

Private Equity: Expanded Scope of Cayman's Corporate Governance Regime

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The Cayman Islands Monetary Authority (**CIMA**) issued new regulatory measures in April 2023, including a new rule and guidance to enhance corporate governance requirements for regulated entities, including regulated private funds.

It is important that private equity (and mutual) fund operators and sponsors review the corporate governance framework of any regulated private (and mutual) funds they operate to ensure that they understand their obligations and implement best practices that meet or exceed the requirements expected under Cayman's enhanced corporate governance regime.

This briefing provides an overview of the core elements of the Corporate Governance SOG, the Corporate Governance Rule and the Internal Controls Rule and SOG, in relation to private funds regulated under Cayman's Private Funds Act and mutual funds regulated under Cayman's Mutual Funds Act (together, **Regulated Funds**).

| What regulations are applicable?

The measures which are applicable to Regulated Funds are:

- Statement of Guidance - Corporate Governance - Mutual Funds and Private Funds (**Corporate Governance SOG**)
- Rule on Corporate Governance for Regulated Entities (**Corporate Governance Rule**)
- Rule and Statement of Guidance on Internal Controls for Regulated Entities (**Internal Controls Rule and SOG**)
- Statement of Guidance on Nature, Accessibility and Retention of Records (**Records SOG**)

The Corporate Governance SOG and Records SOG came into effect on 14 April 2023, while the

Corporate Governance Rule and the Internal Controls Rule and SOG come into effect on 14 October 2023.

Corporate Governance SOG – scope and principles

It is helpful to note that the Corporate Governance SOG does not fundamentally deviate from the key corporate governance principles already set out under and/or guided by the Cayman Islands' previous corporate governance framework, including CIMA's previously issued Statement of Guidance on Corporate Governance for Regulated Mutual Funds (2013) (**2013 SOG**), which applied to funds regulated under Cayman's Mutual Funds Act only. One key change, however, is that the scope of application of the Corporate Governance SOG has been extended to include regulated private funds for the first time.

The purpose of the Corporate Governance SOG is to provide the **Operators** of a Regulated Fund with specific industry guidance on the minimum expectations for the sound and prudent governance of any Regulated Funds that they operate and represents a measure against which CIMA will assess Regulated Funds' compliance with, for example, the Private Funds Act or the Mutual Funds Act (as applicable) in the event that CIMA needs to consider whether the direction and management of a private fund or a mutual fund (as applicable) has been conducted in a "fit and proper manner".^[1] It is also anticipated that the Corporate Governance SOG will assist Regulated Funds in addressing their obligations under the Corporate Governance Rule (which creates binding obligations on all CIMA regulated entities (see more on this below under 'CIMA Powers')).

An **Operator** means the board of directors of a fund incorporated as a company, the general partner of a fund established as an exempted limited partnership, the manager (or equivalent) of a fund incorporated as a limited liability company or the trustee of a fund established unit trust. A Regulated Fund's Operators are also considered to be its Governing Body.

Importantly, and consistent with the application of the Corporate Governance Rule and Internal Controls Rule and SOG, CIMA have expressly stated that the adequacy and suitability of the corporate governance structure of a particular Regulated Fund should be appropriate for, and proportionate to, the size, complexity, structure, nature of business and risk profile of such Regulated Fund's operations, thereby allowing Operators to take a measured and flexible approach to the corporate governance framework for any particular Regulated Fund they operate, i.e. there is no "one size fits all" approach to the corporate governance framework of a Regulated Fund. CIMA has noted that factors determining the size, complexity, structure, nature of business and risk profile of the operations of a Regulated Fund could include, but are not limited to: assets under management, number of investors, complexity of the structure, nature of investment strategy and nature of the operations.

