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Cayman Compliant:

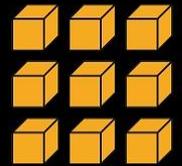
Private Funds investing in FinTech, Digital Assets, and Blockchain Technologies

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JupiterBlock

What is this about?

The FinTech, digital assets, and blockchain or distributed ledger technologies space is now (again) trendy. The internet is full of daily news about more institutional investors coming in, big banks or companies rolling out their own solutions, and more and more sophisticated service providers offering KYC/compliance, custody, or trading options. Covid-19 accelerated many things, and mainstream adoption of digital solutions of all sorts is one of them.

Cayman is the premier offshore funds jurisdiction, both in terms of volume and quality of offering, and therefore an attractive option for venture capital and private equity funds. Yet, the Cayman regulatory environment has recently changed in many respects, leaving fund operators with an added compliance burden and expense on top of the changed business landscape.

Various regulations have been **expanded** due to efforts to move towards increased transparency, protection of investors and to comply with international standards. Under the Private Funds Law 2020, as amended, entities which were previously referred to as closed-ended funds (venture capital and private equity funds included) now fall under a definition of **private funds, subject to registration and additional ongoing compliance requirements.**

What is a private fund?

Any Cayman Islands closed-ended fund could now fall under the definition of private fund under the Private Funds Law 2020, as amended, which has been recently simplified:

- a company, unit trust or partnership
- 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 —
 - (a) the holders of investment interests do not have day-to-day control over the acquisition, holding, management or disposal of the investments; and
 - (b) the investments are managed as a whole by or on behalf of the operator of the private fund, directly or indirectly.

Banks, trust companies, insurers and certain other companies registered under certain Cayman Islands laws, and non-fund arrangements are still excluded.

I don't have an auditor yet.

Under the current laws, each Cayman Islands fund, including a private fund, is required to appoint auditors, from a list approved by the Cayman Islands Monetary Authority (CIMA).

Previously, closed-ended funds were not required to have an auditor appointed. Many funds still had auditors in order to protect investors, but not necessarily from a CIMA-approved list (for example, a Cayman feeder into a U.S. master fund would simply use the auditors of the master fund in the U.S.).

The accounts are required to be prepared in accordance with IFRS or GAAP (U.S., Japan, Switzerland or another non-high risk jurisdiction) and audited, as well as filed with CIMA on an annual basis.

For private funds investing in digital assets or blockchain companies, it is very important to choose an auditor firm who is familiar with and understands digital assets.

I don't have a second director yet.

In application of a CIMA policy called the **four eyes principle**, a minimum of two (2) directors are required for private funds that are companies. The regulator also requires a minimum of two (2) natural persons to be named in respect of a general partner (GP) or a corporate director of a private fund. Each needs to be a **fit and proper person**, a concept that relates to honesty, integrity and reputation, competence and capability, and financial soundness.

Directors' responsibility:

Directors are liable for a private fund's compliance with regulatory requirements, including, among other things:

- (i) AML/CFT obligations (3 officers appointed, manual and audit);
- (ii) FATCA/CRS reporting;
- (iii) data protection; and
- (iv) registration with CIMA and related obligations under the Private Funds Law, 2020, as amended.

What are the registration requirements?

The application for the registration of a private fund can be submitted by any corporate services providers (auditors, registered offices, administrators, and law firms) through CIMA's secure Regulatory Enhanced Electronic Forms Submission (REEFS) web portal. However, CIMA will reject the registration if the documentation submitted is incorrect or incomplete.

The deadline for registration of all existing private funds is still 7 August 2020.

Documentation required for registration:

1. Certificate of Incorporation/Registration;
2. Constitutive Documents (Memorandum & Articles of Association/Trust Deed/Declaration of Partnership);
3. Offering Memorandum/Summary of Terms/Marketing Materials;
4. Auditor's letter of consent (if available);
5. Administrator's letter of consent (if available/applicable); and
6. Structure Chart.

What happens if I miss the deadline?

There will be no annual registration fee assessed by CIMA for funds registering during the transition period, which ends on 7 August 2020; however, an application fee of CI\$300 (US\$365.85) is due. An annual registration fee of CI\$3,500 (US\$4,268.29) will be next due in January 2021.

Funds registering starting with 8 August 2020 will pay the annual registration fee of CI\$3,500 (US\$4,268.29) and the CI\$300 (US\$365.85) application fee.

These fees are usually paid via the fund's registered office in the Cayman Islands, however, for the initial registration before 7 August 2020 any corporate service provider with a REEF access could carry out the registration and pay the related fees.

Missing the deadline for registration also means that the private fund would be considered as not complying with the Private Funds Law 2020, which is an offence for the operator of the fund (trustee of the unit trust, general partner for a partnership, director for a company or manager for a limited liability company).

What else do I need to worry about?

The manager or operator of a private fund is generally liable for compliance.

Because the transitional period for CIMA registration ends on 7 August 2020, it's time to think about a regulatory and compliance health check. Ideally, the manager or operator should already have a checklist, but:

- (i) Has the fund appointed AML officers?
- (ii) Who is in charge of compliance? Does the fund have a compliance manual or even policy? What is the date of the last audit? What is the date of the last training?
- (iii) Who is carrying out the FATCA/CRS reporting for the fund?
- (iv) Have the annual filings been carried out?
- (v) When was the date of the last Board meeting?
- (vi) Who has control or is processing investor data, and in which country?
- (vii) Where are the investment manager and the investment advisor located, and are they in compliance with all regulatory obligations?

