Innovation, challenges and competition

The dynamic landscape that is the Cayman funds sector with all its opportunities and challenges was debated by a panel of executives and politicians at the annual *Cayman Funds* roundtable hosted by EY. Regulatory changes, competition and the potential of cryptocurrencies were hot topics.

How would you characterise the health of the Cayman funds sector at the moment

Marco Calleja: Thank you to everyone for participating. Our industry has been successful as a result of collaboration between public and private sectors and this is a great forum for us to share insights on that basis.

Heather Smith: For the 12 months to the end of December 2017 there was a slight decrease in the total number of funds, with 10,559 funds registered /licensed as compared to 10,586 as at the end of 2016.

However, the 2016 Investments Statistical Digest reported that the total assets of regulated funds increased 7.6 percent during that year. It is also clear that Cayman remains the domicile of choice with 53 percent of global total by net asset value reported through Cayman funds, as per the IOSCO 2016 Hedge Fund Survey, which has been the position for the last few years.

In addition, since the introduction of the Directors Registration and Licencing Law, CIMA continues to see more proactive actions by directors and service providers in ensuring that funds that are

inactive are wound up. CIMA thus views the current numbers as a more accurate reflection of funds that are actively operating. CIMA's tracking, quarter on quarter, also shows the spikes in numbers around the middle of the year and then the dip as you get the terminations in at the end.

Overall, compared to other jurisdictions, Cayman remains well ahead of its competitors. We continue to see about 100 new funds a month, even though the terminations that come, mainly towards the end of the year, will tend to balance out the overall total. It is still a very robust industry.

The Hon. Tara Rivers: Based on those statistics, our legislative and regulatory framework continues to create the environment for a thriving funds industry. We consult with industry and CIMA in order to achieve this.

Jude Scott: We also have a very strong positive feeling about the jurisdiction. It ticks all the boxes for the alternative investment space. The hedge fund side is levelling out at a very strong level, but where we see money shifting out of hedge funds, we see it moving into the private equity space where we're probably equally strong, as well as into real estate funds.

In some growth areas like Asia, the preferred vehicle is private equity. The jurisdiction has a very strong offering in those spaces as well.

In attendance

Michelle Bahadur, director, Cayman Islands Government Department of Financial Services

Trinda Blackmore, board member, Cayman Islands Directors Association

Chris Bodden, director, The Harbour Trust

Marco Calleja, partner, EY

Mark Cook, fund fiduciary, IMS

Colin MacKay, chairman, Alternative Investment Management Association

Ingrid Pierce, managing partner, Walkers

The Hon. Tara Rivers, JP, MLA, Minister of Financial Services

Jude Scott, chief executive, Cayman Finance

Heather Smith, head of Investments and Securities Division, CIMA

Simon Thomas, partner, Campbells

Monette Windsor, managing director of MUFG Investor Services

Moderator:

Wyn Jenkins, editor, *Cayman Funds*

> "We'll have a better idea of what's happening in the multinational space once country-by-country notification and reporting commences."
> *Michelle Bahadur*

We see the market as very fluid, but Cayman remains dominant and a lot of that has been led by the good work of government, CIMA and industry. There has been some good innovation through things such as LLC and exempted limited partnership legislation.

Colin MacKay: If you look at the volatility index for the US market in particular, over the last two years, it's not quite flat-lined but its movements have been very modest. Certainly, in 2016/2017, there was very little volatility in the market.

Our membership in the alternative asset management community has had to look at how to achieve asset growth, through longer term performance. That's why some have turned to private equity style strategies. Investors are willing to lock in capital for longer periods in return for improved returns and there's definitely been a strong uptake in the private equity structuring.

Jude is correct, Cayman is very well positioned as the domicile of choice for private equity, every bit as much as it is for hedge funds.

There has been greater volatility recently and maybe that will prompt an increase in new fund launches as that creates opportunity for gain. We could see some opportunity for new managers and new products. That brings new exposure to the jurisdiction which is important for us going forward.

From an asset management community perspective, 2017 was a very strong year, and the start of 2018 bodes well.

Calleja: In our 11th annual hedge fund survey in November last year, and our recent private equity survey one of the common themes was changing investor preferences. There's a shift to investors wanting more customised terms and conditions, whether that's liquidity or exposure to new asset classes.

Ultimately, the vehicle of choice is still a Cayman product from a jurisdictional perspective.

Other challenges and shifts that we see are continued pressure on fees; managers continue to see their operating expense ratio come down and it's not as a result of management fees being cut, rather it is through operational efficiencies. We're seeing more robotic process automation, not just in the front office, but across the board at service providers as well.

