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SPECIAL REPORT

CAYMAN 2016

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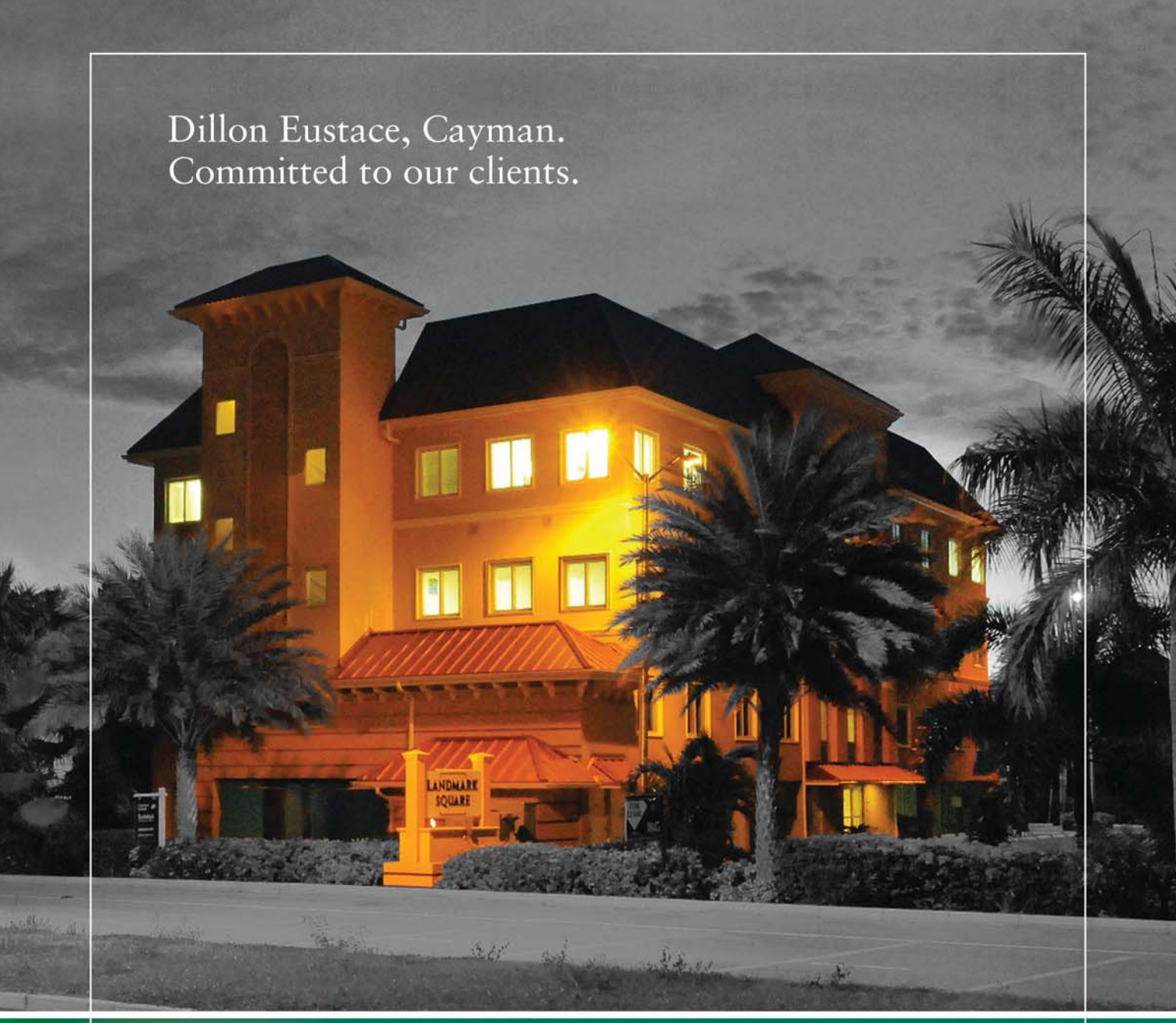

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HFMWEEK

Published by Pageant Media Ltd

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HFMWeek is published weekly by Pageant Media Ltd ISSN 1748-5894
Printed by The Manson Group
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The past 12 months have seen various challenges for the hedge fund industry – geo-political tensions in Ukraine, the Korean Peninsula and the South China Sea; regional issues including the risk of Grexit, the hard/soft landing debate surrounding the Chinese economy, continuing conflict in Syria and Libya creating a migrant influx and security challenge for Europe; and more recently, the start of campaigning around the UK's EU referendum. Those challenges have contributed to periods of volatility which have made it harder for managers to deliver positive performance returns.

Hedge Fund Research, Inc. reports that sector specific indices over the 12 months to mid-April are broadly down in performance terms with only the Asian referenced indices showing consistently positive returns. Certain specific event-driven and macro strategies have also been able to deliver positive performance over that period and, of course, individual managers have been able to buck the index trends. Couple low or negative performance returns with a capital inflow into the industry in 2015 of $44bn, the lowest value since 2012, and it is easy to see why it has been a tough period.

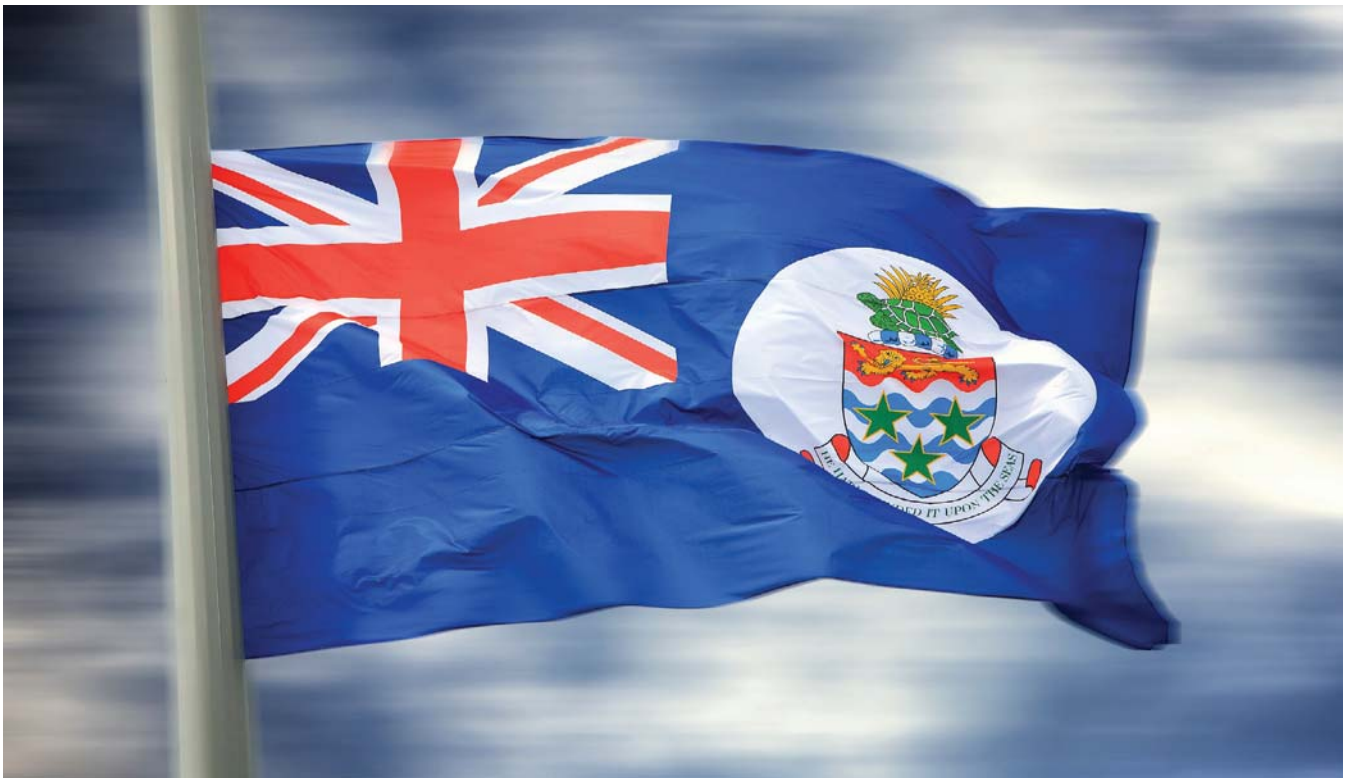
Cayman is often described as housing the plumbing for the industry; the infrastructure of entities, service providers and administrative/operational functions which are fundamental to capital aggregation, strategy pursuit and operational oversight. While we in Cayman would acknowledge that 2015 was difficult, 2016 has begun positively. New manager set ups are on the rise, capital raising is improving and innovation in product, strategy and investment terms is thriving.

Regulatory challenges have had time to settle – US and UK Fatca are now well embedded in understanding and practice and CRS is viewed as a progression rather than a whole new burden. The legislative framework has been stable with only the positive advent of Cayman's LLC legislation rippling the waters. Regulatory priorities, such as the need for a comprehensive and planned approach to cyber-security, are well understood, accepted and comprehensively addressed by those who retain investor and investment data.

The EU Commission's direction to Esma to provide a jurisdictional assessment and recommendation on Cayman's access to the AIFMD passport regime remains one of the most important events scheduled for 2016. With Esma's recommendation due by 30 June, the Cayman Islands Monetary Authority has been working hard with Esma to ensure that the jurisdiction is best placed to obtain the recommendation and gain access to the passport provisions whenever they come on line.

Retaining the jurisdiction's pre-eminence in regulatory, legislative, transparency, legal, accounting, administrative and governance expertise remains the priority of the Cayman Islands Government, Cima and the local industry. For its part, AIMA in Cayman continues to strengthen its membership, increase the research, education and information aspects of its mandate and be a leader in the development of the industry and Cayman's position within it.

