

# Changes to Governance Framework for Funds Registered in Cayman Webinar Transcript

10 August 2023 | 10:30am EDT

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Oh, good morning, good afternoon, and good evening, everybody.

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Thank you for joining our Webinar today, to discuss the changes in the governance frameworks for funds that are registered in Cayman.

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My name is Jonathan White, I'm the Chief Revenue Officer for Waystone governance and compliance based out of New York City.

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I'm joined today by Lynden John and Vanessa Gilman, both of who are based in Cayman.

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Just to introduce the topic in April, this year, that Cayman Island Monetary Authority, CIMA, issued a rule based on, focused on the governance frameworks related to regulated entities in Cayman, as well as a statement of guidance, which compasses the governance framework for both mutual funds and private funds in Cayman, also.

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The objective today is to really talk about these recent developments and the regulatory landscape and the changes in the regulatory landscape.

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Provide some insight to the audience as to what these changes actually mean.

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And then additionally, we want to talk about what the potential risks are for fund managers should they find themselves not completely addressing the state with the guidance.

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The rule itself, the goal really is to equip you the fund manager with the information that needs to take away.

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And I'd like to start off by providing introductions to Vanessa and Lynden. So, Vanessa brings over 20 years of experience.

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In the offshore financial services.

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She's an Independent Director in our fund governance team based out of Cayman, and what she brings to the table is that specialist in regulatory matters.

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Given her background, she offers extensive regulatory knowledge around hedge funds, private funds.

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Fund of funds, SPVs, across a boardway of investment strategies and asset classes.

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She's an accredited director.

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She's a Chartered Alternative Investment Analyst and a member of the Chartered Institute of Securities and Investment. Lynden. Lynden John, brings over 17 years of experience in the financial services sector. He is an Executive Director.

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Based out of Cayman, focused on the product development related to our Cayman service offering.

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And he really specializes in the provision of governance and regulatory services for both mutual funds and private funds.

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Lynden has an extensive track record of providing tailored and commercially effective solutions across areas like tax planning, bankruptcy, remote transactions, economic substance and distress situations and even resolving regulatory matters and restructurings.

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So thank you both for joining us. Lynden, let's start off with yourself.

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Can you, just, for the audience, provide the key highlights of both the statement of guidance and the rule, just to level set with, with an understanding of what they mean.

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Yeah, in short, there's been several updates and new seminar guidance that have been issued by the regulator and then apply it to mutual funds, private equity funds alike.

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The updates cover a range of topics, for example, Cybersecurity, Conflict of interest, the operators governance.

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And then there's the several quirky ones out there as well.

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And while the rules and the statement of guidance are quite detailed, there's two key areas that come out of the statement of guidance. One is the independence and the ability of operators to demonstrate the independence of judgement.

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And then the others are under internal controls.

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And whether you are able to document them, implement them, and then obviously monitor.

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Abide by them.

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And those are the key tiers, so that the key takeaway today, we talk about how operators missed or should exercise independent judgement, and around the internal governance framework that can capture your control environment and how you monitor it, and how do you document your adherence to the controls.

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Thanks Lynden. Vanessa, just going up to you, would be helpful for you to provide the audience.

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some context to why this is happening. What is what is happening in Cayman, and what's the background to this state of the guidance.

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Sure. Thank you. And it's actually very important to understand that wider context, because by understanding that, it will also help us to see why it is that these rules are very important to implement. So let's just take a step back even just a few years.

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So the jurisdiction as a whole has been seeing a good deal of pressure from the G 20, also from the FATF, and also from the European Union. And this pressure has been for overall transparency increasing.

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But then also just general improvements in the and the anti-money laundering regime that we have here also to combat proliferation financing and terrorist financing.

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So there's been a number of initiatives that have come about to support that this overall objective across the globe not just in Cayman but in Cayman as well. We've seen the introduction of

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The FATCA and CRS filings that now me to get made, there's a beneficial ownership regime that's also come into the mix. Also, private funds have fairly recently been captured under the banner of CIMA regulation and there have been various enhancement to the AML regulations overall. So now with that general background and context, this momentum is sort of continuing. and most recently, the jurisdiction of the Cayman Islands was placed on the FATF's gray list. And the reason for that was that the jurisdiction needed to demonstrate over a period of time that it was in fact enforcing its very strong AML regime, amongst other things.

