



Opalesque Roundtable Series '15 CAYMAN

Opalesque Roundtable Series Sponsor:



Editor's Note

Times are changing for Cayman as hedge funds start physical operations on the island

Since 2009, I have been six times to Georgetown to produce the Opalesque Cayman Islands Roundtable. For the first time we were able to include this year a hedge fund manager who actually operates and set up his fund management company on the island. And he's not the only one.

It has often been criticized that fund managers would be operating from their onshore jurisdiction with just a nameplate on the door with their token service providers rubber stamping things in the offshore market and claiming the benefit of being offshore in terms of tax and regulatory mutuality. But with more and more governments looking for more revenues, they will search for ways to increase their tax revenues by all sorts of measures. So actually those managers who create true substance offshore may be ahead of the curve...

Stefan Henning, who launched his Cayman fund from Cayman in September 2014, was *"amazed by the professional business environment that we found in the Cayman Islands in general, and the Special Economic Zone (CEC) in particular: Besides taxes, we are being offered a full service, plug-and-play situation with the Cayman Enterprise City. We didn't have to find office space, buy a printer and all those other things that take a lot of time for a startup, but could instead work on the fund launch from day one. It took us less than a month from the time we made the decision to set up our company in Cayman until we received our work visa. Going forward, it will take five business days to receive additional work visas for new employees."*

Flight to quality: How investors drill down

Investors have increased their level of diligence and some institutional investors require new funds to change their structure in order to accommodate a particular level of oversight. Investors have always commented on or requested changes to fund terms, particularly seed or strategic investors, but now we are seeing that comments are not just limited to the terms of the offering, but extend to the identity or quality of the service providers. More investors are coming to the island for more in-depth conversations with the local service providers and directors before they make their investment.

Those investors will drill down, they will ask a fund director about the documents and question things like, *"why did you allow this clause through, and what was your thinking on that clause?"* This means the fund director really need to know the fund and the documents inside out which naturally means that he can't take on hundreds of relationships. Some investors may even request that the manager representative who is proposing to sit on the board reconsider the appointment in favour of a third party provider, or switch out a third party director in order to accommodate what the investor perceives to be the right quality of independent oversight.

Rise of regulated products not at the expense of hedge funds

The trend for more regulated products has not been at the expense of the hedge fund industry so far. The new fund business has not slowed down for Cayman service providers. There is a strong demand for not only new funds but also for more customized solutions, bespoke products and more funds of one. Hedge fund assets are at record levels and continue to grow while regulated vehicles provide a middle ground to traditional products, so you find them side by side giving managers a suite of products through which they cater to a diverse investor base.

This Opalesque Roundtable took in Georgetown, Cayman Islands, with:

1. Ingrid Pierce, [Global Managing Partner, Walkers](#)
2. Darren Stainrod, [Principal, HighWater Limited](#)
3. Stefan Henning, [Co-founder, Managing Director and Portfolio Manager, balmoREAL Capital SEZC Ltd](#)

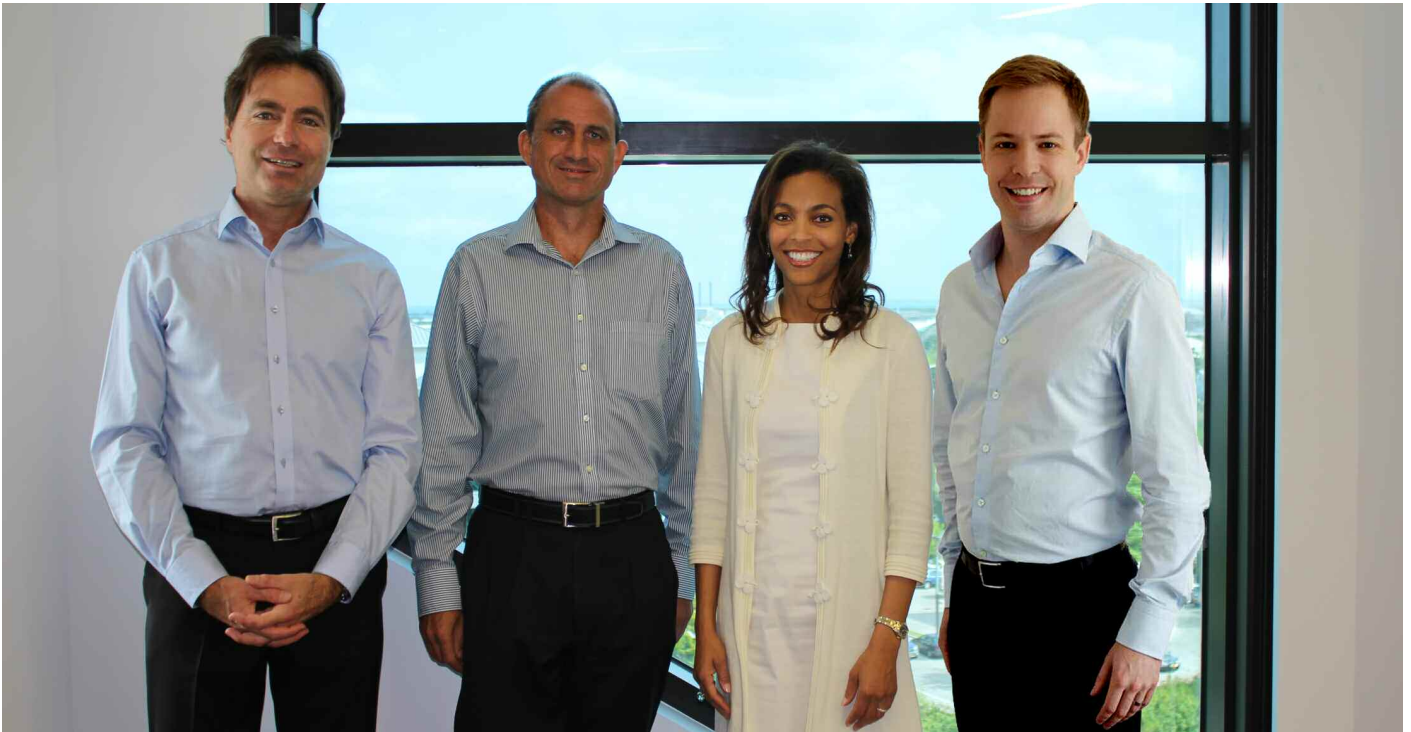
The group also discussed:

- How is the industry prepared for another 2008 scenario? What has been done to improve investor protection?
- Why it is time for a regulatory paradigm change to turn the "we need to protect people from the evils of the hedge funds" notion?
- Did you know that some 12,000 independent fund directors are now registered with the Cayman regulator?
- How are managers today selecting independent directors?
- Cayman recently upgraded its LP law to make it more attractive: about 1/3 of launches are now using an LP at the master level
- Why Cayman won over New York or London to set up balmoREAL fund management company
- Should the minimum investments be lowered for hedge funds?

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Darren Stainrod, Ingrid Pierce, Stefan Henning.

Cover photo: Cayman Islands, © Mark Lewis Photography under Creative Commons license

Introduction

Ingrid Pierce
Walkers

My name is Ingrid Pierce. I am the Global Managing Partner of Walkers, a law firm headquartered in the Cayman Islands. We have been in existence for over 50 years and we have eight offices operating from the Caribbean, Europe, Asia and the Middle East.

Darren Stainrod
HighWater Limited

I am a Principal at HighWater Limited based in the Cayman Islands, who provide Professional Director Services to the hedge fund industry. We have 21 staff, 8 of whom serve as directors on hedge funds, fund of funds, investment managers and private equity vehicles.

Stefan Henning
balmoREAL Capital SEZC Ltd.

My name is Stefan Henning, I am the co-founder, Managing Director and Portfolio Manager of balmoREAL Capital SEZC Ltd., a Cayman based hedge fund manager that launched its first fund in September 2014.

balmoREAL executes a value focused, market neutral, long-short equity strategy that invests exclusively in publicly listed U.S. Real Estate Investment Trusts (REITs). The Investment Manager uses its principals' deep understanding and many years of experience in the real estate market to constantly monitor the REIT universe and to fundamentally analyze approximately 75 REITs through our proprietary, real-time valuation technology. The discovered mispricing in the REIT space is used to construct a market neutral portfolio, which is designed to deliver arbitrage-like returns in all market environments.

70

percent of the world's surface is covered by water.



Eurex Exchange turns figures into opportunities. About 70 percent of all listed and centrally cleared euro interest rate derivatives are traded on Eurex Exchange, making us the home to the euro yield curve.

We help investors get more from the market and maximize capital and cost efficiencies. www.eurexexchange.com/rates

Eurex Exchange – the home to the euro yield curve.



The information published in this publication is for general information purposes only. It is not intended to constitute investment advice nor is it intended for solicitation purposes. Eurex is not responsible for any errors or omissions contained in this publication. Before trading, persons should consider the risks involved and the legal requirements of the relevant jurisdiction.

Stefan Henning: Our firm balmoREAL is a real life example. Several years ago we started to research locations to set up our hedge fund operations and we were amazed by the professional business environment that we found in the Cayman Islands in general, and the Special Economic Zone (CEC) in particular.

It seems only few people in the hedge fund industry are aware of the Cayman Islands efforts to attract hedge fund managers by creating an amazingly business friendly environment along with political stability and a top notch infrastructure.

So, to answer your question, we feel that we are part of the change that is going on in the Caymans since we chose this location over New York or London to set up our operations, and we are sure that without the recent development of the Cayman Enterprise City, we wouldn't be here today.



Darren Stainrod: This will probably affect in particular Cayman's wealth management trust business. If you look at other sectors, hedge funds are still growing, the audit firms are growing, I believe the law firms are doing very well and certainly there has been a proliferation of the director service firms in Cayman as the standards have changed and people are now taking on less directorships per director along with the general growth of the industry.



Cayman is currently benefiting from an uptick in the hedge fund industry. However, the country also continues to seek to diversify away from the traditional two pillars – tourism and the financial industry – with developments like the economic zone as well as the Dr. Shetty's hospital which has introduced medical tourism to the Islands.