The biggest threat to the industry, besides investor preferences, is sourcing and retaining talent. We've seen a lot of investment managers introduce HR programmes. The other big topic is more disruption and opportunities and challenges as a result of technological innovation. Some of that innovation is resulting in operational efficiencies but it is also disrupting our product. As an industry we need to be nimble and understand what changes may result in our product going forward.

How has the landscape changed for new launches and new managers?

MacKay: My sense is in the last three years what we've seen is capital aggregation for larger managers. We've seen a lot of the managers coming forward with new products, but within the stable of the large investment management houses. We have not seen as many new manager launches. In 2016, only 80 new managers that launched new products in Cayman were not previously managers of Cayman products.

That seems a low number in absolute terms, and I think we had 1,000 new structures over the course of that year. The low volatility has made it harder to create differentiation among investment products, which has led to the search for improved efficiencies, profitability and return to the investors. The larger managers are better equipped to take advantage of that.

The barrier to entry over the last couple of years has been a very practical one in terms of capital-raising. If there is increased volatility in the market, and strategies can differentiate, the barriers to entry then become the cost of setup. In that respect the regulatory burden is a primary concern, both onshore and offshore.

It's important that we don't view this in isolation. Yes, there have been changes in Cayman, yes there's enhanced reporting, but there's also enhanced regulation onshore. Wherever a manager is setting up, what they are required to do now from a regulatory perspective is different from what it looked like six or seven years ago. That's an evolution for the industry as a whole.

Smith: That ties in with CIMA's experience: we are seeing more existing funds launching new asset classes, primarily through segregated portfolio companies, than we are seeing new launches. It appears to be easier than launching a standalone fund. We also see different managers using different structures, included segregated portfolio companies but it is certainly a trend that these existing managers are creating emerging managers platforms rather than new managers themselves setting up their own standalone fund.

Of course, from a regulatory perspective, these platforms create certain challenges but it is certainly one of the responses we're seeing to the cost issue.

MacKay: The exercise that CIMA is doing of gathering the details on the segregated portfolios that exist within the structures will bring important transparency to the segregated portfolio companies in particular. Some other jurisdictions such as Ireland report fund numbers to include individual portfolios, whereas currently Cayman doesn't. It's comparing apples and oranges.

Smith: The information on number of segregated portfolios per segregated portfolio company should be available within a few months. In addition to the exercise of updating the information for existing funds, CIMA now has the online reporting system—whereby when adding a new portfolio this information must be provided to CIMA and is then automatically recorded in its system.

Previously, the existence of a new portfolio came to the Authority's attention usually because of some issue arising and we would then realise that it's a segregated portfolio that we didn't know existed. There are some challenges around tracking these portfolios but hopefully this reconciliation exercise and enhanced reporting requirement will ensure that CIMA has accuracy in terms of number of segregated portfolios that exist.

Ingrid Pierce: I agree about the jurisdiction being robust. The number of registrations is healthy and while we have seen some changes the market has also changed. We haven't had a lot of startups although we've seen the larger managers start to do more things. I am also seeing some newer managers pushing ahead; given the number of terminations some people have spun out of closing shops and set up their own shops and they are now coming online.

If you look at those managers registered with the SEC, over 50 percent are US domiciled, as you would expect, but 36 percent are Cayman-based. The next highest number drops down to only 4 percent, so Cayman remains the domicile of choice.

If you look at the more closed-ended structures such as private equity, again for those subject to registration in the US, Cayman is the number one with 52 percent of the market share and the US drops down to nearly 35 percent.

The second point is we shouldn't just focus on the registered space, because Cayman has a whole range of funds and products that are not registered with CIMA, either for a sound structuring reason, or because there is a single distributor, or for other good reasons. Those statistics are not captured so the market is much bigger than first appears just based on those numbers.

Chris Bodden: I agree and have observed increased interest in private equity and other closed end vehicles, both from investors seeking better returns and managers seeking ways to differentiate themselves in order to attract and retain capital. Typically it is our larger managers with robust infrastructure who are successful in expanding into this space or offering multiple product types to their investors.

This continues the trend of large managers getting larger. New managers are finding it increasingly difficult to launch and have to be innovative in the way they differentiate themselves from the rest of the market, most of which revolves around lower fees or fee structures they feel will be attractive to investors.

Given the number of existing managers, new entrants struggle to attract capital and have an increasingly smaller window in which to execute on their strategy before investors return to more established fund complexes.

