



INNOVATION, CHALLENGES AND COMPETITION

The funds industry continues to innovate and embrace change as it keeps pace with increasingly dynamic investment markets and global economic uncertainty. All this plus the implications of economic substance regulations were among the topics discussed by a panel of experts at a roundtable hosted by EY.

How do you characterise the health of the funds sector in Cayman?

LaNishka Farrington-McSweeney: We think the industry is in good health. Discussions like this are really important because it allows the industry to collectively discuss some of the challenges and opportunities we face.

On behalf of EY, we are excited to have you here and see what you have to say today. We want to be a part of that and help communicate these messages to the wider industry. We want you to share with us how business is for you and how you are faring. But first I think we have some statistics from CIMA.

Heather Smith: It's good to report that after about four years of seeing the overall fund numbers fall year on year overall, we have had a slight increase. At the end of December 2018, we saw 10,992 funds compared with 10,559 the year before—a 4 percent increase. It was modest, but we were happy to see that. Last year, about 109 new funds per month were formed compared to about 90 per month in 2017.

We also saw fewer terminations. In previous years we had seen more directors and operators of funds terminating funds pretty quickly if they were not active or not doing what they were intended to do. But we are fairly confident what is left are truly active funds, or there is some intention of business getting underway shortly.

In relation to fund administrators we continue to see a decline in the overall numbers, and a lot of requests for changes in shareholding. That's not unique to Cayman; we're seeing fewer but larger fund administrators globally.

In terms of investment managers, and in relation to overall number of licences, we went from 34 at the end of 2017 to 38 at the end of 2018 and we've also seen quite a bit of interest in terms of new applicants. There is also a lot more interest in getting a full licence here in Cayman. We are seeing interest mainly in relation to broker dealer and market makers activities, and online trading platforms remain very popular.

This increase in new applications has been fuelled mainly by changes in Europe. European entities could previously provide securities investment business services to the rest of the world from their operations in Europe but this has now changed because of new rules in Europe.



Overall, everything is on a very positive trend. There has been overall stabilization in the industry generally and we see this as positive as well. In addition to all this, overall gross assets were up 13 percent for regulated funds in 2018, reaching \$6.9 trillion.

Michelle Bahadur: These discussions around funds are very important since they are such a significant aspect of our financial services industry. As a government we see funds as strong investment vehicles that are appropriately tax-neutral. We are providing an environment in the Cayman Islands for funds to continue to grow, and we are very open to feedback and improvements that we can make.

Jude Scott: As a jurisdiction Cayman has positioned itself very well over the years. When we look at our funds product it is very dominant and strong product globally. Where some parties may have sought cheaper jurisdictions in the past, we're starting to see that they're also recognising the importance of a strong respectable domicile and there is a flight to quality now.

They are looking at Cayman to set up new structures and new products. We have the expertise on the ground, the relationships we maintain, the quality of the service, the willingness of participants in Cayman to travel, do thought leadership events, engage, and focus on market-leading activities.

The statistics play out not only in terms of what has been happening through the end of last year, but I think we're going to continue to see an acceleration and growth on that.

We have also been focused on creating more awareness in terms of the amazing products that we have in Cayman and the clients and the ability of the jurisdiction to support other countries with things such as foreign direct investment.

IN ATTENDANCE



Michelle Bahadur, director, Department of Financial Services Policy and Legislation



Mark Cook, senior manager, International Management Services



LaNishka Farrington-McSweeney, partner, EY



Ronan Guilfoyle, deputy chairman, Alternative Investment Management Association (AIMA) Cayman



Anne-Marie Leadbetter, director, Harbour



Gwen McLaughlin, director, fund services, Trident Trust



Victor Murray, committee member, Cayman Islands Directors Association



Ingrid Pierce, global managing partner and head of the Cayman Investment Funds Group, Walkers



Kendell Pierre, executive director, MUFG Alternative Fund Services (Cayman)



Andrea Proctor, deputy director, Department of Financial Services Policy and Legislation



Jonathan Roney, director, fiduciary services, Intertrust



Tim Rossiter, incoming chair, Cayman Islands Fund Administrators Association



Jude Scott, chief executive, Cayman Finance



Heather Smith, head of the Investments and Securities Division, Cayman Islands Monetary Authority



Giorgio Subiotto, partner, Ogier



Moderator:
Wyn Jenkins, editor, Cayman Funds



“When you go into a PE fund, you know precisely what you’re investing in.”
Ingrid Pierce

We are seeing more countries looking to Cayman to see how they can harness and leverage this tremendous amount of investable capital that’s pooled in Cayman and redeployed around the world. I’m very positive, we anticipate even further growth and acceleration in that space.

