

HEDGE FUND MANAGER **HFM WEEK** SPECIAL REPORT

The *long* and the *short* of it

CAYMAN 2010

GAINING MOMENTUM

The beginning of 2010 sees the domicile of choice gaining in strength

Offshore giant

In 2010, the Cayman Islands has seen itself lift out of the economic crisis in true strength, as the world's leading offshore jurisdiction, where investment vehicles continue to be set up on a tax-neutral basis. Whilst 2009 witnessed a global decline in hedge funds of 40%, Cayman maintained its strength and 2010 looks set to continue in similar fashion.

Smaller jurisdictions will struggle in the battle to survive against the offshore giant. In the face of economic turbulence, the Cayman Islands suffered, with new funds registered in 2009 down by 30%, but this suffering was minimal in comparison to the global impact of the financial crisis.

With the glory days prior to 2009 over, 2010 looks set to re-ignite the old flames in the market, with the tax-neutral domicile of the Cayman Islands yet again in pole position. Many of the legal changes brought about by the financial crisis have seen Cayman dominate the regulatory scene, with others following behind in an attempt to mimic its success. With the success of Strategic Turnaround Master Partnership making inroads into the ever-evolving face of the industry, players in the Cayman Islands have been integral to driving this momentum. With these legal and regulatory changes, the Cayman Islands is now a place ready and prepared to shine, yet again, in the aftermath of the crisis.

A growing need for more independent administration, due to regulatory changes and the

changing demands of the investor, leaves a gap in the market for the Cayman Islands where more third-party administrators may start-up. With transparency the buzzword of the moment, its importance is becoming one of the fundamental tenets of any sustainable fund. Currently, most independent administration for the funds based on the Cayman Islands is not undertaken in the jurisdiction, but this looks set to change and will undoubtedly strengthen Cayman's place, ever-solidifying its backbone in the market.

Independent directors now hold more responsibility than ever before; what was done in-house has become the role of the independent administrator, and those administrators who do not keep up with these changes will suffer in gaining new business. This leaves the powerful Cayman Islands with space to grow, and, yet again, place the footsteps of the next few years of hedge funds on the map.

Ruth Gillbe
Report editor

HFMWEEK

Published by Pageant Media Ltd

London

Suite L, 1 East Poultry Avenue EC1A 9PT
T +44 (0)20 7029 4007

New York

1375 Broadway, 11th Floor, NY 10018
T +1 (646) 278-9961

Dubai

502 La Riviera Tower, Dubai Marina,
Dubai, UAE
T +971 (55) 6959773

Report editor: Ruth Gillbe

Tel: +44 (0)20 7029 4064

r.gillbe@pageantmedia.com

Editor: Gwyn Roberts

Tel: +44 (0)20 7029 4057

g.roberts@pageantmedia.com

Production editor: Claudia Honerjager

Sub-editor: Rachel Kurzfeld

Contributing sub-editor: Melanie Rockett

Operations director: Sebastian Timpson

Managing director: Charlie Kerr

Commercial manager:

James Blanche

Tel: +44 (0)20 7029 4051

j.blanche@hfmweek.com

Head of event sales:

Lucy Guest

Tel: +44 (0)20 7029 4052

l.guest@hfmweek.com

Senior publishing executive:

Sally Boyle

Tel: +44 (0)20 7029 4053

s.boyle@hfmweek.com

Subscriptions:

Daniel Pope

Tel: +44 (0)20 7029 4056

d.pope@hfmweek.com

Circulation manager:

Fay Muddle

Tel: +44 (0)20 7029 4084

f.muddle@pageantmedia.com

PAGEANT MEDIA



HFMWeek is published weekly by Pageant Media Ltd, a certified member of the PPA ISSN 1748-5894

Printed by Wyndeham Grange

© 2010 all rights reserved. No part of this publication may be reproduced or used without the prior permission from the publisher



IN THIS ISSUE □ □ □

6 Evolution of administration

ADMINISTRATION

Ben Pershick of **Admiral Administration** explores how advances in technology have pushed the administrator's role above and beyond its previous comfort zone

8 Outsourcing hedge fund services

ADMINISTRATION

Karen Watson of **Maples Finance** discusses the benefits of outsourcing hedge fund services to independent fund administrators post the economic crisis

11 Swiss move is not as simple as it seems

ADMINISTRATION

Aldo Ghisletta of **Offshore Business Solutions** outlines the ways in which the service provider focuses on the unique needs of the Cayman-domiciled investment managers

15 Cayman's courts lead the way

LEGAL

Anthony Akiwumi of **Stuarts Walker Hersant** reveals why two decisions by the Cayman Islands Court of Appeal set the territory apart in the financial world

