

CAYMAN LEGAL UPDATE - New Corporate Governance Standards for Regulated Mutual Funds

In response to feedback from its consultation with stakeholders in the Cayman Islands financial services industry (including feedback on a draft Statement of Guidance on Corporate Governance for Regulated Mutual Funds), the Cayman Islands Monetary Authority ("**CIMA**") has formally issued, on 13 January 2014, a final Statement of Guidance on Corporate Governance for Regulated Mutual Funds (the "**Statement of Guidance**").

CIMA had announced in January 2013 that it would be undertaking a consultation process with stakeholders in the financial services industry in respect of CIMA's proposals to enhance the Cayman Islands' corporate governance regulatory framework.

CIMA instigated the consultation process in light of "*international developments recommending or requiring greater probity, transparency and accountability in the financial services sector [which] initiated wide-ranging assessments of corporate governance requirements at a national level.*"

Other Corporate Governance issues under consideration by CIMA

Licensing/Registration of Directors

CIMA noted in the consultation process that it has been considering the development of system for the licensing and registration of directors of investment funds registered with and regulated by CIMA ("**Regulated Mutual Funds**"). The system would be operated and controlled by CIMA, and available for access by interested stakeholders.

Introduction of Public Database and Limitation on Number of Directorships

CIMA also noted that it intends to proceed with the introduction of a public database for Regulated Mutual Funds.

CIMA believes the introduction of a public database, which is accessible online, will assist in responding positively to the “*international call for heightened disclosure and transparency*” and “*will not only complement current due diligence processes but also enhance the reputation of [the] financial services industry*”.

CIMA also announced that it would like a two year period to pass during which it would be able to monitor the effects of the introduction of the public database for Regulated Mutual Funds and the Statement of Guidance before CIMA considers whether, it is beneficial, from a corporate governance viewpoint, in introducing limitations on the number of Regulated Mutual Fund directorships that an individual can hold.

Significance of the new Statement of Guidance

- The newly introduced Statement of Guidance is in line with international governance practices and re-affirms certain principles and practices that have been discussed in recent Cayman Islands case law in this area (e.g. in Weaving Macro Fixed Income Fund Limited .v. Peterson and Ekstrom [2011] 2 CILR 203).
- The Statement of Guidance only applies to Regulated Mutual Funds. It does not extend to regulated entities in the banking and insurance sectors. It applies to all Regulated Mutual Funds (i.e. licensed funds, administered funds, and section 4(3) registered funds) irrespective of the manner in which they are regulated under the Mutual Funds Law (2013 Revision).
- The Statement of Guidance applies to all “**Operators**” of Regulated Mutual Funds wherever in the world they may reside. It does not apply solely to those Operators who are resident in the Cayman Islands. A Director of the Fund will be an “*Operator*” where the Regulated Mutual Fund is a corporate, a general partner will be an “*Operator*” where the Regulated Mutual Fund is an exempted limited liability partnership, and a trustee will be an “*Operator*” where the Regulated Mutual Fund is a unit trust.
- The Statement of Guidance is not intended to be prescriptive or exhaustive as to CIMA’s expectations with regard to corporate governance of Regulated Mutual Funds.

- The Statement of Guidance is not mandatory but it does reflect CIMA's expectations of what should be the minimum level of "sound and prudent governance" (rather than best practice) that should be in place for Regulated Mutual Funds.
- Though the Statement of Guidance is not mandatory, it will most likely become a benchmark against which investors, CIMA, service providers, and Courts measure actual practices of Regulated Mutual Funds. Accordingly the corporate governance principles set out in the Statement of Guidance should be reviewed, and become increasingly relevant to, Operators of Regulated Mutual Funds and, at the very least, become the minimum standards for corporate governance arrangements and practices for Regulated Mutual Funds.

Main features of the Statement of Guidance

Oversight Function

The Statement of Guidance states that a Regulated Mutual Fund's "**Governing Body**" (that is, the board of directors where the Regulated Mutual Fund is a corporate, the general partner(s) where the Regulated Mutual Fund is an exempted limited liability partnership, and the trustee(s) where the Regulated Mutual Fund is a unit trust) should:

- i. monitor and regularly take steps to satisfy itself that the Regulated Mutual Fund is conducting its affairs in accordance with all applicable laws, regulations, rules, statements of principles, statements of guidance and anti-money laundering or combating terrorist financing requirements.
- ii. regularly take steps to satisfy itself that the Regulated Mutual Fund's service providers are monitoring compliance with applicable laws, regulations, rules, statements of principles, statements of guidance and anti-money laundering or combating terrorist financing requirements.
- iii. request appropriate information from the Regulated Mutual Fund's service providers and/or professional advisors to enable it to satisfy itself regularly that the Regulated Mutual Fund is operating in compliance with the applicable laws, regulations, rules, statements of principles, statements of

guidance and anti-money laundering or combating terrorist financing requirements.