Colin MacKay
is the deputy chairman of AIMA's Cayman branch. An attorney by profession with over 15 years of professional experience advising on fund structuring, Colin is now a group director of Elian Fiduciary Services leading Elian's cross jurisdictional hedge fund governance and services business across its Cayman, BVI and New York offices.



HOW WILL THE LLC IMPACT CAYMAN?

MATT MULRY, PARTNER OF DILLON EUSTACE, EXAMINES THE DECISIVE FEATURES OF THE LIMITED LIABILITY COMPANIES BILL AND WHAT IT MEANS FOR THE CAYMAN ISLANDS

Matt Mulry is a partner of Dillon Eustace and has worked in the offshore investment funds industry for over 15 years. He covers private equity, hedge fund, compliance, regulatory and general commercial work and has been involved a number of major transactions for leading onshore law firms and investment managers.

HFMWeek (HFM): What is the Limited Liability Companies Bill (LLC)?
Matt Mulry (MM): The bill, when enacted, will provide for the introduction of a new Cayman legal vehicle, the Cayman Limited Liability Company. The draft legislation is closely based upon the equivalent United States' Delaware LLC legislation with the intention of appealing to the US market. This is a significant development for Cayman and will represent an entirely new corporate form for managers and investors to use in their Cayman fund structuring. The bill has been through a wide consultation process both within the Cayman financial services industry and the wider international industry with input being sought from leading investment funds professionals who have used Cayman hedge and private equity funds since its inception.

HFM: Why have the Cayman Islands created a new vehicle?
MM: The motivation for creating the new vehicle comes from a drive within the Cayman Islands government and profession to remain at the forefront of the offshore investment funds market and also represents an acknowledgement of the needs of US-based managers and their US legal teams. The LLC has been a common vehicle for US managers to use in establishing their own businesses, those of their investment advisors and their general partners and is also a common vehicle for trading entities and holding entities in fund structures.

The bill has been drafted so that the Cayman LLC can be used for similar purposes but also with the expectation that the Cayman LLC will become a popular corporate form for the investment fund vehicles themselves. It should be noted that whilst the bill envisages that a Cayman LLC can be established with members only, so that it has no equivalent of a board of directors. Where a Cayman LLC is used as an investment fund registered with the Cayman Islands Monetary Authority it will need to appoint managing members who will have an equivalent role to the directors of a registered investment fund structured as an exempted limited company. In this way the Cayman corporate governance principles applicable to its registered investment funds as popularised through the Weavering judgments and related statements of guidance will also apply to the LLC where it is set up as a Cayman registered investment fund.

The LLC is the most commonly used corporate vehicle in the US and could well become the most popular corporate vehicle in Cayman.

HFM: How will the LLC set the Cayman Islands aside from competitors?
MM: Cayman is leading the field among the investment fund focused offshore jurisdictions in providing for the establishment of LLCs. Only a handful of offshore jurisdictions currently offer an LLC structure and none of them are significant jurisdictions in the offshore investment funds market.

The introduction of the Cayman LLC is likely to have a big impact in Cayman and among those managers and professional advisers who use the Cayman Islands for their hedge fund and private equity fund structures. It is likely to gain immediate recognition with US lawyers and US fund managers and to have an immediate application in US master feeder structures, but is also likely to be popular with the wider international financial services market.

HFM: What key features will the LLC implement and how will the LLC be used?
MM: The Cayman LLC will have the structural flexibility of a limited partnership, but unlike a Cayman exempted limited partnership, the LLC will have a legal personality

separate from its members. The fact that it has a legal personality and a flexible capital account structure is likely to assist with international tax and regulatory structuring, which will drive the particular uses to which the Cayman LLC will be put.

The draft legislation provides for the conversion of exempted companies to a Cayman LLC, for the merger of exempted companies into a Cayman LLC and for the redomiciliation of foreign entities into Cayman as a Cayman LLC. This anticipates a wide use of the LLC in new and in existing Cayman structures as well as in non-Cayman structures looking to redomicile to Cayman. Wide flexibility will be available to craft the constitutional document of a Cayman LLC to allow bespoke terms to be created to meet the needs of investors and managers. The LLC will be operated on the capital commitment and contribution model used in a limited partnership structure and so will lend itself well to use in private equity funds. Although, hedge funds will also find benefits in using the Cayman LLC particularly in the more straightforward valuation and administration of a corporate entity which represents its investor's interests in a capital account rather than a fixed number of shares.

Cayman exempted limited partnership funds have traditionally used exempted limited companies as their general partners and the exempted limited company has generally been the popular choice for Cayman domiciled investment management and advisory companies. This may change with the introduction of the Cayman LLC, particularly for US fund structures where the Delaware LLC is a common vehicle for use as the general partner in both the US and Cayman limited partnerships in a master feeder structure.

The use of trading companies is still relevant within Cayman fund structuring, despite the introduction of the Cayman segregated portfolio company, and the LLC will provide an attractive vehicle for an underlying trading company where such a structure is preferred. Holding entities used in Cayman investment fund structures, whether as a vehicle for investors or for structuring long-term illiquid or side pocket investments, have historically taken the form of the Cayman exempted limited liability company and the LLC is also likely to provide an attractive alternative vehicle in these situations.

> "THE AVAILABILITY OF A NEW CORPORATE FORM IN THE CAYMAN ISLANDS, PARTICULARLY ONE THAT IS ALREADY FAMILIAR TO US MANAGERS AND INVESTORS, CAN ONLY IMPROVE THE POSITION OF THE ISLANDS AS A FINANCIAL CENTRE"

HFM: What effect will the Cayman LLC have on the position of the Cayman Islands as an offshore market leading financial centre?

MM: The availability of a new corporate form in the Cayman Islands, particularly one that is already familiar to US managers and investors, can only improve the position of the islands as a financial centre. By introducing the LLC legal vehicle, Cayman is demonstrating that it is actively supporting the needs of those involved in the international funds industry. It's likely that the wider offshore funds market will follow suit with the introduction of LLCs in the smaller offshore funds jurisdictions, expanding and developing the range of vehicles available in international offshore fund structuring. As the premier offshore investment funds jurisdiction, Cayman is rightly taking the initiative with this important offshore structuring development and leading the way for its offshore competitors. ■

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Craig Smith, Partner

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SELECTING YOUR HEDGE FUND DIRECTOR – CHOOSE CAREFULLY

CASSANDRA POWELL, DIRECTOR OF HARBOUR, DISCUSSES THE IMPORTANCE OF CHOOSING THE RIGHT DIRECTOR FOR YOUR FUND, WHY YOU SHOULD NEVER GET COMPLACENT AND WHAT KEY AREAS TO WATCH FOR IN POTENTIAL DIRECTORS

Cassandra Powell is a director of The Harbour Trust Co. Ltd. and has responsibility for providing fiduciary services to Harbour's fund clients, including serving as an independent director for such funds as well as having responsibility for unit trust structures for which Harbour serves as trustee. Cassandra is an accomplished fund professional, specialising in hedge funds and related structures with a variety of investment strategies.

In the wake of several high-profile blow-ups and frauds (think Weavering and Madoff), the hedge fund environment continues to face increased regulatory pressures, investor due diligence and transparency demands, which have increased the need for both start-up and established hedge fund managers to develop institutional quality infrastructure to facilitate growth and to attract institutional capital. As a hedge fund manager you recognise the benefits that can be derived from an institutional infrastructure, but how do you go about organising all the elements of your business to create an efficient and effective operational infrastructure?

You start from within and analyse your data, workflow and information requirements to determine whom best to satisfy your needs. A key decision revolves around the selection of service providers who can address those needs. As a manager, you recognise the importance of selecting the right lawyer, auditor, administrator, prime broker and custodian, but does your hedge fund director effectively meet your needs and add value?

Directors are not typically thought of as service providers, but they should be. Directors provide an oversight role by monitoring and advising the fund and its service providers, so you need to exercise as much diligence here as with any other provider.

So how do you analyse and select the right director for your hedge fund board that will work to develop a meaningful long-term relationship with you, to help you launch, grow and meet the institutional needs of your firm and those of your investors?

Whether you're just starting out or you've known your directors for years, there are key areas you should consider.

INSTITUTIONAL INFRASTRUCTURE

What is the infrastructure of your director's business or of the firm that provides your director? As a manager you continue to face increased pressures from institutional investors and from regulators such as the SEC on many aspects, including cyber-security, disaster recovery, business continuity, succession planning and insurance. So these pressures should also translate down to your director. Do you know how your director is dealing with these? Do they have internal written policies to assess and address risk in these areas? Can you gain comfort that your director can continue to service your fund in the event of an infrastructure failure or a natural disaster?

To effectively carry out their fiduciary duties, directors must be kept informed and accordingly will have access to large amounts of sensitive data in relation to your business, the fund and its investors. The responsibility to safeguard your information rests not only with you but also your service providers, including your director. Are you comfortable with how your director is safeguarding your data and that of your investors?

INDUSTRY EXPERIENCE

We continue to see due diligence queries focused on a director's relevant years in industry and this poses the question of how long should a director have been in the industry to satisfy the 'sufficient experience and knowledge' test? Respondents of the Cayman Islands Monetary Authority (Cima) survey conducted by Greenwich Associates in 2013, viewed experience as a critical aspect and wanted information on experience and qualifications of directors. Reports indicate that institutional investors are looking for directors with well over 10 years relevant industry experience. Does your director have sufficient industry experience, knowledge of local laws, regulations and guidance to add value to your fund?

INDEPENDENCE

There continues to be a critical focus on whether a director is truly independent and free from conflicts. This test of independence is not only independence from other service providers (e.g. your legal or administrator), but also independence from you as the manager of the hedge fund. Institutional investors are driving independence, they are looking for directors to play a larger role and the level of transparency on directors involves understanding the number of relationships a director has, as well as the materiality of any one manager to a director. Whether your fund, or funds, represents a material amount of your director's total earnings should be a concern. Investors want to see that an independent director does not have an economic overreliance on any one manager and that the independent director will step in when disputes arise to ensure that shareholder interests are protected.