Tim Rossiter: There has been considerable consolidation in the industry but from the Cayman Island Fund Administrators Association’s view, we think there should be that flight to quality. We’ve got great infrastructure here, there’s an excellent ecosystem in particular for fund accounting coming through the audit firms.

That equals a great opportunity for us to embrace. Changes in the economic substance regulations and other regulations globally mean we need to ensure that the rest of the world understand what goes on here. The more we can communicate what we do and how we add value to the rest of the world, the more Cayman will benefit.

We see other jurisdictions trying to replicate our models in particular our private equity structures. Some want less regulation but the oversight we have in place, on our fund structures, is pragmatic and designed to make sure that people are doing the right thing via licensees and without too much bureaucracy.

The media are constantly turning things to a negative connotation, so we need to keep pushing through the message that we have high

standards and high quality here and that is the reason we have an advantage to the rest of the world.

Victor Murray: There is something that’s unique to the Cayman Islands: being a professional director is a recognised profession here in its own right and that is borne out by our membership. The Cayman Islands Directors Association now has some 320 members, all of whom provide professional director services to financial services. When a business comes to the Cayman Islands they can be assured they can get a high quality, independent director who knows what they’re doing.

Anne-Marie Leadbetter: We at Harbour sit as directors on various sized funds and see a wide range of products, and for the most part the growth we’re experiencing is through the big firms getting bigger. The large institutional investment managers are creating more products, due to demand from the investors who want different types of structures or different type of investments.

That means getting a foothold is getting harder and harder for small investment managers. It’s a bit prohibitive for new investment managers who are wanting to start up but, if they can last through those lean two or three years and get to that critical mass, they can survive and thrive.

Murray: We have seen large pension funds that can’t get the growth from bigger managers backing smaller managers to get their growth.

What other changes are you seeing in the landscape?

Farrington-McSweeney: We are seeing changing fund structures and product mix; a rise in people moving away from the traditional hedge fund products. We are seeing a lot more private equity (PE) structures in the last six months. If we get 100 audit queries, 45 of those are now PE which never happened before. We have even established a new PE group whose sole job is to go out and meet with these newer managers.

We're also seeing some of our larger managers creating their own PE structures because their investors are demanding a different structure.

In terms of the global competition, Luxembourg is actively targeting Cayman funds and they're going after the markets that we have previously been very strong in. That said, everyone we meet thinks that Cayman has a better professional structure. You're able to get a director, you're able to get an audit firm, and CIMA's very responsive to queries. In other jurisdictions it takes longer to get the entire structure up and running.

Gwen McLaughlin: The PE business is the growing side of our business as well. I don't think CIMA has any statistics on PE because they don't have to be licensed. But it is definitely a really big area of growth that we will see in the next few years because a lot of them are self-administered.

Rossiter: In the early days, in the hedge fund world, they didn't see the value of the fund administrator either, but institutional investors want that in PE structures too. They will say if they are going to be involved, they want that kind of mutual oversight structure, they want someone in there to make sure that what the fund is doing is correct and accurate.

They want everything put in place properly and they will understand that administrators are able to add value, especially in terms of systems, so hopefully we're seeing that it will be a bump in the amount of business that we're doing here as these mutual oversight structures become the norm in PE too.

Ronan Guilfoyle: We had a call from a UK-based PE manager who mentioned that a potential US pension fund investor insisted that they have an independent board of directors before they would invest.

We can see more of that not only on the fund administration side but also the governance side more generally. It should be a great opportunity to show how we excel at the services we provide because that's our big differentiator here: we've got fantastic service providers and a regulator who's responsive.

That's where we push Cayman as a jurisdiction and say, look we're a proven quantity, with tried and tested products that people trust.

While we do face pressure from jurisdictions such as Dublin and Luxembourg, the majority of our business still comes from North America, it is growing in Latin America, and Asia has been growing consistently over the last few years. They continue to see Cayman as the jurisdiction of choice, we just have to ensure that we continue to provide the quality services and fight off a lot of the other threats from regulators and other jurisdictions.

Smith: CIMA is seeing a lot more PE funds wanting to be regulated, as well as seeing the appointment of independent directors to such funds. We could query as to why there's a need to subject yourself to regulation; often it is because they have large pension funds as investors who want the additional comfort of knowing that the fund is subject to regulatory oversight.

We also get the same feedback from our administrators that a lot of their increase in business is coming from the PE space.

Ingrid Pierce: We have always seen a lot of PE business on Cayman so that is not hugely new but it is interesting that they want the structure and formalisation of what they're doing. There's been a bit of migration from the traditional hedge fund managers into PE, that's where some of the increase is coming from.