In addition we now have a handful of hedge fund managers like Stefan and his firm, who have come to the island and actually work from Cayman. We see this diversification of the type of businesses that operate or are being serviced out of the Cayman Islands as very positive.

Ingrid Pierce: From our side, the legal marketplace hasn't changed that much in the last year. We now have a few more players in the market and there are a couple of international firms looking at the jurisdiction.

Even with some providers moving out, others are moving in so there are plenty of opportunities in the industry, especially in professional services and in the high net worth space.



Darren Stainrod: As you know, in response to investor demands for higher standards of corporate governance, CIMA introduced the statement of guidance in January 2014 which solidified the practices that were largely taking place already. The statement wasn't prescriptive but offered guidance as to what was expected of directors and has at least set a minimum standard for those responsible for corporate governance of hedge funds.

In reality the industry has, in any case, been pushed toward self-regulation by the demands of institutional investors for stronger oversight. This has fast tracked recent changes in best practices, independence and capacity ahead of any formal regulations. However, CIMA has responded with the Director Registration and Licensing Law ("DRLL") in 2014 which requires an annual confirmation of contact details and, while falling short of regulation, does give them the power to refuse or remove the registration of a director.

Directors with up to 20 funds have to be registered and those with over 20 are deemed to be professional and are subject to a fit and proper test. Most firms such as HighWater have a company's manager's license (and so are already regulated by CIMA) and receive an exemption, but basically it brings under CIMA any directors not already covered.

Importantly it allows CIMA to have updated information on who the current directors are on funds so they can contact them if anything goes wrong. Prior to the DRLL much of the data was old and directors listed had long since changed or in some cases even died many years ago.

The DRLL was implemented fairly efficiently and the ability to register on line and pay the fee by credit card enabled some 12,000 directors to be registered in a relatively short space of time, in contrast to when the FAR fee was first implemented and CIMA received thousands of \$300 checks that took forever to reconcile.

So, there have been some recent improvements in both the regulations and process and CIMA continues to consult with the private sector before moving ahead, which is a strength in the Cayman model. They have also signaled that there should be no new fees or fee increases in the near term which is another positive result of taking in feedback from the industry.



Ahead of any clarification of the capacity issue raised in the DRLL, there is a continuing trend away from the more volume players towards more boutique type firms like HighWater which limit the number of relationships that any particular director takes on. This allows them to meet the growing demand for more experienced, independent and hands on directors who actively engage with the clients and their service providers, understand the strategy, hold regular board meetings, review the financials and really play a more effective oversight role for the funds and their investors. As demand for these more extensive services has increased along with fee levels, a number of new providers have emerged both in Cayman and other locations that use Cayman products.

Ingrid Pierce

As you may have heard CIMA is continuing to look at capacity of directors so I think we will see that coming up on the agenda - perhaps at next year's Roundtable!

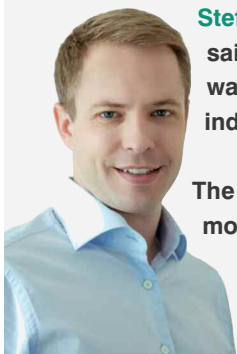
Darren Stainrod: Yes I agree. I hope they understand that there are different models which work well for different products. The so called “jumbo directors” have platforms and a lot of staff in place and are not just ignoring their fiduciary duties, they are just doing it in a different way, perhaps more akin to an audit firm where you have junior people doing the bulk of the work and the directors then reviewing it or dealing with issues that have been escalated up to them as an audit partner would.

This platform model suits certain types of funds and other products, but institutional investors allocating large sums into complex hedge funds are generally willing to pay a little extra for a more direct approach. This has certainly resulted in more entrants to the industry as mentioned earlier as well as a reduction in the number of relationships that the average director holds.



Stefan Henning: From a managers’ perspective I couldn’t agree more to what Darren and Ingrid just said. To start, good corporate governance cannot be achieved with boiler plate fund documents. We wanted to build what investors demand, but this then goes even further for us and we experience our independent directors as true enrichment on the operational and compliance side of the business.

The fact that CIMA accounted for what investors demanded in a relatively short time frame proves one more time that Cayman is a leading hedge fund jurisdiction. The regulators here understand the needs of the industry and implement changes quicker than most other regulators – a fact that will help to maintain the status and the reputation of Cayman in the hedge fund industry.



Matthias Knab

I agree with you and believe it's fair to say that generally there is a certain shift in the alternative investment funds space to more quality and higher standards.

Back in the boom years of say 2005 or 2006, a good number of funds setting up then were almost like a commodity: they were pushed out very quickly, in many cases with boiler plate type documents, and everybody was recycling similar strategies and also business practices. That also meant that directorship services may have very much been done on a volume basis with less emphasis and due care and understanding your client.

And what has happened after the market crashed in 2008 was that people are probably taking a lot more interest in the value provided by everybody, so the full chain of service providers, and creating a true product that is unique and fitting to what they are looking to achieve. So, rather than having the same long short hedge fund model with a similar set up, procedures and documents being pushed out, people today are looking for probably more customization. Along with that also probably came a certain push back on fees.