FULL-TIME OR PART-TIME

Is your director a full-time director or only devoting a few hours each day (or every other week) to this role? Institutional investors have indicated a clear preference for directors to be full-time, which means more opportunity for them to be involved in the industry, including via professional associations and working groups, which provides access to knowledge and allows them to keep abreast of current developments. Directors active on a full-time basis

will be dealing with current issues across a multitude of clients, and thus will be familiar with these issues and established best practices.

SPECIALISED KNOWLEDGE

There are no formal qualifications to becoming a director, beyond local registration or licensing with regulators such as Cima under the Directors Registration and Licensing Law which came into effect in 2014. However, regulators such as Cima and industry groups such as Aima have issued guidelines as to appropriate levels of expertise a director should have such as the Cayman Islands Statement of Guidance for Regulated Mutual Funds and Aima's Directors Guide. Do you know the educational and professional qualifications of your director? Does your director have a working knowledge of local laws, regulations and guidance? There has been a lot of discussion around whether a director should have specialised expertise in accounting, legal, industry, compliance or governance, and with the continued rise of split boards, we see managers and investors selecting directors with differing skill sets to best suit their funds. In the end, your director should have sufficient experience and knowledge to understand your fund's strategy and to provide effective oversight.

> "AS A MANAGER, YOU RECOGNISE THE IMPORTANCE OF SELECTING THE RIGHT LAWYER, AUDITOR, ADMINISTRATOR, PRIME BROKER AND CUSTODIAN, BUT DOES YOUR HEDGE FUND DIRECTOR EFFECTIVELY MEET YOUR NEEDS AND ADD VALUE"

CAPACITY

Is your director available when you or your investors need him/her? Does your director have sufficient resources to meet your needs and those of your investors? Your director should have sufficient time to properly discharge their fiduciary duties and the industry has generally accepted a director's number of relationships as a proxy for a director's capacity. Focus should not only be on the relationship numbers but also the director's resources and support system which can impact capacity. As a manager, the availability of your director to add value during the review of documents, to deal with day-to-day transactions or to be available in times of need, is of critical importance.

LOCATION

Where is your director located and where are they conducting their business? Although there may be no regulatory requirement to do so, consideration needs to be given to where the mind and management resides versus the legal domicile of the fund to avoid unintended tax consequences to the fund and its investors. An analysis should be performed: where is the director resident, do they spend a disproportionate amount of time in any other jurisdiction that could create a nexus with that location, and where will they be when making decisions on behalf of the fund? Location of your director can also impact their level of connectivity to the regulator in your fund's legal domicile as well as with other key service providers to your fund.

PICK WISELY

The expectations of institutional investors are never-ending, so choose carefully. For new managers, you need to partner with a director that will help you create an appropriate governance structure. If you've been around for a while, your current director may have served you well over the years, but can they meet institutional investor demands and can they take you to the next level? ■

THE COMMON REPORTING STANDARD

ALRIC LINDSAY, OF HIGGS & JOHNSON, EXPLORES THE COMPLEXITIES SURROUNDING THE COMMON REPORTING STANDARD AND OFFERS AN INSIGHT INTO HOW TO COMPLY WITH REPORTING OBLIGATIONS

Alric Lindsay is a senior associate in the Investment Funds practice group of Higgs & Johnson. He advises on all aspects of investment funds, specialising in private equity and hedge fund formation.

Following the OECD's publication of the Standard for Automatic Exchange of Financial Account Information in Tax Matters (the Common Reporting Standard or CRS) in 2014, the Cayman Islands entered into a Multilateral Competent Authority Agreement, agreeing to exchange financial account information. Not long after (in December 2015), the Cayman Islands passed regulations in relation to the CRS (the Cayman CRS Regulations), making it mandatory for Reporting Financial Institutions to report certain information related to Reportable Accounts. These Cayman CRS Regulations were made effective from 1 January 2016. Guidance notes were then issued in April 2016 (the Cayman CRS Guidance Notes) by the Cayman Islands authorities to aid compliance with the Cayman CRS Regulations and to provide guidance aspects of the CRS that are particular to the Cayman Islands. Taking together, Reporting Financial Institutions must apply the Cayman CRS Regulations in force at the relevant time, with reference to any OECD explanatory materials for the Common Reporting Standard and the Cayman CRS Guidance Notes.

WHO GETS CAUGHT BY THE DEFINITION OF REPORTING FINANCIAL INSTITUTION?

According to the Cayman CRS Regulations, the term "Reporting Financial Institution" means any Participating Jurisdiction Financial Reporting Financial Institution that is not a Non-Reporting Financial Institution (Non-Reporting Financial Institution is defined in the Cayman CRS Regulations and further categories of Non-Reporting Financial Institutions may be published in official notices from time to time by the relevant Cayman Islands authority). Generally speaking, such a Reporting Financial Institution is one which is resident in a Participating Jurisdiction (the published list of Participating Jurisdictions includes the United Kingdom, The Bahamas, Germany and the Netherlands, to name a few. The US is not currently on the list of Participating Jurisdictions.)

CATEGORIES OF REPORTING FINANCIAL INSTITUTIONS

In terms of specific types of Reporting Financial Institutions, the following will generally be caught by the definition under the Cayman CRS Regulations if resident in a Participating Jurisdiction:

- A custodial institution (any entity that holds, as a substantial portion of its business, financial assets (securities, partnership interest, commodity swaps and equity swaps) for the account of others. An entity holds financial assets for the account of others as a substantial portion of its business if the entity's gross income attributable to the holding of financial assets and related financial services equals or exceeds 20% of the entity's gross income during a specified period

- A depository institution (an entity that accepts deposits in the ordinary course of a banking or similar business)

- An investment entity (generally speaking, an entity that primarily conducts as a business one or more of certain activities, including trading in money market instruments, foreign exchange, exchange, interest rate, index instruments, transferable securities and commodity futures trading)

- A specified insurance company (generally speaking, an insurance company (or the holding company of an insurance company) that issues, or is obligated to make payments with respect to, a cash value insurance contract or an annuity contract)

OBLIGATIONS OF A REPORTING FINANCIAL INSTITUTION

Under the Cayman CRS Regulations, a Reporting Financial Institution must establish policies and maintain procedures designed to identify Reportable Accounts.

Reportable Accounts may include depository accounts, custodial accounts, certain other accounts and, in the case of an investment entity (subject to certain exceptions), may include any equity or debt interest where the account holder in the Reporting Financial Institution or any "controlling person" exercising control over an account holder which is an entity, is tax resident in a Participating Jurisdiction.

The policies and procedures established by a Reporting Financial Institution must:

- Identify each jurisdiction in which an account holder or a controlling person is resident for income tax or corporation tax purposes or for the purpose of any tax imposed by the law of the jurisdiction that is of a similar character to either of those taxes

- Apply the due diligence procedures set out in the Cayman CRS Regulations

- Ensure that any information obtained in accordance with the CRS Regulations, or a record of the steps taken to comply with these Regulations in respect of a Financial Account, is kept for six years from the end of the year to

which the information relates or during which the steps were taken

HOW MUCH TIME DO YOU HAVE TO COMPLY WITH REPORTING OBLIGATIONS?

Under the Cayman CRS Regulations, Reporting Financial Institutions must apply the due diligence procedures and comply with their reporting obligations (as set out in the Cayman CRS Regulations) from 1 January 2016.

CAYMAN TAX INFORMATION AUTHORITY TO BE NOTIFIED OF REPORTING OBLIGATIONS

A Reporting Financial Institution that has reporting obligations under the Cayman CRS Regulations shall notify the Cayman Tax Information Authority of that fact, along with details of the categorisation of the Reporting Financial Institution. This categorisation is as determined in accordance with the Cayman CRS Regulations and the full name, address, designation and contact details of the individual authorised by the Reporting Financial Institution to be the Reporting Financial Institution's principal point of contact for all purposes of compliance with the Cayman CRS Regulations. This notification must be completed electronically through the Cayman Tax Information Authority's automatic exchange of information portal (AEOI Portal) no later than 10 June in the first calendar year in which the Reporting Financial Institution is required to comply with reporting obligations under the Cayman CRS Regulations. The Cayman CRS Guidance Notes defines this date as 30 April 2017 and stipulates that notification is a one-off process and does not need to be completed annually (however, changes in notification details must be filed via the AEOI Portal).

OBLIGATION TO MAKE A RETURN FOLLOWING NOTIFICATION

Under the Cayman CRS Regulations, a Reporting Financial Institution shall make a return on, or before 31 May of the year following the calendar year to which the return relates (the Cayman CRS Guidance Notes confirm that the first return is required to be made on or before 31 May 2017 and annually thereafter). The information to be set out in the return includes the name, address, jurisdiction of residence, tax identification number and date of birth of each Reportable Person (who is an account holder) and any persons who exercise control over any entity that is an account holder with the Reporting Financial Institution.

OTHER IMPORTANT TIMELINES

1. The due diligence procedures for identifying high-value pre-existing (i.e. existing as of 31 December 2015) individual accounts with balances exceeding $1m will be required to be completed by 31 December 2016.

2. The due diligence procedures for lower-value pre-existing individual accounts with balances not exceeding $1m and for entity accounts with account balances greater than $250,000 as of 31 December 2015 will be required to be completed by 31 December 2017.

> "UNDER THE CAYMAN CRS REGULATIONS, A REPORTING FINANCIAL INSTITUTION MUST ESTABLISH POLICIES AND MAINTAIN PROCEDURES DESIGNED TO IDENTIFY REPORTABLE ACCOUNTS"

3. First exchanges of information by the Cayman Islands Tax Information Authority to partner jurisdictions will occur on or before 30 September 2017 (once the Cayman Islands Tax Information Authority is satisfied that partner jurisdictions have adequate confidentiality and data safeguards are in place, the exchange of information will take place).

