

CIMA rules on calculation of asset values for regulated mutual funds and registered private funds

GUIDE

Last reviewed: February 2023

Introduction

In July 2020, the Cayman Islands Monetary Authority (**CIMA**) issued rules on calculation of asset values for both regulated mutual funds and registered private funds. The key premise of both sets of rules is that a fund must establish, implement and maintain a NAV calculation policy that ensures a fund's NAV is fair, complete, neutral, verifiable and free from material error. The rules for registered private funds include a further requirement that the fund's NAV be reliable.

A brief summary of both rules is set out below.

Summary of the rules

Rule on Calculation of Asset Values - Regulated Mutual Funds

The NAV calculation policy must:

- be written and disclosed in the fund's offering document;
- describe the fund's practical and workable pricing and valuation policies, practices and procedures;
- require regular calculation of the fund's NAV (at least quarterly);
- state when NAV will be calculated, how it will be used and when and how it will be published;
- state the accounting principles or reporting standards that will be followed, which must be:
 - based on the International Financial Reporting Standards or generally accepted accounting principles of the USA, Japan, Switzerland or a non-high risk jurisdiction; and
 - consistent with the accounting principles or reporting standards used in the fund's audited financial statements;
- define the role and responsibilities of the fund's service providers in the valuation process;
- identify the price sources for each instrument type and a practical escalation of resolution procedure for the management of exceptions;
- incorporate internal controls that are appropriate to the size, complexity and nature of the fund's operations; and
- subject to the requirements of accounting principles, require the fund to value the securities within its portfolio(s) by giving priority to unadjusted market prices.

Hard-to-value securities

In the case of hard-to-value securities¹, priority should be given to valuation inputs that are directly observable (i.e. derived from market data, including publicly available information about events and transactions or reflective of assumptions that market participants would use). The lowest priority should be given to inputs where market data is not available (i.e. regarding the assumptions that market participants would use).

Pricing models

A fund may use pricing models to determine a fair value² for hard-to-value securities. To the extent appropriate to address the risk of material error, a fund should calibrate pricing models by verifying the inputs used and testing whether the pricing model reflects current market conditions (e.g. by applying the model and inputs to a similar instrument for which pricing information is available).

When applying a pricing model, a fund should take into account all information which is reasonably available at the NAV calculation date that would be considered by a market participant in the application of its pricing model but need not undertake exhaustive efforts to obtain that information.

A fund must require the relevant service provider to apply the NAV calculation policy and any pricing models consistently unless there is satisfactory reason not to do so. Any deviations must be disclosed in the fund's marketing material. Where they have an effect on the reported NAV, they must be immediately disclosed to the fund's investors and agreed by the operator(s) in advance of the determination or production of the NAV.

Service provider charged with NAV preparation

The NAV must be calculated by a competent service provider that is independent of the fund's investment manager (or advisor) and operators, and has the capability to value the portfolio of the fund and adhere to the NAV calculation policy. Where the NAV is not calculated by an independent service provider, CIMA may require the fund to have its valuations verified by an auditor or independent third party.

The NAV must be communicated directly to the fund's investors by the service provider, including each particular investor's share of the balance or NAV per unit.

A fund's investment manager or operators may calculate or assist in the calculation of the fund's NAV only if this fact is explicitly detailed in the fund's offering document, together with an explanation why another service provider could not calculate the fund's NAV. This requirement does not prevent the involvement of the operators in the NAV calculation where the involvement is:

- necessary to comply with:
 - the requirement for the NAV to be communicated directly to investors;
 - any fiduciary, legal or regulatory obligations;
 - their responsibility for the fund's audited financial statements;
- due to a failure by the service provider to comply with the NAV calculation Policy; or
- is determined to be in the best interests of the investors.

Where prices are provided or sourced by the investment manager or operators:

- the manager or operator must also provide any supporting information that is used to determine the prices; and
- the service provider calculating the NAV, must take steps that are reasonable and proportionate to the risk of material error or bias to verify the facts on which the prices are determined and the appropriateness of the provided price to the extent reasonably possible.