Today, the managers are not necessarily just grabbing whichever director hangs a sign out, but rather look for more skilled directors and more attention from them. So both from the manager and the investor side I think we are seeing a move away from that commoditization of hedge fund and private equity fund model towards more of a bespoke product that requires a greater attention to detail.

Several of you were pointing towards what is on the investors' agenda and how investors are causing this industry to change. How do you see that to continue going forward, what else is on the agenda? What else are they requesting?

Darren Stainrod: Apart from the general flight to quality that we already spoke about, which by the way is also supported by regulatory pressures, we have seen the continuing use of managed accounts and funds of one for many of the large institutional investors. I also think demand for more regulated products like 40 Act funds in the U.S. and UCITS in Europe will continue to grow as more people become interested in alternative strategies.

But what's interesting is that this trend for more regulated products has not been at the expense of the hedge fund industry so far. Hedge fund assets are at record levels and continue to grow while regulated vehicles provide a middle ground to traditional products, so you find them side by side giving managers a suite of products through which they cater to a diverse investor base.

We also see that investors are becoming more and more sophisticated. They are doing active due diligence on fund directors and service providers. We are seeing more and more of them coming to the island, and of course we welcome that. We have more in-depth conversations with them before they make their investment as well as part of their ongoing due diligence. And those investors will drill down, they will ask about the documents and question things like, "why did you allow this clause through, and what was your thinking on that clause". So, you really need to know the fund and the documents inside out which naturally means that you can't take on hundreds of relationships.



Matthias Knab

Darren, I wonder if this has also changed the way directors interface and interact with the managers?



Darren Stainrod: In our case no, we have always taken the view that we will develop a close relationship with the manager as well as the service providers and even some of the investors these days. If a manager only wants a board that will rubber stamp everything and never interacts with them then we aren't interested in working with them, and they wouldn't be interested in our model anyway. But to your point I think the vast majority of managers these days see the benefit of an independent board, or at least they know they must work with one in order to attract institutional capital

Ingrid Pierce: While it might not have changed the way that Darren or his firm operates, I do think it has changed the way some firms operate. I see directors engaging much more with managers, spending a lot more time upfront on their own diligence to decide whether they want to accept the engagement, and asking many more questions during the onboarding process.

Investors have also increased their level of diligence and some institutional investors require new funds to change their structure in order to accommodate a particular level of oversight.

Investors have always commented on or requested changes to fund terms, particularly seed or strategic investors, but now we are seeing that comments are not just limited to the terms of the offering, but extend to the identity or quality of the service providers. We have had a number of investors request that the manager representative who is proposing to sit on the board reconsider the appointment in favour of a third party provider, or switch out a third party director in order to accommodate what the investor perceives to be the right quality of independent oversight.



Stefan Henning: We also monitor the change in investor demand, so I agree with you about a flight to quality regarding, for instance, independent director services. Furthermore, the entire legal set-up needs to be more investor friendly today as gates, soft dollar arrangements or redemption periods that are mismatched to the liquidity of the portfolio are no longer acceptable to most investors.

The independent director service is no longer simply a “check the box” necessity for funds and pricing is no longer the key variable for choosing the right fit. Managers need to thoughtfully select directors with respect to pedigree and time commitment which then also translates into directors limiting their number of relationships or building out their platform. At the same time, the directors are more concerned than ever with their own reputation and have very selective processes in place when choosing their relationships. As mentioned above, for balmoREAL we think of the independent directors as a real enhancement to our business.

All of that means that the bar is set quite high for emerging managers to fulfill even the minimum requirements investors seek in terms of service provider quality. Even a startup manager today needs a brand name administrator, auditor, prime broker, legal counsel and two independent directors along with a quality middle and back office. While you could think of this as a flight to quality, it should also be seen as a flight to size or AUM in the hedge fund or alternative space.



Only larger funds can easily provide that sort of infrastructure while smaller, innovative managers face a tremendously tough environment to launch their products. The up-front investment and the drag on performance is often too high for a \$5m or \$10m startup manager to even launch. In addition, if the strategy is capacity constrained, there likely isn't much appetite from the seeders and accelerators to fund the product. The result may well be that many innovative, niche and capacity constrained strategies will no longer be offered in a fund format, but will remain in the hands of family offices or individuals and most of the other investors won't be presented the opportunity to invest with these strategies.

So I think that while general corporate governance and investor rights will improve, it remains to be seen if this institutionalization of the space will really benefit the investors in terms of total fund performance over a full cycle.

Matthias Knab

Are there still as many hedge fund launches on Cayman as before?

Ingrid Pierce: The new fund business has not slowed down for us. We are seeing more customized solutions and bespoke products and more funds of one. Having said that, as with all new businesses not all start up managers make it and some close down within a few years.

What we have also noticed is that launch periods are getting shorter, particularly on the offshore side where managers are going to market more quickly.

From a geographical perspective, we have asset manager clients all over the world, although the Caribbean jurisdictions principally see new funds launched by managers from the U.S., to some extent from Europe, and some increase from South America, particularly in the family office space.



Darren Stainrod: It appears that Europe is active again following the recent onslaught of FATCA, AIFMD, EMIR and even changes in the tax laws relating to partnerships in the U.K.

