

BULLISH DESPITE SOME FATCA FATIGUE

Against a backdrop of ongoing regulatory change for the Cayman Islands, this magazine gathered eight experts for the *Annual Cayman Funds Round Table* hosted by EY to discuss what the rapid pace of change means for the funds industry on the Island, and how it might ultimately influence the sector's long-term competitiveness and health.



A number of new regulations are coming to the Cayman Islands, many of which have been imposed on it by external forces. How could these new pieces of legislation affect business here?

Chris Gauk: Clearly the Cayman Islands remains the jurisdiction of choice for offshore funds. We have seen continuous growth now for more than 15 years. But while things are going well, there is room for improvement.

There is a delicate balancing act to be made. There are many regulations that directly apply to us from overseas. I feel the Cayman Islands not only needs to act accordingly but also be seen to be doing the right thing. This said, however, we do need to be cautious. We don't want to end up in a position where we are challenged for over or under applying these new requirements or where doing business in Cayman gets too expensive or regulations too burdensome. There is the danger we become front page news then for the wrong reasons.

Nick Rogers: The Cayman Islands became the success it is because of regulation rather than in spite of it. We have embraced the regulatory shift that has taken place and we are now the place to do business. Fund managers try to break away and find that unexplored bit of opportunity in their investment strategy, but when it comes to choosing what they see as a trustworthy domicile they want to stay in the centre of the herd.

In attendance



Wyn Jenkins, editor,
Cayman Funds



Chris Gauk,
partner, financial
services, EY



Phil Dickie, director,
Harbour



Paul Harris, chairman
of International
Management Services
and president, Cayman
Islands Directors
Association



Nick Rogers,
managing partner,
Ogier Cayman



Monette Windsor,
head of UBS Fund
Services (Cayman)



Susan Lock, partner,
Campbells



Mark Fagan, principal,
Highwater



John Ackerley,
director,
Carne Group



Mark Fagan: The success of Cayman is down to the ease of doing business here and the ease of setting up funds. We have the first mover advantage which we intend to keep, and this depends on how we respond to these regulatory changes. We don't want to impose overly burdensome regulations that are going to result in its becoming more difficult and onerous to set up funds in Cayman. Transparency is a good thing, but over-regulation can be harmful.

Susan Lock: There is obviously regulatory fatigue and overload at the moment. It's true that the Cayman Islands' solid reputation was built on sensible and reasonable regulation but now it seems that much of it is being imposed on us from outside jurisdictions. That makes it an interesting time.

Cayman's challenge is implementing legislation that has, essentially, been imposed on it while not gold-plating this additional regulation and for us still to find inventive ways to remain on top of the market and flexible.

Gauk: To stay on top, we need to stay the course and refine. A manager is not going to change its jurisdiction unless something drastically wrong occurs here or another jurisdiction does it much better. They just want to focus on investing and profits rather than worrying about domiciles.

John Ackerley: Bermuda has been making a big push for this business and there is speculation in some circles around how that could impact Cayman. Should we be concerned about that?

Gauk: I do think that other offshore jurisdictions are now essentially equal to Cayman on what they can offer from a time to market and a cost perspective. For example, Bermuda is closer to New York and a traveller can clear US immigration in Bermuda. But even if Bermuda was otherwise equal, Cayman has the advantage of still being the jurisdiction of choice. Funds don't want to be answering questions on why they have switched jurisdictions.



Paul Harris: Reporters often ask me why Cayman is so popular. I could talk about the absence of taxes, the professional expertise and many other things. But other jurisdictions also have those. What I actually say is that they come here because they have to. It is because it's acknowledged that Cayman is the top of the tree for funds. If they are not here, investors would question why they are not.

The one thing that could alter that is the cost. All the new regulations coming in have the potential to hit costs. All of these things have to be added up; we have to keep a very watchful eye on that.

Is it a level playing field when competing with other jurisdictions?

Rogers: Other jurisdictions are in the same position as we are in relation to FATCA, but where we face a challenge is that the costs associated with compliance are layered on top of what are seen by some to be the relatively high fees we have here.

Fagan: Costs are creeping up incrementally. Eventually, it will become an issue.

Phil Dickie: Regardless of costs, a real benefit of doing business here is the people. There is real critical mass, with some very talented people working here. And people are very collaborative. Having worked in other jurisdictions, I was very surprised upon arriving in Cayman to find that everyone works for the greater good here, and industry participants also work closely with the legislators and regulators.

