



**SUMMARY OF PRIVATE SECTOR CONSULTATION AND FEEDBACK STATEMENT**

**Rule on Calculation of Asset Values – Registered Private Funds**

<b>Rule</b>	<b>Comments from the Private Sector</b>	<b>Authority’s Response</b>	<b>Consequent Amendments to the Proposed Measure</b>
<b>GENERAL COMMENTS</b>			
	<p>The draft PFL Rules on calculation of NAV assume that a PF operates in a similar manner to an MF. PFs do not calculate NAV, neither is there any reason for them to do so. It is true that PFs are required by the terms of the PFL to value each of their assets (as they routinely do), and to have in place a valuation policy that is disclosed to investors (as is, again, routine). But that is some way removed from a determination of NAV. Publishing a specific set of rules for the calculation by a PF of its NAV would be entirely meaningless, and we would suggest that you to withdraw that paper in its entirety. In the exercise of its authority under Section 34 of the MAL it is critical that CIMA demonstrate an understanding of the products that you are seeking to regulate.</p>	<p>The principal components of the PFL and the MFL and the related rules were shaped by the EU’s criteria.</p> <p>The proposed Rules on the Segregation of Assets and Calculation of Asset Values for regulated mutual funds and registered private funds have been reviewed by and have largely received a positive assessment by the EU Commission.</p>	<p>No changes.</p>
	<p>An important benefit of the Cayman approach, as set out in the PFL, is that it does not prescribe the terms of the valuation policy required to be adopted. That sets us apart from jurisdictions such as Luxembourg, where compliance with the valuation rules imposed by the Lux authorities is a significant and material administrative and financial burden.</p>	<p>Under Section 34(1) of the Monetary Authority Law (2020 Revision), CIMA may issue rules concerning the conduct of licensees and their officers and employees, and</p>	<p>No changes.</p>

<p>The PFL prescribes the requirement for disclosure in relation to valuation in a way that is clear and unambiguous. The draft PFL Rules published by CIMA are anything but clear and unambiguous. Moreover, they materially overreach the provisions of the PFL. Again, we urge you reconsider whether they are necessary.</p>	<p>any other persons to whom and to the extent that the regulatory laws may apply, in this case the Private Funds Law, 2020. Again, the requirements to value funds fairly and consistently is a most basic requirement of prudential regulation and accounting principles. In light of this, the Authority is not of the view that the Rules overreach the provisions of the PFL.</p>	
<p>It is critical that the New Valuation Rule appear to the industry to be, and are, consistent with the existing internationally accepted accounting and auditing practices in the closed-ended funds space. We suggest that CIMA have one of the on-Island accounting/audit firms that have been performing private equity fund accounting and audit on Island for some time (such as KPMG) go through these rules in detail to ensure that they accord with industry best practice and do not inadvertently cut across the existing rules and procedures applicable to fund managers in the sector, who in the majority of cases are already subject to SEC regulation. In similar vein, the disclosure required around valuation should be appropriate, and that required for existing funds launched by SEC regulated managers in the private equity space would probably provide a useful guide. As noted elsewhere in these responses, private funds do not typically calculate net asset values and the rule should be updated accordingly.</p>	<p>The Authority has consulted with all of the parties outlined in the Monetary Authority Law, of which the Cayman Island Institute of Professional Accountants is one.</p>	<p>No changes.</p>