Monette Windsor: It's not just the managers who are continuing to choose Cayman as the preferred domicile, investors are driving this decision as well. The large institutional investors, whether they're putting money into well-known managers or newer startups, they're comfortable with Cayman.

Comfortable with the pro-business government that we have, the stable monetary authority that has been very transparent and all

the service providers we have in the room—the directors, lawyers, auditors and fund service providers. That's also one of the key reasons Cayman is continuing to be successful, because you have the support of the investment managers and the investors as well.

Trinda Blackmore: With new managers, it's usually their institutional investors saying Cayman is the choice because of their comfort and familiarity with the jurisdiction. There are some low-cost domiciles that may be better for certain things where cost is a factor, like multiple SPVs, but outside of that I think we continue to consistently see Cayman as the favoured domicile.

Cayman avoided being on the EU blacklist but needs to address certain things around economic substance. Can you give us an update on that?

Rivers: Cayman is not on the EU's non-cooperative list because we demonstrated our cooperation on tax transparency, as we have automatic exchange of tax information through CRS, as well as on request. Our transparency also is recognised by the OECD.

I wanted to underscore that for people to understand and appreciate that all the efforts we've taken in that regard have been recognised.

Before we go into the economic substance question, it's also important to mention our cooperation in tackling base erosion and profit shifting (BEPS), another OECD initiative that has been incorporated into the EU blacklisting process. Cayman has signed up to, and will be participating, in the country-by-country reporting under that particular regime. As such, the EU and OECD recognise our cooperation with BEPS.

The only area that the EU had some lingering concerns over is the more nebulous definition of fair taxation, and in particular the issue of substantial economic presence. With the type of products we have in the Cayman Islands we, and indeed all of the Crown Dependencies and Overseas Territories assessed, fell into that category.

We're therefore continuing our engagement with the EU. We have committed to work with them to determine what would be considered appropriate economic presence, given the different types of products we offer, which besides funds include special purpose vehicles, private wealth and family offices, and reinsurance.

Even within our own financial services industry, there can't be a one-size-fits-all model in terms of the definition of what would be appropriate substantial economic presence. This is something that we are working very closely with the EU to discuss the variation in our industry, and to determine what would be appropriate to ensure that we can continue to thrive as a jurisdiction.

Are you hoping that the EU will define what it means by economic substance?

Rivers: The challenge is that some of the EU countries have a very different economic model from ours, and helping them to understand this is vital. That one-size-fits-all model just does not work and it would be harmful to approach it this way. Indeed, from my understanding there isn't even a uniform model as it relates to substance requirements that have been adopted by the EU member states themselves.

We are very cognisant of the fact that there are nuances, even within the financial services industry, that we need to be aware of. We're working very closely with industry through the work of Cayman Finance and through the broader industry associations to hash out what those considerations will be as the dialogue continues.

Scott: It's remarkable what this jurisdiction has been able to achieve in this space. I also see it as an opportunity. Cayman is uniquely placed not only to be the recipient of what other people define substance to be, but also to influence that process in a very pragmatic and positive way.

When we look at the hedge fund or private equity space, we're uniquely placed doing 50, 60, 70 percent of the offshore structures through Cayman. There's no other international financial centre that has the same type of mix that we have, and a very tax-transparent, very neutral platform.

We don't have things like double taxation treaties which are some the main concerns of the EU. We have a real opportunity with the work, with the relationships that government has, the role on global forums to help shape pragmatic definitions for these types of global financial services transactions.

Ultimately we want to develop definitions that work not only for Cayman, but for London, New York and all financial centres around the world and look to have those endorsed from an OECD perspective which will then stabilise some of the volatility of definitions. We really need a comprehensive global substance definition.

Michelle Bahadur: The OECD has established an informal working group to explore the issue of what economic substance means, in the context of the EU code of conduct group. The OECD has been working in this area for 20 years, so there is a fair bit of jurisprudence in this area.

The OECD is working to help to flesh out these issues, which will certainly be a big help in maintaining a level playing field. After the code of conduct group meets next week, we may have more detail on their thinking on economic substance.

We are very keen on helping the EU and the OECD to understand our industry and the different sectors. The OECD has acknowledged

that the fund space could be considered differently for economic substance purposes.

Simon Thomas: My understanding is that the EU and OECD initiatives were targeting big multinationals that are essentially jurisdiction-shopping to get the best tax deals. In the fund context, where portfolio companies and investors are paying the appropriate level of taxes due in their home jurisdiction, no-one is saying that the funds themselves should pay more tax.

The fund industry is absolutely right, participants should be engaging with this and explain why they are different.

