



Opalesque Round Table Series '13 CAYMAN

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Editor's Note

Dear Reader,

The success of the Cayman fund regulations are based on the innovation, creativity and forethought of the local legal and structuring talents more than a decade ago. Very quickly, the Cayman hedge fund has become the default model for an entire industry, and investment managers as well as investors have been attracted by the jurisdiction because of its efficiency. By a significant margin, Cayman remains the leading hedge fund jurisdiction selected by existing and new launch managers.

Jurisdictions should compete, but in a fair and equitable manner

Looking at the total of global invested assets, the hedge fund industry is only just about 1% of the \$300 tln in financial investments. That means there is a huge potential for more business in the alternative investment space, and of course all jurisdictions will want to do whatever they can to make it attractive for funds to domicile in their jurisdictions or assets to flow through them. However in some countries, political pressure has been put onto local investors to move assets to certain places that are *perceived* as better regulated jurisdictions even though the product is essentially the same structure and regulatory model as the Cayman product. While competition is healthy and jurisdictions should compete, this should happen in a fair and equitable manner and not through inappropriate protective legislation that mandates one jurisdiction over another.

Improved Governance

The trend to increased regulation has changed how investment managers, along with their independent board, are operating. Today, *board members are required to know a lot more about the laws and regulations where the fund manager is based, jurisdictions where they invest and jurisdictions where they raise capital*. As a consequence, independent fund directors face a lot more scrutiny and pressure. But, most industry experts agree that corporate governance and board composition has measurably improved, for example by including more directors with an actual investment management background or from different geographies.

The Roundtable took place on December 12th 2012 at Walker's Georgetown office with:

- Ingrid Pierce, **Managing Partner, Walkers**
- Gary Linford, **Managing Director, HighWater**
- Darren Stainrod, **Managing Director, UBS Fund Services (Cayman Islands)**

and offers interesting insights about:

- **Why has Cayman become the number one hedge fund jurisdiction?**
- **Why must the Cayman regulator now walk a tightrope?**
- **Can Cayman remain competitive going forward?**
- **Considerations regarding board composition: What defines a good board? What defines a good director?**
- **What are some of the newer best practices in corporate governance?**
- **How should a hedge fund manager manage conflicts when he is also a board member?**
- **The “regulatory boiling point”: how can an investment manager deal with delivering 250 regulatory reports per year?**
- **Why has the number of Cayman registered hedge funds surged in 2012? What is the outlook?**

Enjoy the read!

Matthias Knab
Director Opalesque Ltd.
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Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Gary Linford, Ingrid Pierce, Darren Stainrod

Introduction

Ingrid Pierce
Walkers

My name is Ingrid Pierce, I am the managing partner of Walkers. I am based in the Cayman Islands which is the headquarters for our law firm. We have eight offices around the globe and I lead the Investment Funds Group here. We also have practices in corporate, finance, insolvency and corporate recovery, trusts and general litigation.

Walkers represents the majority of the top 50 hedge fund managers and private equity fund managers worldwide. Our Global Investment Funds practice is one of the largest specialist offshore teams. We provide legal advice on all aspects including fund formation, structural issues, regulation, distressed funds, re-domiciliation, termination and on-going general advice to investment funds and managers. We tailor each hedge fund structure to suit the client's overall objectives and our team has extensive first-hand experience in numerous structures used in the market with in-depth knowledge of the practical and legal consequences as well as the commercial rationale behind them.

Personally I have been advising clients on fiduciary issues for close to 20 years. I joined Walkers in 2002 having previously practised as a barrister in London in the commercial/chancery field.

Gary Linford
HighWater

I am Gary Linford, Founder of HighWater. We are a boutique director services business founded in early 2007. We have 14 staff members in Grand Cayman, of which four provide directorships. We also have Simon Cox in our Hong Kong office, Matt Auriemma in New York and Todd Groome who will be joining HighWater in the new year, all providing directorships.

HighWater's formula is centred on the diverse hedge fund experience at a senior level of all its seven principals. We have varied and complementary skill sets which ensures we add real value both at and between board meetings as well as meet our general oversight obligations.

On the personal front, I came to Cayman for the first time in 1996 before spending a few years away in Europe with Deutsche Bank. I then returned to Cayman in early 2004 to head up the Investment & Securities Division at CIMA as a sort of 'poacher turned gamekeeper'. Despite 24 years of experience in the private sector, it appears my two-and-a-half years with CIMA has marked me as a public sector regulator.

Darren Stainrod
UBS Fund Services

My name is Darren Stainrod and I am the Managing Director of UBS Fund Services in the Cayman Islands. We have 155 people in our Cayman office servicing single manager hedge funds, funds of funds, managed accounts and private equity vehicles. UBS Fund Services also has offices in New York, Toronto, Dublin, Luxembourg, Switzerland, Hong Kong, and Singapore servicing alternative funds. I have been based in Cayman for 21 years the last 17 of which have been with UBS.