18 A desire for transparency

LEGAL

Richard Addlestone of **Appleby** outlines why institutional investors' need for more transparency in the funds industry must be met in this post-financial crisis era

21 Independence day looms

INVESTORS

Alan Craig of **Campbells Attorneys-at-Law** outlines potential considerations for fund investors in 2010 that have been highlighted by the difficulties that faced the industry in 2009

24 Fighting your corner

LEGAL

Sophia Harris of **Solomon Harris** reviews the lawyer's position in the face of more industry-aware investors questioning whose side their lawyer is actually on

27 Corporate control key to confidence

CORPORATE GOVERNANCE

Colin MacKay of **Ogier** discusses the shift in investor focus in the Cayman Islands and how the industry can make use of Cayman's pool of talent to approach the issue

30 Clearing skies ahead

HEDGE FUNDS

Christopher Lumsden of **Cayman National Financial Group** examines the realities of transparency within the hedge fund market following the global economic downturn

33 Rights and recognition

INSOLVENCY

Nick Matthews of **Kinetic Partners** explains recent developments in the Cayman insolvency landscape and why further clarification will be necessary in future

37 The future of funds

HEDGE FUNDS

Tim Clipstone of **Harney Westwood & Riegels** looks at what increasing regulations in the European Union and United States will mean for investors in the Cayman Islands

40 Happy days will open new doors

ADMINISTRATION

New fund administrators are in a strong position, but they must be at the top of their game to deal with increasingly demanding investors, says **Martin Laidlaw** of **JP Fund Administration**

42 Hedge funds set to bounce back

HEDGE FUNDS

James Wauchope and **Neal Lomax** of **Mourant du Feu & Jeune** assess the outlook for Cayman Islands hedge funds in 2010 and highlight signs that a better year is on the horizon

45 Chapter 15: will it provide hope?

INSOLVENCY

Margot MacInnis and **John Skelton** of **Krys & Associates** Cayman discuss the benefits that Chapter 15 of the Bankruptcy Code will provide to offshore financial centres when managing insolvency

Richard Addlestone of **Appleby** outlines why institutional investors' need for more transparency in the funds industry must be met in this post-financial crisis era

A desire for transparency



Richard Addlestone is a partner in **Appleby's** Funds and Investment Services Team. He has over 16 years legal experience, with over eight years of Cayman-specific experience in private equity and hedge funds.

Investors are increasingly looking for more transparency in the investment funds industry and none more so than institutional investors. However, there is debate about what transparency means. An important aspect to transparency is appropriate disclosure and information rights. Independent oversight is also key, especially with regard to valuation of assets and when they are or become illiquid. There is now a trend for detailed valuation policies to be worked up and provided to investors in advance.

Even where a fund has an independent administrator whose responsibility is to provide the NAV, investors are drilling down further, to establish whether the administrator is doing this merely on the basis of data provided by the manager or whether this data comes from an independent source. The former is far less attractive to investors. Already, investor desire for enhanced independent valuation is having effects. For example, it has helped spawn a new up-and-coming industry of valuation firms whose specialised role is to provide independent data.

The credit crisis has brought some issues to the fore. Although lock-ups, gates and side-pockets can be legitimate mechanisms that a fund may adopt to deal with liquidity problems, unsurprisingly, investors do not like them. Whether such a view is justified or not, some institutional investors consider their use as being a fundamental breach of the relationship given that liquidity of their investment was a key feature to having invested in the first place.

In talking to investors, there is a definite sense of investor frustration with the industry generally. Having spent considerable effort in whittling down the long list of possible products in which to invest, institutional investors find that the documentation of the selected funds falls short and is too manager-friendly. They then resort to the process of negotiating information rights and other variations in side-letters to obtain anything close to the levels of transparency that they require. This can be a time-consuming process. Often, complex structural issues arise in trying to implement the variations. In a Cayman fund, the fundamental principle that investors of the same class must be treated equally can present obstacles to variations and so require innovative so-

lutions. This is where law firms, such as Appleby, have such a key role to play in problem solving.

Bear Stearns/Lehman effect

Following the Bear Stearns and Lehman Brothers collapses, the investment funds industry were rudely awakened to the issues arising out of rehypothecation of assets for example, where collateral posted by a prime broker's client to the prime broker is used as collateral by the prime broker for its own purposes, for example. Prior to the credit crisis, it was not unheard of for investment funds to be content to have their assets commingled with those of the prime broker or at least isolated from the assets of the prime broker but commingled with assets of other investment funds. There is now a trend for fund assets to be isolated even from other funds' assets. Despite the added costs imposed for this level of service, managers are increasingly seeking this option. Managers are looking increasingly to spread risk and utilise more than one prime broker, in order to avoid having all their eggs in one basket.