<p>As we and others have already indicated, the valuation rules for private funds may be problematic. Non-marketable securities are often valued at fair market value as determined by the general partner in good faith or in accordance with the manager's valuation policies but in accordance with the terms of the limited partnership agreement. Generally, value is immaterial until after the investment period when there is a step down in the management fee or a distribution of marketable securities during the term. We have come across a few fund vehicles which are not audited, in some cases because they are investing in pre revenue companies (mainly seed stage VC funds).</p>	<p>The Authority requires valuations to be in line with international accounting standards as outlined in the PFL and in the Rule.</p>	<p>No changes.</p>	
<p>If CIMA insists on publishing a Rule on valuation, then we would suggest that we start from scratch to produce a Rule that reflects an understanding of the PF industry accurately reflects best market practice.</p>	<p>As part of its overview of industry, the Authority amends its rules and guidance from time to time.</p>	<p>No changes.</p>	
<p>As a general comment and something we should check with the Auditors, Appendix D refers to calculating NAVs that must use Fair Value, IFRS and GAAP. We know of some very large clients who use Cost as a basis for marking some of their securities in their book. Cost would not be Fair Value as defined in Appendix D and would most likely be a departure from IFRS and GAAP. Cost has historically been used for valid reasons - where there is no real market for the asset - and as the fund is closed ended and the manager only gets paid when he sells the asset, there is no negative impact to the investors. Should these definitions be looked at to take this into account in Appendix D?</p>	<p>The Authority requires valuations to be in line with international accounting standards as outlined in the PFL and in the Rule.</p>	<p>No changes.</p>	
<p><b>SECTION-SPECIFIC COMMENTS</b></p>			
<p><b>1.1 Statutory Authority</b></p>	<p><b><u>Typographical error noted by industry:</u></b>  These Rules are issued pursuant to section 34 of the Monetary Authority Law (<del>2018</del>2020 Revision) ("MAL"), .....</p>	<p>Typographical error is noted for amendment.</p>	<p>Amended.</p>
<p><b>3 Scope</b></p>	<p><b><u>Industry commented:</u></b>  Since the New Valuation Rule applies to all existing private funds, please include a provision in Section 3 of Appendix D giving existing private</p>	<p>Please refer to section 2 of the Private Funds (Savings and Transitional Provisions) Regulations, 2020.</p>	<p>No changes.</p>

	<p>funds time to comply with the New Valuation Rule.</p> <p>The 2008 Rule relating to Calculation of Asset Values - Licenced Funds (the "<b>2008 Valuation Rule</b>") appears to grant some sort of transition period to funds existing at the time the 2008 Valuation Rule came into force. In light of the ability of CIMA to enforce breaches of the New Valuation Rule, and because compliance with the New Valuation Rule might require changes in certain operations of a fund, a transition period is critical.</p>		
<p><b>4.2</b> NAV (Net Asset Value) means the value of a Fund's total assets (including accrued interest, dividends and other receivables), minus the value of the Fund's total liabilities (including accrued expenses (including fees) and other payables).</p>	<p><b>Industry commented:</b> Perhaps add clarification for those reporting under IFRS for cases when the puttable shares are classified as liability instruments. IAS 32 gives an example of how to present net assets in that case so perhaps add a "or calculated as otherwise indicated by the applicable GAAP"?</p>	<p>The Authority is not of the view that this amendment is needed as rule 5.2 covers this.</p>	<p>No changes.</p>
<p><b>4.4</b> Fair Value 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</p>	<p><b>Industry commented:</b> Liabilities are not covered - should also have to transfer a liability not only received to sell an investment. Although rarer for PE funds than HF to have short positions, they still do. <b>Suggested wording:</b> Fair Value means the price that would be received for the sale of an <del>investment</del> <u>asset or paid to transfer a liability</u> in an orderly transaction between market participants <u>at the measurement date, in the principal market</u></p>	<p>The Authority accepts the proposed wording.</p>	<p>Amended</p>

	<del>or in its absence, the most advantageous market for the asset.</del>		
<p><b>4.5</b></p> <p>Hard-to-Value Assets or Holdings means investments for which there are no readily available market values to be transacted between knowledgeable and willing parties in an arm's length transaction, or with no registered turnover in the prior 30 days, and may include illiquid holdings, fixed-income securities, restricted securities, derivatives, private operating companies and special purpose vehicles.</p>	<p><b>Industry commented:</b></p> <p>To define in such a way as to represent the population of investments that do not have market determined prices and be consistent with the requirements in 5.2 in the application of 5.7.</p> <p><i>Is this intended to catch all lvl 2 and 3? Or simply the lvl 3 positions? As it is worded it will include the lvl 2 ones as well.</i></p> <p>Suggested Edit: Hard-to-Value Assets means an investment for which there is no active market price for identical assets or liabilities that the fund can access at the NAV calculation date.</p>	<p>The Authority adopts:</p> <p>Hard-to-Value Assets means an investment for which there is no active market price for identical assets or liabilities that the fund can access at the NAV calculation date.</p>	<p>Amended</p>
<p><b>5.1</b></p> <p>A Fund must establish, implement, and maintain a NAV Calculation Policy that ensures a Fund's NAV is fair, reliable, of high quality, and verifiable.</p>	<p><b>Industry commented:</b></p> <p>Fair, reliable, of high quality, and verifiable are rather subjective.</p> <p>This will be likely to raise comments from clients as many of the valuations are going to have unobservable inputs and assumptions.</p>	<p>This language is consistent with international accounting standards with which funds are required to comply.</p>	<p>Amended.</p>