Mark Cook: I've had a few instances where European managers have essentially redomiciled funds because they were getting pressure from investors, but I find it very encouraging that there is recognition by the EU and OECD that the fund space is different. Managers are regulated and investors are taxed in the jurisdictions they're in. A Cayman Islands fund vehicle is a sensible vehicle to enable parties from different jurisdictions to come together.

The Cayman Islands professional community does a great job of providing support and infrastructure to facilitate that. For me the concerns of the OECD have been misplaced.

Scott: As a jurisdiction what our clients are really looking for is for us to be proactive in the process. We need to visibly show we are engaging on regulatory matters. We also need to appreciate that politics come into play as well. If you take Brexit, there may be definitions that work for the EU that may be disadvantageous to the UK.

We must look beyond short-term decisions and take a proactive approach that finds a solution that works for all financial centres in and out of the EU and globally.

MacKay: There are strong politics at play in whatever moves the EU is trying to make. They represent a populace but a relatively small part of the world. For us as a global industry, the OECD is probably the most important player in this debate. We need a standardised approach but the application needs to be proportionate to the industry. The funds products are different, they are not operating companies, they are capital vehicles. That presents a very different model for economic substance than does an operating vehicle.

The other factor to bear in mind is that there is a lot of economic substance in Cayman. We have regulatory requirements, the audit process is led from Cayman and a significant proportion of funds have independent directors based here in Cayman.

Going forward, will we see administration done more on-island? Potentially. That will perhaps come out of what economic substance means, but that could be good for the jurisdiction from a local economy perspective; everyone around this table would welcome that.

That has to be balanced with investor preference and the economics of the fund itself. You can't increase the cost base. Investors will vote with their feet. And it comes back to the underlying political element, which is, unfortunately, the reality of the world we live in. The fact is that those who debate the Cayman Islands and international taxation and regulation do not always have an informed position.

The OECD has recognised the level of cooperation from a tax perspective that Cayman has had for 20 years, but that doesn't play in the public domain. Whatever the discussion is and goes for economic substance, it needs to be debated by informed participants and the OECD has a material role to play in it.

Rivers: Those who know us, know what we do. They know the structures; they know the benefits to the global economy that we provide, as well as to domestic economies. But perhaps we do need to do more to engage or influence the public perception, because of the political pressure placed on the policymakers in those jurisdictions.

We need to help the average person on the street understand what we do and how we benefit the global economy. The political pressure that's happening in Europe, and in the UK, could have a knock-on effect to us—I don't think we can afford not to engage.

"Investment firms are struggling to figure out how they can still be efficient while addressing the needs of individual investors."
Marco Calleja

Government and industry both need to start to dispel those misperceptions and the myths that continue to occupy the space of public debate. That is probably our greatest challenge. We need to tell our story. We have to combat perception with facts, and we have to connect with the public.

Cook: I see a great deal of irony that the world's largest sovereign wealth funds and pension funds that represent the general public find a way to invest into Cayman funds anyway. Yet the person on the street has the idea that the Cayman Islands only serves wealthy people around the world. It's misplaced.

Rivers: Cayman provides the ability for them to live comfortably in their old age. That's the kind of message that we need to be able to create, based on facts,

Calleja: You could say the same thing about private equity. Banks are much more reluctant to provide credit these days and when it comes to job creation, infrastructure opportunities, and developing economies private equity vehicles are picking up the slack. The capital is often coming through a Cayman entity, so you can connect the dots of the opportunities, job and wealth creation as a result of investors who are willing to accept the risk:return profile and invest in the private equity vehicle.

If PE was absent from capital markets then we would have a very inefficient way of raising capital and one could argue that there wouldn't be the capital available for some of that development.

Smith: It is an interesting ongoing conversation between securities and bank regulators in relation to this topic. Banking regulation has become more prescriptive, with a lot more rules appearing in that space, which has had the effect of making the provision of credit by the banks a much more rigorous process. Securities and capital markets regulation, on the other hand, has remained more nimble and arguably more responsive to the needs of the market, thus seeking to strike the balance between effective regulation and the continued availability of economic growth opportunities utilising the capital markets.

"Independent directors or an independent board can help resolve many issues in a variety of situations." *Mark Cook*

"It is encouraging to see an increase in independence on the boards of private equity funds." *Trinda Blackmore*

Rivers: There are three types of audiences we need to be aware of. There are those who know us and love us, and they're not going to take much convincing on the benefits of doing business in Cayman.

