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# A New Era for Private Equity Funds formed in Cayman Islands?

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On February 18, 2020, the EU's Economic and Financial Affairs Council added the Cayman Islands to the non-cooperative jurisdictions for tax purposes list, also known as the "EU Blacklist", for not having "appropriate measures in place relating to economic substance in the area of collective investment vehicles".

A few days before it has been added to the list, Cayman Islands, enacted the Private Funds Law (2020) ("**PF Law**") and the Mutual Funds (Amendment) Law, with the view of addressing the EU's concerns. It remains unclear whether Cayman Islands has been listed only because it missed the EU's deadline for adopting economic substance laws.

The EU Blacklist does not impose automatic sanctions on blacklisted jurisdictions. Rather, each EU member state may take certain measures for tax purposes with respect to transactions or structures involving blacklisted jurisdictions. In addition, by 2021, EU member states are required to adopt at least one defensive tax measures such as non-deductibility of costs, application of CFC rules or increase of withholding tax rates.

Until the EU Blacklist is next scheduled to be updated, Cayman Islands' funds or other funds having a Cayman Islands aspect (including Israeli managed funds) ("**Cayman Islands Related Funds**"), are encouraged to carefully review their side letters which in many cases include undertakings towards certain investors to avoid investments through a non-cooperative jurisdictions. Furthermore, in terms of future investments in Cayman Islands Related Funds, the inclusion of Cayman Islands in the EU Blacklist might also deter certain investors, particularly regulated institutional investors. There are already certain European pension funds which expressed in the media their intention to avoid investing in Cayman Islands Related Funds in light of their tax policies.

In addition to Cayman Islands' presence in the EU Blacklist, the PF Law might also affect the reputation of Cayman Islands in the private equity industry.

The PF Law introduces for the first time a regulatory regime applicable to private investment funds. The PF Law generally applies to closed-ended funds. It addresses certain scenarios which might potentially require an independent supervision on the fund's

economic operation. Among other things, a private fund must apply for registration with the Cayman Islands Monetary Authority ("**CIMA**") within 21 days after acceptance of capital commitments from investors and pay an annual registration fee. The application process will involve a disclosure of certain prescribed details on the fund. Capital contributions may not be accepted prior to the CIMA registration (the fund however may enter into agreements with potential high net worth or sophisticated investors prior to the submission of its application with CIMA).

In addition, private funds are generally required to submit their audited financial statements and their annual returns to CIMA. The audited financial statements must be filed with CIMA within six months of the fund's financial year end. For this purpose private funds will be required to engage a Cayman Islands auditor who will audit the annual financial statements.

The PF Law also regulates how private funds can evaluate their assets. Valuations must be carried out by an independent appropriately qualified third party, the manager or operator of the fund (provided the valuation function is independent of the management function or that potential conflicts of interest are properly identified and disclosed to investors), or the administrator of the fund. Where valuations are not carried out by an independent third party, CIMA may require a fund to have its valuations verified by an auditor or independent third party. Other economic-related matters regulated by the PF Law are title verification of the funds' assets and cash monitoring process.

Failure to comply with certain provisions of the PF Law constitutes an offence and might trigger certain fines. Furthermore, the PF Law confers CIMA with powers and authority to take certain actions in respect of private funds, including requirement to substitute the funds' operator and appointment of a person to assume control of the affairs of the private funds. The PF Law will apply to existing and newly formed private funds beginning 7 August 2020 (or such longer period permitted by CIMA).

The PF Law effectively introduces a new regulatory regime involving more time and costs than before and potentially, more burdensome requirements for private funds registered in Cayman Islands. However, the way the PF Law would eventually be implemented remains to be seen. This, together with the recent inclusion of Cayman Islands in the EU Blacklist might affect the reputation of Cayman Islands as a go-to jurisdiction for Cayman Islands Related Funds and their investors.

**\*\*\* This summary is not a legal advice (including under the Cayman Islands Law).**

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