Will I need to update my fund documentation?

Only to the extent the fund will go through additional fundraising and further closings. For existing investors, the updated data protection policy should be circulated with the ongoing investor communications, and the information regarding the auditor appointment and registration with CIMA as well.

However, to the extent the initial fund documentation was insufficient, this would be a good opportunity to amend and update. Any significant changes to how the fund operates or the investment strategy would need investor approval in addition to Board approval.



When in doubt, please check with your Cayman counsel.

Because the Offering Memorandum, Summary of Terms, or Marketing Materials, as applicable, are required by CIMA as part of the registration process, any material changes to such documents, as well as any changes in the registered office or the location of the principal office, after the registration of the fund with CIMA, are required to be filed with the regulator as well, within twenty-one days after the change.

Will I need a custodian for the digital assets?

Most larger funds will want to have a custodian for their digital assets, especially now when custody solutions available on the market have multiplied. Under the Virtual Asset (Service Providers) Law, 2020, the Cayman Islands Monetary Authority (CIMA) will also be able to issue licenses for custodians of virtual assets, which in the future will help Cayman funds to choose a Cayman-compliant solution for their custody needs.

However, currently a private fund is not required to appoint a custodian if this would be neither practical nor proportionate, taking account of the fund's assets and operations. In such a case, the fund would inform CIMA of the identity of the person in charge of the safekeeping of the fund's assets, which remains an obligation.

In the absence of a custodian, the obligation to verify that the fund holds title to its assets and to maintain a record of those assets can be met by the fund's administrator, an independent third party, or even the manager or operator of the fund or an affiliate, provided that:

- (a) the function is independent from portfolio management, or
- (b) conflicts of interest are properly identified, managed, monitored and disclosed to investors.

However, in this case, the regulator may require additional verification by a professionally qualified independent third party.

Do I have an obligation to segregate digital assets?

Yes. One of the fundamental obligations of a private fund's manager or operator is to maintain **segregation of assets** between the fund's portfolio and any similar assets of the manager and operator. No manager or operator of a private fund may use the fund's portfolio to finance its own or other operations. **What does this mean for digital assets?**

- Private wallet addresses for the manager or operator cannot be used for the fund.
- Separate multi-signature wallet addresses must be used for the fund's assets.



The wallet provider should ensure that funds are not commingled with other customers.

- Addresses used to hold fund assets are independently verifiable by the administrator, third party or other person in charge of the safekeeping of the fund's assets, as well as the auditors of the fund.

Overall, the proper policies and controls should be in place to ensure segregation of assets. Also, in the absence of an appointed custodian, additional risks related to self-custody will need to be disclosed to investors.

Do I need to change my valuation policy?

Maybe. Typically, a private fund is required to have appropriate and consistent procedures for valuation of its assets, on at least an annual basis. If carried out internally, the Cayman Islands Monetary Authority (CIMA) requires segregation of the valuation function from portfolio management, disclosure and management of conflict of interests, and may also require verification by an auditor or independent third party. However, **more detailed further guidance from the regulator was recently published**, which may require certain funds to update their valuation policy and fund documentation.

1. The valuation must be fair, reliable, complete, neutral and free from material error and verifiable.
2. The methodology must be consistent with the accounting principles or reporting standards used to prepare the fund's audited financial statements.
3. The policy should be written and disclosed in the constitutional documents, Marketing Materials or other form of investor communication.
4. The Fair Value Method must be used, or Pricing Models for Hard-to-Value Assets.
5. The fund documentation must explicitly describe any material involvement by the manager or any affiliate and any conflicts of interest.

When should I reach out for help?

1. If you have a Cayman fund of any type and it is not currently registered with the Cayman Islands Monetary Authority (CIMA) or in the process of being registered.
2. If you don't have an auditor yet.
3. If you are not certain if you have a fund or not.
4. If your fund doesn't have AML officers and an AML compliance manual.
5. If your fund doesn't have a valuation policy.
6. If the fund's assets are not properly segregated.
7. If you have a Cayman manager or advisor but they are not registered with the Cayman Islands Monetary Authority (CIMA).

About the Author

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Broad legal background in U.S. and E.U. business law

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About JB Advisory Services SEZC



JupiterBlock

JB Advisory Services SEZC is part of Cayman Enterprise City (CEC) and actively supports the growing blockchain, FinTech and digital ecosystem in the Cayman Islands. JB stands for **JupiterBlock**, in relation to our affiliate **JupiterBlock LLC**, which is incorporated in Wyoming and active in the United States.

We are just at the beginning of an extraordinary journey which will see blockchain technology completely revamp the existing financial systems all over the world.

We consult and advise clients in connection with:

- early-stage feasibility investigations, product design and development (including embedded corporate governance and compliance features and smart contract specifications);
- how to integrate blockchain and digital assets into existing business models;
- commercialisation and IP protection strategies; and
- how to manage regulatory and compliance challenges.

We also provide the bridge with venture capital and private equity funds, their expectations and requirements, and assist with drafting and conducting due diligence of prospective strategic acquisitions/investment opportunities and accessing potential sources of capital.