

CIMA rules on segregation of assets for mutual funds and private funds

Last reviewed: February 2023

Background

The key premise behind the rules on the segregation of assets for regulated mutual funds and registered private funds issued by the Cayman Islands Monetary Authority's (CIMA) is that all financial assets and liabilities of a fund must be segregated and accounted for separately from any assets of any of its service providers.

When the rules were first issued in late May 2020, there was some concern that they did not reflect the day-to-day operation of the prime brokerage/custody arrangements seen in the alternative funds industry. The rules were subsequently amended in July 2020 to clarify that neither rule prohibits prime brokerage/custody arrangements that allow, in accordance with established and accepted industry practice, a custodian/sub-custodian to hold all client assets in a commingled client omnibus account along with the assets of other clients.

In September 2020, CIMA made a further amendment to both rules to make clear that the transfer and reuse of assets as consented to by a fund does not constitute the financing of a service provider's or a custodian's own operations, provided that a description of these arrangements entered into with any service provider or custodian is disclosed in the offering document or otherwise disclosed to investors before they invest, and that any material changes thereto are also disclosed to investors. This clarification was of critical importance in the context of prime brokerage arrangements for hedge funds. Full details are set out in the summary of each rule below.

Summary of the rules

Rule on Segregation of Assets - Regulated Mutual Funds

A fund must appoint a service provider (which includes an administrator, auditor, custodian, investment advisor, investment manager, operator, prime broker, promoter or registrar or any of their delegates) to ensure safekeeping of the fund's financial assets and liabilities (or **portfolio**), which must be segregated and accounted for separately from any assets of the service provider. The fund must ensure that any service provider holding or managing the portfolio also complies with this requirement. Ultimately, a fund must ensure that none of its service providers use the portfolio to finance their own or any other operations in any way.

The rules provide for the following exemptions which will not constitute the financing of the service provider's own operations:

- remitting redemption or distribution proceeds being paid on behalf of the fund to the relevant investors;
- paying fees, charges and expenses that are payable by an investor in connection with the purchase, conversion, holding, transfer or redemption of equity interests of the fund;

- acquiring or disposing of assets for investment purposes in accordance with the fund's constitutive documents and offering document;
- paying fees, charges, expenses and taxes that are properly payable by the fund and as disclosed in and in accordance with the fund's constitutive documents or the offering document or as otherwise disclosed to investors; or
- transfer and reuse of assets as consented to by or on behalf of the fund, provided that a description of the arrangements entered into with any service provider allowing for the possibility of transfer and reuse (and the maximum permitted level of transfer and reuse) is disclosed in the offering document or otherwise disclosed to investors before they invest, and that any material changes thereto are also disclosed to investors.

The operators of a fund must:

- establish, implement, and maintain (or oversee the establishment, implementation, and maintenance of) strategies, policies, controls and procedures to ensure compliance with the rules, consistent with the fund's offering document and appropriate for the size, complexity, and nature of the fund's activities and investors; and
- ensure that verification, based on information provided by the fund and available external information, that the fund holds title to fund assets and maintenance of a record of those fund assets, is carried out by:
 - an administrator or other independent third party; or
 - the manager, operator or person who has a control relationship with the manager or operator, provided that such function is carried out independently from the portfolio management function or that potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the fund.

Rule on Segregation of Assets – Registered Private Funds

A fund's portfolio must be segregated and accounted for separately from any assets of the manager, operator(s) or any custodian. The obligation is on the fund to ensure any manager, operator(s) or any custodian complies. The fund must ensure that no manager, operator(s) or custodian uses the portfolio to finance its own or any other operations.

As above, the rules provide for the following exemptions which will not constitute the financing of the manager's, operator's or custodian's own operations:

- remitting to the relevant investors, redemption, withdrawal or distribution proceeds being paid on behalf of the fund;
- paying fees, charges and expenses that are payable by an investor in connection with the purchase, conversion, holding, transfer, withdrawal or redemption of investment interests of the fund;
- acquiring or disposing of assets for investment purposes in accordance with the fund's constitutive documents and marketing materials;
- paying fees, charges, expenses and taxes that are properly payable by the fund and as disclosed in and in accordance with the fund's constitutive documents or marketing materials or as otherwise disclosed to investors; or
- transfer and reuse of assets as consented to by or on behalf of the fund, provided that a description of the arrangements entered into with any custodian allowing for the possibility of transfer and reuse (and the maximum permitted level of transfer and reuse) is disclosed in the offering documents or otherwise disclosed to investors before they invest, and that any material changes thereto are also disclosed to investors.

The operator(s) of a fund must establish, implement, and maintain, (or oversee the establishment, implementation, and maintenance of) strategies, policies, controls, and procedures to ensure compliance with the rules, consistent with the fund's marketing materials and appropriate for the size, complexity, and nature of the fund's activities and investors.

Considerations for private funds

The vast majority of private funds will not have appointed a custodian as pursuant to section 17(3) of the Private Funds Act (as amended), a private fund is not required to appoint a custodian if it has notified CIMA that it is neither practical nor proportionate to do so, having regard to the nature of the private fund and the type of assets it holds. Where this is case, the obligations on the fund in relation to custodians will not be relevant.

Contacts

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