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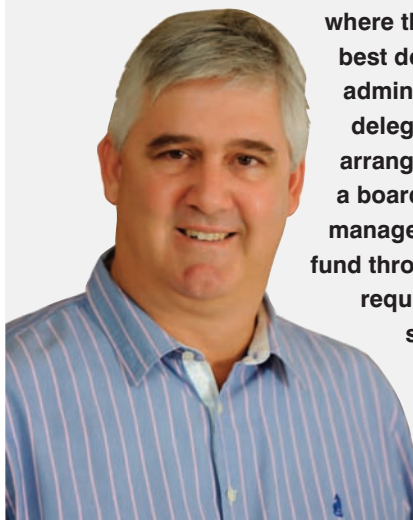


The legal and regulatory environment of alternative investment funds is going through major changes globally. Let's start by discussing how Cayman as the number one hedge fund jurisdiction has been evolving and coping with the global changes.

Gary Linford: One of the biggest impacts within the Cayman Islands from a director's perspective is the increased onshore regulations that we need to deal with today. While these onshore regulations are mostly directed at the investment manager, the board of directors to the Cayman fund cannot close their eyes to their responsibility to ensure the contracted service providers to the Cayman fund are in compliance with all relevant laws and regulations. Whether it's the short-selling rules in Hong Kong, the Alternative Investment Management Directive in Europe, FATCA, CFTC registration, SEC registration or new distributor rules in Switzerland, it comes back to the board of directors of the Cayman fund.

In years past, those that acted as a director of a Cayman-based hedge fund tended to focus on Cayman issues like the statutory filings, the fund audit and ensuring the NAV was calculated appropriately. Today, board members need to

know a lot more about the laws and regulations where the fund manager is based, jurisdictions where they invest and jurisdictions where they raise capital. These issues are complex and best described by way of example – acting as a director to a Cayman fund that is administered by a local fund administrator, let's say Darren at UBS Cayman, who may delegate certain duties and obligations to their Dublin office. This cross border arrangement may have a manager that has an office in both New York and in London and as a board director, we then need to understand the regulatory framework impacting the manager. To compound the jurisdictional complexity we may have investors in our Cayman fund through reputable intermediaries in Switzerland that are subject to local AML and KYC requirements that are in conflict with the laws that UBS Dublin must comply with as the sub-administrator based there. We might have US investors that must comply with specific US State level legislation, so knowing where and when to seek guidance is important. These complexities can obviously be overcome, frequently with the assistance of law firms such as Walkers, but it is evident that board directors require a far more demanding level of understanding than six or seven years ago.



So how in detail have these developments and additional responsibilities changed the way a board member of a Cayman hedge fund operates? In other words, how do you operate now compared with before?

Gary Linford

The operation of a board is definitely impacted by its composition and even more so in this evolving environment - so it is important to ensure the right mix of skills and experience. Before I am appointed to any fund board I want to understand who will form the independent majority with me. Do I know them? Do I have comfort they will act in the best interests of investors and will they put the necessary effort into doing their fair share of the increasing work load that passes to the board of directors? Where there is another professional director, my preference is to work with another HighWater-introduced director with a different skill set to mine but I do accept appointments alongside other individuals from competing director services firms. At HighWater we devote considerable time to assessing individuals who we might need to work alongside to minimize surprises after appointment.

At HighWater we do not accept appointment by Articles alone, we insist upon the execution of our director services agreement that includes certain terms and conditions of appointment, for example the right to appoint our own legal counsel in times of need or the right to appoint specific service

providers such as valuation agents, if necessary. Of course, on most occasions we will have the expertise within our director bench at HighWater and we will be confident in making decisions without further consultation, but we understand the need to seek out specialist advice in this increasingly complex world.

Gary Linford: From a broader perspective, another real concern for Cayman as well as all other hedge fund jurisdictions is the barrier to entry that just gets higher and higher. The \$50m fund that may have been the next Tudor may not launch today, whereas five years ago you could easily launch a fund with \$50m. How will this trend impact Cayman? If you look at the CIMA statistics, I recall approximately 82% of the funds have less than \$250m or something like 60% of the 10,000 funds registered in the Island that have less than \$100m in assets. A critical question for our local industry is whether the number of funds registered with CIMA is going up or down, as the cost and barriers to entry are getting higher and higher. Part of the massive increase in costs are external to the Cayman Islands, but other direct cost increases lie squarely with CIMA and the Cayman Islands Government.

How many of the funds that are now \$50m are we going to have in three years time? Higher incidence of business failure affects the board of directors like all service providers, and can involve the board in a number of tough decisions in a windup.



Ingrid Pierce: The barriers to entry are high and will remain high. Corporate governance has become a bigger issue in the last few years. The industry is keen to portray itself as having high standards and robust governance, but this has come into focus more recently, partly as a result of litigation which sparked a lot of industry dialogue. This is a positive thing because you can see it having a ripple effect throughout the industry as more white papers get produced on the subject and service providers are generally singing the same tune, so to speak.

