CONSULTATION FEEDBACK – STATEMENT OF GUIDANCE FOR REGULATED MUTUAL FUNDS

This table is a schedule of the industry responses received during the 16th July- 16th August 2013 private sector consultation on the proposed Statement of Guidance for Regulated Mutual Funds. In accordance with s4(1)(b) of the Monetary Authority Law (2011 Revision) (as amended), the Authority is responding to these industry comments. The Authority has reviewed and considered the industry comments it received and provides its position/views on the comments and the reasons therefore. This table also confirms the final draft of the Statement of Guidance for Mutual Funds.

On the 16th July 2013 the Authority commenced a private sector consultation ('Consultation') on a Statement of Guidance on Corporate Governance for regulated mutual funds (SOG-MF). The Authority received twenty-two responses to this Consultation. The breakdown of respondents is as follows:

- nineteen Cayman Islands-based associations, entities or individuals; and
- three foreign-based stakeholders in entities regulated by the Authority or domiciled in the Cayman Islands.

FEEDBACK ON INDUSTRY RESPONSES TO CONSULTATION		
	INDUSTRY COMMENTS	**CIMA FEEDBACK**
FUND-SPECIFIC GUIDANCE ON CORPORATE GOVERNANCE		
1.	Respondents generally considered this a positive proposal that would be beneficial for the investment funds sector. Ten respondents support the funds-specific guidance on corporate governance with no respondent opposing the proposal. Respondents voiced a preference for guidance rather than prescriptive rules. Two respondents suggested applying the SOG-MF to all regulated mutual funds, i.e. licensed funds holding a licence under section 4(1)(a) of the Mutual Funds Law (2013 Revision) ('MFL'), administered funds regulated under section 4(1)(b) of the MFL and registered funds registered under section 4(3)(a) of the MFL. Two respondents felt the SOG-MF should go beyond guidance and adopt the substance of a 'best practice' code. Notwithstanding the call for a code, these respondents added that, irrespective of whether the guidance is retained or a code is implemented, in time legislative provisions may need to be considered.	The Authority acknowledges the support received for the proposal and will continue with the implementation of the proposal. The Authority has decided to apply the SOG-MF to all regulated mutual funds, i.e. funds licensed or administered under section 4(1) of the MFL and funds registered under section 4(3) of the MFL. As a result of the feedback received, the SOG-MF now provides more tailored advice and guidance than originally proposed and, as such, the guidance provided makes the SOG-MF more relevant and appropriate for licensed funds.

OPERATOR'S PRIMARY FUNCTION		
2.	A number of respondents provided their interpretation of what the primary function of an Operator[1] entails. These comments included: • An Operator's primary function is the oversight and monitoring of a fund. An Operator is not responsible for executing functions such as administration and investment management. Those tasks should be delegable subject to the Operator's oversight and monitoring. Therefore the SOG should refer to the Operator 'ensuring' or 'taking steps to ensure' tasks are completed rather than being responsible for the task in all instances or implying a level of omnipresent involvement of the Operator in respect of supervision. • Most fund directors are non-executive directors and are entitled to delegate most of the management and administration of the fund to qualified investment managers or service providers. Directors should consequently only have residual supervisory responsibility and should not have strict responsibility for all delegated functions. Therefore the SOG should state that the director's primary function is to see that the fund appoints service providers to carry out the business of the fund and then takes regular steps to check that the service providers are providing services to the fund in a manner that ensures the fund is conducting its affairs, in all material respects, in accordance with the respective laws/regulations and terms of their contract with the fund. • The directors do not in fact "supervise all delegated functions" or continuously monitor delegated functions on a day-to-day basis; instead they retain only a residual oversight and will only periodically check to see that service providers are	The industry comments describing the primary function of an Operator indicate a lack of uniformity on what the primary function entails. The divergence in views is arguably sufficiently material to manifestly result in substantive variances on the role of an Operator. On this basis alone, the SOG-MF should provide constructive guidance in clarifying what the primary function of an Operator is. The Authority agrees the Operator's duty is primarily to retain sufficient oversight over a fund so as to enable the Operator to satisfy itself that the fund is efficiently and effectively operated and managed, and in accordance with all applicable laws, regulations and rules. The Authority further agrees that the Operator of a fund is normally a non-executive director and as such is not actively administering or operating the fund. It is not the intention of the SOG-MF to require the Operator to be omnipresent in a management or executive role. The Authority understands that funds often delegate a number of functions to service providers however delegating the function does not abrogate the Operator from being ultimately responsible for the delegated functions. The Authority does not agree that an Operator only retains a 'residual' supervisory responsibility over a delegated function. Delegating the function does not delegate the Operator's inherent responsibility in overseeing the function. In the comments received it is contended that a fund

[1] In this feedback statement, 'Operator' has the same meaning as defined in section 2 of the MFL.

