

# Cayman Islands Monetary Authority

## PRIVATE SECTOR CONSULTATION



**Rule on Calculation of Asset Values – Regulated Mutual Funds**  
**Rule on Segregation of Assets – Regulated Mutual Funds**  
**Rule on Contents of Offering Documents – Regulated Mutual Funds**  
**Rule on Calculation of Asset Values – Registered Private Funds**  
**Rule on Segregation of Assets – Registered Private Funds**  
**Rule on Contents of Marketing Material – Registered Private Funds**

### **A. Introduction**

1. Section 34(1)(a) of the Monetary Authority Law (2020 Revision) ("MAL") states that

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*"After private sector consultation and consultation with the Minister charged with responsibility for Financial Services, the Authority may –*

- (a) issue or amend rules or statements of principle or guidance concerning the conduct of licensees and their officers and employees, and any other persons to whom and to the extent that the regulatory laws may apply;"*

2. Requirements specific to the private sector consultation are outlined in section 4(1) of the MAL as follows:

*"When this Law requires private sector consultation in relation to a proposed measure*

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- (a) the Authority shall give to each private sector association a draft of the proposed measure, together with –*
- i. an explanation of the purpose of the proposed measure;*
  - ii. an explanation of the Authority's reasons for believing that the proposed measure is compatible with the Authority's functions and duties under section 6;*
  - iii. an explanation of the extent to which a corresponding measure has been adopted in a country or territory outside the Islands;*
  - iv. an estimate of any significant costs of the proposed measure, together with an analysis of the benefits that will arise if the proposed measure is adopted; and*
  - v. notice that representations about the proposed measure may be made to the Authority within a period specified in the notice (not being less than thirty days or such shorter period as may be permitted by subsection (3)); and*

*(b) before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector associations, and shall give a written response, which shall be copied to all the private sector associations."*

3. The Cayman Islands Monetary Authority ("the Authority" or "CIMA") seeks consultation and comment from the private sector associations concerning the proposed:
  - i. *Rule on Calculation of Asset Values – Regulated Mutual Funds* (see appendix A);
  - ii. *Rule on Segregation of Assets – Regulated Mutual Funds* (see appendix B);
  - iii. *Rule on Contents of Offering Documents – Regulated Mutual Funds* (see appendix C);
  - iv. *Rule on Calculation of Asset Values – Registered Private Funds* (see appendix D);
  - v. *Rule on Segregation of Assets – Registered Private Funds* (see appendix E); and
  - vi. *Rule on Contents of Marketing Material – Registered Private Funds* (see appendix F).
4. The proposed amended measures in appendices A to C are applicable to mutual funds regulated under the Mutual Funds Law (2020 Revision) ("MFL"). The proposed measures in appendices D to F will be applicable to private funds which will be registered under the Private Funds Law.

## **B. Background/ Scope of Application**

5. In April 2008, the Authority issued the proposed Rules for mutual funds in order to help meet the requirements of the International Organisation of Securities Commissions' (IOSCO) principle relating to retail funds while leaving some flexibility in the regulatory framework for non-public funds. Since that time, the Authority has considered ways in which to oversee "unregulated" mutual funds in a more meaningful way and further address certain prudential matters. Additionally, the urgency around developing a more robust framework for non-public funds, was heightened by the fact that some Cayman Islands companies are going to be required to show economic substance to the European Union (EU) and the Organisation for Economic Co-operation and Development (OECD) for tax purposes.
6. The Council of the EU adopted a resolution on a Code of Conduct for business taxation, the aim of which is counteracting the effects of zero tax and preferential tax regimes around the world. In 2017, the Code of Conduct Group (COCG) investigated the tax policies of both EU member states and third countries. The EU criteria are based on the OECD's criteria that are concerned with preferential taxation. Imposing economic substance requirements is aimed at forcing jurisdictions to shed preferential regimes for foreign companies as it is meant to create a level playing field for local and foreign companies. The significant concern is the cross-border tax base erosion and profit shifting which is mostly associated with investments in offshore financial centres which are commonly low tax or tax-free jurisdictions.
7. On 27 May 2019, the General Secretariat of the European Council submitted a report from its the COCG to the Permanent Representatives Committee of the European Council. The COCG developed technical guidance on the substance requirements for collective investment schemes (the Guidance). The Guidance detailed four pillars against which the legislation of various jurisdictions, including the Cayman Islands,

will be assessed to determine whether it prescribes appropriate economic substance requirements for funds. These pillars (the "Four Pillars") are as follows:

- a. **Pillar 1:** Legislative and Administrative Framework for Collective Investment Schemes' (CIVs) Authorisation and/or Registration;
- b. **Pillar 2:** Legislative and Administrative Framework for CIVs' Supervision and Rules' Enforcement;
- c. **Pillar 3:** Legislative and Administrative Framework regarding Valuation, Accounting and Auditing of CIVs; and
- d. **Pillar 4:** Depositary rules.

