

STAYING AHEAD OF THE GAME

MARCO MARTINS AND PATRICK COLEGRAVE, OF HARNEY WESTWOOD & RIEGELS, EXPLAIN HOW CAYMAN IS ADAPTING TO CHANGE SO AS TO REMAIN THE JURISDICTION OF CHOICE FOR THE ALTERNATIVE INVESTMENT INDUSTRY



Marco Martins,

managing partner of Harneys' Cayman Islands office and head of the firm's market leading Latin America Group, has more than 18 years of experience working in international finance with leading law firms. He has extensive expertise in the establishment and restructuring of offshore investment funds.



Patrick Colegrave,

is counsel in Harneys' investment funds team. Patrick has particular expertise in the establishment and maintenance of offshore hedge, venture capital and private equity funds and on corporate transactions involving Cayman vehicles. He has advised on the establishment of more than 500 Cayman Islands funds.

2013 is lining up to be a pivotal and successful year for both the Cayman Islands and the global hedge fund industry. Many of the developments which started in the last decade, ranging from worldwide regulatory and financial consequences of the financial crisis of 2008 to the ongoing evolution of the international regulatory framework governing international financial centres, are now culminating in actions taking effect in 2013 and soon thereafter. From the implementation of the Alternative Investment Fund Managers Directive (AIFMD) to the Foreign Account Tax Compliance Act (Fatca) by the US, change is finally set to hit the hedge fund industry and the Cayman Islands.

In this article we look at how the Cayman Islands has prepared for this pivotal year, and why we believe Cayman is well positioned to remain the preferred jurisdiction for alternative investment vehicles. What we see is an industry in the Cayman Islands that has taken the necessary steps to maintain its competitive advantages and strengthen its offering.

THE INVESTMENT FUNDS MARKET

As of the end of Q1, we have seen a material increase in the number of new fund formations from recent years, with this increase coming from both the US and from emerging markets. Whereas in the past investment vehicles may have traditionally been the domain of professional

investment managers focusing on raising capital from sophisticated or institutional investors, we increasingly see investment fund vehicles being used by high net worth families and their intermediaries to help them better manage their assets and risks. Current global financial and political uncertainty is fuelling growing demand for trusted, dependable, cost effective vehicles, and Cayman Islands investment fund structures remain by far the preferred product to meet these requirements. We expect this trend to continue, and to fuel the continued growth of Cayman Islands' investment fund industry.

AIFMD

The European Union has, since 2009, been working on a comprehensive package of regulations of the alternative investment industry. The AIFMD came into force in 2011 and must be implemented by EU Member States by 22 July 2013. Broadly speaking, the AIFMD impacts managers based in the EU who manage Cayman investment funds, managers based outside the EU but who manage investment funds established within the EU and generally any manager looking to market their Cayman investment fund to investors within the EU. The 'Level 2' implementing measures which guide how the AIFMD will operate in practice were published in December 2012 and provided what most think is a workable pathway for the Cayman Islands to enable Cayman-based funds to continue to be marketed

into the EU via the private placement route. Importantly, the Cayman Islands already meets important requirements imposed by the AIFMD, in particular: 1. The Cayman Islands Monetary Authority (Cima) is a party to the IOSCO Multilateral Memorandum of Understanding concerning Consultation, Cooperation and the Exchange of Information; 2. The Cayman Islands is not on the Financial Action Task Force (FATF) list of non-cooperative jurisdictions; and 3. The Cayman Islands has entered into over 30 agreements for the exchange of tax information, including with the vast majority of “key” EU states in which Cayman funds are currently marketed. These are essential pre-requisites and reflect well on Cayman’s long standing and continued commitment to best international practices.