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And so the Cayman Islands did set out to demonstrate that enforcement and CIMA's role in that included the on-site inspections of various service providers.

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Now, these service providers did in fact receive administrative fines. In some cases, there were breaches.

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If there are deficiencies that seem a noted, and in fact, some of the service providers actually took CIMA to court to defend themselves against these administrative fines, and that was a very interesting outcome, as part of the court's ruling, the court actually confirmed that statements of guidance are just that, their guidance and their subjective.

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So, if CIMA wants to demonstrate and have the power to enforce and take meaningful enforcement action, the best way to do that is to promulgate rules, because it's with a breach of a rule that CIMA is actually empowered to levy and administrative fine. So that's what we're seeing. That's the general context internationally and also affecting Cayman. And so there's various rules and SoGs that have come about, including on corporate governance. And, in fact, many were gazette-d in April 2023 of this year. And will come into effect. At least, the rules component will come into effect on the 14th of October. So that essentially gives industry, about six months, to digest these rules and to implement them, which we are encouraging all of our client funds and prospective clients to do so. Because the intention is, of course, for CIMA to enforce them.

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So thank you very much for that, Vanessa. So really in summary, this is something that fund managers really need to pay attention to, particularly in light of the, the potential for enforcement.

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As this rule becomes, in effect, in October. Switching over to you, Lynden, you talked about independence and internal controls in your introduction to the state of guidance and rule. Could you elaborate on that, please?

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Absolutely, so independence is an issue in topic prior to the statement of guidance being updated in the new rules.

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Funds really drove whether your board is independent from ...

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its investor side or tax requirement. The new rules state that the operators do you need to demonstrate and how they exercise independent judgement, and this...around that issue. In fact, how do you actually demonstrate that?

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And the simplest way of looking at it is putting an independent director on the board, or having independents governance committee, several our clients, have asked us to, do you know, what does it mean to demonstrate independent judgement?

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When you, when you, take the simplest example of a fund, for example, where the board is made up of employees, of the manager, it's quite difficult to demonstrate that there's independent judgement, because of the conflict of interest.

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That should be an employee of the manager who receives performance, and management fees, from the entity that there, providing oversight, too, may cause conflict when it comes to the governance, and ensuring that the controls in place, or working efficiently.

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And that is what the Operator, or what CIMA is trying to get the operators to, be able to articulate, so the golden rule of thumb is, if it's easy to articulate, and you have, an independent director, therefore, independent judgements made, you should be fine. You should be in compliance.

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But, if it's quite difficult to articulate why those board members, or your committee members are independent from the other service providers, and you can articulate that independent judgement, you may have an area that you need to focus on, and consider your options, and that brings you to the control environment, which is the second part of this, the main updates.

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Traditionally, if you think about control, they're documented in policy procedures, and with a hedge fund, or a private equity fund, majority of rules are written into the operating membrane, or the defense constitutional document.

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And the regulations for the statement of guidance...around controls.

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Recognize and actually state...that CIMA appreciate that offend does not have any employees that most, if, not all of its business operations outsourcing service providers and, therefore, by default, the operators can take reliance on the service providers on their internal controls.

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There's no, it just says, Oh, I delegate it, it's in...reliance. You have to demonstrate how you've assessed, and that's the step into guidance and outsourcing.

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So, what we articulate a little bit earlier is, the simplest way to do that is through a very well defined board meeting process where the operators come together on a frequent and regular basis that is suitable to the nature of the fund.

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You would have reports in, question is completed by the various service providers and are responsible for the various aspects of the fund.

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It would address the statement of guidance questions, and make sure that they've been completed as a board you, you read it, assess it and document it through the minutes process.

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in doing that, by default, you are following a monitoring of controls. testing the controls.

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And wherever there's a deficiency, or an area of gap, the board will intake, their correct actions to, to resolve that.

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That is really what we mean by independence and the focus on controls.