There is much more scrutiny and pressure on independent fund directors. A few of them have come under some criticism whereas others have managed to shine. As a result certain directors tend to be put forward for board positions on existing funds that have tricky issues precisely because they have relevant experience and someone has seen them in action in a crisis. They can use that experience to add value.

On the whole, governance has greatly improved and the conversation has now escalated to considering whether specific governance rules should be embodied into regulation or statute.



Gary Linford: Cayman fund regulation has historically been really simple but very effective. The core principle is that if a fact is material, it gets disclosed. Historically, CIMA, as the regulator, has not been interested in telling stakeholders what should or should not be disclosed in the PPM. In other words, if it's material enough to the investors to induce them to subscribe or redeem, the disclosure should be made or, as a director, you take responsibility for a misleading PPM.

If there is a question over whether a fact is material, at HighWater we would advise disclosure or obtain guidance from counsel as to whether or not it is indeed material. I love the simplicity of the directors' responsibility without any obligation by CIMA to define 'materiality'. I think the concept of what is material evolves over time. Therefore, why should our Cayman regulator or legislature attempt to define this important concept underpinning our regulatory regime; it is far better to continue to impose the obligation on directors to determine what might be material in the context of their specific fund offering. If investors think the directors got it wrong and want relief, they seek compensation through the courts as they have always done, not through



ill-founded reliance on a regulator which can create moral hazard. Of course, this regulatory philosophy only has application to private funds and would be inappropriate in the retail funds sector with unsophisticated investors which is not where we in Cayman wish to play.

My fear is that we are now going down the road of prescriptive regulation in too many areas that will potentially impact Cayman's effectiveness. Our model has been successful and importing UCITS-style prescriptive regulation for our predominantly sophisticated private fund sector will satisfy other national regulators but add very little regulatory value.

Ingrid's point about the increasing focus on corporate governance is a very important one. But my fear is that CIMA may move us away from the current market-driven approach where the investors in Cayman funds drive meaningful changes to the typical Cayman hedge fund structure, documents, service providers and risk parameters. Sophisticated investors really don't need CIMA to tell them what they need, particularly regarding competence and effectiveness of directors. By all means come out with a Guidance Note on what CIMA believes are the important criteria in assessing directors, but make this guidance not a prescriptive regulation. Regulation of directors will also impose yet another layer of costs to be passed on. Sadly, CIMA is increasingly taking on the role of a revenue raiser for the Cayman Islands Government rather than focusing on their more important mandate, effective regulation.

Ingrid Pierce

Coming back to developments around governance, we have seen law firms and other service providers publishing white papers about what the best practice is or should be. Many of our clients ask very detailed questions about the composition and expected levels of activity of a board when structuring a fund.

More recently there has also been some discussion about having an independent advisory board on a fund that does not otherwise have independent directors. That is another topic on its own, but it shows that independent oversight is being considered, particularly by the larger investors. All these questions revolve about good practice, and there is no "one size fits all".

Darren Stainrod: From a fund administrator's point of view I can certainly echo the above points on corporate governance. There is a lot more demand today for our presence as administrator at the board meetings than ever before. We see the frequency of these meetings trending from annually to quarterly and we are often now requested to present an administrator's report to the board either electronically or by conference call and sometimes even by physically attending the board meetings, especially when they take place in Cayman.



The improvements in best practices on the fund governance side has not been driven by regulation but by the demands and expectations of institutional investors and more recently by some court cases, such as the Weaving case, where the judge took the opportunity to set out what is expected of a director in carrying out his or her fiduciary responsibility. That said, the case related to non-professional directors outside of Cayman. I think the vast majority of independent directors in Cayman are exceptionally good, and are already carrying out the measures of oversight that would be in a code of conduct or best practice.

Matthias Knab

In more detail, what are some of the best practices you are seeing in corporate governance?

Gary Linford: One area that the board needs to define at the outset is an appropriate communication policy by directors with investors. The demands on those responsible for corporate governance oversight is growing. This development partly accounts for the growing interest in an individual director's capacity. It can be as simple as when directors get direct calls from investors on their mobiles – what is the appropriate procedure for responding to such

investor calls, what can or cannot be discussed? The board should formulate policy and procedures on this sensitive issue.

Secondly, directors need to understand, from the outset, where the conflicts of interest lie. Conflicts with service providers, the manager and between investors need to be understood while the fund is operating well, as information flows more easily than when difficulties arise.

Conflicts or preferential treatments that need monitoring include the likes of special consent rights, liquidity rights, transparency rights etc. and are mostly handled through good disclosure. However, this is not always straightforward, particularly where lawyers' boilerplate language is inserted to protect the manager. I am not suggesting working against the manager in challenging some of this boilerplate language but rather forestalling a later rewrite of the PPM or a proliferation of side letters when the more sophisticated investor rejects such drafting. I believe we do far more good as a director when we speak up and propose changes that we know later stage investors will insist upon. A good director will not be an obstacle to certain conflicts that are part and parcel of our industry but rather will ensure appropriate disclosure is made in the PPM. In such situations the director needs to watch carefully the use of side letters to win large subscriptions to ensure that other investors are not prejudiced. It is a fine balance.