Investors are generally more wary than in the past for a number of reasons. Certainly, the Bear Stearns/Lehman effect has had an impact – even more so has Madoff. There is enhanced focus on due diligence. Fraudulent schemes, such as ponzi schemes like the one Madoff carried out are prevalent. The Securities and Exchange Commission (SEC) is flooded with reports of such schemes and its resources are stretched such that it is forced to focus on the most material wrong doers.

Independent directors

Institutional investors are looking much more to the independent director as the guardian of their interests. Generally, investors find that fund structures are geared more in favour of managers rather than investors. This is hardly surprising given that it is managers who form funds and they are advised by counsel who look after the manager's interests. When problems arise in an investment fund, investors gravitate to the independent directors as their champions. There is a clear desire on the part of investors to partner with the independent directors, and to have the independent director 'in their corner'. As a result, investors are more wary than ever of any conflicts of interest that the independent director may have.

“Having spent considerable effort in whittling down the list of products in which to invest, investors find that the documentation of the selected funds falls short and is too manager-friendly”



Where there are two independent directors appointed, investors prefer to see that each one is provided by a different independent director service provider, so as to maximise the four eyes on everything approach. Where the same firm provides two directors, there is sometimes a tendency for one of the two to take the lead. This may mean diminished oversight and poor value for service if full fees are paid to both board members.

Controversially, investors are concerned to ensure that the independent director has sufficient capacity and resources such that the director can devote adequate time to each fund. The perennial question is always over what is the maximum desirable number of directorships. Independent directors provide services as a livelihood. Restrictions on the number of their appointments, requirements to devote more time to each fund and to be more proactive is bound to have a knock on effect on their fees. However, some investors maintain that they are fully prepared for that and this is a cost worth paying to ensure that their interests are preserved.

Redemption rights – now and the future

There are a variety of redemption provisions which have emerged from the credit crisis to deal with illiquidity. Suspension rights have become more focused and afford the ability for the fund to suspend redemptions without the prerequisite of suspending the NAV calculation. There are provisions for distributions in kind, in the form of interests in liquidating accounts and liquidating trusts. Gates on redemptions have been introduced, which allow the fund to reduce redemption requests to a certain percentage of the fund's total assets during any redemption period in order to prevent a run on the fund. Side-pockets are increasingly considered.

The Cayman court case of Strategic Turn-around has resulted in more careful consideration than before of redemption provisions in corporate funds. The case determined that redemption is a process comprising of several stages and, in the absence of anything to the contrary in the fund's documentation, the investor remains a shareholder in the fund until the proceeds

of redemption are paid to the shareholder and the register of members is updated by the administrator to show it is no longer a shareholder. Furthermore, if the fund suspends redemptions, the suspension applies to all of the stages that have not been completed, which could, therefore, include the payment of redemption proceeds. Fund documentation is now far clearer on exactly what powers the fund has, with regard to its ability to suspend the redemption process and the status of the investor in the redemption process so that the desired results are achieved.

Cayman as a domicile of choice

Cayman is the domicile of choice with 80% of hedge funds; a total just short of 10,000 funds. The Cayman fund is a tried-and-tested product to a level which no other jurisdiction can match. The registration procedure for open-ended funds, where the regulator has no discretion to refuse registration if the simple documentary and fee requirements are met, is popular within the industry. However, Cayman needs to maintain its competitive edge and especially in these difficult economic times. The AIFM directive is an area for concern. However, on balance, it may not have that much of an impact on the jurisdiction.

The future for Appleby

Appleby is the leading provider of offshore legal, fiduciary and administration services with over 800 lawyers and professional specialists globally. While many competitors have recently reduced in size, Appleby has seen great expansion in the past 12 months. The group now has 12 offices with the most recent office opening in Guernsey in April 2010 and the merger with leading Isle of Man firm, Dickinson Cruickshank in October 2009.

In order to enhance the service that Appleby is able to offer, the group has also strengthened its expertise particularly in the corporate and commercial practice group with the lateral hires of Richard Addlestone, Julian Black, Matthew Feargrieve, James Gaudin and Matthew Stocker. All join from other leading offshore law firms. ■



APPLEBY

Navigating offshore options can be tricky. Guiding clients, while keeping their unique business goals in mind, takes skilled lawyers with an unbiased perspective and complete knowledge of jurisdictional strengths. Experienced professionals providing tailored solutions. **Appleby.**

applebyglobal.com

THE RIGHT PEOPLE. THE RIGHT PLACES.
THE RIGHT SOLUTIONS.

Bahrain
Bermuda
British Virgin Islands
Cayman Islands
Guernsey
Hong Kong
Isle of Man
Jersey
London
Mauritius
Seychelles
Zurich

Offshore Legal, Fiduciary
& Administration Services