There was just so much going on from the legal and regulatory side that a good number of managers held off launching new products for a while. Now that a lot of the new regulations are in place we are starting to see renewed activity.

Meanwhile in the U.S., managers never took their foot off the gas. We saw numerous launches in 2014 as money flowed into the industry on the back of strong performances in 2013, particularly in the long/short equity space. The U.S. managers had already been through a lot of the changes that shackled the U.K. managers last year and I think they largely circumvented AIFMD by keeping to Switzerland and using reverse solicitation in the U.K.



From a structural viewpoint we saw U.S. managers moving toward the increased use of limited partnership structures at the master fund level. To facilitate this Cayman recently upgraded its LP law to make it more attractive and I estimate about a third of launches are now using an LP at the master level. This then raises issues from a corporate governance point of view as US managers tend to serve as directors on the general partner for tax reasons, and so the offshore feeder might have an independent board but with no representation at the master level. In order to close this gap often an advisory committee is created with responsibility for key terms such as liquidity, suspensions and conflict resolution of cross trades and principal trades.

Matthias Knab

Obviously a lot of the changes we have described here are in the end also consequences of the great financial crisis of 2008. Since then we have had roaring bull markets everywhere for many years now, so some investors are looking at what happened in 2008 and try to position themselves to basically survive the next crisis.

Do you think the investors and the industry in general are better equipped now to deal with the next downturn? What do you see from your perspective regarding this question?

Stefan Henning: Let's distinguish between improvements to governance, regulation, transparency or investor rights and lessons investors and fund managers have learned with respect to investment strategies.

Regarding the latter, there was greater awareness in the early phase of this cycle that markets go through bull and bust cycles and that we all need to construct our investment portfolios accordingly. As a result, there was and still is healthy demand for low net, non-correlated strategies, and top notch risk-management has become a key aspect of investor diligence today. I know a couple of "black swan" hedge funds with, obviously, negative performance for the past seven years that still see investor demand for their insurance-like strategies.

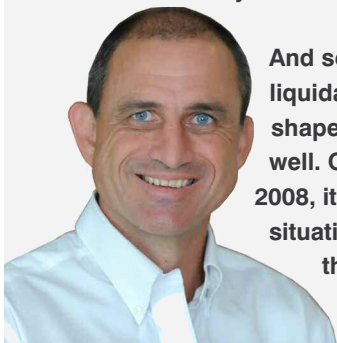
Unfortunately, this sentiment seems to be slowly fading away and some investors begin to forget the pain they suffered in 2008. Instead, their attention is turned to the more recent pain they suffered because of their portfolio's sub-S&P 500 performance, which is an unavoidable fact for most well balanced portfolios during up markets.

A good example of this newly developed "risk-on" mentality can be observed in the U.S.-REIT space.



Over most of the past twenty years, the market was willing to pay a premium for REITs with bullet proof balance sheets and the market discounted those REITs using a lot of leverage to enhance face value returns. Very similar to how investment grade bonds offer a lower yield than non-investment grade bonds. We have only observed two periods when this price for risk virtually diminished. The first time started in 2005 and ended with the bust in 2008 which is part of the reason we chose to run a market neutral portfolio when implementing the strategy in 2008. The second time started with the Fed's introduction of QE3 in September 2012 and continues to this day.

Darren Stainrod: Crises happen on a cyclical basis. I believe the big difference now compared to past ones is that I think the documents are now written with an expectation of such things happening at some point again. Therefore liquidity clauses such as gates, side pockets, suspensions and key man provisions have been reviewed and a lot of uncertainties have been taken out. You now find very clear language as to what would happen in those scenarios, what are the rights of investors, when a director can suspend, when the subscription is effective, etc. If you wire your money and the fund goes belly-up before it's invested, are you in the fund or can you expect a return of capital, and for redemptions at what point do you become a creditor or remain as an investor in the fund? Also the investors are wary of funds with liquidity mis-matches or gates where the strategy doesn't warrant any. They are certainly more cautious these days and their due diligence extends to directors, service providers and to their general control frameworks, cyber security policies and liability caps.



And so I think the documents themselves are in better shape and things like side pockets, gates or liquidating scenarios are either removed or better clarified, so the industry as a whole is in better shape. The investors have pushed for those changes, and I believe the industry has responded well. Of course, there will always be surprises in the future, so the future crisis won't be another 2008, it will be something different. Always when you react to a crisis you are reacting to the situation that has just happened, while the next crisis will be something completely different. But I think in general we are better prepared for the next storm.

Ingrid Pierce

Speaking of cycles, it's easy for people to go from comfortable to over confident so let's hope we are in fact prepared.

Darren Stainrod

Yes, Ingrid is right, and you can recognize that even if you look out of the window here. Right after hurricane Ivan that happened in September 2004, when people started to build their houses again they were using 20 foot of fill, and now it is back to that one foot again.

Matthias Knab

I had some conversations with people involved with private banking and wealth management here on Cayman, and the observation was that people are looking for more diversification. There is a high demand for alternatives, but if you look specifically it is often about reducing certain concentrations that a particular investor has in certain assets, and so they are looking for new relationships or new products.

