

## FOCUS ON

## CAYMAN ISLANDS

John Wallace of Deutsche Bank, Ian Dillon of Campbells and Julian Stockley-Smith of JP Fund Group discuss investor appetite for the Cayman Islands as a leading offshore jurisdiction for hedge funds



**John Wallace** is managing director and co-head of alternative fund services within Deutsche Bank's Global Transaction Banking division. Based in New York, he is responsible for the development of Deutsche Bank's alternative fund services.



**Ian Dillon** is a partner in the corporate department of Campbells. Ian specialises in all aspects of corporate and financial services law, including, in particular, investment and private equity fund formation, structuring/restructuring and governance.



**Julian Stockley-Smith** is founding shareholder of the JP Fund Group and director of JP Fund Foundations, Cayman. He has extensive experience in international financial markets gained in Europe, Asia and Australasia, particularly in broking and banking services.

**Q HFMWEEK (HFM): WHAT CONTINUES TO MAKE CAYMAN AN ATTRACTIVE AND VIABLE DOMICILE FOR HEDGE FUND MANAGERS?**

**A JOHN WALLACE (JW):** The Cayman Islands developed into the leading offshore jurisdiction for hedge funds because of its regulatory regime and the quality and expertise of the local administrative, accounting and legal professionals who live and work on the island. The flexible but effective regulatory framework provides safeguards to investors but does not impose restrictions on a hedge fund manager's investment strategy; coupled with the infrastructure and world-class service providers, this jurisdiction continues to attract the majority of global hedge fund managers. The past few years have served to demonstrate its strength and viability as a leading regulator which dynamically adjusts to best practices and the needs of the marketplace.

**A IAN DILLON (ID):** Essentially, the willingness to adapt and address issues as they arise has allowed Cayman to retain its position as the world's premier hedge fund jurisdiction. Despite the offshore bashing that's been going on for the past few years, Cayman's consistently positive approach to dealing with the challenges of increased

scrutiny and regulation has ensured that it remains attractive to hedge fund managers and the sophisticated and high-value clients they service.

**A JULIAN STOCKLEY-SMITH (JSS):** The Cayman Islands are generally regarded as the world's leading offshore hedge fund centre for a number of widely accepted reasons: flexible financial services and fund laws, pragmatic regulation and the presence of locally based fund-servicing professionals (including lawyers, administrators, accounting and other supporting services). One of the key and more prominent characteristics of the Cayman Islands fund environment is that any reasonable, fully disclosed strategy is normally possible. In Cayman, it's about working with qualified investors that understand the nature of the venture, rather than expending resources dealing with compliance and red tape; ultimately, this all adds to the potential for improved performance. As the regulatory burden (sometimes with uncertain benefit) increases in some regions, this characteristic of Cayman Islands funds is likely to become more popular.

**Q HFM: HOW HAS CAYMAN CHANGED AS A DOMICILE FOR FUNDS IN LIGHT OF THE CURRENT SPATE OF ONSHORE REGULATION (AIFM, DODD-FRANK)?**

**A JW:** Recent changes proposed which would require master funds (in the context of master/feeder funds) to register with the Cayman Islands Monetary Authority (Cima) are evidence of the jurisdiction responding to changes in the global regulatory landscape. As generally all of the assets of this fund structure are held at the master level and custody of assets has been a specific target of regulatory change across the globe, the proposed regulations are very much in line with changing best practices.

Under the AIFM Directive (AIFMD), non-EU AIFs (such as funds registered in the Cayman Islands) will continue to be able to market their funds in the EU under the current private placement regime and much of the onus to comply with AIFMD largely rests with the non-EU jurisdiction. Although there is a modest increase in regulatory reporting, it is not likely to result in the competitive disadvantage that was initially feared.

With the US being the largest hedge fund market and Cayman the leading jurisdiction for hedge fund domiciles, there will be Cayman-based fund managers who will now need to become SEC-registered investment advisers due to the Dodd-Frank legislation. Many Cayman-based hedge fund managers are existing SEC registrants, so precedent exists for managers to adopt and comply with their new regulatory obligations. Deutsche Bank is actively monitoring the impact of Dodd-Frank and we have already enhanced our administration offering with investments in technology and infrastructure to help meet the needs of US-based managers, whether new SEC registrants, existing SEC registrants who are now deemed major swap participants due to their OTC investments or managers currently exempt but planning for the future.