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So, so what you're saying in summary is, you know, the, the simplest way to provide the demonstrable independence, and objectivity is through independence, or independent governance committee members.

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To, to be able to focus and really think about their internal controls.

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And then really hold those regular board meetings that are in line with an agenda based on the expectations of both the guidance and the rule.

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From CIMA, um, just pivoting now over to Vanessa and thinking about, well, how should the manager consider research and understand whether they are doing these things today. And then how should they address them if they're not?

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And that's a very interesting question. Many managers will take this approach where it's sort of, let's wait and see, let's wait and see what others do. Let's wait and see if CIMA is actually going to enforce this. So we're encouraging clients and prospective clients to take a more proactive stance.

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Why? Well, let's consider the reason these rules and SoG have come about in the first place, and that is because we're in a climate of ...

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increased enforcement where Cayman needs to be removed from a gray list. Definitely not put on a blacklist, which would be detrimental to financial services and the funds industry in particular as well.

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And so things have changed and some funds this year have already seen a difference. So if audited financial statements haven't been filed, maybe foreign filing fees haven't been submitted for a number of years.

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Some funds in this circumstance have received warning letters from CIMA, explaining that they could be subjected to an administrative fine. And so that's the climate that we're working in at this stage.

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And so what we want to see as that our clients are taking proactive stance at implementing these rules.

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And that's because CIMA could, in fact, bring an enforcement action against either the fund against its service providers or to the board as a whole and to individual directors as well. And this is something that as directors, any individual director this could have a lasting impact, lasting and adverse. So, one example would be the completion of due diligence requests and questionnaires, now in that case.

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If there were a CIMA administrative fine levied, in fact, that's considered an enforcement action and would now have to be disclosed as a part of a due diligence questionnaire or request. And so for many directors that would be something to avoid, it does have a lasting impact.

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Thank you, Vanessa.

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That's clear and consistent message and certainly in line with what we've been seeing over the past couple of years related to CIMA enforcement objection, objectives.

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But I guess the key question is, how would the regulator actually know.

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And that's a very interesting question. How would CIMA know if a fund complies?

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And of course, it's possible that CIMA could enhance the current reporting requirements for funds. They certainly have the power to do so under the Mutual Funds Act and the Private Funds Act.

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They could very well introduce new reporting requirements. They can also inquire on the general affairs and in any manner that that they see fit in order to carry out their their functions as a regulator. So they have that power. But let us consider, two, they already have a lot of information at their disposal, including through the Fund Annual Return form, which is, which is submitted as a part of the audited financial statement submission process to CIMA on an annual basis. So there's some very key questions on there. For example, how many board meetings are being held?

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OK, we can get a sense of is a fund actually following the guidance to have at least one meeting a year. And also, there are questions about who is serving on the board?

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So CIMA can get a sense of, are these parties, maybe parties of the investment manager, or are they independent parties?

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And they're specific questions in terms of, is the investment manager independent?

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And of course, the idea there is that if a fund's board is comprised mainly of employees of the asset manager, is going to be impossible, really to answer that question in a way that that would show and demonstrate effective adherence to the new rule and SoG.

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So those are just a few ways that CIMA could actually gather information just from the far itself. But let's also remember that CIMA is going to continue to conduct on site inspections of service providers.

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And as part of that process, they are going to be sampling records of the clients of those service providers, so let's say that the registered office of a fund was subjected to an inspection.

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It could be that, that funds records are included in a sample, that, the authority requests.

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So that's a way, for the fund, for the fund to actually be more visible and the authority to get even more insight, then perhaps it would normally have and to things like minutes, what is discussed at meetings, etc.

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So, there's a number of ways that CIMA could already access information, its empowered to do so.



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And there could be more to come.

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Yeah, no, thank you for that. That's very helpful.

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Uh, switch it up, right? Waystone, spent the past couple of months having extensive conversations with, with clients and managers around the globe around this topic.

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providing insights where you want to come up with some of the common questions that come up around the topic. One of the common questions that I certainly hear often is, does the rule actually state the independent directors are required. Can you comment on that, Vanessa?

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So, to be clear, the rule is not saying that there must be an independent director, or an ...