Those managers are very used to the governance structure, they understand the need to have independent oversight, to have independent administrators so that's nothing new for them. If it becomes the norm to have governance or to have administrators they'll do that as well.

Certainly with our institutional PE clients, we see that they're actually not seeking regulation, they are quite happy to stay outside that net but they do want to demonstrate that they have great governance internally. The way they are structured and the way they are set up is exactly what their investors want.

The other thing we have seen is that the reason they continue to use Cayman is because of the flexibility of our jurisdiction, the speed to market and all the other things that go with it. We've got to work really hard to protect that because not only do we have competition from other jurisdictions that are trying to emulate what we do but we also have a lot of people coming into the industry that are trying to shift the balance of power, whether that's from external regulators, pressures from the EU, or other forces.

If we don't continue to recruit the best people, train them, and ensure we have a good public-private partnership with the financial services industry and with government and with CIMA, then we're going to find ourselves under threat.

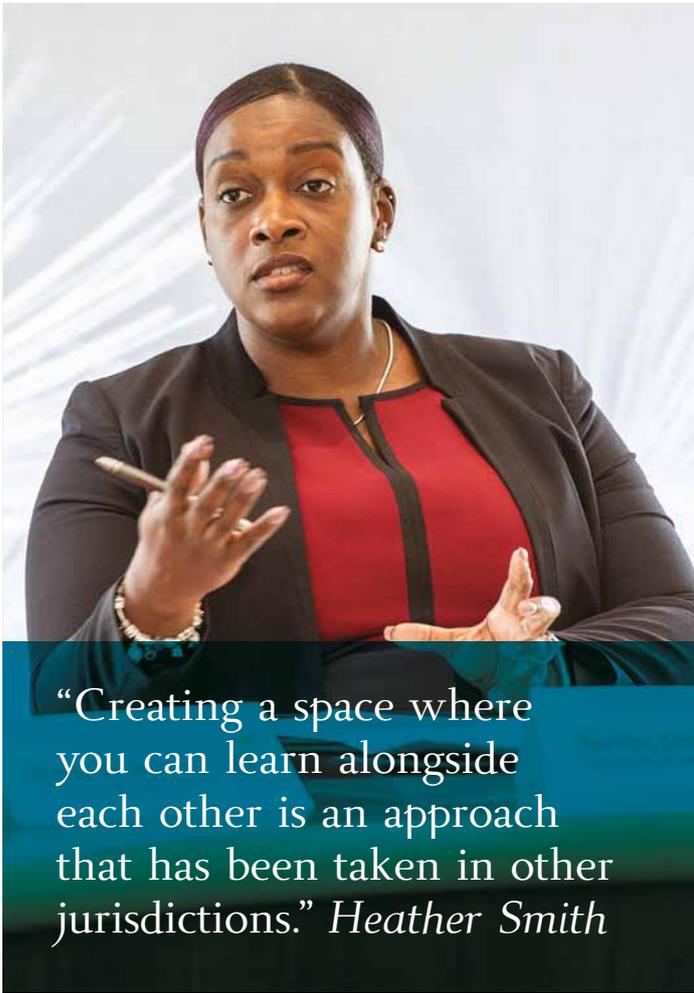
Smith: In terms of competition from other jurisdictions, I would agree we should not be complacent. Looking at the numbers from the jurisdictions that we track, including Bahamas, Bermuda, BVI and Dublin, Jersey, Guernsey and of course Cayman, as of September 2018 Jersey was slightly down, about 7.6 percent, Cayman was up at that point, Bermuda was down and BVI showed a slight increase.

We should never rest on our laurels, but we're far ahead in terms of overall totals.

Pierce: There is also a threat from onshore: several are trying to emulate Cayman. The UK is going to produce its own funds regime and Singapore and Hong Kong are doing the same. Those are the jurisdictions that are going to be competitors for us.



“Everyone involved in the industry has a genuine vested interest in making sure that everything runs smoothly.” Mark Cook



“Creating a space where you can learn alongside each other is an approach that has been taken in other jurisdictions.” *Heather Smith*

Farrington-McSweeney: A few of our partners and senior managers were in Singapore two weeks ago and everyone you speak to wants to know what Cayman is doing, it was the hot topic. They want to know about the new regulatory updates, if funds are growing, new structures. No, we can't rest on our laurels but I think the root of the interest is the economic substance concerns.

Guilfoyle: We're not seeing people closing structures and saying 'we're going to go somewhere else where this is not an issue'. The regulation applies to all the jurisdictions we compete against.

Mark Cook: If anything this is our opportunity to leverage the broad network that we have here, and our infrastructure. We're much better off compared with most jurisdictions. We've got people across many professional services looking after the funds in the industry across hedge funds and PE and other investment vehicles.

