

FOCUS ON

REGULATED MUTUAL FUNDS

Chris Humphries, head of investment funds and managing director of Stuarts, talks to *HFMWeek* about regulated mutual funds in the Cayman Islands and the implications new corporate governance guidelines could have on the industry



Chris Humphries

is the managing director and one of the founding directors of Stuarts. Chris is recognised as a leader in his field by Chambers & Partners; he has registered several hundred mutual funds and frequently advises on regulatory and compliance issues involving funds, investment managers and fund administrators.

The Cayman Islands Monetary Authority (the Authority) has issued a new Statement of Guidance for regulated mutual funds, in which it sets out the Authority's expectations regarding the corporate governance regime of regulated mutual funds.

WHO IS AFFECTED?

The Statement of Guidance applies to all regulated mutual funds, as defined by section 2 of the Mutual Funds Law (2013 Revision) and includes funds licensed or administered under section 4(1) or registered under section 4(3) of the Mutual Funds Law (regulated mutual fund).

STATEMENT OF OBJECTIVES

The Authority expects the oversight, direction and management of a regulated mutual fund to be conducted in a fit and proper manner. Accordingly, the Statement of Guidance is intended to provide the governing body of a regulated mutual fund and its operators (as defined in the Mutual Funds Law) with guidance on the minimum expectations for the sound and prudent governance of the regulated mutual fund, by setting out key corporate governance principles pertaining to the governing body and the operators.

The Statement of Guidance is not intended as a prescriptive or exhaustive guide to the Authority's expectations. It should be noted that all existing duties of a director of a regulated mutual fund remain unchanged.

The governance framework of a regulated mutual fund must be appropriate and suitable to enable effective oversight. The size, nature and complexity of a regulated mutual fund are fundamental factors in determining the adequacy and suitability of such governance framework.

Factors determining the size, nature and/or complexity of the regulated mutual fund could include, without limitation, assets under management, number of investors, corporate structure, and the nature of investment strategy and operations.

THE GOVERNING BODY

The governing body of a regulated mutual fund is regarded as the board of directors where the regulated mutual fund is a corporate entity, the general partners where the regulated mutual fund is an exempted limited liability partnership, and the trustees where the regulated mutual fund is a unit trust.

The Statement of Guidance states that the governing body should monitor and regularly take steps to satisfy itself that the regulated mutual fund is conducting its affairs in accordance with all applicable laws, regulations, rules, statements of principles, statements of guidance and anti-money laundering or combating terrorist financing requirements, including those of the Cayman Islands and the Authority (applicable governance).

The governing body should regularly take steps to satisfy itself that the regulated mutual fund's service providers are monitoring compliance with the applicable governance and, where required, should provide appropriate directions to the service providers to rectify any non-compliance.

The governing body should require regular reporting from the regulated mutual fund's investment manager and other service providers, to enable it to make informed decisions and to adequately oversee and supervise the regulated mutual fund.

CONFLICTS OF INTEREST

The governing body of the regulated mutual fund and its operators must suitably identify, disclose, monitor, document and manage all its conflicts of interest.

GOVERNING BODY MEETINGS

The governing body of the regulated mutual fund should meet at least twice a year in person or via a telephone or video conference call. Where the circumstances or size, nature and complexity of the regulated mutual fund necessitate it, the governing body should meet more frequently than this so as to enable it to fulfil its responsibilities effectively.

Where necessary, the governing body should request the presence of its service provider(s) at its governing body meetings.

OPERATOR'S DUTIES

The Statement of Guidance is not intended to be an exhaustive guide, but sets out a number of duties that the Authority considers applicable to an operator, a number of which are summarised below:

- a) The operator must:
 - Be independent;
 - Act in the best interests of the regulated mutual fund (taking into consideration the interests of its investors as a whole and/or, where applicable, the creditors of the regulated mutual fund);
 - Operate with due skill, care and diligence;
 - Act honestly and in good faith at all times; and
 - Ensure they have sufficient and relevant knowledge and experience to carry out duties of an operator.

“ THE OPERATOR SHOULD ENSURE IT PROVIDES SUITABLE OVERSIGHT OF THE RISK MANAGEMENT OF THE REGULATED MUTUAL FUND ”

- b) The operator should communicate adequate information to the regulated mutual fund's investors where it is properly able to disclose.
- c) The operator must ensure it has sufficient capacity to apply its mind to overseeing and supervising each regulated mutual fund of which it is an operator. Consequently, before taking on any additional funds, the operator should always ensure that it is able to perform the functions and duties of an operator in a responsible and effective manner.
- d) Upon registration of a regulated mutual fund with the Authority, and on a continuing basis, the operator is responsible for ensuring the constitutional and offering documents of the regulated mutual fund comply with applicable Cayman Islands laws, rules and regulations. Also, that the offering documents contain such information as is necessary to enable a prospective investor to make an informed decision as to whether or not to subscribe for the equity interest.
- e) The operator is responsible for approving the appointment and removal of the service providers and the terms of their contracts, and for notifying the investors and the Authority of any changes to such appointments.
- f) The operator retains responsibility for functions delegated to service providers and should therefore regularly monitor and supervise such delegated functions.
- g) The operator should ensure the roles and responsibilities of all service providers are clearly defined, understood and are being adequately performed.
- h) The operator should regularly verify or seek confirmation from the service providers that they are acting in accordance with the regulated mutual fund's constitutional and offering documents.
- i) The operator must regularly monitor whether the investment manager is performing, in accordance with the defined investment criteria, strategy and restrictions.
- j) The operator should, as necessary, and at all material times, inform itself of the regulated mutual fund's investment activities, performance and financial position, and should review and approve the regulated mutual fund's financial results and audited financial statements.
- k) The operator should regularly monitor the regulated mutual fund's net asset valuation policy and compliance with such policy.

DOCUMENTATION

The operators are responsible for ensuring that a full, accurate and clear written record is kept of the governing body's meetings, which should include:

- The agenda items and circulated documents;
- A list of attendees present at the meeting and whether that attendance was in person or via telephone or video conference;
- The matters considered and decisions made; and
- The information requested from, and provided by, service providers and advisers.

RELATIONS WITH THE AUTHORITY

The operators should conduct the regulated mutual fund's affairs with the Authority in a transparent and honest manner, always disclosing to the Authority:

- Any matter which could materially and adversely af-



fect the financial soundness of the regulated mutual fund; and

- Any non-compliance with the applicable governance, including those of the Cayman Islands and the Authority.

RISK MANAGEMENT

The operator should ensure it provides suitable oversight of the risk management of the regulated mutual fund, ensuring the regulated mutual fund's risks are always appropriately managed and mitigated, with material risks being discussed at the governing body meeting with the governing body taking appropriate action where necessary.

CONCLUSION

The Statement of Guidance affects all registered funds and sets a benchmark for all Cayman Islands funds generally. Regular meetings must be held (as least two each year) and it would be advisable to have a representative from the key service providers present at the meetings, to give the governing body an opportunity to ask questions and seek confirmation that they are acting in accordance with the Statement of Guidance. All conflicts of interest must be properly disclosed and recorded, and we would suggest that the investment manager maintains a log of all conflicts disclosed.

An operator of a regulated mutual fund should take this opportunity to undertake a review of the fund's corporate governance arrangements and practices, in light of the new Statement of Guidance.

Cayman Islands counsel can assist in ensuring all regulated mutual funds are conducting their affairs in accordance with all applicable governance. ■