Further, the EU stipulated a deadline of end of year 2019 by which the Cayman Islands was required to have the necessary framework in place to comply with economic substance provisions.

8. The Legislative Assembly has passed the Private Funds Bill into law to establish economic substance requirements for funds.
9. In addition to the Private Funds Law, there were certain prudential matters that needed to be addressed to support the Government's effort to meet the minimum requirements of the EU's Four Pillars. As such, the decision was taken to expand the scope of application of certain existing measures. The extension of the Rules would cover funds registered under the MFL; and capture certain currently unregulated private funds which will be required to be registered once the proposed new law is commenced, subject to any transition period.
10. The revisions of the MF Rules are necessary in order to codify and extend prudential standards to all mutual funds under the MFL, as the current Rules only apply to licensed funds. The proposed Private Funds Rules are also necessary to enhance the legal framework and to establish a registration regime and to apply prudential standards. To facilitate the scope expansion of the Rules to both registered mutual funds and private funds, certain elements in the current Rules required relatively minor changes.
11. The Cayman Islands encourages funds that wish to be domiciled here to meet basic requirements in keeping with good practice in order to offer investor protection and minimise opportunities for reputational damage.

### **C. Purpose of Proposed Measure and Consistency with Authority's Functions**

12. Pursuant to section 6(1)(b) of the MAL, one of the principal functions of the Authority is:
  - "b) *regulatory functions, namely -*
    - (i) *to regulate and supervise financial services business carried on in or from within the Islands in accordance with this Law and the regulatory laws;*
    - (ii) *to monitor compliance with the money laundering regulations; and*
    - (iii) *to perform any other regulatory or supervisory duties that may be imposed on the Authority by any other law;"*
13. Section 6(3) of the MAL provides that in performing its regulatory functions, the Authority shall, *inter alia*:

- i. endeavour to promote and enhance market confidence and the reputation of the Islands as a financial centre;
- ii. recognise the international character of financial services and markets and the necessity of maintaining the competitive position of the Islands, vis a vis both consumers and suppliers of financial services, while conforming to internationally applied standards insofar as they are relevant and appropriate to the circumstances of the Islands;
- iii. recognise the principle that a burden or restriction which is imposed on a person or activity should be proportionate to the benefits, considered in general terms; and
- iv. recognise the need for transparency and fairness on the part of the Authority.

**14.** The proposed revised Rules will allow for the expansion of supervisory oversight in the specific areas to funds which were not previously held to the minimum standards established therein. The regulatory function of the Authority will be enhanced in line with Sections 6(1) and 6(3) of the MAL, as stated above. The proposed Rules largely reflect the minimum international standards for segregation of assets, calculation of asset values and the contents of offering documents/ marketing material for funds; and support the Authority's objective to maintain the competitiveness of the Cayman Islands' financial sector through, *inter alia*, conformity with relevant international standards for regulated entities.

#### **D. International Standards**

**15.** IOSCO, is the global standard setter for securities market regulation and has implemented a set of objectives and principles in this regard. The specific principles related to the measures being proposed in this paper are outlined in Table I:

**Table I: International Standards Related to the Proposed Rules**

| <b>Rule</b>  | <b>IOSCO Principle</b>  | <b>No.</b> |
|--|---|------------|
| <b><i>Rule on Segregation of Assets</i></b>                              | The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.   | 25         |
| <b><i>Rule on Calculation of Asset Values</i></b>                        | Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.  | 27         |
| <b><i>Rule on Contents of Offering Documents/ Marketing Material</i></b> | There should be full, accurate and timely disclosure of financial results, risk and other information which is material to investors' decisions.  | 16         |
|  | Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme. | 26         |

**E. Jurisdictional Comparisons**

16. The Authority notes that comparable jurisdictions have implemented similar requirements for their securities sectors given that these are based on internationally accepted principles. Table II presents a summary of the requirements relating to segregation of assets, calculation of asset values and the contents of offering documents/ marketing material in select jurisdictions.