That can include anything from private equity to money market funds and things like that to manage the liquidity. Some of those advisors I spoke to also noted that investors in general have also become more prudent and follow less of a herding approach. They don't just put all of their net worth into a fund just because it had a tremendous return for the last six months. People are a little more cautious and diversify.

Darren Stainrod: I know of a manager who was up 40% this year and 30% the year before. However when three years back he was attending a prime broker's cap intro conference, there was nobody passing by his table. Of course this has changed after he has pulled in those returns, his table is now packed. However, what he tells those people is that they should not invest with him based on his past returns, because they may be different going forward, but because of his process and his strategy. People shouldn't chase past returns.



Stefan Henning

As much as I would like to disagree with Darren's observation, I think for a large part of the industry this is the reality. The most recent performance is key for attracting AUM.

Matthias Knab

While most people I spoke to here confirmed what I said before, that investors in general have also become more prudent and follow less of a herding approach, you can of course always find the exception to the rule.

One anecdote I heard was about an investor who was looking at a fund that did 30% last year, and the person was beating himself up that he should have been invested with the manager and how much money he would have made. He added he would put his money now into the fund. But when you asked about the strategy of the fund it turned out that he couldn't really intelligently answer that question.

I mean, there was a very superficial understanding, but when you ask in-depth questions about the strategy, the managers, the service providers and things like that, there is really no understanding of it other than the return number and that thought of had he invested what amounts of money he would have made. That also to some extent scares me because it's so reminiscent of the pre-market crash.

That brings me to another point. In December 2014 I attended an emerging manager conference in Miami. The chairman said that in the U.S. there would be 50,000 people with \$50 million investable assets or more, and that group of people would be growing annually by 16%. That is an enormous number of very high to ultra high net-worth individuals and families, and they just do things their own way, certainly much different to the way the larger institutions have come to invest.



Ingrid Pierce: Indeed. We see private wealth investors really making an effort to diversify their asset base. They are looking for alternative vehicles in which to invest, and actually many of them want to set up their own vehicles or platforms, principally to manage their friends and family money, but ultimately to broaden that into managing third party money.

Matthias Knab

Single and multi family offices are set up and grow at a rapid pace, that is a global phenomenon.

Ingrid Pierce

Correct, the ones we have seen over the last twelve months have been quite successful. Many of these investors had a lot of their wealth invested in the original business they created or in the stock market, but now they are intent on investing differently.

Darren Stainrod: We and the whole industry are still calling certain strategies “alternatives”, but the reality is that they are almost mainstream, or should become mainstream in the near future.

If you look at all the laws and regulations around alternatives, they are mostly designed to protect people, the moms and pops, from the “dangers” of alternative products, but maybe it should be the other way round so that more investor groups are able to diversify and hopefully protect their portfolios in the way that sophisticated investors can. I mean, the reality is that most people are almost excluded from those investments, other than through their pension funds.

As we speak, the main markets continue to climb and reach new highs, so if you look at the returns the markets have produced over the recent years then probably a well composed portfolio of hedge funds can protect your gains when the next downturn occurs. There is in fact a slow realization of what hedge funds and alternatives can offer to investors, and so we have seen some softening of the laws in terms of being able to advertise hedge funds, for example. I think it is important that the minimum investments continue coming down and more of those products become available to everyday investors.



Stefan Henning: Your comment reminds me of the “alternative” music scene when I was a student, where everyone would listen to alternative music - not noticing how little alternative it was to be like everyone else.

Regarding the alternative investment space, you make a great point that for many markets, these products are a lot more mainstream today and I think this is a very healthy development, especially with markets reaching new highs.



However, this is only true for some markets. When I mention hedge funds in my home country Germany I don't exactly sense that alternative investment vehicles have become mainstream and that regulators are trying to enable a broader investor base to invest in alternatives. I feel that regulators rather try to prevent everyone from marketing and investing into these “risky” products altogether. Hedge funds in particular are being blamed for causing the financial crisis in Germany and if regulators could, my sense is that they would rather prohibit than promote them. But with respect to the U.S., I completely agree that “alternatives” are on their way to become almost mainstream

Matthias Knab

We had the passing of the JOBS Act in the U.S. that finally came into effect in April 2012. But we haven't seen much hedge fund advertisements, have we?

Darren Stainrod: Right, so far it didn't happen, I can't see too many bill boards going up because it is still a private funds industry and because of the minimums. But I don't see any reasons why good managers with proven returns and track records can't come out with attractive, diversified products for the smaller investors and lower minimums. And of course, we are seeing that already with the 40 Act funds and UCITS. However those frameworks don't suit every strategy, so while it is good to see the growth in those new products there is still some way to go.



Ingrid Pierce: I tend to disagree. I think the minimum investment levels are there for a reason. Of course they are not always effective - just because there is a high minimum investment threshold doesn't mean an investor is actually a "sophisticated" investor, but it does at least provide a barrier to entry.



If you are going to lower the minimum investment level for a hedge fund to \$100 instead of \$100,000 or \$1,000,000 then the regulatory framework has to be a lot stricter. I think we would see many more dissatisfied investors who could not afford to lose their investment or weather the inevitable ups and downs and there would be a lot more litigation.