One of the important responsibilities as a fund director is to protect the assets. What does this mean? Directors need to understand the discretion they extend on prime brokerage and custody mandates. Too frequently boilerplate launch resolutions allow any one director to open bank and/or brokerage accounts as they see fit with inadequate attention to the safety of such assets through limitation of third party payments etc.

Valuation is another key area. The use of manager marks rather than independently sourced prices obviously creates issues. The role of the fund administrator is important. At HighWater we only work with a limited number of fund administrators and prefer to pass on business where we are unable to get comfortable with the administrator.

Investors are increasingly demanding performance fees crystallize annually. The old quarterly payment is disappearing as more sophisticated investors are tired of paying and then seeing performance pull back. More and more funds have to accept annual crystallization, which means the desire to abuse portfolio marks is that much greater than when crystallization was still quarterly.

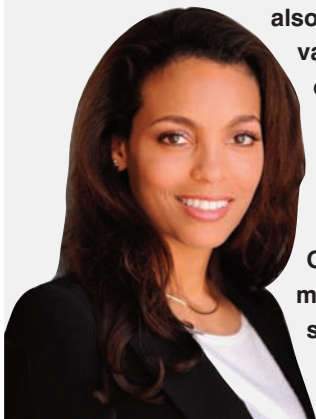
Therefore, if I were in Darren's shoes, as a fund administrator I would want a more engaged director, because such a director provides additional checks and balances an administrator would benefit from.

These are just a few of the many things that I think are increasingly becoming best practice in my world of independent directorships. While investor due diligence cannot be replaced by independent director oversight, it is obvious that the director possesses more authority to demand information of all service providers than the investor.

I assume you will at some stage ask me about director capacity so let me get this out the way. Yes it is important but it receives far too much attention in comparison to equally important other matters. The key question is whether the director competently fulfills his function, including in times of stress. Whatever the number you believe is an appropriate maximum, it is clear that number will fall over time as directors are asked to do more and more. I believe that, rather than CIMA getting involved in prescribing an arbitrary number, it is the director who should conclude what number is appropriate given the strategy, risk profile, jurisdiction etc. of his appointments. For me, this is another consequence of evolving best practice rather than regulation driving our industry.



Ingrid Pierce: As Gary said, conflicts are a major area within governance. There are lots of obvious conflicts - conflicts involving the manager range from straightforward issues to more complex questions, particularly when the manager is also sitting on the board of directors. A number of independent directors have said they really value having a manager on the board, but it can also be a bit of a hostage to fortune depending on whether or not the conflicts are properly managed and disclosed. A decision might be beneficial to the management company but the conflict is still capable of being resolved and a proper decision can still be made. The question is always whether decisions are made in the best interests of the fund and all of its shareholders as a whole.



One issue for managers to consider is the liability that comes with being on the board. The manager may be a fiduciary anyway, so you could say what difference does it make if he also sits on the board? The fact is, it is a different proposition and it is not as simple as just having a board seat to exercise control.

Gary Linford

As a smaller example, I have often had investors ask me how certain expenses such as D&O and, more recently, Form PF filing fees are allocated between the fund and the investment manager. This requires effort by the independent director to gather all pertinent information and make what you believe is a fair decision.

Darren Stainrod: We see the make-up of the board of directors has in fact improved over time. For instance it used to be common practice for the administrator to sit on the board and even provide a majority of members, despite the obvious conflicts. UBS never engaged in this practice and it is almost unheard of in the industry today, however representation on the board by the administrator does occasionally occur. This has some advantages but few that cannot be provided by open lines of communication between the administrator and the board as well as regular reporting by the administrator at the board meetings.

Board composition has also improved in other ways. For example certain law firms that once provided legal advice and fund administration as well as the “independent directors” no longer do so. At least now the fund administration has generally been segregated, although in some case the legal counsel and directors are still linked, which I believe is a clear conflict. However, in general the conflicts issue has changed dramatically and the typical board now consists of one representative from the manager and two independent directors making a majority independent board. As long as the manager discloses any conflicts, abstains from board involvement in any issues which could involve an element of potential conflict and there are clear policies and process that are followed then this structure should work well to protect the investor.



Gary Linford

We also have to keep in mind that certain conflicts may be recurring, so it isn't enough to state it just once and then assume disclosure has cured it.

Darren Stainrod

Right, the area of conflicts requires permanent attention, but again I believe as an industry we have come a long way to improve in the area of corporate governance,

However, few would argue that the biggest driver of change in our business at the moment is regulation, which continues to define the landscape. Immediately following the credit crisis it was the institutional investors that were driving changes ahead of the regulators, but we are now living in a world where managers and by delegation the manager and fund service providers need to allocate significant resources to comply with all the new regulations.