Core elements of the Corporate Governance SOG for Regulated Funds

The Corporate Governance SOG provides guidance on seven core elements of corporate governance, namely:

1. Oversight Function of the Operators
2. Conflicts of Interest
3. Operator Meetings
4. Duties of Operators
5. Documentation
6. Relations with CIMA
7. Risk Management

Oversight Function

Notwithstanding delegation or outsourcing of operational matters to service providers (which is to be expected in the context of Regulated Funds), the Operators of a Regulated Fund have the ultimate responsibility for effectively overseeing and supervising the activities and affairs of the Regulated Fund and for monitoring and regularly taking steps to satisfy themselves that the Regulated Fund conducts its affairs in accordance with all applicable legislation, regulations and regulatory measures of the Cayman Islands (and those of any other jurisdictions where the Regulated Fund may operate). The Operators of a Regulated Fund should constitute an appropriate number of individual(s), as required by the relevant regulatory acts and regulations, with a diversity of skills, background, experience and expertise to ensure that there is an overall adequate level of competence at the Operators level.^[2]

Conflicts of Interest

Regulated Funds are required to have a written conflicts of interest policy commensurate with the size, complexity, structure, nature of business and risk profile of the Regulated Fund's operations. CIMA has helpfully confirmed that such policy may be documented in the relevant Regulated Fund's constitutional documents, offering documents or marketing materials (as applicable), which is consistent with industry practice. The Operators must suitably identify, disclose, monitor and manage all conflicts of interest; and must document any disclosed conflicts of interest in a manner consistent with the Regulated Fund's constitutional documents or offering documents. Operators are also expected to record, in their meeting minutes, all disclosed conflicts of interest relevant to a meeting during which a matter is being decided or approved and, furthermore, CIMA will expect all conflicts of interest to be disclosed at least on

an annual basis.

Operator Meetings

Operators of a Regulated Fund are expected to convene a meeting at least once a year, or more frequently where the circumstances or size, complexity, structure, nature of business and risk profile of the operations of the Regulated Fund require. See more on some of the items that Operators should add to their standard agenda under 'Corporate Governance Rule' (below). The manner in which such meeting is held will be determined by the Regulated Fund's constitutional documents, which we would ordinarily expect to permit virtual and electronic meetings. However, the constitutional documents should be reviewed to ensure meetings are convened in accordance therewith. Where necessary, Operators should request the attendance of the Regulated Fund's service providers at such meetings.

Duties of Operators

The Corporate Governance SOG provides guidance on Operators' duties, including that an Operator:

- must exercise independent judgement, always acting in the best interests of the Regulated Fund (other than where lawfully permitted or required to consider other interests) and taking into consideration the interests of the Regulated Fund's investors as a whole^[3]
- must operate with due skill, care and diligence and must always act honestly and in good faith
- must oversee and supervise each Regulated Fund for which it functions and all matters falling within the scope of its related responsibilities and, before taking on any additional Regulated Funds, should ensure that it is able to perform its functions and duties in a responsible and effective manner (and in accordance with applicable acts, regulations and regulatory measures)
- retains ultimate responsibility for functions delegated to service providers and should regularly monitor and supervise any such delegated functions
- should regularly monitor whether the Regulated Fund's investment manager is performing in accordance with any defined investment criteria, investment strategy and restrictions
- should, as necessary and at all material times inform itself of the Regulated Fund's investment activities, performance and financial position
- should review and approve the Regulated Fund's financial results and audited financial statements and regularly monitor the Regulated Fund's net asset valuation policy and whether the calculation of its net asset value is being calculated in accordance with such net asset valuation policy

- should ensure that it has sufficient and relevant knowledge and experience to carry out its duties as an Operator of a Regulated Fund.

Documentation

The Operators are responsible for ensuring that a full, accurate and clear written record is kept of the Operators' meetings and/or determinations in relation to the Regulated Fund. Notably, records of the Operators' meetings and/or determinations should include: (i) agenda items and any circulated documents; (ii) a list of attendees present and whether attendance was in person or via telephone or video conference; (iii) the matters considered and decisions made; (iv) any information requested from, and provided by, any service providers and advisors; and (v) a declaration of conflicts of interest.

