



The Cayman Islands – A Tall Poppy

This article considers the future of the Cayman Islands hedge funds industry, following the upheaval of the recent global economic downturn. Cayman, as the “tall poppy” in the hedge fund space, has come under some pressure in recent times, but it continues to be the domicile of choice for a large majority of international hedge fund managers and investors and is set to continue to dominate this market for the foreseeable future.

While there is no doubt that the Cayman Islands’ funds industry has taken a knock in recent years, as has the industry generally, it remains phenomenally strong. Recent statistics from the Cayman Islands Monetary Authority (“CIMA”) show registered fund numbers hovering around 9500, a drop of only 5% below the all time high water mark of 10,000 registered funds in mid-2008. This is not a dramatic decrease in numbers, considering the massive economic turmoil of the past two years. Indeed, fund numbers have continued to rise on a monthly basis in 2010, with some predicting they will be back up over 10,000 by the end of this year. There are also thousands of private equity funds established in the Cayman Islands.

While a few European based managers and investors are taking steps to move their funds closer to home, we are not seeing the threatened drift away from the Cayman Islands to destinations like Luxembourg and Dublin. Accordingly, despite attacks on offshore centres, the attraction of the Cayman Islands is still strong, in large part because setting up in the Cayman Islands is so simple, with minimum red-tape, service providers with a wealth of knowledge and experience, and zero tax.

This article considers Cayman’s strengths, and why it will continue to lead the way in the funds industry, as well as threats the jurisdiction presently faces.

Key Strengths

Sensible Legal Framework

Much of the Cayman Islands' success in attracting funds is due to the fact that the Mutual Funds Law does not impose restrictions on a fund's investment strategy or require exhaustive due diligence on fund promoters and directors. The key regulatory objective under this Law is to compel proper disclosure by fund operators so that investors are fully aware of what they are investing in. Cayman maintains a strong advantage over many other jurisdictions because of this sensible and workable approach to fund regulation and its well established legal system, based on English common law.

Centre of Excellence

The Cayman Islands has established itself as a leading financial services centre by being an open, free-market, tax neutral economy which caters to a global client base, serviced by highly qualified, sophisticated professionals. It is a centre of excellence for hedge fund formation with a large infrastructure of professional legal, accounting, audit, administration and fiduciary expertise. With the new emphasis by investors on increased transparency, third party service providers and rigorous due diligence on fund documents, custody and administration arrangements, this established infrastructure and the wealth of hedge fund expertise here makes choosing Cayman an easy decision.

Proven Model

There has not been the dramatic number of fund closures and fund related litigation some predicted at the end of 2008. With the right advice and tools, many managers of Cayman based funds have been able to restructure and work their way out of difficulties. This is in large part due to the quality of legal and other services funds have traditionally received in Cayman. Further, Cayman Islands' legal advisors and funds (not to mention investors) have learned from the economic crisis and have overhauled fund documentation to ensure it is sufficiently flexible, clearly drafted and provides the tools and mechanisms necessary to deal with potential future problems. The Cayman model for hedge funds is tried and tested and it works.

Strong Regulation

All registered funds are subject to the Cayman Islands anti-money laundering and international co-operation regimes. International assessors, including the International Monetary Fund, the OECD and the Caribbean Financial Action Task Force, have acknowledged the quality of Cayman's regulatory regime and its high compliance culture.

Ability to Adapt

In the past, the Cayman Islands has shown its resilience and ability to adapt in the face of challenge, by responding to the changing product needs of clients, by meeting or exceeding relevant international standards and by engaging in constructive dialogue with international regulatory bodies.

Despite agreement in most quarters that offshore financial centres were not the cause of the global financial crisis, Cayman continues to come under attack in some quarters as a “tax haven” and a “secrecy jurisdiction”, which it most assuredly is not. The importance of a tax neutral platform is often misunderstood. Accordingly, Cayman is faced with another period of challenge and adaptation and is working hard to meet this challenge – through continuing to refine and update its commercial legislation, ensuring it attracts high quality professionals to man the financial services industry here, entering into further tax sharing arrangements with countries around the globe and continuing to provide outstanding services to the global hedge funds industry.

Key Threats

New Regulation of Funds and Managers

The Cayman Islands presently faces regulatory challenges from both the US and the EU relating, at best, to matters of transparency and the exchange of tax information, or, at worst, to measures preventing certain investors from investing in Cayman Islands funds. It is expected that a proportionate approach will eventually be taken and that regard will be had to the lobbying of the global financial community for maintaining a competitive global market unhindered by protectionist regulation. Whatever the final form of regulation introduced, the Cayman Islands, with its observance of recognized international standards and full IOSCO membership, should be in a position either to satisfy or, if need be, adapt to satisfy any reasonable regulatory requirements to retain its status as a leading international financial centre.

UCITS Funds

Much has been made in the press recently about a preference for new hedge funds to be domiciled in Dublin or Luxembourg at the expense of Cayman. However, the UCITS model means an increased cost of doing business and restrictions on investment strategy and leverage flexibility. Accordingly, a more likely scenario is that these jurisdictions will co-exist with Cayman, appealing to different types of investors and managers. While UCITS funds are suitable for investors with particular requirements and certain strategies, they are completely unsuitable for many other kinds of funds which will likely continue to be established in Cayman.

Conclusion

While Cayman’s position of dominance in the hedge fund world has certainly come under threat, Cayman continues to be the jurisdiction of choice for a large majority of global investors and managers. With its ability to adapt, its strong legal and regulatory regime and its wealth of expertise in the hedge fund space, Cayman is ideally placed to continue its reign as the “tall poppy” and domicile of choice for investment funds.



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This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

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