Darren Stainrod: As to the initial question regarding the Cayman regulatory environment, like Gary and Ingrid, I also believe that this has worked very well to date. However, the Cayman regulator must now walk a tightrope. On the one side there are global pressures, especially from Europe, pushing towards the sort of prescriptive changes mentioned before, but this must be balanced with the need to keep the flexible and efficient model that attracted (and continues to attract) funds to Cayman. Going forward the challenge will be to make sensible changes to fine-tune the regulatory framework, but without drastic measures that could remove the features that make the Cayman jurisdiction competitive such as speed of set up, flexibility in strategy and use of leverage and open architecture allowing the service providers to be located outside of Cayman.



Whilst its open architecture has greatly contributed to Cayman's success as a hedge fund jurisdiction, globalization and the advances in technology continue to shape our industry and affect some of the service providers to hedge funds that are based in Cayman. For example over the past two to three years many functions of hedge fund administration have moved away from Cayman, not necessarily to where the managers are located, but to less expensive hubs supporting global operating models by providing time zone arbitrage in cost effective locations. In this way a daily environment is created using a "follow the sun" model and only the end processes of NAV calculation client relationship management and reporting are needed in the more expensive locations such as Cayman, New York and London. Improvements in technology and communication have made this seamless to clients.

Ingrid Pierce: I have an enormous amount of sympathy for the smaller firms who don't have a compliance group or teams of advisers they can call on. They are struggling to know which rules they are supposed to be complying with. Of course many of the rules are new and have not yet been tested so even their advisers cannot say definitively that the rule will be interpreted in a particular way. So, it is a constant struggle and my feeling is that possibly the swing of the pendulum has brought us to a kind of boiling point. There are almost too many regulations for people to keep up with. Although there is help available through industry bodies that spend a huge amount of time analyzing the issues and advising their members, it is almost impossible to keep pace with everything that is going on that is relevant to your part of the industry. It is very easy to find yourself in breach of a foreign rule you don't even know that you are supposed to be complying with. And if the fund is in breach, the directors are responsible.



Ingrid Pierce

Cayman is impacted by what's going on globally and many of the businesses that operate here also operate internationally. We have to be very careful that we don't overstep and cause people to find themselves in breach of the rules such that they can't properly operate and do their jobs. That is what worries me.

Gary Linford: What worries me? I am not so much concerned about myself or HighWater as our model is sustainable and, more importantly, portable but I do worry for Cayman. Our Island is still by a significant margin the leading hedge fund jurisdiction selected by existing and new launch managers. However, this means that the manager picks Ingrid, he picks Darren and he picks me, but actually the most important constituent in the continuing success of our industry globally is the investor himself. I fear that investors in Cayman hedge funds do not have a voice in Cayman, are not consulted adequately by CIMA and they are drowned out by vested interests of certain lobbying groups that have access. I am worried that our industry continues to suffer additional costs in Cayman in the name of investor protection when the increased regulations add little real value other than to fill the coffers of our Government. So ultimately I worry that investors who are frustrated with certain issues will simply find other solutions that do not include a Cayman domiciled entity.



Investors in Cayman funds know very well why they are comfortable with a Cayman vehicle. They appreciate the distinguishing features between a public fund and a private fund. They do not confuse Cayman with the UCITS model of Europe which is mostly pitched at retail investors. Unfortunately the politicians and a few national regulators in Europe would love to harmonize investment structures in the same way that they would love to harmonize tax (up). Those politicians know that if the Cayman Islands is forced to follow inappropriate UCITS regulations for our private funds, it will drive our costs up and much of our business to Europe with no added benefit to investors. The reality is that most sophisticated investors in our private funds are not looking for UCITS type features when they invest through a Cayman entity, otherwise they wouldn't use Cayman entities. I believe it would be a huge mistake if CIMA allowed other regulators in Europe to bully our jurisdiction into following a UCITS approach as it will water down the attractiveness of the Cayman model.

Ingrid Pierce

On the other hand, Gary, there are some fund of funds and other investor groups that are quite vocal.

Gary Linford: Yes I agree with you Ingrid, there are certain investors who are engaged in this dialogue. They have had some success, but the points I am trying to make is that there isn't really an effective platform for them so I am not sure they are getting their voice heard in the Cayman Islands. I also realize most investors are not departing Cayman hedge funds due to dissatisfaction with our regulatory approach but rather the disappointing returns of certain hedge fund strategies.



Darren Stainrod: That is absolutely correct. At the end of the day it is the investors' choice as to which asset class they invest in. It depends on their specific risk appetite, return requirements and possibly their macro view at the time that steers them towards allocating to traditional investments, alternative products or simply staying in cash. If hedge fund returns are watered down by regulatory costs or handcuffed by too many restrictions, then they may lose some of their shine. However, within the industry if relative regulations make the Irish QIF, Lux SIF or NEWCITS under AIFMD passport rules more attractive then global players like UBS Fund Services are set up to cater for these products in the various locations that they exist.