If economic substance is going to apply to everyone then surely we're miles ahead in terms of being able to demonstrate that we've got the right people in the right roles and the right infrastructure already here to prepare for what's coming in the future.

Where are we with the economic substance regulations?

Bahadur: Last year the ministry was spending much of its time engaging in dialogue with the EU on addressing economic substance concerns. Three laws were passed at the end of last year which came into force on January 1 which are meant to deal with the EU's concerns on economic substance.

The EU initiative is based on the international standards set by the OECD's Forum on Harmful Tax Practices (FHTP). These standards apply to more than 120 jurisdictions that are members of the inclusive

framework. As the FHTP has extended the scope of its work to what are considered the low and nominal tax jurisdictions, Cayman is now required to comply with the standard. Because these requirements are globally accepted, it will be difficult for entities to relocate somewhere else.

Work is still being done on exactly how the FHTP will assess no and nominal tax jurisdictions against its criteria, and we are directly speaking with the OECD on those matters so that our regime is understood.

Murray: People always say, 'why does Cayman do it first, why are we jumping to do this?'. But it is because we can help define the scope of the regulations and we can decide how they are implemented. Then other jurisdictions usually follow our version of the implementing law.

Bahadur: We have been at the table when these initiatives have been developed, so we can provide input and explain regarding how Cayman works. It is about providing and getting the message out there. It's very important for us to be able to explain what it is we do as a jurisdiction and dispel myths.

The EU is currently reviewing that framework and we were anticipating that conclusions would be developed in February but we have been advised that that has been pushed back to March.

We are continuing our discussions with the EU to ascertain the outcome of their assessment of Cayman's legislative framework. We also recently concluded a consultation on the economic substance guidance notes; those are currently being revised and will be formally issued before the end of this month.

Scott: When we look at the substance requirement and changes that are being imposed globally, they're primarily being driven to try to deal with tax threats.

We're dealing with the process in a very prudent, pragmatic fashion, and it also gives us the opportunity to explain how the jurisdiction works and how the jurisdiction is well positioned providing benefits globally and not posing tax harm.

Whether we choose as part of emerging global standards to also implement aspects of substance, even without that in place we structurally do not pose a tax harm because we're truly tax-neutral.

It's important for us to make sure we continue telling our story to make sure that when we're looking for examples in the funds space there is an awareness that we have good consistent standards in place, so they see that we're able to explain what we're doing.

As we go through the process, it's probably going to drive more fund administration to the jurisdictions, it's going to drive more demand for directorship services, we're going to see more family offices setting up in Cayman and using our products. We're also going to see more attractiveness for actual investment management being located in the jurisdiction.

Giorgio Subiotto: We feel very confident with the fact that the EU and the FHTP seem to have recognised that the fund structures are not profit-shifting structures and I think that's been well accepted.

Funds are the backbone of our industry, so that causes us to relax a bit and it does open opportunities because the bigger clients are getting bigger and we're seeing a bottoming out of the startup managers. Bigger clients don't shy away from regulation; for some the more regulation the better as it doesn't stop them doing what they need to be doing.

Some embrace this slight increase in regulation we've been seeing in Cayman and are very comfortable with it. For example, the requirement to have some sort of management activity here might not be something that they'll shy away from, and that will play into the hands of Cayman.

Pierce: It's the managers in that space, the institutions which are already regulated in their home jurisdictions, typically in the UK or in the US, that are already used to a very high level of regulation. But they don't want necessarily want another layer in another jurisdiction, unless there's a very good reason for it.

If there is a reason and if it's no more effort than what they're already doing and it's not going to be hugely costly or cause aggravation, then fine—but if they have to do something that they're not already required to do then they just don't want to do it. It's a fine balance.

Subiotto: Cayman has balanced it quite well so far. We don't think greater regulation will drive the industry away, it just needs to be done sensibly, and in a way that doesn't add an unnecessary layer of regulation. When you look at what our clients have to deal with outside Cayman, it's not too bad. We can put a more positive spin on the benefits of regulation.

Smith: In Cayman, in terms of a regulatory approach, we look at where the entity is based and for an investment manager, for example, we know there are comprehensive regulatory frameworks elsewhere. So if they are regulated in the US, for example, we know that there are certain requirements. Do we need to replicate that within our regulatory framework?

What we're finding more and more in terms of international standards is that the standard setters are requiring that we have in place certain requirements, regardless of whether these requirements also exist elsewhere. They are saying if a fund is operating within your jurisdiction, they are considered to be entities regulated by you, so you then need to do your own assessment.

We do cooperate as regulators. CIMA has in place bilateral and multilateral exchange of information frameworks, which enables us to obtain the necessary information with regard to an entity's operations in other jurisdictions, so that cuts down the need for us to have exactly the same thing replicated within our own regulatory framework.