This means we're able to put out a really good product that meets our users' needs and to respond to changes dynamically in a short time frame. Not many other jurisdictions can do that and it gives us a competitive edge.

We're not resting on our laurels but we are continuously refining and addressing user needs. There are issues around things such as cost but the very fact that we're all having these discussions and working



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together to resolve things will help ensure that Cayman remains the premier jurisdiction.

Gauk: If other offshore jurisdictions are now making an effort to promote themselves, they may do well compared with their performance in recent years but I don't think they will take over from Cayman. First, Cayman is entrenched in the international marketplace. Second, with regard to regulation, it is a question of how efficiently we can apply it. Whether it is FATCA or the automatic exchange of information, the implementation in Cayman must be done as efficiently as possible compared with other jurisdictions which are also implementing these rules.

Ackerley: I agree that is important. A lot of the regulatory issues people are dealing with are not Cayman regulatory issues. But I believe we have the talent here to be able to deal efficiently with these matters and build them into our existing systems.

Monette Windsor: But that is a challenge, and people are tired of regulations. There's a kind of regulatory fatigue that a lot of our managers and clients are experiencing. We actually see that as a sort of opportunity. First, it is good that it's clear that the Cayman government is being very proactive and is one of the first countries to sign many of these treaties. That sends a strong message to clients and investors that Cayman is a good place to do business.

As a service provider, we can also help our clients deal with these regulations—they can lean on us. We can innovate around that and it can create new services and revenue streams around these regulatory challenges.

Dickie: We are definitely seeing a significant increase in vigilance from overseas regulators, not just in the form of additional regulation but also in the manner in which they conduct their authorisations and onsite inspections. Several regulators have recently increased their focus on areas such as fund governance, specifically as this relates to the control environment and management of conflicts of interest.

So to help managers comply with their various registrations, they need to interface directly with service providers and incorporate them into their key processes. That means that now more than ever, it's important that they pick the right people and work very closely with them whether they are directors, administrators, lawyers or auditors.

Lock: I agree that Cayman is still the jurisdiction of choice, especially for certain markets such as the North American market. If you look at the statistics on funds registered with CIMA, about 55 percent have North American investment managers and we are absolutely and clearly the jurisdiction of choice for that market.

As others have said, these North American managers choose Cayman because otherwise their investors, and potential investors, would question the manager's jurisdictional choice. That's not necessarily true in the Asian market or South American market where we have do have competitors. With this in mind, we certainly don't need regulation for its own sake.

What is your view on the pending legislation on fund governance that could result in a database of directorships being created?

Gauk: It's important to separate regulation into what is being imposed on Cayman by external forces versus what is being created here. While we don't have as much influence on external regulation, it is important that we manage it and implement it efficiently and remain ahead of the curve in terms of what the rest of the world is doing.

Of more importance is the regulation being generated locally. We can influence that and whether it is too much or too little.

Rogers: The fact is that people don't mind regulation when they see the benefit of it. Some things clearly offer an international benefit. The Financial Action Task Force Recommendations called for the introduction

of measures against the proliferation of weapons of mass destruction. Few would say that's not a good recommendation, albeit that it may not have day-to-day relevance. So this was an international measure that we enacted into our laws.

But when it comes to the codification of directors' duties and the database, I take a different view. We aspire to be one of the leaders of the pack in terms of signing up to regulation, but in a competitive environment I think we need to be wary of going too far beyond what has been requested by a majority of stakeholders and clients.

Harris: On that, the government was prompted towards it a few years ago by investor groups seeking more transparency. But those same investor groups are now saying: 'Wait a moment, we don't want regulation; we don't want things any more complicated.'

What they really want is transparency and we can give them that. Our job is to do due diligence and ensure the information we're giving is accurate. These are sophisticated investors and they don't want a huge piece of regulation that makes life more complex or expensive.

Ackerley: We must also be very clear that the jurisdiction should not aim to use regulation as a revenue driver. That is a big issue. Regulatory actions should only ever be appropriate and necessary.

On the directorship transparency initiative, as far as I am aware there is no equivalent legislation being proposed anywhere else. The whole issue is transparency, or the lack of transparency, around directors' capacity but there are many ways of tackling that rather than bringing in unwieldy and expensive regulation and systems. There could simply be an amendment to the law to ensure it is a legal obligation to disclose pertinent information to interested parties when requested.