ABILITY TO RELY ON SELF-CERTIFICATION

In connection with the completion of required due diligence procedures and in order to comply with its reporting obligations under the Cayman CRS Regulations, a Reporting Financial Institution may generally rely on self-certification forms (confirming tax residence) completed by, or on behalf of account holders of the Reporting Financial Institution, in order to confirm whether such account holder holds a Reportable Account with the Reporting Financial Institution. Self-certification forms can be found on the website of the Cayman Islands Tax Information Authority.

RESTRICTIONS ON RELIANCE ON SELF-CERTIFICATION

A Reporting Financial Institution may not rely on a self-certification or documentary evidence if the Reporting Financial Institution knows, or has reason to know, that the self-certification or documentary evidence is incorrect or unreliable.

NEXT STEPS

If you are a Reporting Financial Institution under the Cayman CRS Regulations, you should bear in mind the above timelines and obligations. Of interest is that, subject to any further guidance notes and/or legislation which may be issued in the Cayman Islands, it is anticipated that a Reporting Financial Institution will be solely liable for any failure to satisfy its reporting obligations (rather than the account holder at the Reporting Financial Institution or any third-party service provider completing the reporting obligations on behalf of the Reporting Financial Institution). ■

ALTERNATIVE INVESTMENT FUNDS – THE FUTURE OF FINANCIAL STATEMENT REPORTING

PARMANAN DEOPERSAD OF PWC INVESTIGATES THE DETERMINING FACTORS BEHIND THE ALTERING FACE OF FINANCIAL STATEMENT REPORTING FOR ALTERNATIVE INVESTMENT FUNDS

Parmanan Deopersad is a director with PwC Cayman's Financial Statement Preparation Services Group. He has extensive asset management assurance experience with a variety of hedge fund structures and strategies and is also a co-author of PwC's *Illustrative IFRS Financial Statements for Investment Funds*. Parmanan has over 15 years professional experience with PwC, is a fellow of the Association of Chartered Certified Accountants and also a member of the Cayman Islands Institute of Professional Accountants.

Financial statement reporting for alternative funds has gradually transformed during the past several years because of influences from regulators, accounting standard setters and investors. In this article, we examine the recent evolution in financial statement reporting and look at where it's headed.

INVESTOR DEMANDS

Since the 2008 financial crisis, investors have placed increased focus on the products in which they invest. Active due diligence on investment funds has become the norm and investors are also taking a much more critical look at the content of the financial statements. The need for a deeper understanding of the products in which they're invested and their risk exposures are driving this increased scrutiny.

Investors are placing demands on their advisors for transparent and understandable financial reporting. And the ability, or inability, of a fund to produce high-quality and timely audited financial statements has become a more prominent factor for investors in determining where to place their trust and their money.

REGULATION

It's no secret that regulators continue to place increased scrutiny and enhanced reporting demands on the alternative asset management industry. While regulations have had some effect on the content of financial statements, their main impact has actually been on the timing of issuance. The main contributors have been the SEC's "Custody Rule 206" and the CFTC 90-day filing requirement under Rule 4.7.

Custody Rule 206 allows registered investment advisors the ability to avoid certain other onerous requirements if they're able to furnish their investors with audited financial statements within 120 days of the fund's year-end (180 days in the case of fund of funds). In addition, the CFTC filing requirement under Rule 4.7 generally results in funds filing audited financial statements within a 90-day deadline.

The number of funds subject to CFTC filing requirements has increased significantly since 2012 because of rule amendments that effectively increased the regulation's scope. This has created a shorter, but much more intense, 'crunch period' in the months subsequent to 31 December (the most common financial year-end date) for funds and their service providers involved in the preparation and audit of the financial statements.

ACCOUNTING DEVELOPMENTS

During the past several years, two main topics on the minds of standard setters have been:

1. The need for increased transparency
2. Convergence

Both US GAAP and IFRS financial statements contain significant quantitative and qualitative disclosures that provide greater transparency into how investments are valued, the relative subjectivity of valuations, risk exposures from financial instruments including derivatives and disclosure on balances that have been offset or are available for offset. The introduction of these new disclosures over a relatively short period of time, while useful, has created an increased burden on preparers of financial statements. This, coupled with the increased focus by investors on understanding the products in which they're invested, has resulted in a consistent call to standard setters from both preparers and users to 'keep it simple'.

The FASB responded with the creation of its Simplification Initiative in 2014. The Initiative involves the FASB adding narrow-scope projects to its agenda with the objective of reducing costs and complexity in financial reporting while, at the same time, improving or maintaining the usefulness of the information reported. The IASB launched a

similar Disclosure Initiative in 2013, aimed at exploring how financial reporting disclosures could be improved.

These initiatives, coupled with the direct demand from investors for transparent and understandable financial reporting, will influence the trend of reporting in the future towards formats and disclosures that are simplified, to the point and user friendly.

With respect to convergence of US GAAP and IFRS, significant progress has been made since the initiative was first introduced, the most relevant being the alignment of fair value measurement and disclosure guidance between both frameworks. However, the momentum for convergence has lost most of its original traction, and full convergence between both frameworks at this point seems highly unlikely in the short to medium term.

The resistance to full convergence from the US, coupled with the increased movement towards IFRS by other non-US jurisdictions (most of which already permit or are planning to permit IFRS reporting), has created the need for asset managers and their fund service providers to become 'financially bilingual'. The commingling of both frameworks within a single group of funds has become increasingly common as asset managers continue to court a wider investor base for their products. While most large jurisdictions would typically have experience with one framework and limited or no experience with the other, jurisdictions such as the Cayman Islands have historically had equal exposure to both frameworks and therefore are well equipped to deal with this increasing trend.

OPERATIONAL CHALLENGES

While regulations, investor demands and accounting standards have evolved, so have operational challenges. A common approach in previous years has been the preparation of first-draft financial statements by the administrator or investment advisor with the expectation that it would be 'fixed' as it goes through the audit process, typically requiring the auditor to process changes directly.

> "WHILE REGULATIONS, INVESTOR DEMANDS AND ACCOUNTING STANDARDS HAVE EVOLVED, SO HAVE OPERATIONAL CHALLENGES"

In today's environment, this model has become all but obsolete. In May 2014, the SEC staff provided clarification guidance, which indicated that auditors should not, amongst other things, provide typing and word processing services or financial statement templates that are not publicly available to an audit client.

Even in cases where funds are not subject to SEC restrictions, to tailor financial statement disclosure towards investor needs and meet tighter sign-off deadlines, asset managers are looking for resources that can be used to prepare high-quality first-draft financial statements rather than sticking with the old 'let the auditor fix it' approach, which invariably leads to audit delays and cost overruns. From this demand, a relatively new niche market has developed for specialist financial statement preparers.

PwC's recent paper, *Alternative Asset Management 2020*, identifies key business imperatives for asset managers in coming years. One of these imperatives is applying the right resources in the right places (right-sourcing). The paper predicts that alternative firms, by 2020, will make more effective use of right-sourcing strategies, using other business process outsourcing firms to buy in key skills. These niche service providers are expected to grow in popularity. The Cayman Islands already has several firms that provide specialist financial statement preparation services, including Big Four firms, such as PwC.

IN SUMMARY

As we look forward, we see several trends in investment fund financial statement reporting:

- Increased focus on report tailoring to meet investor demands for transparent and understandable disclosures
- Increased need for asset managers and fund service providers alike to be financially bilingual with respect to IFRS and US GAAP
- Increased use of specialist service providers for the preparation of financial statements. ■

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CAYMAN ISLANDS FUNDS INDUSTRY UPDATE

CHRIS HUMPHRIES, OF STUARTS WALKER HERSANT HUMPHRIES, PROVIDES AN ESSENTIAL INSIGHT INTO THE PROGRESSION OF THE CAYMAN ISLANDS IN THE HEDGE FUND INDUSTRY

Chris Humphries is the managing director and one of the founding directors of Stuarts. He is a recognised leader in his field by Chambers & Partners and Legal 500. He has registered several hundred mutual funds with the CIMA and frequently advises on regulatory and compliance issues involving funds, investment managers and fund administrators.

The Cayman Islands is the principle offshore jurisdiction for investment funds. It seeks to maintain its status by executing an innovative legislative and regulatory regime and by continuing to have an absence of taxation. It also boasts the existence of refined and qualified service providers who are knowledgeable in the nuances of the funds industry.

Some of the core changes to the funds industry in the Cayman Islands in the last year are:

AIFMD PASSPORT REGIME UPDATE

The Cayman Islands is confident it will be granted the EU's AIFMD passport. Cayman is awaiting assessment by the European Securities and Markets Authority, which it hopes will lead to its approval for the pan-European marketing passport.

The Mutual Funds Law (MFL) and the Securities Investment Business Law were amended earlier this year to establish an opt-in regime for regulating Cayman Islands-domiciled investment funds and managers with connections to the EU, in order to facilitate extending the AIFMD passport to the Cayman Islands.

Until a decision is made regarding extending the AIFMD passport to the Cayman Islands, Cayman investment funds may continue to be marketed in the EU under national private placement regimes that require, among other things, that Cayman's regulator, Cayman Islands Monetary Authority ("CIMA"), has signed memoranda of understanding (MOUs) with individual EU member states. These arrangements can continue until at least 2018. CIMA has signed MOUs with 27 EU member states.