We're conscious of the cost to business when you have to do the same thing over and over but then a lot of international standards seem

to suggest that if Cayman does not get exactly the same information, as say the EU regulator has, then CIMA's level of regulation is perhaps not to the same standard.

But that is not true. In fact it creates regulatory arbitrage. We're continuing to hold firm in terms of we're not looking to exactly replicate requirements, as long as we feel comfortable that we can get information as/when necessary from another regulator.

What about other regulatory changes?

Farrington-McSweeney: The elephant in the room is that CIMA now has increased enforcement actions power and so forth but we have not yet seen a major action from CIMA. The Bermuda Monetary Authority has issued some big fines and outsiders might see that as a more proactive regulator as a result.

Smith: The debate is whether the best way to demonstrate control is to name and shame. But if you want to change a behaviour fining people doesn't necessarily bring that. We prefer to intervene earlier and never get to that stage.

We've seen a certain level of responsiveness to early intervention and we are seeing changed behaviour demonstrated by a decreased number of certain findings when we do onsite inspections.

Fines grab the headlines but what you are then seeing is when things go really wrong. We try not to get to that stage.

Pierce: The good thing is you have more flexibility and power now.

Subiotto: But you need to be careful that it's not viewed as a money-raising exercise. It depends how's it used.

Cook: The reality is that everyone involved in the industry has a genuine vested interest in making sure that everything runs smoothly and no-one wants to be involved in any of those headline cases.

The issue isn't with regulations—the only concern that I ever hear raised is around lack of clarity around the compliance with this new



“Clients are happy as long as you can explain why the regulations exist.” *Tim Rossiter*

regime. We know we want to do it, obviously—being compliant is not optional, so the sooner we can be in compliance the better.

Subiotto: With great enforcement comes a duty to provide greater clarity. It would be very useful for CIMA to consider a ‘no action’ letter approach where industry will then have clarity as to the areas where CIMA will, and will not, take action.

Smith: We have issued letters of that nature, so maybe you haven’t got one. In certain instances we have reached a place where we’ve reviewed and assessed the situation, we’ve determined that an enforcement action at this point is not necessarily the step we are going to take but we’re making it perfectly clear what the issue was, and that it is something we expect to be addressed.

Kendell Pierre: In terms of the cultural shift you’re trying to achieve it’s obviously a great approach in terms of getting the industry to be on the same page.

From a regulatory perspective my observation is that a robust regulatory environment would definitely help to debunk some of the myths that are out there and positively impact our international profile, especially within our industry.

However, we do need to be careful that we don’t shoot ourselves in the foot in order to demonstrate that we’re policing the industry.

Smith: That’s exactly the point to CIMA’s approach because certainly there is pressure now ‘to show us that you’re more robust’.

We’ve seen a lot of regulators show that through increasing the levels and amount of fines, but I don’t believe that CIMA is prepared to take that approach, we don’t see it as necessary.



“It’s going to be very hard to get over the finish line but it will be a massive step forward.” *Jonathan Roney*



“We can’t rest on our laurels but I think the root of the interest is the economic substance concerns.” *LaNishka Farrington-McSweeney*

Despite the global pressures, we have remained steady in the course we’ve taken, we’ve tried to analyse each action so certainly there’s a plethora of changes and a whole raft of new requirements coming online every day. But when we take the decision, it’s because we’ve considered that’s the best decision to take.

We’re not going to fine everyone just to say we’ve taken in \$10 million worth of fines in the first two years of implementing the regime or just to show that we are robust. We think we’re robust now. The ability to fine is simply another tool we have available to us, but it does not discount the other tools that we’ve always had available.

Pierre: If there was any doubt in terms of the robustness of our regime, and I’m not suggesting that there should be, the recent changes are probably a clear indication that the regulators are serious.

Smith: A lot of the changes came from our national risk assessment—the ones we made to the anti-money laundering (AML) rules. But not every country undertook a national risk assessment. We did our own, which is better than somebody external coming in and saying ‘these are the things you must do’. We have an ongoing assessment of our own industry from a regulatory and policymaking perspective so that we can anticipate change.

Bahadur: The government’s position is that we will be compliant in international standards. We will always consult with all our stakeholders so that we get their input into our regulatory framework.

The economic substance legislation is an area where there is extensive consultation. I’ve never been involved in a piece of

legislation that was so extensively consulted upon; the government wanted to make absolutely sure that it had the input that it needed to make sound decisions.

I also want to stress the importance of information, which we use to explain our business. When the EU asks questions about the funds for example it is a regulated sector and we know the answers. But if they ask about private equity and other areas, we don't always have specifics. It is important to have that type of information so we are able to explain our regime, when changes are called for.