Relations with CIMA

The Corporate Governance SOG calls for transparent and honest communication with CIMA of any matter that could materially and adversely affect the financial soundness of a Regulated Fund (i.e. a Regulated Fund's ability to continue as a going concern) and/or any non-compliance, by a Regulated Fund, with any applicable acts, regulations and/or regulatory measures, including those of the Cayman Islands and CIMA; and encourages communication of information to CIMA as a default in the case of uncertainty.

Risk Management

The Operators should provide suitable oversight of risk management, ensuring the Regulated Fund's risks are always appropriately managed and mitigated, with material risks being discussed and acted on by the Operators where necessary.

Corporate Governance Rule

The Corporate Governance Rule (which Regulated Funds should read in conjunction with the Corporate Governance SOG) requires all regulated entities, including Regulated Funds, to establish, implement and maintain a corporate governance framework that is commensurate with the size, complexity, structure, nature of business and risk profile of their operations and which addresses, at a minimum: its objectives and strategies; structure and governance of the Governing Body; appropriate allocation of oversight and management responsibilities; independence and objectivity; collective duties of the governing body; duties of individual directors of the Governing Body; appointments and delegation of functions and responsibilities; risk management and internal control systems; conflicts of interest and code of conduct; remuneration policy and practices; reliable and transparent financial reporting; transparency of communications; duties of senior management; and relations with CIMA.

A key requirement of the Corporate Governance Rule is that a Regulated Fund's Governing Body

should, at least annually, meet to review and amend (as necessary), certain elements of such Regulated Fund's corporate governance framework, including, reviewing the composition and collective skill set, experience and expertise of the Governing Body of the Regulated Fund, reviewing the internal controls of the Regulated Fund, to ensure they are operating effectively and that any deficiencies are addressed, reviewing the implementation of risk assessment and risk management systems to ensure that all significant risks are being adequately measured, monitored and mitigated as well as a requirement for all conflicts of interest to be disclosed to the Governing Body on at least an annual basis, via a written annual declaration (and for any changes to such declaration to be communicated throughout the year). The Governing Body of a Regulated Fund should ensure that these, and all other applicable governance matters, are added to their standard agenda for consideration by the Governing Body on at least an annual basis. As a Regulated Fund's Governing Body should already be reviewing and approving the Regulated Fund's audited financial statements and NAV Calculation Policy on an annual basis, this may provide a suitable opportunity for the Governing Body to meet in order to review and evaluate the Regulated Fund's corporate governance matters; and to ensure that these are in line with all applicable Cayman requirements.

In terms of practical guidance for compliance with the Rule on Corporate Governance, CIMA has acknowledged that a Regulated Fund may deem certain of its internal governance practices and procedures to be appropriately captured in its constitutional documents and/or offering documents. Furthermore, CIMA has acknowledged that a Regulated Fund may deem the policies and procedures (for example with respect to conflicts of interest and code of conduct) of certain of its service providers engaged for governance support to be sufficient for it to demonstrate compliance certain requirements of the Corporate Governance Rule (assuming that the Governing Body of such Regulated Fund is satisfied and can demonstrate to CIMA that such policies and procedures are sufficient to meet the relevant requirements of the Corporate Governance Rule (as may be applicable)).

Internal Controls Rule and SOG

The Internal Controls Rule and SOG applies to all regulated entities, including Regulated Funds, subject to the same proportionate application as outlined above with respect to the Corporate Governance Rule. The Internal Controls Rule and SOG is comprised of two parts, Part I sets out general rules and guidelines for all regulated entities covering five components of internal control, namely: control environment; risk identification and assessment; control activities and segregation of duties; information and communications; and monitoring activities and correcting deficiencies in internal controls, and Part II provides sector specific rules and guidelines (which are not specific to Regulated Funds).