Really small investors just don't have the same tools, access and transparency that the larger investors get from an alternative investment manager in order to make an informed investment decision. Unlike the mutual fund world, a lot of this information has to be specifically negotiated. Small investors simply aren't in a position to negotiate anything with the manager of a private fund, and they are unlikely to have the benefit of proper advice before they invest in the product because they probably wouldn't be able to afford it.

Darren Stainrod: Well, the regulations I had mentioned try to address at least some of those concerns, but I also have to say they add a higher cost level to these funds. I take Ingrid's point but honestly we all know so many people who have lost significant wealth investing in tech stocks, or even putting it all into something seemingly safe like gold at the wrong time. People make bad decisions all the time. I am convinced that they would be better off with a diversified portfolio that included hedge funds.

I agree with the concept that certain controls and limits are needed when you offer a retail alternative investment fund, but coming back to my previous statement I think it's time for a kind of paradigm change to turn this "we need to protect people from the evils of the hedge funds" idea, because by now, for many decades the managers who offered more diversified products have clearly demonstrated real value and substance in their track records.

Also, the way the offshore hedge fund industry operates with cumbersome subscription documents, terms, negotiations and so forth isn't for the smaller investor, so the 40 Act and UCITS type structures make it easier to invest in alternative strategies.



Stefan Henning

Apart from regulatory questions: Hedge funds are relatively complex and inhomogeneous types of investment products. Marketing a hedge fund requires a fair amount of time to explain the product and the strategy with all of its specifics – you won't find it on many billboards in the future.

Matthias Knab

Darren, you are mostly dealing with the larger institutions. Do you see those also investing in the regulated 40 Act or UCITS funds?



Darren Stainrod: Yes indeed, some do, and for certain investors the regulated funds are popular because the investor can rely on defined and stable regulatory rules and adding certain restrictions and limits around them. These products have opened up new investor bases for the alternative investment managers. Also in Europe the UCITS funds offer foreign managers a much simpler access to European investors than through AIFMD.

Matthias Knab

Many Asian managers seem to follow the strategy to first launch an offshore vehicle and when they have grown enough they they may add on a UCITS or 40 Act funds. That seems to be different in the U.S., which may also have to do with the larger size of U.S. managers.

Darren Stainrod: True, much of the Asian money is actually invested through UCITS and similar products.

In the U.S. I believe the 40 Act Funds haven't taken up alternatives yet in the way that a lot of people have expected. Many managers launched these expecting the investments to come, but probably a good number are still not profitable because they haven't grown yet to the required size levels. That said, there is still a proliferation of them, they are growing and also see more inflows over time. So it's happening but a bit slower than people thought.

From a director point of view it's also something we are looking at and one of our directors has just been appointed to a 40 Act fund board to test the waters. There is a lot more involved and meetings can take five, six hours or longer with lawyers from all sides at the table, and a very cumbersome redemption process where investors have to lobby for redemptions. So it's quite a different animal.



Matthias Knab

Let's look at hedge funds that actually operate from Cayman, I find this a fascinating development. Stefan, can you share with us more details about this new trend? What are some of the benefits of being based in Cayman?

Stefan Henning: As mentioned earlier, we chose Cayman over classic hedge fund destinations like New York or London, and we see a number of other startup managers doing the same. From a marketing perspective there is no doubt that those locations still offer benefits over a more remote location like Cayman, but we were convinced by all the other advantages Cayman offers.

Besides taxes, we are being offered a full service, plug-and-play situation with the Cayman Enterprise City. We didn't have to find office space, buy a printer and all those other things that take a lot of time for a startup, but could instead work on the fund launch from day one.

It took us less than a month from the time we made the decision to set up our company in Cayman until we received our work visa. Going forward, it will take five business days to receive additional work visas for new employees.



It is also often overlooked what a broad talent pool Cayman offers. With many of the administrators, auditors and banks located on Island, there is tremendous talent available. For example, we were able to find a Wharton educated CFO with a top four auditor background within a few weeks.

So all in all, Cayman is a tax free, cost and time-efficient, business friendly location that offers a great talent pool and all hedge fund service providers are located within a five minute ride. For us, the decision was easy and we are glad to be here.

Darren Stainrod: Apart from Stefan, we have seen a few managers set up in Cayman over the years.

I think most of them are smaller managers who have decided to start their firm from here as it doesn't necessarily suit big operations with many people that need to be relocated or certain strategies. But for some it is a perfect solution with an attractive lifestyle, tax efficiencies and strong infrastructure.



Ingrid Pierce: It's still a relatively small community of managers, although the government has made an effort to make it attractive to set up business in the jurisdiction and it would be good to see more managers having physical operations here or at least relocating certain principals with investment management expertise.



There are some locally established firms who already provide investment advice to advisors or funds in other jurisdictions, which provides additional substance and could be beneficial from a tax structuring perspective. That is potentially a new product for managers who domicile themselves in Cayman. This would also provide additional flows into the local economy and increase opportunities for residents to become involved in other aspects of the financial services sector.