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governance committee member. What the rule is emphasizing is that the governing body of a fund must be able to demonstrate, and it must be exercising, independence and objectivity in decision making. So that's what's emphasized.

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And presumably, if a board of a fund is comprised strictly of employees of the asset manager, it would sort of limit that argument that they are actually exercising that sorted independent and objective decision making. And so, that's why we're encouraging our clients and prospective clients to really consider that point and add that independent component.

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The other question that comes up, right, because this rule now encompasses private funds, impacts private equity managers, it impacts hedge fund managers, that traditionally have a board of directors on their Cayman...and now, from a private fund perspective, talk about governance committee.

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Could you just talk a little bit about the

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Difference between board members and boards as it also relates to governance committees?

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Yes, and that's an important element to, to discuss.

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So when would you use either? Either or? So, I guess, first of all, it depends how a fund is structured. So, let's say a fund had, is, established as a company. So, in that case, there would be board of directors that will be serving as the governing body of that fund.

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So, adding an independent director would mean, actually, that independent director serving on the board of directors of that fund. Now, a lot of funds, including a lot of our private equity and private fund friends, are in fact, established as limited partnerships, and in that case, there's a general partner.

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That would be the, be considered the governing body or the operator to that fund.

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Now, where would, where would an independent component come into play if there were a general partner? So, there could be an independent director appointed directly to the general partners. Say, if the general partner itself was a company or an independent manager, if it was an LLC, so that that could be one way to go.

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But the general partner could also establish governance...governance committee that would essentially carry out very similar independent decision making and allow the, the general partner to fulfill the rule and the statement of guidance in that way. Now, when would you use direct appointment? When would you use the governance committee?

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Again, it kind of depends on the way that fund structure is set up.

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So, for example, let's say the GP is serving a group of funds.

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Some of which are, are maybe onshore and the home jurisdiction of that sponsoring entity, or there could be some offshore feeders as well. And maybe the offshore feeders are subject to Cauman. So, you'd have a mix there.

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Some funds are in the picture that are not actually regulated and Cayman, so in that case, it might be a bit cumbersome and maybe not cost efficient to have an actual independent member appoint to the general partner itself.

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In that case, that's where a governing committee might be more useful and, and more of a practical solution.

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In other cases, though, the GP is just serving, maybe a master feeder structure, and both the master and the feeder are regulated here in the Cayman Islands and in that case the simplest solution likely would be to appoint an independent party to serve directly on the general partners.

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But in either case, the key thing to take away as Lynden was, was mentioning earlier is that the governing body needs to host and also have their meeting agendas be very tailored to the Cayman Islands regulatory requirements.

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And so, of course, a governance committee can accomplish the same, can accomplish the same thing it can be set up with, with properly, noted agendas and meeting minutes as well to demonstrate that compliance of regulatory requirements here in Cayman.

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Thank you, Vanessa. That's very helpful.

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one more question for you, though. Can anybody be an independent director? Are there any regulatory requirements around the role?

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Are there any specific expectations as managers consider who they might go to fulfill these obligations?

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Sure, and I'm glad you asked that.

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one area that the rule on corporate governance, and, also the SoG, both speak to, is the expectation that there's a diversity of skills, background, experience, and expertise.

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So what we would encourage our clients and prospective clients to do when you're screening for independent candidates to join the board.

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Do consider that diversity, consider whether there is familiarity with, Cayman fund, specifically, and the Cayman.

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regulatory regime and requirements here.

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You want your independent candidates and your governing body as a whole to be able to identify any, any specific gaps, and then to be able to support the board overall with carrying out it's, its responsibilities to ensure that fund is in compliance.

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Thank you. Thank you for that, Vanessa, and Lynden and over to you.

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Now, switching back to board meetings.

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You talked about professional board meetings being an elegant way, a simple way of addressing the requirements from the state of the governance and the rule, especially when establishing an agenda that is relevant to addressing the requirements of the rule set in the guidance.

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Can you give a little bit about, information about what that agenda should look like?

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Sure.

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And it's important, too, to remember that a board meeting is a tool and if you set it up correctly, it can achieve various outcomes.