CIMA recognises that regulated entities may outsource some business functions, delegating their duties for day-to-day management to service providers; and the Internal Controls Rule and

SOG confirms that a Regulated Fund may rely on its service providers' (for example its investment manager, administrator or other service providers) system of internal controls over its outsourced activities provided that the Governing Body of such Regulated Fund is satisfied and can demonstrate to CIMA that such system of internal controls meets the requirements of the Internal Controls Rule and SOG and any other applicable Cayman Islands laws and regulations.

CIMA Powers

Unlike the Corporate Governance SOG (which contains recommendations as to how Regulated Funds should operate and represents a measure against which CIMA will assess their regulatory compliance), the Corporate Governance Rule and the Internal Controls Rule and SOG create binding obligations on all CIMA regulated entities in respect of which a breach may lead to the imposition of a fine or a regulatory action being taken against a regulated entity (and/or its Operators, where applicable) by CIMA pursuant to the exercise of its powers under the relevant regulatory acts. CIMA has expressed that where a regulated entity is of the view that a particular provision (or application of a provision) of the Corporate Governance Rule is not applicable to such entity based on the size, complexity, structure, nature of business and risk profile of its operations, it is the responsibility of such entity to ensure this can be comprehensively demonstrated to CIMA, as may be required.

Action points

In the current regulatory environment, new and updated regulatory measures such as those set out above should not take Regulated Funds by surprise; and CIMA's continued focus on setting out enforceable standards of corporate governance should ultimately benefit investors and sponsors alike. We would however urge Operators and sponsors of Regulated Funds to review the corporate governance framework of any Regulated Funds they operate and to ensure that they are familiar with and understand their obligations under, and implement practices that meet or exceed the requirements of the Corporate Governance SOG – as well as all applicable provisions of the Corporate Governance Rule and Internal Controls Rule and SOG prior to the 14 October 2023 effective date. Where gaps are identified, these should be addressed with the relevant fund's Cayman counsel.

How can Ogier assist further?

Ogier's Investment Funds and Regulatory teams have extensive experience advising funds and other regulated entities in the Cayman Islands on corporate governance and compliance matters. For advice concerning any of the above matters, please contact your usual Ogier attorney or any of the contacts listed in this briefing.

Ogier's corporate and fiduciary business, Ogier Global, has a team of highly experienced, professional, Cayman resident directors that can serve on the boards of Cayman corporate funds, general partners and on advisory boards of exempted limited partnerships. Ogier Global's services include approval of legal agreements (including onboarding and ongoing due diligence) and ongoing governance and oversight of service providers covering review of service provider reports, governance meetings with key service providers and review and approval of financial statements.

Ogier Global can also assist Cayman funds meet their corporate governance obligations by providing full corporate secretarial service in relation to meetings of a board of directors (or the trustee of a unit trust or advisory committee of an exempted limited partnership).

For advice concerning any of the above matters, please contact your usual Ogier attorney or any of the contacts listed in this briefing.

[1] Pursuant to section 25(1) (e) of the Private Funds Act (Revised) and section 30(1) (d) of the Mutual Funds Act (Revised) (as applicable)

[2] CIMA requires a "four eyes policy" and as such a minimum of two directors must be appointed to a regulated private fund that is a company and a minimum of two natural persons must be named in respect of a general partner or corporate director of a private fund, the operators of the general partner and directors of regulated private funds are not currently required to be registered or licensed by CIMA under the Directors Registration and Licensing Act (Revised) of the Cayman Islands (**DRLA**). With respect to regulated mutual funds, CIMA requires a minimum of two directors for regulated mutual funds that are companies (or two managers for LLCs), and requires a minimum of two natural persons to be named in respect of a general partner or corporate director of a regulated mutual fund. The DRLA applies to all directors of Cayman regulated mutual funds (and certain vehicles carrying on securities investment business) and requires the directors of such entities to be registered with or licensed by CIMA.

[3] As noted above, CIMA acknowledges that Operators may be closely associated with the Regulated Fund and/or its investment manager or advisor; but nonetheless expects all Operators to exercise independent judgement and objectivity in their relevant decision making.

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