There is the audience that don't know because they don't want to know. It doesn't matter how much information you give them, they won't change the narrative. It's a campaign. You cannot be too concerned about changing the hearts and minds of that group.

The group that is most influential is those who don't know because they just don't know. They haven't been given the information, and they don't feel an impetus to go out and get the information, so they rely on the public messaging. That's the group we really need to figure out how to address.

Obviously, the Ministry, government and industry have a role to play. We need to figure out very quickly how we develop those informed messages. We should be shifting from being reactive to being proactive to ensure that when they have the other messages, at least there's some balance.

Windsor: Even on-island we need to consider the message. Cayman Finance has been great in terms of educating the public on the benefits that the finance industry brings to the community and job creation. We need to stress how easy it is to do business in Cayman.

What will the recent tax reforms in the US mean for Cayman? Has CRS meant any changes?

Rivers: It is a space we're watching closely, and we are getting advice from our US tax counsel as the rules and the regulations are developed. The reduction in the corporate tax rate to 21 percent may lead to funds or other investment vehicles deciding that they need to reconsider the most beneficial structure, but it may motivate certain businesses to move to jurisdictions such as Cayman because they are unable to obtain the foreign tax credits for foreign taxes paid.

Bahadur: For FATCA and CRS, there are now over 70,000 entities registered in our system, with the majority of those being investment entities. Looking forward to 2018 we are continuing to engage with the OECD's automatic exchange of information, as they conduct assessments and monitor jurisdictions' implementation of CRS.

Blackmore: It would be interesting to know how many other entities there are, as we talked about the economic substance concerns. If 70,000 are captured and reporting under CRS, how many does that leave for economic substance concerns?

Bahadur: In addition to the 70,000 for which we have data, we'll have a better idea of what's happening in the multinational space once country-by-country notification and reporting commences, and that will help us in the discussions with the EU regarding economic substance.

Scott: Because we don't have things like double taxation treaties Cayman has never been a jurisdiction that's been involved in trying to shift tax bases.

Thomas: The tax changes are an interesting signpost because carried interest tax has been on the agenda for probably in excess of 10 years now. As part of that bigger political picture there is pressure on governments to close what the media perceives as loopholes. But these arrangements have been put in place intentionally. The UK, for example, has historically given private equity firms preferential treatment of carried interest to encourage managers to establish in, and carry on investment activities from, the UK. After all, investment drives growth—tax doesn't drive growth.

Pierce: Where we might see more of an effect is driving some of the structures to Cayman for ECI (effectively connected income) reasons. That's one of the drivers onshore tax advisors seem to think is going to be beneficial for us.

MacKay: If the US is about to embark upon a material infrastructure investment strategy, that's ready made for private equity to come in on public/private partnership arrangements.

Scott: It possibly will also drive more interest in physical presence in Cayman. I wouldn't be surprised if we see more investments teams starting to set up physical presence and operating from Cayman.

Calleja: One impact of US tax reform is on private equity. All valuations have had a nice uplift so that is positive for encouraging investment as you now have more attractive returns on investments and you'd expect dividend yields to be higher. All this points to the increase in private equity and investment.

Smith: Between September 2017 and early January the Authority received 15 new applications for securities investment business, which is unprecedented. We're seeking to ascertain what's driving this growth and whether there is more to come. Should those applicants be successful in obtaining a licence, this would be a 42 percent growth in the number of licensees. So potentially this is reflective of the trend of increased private equity investment.

"There's a record amount of dry powder sitting there and waiting to be deployed."
Simon Thomas

How have valuations changed in recent years?

Calleja: We had seen some traditional hedge funds dabbling in the private equity space. We also expect to see more use of third party service providers in assisting managers with valuations. With the rise in private equity, with the traditional hedge fund managers dabbling into the space, we see as service providers more traditional managers needing to enhance their in-house infrastructure to be able to deal with valuing a private investment.

There's been a lot of talk around advisory committees on private equity funds and there's a well understood process of frequency of board meetings for hedge funds, which is the less complex, the more liquid asset class versus private equity where you have assets which are based on largely investment manager's assumptions. Fund governance and valuation controls aren't always present especially with emerging private equity players. This is an opportunity for the jurisdiction to service those private equity funds.

Bodden: As managers, who historically offered hedge products, continue to seek additional sources of alpha we have seen an increased willingness to invest in private or thinly traded securities. This has only served to increase the complexity around the valuation process and as mentioned previously, sometimes requires third party expertise to augment the manager's existing processes.