Fagan: There are two separate issues: regulation versus transparency. We're all for transparency but in our experience investors have always been able to simply ask the question, although not all directors have, historically, responded. It is more important that CIMA has an accurate database of up-to-date information on those providing directorships to Cayman funds, so there is an independent source for investors to rely on.

Ackerley: The problem is that it's also about perspective: there are commentators in the UK and the US who will state categorically that no-one should be a director of more than five or 10 funds. But those people simply don't understand what we do and why it's appropriate in the context of a non-executive position. The other fear is that the public release of this type of data could cause more harm than good.

Harris: They seem to have made up their minds that they want this database. They issued a survey to discover what people thought and it seems they concluded it was a good idea. It would mean all directorships would have to be disclosed.

Ackerley: The fact is that to ask about capacity of a director is a commercially reasonable question for an investor to ask. It gives a sense of whether the individual has time to devote to the business of being a director. But investors should be able to ask that question anyway, with an expectation of receiving a response. There is no good reason for not answering the question.

My concern is that the information being provided widely is going to put Cayman in a position where we have to defend ourselves over and over again despite having taken extensive and costly action to attempt to address investor concerns. Frankly, there are simpler solutions and there is no need for a database.

Lock: Yes, I don't imagine any public database is going to be used to send positive messages about the jurisdiction. Implementing a database does seem very reactive and ultimately not very helpful to the jurisdiction.

Windsor: The number of directorships is not what's important. The level and quality of service should matter more.



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Ackerley: The focus on the number is an oversimplification of the sector—it's as if every fund is the same and should have the same governance model. Funds vary so the number of funds that one can satisfactorily oversee varies.

Dickie: The main problem with databases is that they lack any context. An individual won't get the opportunity to explain their directorship number and to discuss why it is as high or as low as it is. There is a big difference in the capacity available to someone providing this service on a full-time basis, compared with someone who may be semi-retired or otherwise employed.

I'm in favour of transparency to relevant users but some qualitative context is needed to accompany the numbers. Simply providing raw numbers does not reflect the amount of time you devote to a fund or the services you actually provide.

Ackerley: If any investor calls me, they can have that information. It is not something that one should be sensitive to if the number is justifiable. Carne issues a quarterly summary detailing the number of directorships each director at our firm has, we freely provide this information to investors and consultants on request. We consider this to be best practice in terms of transparency.

Gauk: It looks like we're all on the same side. We are under pressure from local regulators and international investors to provide this level of transparency. But why are they asking those questions?

Lock: Exactly, who is the public database for? Who is asking for it? I don't think any of us are completely sure of the answer. Prospective investors can and will get the answers they desire from their due diligence.

Ackerley: I've not spoken to a single investor who specifically wants a database. They want to get the information directly from individuals.

Harris: CIMA was concerned by the number of directorships that some people had. They thought full disclosure through a database was the safest way.

Where does the industry stand on the introduction of a register of beneficial ownership for Cayman vehicles?

Harris: Fund managers—and their own investors—don't want their investors disclosed because that's their client base.

Ackerley: That crosses the line on transparency. I personally think that becomes a confidentiality issue—why would anybody want to have a public list of all shareholders?

Rogers: Cayman needs to have the courage of its convictions and stand firm on this. We know our industry best, we know how we deliver our services best. We know what will work and what will not, and we can form a view as to the likely value of any such disclosure. I understand why UK prime minister David Cameron may make his suggestions but there is a long road to be travelled before the UK itself introduces such a register, so we should not feel pressured to go down the same path.

Harris: He said it will not apply to trusts. It will be beneficiaries. So it would apply to corporate entities but not trusts.

Ackerley: They haven't committed to this in the UK, so why would Cayman do it first? From an international perspective, we're ranked higher than the UK for the availability of beneficial owner information.

Lock: The fact that the deadline for comments has [at the time of the discussion] just been pushed back is probably quite telling of industry's view of this.

It is always a balance between transparency and ensuring efficiency for business. Is the balance right at the moment?

Ackerley: With FATCA there was no choice. Cayman had to comply and we made the right decision and chose the right model. When it comes to the issue of registered beneficial ownership, that's different and I am not sure we are getting it right.

Harris: We have always taken pride in being the lead in legislation, but it hasn't always paid off because it is sometimes perceived as 'Cayman gives in'. It can also give our competition an advantage in the short term each time before they sign up.