Smith: A key question I get is: do you understand the risk? With funds we can say we understand the risks because when we look across our fund population, X percent do this sort of activity and most of them are structured this way, etc. The standard setters like statistics, they like hard numbers, that kind of very granular reporting.

If you don't have the information, the conclusion is that you don't know and therefore the activities undertaken are risky and there are a lot of black holes in your industry. So yes, the more we know and the more we understand, the better able we are to respond to the various requests for information.

Murray: Coming back to the fines, the regulatory regime in the Cayman Islands does not allow the egregious behaviour to accumulate to such a level where a million dollar fine is needed.

Smith: Yes, ideally that's what we want.

What are the plans for how Cayman might treat unregistered funds going forward?

Smith: The changes in the AML framework require that they have AML officers in place and through a lot of service providers we know

we're seeing where that's being done. CIMA's not currently collecting information specific to every unregulated fund to check if they have made these appointments. It is a process. It is hard to say how many unregistered funds there are.

In any regulatory regime there are going to be true exemptions, entities that don't need to fall under the regulatory framework. Trying to regulate everything would never be an advisable approach. The more important thing is to understand the risk and the more information you have about a fund structure, the better.

McLaughlin: For the unregulated business, having to appoint an AML officer will help them to focus their efforts and perhaps make them a little less risky because now that they have somebody that's overseeing their due diligence.

Rossiter: We have to be very wary of the statement that no regulation equates to nothing happening. Look at the service providers that are associated with these entities—they are covering all of these regulatory roles. There needs to be a happy balance for effective regulation, it should be prudent and pragmatic.

Just because you've got regulations in place doesn't necessarily mean that it's either going to be better or worse. There needs to be a reason for the regulations and clients are happy as long as you can explain why the regulations exist, as the managers are regulated wherever they are located.

Murray: It should be light and it should be appropriate and not too costly.

Leadbetter: Everything costs more. If you're getting your service providers to run extra reports or you have to appoint outside service providers, there is a cost associated which drives up expense ratios. If funds are underperforming this can result in increased pressure on fees.



“We are continuing our discussions with the EU to ascertain the outcome of their assessment of Cayman’s legislative framework.”
Michelle Bahadur



“The recent changes are probably a clear indication that the regulators are serious.” *Kendell Pierre*

Investors want to make sure they're getting good value for their money and the industry's getting very fee-sensitive.

Guilfoyle: For the PE funds specifically the AML compliance officer is responsible for doing procedures on the underlying assets as well. That becomes a lot more difficult with those PE investments as opposed to hedge funds. The PE side is a completely different kettle of fish.

What are the challenges around valuations as more PE firms emerge and funds also implement new structures?

Farrington-McSweeney: On the valuation side specifically in the context of the PE funds, the AML clarification says you have to do due diligence, on the service providers, the products and so forth. We've seen a lot of issues around valuation in the PE space.

A lot of them are investing in real estate, for example. We are finding a lot of unusual assets in PE funds that are hard to value.

Some PE funds hold one asset for 10 years, so it's closed and then once the asset matures it pays out. Clearly that's less risky than a PE fund that's investing in alternative assets. The issues we are seeing coming out of the PE industry are primarily valuation, existence and custodianship, as well as the third party service providers.

We didn't have that in hedge funds because everything was listed or was done by a broker over the counter that we could see, but we're now getting into an industry that is not as transparent as previous industries. We have increased valuation risk but also on the regulatory side if those investment managers aren't regulated.

Rossiter: Doesn't it start with the structure? In terms of valuations the only times you care, apart from fraud, is when you buy and when you sell that fund, so as long as you set up the structure correctly that should be your focus.

Cook: Investors typically want 100 percent transparency through the portfolio of the PE fund, whereas in the hedge fund they wouldn't.

Murray: I would say that the vast majority of PE clients are blue chip who are not dealing in 'art'; it is providing private placements in public companies with household seminal tech names.

Pierce: I agree with the comments about transparency. But although the trade in some respects has been unusual, unseen, unknown, in fact it's the opposite in many ways.

When you go into a PE fund, you know precisely what you're investing in. You know what the duration of the fund is, you know how long the investment is going to be held for, that there could be following on investments and so on. I don't think from a legal perspective it's problematic.

The question is around the difficulties with valuing the assets when do you need to value them, and whether you have the right people who can do that exercise. So I don't really see this as particularly problematic.

What innovations are we seeing in the funds market?

Guilfoyle: There has been the rise of artificial intelligence (AI) and managers implementing that into their strategies but, I do ask how's that different from a box that you built to trade previously. There's been a lot of systematic trading strategies out there for a number of years, now you are calling it AI, but it's pretty much the same.

