

A SIMPLE PROPOSITION

MONA NAINIE, OF HARNEYS LAW FIRM, TELLS *HFMWEEK* WHY, DESPITE A GLOBAL CLIMATE OF APPREHENSION, THE FUTURE IS BRIGHT FOR THE CAYMAN HEDGE FUND INDUSTRY



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Einstein said that everything should be made as simple as possible but not simpler. If we take a simple but contextual look at the suitability of the Cayman Islands as a hedge fund domicile today and strip away all the doomsday talk of under/over regulation, the fear of draconian regimes being laid down by the EU and the witch-hunting talk of ‘tax havens’, what do we have?

We have overwhelming industry support for the ‘Cayman brand’, from both established and emerging markets. We have clarity on the EU’s Alternative Investment Fund Managers (AIFM) Directive and forthcoming US legislation with minimal impact for the Cayman framework. We have statistics that tell us, without a shadow of a doubt, that the feared mass migration to Ucits and other jurisdictions has not happened. We have clear evidence of the ongoing commitment of the Cayman Islands to the increasing global demand for regulation. We have even more commitment to improve the commercial, streamlined approach taken by Cayman Islands company law to particular company structures such as funds and to develop case law in key areas for hedge funds to do with redemptions and creditors.

SIMPLE STATISTICS

Any attempt to examine the more telling aspects of the current state of the Cayman Islands hedge fund should begin with the statistics that tell such a simple and undeniable story. Despite the mass redemptions, suspensions and liquidations experienced by hedge funds since 2008, the jurisdiction continued to register between 80 to 100 new funds per month throughout 2010 and the trend has held steady. These numbers, confirmed by the Cayman Islands Monetary Authority (CIMA) are to be contrasted against the four to six redemptions that occurred during 2010 and the first quarter of this year.

One of the reasons for this, clearly, is that investors have more control now and are able to dictate the structure and terms of the fund to a greater degree, particularly as they relate to transparency and liquidity. Industry commentators are in agreement that the result of this control is that the investor pendulum has swung back towards high performance. A Ucits vehicle trades off performance for transparency and liquidity and is constrained on one hand by a complex service provider/fund relationship and even more complex replication of traditional hedge fund

strategies, and on the other hand by the implementation of various investment restrictions. Given the fact that clarity is now being provided on the impact of EU and US regulation on the Cayman hedge fund, and the consensus is that this impact will be minor to benign, the push by managers to circumvent such regulation no longer appears to be driving their thinking. The fact that the AIFM Directive has taken 26 months to get to this point, with details yet to be hammered out, also carries with it the risk that there may be a reversal of some of the changes aimed at making the Ucits vehicle less restrictive regarding investment strategies.

The Cayman hedge fund model, by contrast, continues to be a stable, straightforward model of light regulation that does not impose restrictions on fund strategies and has a flexible, commercial architecture. This is the same light regulation that has met the standards re-

quired by Iosco, the International Monetary Fund (IMF), OECD and others. The Cayman hedge fund still revolves around, *inter alia*, transparency and full disclosure in the offer document to a level appropriate for its target investor, an audit firm which has been vetted and approved by CIMA and nearly always, the appointment of a properly qualified independent administrator.

Cayman also remains committed to its framework for the regulation and supervision of the funds industry. The

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IMF stated in its 2009 assessment that this framework exhibits high levels of implementation of the Iosco principles. Cayman is on the OECD white list of jurisdictions that substantially implement international tax standards and has entered into more than 20 tax information exchange agreements (TIEAs). Cayman is also an active participant in the OECD Global Forum on Taxation and was one of the first non-OECD jurisdictions to adopt, in 2000, the principles of transparency and tax exchange of information. CIMA has a statutory obligation to co-operate with overseas regulatory authorities under the regime delineated in the Monetary Authority Law and has extensive powers in that regard. It has signed 14 bilateral agreements, one multilateral memorandum of understanding (MOU) with eight Caribbean regulators and is a full signatory to the Iosco MOU. Indeed, since 2000, CIMA has handled more than 990 requests for assistance from overseas regulatory authorities.

LEGISLATIVE DEVELOPMENT

The most recent developments in Cayman legislation and case law also underscore Cayman's ongoing attraction in 2011 as a domicile of choice for hedge funds. A series of high-profile Cayman Islands cases continue to bring clarity to key issues for hedge funds, namely, the timing of various steps in the redemption process and the circumstances under which it may be just and equitable for a court to allow a shareholder's petition to wind up a fund during a valid suspension of redemptions. Related to this, the most recent cases have been primarily concerned with an examination of the 'substratum' of a fund (the purpose for which it was formed) and how it may be said to be lost, such that it is just and equitable for a court to order the fund be wound

up and placed into formal liquidation at the request of a dissatisfied investor. These cases have all served to simplify the decision-making process that underpins the language and provisions of hedge fund documentation, by highlighting its contractual nature and the need for clarity in order to easily and simply pursue the enforcement of rights and obligations arising under it.

Similarly, the most recent legislative amendments to the Companies Law have been driven by an attempt to clarify and simplify the processes by which Cayman companies and funds can undertake mergers, acquisitions or changes to corporate structures while ensuring global standards of transparency and accountability are maintained. Going forward, the Cayman Islands' government hopes to amend legislation to create a new Mutual Funds Administrators (MFA) licence category to attract smaller operators and also thereby facilitate greater depth in the mutual fund administration industry. Many licensees conduct only one component of mutual funds business (such as registration and transfer agency services). However, there is currently no ability for an applicant to apply for a MFA licence that allows it to be appropriately licensed so that it may conduct partial business. The proposed new MFA licence category will cater to such entities, while requiring them to have a nominal net worth, professional indemnity insurance and an obligation to have a principal office in the Cayman Islands.

It is for reasons such as these, together with the developing trends of rapidly increasing emerging market and start-up manager interest in the Cayman Islands, that makes the proposition that the Cayman Islands continues to retain its dominance as a hedge fund domicile in 2011, a very simple one. ■