- iv. Where required, provide appropriate directions to the Regulated Mutual Fund's service providers to rectify any non-compliance with the applicable laws, regulations, rules, statements of principles, statements of guidance and anti-money laundering or combating terrorist financing requirements.
- v. Require regular reporting from the Regulated Mutual Fund's investment manager and its other service providers to enable the Governing Body to make informed decisions and to adequately oversee and supervise the Regulated Mutual Fund.

Conflicts of Interest

The Governing Body must:

- i. suitably identify, disclose, monitor and manage all its conflicts of interest;
- ii. document the disclosed conflicts of interest.

Board Meetings

The Governing Body should:

- i. meet at least twice a year in person or via a telephone or video conference call;
- ii. where the circumstances or size, nature and complexity of the Regulated Mutual Fund necessitates it, meet more frequently than the twice a year, so as to enable it to fulfil its responsibilities effectively;
- iii. request the presence of the Regulated Mutual Fund's service providers (e.g. representatives from the Regulated Mutual Fund's administrator, investment manager, and auditor) at these meetings.

Records of Board Meetings and other documentation

The Operators of a Regulated Mutual Fund are responsible for ensuring that a full, accurate and clear written

record is kept of the Governing Body's meetings, including:

- i. agenda items and circulated documents;
- ii. list of attendees at the meeting and whether attendance was in person or via telephone or videoconference;
- iii. matters considered and decisions made at the meeting; and
- iv. the information requested from, and provided by the Fund's service providers and advisors.

Operators' Duties

- i. **Exercise Independent Judgment** - There is no formal requirement in the Statement of Guidance for Regulated Mutual Funds to appoint independent directors. However it does require, among other things, that the Operator "*must exercise independent judgment*". It could be argued that this requirement will be more often tested in Regulated Mutual Funds where all Operators are affiliated to the investment manager and/or there are no independent appointees.
- ii. **Act in the best interests of the Regulated Mutual Fund** - taking into consideration the interests of its investors as a whole and/or, where applicable, the interests of the Fund's creditors.
- iii. Operate with due skill, care and diligence and act honestly and in good faith at all times.
- iv. **Sufficient capacity to apply mind to overseeing and supervising the Regulated Mutual Fund** – The Operator must ensure that he/she has sufficient capacity to apply his/her mind to overseeing and supervising the activities of each Regulated Mutual Fund for which he/she is the Operator.
- v. Ensuring that the Regulated Mutual Fund's investment strategy and conflicts of interests policy are all clearly described in its offering document.

- vi. Approving the appointment and removal of the Regulated Mutual Fund's service providers and the terms of their contracts with the Fund; and ensuring that the Fund's investors and CIMA are notified of these appointments/removals.
- vii. Retain ultimate responsibility for functions delegated to the Regulated Mutual Fund's service providers, and should regularly monitor and supervise the delegated functions.
- viii. Ensure that the Regulated Mutual Fund's service providers are performing their functions in accordance with the terms of their respective contracts and that their roles and responsibilities are clearly defined.
- ix. Regularly monitor whether the investment manager is performing in accordance with the defined investment criteria, investment strategy and restrictions.
- x. Review and approve the Regulated Mutual Fund's financial results and audited financial statements and regularly monitor the Fund's net asset valuation policy and check that the calculation of its net asset value is being done in accordance with this policy.
- xi. Assess whether he/she has, together with any other Operator of the Regulated Mutual Fund, sufficient collective knowledge and experience to perform the duties imposed upon the Operator.
- xii. On an on-going basis, disclose to CIMA (i) any matter which could materially and adversely affect the financial soundness of the Regulated Mutual Fund, or (ii) any non-compliance by the Regulated Mutual Fund with applicable laws.

Risk Management

The Statement of Guidance specifies that an Operator should ensure that it provides suitable oversight of the risk management of the Regulated Mutual Fund, ensuring that the Fund's risks are always appropriately managed and mitigated (with material risks being discussed at meetings of the Governing Body and the Governing Body taking appropriate action where necessary).

Conclusions

As stated above, the Statement of Guidance is not intended to be prescriptive or exhaustive as to CIMA's expectations with regard to corporate governance of Regulated Mutual Funds. Although the Statement of Guidance is not mandatory it does reflect CIMA's expectations of what should be the minimum level of "sound and prudent governance" (rather than best practice) that should be in place for Regulated Mutual Funds. Accordingly, an Operator of a Regulated Mutual Fund should commence (what should become an ongoing process) a review the Fund's corporate governance arrangements and practices in light of the Statement of Guidance.

The Statement of Guidance can be accessed and read in its entirety through the following link:

<http://www.cimoney.com.ky/search/searchresults.aspx?searchtext=statement%20of%20guidance>

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