman Islands has introduced innovative legislation to regulate virtual asset service providers, opening the doors to this market.

It is no surprise therefore that when fund managers were looking for the best jurisdiction to establish new funds investing cryptocurrencies and blockchain products that the Cayman Islands was the jurisdiction of choice

Regulation of Funds

The Cayman Islands are home to both regulated mutual funds (open-ended) and regulated private funds (closed-ended) for which both are applicable to cryptocurrency and blockchain structures and are explained in more detail below.

Mutual Funds

Mutual Funds are regulated under the Mutual Funds Act (the "MFA"). The MFA defines a mutual fund as a company, unit trust or partnership that issues equity interests, the purpose or effect of which is the pooling of investor funds with the aim of spreading investor risk and enabling investors to receive profits or gains from the acquisition, holding, management or disposal of investments. Equity interests are defined as a share, trust unit or partnership interest or any other representation of an interest that carries an entitlement to participate in the profits or gains of the company, unit trust or partnership, as the case may be, and which may be redeemed or repurchased at the option of the investor.

The MFA applies to all open-ended funds (funds in which the investors have the right to redeem their interests at their option), except those specifically excluded from regulation. Therefore, Tokens which carry an entitlement to participate in the profits or gains of the company will require registration under

the MFA if they are redeemable at the option of the holder.

Types of Regulated Mutual Funds

There are at least six (6) types of mutual funds that are subject to regulation and supervision under the MFA by the Cayman Islands Monetary Authority ("CIMA") but the one most popular for Crypto Funds is the Registered Mutual Fund which has a streamlined registration procedure available where:

- the initial minimum equity interest purchasable by an investor is US\$100,000; or
- **whose equity interests are listed on an approved stock exchange such as the CSX.**

Requirements for all Registered Mutual Funds

All Regulated Mutual Funds are required to:

- Submit to CIMA a current copy of the fund offering document. The offering document must describe the equity interests offered to investors in all material respects and must contain such information as is necessary to enable a prospective investor to make an informed decision as to whether or not to purchase the equity interests.
- Submit to an annual audit and file accounts within six months of the end of the fund's financial year. This will involve appointing an auditor in the Cayman Islands. All of the major accounting firms are represented in the Cayman Island.
- Pay a prescribed annual registered fee.

Private Funds

Private Funds are regulated under the Private Funds Act (as Revised) (the "PFA"). The PFA defines a private fund as a company, unit trust or partnership that offers or issues or has issued investment interests, the purpose or effect of which is the pooling of 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:

- the holders of investment interests do not have day-to-day control over the acquisition, holding, management or disposal of the investments; and
- the investments are managed as a whole by or on behalf of the operator of the private fund, directly or indirectly,

The PFA applies to all closed-ended funds (funds in which the investors do not have the right to redeem their interests at their option), except those specifically excluded from regulation.

Types of Regulated Private Funds

There are two (2) types of private funds that are subject to regulation and supervision under CIMA, and the most popular structure for Crypto Funds is the Registered Private Fund.

Requirements for all Regulated Private Funds

The PFA requires closed-ended private funds to register with CIMA. The PFA imposes extended administrative and operational requirements upon previously exempted closed-ended funds. The PFA

sets out a registration process for private funds which involves the filing of prescribed details with CIMA and payment of an annual fee. The PFA does not require the filing of a full offering memorandum (or similar) in relation to a private fund or impose any requirements on the contents of a private fund's offering materials (if any).

Where a private fund (a) makes any changes, or becomes aware of any changes, that materially affects any information submitted to CIMA under the provisions of the PFA; or (b) changes its registered office or the location of its principal office, the private fund must within twenty-one days after making the change or becoming aware of the change, as the case may be, file with CIMA the details of the changes.

Operating Conditions for Private Funds

The PFA requires a private fund to ensure it has certain ongoing operating provisions in place relating to annual audits, annual returns, retention of records, valuation of assets, safekeeping of fund assets, cash monitoring and identification of securities for which each are outlined in further detail below.