I would also agree there has been increased discussion around advisory committees, however in our view the concept has not been widely adopted in the private equity space. In those instances where it has been implemented, it is either investor driven or where a manager who traditionally offered hedge products is now launching a PE type fund.

These managers benefit from replicating the efficient hedge fund-like governance structure which provides added comfort to investors in the form of independent oversight of the service providers in general. They also benefit from the independence that can be demonstrated around conflict resolution, review of fund documents or other areas where the investors feel independence is required.

Cook: Independent directors or an independent board can help resolve many issues in a variety of situations. I've heard of instances where private equity funds have not had any independent governance mechanism in place, but there's been a limited partner's advisory committee that has been constituted with representatives of some but not all limited partners. There have been situations where an issue has arisen and certain individual members have not been able to give an opinion on committee matters because they've got their own vested interests to consider. This can cause the committee's usefulness to be severely restricted.

This is a gap that could be quite easily be filled by independent people but the message I've received is that until everyone recognises that there's a need to do something differently they're sticking with the status quo.

Pierce: We have seen an increase in valuation activity, on the private side, but typically where there is a contentious issue requiring the valuation of a particular security or a basket of securities. We've seen a lot more uptake in the merger space, with dissenting shareholders and section 238 applications.

Windsor: Not only do we see the continuing trend of private equity launches, but we're seeing a trend in hybrid funds—funds that were typically hedge funds or fund of funds, are now allocating a part of their portfolio to private equity investments. Traditional private equity structures are closed-ended, so although there are regular valuations, investors won't receive the money until the sale or end of each investment. But if you're an open-ended hedge fund with some

private equity investments, your portfolio is a mixture of liquid and not-so-liquid investments.

If you have investors redeeming, the fund will liquidate assets, and the remaining investors may be left with a less liquid portfolio. That's when it can be a grey area, where you need to get guidance from the investment managers and directors on how to proceed.

Blackmore: One of the things I look for when a fund structure is being launched is if the redemption terms reasonably match the liquidity of the investments, which is even more important in a traditional hedge fund than a private equity fund where there is limited ability to redeem. I'm seeing more special situations funds where it might make sense to move an asset into its own SPV so you have that protection that the last investor standing isn't bearing all of the risk of an illiquid investment.

In terms of governance on private equity funds, it is a much slower uptake and depends on the investor base and if those investors are saying 'we want some independence here'. But it is encouraging to see an increase in independence on the boards of private equity funds and hopefully this trend will continue.

Thomas: The investors that have the weight to move funds towards appointing independent directors are the ones that are sitting on the limited partner advisory committee (LPAC) anyway where they will be reviewing and approving valuations. In a sense, when considering independent governance, the valuation is irrelevant in the private equity context where it's all about realisations.

There would be other factors that might drive a manager towards considering independent governance. The SEC has carried on levying fines against private equity funds, where they have looked into allocation of investments between fund vintages, managers taking transaction fees, monitoring fees and so on. If you've run that decision-making progress past an independent director it strikes me that you're in a much better position when the SEC comes knocking.

Have fees and their structures changed in recent years?

Calleja: There is a lot more customisation. Investment firms are struggling to figure out how they can still be efficient while addressing the needs of individual investors. It's more about selling the solution that the investor wants. What's their liquidity appetite? What's their fee appetite? We are seeing more use of SPC structures for that reason.

Windsor: Managers are under a lot of pressure and they are looking for their own internal operational efficiencies. They're looking to outsource as much as they can to avoid having to employ a large number of employees. Instead of having their own staff doing a lot of manual work or processing, they are looking to outsource to a service provider. We're doing much more for the investment managers, whether it's business process outsourcing, or doing the heavy lifting of collecting and processing data.

A hot topic in the industry right now is artificial intelligence (AI), which managers are interested in. As a fund services company, we want to make ourselves more efficient so that we can still be profitable off the shrinking fees. Maybe AI and robotics are going to revolutionise not only the way investment managers work internally but also their service providers.

I'm not concerned that it's going to decrease the jobs in Cayman Islands because the jobs the robotics and AI would replace left the jurisdiction years ago. You still need skilled professionals and talented people with experience in the hedge fund industry to manage the processes and face the clients, and Cayman is well placed as a jurisdiction to attract and retain that kind of talent.

Pierce: We haven't seen as much pressure on fees, perhaps they've just come down to a comfortable level and people are not negotiating quite as much.

Certainly we are seeing new products coming online. It's horses for courses. If you're new and don't have much of a track record, then you probably have to shave a lot off your management fee. On the other hand, the large managers who have a lot of capital can afford to lower that fee or be more efficient. There's been a bit of fluctuation here and there but I don't think it's dramatic.