**A ID:** Cayman has always been a jurisdiction with strong, yet appropriate, regulation. During the past few years, in particular as a result of increased regulatory pressures and scrutiny from onshore jurisdictions, our local regulator – always very aware of external pressures – has moved rapidly to address them in local regulation. But



whether the increased regulation has improved the offering remains to be seen. You would be hard pressed to find, in the litany of issues and problems that occurred during the global financial crisis (which AIFMD and Dodd-Frank were at least partially aimed at addressing), a problem whose genesis was a failure of Cayman Islands regulation.

**A** **JSS:** Cayman Islands regulatory changes have been targeted to improve compliance in line with generally accepted international standards in several areas, including anti-money laundering (AML) and anti-tax evasion. For example, the Cayman Islands government has executed tax information exchange agreements (TIEA) with 25 jurisdictions to ensure tax transparency and a number of new agreements are in the final stages. There will inevitably be some impact from the changing regulations in Europe and the US and the jury is still out on the net result of this, largely because new legislation hasn't yet fully come into effect. As above, this is an opportunity for the Cayman Islands, provided the key AML procedures and information disclosure agreements are in place. We understand the Cayman Islands government is working with the EU towards recognition of AIFMD equivalency and, given that private placement rules remain in place until at least 2018, there is no immediate concern about the ability to offer Cayman funds in Europe.

**Q** **HFM: HOW WOULD YOU RATE THE CURRENT INVESTOR APPETITE FOR FUNDS DOMICILED IN THE CAYMAN? WHAT INVESTOR TRENDS ARE YOU SEEING?**

**A** **JW:** Strong. At Deutsche Bank, we have seen increased asset inflows across our administration clients, but predominantly those which are domiciled in Cayman. In recent months, we have seen a growing number of investments into managed account platforms and Segregated Portfolio Companies (SPC), which have the ability to quickly rebalance their portfolio holdings and provide better liquidity terms.

**A** **ID:** Although the appetite for new fund establishments is nothing like the pre-2007 heyday, in the context of global trends there is no reduction of investor

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IAN DILLON, CAMPBELLS

appetite for Cayman funds in favour of, for example, Irish or Luxembourg funds. The Cayman Islands remains a hugely relevant jurisdiction for sophisticated, professional, institutional and high-net-worth investors and nothing that we are seeing in the global markets would appear to suggest otherwise. The only change in attitude with regard to investors and Cayman Islands funds would appear to be a trend towards better due diligence and understanding of the products into which they are investing. But this is more of a global, rather than a specifically Cayman, trend.

**A** **JSS:** It is important to note investors in Cayman offshore funds are required to be institutional, or qualified, in their local jurisdiction, which is in itself a moving target. In general we find these investors remain very comfortable with the Cayman Islands and have a sound understanding of what is really important in terms of the fund, including transparency, independent oversight, administration, reporting and audit. Some smaller investors may have been deterred by press and political rhetoric but for the most part these investors are less likely to be target investors for Cayman offshore funds in any case.

**Q** **HFM: WITH INCREASING INTEREST IN ONSHORE AND UCITS PRODUCTS, HOW WILL CAYMAN CONTINUE TO REMAIN RELEVANT?**

**A** **JW:** Ucits products are not suitable for every manager and every fund. In order to operate



within the Ucits framework successfully, a hedge fund manager must first establish whether his or her strategy is compatible with applicable investment restrictions and whether the additional legal expense of a Ucits fund formation will be offset by the new capital raised as its result. Cayman will continue to be relevant as it affords hedge fund managers the freedom to manage assets in accordance with the investment strategy defined in its offering memorandum, not in accordance with statutory guidelines. Plainly put, regulatory investment restrictions are inconsistent with the often varied and complex trading strategies employed by hedge fund managers.