	<p><b>Industry commented:</b></p> <p>Please delete the words 'of high quality' from Rule 5.1 of Appendix D - <a href="#">A Fund must establish, implement, and maintain a NAV Calculation Policy that ensures a Fund's NAV is fair, reliable, of high quality, and verifiable.</a></p> <p>This language appears to be very subjective. We recommend deleting same.</p>	<p>The Authority accepts the recommended revision.</p>	<p>Amended.</p>
	<p><b>Typographical error noted by industry:</b></p> <p>Please include a space between Rule 5.1 and 5.2 (typographical error).</p>	<p>Typographical error is noted.</p>	<p>Amended.</p>
<p><b>5.2</b></p> <p>The NAV Calculation Policy shall be based on the International Financial Reporting Standards, or generally accepted accounting principles of the United States of America, Japan or Switzerland</p>	<p><b>Industry commented:</b></p> <p>Regarding accounting standards being US GAAP, IFRS, Japan or Switzerland – Missing "...or a non-high-risk jurisdiction." To agree back to the PFL</p>	<p>Comment has been noted.</p>	<p>The term "or non-high- risk jurisdiction" has been added to paragraph 5.2.</p>
	<p><b>Industry commented:</b></p> <p>Rule 5.2 should be expanded to refer to other non-high-risk jurisdictions.</p> <p>Please see our comment above at <b>Row 4</b> (relating to valuations on a basis other than Fair Value) which also applies to Rule 5.2 ('<a href="#">The NAV Calculation Policy shall be calculated in accordance with the International Financial Reporting Standards, or generally accepted accounting principles of the United States of America, Japan or Switzerland</a>').</p>	<p>See comment in box directly above.</p>	<p>See comment box directly above.</p>

<p><b>5.3</b> The methodology used to perform the NAV calculation must be consistent with the accounting principles or reporting standards used to prepare the Fund's audited financial statements.</p>	<p><b>Industry commented:</b> It seems that valuation standards ought to be included such as those promulgated by the International Valuation Standards Council.</p> <p>We recommend speaking with the Auditors to clarify whether the methodology used to perform the NAV calculation can always be consistent with the accounting principles or reporting standards used to prepare the fund's audited financial statements. We understand that some GAAP/IFRS treatments may differ from the NAV calculation treatment (e.g. amortization of set up costs), however this may be more relevant to hedge funds.</p>	<p>The Authority is satisfied that Rule 5.3 is sufficient.</p> <p>The Authority consulted with all the required private sector associations listed in the Monetary Authority Law, including CIIPA.</p>	<p>No changes.</p> <p>No changes.</p>
<p><b>5</b> <b>5.4.2</b> describe the Fund's practical and workable pricing and valuation policies, practices, and procedures.</p>	<p><b>Industry commented:</b> Some clarity will be needed in terms of the level of detail needed to be included especially regarding the practices and procedures.</p>	<p>The Authority will develop further guidance as needed.</p>	<p>No changes.</p>
<p><b>5.4.3 and 5.4.4</b> The NAV Calculation Policy must:  5.4.3 require the calculation of the Fund's NAV regularly, at least annually;  5.4.4 state when NAV will be calculated, how it will be used, and when and how it will be published;</p>	<p><b>Industry commented:</b> We recommend updating Rules 5.4.3 and 5.4.4 to reflect the nature of a private fund. For example, instead of 'calculating NAV' it may be more appropriate to refer to 'valuing assets'.</p>	<p>The Authority accepts the rrecommended revisions.</p>	<p>Amended.</p>

<p><b>5.4.7</b></p> <p>Identify the price sources for each investment type and a practical escalation of resolution procedure for the management of exceptions.</p>	<p><b>Industry commented:</b></p> <p>Rule 5.4.7 of Appendix D provides that the NAV Calculation Policy must '<a href="#">identify the price sources for each investment type and a practical escalation of resolution procedure for the management of exceptions</a>'. Please confirm whether it is expected that the NAV Calculation Policy break out an exhaustive list of each instrument type and the source line by line? A lot of listed/marketable securities may use different price providers depending on the security in question. For closed ended funds with real assets, there may be no price source available and given that they would make up the majority of the fund's book they would not be exceptions. Would it be sufficient/permissible to list the fund's investment manager as the price source in this instance?</p>	<p>The Policy should outline the sources for pricing and a process for escalation to management for exceptions, with sufficient documentation and details maintained for verification by the Authority if necessary.</p>	<p>No changes.</p>
<p><b>5.4.8</b></p> <p>Incorporate internal controls that are appropriate to the size, complexity, and nature of the Fund's operations.</p>	<p><b>Industry commented:</b></p> <p>Would the internal controls need to be described in the offering documents? This could be extensive.</p>	<p>The internal controls should be described in the offering documents.</p>	<p>No changes.</p>