There are new asset classes but in terms of how managers do what they do, I haven't seen a lot of change. The infrastructure that managers put in place and the quality of the service they put in place definitely has increased. It is a minimum expectation from investors looking to invest and then it all comes down to performance.

It's difficult to start up, it's far more costly than say going back 15, 20 years ago where you might have had two guys with a machine and they suddenly have \$100 million and everyone's just pouring money at them. Those days are gone, there has been a flight to quality and the investment manager industry is definitely proof of that but as regards to how people do what they do, I haven't seen a lot of changes in that for 10 years.

Murray: The biggest change is fee structures and how they're calculated. And you do need technology to calculate these rather complex calculations that a human cannot.

Smith: We've seen a lot of the segregated portfolio companies (SPCs) that offer bespoke investment opportunities for an individual investor's needs. If smaller managers are really struggling to break into the space, are they then using SPC structures?

One of the things we're looking at from a regulatory perspective is this increase in SPCs where managers can implement a bespoke strategy without having to then set up a standalone fund.

Guilfoyle: Well, it's cost-effective. That's the whole idea behind the SPC initially. You can have multiple managers, and it can save fees. It is one of the tools Cayman has for emerging managers who are struggling to maybe put the full fund structure in place where they can have itemised fees for itemised investors. It's a very costly industry to get into otherwise.

Leadbetter: Being on a platform with other emerging managers in an SPC enables the investment managers in those individual cells to build up their track record with lower overheads, do a good job raising

funds and prove themselves to get to a size where they can come out on their own.

Andrea Proctor: Is it trying to give each individual investor some sort of tailored strategy, or it is an emerging manager platform—a kind of incubator fund?

Subiotto: The ones we see set up mostly fall in the first category. We have seen hundreds set up that are actually emerging manager-type platforms.

Rossiter: Some partnerships are formed between a law firm, broker, and administrator, so you've got a pre-packaged deal where you can say, okay here's my platform, it's going to be a standardised document, it's going to appeal to this particular broker or no broker at all and an administrator and an auditor. It's a package you can go to which is cost-effective and allows you to build that track record.

These people have an opportunity to build something up because I think we also need to bear in mind we're in pretty unusual times. You could say you've got a 10-year track record but the reality is you've been in a market where the central banks have been pumping money in, so everything has been going up, and it's very easy to be a passive performer.

In the context of volatility, I would suggest we're moving back into an environment where active management is going to become a lot more valued because the market is harder to predict. Volatility is coming back, a whole lot of geopolitical changes are happening, active managers theoretically are those ones that should really earn their fees in that environment.

Pierre: I agree with your point in terms of seeing partnerships, we're in the 21st century so it's all about instant gratification and it's no different for funds. What we're finding is that people want to have a one-stop shop, they want to be able to come to you and get what they need, so you're seeing a lot more alliances between service providers to satisfy the demand.

Guilfoyle: It depends on the client. If you're an institutional, you're going to want to split up all the service providers so that you have independence. If you don't have the resources yourself it's very easy to go to a platform provider. It's horses for courses.

What about cryptocurrencies? Is that one form of innovation?

Scott: All too often we don't give the industry enough credit for the amazing amount of innovation it has been driving over many years. It's a very entrepreneurial industry and has invested heavily in innovation and technology.

We see that in terms of the types of investment managers, how they approach the trading strategy, how they invest in technology, also how they supplement what they do because these are businesses that not only need to stock pick, they also need to understand economies, they need to understand geopolitical impacts. When we're looking at PE the holdings are longer, they're investing in emerging technologies and markets.

The infrastructure, the talent pool they put in place are a constant innovation process within them. We're probably not seeing real, amazing, dramatic applications of new innovations because they've been constantly doing that over time, constantly testing new technology.

There are two things on our radar with innovation. We're looking at say the PE space, the growth of that will have an impact on our needing to help them move to a more institutional type framework.

Second is the application of fintech to the space and things such

as the issuance of cryptocurrency tokens, the ability to trade in secondary markets. That might allow you to translate something which was originally designed to have a three to five-year lockup period to actually something which could be very liquid in a secondary market. It does need to have reasonably precise valuations.

We're looking at digital assets. They have the potential to start transforming beyond what we've seen PE traditionally investing into, which typically are hard assets, real estate, paintings. Now we're getting into even more esoteric things which could be a digital unit in an income stream that's part of a business somewhere in the world.

A lot of what we've seen develop in the hedge fund space, those types of frameworks are going to need to start being applied also into this space and specifically on fintech itself.

Cayman Finance has been focusing on looking at the trends that we see in terms of fintech technology implementation in the industry, newer technologies such as blockchain, and how we prepare properly to ensure Cayman continues to be a leader in that space.