On the other hand, when we're looking at it from a Cayman Inc. point of view and what share of the market that Cayman is picking up then, as Gary said, we need to be very careful with the amount and type of regulation that is introduced in Cayman. There has been a lot of political pressure from Europe to push investors towards European products that offer more liquidity or tighter regulation, but these vehicles typically also have more investment restrictions. That said we are seeing some fund managers setting up products in Europe ahead of any changes as a hedge against what might come.

Gary Linford

Do you think it is healthy for the global fund industry if a certain trend towards using one jurisdiction is driven by inappropriate protective legislation that mandates one jurisdiction over another?

Darren Stainrod

I think it's definitely unhealthy if it leads to less choice, higher costs or lower returns for investors. More choice is a positive factor but some of this protectionism leads to having less alternative options available to investors.

Gary Linford: There are a lot of political motives at play. Of course, there is very little that the Cayman Islands can do about that other than continue to do our best to attract business here based upon service and price, but I fear we will continue to see onshore governments create laws that artificially require you to do business in their jurisdiction.

That may be neutral for firms like Darren's who are global, but it is not good for the Cayman Islands itself. Increasingly all of our good service providers here on Cayman are or will have to become global as inappropriate CIMA regulations and offensive new fee increases reduces the attractiveness of Cayman. Sadly, there is increasingly less of an impetus for someone like say Darren to get engaged and argue why certain business should be directed to or stay in Cayman. If it's correct legally and commercially for his client to go to Luxembourg, then the client goes to Luxembourg and UBS processes his business there. The point I am trying to make is to step back and look at why this is actually occurring. In my view, this happens because of inappropriate regulation, fees and immigration legislation. None of our managers or investors are pushing for it.



Darren Stainrod: What Gary said is correct in terms of the pressures on investors to move to certain places that are perceived as better regulated jurisdictions even though the product is essentially the same structure and regulatory model as the Cayman product. And even more pressure is being created in other ways. For instance, some Dublin administrators now refuse to process and pay the redemption of a Cayman fund of funds redemption unless they get full underlying KYC and disclosure of the underlying investor, which is a demand they don't make everywhere else. Their rationale is that Cayman is not an equivalent jurisdiction for AML/KYC which is out of line with many studies and OECD inspections that confirm the strengths of Cayman's AML/KYC regulation. I would tend to agree that some of the pressure is political.



Matthias Knab

We covered themes that are important for Cayman and the global industry. All three of you are active in multiple jurisdictions, what other developments do you see globally for the alternative investment industry?

Darren Stainrod: I think that everyone is chasing the money and trying to get an increased share of the global alternative business. Hong Kong, for example, has a good PE structure and now they are looking at creating a hedge fund type product there to compete with the Cayman model as well as other products to capture assets as China continues to open up. Singapore, Malta, Gibraltar, the Channel Islands and elsewhere are also competing with the Cayman/Dublin/Luxembourg products. Bahamas has a less expensive SMART fund which is heavily marketed to start-ups and family offices in Brazil and obviously UCITS are a continuous project in Europe, so I think everyone is positioning themselves for more market share.

At the moment, nobody knows the lay of the land in the future and this uncertainty can create opportunity. But, at least for the moment, while there is an increase in activity in Europe ahead of AIFMD, there hasn't been a lot of actual asset flows or re-domiciliation out of Cayman which remains stable in assets and the number of funds registered.



Ingrid Pierce: There is a lot of potential for more business in the alternative investment space, and of course all jurisdictions will want to do whatever they can to make it attractive for funds to domicile in their jurisdictions or assets to flow through them. Historically, Cayman has been a great conduit jurisdiction and it has to remain competitive because every other jurisdiction is biting at its heels. They are either copying the Cayman model or trying to get ahead if Cayman slips behind or becomes too stringent for the needs of the institutional investors.



Perhaps there will be more jurisdictional arbitrage going forward. For now the funds market in Cayman is still doing very well. There was a surge in registration numbers in Cayman in 2012 largely because of the new regulatory requirement to register master funds. There are now well over 10,000 registered funds and we will see how it looks at the end of the first quarter of 2013 as there are usually some terminations at this time of year when people do restructurings or deregister their funds.

Overall new funds have been a bit slower to launch; it seems to be taking longer for people to raise capital. Still, we have quite a lot of new funds in the pipeline for the first quarter of next year, so we are pretty positive. There is a lot of activity in Asia, but we are also getting a significant number of inquiries from the U.S., especially for start-up funds. A lot of these new managers launch with a relatively low asset base, but that isn't stopping people from going offshore, which is a good indicator of what's to come.