Annual Audit of Private Fund.

A private fund shall have its accounts audited annually by an auditor approved by CIMA. Accounts will need to be prepared in accordance with International Financial Reporting Standards or the generally accepted accounting principles of the United States of America, Japan or Switzerland or any non-high-risk jurisdiction.

Annual Return

A private fund will, in respect of each financial year of the private fund, be required to submit an annual return in the prescribed form.

Retention of Records

A private fund shall maintain its records in an accessible manner and in accordance with rules, statements of principle and guidance issued by CIMA under section 34 of the Monetary Authority Act (as Revised). This requirement includes an obligation to maintain a record of the identification codes of any securities that are regularly traded or held on a consistent basis.

Valuation

A private fund shall have appropriate and consistent procedures for the purposes of proper valuations of its assets, which shall ensure that valuations are conducted in accordance with the requirements in the PFA. Valuations of the assets of a private fund shall be carried out at a frequency that is appropriate to the assets held by the private fund and, in any case, on at least an annual basis.

Valuations of the assets of a private fund shall be performed by (a) an independent third party that is appropriately professionally qualified to conduct valuations in a non-high-risk jurisdiction or (b) the manager or operator of the private fund, or a person who has a "control relationship" with the manager of the private fund. If the valuation is undertaken by the latter of these options then it must be independent from the portfolio management function and potential conflicts of interest must be properly

identified, managed, monitored and disclosed to investors. Alternatively, the valuation function could be undertaken by an administrator not falling under option (a) who is appointed by the private fund.

Safekeeping of Fund Assets

A private fund shall appoint a custodian to hold in custody, in segregated accounts opened in the name, or for the account, of the private fund, the custodial fund assets and 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 notifies CIMA that it is neither practical nor proportionate to do so, having regard to the nature of the private fund and the type of assets it holds.

Beneficial Owners. A VASP entity must ensure that its beneficial owners are fit and proper persons to have such control and ownership.

Senior/AML Officers. A VASP entity must ensure that its senior officers/trustees, as

In this scenario the private fund shall appoint either an administrator or another independent third party or the manager or operator, or a person with a control relationship with the manager of the private fund, provided that the verification function is kept separate and conflicts of interest are identified, managed and monitored in the same way that the valuation function is administered as set out above.

Cash Monitoring

The PFA requires that monitoring of cash flows and checking of cash accounts and receipt of investor payments be carried out by any of the manager or operator of the private fund (subject to functional independence or conflicts management requirements), an independent administrator, independent custodian or other independent third party.

Virtual Asset Services

The Cayman Islands Government passed the Virtual Asset (Service Providers) Act, (as Revised) (the "VASP Act") on 25 May 2020. The VASP Act applies to any persons involved in providing one or more 'virtual asset services'.

Issuing tokens is a virtual asset service and any fund that wishes to issue tokens rather than shares will need to register as a virtual asset service provider.

Further, any fund that accepts fiat as a subscription in kind and redeems out the investors with a token will need to consider registration as an exchange (this will also apply where tokens are used to subscribe and an alternative token or fiat are paid out on redemption of the shares).

In order to register with CIMA as a virtual asset service provider, a Crypto Fund is required to file with CIMA certain documents, declarations, an application form, the relevant fee and various policies which are outlined in further detail below.