I have been here for 47 years and I would not say legislation is necessarily the biggest threat. Every time legislation takes place it always seems the end of the world. But we've recovered and carried on. So there's always going to be a place for offshore financial centres and I'm pretty certain that Cayman will stay in the forefront.

Do we have the balance right? I don't know. Particularly on this register of beneficial ownership, it needs more measured thought. There does seem to be better communication between the public and private sectors now.

Rogers: There have certainly been peaks and troughs in the way the public sector and private sector work together. We're on an upswing now but there are still occasions where regulation is introduced with minimal consultation or warning. Cayman Finance has an important role to play in



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helping to promote communication, and this should increase the chances of maintaining the appropriate balance.

Dickie: I agree that there's always room for improvement, although we sometimes lose sight of the fact that we're still doing a better job on this than other jurisdictions. We can sit here and find flaws in our system but overall I think we still do a great job.

Harris: I've always suggested that Cayman should follow the UK on many laws. They have done the research and there's no point reinventing the wheel. For example, we are one of the few territories to do due diligence on many things. We were proud about that but there was quite a cost involved. Instead, we should follow the UK's lead to a certain extent and then we can make up our minds whether we want to follow or not.

Lock: The Cayman regulator did listen in the consultation process on the statement of guidance and corporate governance. It may have taken some time and effort, but the regulator did listen to what the industry had to say.

Fagan: For the most part CIMA does the right things and seems to be ahead of the curve.

Dickie: Over the years there have been so many regulations, the costs add up incrementally. For a jurisdiction today trying to get into the market that is a real barrier to entry. We're making these continuous investments in our regulatory framework to stay in that top class of jurisdiction and there's an advantage to that. Although these are often perceived as nuisances, they allow us to remain competitive.

Ackerley: Let's not lose sight of the fact that while there are always issues to deal with in our industry there are few places that do it better.

Windsor: It is true that investors have confidence in the Cayman Islands.

What about the effects of FATCA?

Dickie: We're suffering from FATCA fatigue. But there's a general confidence that people know roughly what it's going to look like at the end and people are ready. They've talked to their administrators over the past few years and identified any accounts that need to be



remediated. Most people just want it implemented now so they can tick the final few boxes.

Fagan: In terms of the US FATCA, yes, but we're all waiting for the other FATCAs to come out now. That could bring more issues. For example, UK FATCA is potentially looking at a system of tax residency as opposed to nationality. Potentially, a German person living in the UK would fall under UK FATCA and a British person living in France would not. But how do you determine tax residency? The US FATCA is more cut and dried due to the US tax system based on nationality.

Gauk: Our goal should be to create a legislative framework that works with US FATCA but is also broad enough to work with all the other FATCAs through an automatic exchange of information. There's a working party looking at this approach now. Ultimately, we should capitalise on a global approach.

Dickie: It does seem possible that different nations will take their own unilateral versions but hopefully there will be a single direction. Following the September 2013 G20 meeting, the OECD has intimated that it will develop a multilateral standard for the exchange of tax information.

Ackerley: How do we change the image of Cayman? From a historical perspective we still get associated with tax evasion. If we can be seen to be working widely with the international community then that is a positive measure.

Windsor: For me, with FATCA and the other FATCAs coming down the line we see it as an opportunity to provide additional services. The real question is the cost and who is absorbing this cost. Ultimately it's the



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investor. The question is whether the benefits of having this regulation outweigh the cost.

Lock: Cayman has some interesting legislation and legislative changes in the pipeline. These have been pushed down the legislative agenda following last year’s election and change of government. There is the Third Party Rights Bill, the helpful proposed amendments/clarification to the exempt limited partnerships law and there is also a proposal around a Cayman LLC, akin to the Delaware entities that may be very useful to our clients. All of these changes/updates will be very positive.

Dickie: That draft legislation was incredibly well received.

How would you describe the health of the funds industry in Cayman now?

Dickie: There has been a slow shift back towards the managers in terms of the balance of power. There has been more capital entering the market in my view.

Gauk: The number of new launches hasn’t been as high as it was pre-crisis, but in 2013 we issued the most consent letters since the crisis. We are seeing funds getting bigger and offering different products. Organisations that already had infrastructure in place are able to deal with regulations. Returns are also coming back and expectations for growth are good.

New opportunities also exist with the convergence of insurance and asset management products. With Cayman’s expertise in the asset management area there is no reason this couldn’t be a meaningful growth area in the future.