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Many managers currently run the meetings and have the minutes and some service providers, particularly outside of the Cayman Islands, hosts meetings.

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But they typically focus on the performance of the operation of the fund, in context of its asset class, what we're talking about, here, having very smart and tailored board meetings, which are designed, not only to go through the operations and the performance of the fund, which is, one of them, operator's fiduciary obligations.

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But you also design them so that they capture the tests of controls, an example of being conflict of interests.

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You'd ask all the the operators attending the meeting to declare if there's any new conflicts.

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And that would tie into your conflict of interest policy, which should which allow the board to demonstrate their ability to identify them, document them, and then deal with them as they occur.

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Those get captured in the minute taking process.

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Other areas and areas to focus on would be, say, the self-review.

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Up until now, some board minutes exclude them or some director's do include them.

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That there's no prescriptive question of what you should or should not I ask.

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The statement of guidance does not clarify what's required.

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So when you set your agenda, it's good to have it as an agenda item.

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But also supported by a questionnaire which captures those answers.

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And the point of having a really well written and smart board meeting agenda that addresses each of these statement of guidance is that you've captured it in a questionnaire process, which goes to the back of those minutes as supporting documentation.

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And that is the internal audit control.

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It says, we've asked these questions of the right people, we have received an adequate response.

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We reviewed it, we've addressed it.

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In our minutes, we've captured any discrepancies or any additional actions that have to be taken.

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Now, when it's summarized and is put into a very neat package that is what articulate and demonstrate that the operators have been providing oversight to managing the controlled environment, and that is why it's quite important, to ensure that you do have board meetings.

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They are hosted by regulatory specialists and understand not just how to run a board meeting, but how to capture statement of guidance into your board meetings.

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It's documented.

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And then, obviously, put it into the....office for preservation, so that if the regulator were to inquire what you're trying to test or assess the efficiency of your controls, you have already documented a very efficient process.

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What are the key things to consider when looking at your control environment is your governance operations to include, that is a process on how you capture that internal control.

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Thank you. Thank you.

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Obviously, this is a topic we can talk about for significantly longer, and I think you hit the nail on the head.

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Right, It's, the every scenario is somewhat different, considered in isolation, and if anybody in the audience has any further questions or would like to speak to one of our professional directors, anybody at Waystone, Lynden, Vanessa, myself, anybody on the team here, please don't hesitate to reach out. We certainly will be sharing content details after this call.

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As a, as a parting shot.

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Vanessa, do you have any, any additional comments that you'd like to throw in?

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Thank you and first of all, let me just start by saying that today's discussion has been very interesting. However, we're really just drawing out just a few key messages about the rules and the statement of guidance on corporate governance and the various areas that those touch on. Something very important to keep in mind is the rule becomes effective on the 14th of October this year.

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That's the date that CIMA will be able to begin levying administrative fines, potentially taking enforcement action and the intent overall is for CIMA to continue on its mission to demonstrate that strong enforcement, because this is integral to the Cayman Islands.

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And just a couple of more technical takeaways. Key question being, how would the funds' governing body demonstrate independent and objective decision making?

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If that's a question for you, that you feel that your fund could answer better than maybe you're considering appointing an independent director, either directly on the fund's board or to the GP or establishing a committee.

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Those are all very viable solutions. We'd be happy to talk to you about those. And as Lynden mentioned earlier, there could be a few modest gaps in a fund's documents. Those can be remedied. And then, last but not least, funds are relying on service providers to carry out their business operations. And, of course, governing bodies are relying on the internal controls of those service providers, and the most efficient way to effectively monitor ongoing controls and compliance, including Cayman regulatory compliance, is through the adhering to meeting agendas and board meetings that are tailored specifically to Cayman requirements. So those are the big takeaways for today. And for any of the fund managers listening today, that this seems a bit new, we welcome you to give us a call. Waystone has been offering fund governance solutions for over 20 years, and we'd be happy to assist your team.

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Thank you very much, Vanessa, thank you very much, Lynden, very informative. Great job in conveying the details of the statement of guidance and rule. Appreciate everybody's attendance today and look forward to following up with you.