**A ID:** For Cayman to continue remaining relevant, I think we simply need to keep doing what we have been doing for the past few decades – keeping up with investor and manager requirements in terms of structure and flexibility, while at the same time balancing the requirement for stronger global regulation. With regard to the increased interest in onshore and new Ucits products, I remain to be convinced the Ucits product is ever going to be a significant competitor for a Cayman Islands hedge fund. By their very nature, Ucits funds can never operate in the same manner as a hedge fund and will always have significant limitations and restrictions that hedge funds can operate outside of, by virtue of the nature of their regulation, but also by virtue of the sophisticated investors that use them. Put simply, Ucits funds and hedge funds are not comparable as financial products, as they both serve entirely different purposes.

**A JSS:** While Ucits and similar formats may be an excellent vehicle for retail strategies, we do not see them as a sustainable structural model for the alternative investment fund industry, nor one that would replace the standing of Cayman offshore structures. Anecdotal evidence suggests the industry is increasingly aware of the limitations imposed by the increased costs and regulatory constraints of Ucits funds, as well as some serious and fundamental problems with offering complex strategies to retail investors (as facilitated by Ucits), although the impact of AIFMD will be interesting. We would be very interested to see a Cayman domiciled AIFMD-compliant product as this may provide a way to offer the advantages of the offshore fund in an EU-compliant format.

**Q HFM: WHAT SORT OF LAUNCH ACTIVITY ARE YOU CURRENTLY SEEING? ARE YOU SEEING A PARTICULAR TYPE OF MANAGER OR STRATEGY SET UP FUNDS IN THE DOMICILE?**

**A JW:** Strong. We have seen increased activity in fund formation and have noted two trends: smaller niche managers who demonstrate a deep expertise in specific market segments have returned; and managed account platforms, which have been embraced by institutions that require greater transparency and liquidity than a typical hedge fund structure.

**A ID:** We continue to see increased launch activity year on year. I think Cayman has been able to say with some confidence since 2009 that activity levels have been regaining traction, and although we might be short of the peak in terms of launch activity, there is certainly a lot more conversion of enquiries. Interestingly, this seems to be more across the board, rather than with

any particular type of strategy or manager involved. Effectively, everybody seems to be regaining confidence and getting back into action.

**A JSS:** Our current hedge fund creation activity has been relatively steady during the past three years and has maintained a broad diversity of strategy. It would also be fair to say this is more dependent on our own promotional activities. The group is looking to expand its services and can assist in launching funds in a range of jurisdictions according to best fit on each occasion. However, Cayman Islands funds still offer many advantages for investment managers and investors and we anticipate it will continue to be the jurisdiction most in demand for some time.

**Q HFM: HOW DOES YOUR BUSINESS HELP MANAGERS WHO CHOOSE TO USE CAYMAN? ARE YOU OFFERING ANYTHING NEW AT THE MOMENT?**

**A JW:** Deutsche Bank has a long history in the Cayman Islands and offers a three-deep client service team of professionals that have global experience in accounting, investor relations, investment management and auditing. In addition to the quality of our team, we continue to make substantial investments in our technology and infrastructure, which has recently resulted in a world-class middle-office risk-reporting offering and solutions to address the changing regulatory landscape. We encourage everyone to take a look at what is new at Deutsche Bank.

**A ID:** Very much in keeping with what we believe is a strong theme in the Cayman Islands generally, Campbells prides itself in providing pragmatic and business-focused solutions for managers looking to either establish products in the Cayman Islands for the first time, or managers with existing products looking for solutions to challenges that may have arisen over time. Campbells continues to offer a partner-led service to all our clients and we pride ourselves on our continuity and the high experience levels of our senior staff. While other firms continue to be very cautious about the future, we firmly believe in the potential for future growth in the Cayman Islands and as such are continuing to actively recruit senior staff. We are constantly adding to the experience and expertise of our team and therefore the offering we give to our clients.

**A JSS:** When we engage with investment managers requiring new structures we generally find the most appropriate jurisdiction is clear. Whether it is EU, US or Cayman, the right solution will also depend on the type of strategy and the target investor base. There are a number of features that make JP Fund Group structures attractive; investment managers may opt to use umbrella funds that are held independently of the investment manager, have independent directors, independent fund administration and independent audits. This can give considerable comfort and assist when raising money from investors. ■

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