

As soon after the arrival of the financial crisis as late 2008, and throughout 2009 governments and economists across the globe predicted that in 2010 the world economy would be coming out of recession and growth would return. That has shown to be misplaced optimism, given that there has been no real turnaround in the United States and the well documented problems of beleaguered Ireland and Greece seems to have brought Europe and its monetary system to the brink. Should Portugal Spain or Italy follow suit and hold out the begging bowl to the EU and IMF this could very well sound the death knell for the Euro, at least as we know it, if not for the whole EU. Those looking for good news have their optimistic eyes firmly focused on Asia to buoy up global trade as well as rely on China's powerhouse economy and government possibly to become lender to bail-out the debt-ridden west.

# Eastern promise: Eyes on Asia

by **Mark Cummings**

**I**nterested parties will, of course, be asking how the Cayman Islands can participate in Asian business while the traditional markets of the US and Europe it has long-served have been less than buoyant and are likely to remain that way for some time? The good news is that Cayman Islands vehicles are very familiar to Asian investors, particularly as the jurisdiction of choice when establishing an offshore fund vehicle and as listing entities for IPOs on the Asia stock exchanges.

## **The good: The IPO gold rush**

Cayman Islands entities are used extensively in stock exchange listings in Hong Kong and Singapore and additionally quite recently in a number of listings on the Taiwan Stock Exchange. Hong Kong's IPO market is the most buoyant and the most China-focused of the Asian international exchanges. In the first 10 months of 2010 the Hong Kong IPO market raised an impressive HK\$345.9 billion (US\$44.3 billion) in total, many of which were Cayman Islands vehicles, chosen for the dependability and flexibility of Cayman's company law and its tax neutrality. Cayman law firms which are present in the Asian financial centres, particularly Hong Kong, continue to be kept busy by the flood of IPO work coming out of China and other Asian economies.

The bad news for Cayman is that Hong Kong and other Asian markets are opening their doors to other countries and now it is possible to list

Jersey, BVI and Isle of Man companies on the Hong Kong Stock Exchange. While Jersey and Isle of Man will remain unfamiliar to many Asians, Cayman Islands will feel most pressure on its market share of the IPO market from BVI entities which have always been widely used for investment and holding entities throughout Asia, especially due to its lower costs for incorporation of companies and their annual maintenance. Cayman will need to remain competitive to keep its market share of the IPO market with one eye on downstream work such as when a listed company is taken private. The merger provisions in Cayman's Companies Law are widely appreciated by practitioners here in Asia, but many of the teething problems with this 2009-introduced legislation still need to be ironed out to give more flexibility to those considering their options in buy-out and M&A scenarios.

## **The good: Growth of funds**

Asian fund managers will invariably gravitate towards a Cayman Islands entity as their fund vehicle due to familiarity at the manager and investor level. Cayman is seen as advantageous due to its flexible Mutual Funds and Securities Investment Business Law regimes as well as its reputation as the pre-eminent offshore funds centre, whether for hedge funds or private equity funds. Service providers, including Cayman law firms, administrators, incorporation agents, directors' services providers are all seeing healthy demand for Cayman Islands funds, small and large. The



g o o d news is that the Asian fund market is in relative infancy compared to the US and Europe and most commentators expect good growth in the establishment of funds. The Cayman Islands should hopefully continue to attract much of the fund establishment business.

The healthy demand means it is a competitive arena for all service providers, helping keeping costs and fees lower. However, the lower legal and fees for administration and other services utilised by funds have been substantially eroded by the increases in early 2010 in fees being charged by the Cayman Islands government for incorporations, tax exemptions and SIBL exemptions. Asians will typically cast their nets wider and look for options if it will save them and their investors' money. Cayman needs to remain competitive in its fees lest there be a flight of capital to more cost effective locations.

However, despite the fee increases, in the face of increased regulation in the US and the EU, which for many managers will be too expensive to

comply with, as well as the BVI's introduction of its own Securities Investment Business Act, there are some managers in Asia actually moving their jurisdiction of domicile to the Cayman Islands, as it offers less demanding regulation in the investment management and advisory sphere. Any further increases in the SIBL exemption license or other government fees could well stem that flow of business and the Cayman government should tread carefully and consider the bigger picture before making any further fee increases.

### The bad: Tax

Cayman Islands vehicles have been used to structure investment into China and other Asian economies. However, the Chinese tax authorities (as well as tax authorities in India, Indonesia and Australia) are now imposing regulations which all focus to one degree or another on the notion of "substance". Innovative ways are constantly being considered to assist companies to demonstrate substance and that decision making processes are being made in the Cayman Islands so as not to fall foul of Asian domestic tax rules.

In the case of China, in December 2009 it released Circular 698 which has caused much debate and concern in offshore circles. Circular 698 applies to the direct or indirect sales of Chinese resident enterprises. In certain circumstances the sale of an offshore holding company would result in Chinese tax liability for its parent company, as the authorities will look through the offshore holding vehicle and deem such a transaction effectively to be a sale of the Chinese company. Such liability may arise where the Chinese authorities considers that the arrangement (ie, the interposition of the offshore holding company as the Chinese company's shareholder) has no reasonable business purpose. However, no definition of the term 'reasonable business purpose' has been provided. Most commentators agree that it will not be enough to demonstrate reasonable business purpose by pointing to the use of an offshore vehicle as facilitating the preference of sophisticated investors or for its suitability in the ease of transfer of shares from one investor to another or its ability to be listed on Asian exchanges. Real operational activities will need to be taken at the holding company level, which brings us once again, back the idea of substance. The Cayman Islands government would clearly welcome real companies setting up real operations together in the Cayman Islands with the undeniably foreseeable

benefits to Cayman's economy and employment opportunities in the Islands, but there are real operational and costs barriers to that happening. Cayman is not a low cost jurisdiction to create or locate businesses operations in, something that the Cayman Islands government needs to consider addressing.

### Good news: Meeting the challenges

The Cayman Islands has taken steps to make sure it remains at the forefront of Asian investors' minds as well as being able to interact with the region's governments and regulators by establishing a representative office in Hong Kong. This is certainly a commendable move showing foresight but the Cayman Islands is not alone amongst offshore centres in having such representatives in Asia – Jersey and Guernsey have people on the ground in Hong Kong and other offshore centres will no doubt follow. Challenges still remain to promote the Cayman Islands in a very competitive arena and in the ever present face of tax authority suspicion and scrutiny. There are many supporters of the Cayman Islands in Asia and its service providers constantly beat the drum in this market. We all hope that Cayman can remain attractive to Asian investors and most importantly that Asia can lead the global markets back on to the right path.

### BIO: AT A GLANCE

Mark Cummings practices a wide range of corporate and commercial law specialising in investment funds, mergers and acquisitions, capital markets, the formation and operations of special purpose investment vehicles and public and private offerings of debt and equity in relation to the Cayman Islands, BVI and Bermuda jurisdictions. Mark is a member of the Law Society of Hong Kong (registered foreign lawyer), the Law Society of England & Wales (non-practising), the Law Society of Ireland (non-practising). Mark has been admitted or registered as a lawyer in Bermuda, New York, England & Wales, Northern Ireland, the Republic of Ireland and the Cayman Islands.



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