Ackerley: I agree that the numbers are not what they were pre-crisis, or even close. However, the launches we have seen recently have been bigger than they have been since the crisis. The start-up market is also seeing some ‘superstar’ managers launching, coming out of existing hedge funds; some are finding it relatively easy to find capital and applying the fee arrangements they wish to apply.

Rogers: Yes, we are not seeing the launch of many \$50 million funds now. The regulatory and compliance framework means that \$50 million is no longer a sustainable number. From conversations I have had with managers, it seems that \$250 million is the minimum now.

Ackerley: You can launch with \$50 million but you need to get to \$250 million really quickly. That is probably a good break-even number and that’s what we tend to cite for sustainability.

Gauk: It depends on which jurisdiction you’re coming from. For funds coming from Asia their cost of doing business is different; they manage with a lower cost structure.

Ackerley: Certainly we see that the pressure on fees has lessened as performance has improved. For big returns, people will pay 2 & 20.

Lock: There is definite pressure on fees, particularly the management fee, and along with ongoing due-diligence investor scrutiny on the expenses they’re willing to bear, in our experience.

Dickie: We have also seen a wider use of expense caps, especially to manage the expense ratio in the start-up phase. Managers seem more willing to concede this in the current environment.

Windsor: Specifically, we have seen managers looking at ways to reduce the regulatory burden. They outsource some functions to try to reduce the overall costs.

Rogers: It doesn't help that the investment environment is relatively stable and benign at the moment. When you are trying to launch, it can be tough to persuade investors to pay a certain level of fees when returns in the global markets are positive, with fairly low volatility.

Windsor: We are definitely seeing more new launches. And that includes some smaller managers.

Gauk: There is still a lot of worry about the costs. Clearly, the costs for funds are critically important when profits are not great. We are also seeing a change of mentality in that managers are running businesses much closer, focusing on cost constraint, than in the past.

Harris: We have noted a greater emphasis on corporate governance. Investors expect much more of directors now. But this also means increased fees, which the investors will ultimately have to pay.

Ackerley: Yes that is true, but fees are generally the last thing we discuss with a prospect. Governance models and how we see the landscape are the focus. They are such a small proportion of the total cost for sustainable funds.

Fagan: I agree. If the first thing a potential client asks about is fees, then they are not the right client for us.

Rogers: To be fair, the people in this room represent organisations that operate at the higher end of the spectrum. For us, our focus is on delivering the highest quality service rather than the lowest cost. If a potential client comes to you and fixates on fees then they might not be the right fit for this level, but one of the strengths in Cayman is that the industry is so developed now that there is a range of providers to choose from.

Final thoughts on the future?

Dickie: We should continue to do what we've been doing well: being responsive and innovative.

Fagan: We are doing the right things and we need to continue doing that and not overly burden the Cayman market with more legislation. We



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must all work together to keep the image of Cayman at the forefront of the industry.

Lock: We must focus on looking at legislation and other things that are going to promote the jurisdiction without being too reactive and over-regulating. Basically, continue doing what we have done over the last 10++ years.

Ackerley: We are in a positive place at the moment—performance is fairly decent and capital is flowing. But we must make sure we don't take our eye off the ball and continue to provide products that meet the needs of industry. Ultimately it is all about what managers and investors need and if we can provide that then I can't see any significant threat to the Cayman industry.

Harris: To stay on top we have to continue to give the service we have become renowned for. New legislation is always observed with some trepidation. However, the private and public sectors working together have always got it right in the past and I am confident that this will continue and that whatever form the legislation does or does not take will only strengthen Cayman's position as the worldwide domicile of choice for hedge funds.

Rogers: I am very confident in and proud of the Cayman product. We are an extremely successful jurisdiction. We can talk about heavy regulation but by global standards it's not a heavily regulated product. We must draw a distinction between regulation we have no choice but to adhere to, and enhancements that are more optional. But I do believe we have been very responsive in the way we've embraced appropriate regulation and transparency and that this will continue to benefit the jurisdiction.

Windsor: Confidence is an important word. I travel extensively through the US, Asia and Europe meeting clients and investors. Investors continue to have confidence in the Cayman product and its jurisdiction.

Gauk: Being a relative newcomer, I see that the strength of the Cayman hedge fund offering stems from two areas: intellectual capital and infrastructure. The legal and physical infrastructure all seems to be working very well. We have a highly refined hedge fund offering and it continues to be important to showcase this to the outside world. ■