UK AND US FATCA

The deadline for financial institutions to provide the first return under UK FATCA has been extended by the Tax Information Authority (TIA) to 8 July 2016. The first return under UK FATCA relates to financial accounts maintained during the calendar year 2014 or 2015. In this regard, if a financial institution did not also notify the TIA that it is a Reporting Financial Institution for UK FATCA purposes when it made its notification in 2015 in respect of US FATCA, it will be required to do so by 10 June 2016 via the Cayman Islands AEOI Portal, accessible at www.ditc.gov.ky.

The first return in respect of UK FATCA should include relevant information relating to:

- All new accounts opened after 1 July 2014
- Pre-existing high value individuals' accounts as the due diligence for such accounts must have been completed by 30 June 2015
- Those pre-existing lower value individual accounts and pre-existing entity accounts that have been identified as reportable in 2014 or 2015.

The deadline for notifications under US FATCA for entities established in 2015 should be submitted by 10 June 2016 and the 2015 US FATCA returns should be submitted by 8 July 2016.

CRS

The Cayman Islands Tax Information Authority (International Tax Compliance) (Common Reporting Standard) regulations, 2015 (CRS regulations) were brought into effect on 16 October 2015. The CRS regulations are the means by which the OECD Common Reporting Standard, being due diligence and reporting standards for the global automatic exchange of information for tax purposes (AEOI), has been brought into force in the Cayman Islands with effect from 1 January 2016.

It should be noted that the CRS regulations incorporate the "wider approach". In this regard, the due diligence procedures in the CRS (in particular the indicia search procedures) are designed to identify reportable accounts understood as those of residents in a jurisdiction that is a reportable jurisdiction at the moment the due diligence procedures are performed.

However, the Cayman Islands has adopted the "wider approach" and extended due diligence procedures to identify each jurisdiction in which an account holder or a controlling person is resident for income or corporation tax purposes. Such an approach could significantly reduce costs for financial institutions because they would not need to perform additional due diligence each time a new jurisdiction joins the CRS.

The Cayman Islands government has now published the CRS Guidance Notes. The Guidance Notes have been developed in consultation with the Cayman Islands CRS Working Group and are intended to provide practical assistance on aspects of the CRS that are particular to the Cayman Islands and as a supplement to CRS regulations. The Guidance Notes are not intended to replicate the information in the OECD CRS documents, such as the CRS implementation handbook and OECD commentary on the CRS.

The Guidance Notes make it clear that the Cayman Islands will not exchange information under CRS until it is satisfied that a partner jurisdiction has in place adequate measures to ensure the required confidentiality and data safeguards are met.

The first notification due date for the CRS in the Cayman Islands is 30 April 2017. The first reporting due date for the CRS in the Cayman Islands is 31 May 2017.

MUTUAL FUNDS FILINGS

CIMA has implemented a new regulatory procedure in connection with the cancellation of a licence or certificate of registration of a Cayman Islands regulated mutual fund.

The new procedure creates a fixed deadline for submitting an application to CIMA for the deregistration of a fund in cases where the fund intends to or has ceased carrying on business pursuant to the MFL. The new procedure requires an application to be made on the earlier of (i) 21 days from the date the fund ceases to carry on business; or (ii) before 31 December of the year the fund ceases to carry on business.

> "THE CAYMAN ISLANDS IS CONFIDENT IT WILL BE GRANTED THE EU'S AIFMD PASSPORT"

LIMITED LIABILITY COMPANIES

It is proposed that a new law be enacted, to permit the formation of a new type of vehicle in the Cayman Islands – a Cayman Islands limited liability company (an LLC).

An LLC will be similar in many respects to a Delaware limited liability company. It would be an entity with separate legal personality (like a Cayman Islands exempted company), but with certain features akin to a Cayman Islands exempted limited partnership (in the sense that such a company would not be limited by shares nor by guarantee, but rather by reference to members' capital accounts and capital commitments, with substantial freedom of contract amongst the members as to determining the internal workings of the LLC).

Some potential advantages of an LLC in the funds context would be to allow for simplified and more flexible fund administration (e.g. easier tracking or calculation of the value of a member's investment in the LLC), more flexible corporate governance concepts and, possibly, a closer matching of the legal framework applicable between the onshore and offshore investors (e.g. where there is a parallel onshore Delaware LLC as a feeder or master fund and an offshore Cayman fund in the structure). Where a closed-ended fund requires separate legal personality (i.e. as opposed to being structured as an exempted limited partnership), a Cayman Islands exempted company can be cumbersome in the operation of capital call and default mechanisms – an LLC may be ideally suited to such a scenario.

Fund promoters often prefer to have a Delaware LLC registered as a foreign company in Cayman, in order for the Delaware LLC to be able to act as the sole general partner of a Cayman Islands exempted limited partnership. Offering a Cayman LLC solution might better suit promoters' needs in this respect (and might also enable the Cayman LLC to provide an alternative solution for promoters and their onshore counsel to consider, for the general partner role to their onshore partnerships).

The following is a summary of this new structure.

KEY FEATURES

The new LLC law includes the following salient features:

- An LLC will be a body corporate with limited liability
- An LLC may be formed for any lawful business, purpose or activity
- An LLC will require at least one member
- Registration is effected by payment of a fee and filing a certificate of formation
- An LLC will have the ability to be member managed or managed by a manager
- Members are free to agree among themselves the internal workings of the LLC, with appropriate minimum safeguards
- The law seeks to take into account existing Cayman Islands laws and considerations, including preserving the rules of equity and common law and addressing minimum statutory duties in the context of members and managers
- Exempted companies may merge into LLCs and foreign LLCs may merge or migrate into Cayman. ■

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HOW GOOD IS YOUR BOARD?

GEOFF RUDDICK OF INTERNATIONAL MANAGEMENT SERVICES EXAMINES THE MANY FACTORS BEHIND A SUCCESSFUL BOARD AND UNCOVERS WHAT MAKES A GOOD FUND DIRECTOR

Geoff Ruddick heads up the fund services division of International Management Services, a firm that specialises in fund governance and fiduciary services. He serves as an independent director to investment funds and has extensive knowledge of the commercial side of fund management as well as with corporate governance, compliance, corporate recovery, administration and audit.

HFMWeek (HFM): Split boards are gaining more and more traction, what is your perspective on them?
Geoff Ruddick (GR): Split boards have been the trend for the last couple of years now. Investors in particular are becoming increasingly interested in board composition and appointing directors with complementary skillsets from different service providers. My understanding is that an effective and diverse board requires competent individuals with complementary skillsets who can work collectively irrespective of whether they come from the same shop or not. The collaborative aspect is equally as important as the individual expertise. There should ultimately be synergies gained so that the board's collective value equates to more than the sum of its individual members. Good governance and the right board composition are key.

HFM: What are the most significant aspects to consider when constructing a board?
GR: Constructing an effective and diverse board does not have to be an arduous, time-consuming process, however, the decision should not be taken lightly. Given the directors are accountable for leading and directing the fund's affairs, effective corporate governance is critical. Therefore the appointment of experienced and qualified independent directors who collectively provide a diverse and complementary board composition is essential. The industry needs to ensure the focus remains on the underlying fundamentals of good governance and the right board composition and not simply focusing on retaining directors from different fiduciary firms. Where the main consideration or key focus is only to engage independent directors from different fiduciary firms, this narrow focus, for the most part, misses the fundamental objective of establishing an effective and diverse board. So they should go beyond the 'split board' sales pitch and have a thoughtful, measured, balanced approach and give all aspects due consideration.

HFM: Are available directors with sufficient experience becoming a rarity?
GR: There has been an influx of individuals with varying skillsets into the fiduciary space which is a positive development, and there is certainly a greater depth of high quality directors in the space to choose from than there was a few years ago. Most are senior people who have excellent experience, qualifications and pedigree and are able to seamlessly make the transition from being an administrator, lawyer, auditor, regulator, risk or investment professional to being a director. Others, however, have difficulty making the transition, as although they have impressive technical skills, they are unable to transition into a leadership and oversight role that goes beyond their area of expertise. Individual personalities can come into play as well.

> "AS IT IS FOR MANY THINGS IN LIFE, THE RIGHT BALANCE OF INDIVIDUALISM AND COLLECTIVE APPROACH IS ALSO PARAMOUNT TO AN EFFECTIVELY FUNCTIONING BOARD"

HFM: With the influx of new directors, how important is it to possess individual personalities?
GR: The credit crisis was really the inflection point where governance started to be taken more seriously. As a result, there has been a flood of new entrants into the fiduciary space, which can be partially attributed to a supply shortage as long-standing individuals are reaching capacity. Other newcomers are simply being opportunistic as they are looking for a career transition. In respect of individual personalities coming into play, for example, some people are too passive, or lack the intellectual curiosity, or gravitas to effectively and appropriately challenge management or their fellow directors, while others have domineering and controlling personalities or simply lack the aptitude to participate in a collective approach. As it is for many things in life, the right balance of individualism and collective approach is also paramount to an effectively functioning board.

HFM: What qualities should you consider when searching for a fund director?
GR: There is a wide range of attributes and characteristics to consider from backgrounds (i.e. accountant, lawyer, ex-regulator, investment or risk expert), independence, qualifications, stage of career/life, level of engagement, technical abilities, personality and interpersonal skills, jurisdictional residence/familiarity/knowledge of and experience within the industry, capacity, support infrastructure, etc. The list goes on. I would, however, emphasise it again, perhaps most importantly is how the individual personally views their role as a fiduciary. ■

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WHAT DOES 2015 TEACH US ABOUT THE YEAR AHEAD?

DAVID BUTLER AND MARC KISH, OF HARNEYS, REFLECT ON AREAS OF SIGNIFICANCE IN 2015 AND HOW TO HARNESS, LEARN AND UTILISE THEM OVER THE NEXT 12 MONTHS

David Butler is a partner and co-head of Harneys' Cayman litigation and insolvency practice. Butler has acted on some of the most notable Cayman cases of recent times, including AHAB versus Saad and Renova Resources versus Gilbertson. In 2015, he acted on Re Rhone Holdings LP and Re Harbinger.