**Table II: Summary of Specific Requirements for Funds**

| <b>Jurisdictions</b>            | <b>Segregation of Assets</b> | <b>Calculation of Asset Values</b> | <b>Contents of Offering Documents</b> |
|---------------------------------|------------------------------|------------------------------------|---------------------------------------|
| <b>Bermuda</b>                  | Y                            | Y                                  | Y                                     |
| <b>The Bahamas</b>              | Y                            | Y                                  | Y                                     |
| <b>European Union</b>           | Y                            | Y                                  | Y                                     |
| <b>Guernsey</b>                 | Y                            | Y                                  | Y                                     |
| <b>Isle of Man</b>              | Y                            | Y                                  | Y                                     |
| <b>United States of America</b> | Y                            | Y                                  | Y                                     |
| <b>Jersey</b>                   | Y                            | Y                                  | Y                                     |

**F. Cost-Benefit Assessment of Implementing the Proposed Rules**

17. The relevant costs and benefits associated with the implementation of the proposed Rules for mutual funds are presented in Table III.

**Table III: Costs and Benefits of Issuing the Proposed Rules**

|                           | <b>Costs</b>  | <b>Benefits</b>  |
|---------------------------|---|--|
| <b>CIMA</b>               | <ol style="list-style-type: none"> <li>1. Increase in staff complement to effectively supervise and monitor the additional entities.</li> <li>2. Staff training.</li> </ol> | <ol style="list-style-type: none"> <li>1. Enhance the reputation of CIMA as a regulator aligned to international trends</li> <li>2. Reduces the regulatory gap and regulatory risks by expanding the regulatory parameter to include these funds.</li> <li>3. Enhances CIMA's ability to perform systemic risk regulation.</li> <li>4. Enables CIMA to provide statistics on the total number of number of funds incorporated in the Islands.</li> </ol> |
| <b>Cayman Islands</b>     | <ol style="list-style-type: none"> <li>1. There are no costs to the jurisdiction as a whole with the implementation of these requirements.</li> </ol>                       | <ol style="list-style-type: none"> <li>1. Increased transparency will enhance the reputation of the jurisdiction, which may lead to more business being done in the Islands.</li> <li>2. Enhance the reputation of the Cayman Islands as a leading hedge fund domicile.</li> </ol>   |
| <b>Regulated Entities</b> | <ol style="list-style-type: none"> <li>1. Costs of regulatory compliance for affected funds.</li> </ol>   | <ol style="list-style-type: none"> <li>1. Increases good governance and practices for all funds thereby increasing transparency and risk management</li> <li>2. Clarity on regulatory obligations for all funds.</li> </ol>  |

**G. Comments and Consultation**

**18.**The Authority seeks consultation through written comments and representations from the private sector associations concerning the following measures:

- i. Rule on Calculation of Asset Values - Regulated Mutual Funds;*
- ii. Rule on Segregation of Assets – Regulated Mutual Funds;*
- iii. Rule on Contents of Offering Documents - Regulated Mutual Funds.*
- iv. Rule on Calculation of Asset Values – Registered Private Funds;*
- v. Rule on Segregation of Assets – Registered Private Funds; and*
- vi. Rule on Contents of Marketing Material – Registered Private Funds.*

**19.**The Authority must receive consolidated representations by 1700hrs on **05 March 2020**.

**20.**Comments and representations must be addressed to:

The Managing Director  
Cayman Islands Monetary Authority  
P.O. Box 10052  
SIX  
Cricket Square  
Grand Cayman KY1-1001  
Cayman Islands  
Tel: 345-949-7089  
Fax: 345-946-5611  
Email:  
[Consultation@cima.com](mailto:Consultation@cima.com)  
[With copy to: AlisaGlace@cima.ky](mailto:AlisaGlace@cima.ky)

- 21.** The Authority shall have due regard to any representation made by the private sector associations and industry stakeholders. The Authority shall provide a written response collating the feedback received and the Authority's position on this feedback. This response shall be copied to all relevant private sector associations only.