Thomas: In private equity there's been the haves and have nots. In 2017 we had the largest fund ever raised and the largest aggregate amount of funds raised in a year in history and we've now got close to three trillion in assets under management which is the highest it's ever been. And there's a record amount of dry powder sitting there and waiting to be deployed.

Pierce: We have seen capacity rights being extended where a fund says it will close at X and actually the investors just want to invest more, so managers are having to extend the initial time period and/or the actual capacity granted to investors.

Thomas: General partners have all of the power on economic terms because the fundraising market has been so buoyant. But in a high price environment coupled with undeployed capital, if you've got managers doing deals just because they've got the dry powder (and not because the price is right) and they get a lower return as a result, or if managers are not doing deals and investors are paying management fees on undrawn capital, it's going to be interesting to see whether in a year or two from now, that pendulum shifts in investors' favour.

How might technology and innovation change the industry?

Cook: The largest managers can afford investment towards new technology, whereas the small ones for these cost efficiency discussions we've already had aren't able to respond.

"We need to figure out very quickly how we develop those informed messages."
Tara Rivers

Calleja: Managers are trying to figure out do we invest the money and self-automate internally or do we outsource. Depending on where you are on the spectrum, which is generally driven by size, that's where the investment is taking place or not.

Cook: We have to acknowledge that we need big data in general to make better informed decisions. But there also needs to be some level of control on the execution of trades such that data is used in line with their strategy.

MacKay: The downside risk of technology is always the gap between innovation and implementation. You're fearful that you select your system, you implement it, but by the time you implement it, it's already out of date. Let somebody else invest in the infrastructure and maintain it and evolve it while you benefit from that through outsource arrangement. It will come but managers will always balance up the risk and the cost aspects.

What about cryptocurrencies? How might the funds industry get involved in that?

Scott: Fintech in general is a huge opportunity for the jurisdiction. It's going to be transformative from a global financial services perspective. I would separate the two elements—cryptocurrencies and blockchain technology (distributed ledger technology).

In the cryptocurrency space, the greatest interest we're going to see is from fintech companies setting up in Cayman potentially looking to issue initial coin offerings (ICOs) or build technology as part of a blockchain or similar technology. We're also seeing an acceleration of fiat currencies being looked into from countries like the UK. It's possible that in the future, digital fiat currencies will be the mainstay global currencies, and cryptocurrencies may move toward being more a new derivative asset class.

"We have seen capacity rights being extended where a fund says it will close at X and actually the investors just want to invest more." *Ingrid Pierce*

That would then mean, for example, that our products in Cayman will be investing into those as an asset class. What comes from that is how you treat that asset class. From a jurisdiction perspective, we're attracting a lot of fintech companies to be setting up in Cayman.

From a financial services perspective, what we're looking at is helping solve some of the global barriers that are holding back the technology from being implemented in financial services transactions globally. There's three areas, one is from a regulation/global policing authority's perspective where you have the natural issue with this type of technology which is anonymity which creates a bearer instrument concept.

We're working on solutions that could solve that with things like certified digital ID that will work from a global perspective, which will allow the technology to still be harnessed with all of its speed, peer to peer, borderless aspects of it, but will create the soundness that's needed in terms of knowing what it is you're dealing with and having them certify it from the anti-money laundering perspective.

Another part of it that's being solved is the digital fiat currencies; we think that will then cause countries to be more willing to adopt the technology because they're not losing control of their ability to adjust their money supply.

The third element is as fintech companies are becoming more mature and are looking to be able to utilise the global platform, they're having challenges because on the surface, taxation authorities are not comfortable, they have ways to be able to tax transactions and in particular the core technology being anonymous.

We're also working on solutions that taxation frameworks can be built into a good sound environment to utilise the technology, but also have taxation frameworks included. We see Cayman as being a centre to solve some of these problems.

Smith: Most regulators will have a challenge with this new innovation especially where anonymity exists on instruments, which as you know is something regulators worked really hard to remove from the financial industry through the prohibition of instruments such as bearer shares.

We, however, recognise that there are potentially advantages for the industry and CIMA regularly fields queries in regards to many different proposals relating to this area. There are also a few funds already registered whose strategy is investing in fintech related technologies or cryptocurrencies. For funds, this is just another product in which to invest and that's pretty straightforward.

CIMA has also had queries in relation to redemptions or subscriptions using cryptocurrencies. However, this is something that we do not currently allow as there remains the question of is a cryptocurrency actually a currency

Another big question for a regulator would be in relation to valuation; we have seen how the value of these cryptocurrencies fluctuate, sometimes wildly, so the question would be how would you accurately value such currencies in order to produce the fund's NAV.