Ongoing Obligations for Virtual Asset Service Providers

AML Obligations. A VASP entity is required to comply with the Anti-Money Laundering Regulations (2020 Revision) (the “AML Regulations”) and CIMA’s Guidance Notes (Amendment) (No. 5): Virtual Asset Service Providers, February 2020 and other Cayman Islands laws, rules and regulation relating to anti-money laundering (“AML”), combating terrorist financing (“CTF”) and proliferation financing (“PF”) and targeted financial sanctions (“TSF”). The VASP entity must establish AML systems and procedures for the purpose of complying with the AML Regulations. The VASP entity must also designate employees to fulfil the roles of AMLCO, MLRO and DMLRO that have the responsibility for procedures with responsibility for the procedures for combating AML/CFT/PF/TSF and undertake audits of its AML systems and procedures at the request of CIMA. A VASP entity is also required to comply with the ‘AML Travel Rules’ as set out in Part XA of the AML Regulations which sets out the identification and record-keeping requirements relating to transfers of virtual assets.

Data Privacy. The Cayman Islands Data Protection Act (as Revised) (“DPA”), came into force on 30 September 2019. A virtual asset service provider is a ‘data controller’ and must comply with the data protection principles set out in the DPA when processing personal data. It must also ensure those principles are complied with where the personal data is processed on behalf of the data controller (e.g., by the administrator of the fund).

Compliance and Reporting. VASP entities are required to establish and implement cyber security policies, data protection and internal safeguards, risk management methodologies, AML/CFT/PF/TSF policies, safeguards asset protection and business model descriptions. VASP entities must take steps to protect and secure personal data of clients and ensure communications relating to virtual assets are accurate. VASP entities are required to maintain a registered office in the Cayman Islands.

applicable, and beneficial owners are fit and proper persons for such positions or to have such control and ownership.

Annual Audit. VASP ‘registered’ entities are not obligated to appoint an auditor but CIMA does have the power to require the VASP to provide an auditor’s report, if it deems this to be necessary.

AEOI. Where a virtual asset service provider is a ‘financial institution’ for FATCA or CRS purposes it must comply with the automatic exchange of information requirements. Financial institutions must have written policies and procedures in place.

AML. All virtual asset service providers must comply with the anti-money laundering regime in the Cayman Islands including the travel rules applicable specifically to virtual asset service providers.

AML Auditor’s Report. CIMA may, at the VASP entity’s expense, require a virtual asset service provider to provide an auditor’s report, prepared by an independent auditor, on the anti-money laundering systems and procedures for compliance with the AML Regulations.

CIMA Regulatory Measures. In addition to the requirements set out under VASPA, a VASP entity is subject to the general regulatory oversight of CIMA which includes the requirement to comply with CIMA’s rules, statements of guidance, policies and procedures. Of note, a virtual asset service provider must comply with the Statements of Principles on Conduct of Virtual Asset Services and Corporate

Governance and Nature, Accessibility and Retention of Records.

Preferred Structures and It's Benefits

There are many vehicles available in the Cayman Islands through which to operate a mutual fund or private fund but the one which has found the most traction for Crypto Funds is the segregated portfolio company ("SPC"). An SPC is one legal entity with different "pots" or "pools" called "segregated portfolios" whose assets and liability are separated and protected (under Cayman Islands status) from the liability of all other segregated portfolios in the same SPC.

The principal advantage of an SPC over a standard exempted company is to protect the assets of one segregated portfolio from the liabilities of all other segregated portfolios. This has been particularly attractive for Crypto Funds where many classes of assets are traded and some have significantly more risk than others. The fund managers naturally wish to isolate the risk of the different strategies and the SPC structure provides the mechanism for this.

The Companies Act (as Revised) of the Cayman Islands (the "Act") states that a creditor will only have recourse to assets from segregated portfolios with which it has contracted, and creditors will have no recourse to the assets of other segregated portfolios of the SPC which are protected under the Act. The Articles of Association of the SPC will have provisions which reflect the Act in this respect.

The benefit of SPCs highlighted above facilitates a more streamlined offering structure for certain mutual funds enabling SPC to be used to structure platforms from which multiple managers can be quickly onboarded into their own segregated portfolio in a structure that has all its service providers already selected and in place.

Contributors

Chris Humphries
**Managing Director & Head of
Funds**

chris.humphries@stuartslaw.com