Matthias Knab

Ingrid pointed to the fact that there is a great potential for a lot more business in the alternative investment space. This is absolutely correct. If you look at the total of global, invested assets, the hedge fund industry is just only about 1% of the \$300 trillion in financial investments. In addition, a lot of investors hold sizable cash positions and are not doing anything with it at the moment. I share the view that there will be a lot of activity and opportunity within alternative investments going forward.

Like businesses with their respective products, jurisdictions should fight for market share as competition is the base of free markets and economic theory. What are some of the strengths of Cayman in this respect?

Ingrid Pierce: We do have a great base from which to start. The success of the industry here has been built on innovation, creativity and forethought by people here more than a decade ago. The reason why Cayman has continued to do well has been because people have been attracted by the jurisdiction and its efficiency.

Cayman operates at an international level. You get world-class services from local and international providers that operate from Cayman. It's an engine that works extremely well and continues to do so. Just look at the institutions that are doing business either from Cayman or through Cayman - even though the alternative space is a small percentage of the overall financial industry - they are some of the world's major players.



Gary Linford: I agree that competition is healthy and jurisdictions should compete, but let's see this done in a fair and equitable manner. I do not want Dublin competing against us by saying they don't accept Cayman AML when they all know very well it's fine. We have passed all FATF and IMF inspections of our AML regime and I believe we earned as high if not a higher assessment than London. It is therefore inappropriate for Dublin to put barriers to entry on cross border AML certification to encourage Irish domiciliation over the Cayman Islands.



When I see all the fee increases and regulation being imposed upon our industry, I am thankful that HighWater clients are the larger funds that can afford these fees but I know the stakeholders will be annoyed at the meaningless added regulations. Unfortunately, not so for over 60% of Cayman's hedge funds with assets of less than \$100m, they will be impacted and many less will launch. The multiplier effect on lost revenues to the Cayman service provider community is immense as the \$50m funds seek out cheaper jurisdictions and take their requirements for an audit, a fund administrator, a lawyer and a director with them. This does not take into account lost government fees and litigation fees when issues are contested in our courts. I believe it is detrimental to the global hedge fund community, not only Cayman, when we create an environment that doesn't allow those startups to flourish. And why shouldn't they when it's not retail money?

Darren Stainrod: As I mentioned earlier one of the ingredients of Cayman's successful recipe and why we have achieved such a strong position globally is the open architecture of the Cayman model. That means that the fund can be Cayman registered and domiciled and the legal set up, fund administration and actual fieldwork for the audit can all be done elsewhere in addition to the fact that the directors can reside outside of Cayman. In fact the only service required to be performed in Cayman, apart from the registration of the company, is the audit sign off. This provides an extremely flexible model.

Over the years, Cayman succeeded in staying competitive and has done a good job providing products for various markets and being very innovative over the years. However, Cayman's ability to continue to do so is threatened by current draft regulation such as the AIFM Directive. Certainly Cayman is doing everything it can to ensure that it is accepted for passporting as a non-EU member when the AIFMD opens up to third party countries in 2015 and there is ongoing dialogue between CIMA, the Cayman government, and the EU/ESMA to this end.

While Cayman has been very innovative in the past we may face a bit more of a challenge in the new world order, especially if activities such as the depository cannot be delegated to an entity outside of the fund domicile.

Having said that, I must underline that as we said before the Cayman product isn't broken, and the Cayman model still remains very much the default for the hedge fund industry.



Ingrid Pierce: If you look at the Cayman model, no-one is forced to work with local providers. Obviously you need Cayman counsel and a Cayman registered office, but only the audit sign-off has to be done in Cayman and only in the case of a regulated fund. So the management, the administration, a lot of the audit work, prime brokerage and banking can all be outside of the jurisdiction, and yet, people flock to the jurisdiction and still work with the local providers. To me, that is the investors' choice. Similarly, you are not required to have directors based in the jurisdiction, and yet we have a very significant independent director industry.

Gary Linford

That is absolutely right and the status quo for now. It is the reason why the Cayman model works and why prominent firms continue to use it. However, the risk is that CIMA may believe we have to keep up with the global regulatory changes that happen in the onshore world in retail products by changing the rules here for the professional investors and institutional products as well.

Matthias Knab

This discussion is really relevant because we are illustrating that there are clear reasons why Cayman has become the default hedge fund set up over the last 15 years. Its character as an open architecture is one of the key factors.

Ingrid Pierce: I agree with Gary's earlier point and also believe it is a mistake to think that forcing clients to do business with any jurisdiction will automatically improve business in that jurisdiction. That is a very myopic way of looking at things as has been demonstrated over the years.



Gary Linford: There have in the past been suggestions from some local fund administrators to pass laws, as in Bermuda, mandating the use of local administration firms. Well, if you look at these sort of jurisdictions, I am not so sure they have performed very well with such prescriptive regulations.