I believe that fintech, cryptocurrencies, ICOs, are here to stay. Therefore, if we have entities in Cayman that are going to be conducting this activity, either through investments or doing some aspect of supporting/enabling such investment, we have to consider the regulatory aspect.

CIMA is doing its best to learn as much as possible and as quickly as possible in order to be positioned where we can, hopefully, allow certain aspects of such business to be conducted locally but also ensuring that we understand the risks posed by each activity.

Thomas: Heather, you said you had 30 existing licensees in December last year and yet you had 15 new applications. Do you know if those are crypto-related businesses seeking licences?

Smith: Quite a few of such applications involve the use of online trading platforms, however, most online trading platforms are used to trade various types of instruments. There have been a few proposals for online cryptocurrency exchanges, however, with no regulatory policy currently in place for such activity these proposals have not moved forward—to CIMA's knowledge.

Rivers: This is certainly an area that the government recognises is here to stay to some degree. Not necessarily every player in the market, we believe, will survive in the end but the technology, the innovation that it brings will certainly be an area that we can't afford not to grapple with. We need to do it in very short order because the world is moving on.

It's creating an appropriate regulatory framework as Heather alluded to, and also trying to solve those challenges more on a global scale.

Bodden: I would be surprised if there is anyone around the table who has not been involved in a recent conversation relating to cryptocurrencies, either a manager seeking to launch a digital asset fund or some other subject relating to block chain technology. In general the key concerns are similar for most of us and have already been mentioned, specifically, valuation, existence, ownership or custody, and investor due diligence in general.

The underlying technology was meant to be disruptive and provide new ways for parties to transact with each other. We can agree it has done just that. Those managers who are thinking how to incorporate this technology in their platform, while maintaining the integrity of their control environment, are likely those who will be successful in attracting capital from traditional sources and therefore likely enjoy some longevity in this space.

As a firm we continue to assess each opportunity presented to us, however, like many, have questions we need addressed before we move forward. As industry best practices evolve and our understanding increases, I suspect this will change as we find ways to adequately address the risks associated with these products in an efficient and commercially reasonable manner.

Calleja: There are two separate conversations here. One is a fund investing in a crypto asset, a digital asset and the other is an ICO and using the technology to raise capital and whether or not there's 1,500 ICOs right now, how many of those are securities, utilities, do they all kind of fall into the security bucket.

If we compare it with a prospectus for an IPO where there's a lot of information disclosed and it's regulated and you've already got a company which is producing revenues and profits, we're talking about capital raising with a white paper. There's obviously a different set of risks with ICOs but I do think the technology behind it could be a big opportunity for the jurisdiction.

There is buzz around tokenising real estate or digitising shares. For the fund industry the opportunity is there to create a more efficient product. Maybe there could be a way of creating a private blockchain with accredited investors and certified digital IDs addressing AML/KYC so you don't have the onerous process where investors have to go through repetitive AML/KYC and they can trade digital shares within a private blockchain exchange.

Regulators need to figure out how they're going to regulate the exchanges if cryptocurrency is held in hot storage.

Pierce: There isn't a week that goes by that we don't have more than one enquiry in the crypto space. Cryptocurrency funds are not that interesting in some ways because it's just another asset class that somebody is investing into and the regulator can understand

that and get their arms around it. There's likely to be some oversight and most of the service providers that people are talking about providing services to these funds are existing reputable providers.

We're seeing lots of activity in new formations and a few actual launches, but we'll see where that goes given the volatility of the pricing which is in rapid decline at the moment. On the secondary point, on the ICO side, that's much more tricky, and requires a lot more consideration. You will see what's been said about it by the SEC, which means that it is going to require regulation of some sort. Japan and other countries have been more open, others have been more closed. I don't think it's something that we can simply embrace wholeheartedly without fully understanding the reputational implications for the jurisdiction.

Scott: That's a great point and this is where Cayman continues to play a leading role when we look at innovation. We have through Cayman Finance a fintech innovation lab that has probably 20-plus experts across the industry locally tapping in to all sorts of business partners and experts globally, looking to feed in, looking at best practices, looking at challenges globally. We also have subcommittees specifically on digital funding and investing from a fintech perspective and we now have a fintech compliance working group.

The collaboration across industry, and with government and the regulator are strong points which have allowed us in the past to look at new innovations but also be pragmatic leaders in that space and that's going to continue with this new technology as well. ■

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