Marc Kish is a partner and co-head of Harneys' Cayman litigation and insolvency practice. Kish routinely advises on restructurings and insolvency proceedings, fraud and asset tracing claims and commercial litigation. In 2015, he acted on Re CSCG.

In the PRC, a potentially toxic mix of a slowing economy and an ever-increasing corporate debt burden (as a proportion to GDP) is already leading to impaired loans in a number of key sectors, including steel and property. If contagion eventuates, we may see increased insolvency and restructuring of Cayman Islands companies which have been used to raise offshore finance for PRC operating subsidiaries. Against this backdrop, we take a look at some of the decisions made by the Grand Court of the Cayman Islands in 2015 and early 2016 involving winding up petitions. In 2015, the Harneys litigation and insolvency team acted on two-thirds of all insolvency cases commenced in the Cayman Islands, and represented China Shanshui Investment Company Limited (CSI), Rhone Holdings LP and Harbinger Class PE Holdings (Cayman) Ltd in the cases discussed below.

Some of the core changes to the funds industry in the Cayman Islands in the last year are outlined below.

RE CHINA SHANSHUI CEMENT GROUP LIMITED[1]

Following a unanimous resolution of its board of directors, China Shanshui Cement Group Limited (CSCG) presented a winding up petition to the Court and applied for provisional liquidation orders. The Court heard certain noteholders and shareholders (including CSI) on the application and agreed with CSI's argument that the directors of CSCG did not have standing under section 94 of the Companies Law (2013 Revision) to present the petition or apply for the appointment of provisional liquidators, in the absence of either an ordinary resolution of CSCG's shareholders or an express provision in its articles of association authorising the directors to present the petition. Mangatal J declined to follow Jones J's decision in Re China Milk Products Group Ltd[2], which arrived at a contrary interpretation of section 94 and allowed the directors of an insolvent company to present a winding up petition.

RE RHONE HOLDINGS LP[3]

The petitioners (all limited partners of Rhone Holdings LP) were precluded by their partnership agreement from presenting a winding up petition in respect of the partnership. Mangatal J struck out their petition, concluding that the agreement did not offend any public policy principle. In any event, any such principle could not override the clear statutory provision of subsection 95(2) of the Companies Law, which requires the Court to dismiss or adjourn a winding up petition where a petitioner is contractually bound not to present one. Mangatal J also concluded that common law recognition of the ability of partners to agree that a partnership should be determinable only by mutual agreement has survived both the Partnership Law (2013 Revision) and the Exempted Limited Partnership Law, 2014, and that nothing in the ELPL is inconsistent with or renders section 95(2) of the Companies Law inapplicable to exempted limited partnerships.

RE HARBINGER CLASS PE HOLDINGS (CAYMAN) LTD[4]

Until the Court of Appeal clarifies the test for loss of substratum, it is likely that a petitioner will need to show that the main object of closed-ended entity has been rendered impossible, following Clifford J's decision in Re Harbinger. Clifford J confirmed that the test for winding up of a closed-ended entity for loss of substratum is whether the attainment of the main object for which a company was formed has been rendered "impossible in some sense". This conclusion contrasts with the lower threshold articulated by Jones J in Re Belmont Asset Based Lending Ltd[5] in respect of open-ended entities, which the Court will wind up where it has become "impractical" for the open-ended entity to carry on its investment business.

Recently, in Re Washington Special Opportunity Fund Inc[6], Mangatal J decided that it was not necessary to resolve the tension between Jones J's decision and decisions in other jurisdictions[7] because the petitioner had not shown that it was impossible or impractical for the fund to carry on its business.

COMMENT

The outcomes in these cases might be interpreted by some as a growing reluctance by the Court to make winding up orders and, in particular, reluctance by the Court to make such orders where it is really dealing with a shareholders' dispute. It will be interesting to see if it is possible to draw such a conclusion following what we expect will be a year in which the Court will consider a high number of winding up petitions.

INCREASE IN DERIVATIVE ACTIONS

The Grand Court could see an increase in derivative actions following the decision of the New York Supreme Court in Davis versus Scottish Re Group Ltd[8]. The Court dismissed certain derivative claims where the plaintiff had failed to comply with Order 15, Rule 12A of the Grand Court Rules (which requires a plaintiff to seek the leave of the Grand Court to bring a derivative claim against a Cayman Islands company), noting that compliance with the rule is a substantive (rather than procedural) condition

precedent to the continuation of a derivative action in New York.

This decision is consistent with the position taken by courts in Hong Kong[9] and England[10] and means that US shareholders, some of whom bring nuisance suits in the US hoping to extract a settlement, will first have to show the Grand Court that there is a case to answer.

In contrast, the Grand Court could see fewer winding up applications for companies with significant Hong Kong-based subsidiaries following the decision of the Final Court of Appeal of Hong Kong in Kam Leung Sui Kwan versus Kam Kwan Lai and Ors[11]. The FCAHK determined that it could wind up a BVI holding company with a 'sufficient connection' to Hong Kong, which could be established through the holding company's shareholders and subsidiaries (if its shareholders and directors were resident in Hong Kong and its underlying assets and the business carried on by its sub-subsidiaries were located in Hong Kong).

> "IF CONTAGION EVENTUATES, WE MAY SEE INCREASED INSOLVENCY AND RESTRUCTURING OF CAYMAN ISLANDS COMPANIES WHICH HAVE BEEN USED TO RAISE OFFSHORE FINANCE FOR PRC OPERATING SUBSIDIARIES"

INCREASING AWARENESS OF REGULATORY DEVELOPMENTS

On 9 February 2016, the Cayman Islands Monetary Authority issued the first edition of its bi-annual Supervisory Issues and Information Circular to Licensees' period. The Circular aims to raise awareness of common regulatory issues and highlight regulatory developments for the financial sector, and "to emphasise regulatory matters which might not be particularly problematic at this time but are important to [Cimas] regulatory objectives".

While the overriding focus of the Circular was anti-money laundering and countering terrorist financing, it also identified data security as an area that Cima expects licensees to consider in conducting business and developing business strategies. The Circular states that Cayman Islands-based firms "are exceptionally vulnerable to data breaches" and that Cima "will review licensees' approaches to data security risk management".

Although the Cayman Islands is yet to enact data protection legislation (The Data Protection Bill, 2016 was released on 1 April 2016), Cima's interest in data security is not surprising, nor is it unprecedented. Data security has caught the attention of other financial regulators. For example, the Australian Securities and Investment Commission has indicated that it intends to play a role in the cyber risk management of its regulated population. We expect that Cima's focus on data protection will continue to intensify following the recent Mossack Fonseca data breach. ■

[1] Cause No: FSD 178 of 2015, 25 November 2015.
[2] [2011] (2) CILR 61.
[3] Cause No: FSD 119 of 2015, 29 September 2015.
[4] Cause No: FSD 80 of 2015, 10 November 2015.
[5] [2010] (1) CILR 83.
[6] Cause No: FSD 151 of 2015, 1 March 2016.
[7] Such as Bannister J's (as he then was) decision in Citco Global Custody NV versus Y2 k Finance Inc BVIHCV 2009/0020A.
[8] 2016 NY Slip Op 01756.
[9] See Wong Ming Bun versus Wang Ming Fan [2014] 1 HKLRD 1108.
[10] See Konamaneni & Ors versus Rolls Royce Industrial Power (India) Ltd & Ors [2002] 1 WLR 1269.
[11] FACV No 4 of 2015.

CAYMAN: SETTING AN EXAMPLE

COLIN MACKAY OF ELIAN FIDUCIARY SERVICES EXAMINES THE UNTOLD STORY OF THE PANAMA PAPERS AND HOW THE CAYMAN ISLANDS WERE FULLY TRANSPARENT LONG BEFORE THE DOCUMENT LEAK

Colin MacKay is a group director of Elian Fiduciary Services based in its Cayman office. Colin was a practising attorney for over 15 years in Cayman and seven years prior to that in the UK. Colin is a member of the Cayman Island Directors Association, Law Society and deputy chairman of AIMA, Cayman.

The recent announcement that over 11 million documents obtained from international law firm, Mossack Fonseca, have been passed to the International Consortium of Investigative Journalists has brought the use of offshore financial centres back into the public consciousness. Much of the coverage of the so-called 'Panama Papers' has centred on the use of cross border corporate or trust structures by individuals for asset holding or succession planning purposes, both of which routinely draw moral outrage caveated by an implicitly cynical or largely disingenuous annotation that neither is necessarily illegal.

While there should be no condoning of the behaviour of those who have sought to abuse the laws of their home jurisdictions through Panamanian structures designed to evade tax or facilitate criminal activities, those reporting the stories should be sufficiently responsible and informed to avoid the broad brush approach of the exception proving the rule. The sensationalist reporting style that has been adopted has sought to associate the legitimate use of cross border structures and jurisdictions with the illegitimate actions of a few, ideally rich, famous or, even better, politically connected, to render all such activities to be suspicious at best. The outrage also ignores that tax evasion, criminality and money laundering are also domestic issues in every jurisdiction around the world.

HOME OF TRANSPARENCY

As has been pointed out by Cayman Finance in its excellent press briefings over recent weeks, Cayman has been at the forefront of global cooperation on tax transparency for a decade and a half. Additionally, Cayman is an institutional jurisdiction focused on structuring for corporate groups, capital aggregation vehicles within the hedge and private equity industries and insurance and reinsurance needs where transparency through consolidated accounting, group reporting and regulatory oversight is inherent. In short, not all international financial centres are the same.