We've also identified that there are some barriers that have held back these types of new technologies from being fully deployed in global financial services. One of the key barriers has been the issue of AML because on its surface when you create things like initial coin or initial token offerings or even security token offerings, you start running the risk of creating an instrument that could be readily exchanged anonymously around the world.

One of the solutions to address this global risk that we've been working on with government, with CIMA, and with industry, is developing a certified digital AML platform that's a regulated platform, that provides an environment where regtech and compliance tech



“For the unregulated business, having to appoint an AML officer will help them to focus their efforts.”
Gwen McLaughlin

companies can be licensed into the platform, subjected to consistent standards, to issue certified digital AML IDs that can be relied on in the current “bricks and mortar” environment but also preparing the certified digital AML IDs for the full deployment of technologies such as blockchain, cross-border peer-to-peer financial services transactions, etc.

Jonathan Roney: That’s a massive opportunity in innovation for the right person, the right platform coming in; it’s something we’re focusing on internally, totally revamping our AML procedures and for the right platform globally.

There are so many different global standards, it’s going to be very hard to get over the finish line but it will be a massive step forward, it will make business so much easier and quicker to close on deals and anyone can participate if you’re a globally recognised citizen.

Proctor: From a policy perspective we are moving forward with the AML work that we recognise as a jurisdiction we have to comply with. The FATF will be issuing its guidance on the AML expectations for cryptocurrency and virtual assets later this year, so that’s a stream of work that the ministry has started and is working with Cayman Finance and industry working groups to progress.

We expect to have more clarity on that by November in terms of technical parameters around the AML supervision for crypto assets and virtual assets.

Smith: A lot of these innovations and proposals do touch on regulatory activity, so one proposal is the creation of a regulatory sandbox because there are aspects of the offerings that are new both for the regulator and for the service providers themselves. Therefore, creating a space where you can learn alongside each other is an approach that has been taken in other jurisdictions.



“We’re so connected globally, we’re connected with the brightest investing minds around the world.” *Jude Scott*

We see this approach as beneficial because you don’t necessarily want to overlay the exact same regulatory framework and requirements for an entity that maybe operates in slightly different way. But you then have to have an understanding of their risks and the differences in the requirements of, for example, an investment manager for crypto assets.

Scott: There are great opportunities that come with innovation and new technology but also there’s a constant need for sharing insights because great unseen risks come with it as well.

The real benefit of an environment like Cayman is we’re so connected globally, we’re connected with the brightest investing minds around the world, we have amazing minds within the jurisdiction that are constantly experiencing these things and the ability for us to come together with the regulator, with government, within industry, talking about what we’re seeing coming down the pipeline. We are starting to share our thoughts and ideas, so we start positively influencing the outcome of it and I think that’s a space in which Cayman’s going to continue to be more and more recognised as a thought leader.

Roney: A key focus should be tax neutrality and tax transparency. We are at the forefront of that. The focus shouldn’t be on implementing arbitrary tax rates to get off black lists which is a hugely subjective area.

We are moving in the right direction with that and I would like to think the rest of the world will see and understand the benefits of going down that route.

Scott: The ministry has been doing a lot of good work in this area of creating knowledge and awareness internationally so it is understood that it’s not just about tax rates, it’s about a combination of stated tax rates, applied tax rates, and tax treaties in conjunction with how some jurisdictions actually focus on creating minimisation of taxes that may be considered inappropriate to other jurisdictions.

When we look at a jurisdiction like Cayman, we have a stated tax rate of zero, an applied tax rate of zero, we do not have tax network treaties, we’re not involved in tax shifting or tax minimisation. We are tax-neutral and I think we need to put more effort into creating that awareness and also deeming it unacceptable that there are going to be lists that are purely based on the stated tax rates.

It’s our responsibility to create that awareness, so that there can be changes over time and more sophistication used if they’re developing those types of lists, so they’re objective and they’re actually meaningful.

Guilfoyle: What do you think Cayman needs to do to be able to do that more effectively?

Scott: The starting point is some of the work that we’re doing now, for example, working with government, we’re putting together a research paper that’s specifically focused. One aspect of it is better understanding tax neutrality but also linking it into how there are specific tax-neutral products in many jurisdictions that function the same way, so their tax rates may be high tax rates but they have specific aspects of their economy that are designed to be tax-neutral.

Creating awareness of that and showing how Cayman’s tax neutrality creates benefits around the world without causing tax harm to other countries—at an academic level that’s probably never been well understood.

Farrington-McSweeney: That’s the point of a roundtable such as this, to communicate externally to a global network, so people know what is going in Cayman and how we’re addressing regulations and new products and new asset clients. ■

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