In order for Cayman to ensure its funds will have continued access to existing national private placement regimes in EU Member States beyond July 2013, Cima has to enter into the requisite ‘Co-Operation Agreements’ with the competent authorities that regulate securities markets in the 27 EU Member States. Fortunately, the model MoU developed by the European Securities Markets Authority (Esma), which provides guidance to such authorities, follows the IOSCO Principles and complements the terms and conditions of the IOSCO Multilateral MoU, both of which are familiar to the Cayman Islands. Cima has been in discussions with Esma since early 2012. Crucially, the Cayman Island’s Monetary Authority Law (2011 Revision) (the MA Law) already provided the base for Cima to meet most of the requirements imposed by the AIFMD, and on 15 March 2013, the Cayman Islands Government passed an amendment to the MA Law, the Monetary Authority (Amendment) Bill 2013, which allows for Cima to enter into certain necessary agreements in relation to the Co-Operation Arrangements, and in particular to act in accordance with any relevant request made to Cima by an EU regulatory authority. This is undoubtedly positive news for managers who manage Cayman investment funds and are currently raising or who have plans to raise capital in the EU.

FATCA

As a result of Fatca, foreign financial institutions (FFIs) in every jurisdiction, including in the Cayman Islands, will be required to make certain reportings to the US Internal Revenue Services (the US IRS). FFIs include, among other types of financial vehicles, investment funds. Thus, Cayman investment funds will be captured by Fatca. The question then is what and how Cayman funds must report. A full description of Fatca requirements is well beyond the scope of this particular article. However, suffice to say that it will impose significant due diligence and reporting requirements on funds which may be caught by the potential withholding penalties for non-compliance.

There are currently two model Inter Governmental Agreements (IGAs) being negotiated. Model II, which requires FFIs to report directly to the US IRS, and Model I, which provides for implementation of the requirements through domestic reporting and reciprocal automatic exchange of information based on existing agreements. The Cayman Islands has for many years had exchange of infor-

mation arrangements with the US. The US Department of the Treasury has announced that it is in negotiation with a number of countries, including the Cayman Islands, on agreements based on the Model I IGA, and the Cayman Islands Government recently announced that it will pursue such an agreement in short course. This would bring a large amount of certainty to Cayman-based funds. Should the Cayman Islands enter into a Model I IGA agreement it would then be expected to put into place mechanisms to ensure that Cayman-based funds carry out the diligence as required and provide the information expected to be gathered. The Fatca Rules published in January 2013 provide guidance on what is expected, including due diligence requirements, governance measures to ensure compliance, and reporting requirements. We therefore recommended that, at the very least, funds include language in their documents allowing them to demand relevant information, and to take action should it be necessary.

The UK is also looking to implement its own version of Fatca. Although the UK and the US differ fundamentally in the treatment of their respective citizens on a world wide basis, the Cayman Islands is also pursuing negotiations with the relevant UK authorities.

“
THE CAYMAN ISLANDS HAS
HISTORICALLY BEEN THE
PREFERRED JURISDICTION
FOR THE ESTABLISHMENT
OF INVESTMENT FUND
VEHICLES AND CONTINUES
TO BE SO
”

CORPORATE GOVERNANCE CONSULTATION ON BOARDS AND DIRECTORS

Keeping in line with the global focus on enhancing governance standards for financial entities, Cima earlier this year launched a consultation on the corporate governance rules currently applicable in the Cayman Islands. The consultation proposes the amendment and extension of the existing Statement of Guidance on Corporate Governance (SGO), which is currently applicable only to ‘licensed’ funds and other licensed entities, to all registered and administered funds. The amended SGO sets forth guidelines on the duties and expectations of Boards and Directors, codifying much of the existing common law of director duties.

The consultation also covers potential changes to the current regulatory structure governing the provision of directorship services in the Cayman Islands, including the proposal to create a searchable database, and registration requirements for directors. Generally speaking, the changes would enhance the transparency of and codify much which is already best practice, thus further strengthening the quality of Cayman investment funds.

CONCLUSION

The Cayman Islands has historically been the preferred jurisdiction for the establishment of investment fund vehicles and continues to be so. It has for a number of years been at the forefront of the global effort to improve standards of governance and has been a leading member of the international organisations tasked with ensuring best practices for key financial products. It is therefore ready for the changes coming into effect.

As the alternative investment fund industry continues to grow to serve ever more critical economic and financial needs of growing populations, the Cayman Islands investment vehicles is well positioned to remain the most efficient, effective and trusted structure. ■