Matthias Knab

Going back to the sort of the commoditization of the industry we talked about earlier, for many years people would basically be operating from their onshore jurisdiction and have the nameplate on the door with their token service providers rubber stamping things in the offshore market and claiming the benefit of being offshore in terms of tax and regulatory mutuality.

But with more and more governments looking for more revenues, they will search for ways to increase their tax revenues by all sorts of measures. So actually those managers who actually create true substance offshore may be ahead of the curve...

A lot of course will depend on where the manager and his team are coming from. There are a lot of other great places in the world to live and do business. For example, Singapore is a wonderful, beautiful place, but if you're coming from North America, or even England, it's a little far.

Having come to Cayman a number of times, I understand that Cayman is well positioned geographically and that it's a great place to live, and the quality of service providers is very high.

Darren Stainrod: Yes, and again, the zone is a huge benefit as most managers will have access to both U.S. markets and U.S. investors in the same timezone.

The government is trying to attract a number of businesses to come here, and asset managers are for sure amongst those. The availability and low costs of work permits through a simple and clear process is attractive to the financial industry. There are even a number of incentives from the government, even providing offices and the basic infrastructure. All this is very cost competitive and designed to attract and set-up investment managers here.



Matthias Knab

The economics on Cayman are very attractive, but I understand that there were also some structural changes over the years. If you go back a couple of years, you find that actually a lot of the operations of fund administrators or custodians for example was actually done physically here in Cayman. Over time, many of those jobs have migrated to even lower costs centers like Halifax or India. Even Ireland got competitive again after the financial crisis. Cayman is now looking to replace those jobs, but that will take time, so initiatives like the economic zone and attracting more managers like Stefan makes total sense. I also heard people saying that the whole of the island should be an economic zone – that would be a good argument to attract more employers. It remains to be seen as to what changes the government will end up doing in order to bring more business here.

So while a few job migrated back especially to Canada, where the people who moved back there now have high taxation and bad weather, others still do come to Cayman where in essence they get no taxes and good weather, so the opposite.

Darren Stainrod

When I was running the alternative fund administration business for UBS from here in Cayman, we used to recruit up to 30 people a year. There was actually one year where all of the 30 were from Edmonton, Canada. I think the weather may have been a factor!

Matthias Knab

I have lived in other places as well, and for me and probably other people or businesses as well the challenge of your daily commute can come up quite quickly in a place like London. Even the smaller cities change when it's rush hour.

Some managers are coming from New York to Puerto Rico right now. Puerto Rico is still part of United States, part of the U.S. common law. While not a U.S. state per se, the big thing there is that they have 5% taxation. Of course, you need to stay at least 90 days a year in Puerto Rico and you cannot be in the United States Mainland for more than 6 months to benefit from that.

I understand that as a result you won't pay any Federal tax in the United States, and as I mentioned, the state tax is at 5%. Of course, the challenge there is if you have family and kids, where will they be going to school? Those are some of the things you will have to think hard about. I know people who commute between Toronto and New York, that's pretty easy, it's a one hour flight. But you are not going to be commuting from New York to Puerto Rico. Also, parts of Puerto Rico are fantastic, others may be more challenging.

All of that probably comes into play why Cayman is getting some traction now. Cayman is a nice place to live and there are lot of benefits to it, so I also foresee more people coming here and operate from here.

accurate

professional reporting service

No wonder that each week, Opalesque publications are read by more than 600,000 industry professionals in over 160 countries. Opalesque is the only daily hedge fund publisher which is actually read by the elite managers themselves



Opalesque Islamic Finance Briefing delivers a quick and complete overview on growth, opportunities, products and approaches to Islamic Finance.

Opalesque Futures Intelligence, a new bi-weekly research publication, covers the managed futures community, including commodity trading advisers, fund managers, brokerages and investors in managed futures pools, meeting needs which currently are not served by other publications.

Opalesque Islamic Finance Intelligence offers extensive research, analysis and commentary aimed at providing clarity and transparency on the various aspects of Shariah compliant investments. This new, free monthly publication offers priceless intelligence and arrives at a time when Islamic finance is facing uncharted territory.

Alternative Market Briefing is a daily newsletter on the global hedge fund industry, highly praised for its completeness and timely delivery of the most important daily news for professionals dealing with hedge funds.

A SQUARE is the first web publication, globally, that is dedicated exclusively to alternative investments with "research that reveals" approach, fast facts and investment oriented analysis.

Technical Research Briefing delivers a global perspective / overview on all major markets, including equity indices, fixed Income, currencies, and commodities.

Sovereign Wealth Funds Briefing offers a quick and complete overview on the actions and issues relating to Sovereign Wealth Funds, who rank now amongst the most important and observed participants in the international capital markets.

Commodities Briefing is a free, daily publication covering the global commodity-related news and research in 26 detailed categories.

The daily **Real Estate Briefings** offer a quick and complete oversight on real estate, important news related to that sector as well as commentaries and research in 28 detailed categories.

The **Opalesque Roundtable Series** unites some of the leading hedge fund managers and their investors from specific global hedge fund centers, sharing unique insights on the specific idiosyncrasies and developments as well as issues and advantages of their jurisdiction.

OPALESQUE

www.opalesque.com