<p><b>5.5</b></p> <p>Other than for Hard-To-Value Securities, the NAV Calculation Policy must require the Fund to value the securities within its portfolio(s) using Market Prices.</p>	<p><b>Industry commented:</b></p> <p>This requirement conflicts with the requirements of 5.2 and 5.3, for example in the application of the IFRS 9 business model requirements for instruments where the instrument is held to collect contractual cash flows of interest and principal and as such is required to be measured at amortised cost less expected credit loss.</p> <p><b>Suggested wording:</b>  <i>Unless otherwise required by the financial reporting frameworks set out in 5.3, the NAV Calculation Policy must require the Fund to value the investments within its portfolio(s) using Fair Value.</i></p>	<p>The Authority agrees with the proposed wording.</p>	<p>Amended.</p>
	<p>Please see our comment above at <b>Row 4</b> (relating to valuations on a basis other than Fair Value) which also applies to Rule 5.5 ('<a href="#">The NAV Calculation Policy must require the Fund to value the investments within its portfolio(s) using Fair Value</a>').</p>	<p>See comment directly above.</p>	<p>See comment directly above.</p>

<p><b>5.7.1</b></p> <p>A Fund may use Pricing Models to determine a Fair Value for Hard-to-Value Assets.</p> <p>A Fund must justify and identify any weaknesses in Pricing Models, by back-testing in normal market conditions</p>	<p><b>Industry commented:</b></p> <p>We recommend the deletion of Rule 5.7.1 of Appendix D.</p> <p>Rule 5.7 / 5.7.2 provides that a Fund may use Pricing Models to determine a Fair Value for Hard-to-Value Assets. A Fund must justify and identify any weaknesses in Pricing Models, by back-testing in normal market conditions.</p> <p>In practice we do not believe that fund's are typically undertaking back-testing. Where a fund holds real assets, back-testing may not be meaningful where there have been no transactions on the asset.</p> <p>Back testing sounds good and is recommend often. However, it is difficult to carry out and can be rather expensive if outsourced.</p>	<p>The Authority is not of the view that Rule 5.7.1 should be deleted, but has amended the Rule to reflect the following:</p> <p>"A Fund must, to the extent appropriate to address the risk of material error, calibrate Pricing Models, by verifying the inputs used in the Pricing Model and testing whether the Pricing Model reflects current market conditions, for example, by applying the model and inputs to a similar instrument for which pricing information is available or other appropriate means"</p>	<p>Amended.</p>
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<p><b>5.7.2</b> Models to determine a Fair Value for Hard-to-Value Assets.</p> <p>Any Pricing Models must be capable of practical implementation by the Section 16 Person.</p>	<p><b>Industry commented:</b></p> <p>Rule 5.7 / 5.7.2 provides that a <a href="#">Fund may use Pricing Models to determine a Fair Value for Hard-to-Value Assets. Any Pricing Models must be capable of practical implementation by the Section 16 Person.</a> Assuming the Section 16 Person is the Investment Manager, then one would hope this would make sense. If an Administrator was to be appointed as the Section 16 Person, then the Administrator would “implement” the pricing model of the fund. This is neither the practice at present nor is it desirable. Depending on the complexity of the pricing model an Administrator would either check the model for reasonableness or may rely on it in its entirety if its been approved by some authority – perhaps the Board of Directors or the valuation committee. On this basis, Administrators will likely be unwilling to be responsible under Section 16 for valuation.</p>	<p>The use of pricing models is optional.</p>	<p>No changes.</p>
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<p><b>5.8</b></p> <p>Subject to Rule 5.8, the NAV of a Fund must be calculated by a Service Provider that is independent of the Fund's investment manager / advisor and Operators, competent, and able to adhere to the NAV Calculation Policy and any relevant Pricing Models.</p>	<p><b>Industry commented:</b></p> <p>The rule should be framed as a requirement to apply the policy rather than a set of 'procedures'.</p> <p>Deviations are likely to be determined based on the specific circumstances long after the investor's subscription and consideration of any Marketing Materials. As such a specific notification requirement would be retrospective.</p> <p>It may also be appropriate to give consideration to aligning this with the requirements with 5.7 of the rules applicable to regulated mutual funds.</p> <p><b>Suggested edits:</b>  <i>The Fund must require the Section 16 Person to apply the Fund's <u>NAV calculation policy procedures for valuation of its assets consistently</u>; unless there is satisfactory reason not to do so, <del>in the potential for which</del> <u>ease-such deviations must be disclosed in the Fund's Marketing Materials, where they are likely to have a significant effect on the reported NAV, they must be disclosed in to the Fund's investors,</u> and agreed by the Operator(s) in advance of the determination or production of the NAV.</i></p>	<p>The Authority agrees with the proposed revision.</p>	<p>The Authority has amended Rule 5.8 to read:</p> <p>"The Fund must require the Section 16 Person to apply the Fund's 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".</p>
	<p>Please include our proposed additional language in Rule 5.8 of Appendix D.</p> <p>The Fund must require the Section 16 Person to apply the Fund's procedures for valuation of its assets consistently; unless there is satisfactory reason not to do so, in which case such deviations must be disclosed in the Fund's marketing materials <b>or the NAV Calculation Policy</b> and</p>	<p>See comment directly above.</p>	<p>See comment directly above.</p>