Beginning in 2001 with a bi-lateral agreement with the US on mutual assistance in combatting the use of structures across both jurisdictions for the laundering of the proceeds of crime, in particular the burgeoning drugs trade into and within the US, Cayman has been a willing participant in the development of global initiatives on transparency and accountability. Cayman is a long-standing supporter and an active participant in the global approach to combating the use of legitimate channels for the movement of illegitimate capital, including through active participation and membership of inter-governmental organisations such as the Financial Action Task Force, the Caribbean Financial Action Task Force, IOSCO, as well as full engagement with G20 and OECD initiatives. It has been some time since the Cayman Islands enacted industry-leading, anti-money laundering and transparency requirements. Given the extent of the regulatory reach within Cayman, those anti-money laundering requirements apply to all facets of the local business population from banks and trust companies to hedge fund administrators, fiduciary businesses, law firms, accountancy firms and even to the local realtors. In each case, detailed client due diligence must be obtained and preserved to allow the beneficial owners and controllers of each entity, or of the individuals behind them, to be identified and validated and for the source of any funds used to capitalise any such venture to be verified.

Anyone doing business in Cayman will recognise the upfront requirements of all service providers to obtain certified true copies of identification documents, proof of residential address, verification of source of funds, etc. These are not new requirements, nor are they requirements which have been resisted or obviated in some way to maintain secrecy. The requirements are ubiquitous and fundamental to anyone wishing to transact through Cayman.

LEGISLATION AND REGULATION

The local legislation has also always gone one step further in making all such records held available to the Cayman Islands Monetary Authority and Cayman law enforcement on request. Combined with the 36 bilateral cooperation agreements on tax transparency which Cayman has entered into, the Convention on Mutual Administrative Assistance in Tax Matters and the Inter-Governmental Agreements with the UK and the US implementing Fatca, the degree to which ownership and control information is available to tax authorities around the globe in respect of Cayman-domiciled entities is amongst the highest.

COMMITMENT

The further irony in the timing and initial focus for the Panama Papers outcry in the UK, in particular, is that the UK has also been leading an initiative to develop central beneficial ownership registers to further assist tax and law enforcement agencies in their work. Again, Cayman has been an active and cooperative partner in the realisation of that aim. However, some, including the UK's opposition leader, have argued that any such register must be publicly accessible but query why that is a relevant

consideration if the stated ambition is to ensure that self-reporting for tax purposes is accurate? The short answer is that it isn't, provided that full ownership information is obtained and retained on a central jurisdictional register or platform. Additionally, access to that platform is available to those charged with responsibility for the exchange of that information with third country treasury departments or law enforcement. That is the model committed to by the Cayman Islands government in its preliminary agreement with the UK on this subject.

Just as media outlets seem to struggle with the distinction between the concepts of tax evasion (illegal) and tax avoidance (legal), they also seem to be unable to distinguish between legitimate concerns around preservation of confidentiality and the potentially illegitimate idea of secrecy to hide criminal acts or omissions. The ability to preserve and protect one's personal information is an essential component of the detailed data protection legislation operating around the globe, including the extensive legislation within the UK and the EU. That legislation exists, as the European Commission acknowledges in the preamble to the EU directive, to provide for the free movement of data between member states but to do so while safeguarding the fundamental rights of the EU's citizens including the right to privacy. Once again, Cayman is at the forefront of global efforts to ensure effective exchange of information for tax transparency and criminal prevention, but those efforts are not served by those who demand that registers of beneficial ownership be available to public scrutiny. The fundamental right of the individual to privacy or confidentiality of his or her affairs remains paramount but must be viewed within the context of regulator to regulator cooperation. This ensures compliance with one's tax obligations and law enforcement to law enforcement cooperation to identify and prosecute criminal behaviours which damage our societies.

> "THE OUTRAGE ALSO IGNORES THAT TAX EVASION, CRIMINALITY AND MONEY LAUNDERING ARE ALSO DOMESTIC ISSUES IN EVERY JURISDICTION AROUND THE WORLD"

A LEADING JURISDICTION

As noted earlier, Cayman is an institutional jurisdiction, specialising in structuring of corporate, partnership and trusts in support of wider corporate groups, capital aggregation or private wealth planning. The majority of investors interacting with Cayman structures are institutional in nature – pension funds, regulated financial institutions, foundations and other such asset allocators. Cayman remains a cooperative partner with all major jurisdictions, willing to support tax and law enforcement efforts, but doing so within the confines of the rights of the individual and particularly the right to privacy which is held in such high regard in the likes of Europe and the US. ■


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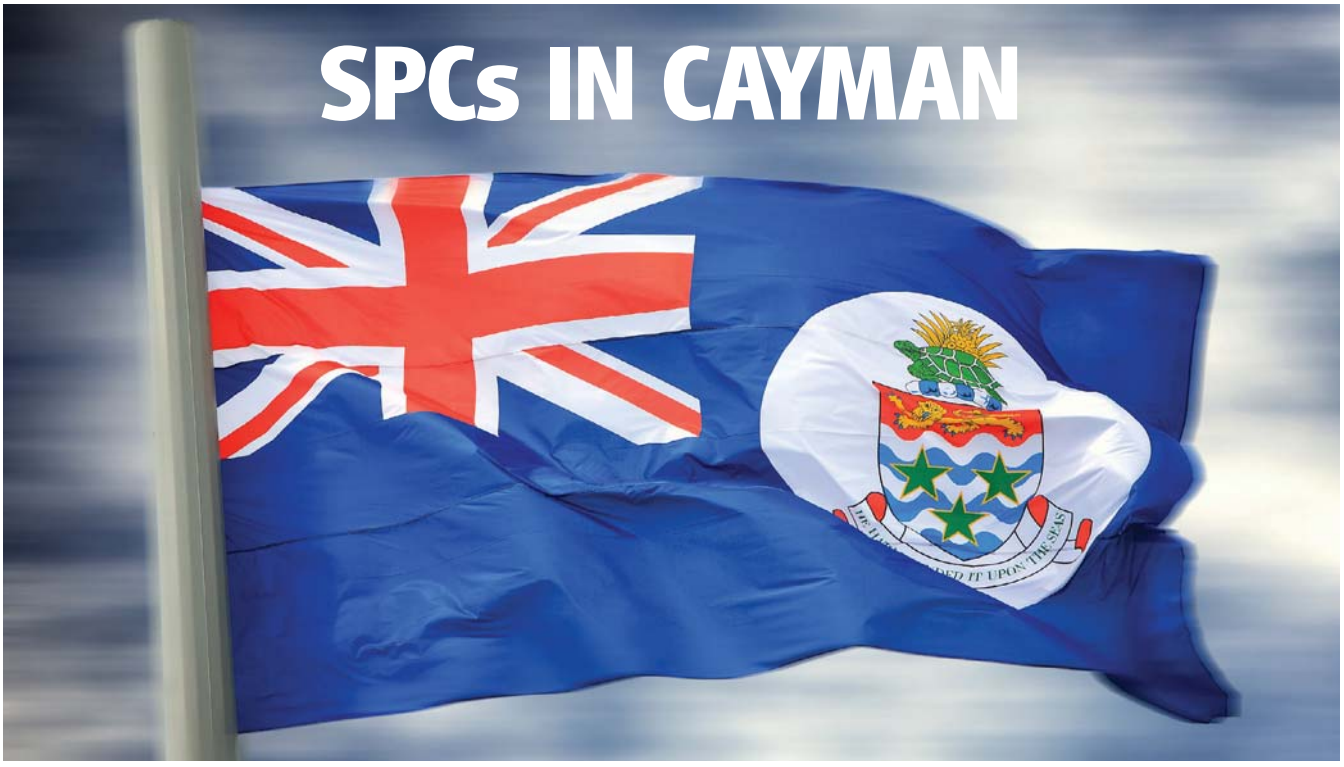
SPCs IN CAYMAN



GARY SMITH, PARTNER AT LOEB SMITH'S CORPORATE TEAM, TALKS TO *HFMWEEK* ABOUT SPCs AND WHY THEY ARE THRIVING IN CAYMAN

Gary Smith is a partner in Loeb Smith's corporate team advising principally on offshore investment funds, IPOs and M&A. Gary has given expert evidence in the United States Bankruptcy Courts relating to Cayman Islands investment funds and has also authored various publications on issues pertaining to Cayman Islands funds.

HFMWeek (HFM): How versatile are SPCs? What makes them this way?

Gary Smith (GS): Under Cayman Companies Law, a segregated portfolio company (SPC) is an exempted company which has been registered as a segregated portfolio company. It has full capacity to undertake any object or purpose, subject to any restrictions imposed on the SPC in its Memorandum of Association. The Memorandum of Association of an SPC usually gives the SPC full capacity to pursue very broad objects. Once registered under the Cayman Islands Companies Law, an SPC can operate segregated portfolios (SPs) with the benefit of statutory segregation of assets and liabilities between portfolios.

The appeal of SPCs extends beyond investment funds and is often used in capital markets and securitisation transactions. In the investment funds context, SPCs greatly enhance the versatility and efficiency of Cayman Islands fund structures. It allows investors to access different trading strategies or investments, different markets or different managers through a single corporate vehicle whilst simultaneously providing the segregation of assets and liabilities through each SP. This feature is unlike, for example, a 'multi-class' fund where there is typically a single legal entity offering various classes of shares designated according to the portfolio investment. The statutory ring-fence of assets and liabilities of an SP affords the SPC structure the ability to avoid cross class liability issues which could arise with 'multi-class' funds.

Cayman Islands Companies Law permits an SPC to create one or more SPs in order to segregate the assets and liabilities of the SPC held within one SP from the assets and liabilities of the SPC held within another SP of the SPC. The general assets and general liabilities of the SPC (i.e. assets and liabilities which cannot be properly attributed to a particular SP) are held within a separate general account rather than in any of the SP accounts. Each SP should have, as appropriate, its own bank account, brokerage account, and other accounts to hold its assets to avoid co-mingling with the assets of other SPs.