¹ 'Hard-to-value securities' are assets or liabilities for which there is no market price meaning fair value must be measured in accordance with the rules.

² 'Fair Value' here means the price that would be received for the sale of an investment in an orderly transaction between market participants in the principal market or in its absence, the most advantageous market for the asset.

Offering document

In addition to any disclosures above, a fund's offering document must explicitly describe the inherent limitations of the NAV calculation policy, any material involvement by the fund's investment manager in the pricing of the fund's portfolio, or otherwise in the calculation, determination or production of the NAV and any conflicts of interest caused by such involvement. A fund's offering documents must explicitly disclose any conflicts of interest caused by such involvement of the fund's investment manager in the determination of the NAV, taking into consideration the pricing of hard to value securities.

Review and approval

The fund's operators have ultimate responsibility for oversight of the entire valuation process and must approve and review, at least annually, the NAV calculation policy and any pricing models.

Rule on Calculation of Net Asset Values - Registered Private Funds

The NAV calculation policy must:

- be written and disclosed in the fund's constitutional documents, marketing materials or other form of investor communication typically used by the fund;
- describe the fund's practical and workable pricing and valuation policies, practices and procedures;
- require regular valuing of assets (at least annually);
- state the value of assets, how it will be used and when and how it will be published;
- state the accounting principles or reporting standards that will be followed, which must be:
 - calculated in accordance with the International Financial Reporting Standards or generally accepted accounting principles of the USA, Japan, Switzerland or a non-high risk jurisdiction; and
 - consistent with the accounting principles or reporting standards used in the fund's audited financial statements;
- define the role and responsibilities of the person appointed to perform the valuation process;
- identify the price sources for each investment type and a practical escalation of resolution procedure for the management of exceptions; and
- incorporate internal controls that are appropriate to the size, complexity, and nature of the fund's operations.

Fair value

Unless otherwise required by the financial reporting frameworks, the NAV calculation policy must require the fund to value the investments within its portfolio(s) using fair value³. In estimating the fair value for an investment, the fund should apply techniques that are appropriate considering the nature, facts and circumstances of the investment.

Pricing models

A fund may use pricing models to determine a fair value for hard-to-value assets⁴. To the extent appropriate to address the risk of material error, a fund should calibrate pricing models, by verifying the inputs used in the pricing model and testing whether the pricing model reflects current market conditions (e.g. by applying the model and inputs to a similar instrument for which pricing information is available).

Any pricing models must be capable of practical implementation by the person appointed by the fund to perform valuations of its assets.

³ 'Fair Value' here means the price that would be received for the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

⁴ 'Hard-to-Value Assets' means investments for which there is no active market price for identical assets or liabilities that the fund can access at the NAV calculation date.

Person appointed to perform valuations of assets

A fund must require the person appointed to perform valuations of its assets to apply the NAV calculation policy, unless there is satisfactory reason not to do so. Deviations from the NAV calculation policy must be disclosed in the fund's marketing materials. Where they are likely to have an effect on the reported NAV, they must be disclosed to the fund's investors and agreed by the operator(s) in advance of the determination or production of the NAV.

Constitutional documents or marketing materials

In addition to any required disclosure above, a fund's constitutional documents or marketing materials or other form of investor communication must explicitly describe the inherent or potential limitations and conflicts of the NAV calculation policy, and any material involvement by the fund's investment manager (or advisor) in the pricing of the fund's portfolio, or otherwise in the calculation, determination or production of the NAV and any conflicts of interest caused by such involvement.

Communication to investors

The NAV shall be communicated directly to the investors (as recorded on the official register of the entity), including to each particular investor their share of the balance or NAV per unit, by the service provider. Reports must be addressed directly to the fund's investors.

Review and approval

The fund's operator(s) have ultimate responsibility for oversight of the entire net asset valuation process, and must approve, and review at least annually, the NAV calculation policy and any pricing models.

AIVs

The rules on calculation of net asset values for registered private funds do not apply to alternative investment vehicles.

Contacts

A full list of contacts specialising in investment funds law can be found [here](#).