Darren Stainrod

Gary referred to the increasing fees and cost of business that also affect fund administration firms like ours. With the advances of technology, certain business processes can be carried out elsewhere on global platforms, and so some local Cayman administrators are doing less business here and more in less expensive alternative jurisdictions. The reason why UBS Fund Services is still running quite a large operation in Cayman is that certain strategies and certain parts of the industry are complex or require a lot of attention to detail and so require a qualified and experienced work force. You need qualified people like accountants and CFAs, and one of the benefits of Cayman is that apart from the home grown talent it is quite easy to attract and retain good quality talent from around the world. In fact we have around 25 different nationalities represented in UBS's Cayman office.

Matthias Knab

Talking about good quality talent, what are the characteristics of a good director?

Gary Linford

For me, as I said earlier, the composition of the board is extremely important with the intention to obtain a good mix of skill-sets, from their understanding of specific investment strategies, to fund administration knowledge to investment risk to operational due diligence with other considerations like regulatory knowledge of specific geographic locations etc.

For example, I don't think it is an optimal situation when you sit here in Cayman and interact with clients in Asia when in fact you have never been to Hong Kong, Singapore, Shanghai, Tokyo etc. So one of the first things we do with our staff at HighWater, even with administrative staff, is encourage them to travel with the directors and learn about jurisdictions where we do business.

Darren Stainrod : We at UBS have started to see that more people with an actual investment management background are being included on the board of a fund. Why do you think that is? Is it investor-driven? Does it result in a better composition of the board?



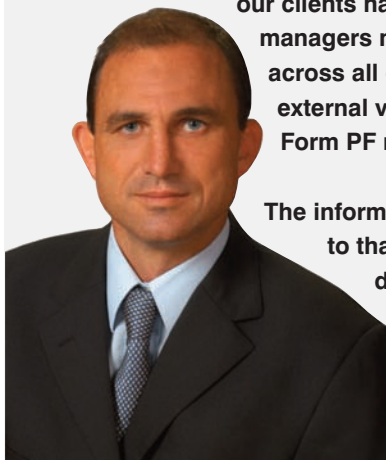


Gary Linford: It is an important development. For example in our case, we have Simon Cox in Hong Kong who has an allocator background. In the Cayman Islands we have Mark Fagan who is a CFA, is comfortable with most hedge fund strategies and has worked in risk management at a large hedge fund. In New York we have Matt Auriemma who has headed up Global ODD for a significant fiduciary investor. However, it is still the more service provider orientated skills of audit, legal, fund administration, regulatory and banking that you see on boards on the independent director side. Increasingly it is the CFO, COO and the CCO that you see representing the investment manager on the board, as opposed to the principals or portfolio managers.

Ingrid Pierce: It is also very much about the mix of the board and making sure people can relate well to each other and relate to the manager. One of the recent trends has been to have directors from different firms; we have seen three independent directors from three different places. When that happens, managers ask not only are the proposed individuals "good" at what they do, but "do they work together, do you know whether they have worked together, do you know if they get along", because it is really important the directors have respect for each other and that they can add value as a collective. The directors shouldn't be competing with each other on the board, because that can be very destructive.



Darren Stainrod: Ingrid explained to us before the challenge managers have today not just in complying with all the new regulations but firstly in identifying all of the ones that need to be complied with. As an example of that, one of our clients has to file over 250 different regulatory reports and surveys annually. Investment managers need to be able to aggregate the data and report it in a consistent and efficient way across all of their funds and to all of the bodies that they report to. This particular client uses external vendor software to do this which UBS Fund Services also provides to clients for their Form PF reporting.



The information and reports we provide from Cayman already include Form PF, PFIC and K-1s. Add to that the information that will need to be provided under FATCA, and going forward no doubt that other countries like Germany, France and the UK will like to get the same "service". It is interesting to note that while Cayman is known for its tax exempt products, which is an important feature for the investment management business, today Cayman seems to be on its way to become not quite yet a tax collector, but a sort of tax reporter to the world.

Gary Linford

Apart from tax, the other area where we see an increase in co-operation and information exchange between the regulators is insider trading. With CIMA becoming an IOSCO member and also signing more co-operation agreements with other countries, we are also seeing more regulatory investigations here in Cayman than ever before.

I won't comment on whether I think this is good or bad, these are just consequences of the industry evolving beyond what are traditionally hedge fund issues. The business of running a fund continues to become more complex and new questions arise with the increased use of these regulatory gateways. For example, what rights or obligations do we have in giving certain information requested by foreign regulators directly of the board of directors? For example, if somebody from Japan just rings up and says, "as the Japanese regulator, I would like to have the investor list of the ABC fund", what should I do? These are complex issues that require confident, experienced directors that can govern, not simply sit in Cayman and ensure statutory filings are made on time.

As we are moving towards a global and interconnected industry, this interconnection might be beneficial for Cayman and over time this will hopefully finally refute the false accusation of Cayman being an uncooperative jurisdiction, when in reality we are very cooperative. It is my hope that CIMA continues with its very effective approach to regulation and stands firm against any attempts by other regulators to encourage our private fund regulatory regime to embrace UCITS type rules and regulation more appropriate for the retail sector.

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