	agreed by the Operator(s) in advance of the determination or production of the NAV.		
	<p><b>Industry commented:</b></p> <p>We recommend considering whether it would be appropriate to include a level of discretion in Rule 5.8 of Appendix D to cover unforeseen circumstances that may arise and affect the calculation of the fund's NAV.</p>	<p>The Authority is of the view that including a level of discretion in the Rule may introduce a level of granularity not envisioned by this Rule, as a list of circumstances would be specific to the particular situations and would not be exhaustive. The procedures supporting this Rule that will be implemented by the fund could cover this.</p>	<p>No changes.</p>
	<p>It may not be feasible to require that the Operators have agreed all potential derivations from the application of the fund's NAV Calculation Policy and any Pricing Models <b>in advance</b> of the determination or production of the NAV (e.g. when unforeseen circumstances arise).</p>	<p>The operators are expected to implement a reasonable and appropriate process specific to the nature and extent of their circumstances, to enable them to make decisions around any deviation.</p>	<p>No changes.</p>
<p><b>5.9</b></p> <p>A Fund's constitutional documents or Marketing Materials or other form of Investor communication typically used by the Fund must explicitly describe the potential limitations and conflicts</p>	<p><b>Industry commented:</b></p> <p>5.11. It is unclear what would constitute a conflict of the NAV calculation policy.</p> <p>Suggested revisions:</p> <p>In addition to any disclosure required by Rule 5.8, a Fund's offering document must explicitly describe the inherent limitations</p>	<p>The Authority notes the recommended revision.</p>	<p>The Authority has amended Rule 5.9 to read:</p> <p>"In addition to any disclosure required by Rule 5.8, a Fund's constitutional documents or Marketing Materials or other form of Investor</p>

of the NAV Calculation Policy, and any material involvement by the Fund's Manager, advisor or Operator(s) in the pricing of the Fund's portfolio, or otherwise in the calculation, determination or production of the NAV	potential limitations and conflicts of the NAV Calculation Policy, and any material involvement by the Fund's investment manager / 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 must explicitly describe the inherent limitations, potential limitations and conflicts of the NAV Calculation Policy, and any material involvement by the Fund's investment manager / 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".
	Comment: 5.8 states "subject to Rule 5.8" this reference may not be correct. 5.11 says "In addition to any disclosure required by Rule 5.8..." there don't appear to be disclosure requirements in 5.8.	See comment directly above.	No changes.
5.10  NAV reports must be addressed directly to the Fund's Investors.	Please include our proposed additional language in Rule 5.10 of Appendix D.  NAV reports must be addressed directly to the Fund's investors (or the authorised agent of such investor).	The Authority has amended Rule 5.10 to read:  "The NAV of the Fund 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 charged in 5.8 with the NAV Calculation. reports must be addressed directly to the Fund's investors"	Amended.
	As per non-private 5.12  <b>Industry Commented:</b>	The Authority accepts the revision.	Amended.

	<p>It is unclear as to what constitutes the NAV report and thus the objective, purpose and investor benefit derived from this rule. Further addressing of the communication does not correspond to a delivery requirement.</p> <p>Suggested revisions: The NAV of the Fund 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 charged in 5.8 with the NAV Calculation. reports must be addressed directly to the Fund's investors.</p>		
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