The Companies Law requires that segregated portfolio assets must only be available and used to meet liabilities to the creditors of the SPC who are creditors in respect of that SP, and who will, as a consequence, be entitled to have recourse to the segregated portfolio assets attributable to that SP for such purposes. Segregated portfolio assets of an SP should not be available or used to meet liabilities to, and shall be absolutely protected from, the creditors of the SPC who are not creditors in respect of that SP, and who accordingly will not be entitled to have recourse to the segregated portfolio assets attributable to that SP.

Accordingly, a creditor will only have recourse to assets from SPs with which it has contracted and creditors will have no recourse to the assets of other SPs of the SPC which are protected under the Companies Law. This statutory protection afforded under the Companies Law to the assets of each SP is one of the key feature and benefit of the SPC structure.

HFM: Why are SPCs flourishing in the Cayman Islands?
GS: The Cayman Islands continue to be the leading offshore jurisdiction for the establishment of hedge funds, private equity funds, real estate funds and other asset classes. The SPC structure has flourished as the Cayman Islands investment funds industry has flourished. Its versatility and efficiency in terms of the ability effectively to 'ring-fence' certain assets and their related liabilities under the same entity has made it increasingly attractive. Like a standard exempted company:

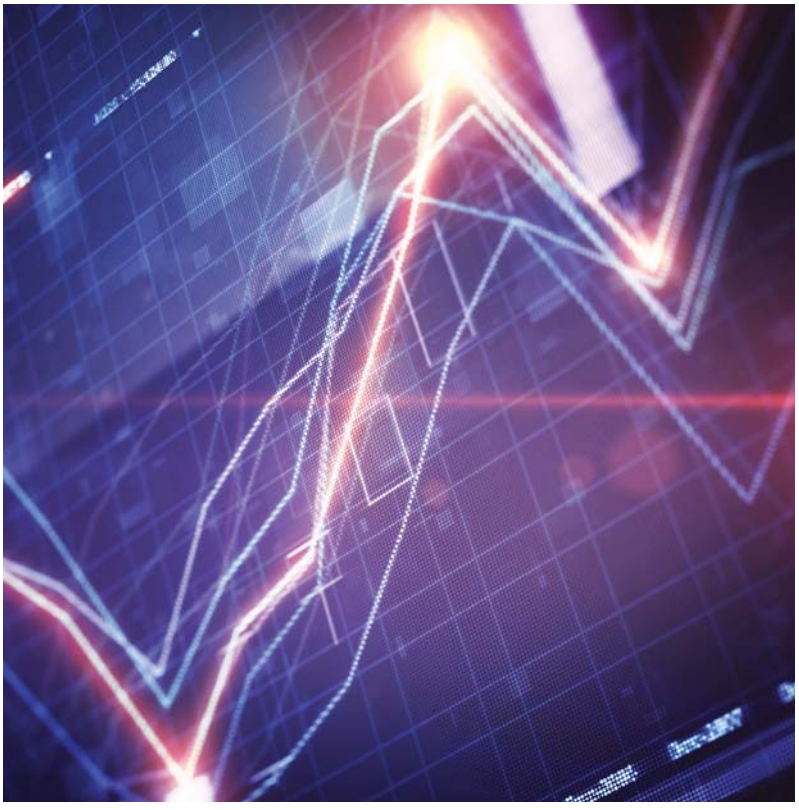
- There are no residency restrictions on directors or shareholders of an SPC
- The annual government fees for an SP is 50% less than the annual government fees for an exempted company
- There are no exchange control restrictions applicable in the Cayman Islands
- There are no Cayman Islands taxes on the SPC or its shareholders.

HFM: What are the main attractions of an SPC for a manager?
GS: The SPC corporate structure allows a fund manager to employ different trading strategies, and/or establish different investment platforms, and/or provide access to different markets, and/or different trading advisers through a single corporate vehicle while simultaneously providing the segregation of assets and liabilities through each SP. Fund managers are able to market an SPC fund to potential investors as being able to provide a statutory 'ring-fence' to protect against cross liability issues relating to the assets and liabilities of the various SPs within the SPC.

The SPC structure is increasingly being used as an investment platform on which investors can use different SPs to hold varying asset classes (e.g. real estate, intellectual property, stocks and shares, and distressed assets) and have their investments managed separately from other investments held by other SPs on the same SPC platform. We have seen an increase in the use of SPCs by fund managers as investment platforms for pursuing different strategies for the same pool of investors, managing investments in different geographical regions (e.g. China and emerging markets in Asia and Africa) and investing in different sectors (clean technology and offshore oil drilling).

The SPC will have a board of directors. In addition, each SP can have its own segregated portfolio directorate or investment or management committee which effectively controls and manages the operations of the relevant SP. The segregated portfolio directorate, investment or management committee would obtain its powers through powers delegated to it by the board of directors of the SPC.

The liabilities to a person arising from a matter imposed on, or attributable to, a particular SP, only entitle that person to have recourse to that particular SP in the first instance and then to the general assets of the SPC, unless the Articles of Association of the SPC prohibits payments from the general assets of the SPC, in which case there is no recourse to the general assets.



> "THE APPEAL OF SPCs EXTENDS BEYOND INVESTMENT FUNDS AND IS OFTEN USED IN CAPITAL MARKETS AND SECURITISATION TRANSACTIONS"

HFM: Are there any misconceptions about SPCs? What are they?
GS:

- Can assets be transferred between SPs? The Companies Law requires the directors of the SPC to ensure that assets and liabilities are transferred between SPs at full value.
- Does an SP have separate legal personality? While the SPC is a company and therefore a corporate entity with separate legal personality, an SP does not have separate legal personality. Accordingly, the Companies Law requires that when contracting on behalf of a particular SP, it should be made clear which SP of the SPC is contracting on behalf. Each SP can have its own investment manager, trading advisor, and other service providers but it should be made clear in the agreements which SP of the SPC has engaged them for their services.
- Can an SP be liquidated without liquidating the entire SPC? An application can be made to the Cayman Court for a receivership order where a particular SP of the SPC is insolvent and other SPs within the SPC are operating on a solvent basis. ■

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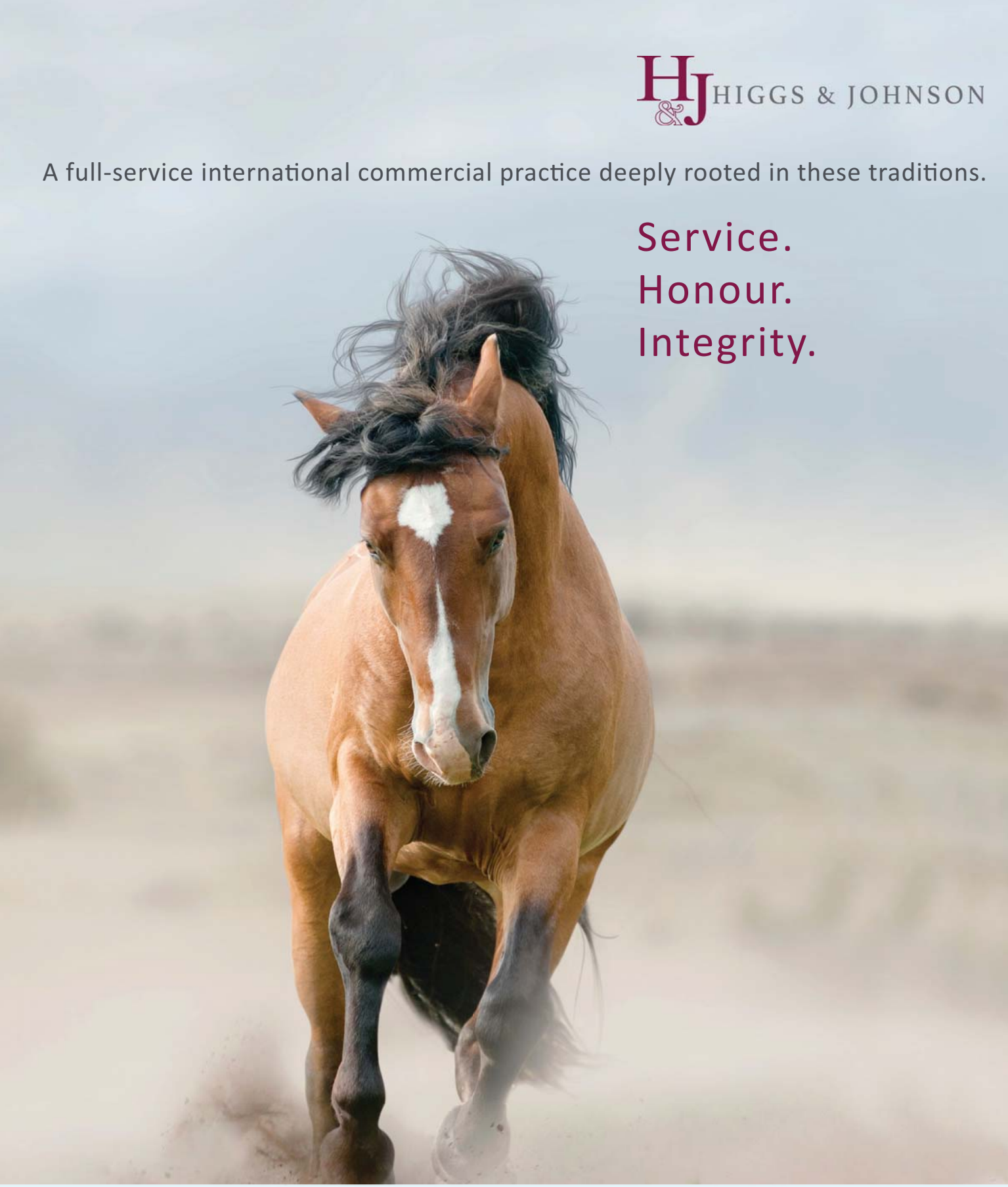

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