	generally conducting operations in a manner that meets the requirements of the fund. • All material functions of the operations of a fund are delegated by the fund itself, not the directors, though the directors clearly approve the delegations. The SOG should recognise the difference between executive and non-executive directors. • Due to many functions being delegated, the SOG should refer to the Operator having 'ultimate responsibility' rather than 'responsibility'. This speaks more to the oversight function rather than an operational role. • It is noted that the proposed SOG-MF suggests that the Operators retain responsibility for delegated functions. CIMA may wish to clarify that in some circumstances and depending on the nature of the fund; some functions may be vested in persons other than the Operators at the outset and therefore are not delegated. It should be clear the Operators have no responsibility for the performance of such functions. Some respondents suggested that as almost all the functions of a fund are delegated by the director to service providers, the SOG-MF should refer to 'taking steps to satisfy itself on a continuing basis' rather than referring to a director 'ensuring' that a particular function is conducted. This would better recognise that functions are delegated and performed by the service provider and obliges the Operator to make regular enquiries of the service providers to establish that they are providing services to the fund in such a way as to ensure the fund is conducting its affairs in accordance with laws/regulations. A respondent also commented that as fund directors are non-executive directors they cannot be expected to supervise all delegated functions as this implies a degree of omnipresent involvement on the part of the director. The respondent added that they considered an obligation to 'monitor' was more reflective of what the director does in practice.	delegates functions. It can occur that service providers are appointed before a fund's board is formed; however, once the Operators are appointed one of their first objectives is to confirm or retract the appointments and make appointments or delegations the board considers most appropriate for the fund. Some responses suggest that as some functions are vested or delegated at the outset, they are 'not delegated', and therefore the Operator has no responsibility for the performance of such functions. Such a statement is incompatible with the regulatory position that the Operators of a fund are ultimately responsible for the effective operation and administration of a fund. This does not necessarily translate into a requirement to maintain daily oversight over a fund or to become involved in the on-going management of a fund but it does translate into an oversight role where the Operator is applying his/her mind to directing the fund through actively enquiring into the affairs of the fund on an on-going basis. The Authority has reservations accepting wording such as 'taking steps to satisfy itself' as it insufficiently pronounces on the duty of an Operator to enquire into the affairs of the fund. "Taking steps to satisfy' does not always sufficiently pronounce on the level of responsibility resting on the Operator to enquire into the affairs of a fund or to take sufficient action to remedy a shortcoming within a fund. However, the Authority agrees that in certain circumstances it is unsuitable to require the Operator to 'ensure' that a function is performed. The Authority has reviewed the SOG-MF and amended the wording to better reflect the non-executive role of an Operator.

	Another respondent requested that as fund directors are essentially non-executive directors, they should be entitled to rely on professional service providers regulated by CIMA or other similar regulators without having to provide a vague "upper level oversight" which is difficult to define. A respondent mentioned that each service provider has its own governing body, independent of the fund and it is generally ultra vires for the directors of a fund to direct the actions of any employee of a service provider. The nature of the relationship and the responsibilities of the service provider (and its associated employees) are contained in the terms of the service provider agreements with the fund. The function of the directors of the fund is to properly operate the fund in accordance with those agreements.	
LEGISLATIVE AMENDMENT TO ENFORCE NON-COMPLIANCE WITH GUIDANCE		
3.	One respondent queried the status of section 3.1 of the SOG-MF. The respondent commented that the SOG-MF is intended to be guidance however the wording of section 3.1 suggests otherwise as it prescribes certain actions the Authority could take should an Operator not be compliant with the guidance. The respondent added that this altered the status of the SOG-MF from guidance to prescriptive standards. This position further raised the question of how the Authority intended to supervise the guidance. Three respondents considered the proposed legislative amendment to the Monetary Authority Law (2013 revision) ('MAL') as being too broad and elevating the guidance to the level of a statutory requirement. These respondents recommended that the SOG-MF should be treated as guidance.	The Authority has decided to temporarily remove section 3.1 until such time as the Cayman Islands government has pronounced on the recommended legislative amendment. Once the Cayman Islands government has decided on the legislative amendment, the Authority will reassess this provision and respond accordingly.

	Two respondents support the MAL amendment and recommended that the Authority use its powers to take action for non-compliance. One respondent suggested that section 30(3) of the MFL include fines or penalties of such amount 'that the Authority may determine' so as to encourage compliance.	
COST/BENEFIT CONSIDERATIONS		
4.	We support CIMA's goal to enhance corporate governance standards but their needs to be a balance between the costs and benefits of the proposals to ensure the Cayman Islands remains a competitive jurisdiction.	The Authority considers there to be an appropriate and reasonable balance between the costs and benefits of the proposal, especially considering that much of the guidance is what Operators should be doing already. There should not be any tangible increase in cost to the Operators or licensees.
REFERENCE TO A 'CONTINUOUS' OBLIGATION		
5.	Eleven respondents thought that the use of 'continuously' suggested full-time engagement on a task. They considered this neither possible nor appropriate for a non-executive director in a delegated model and - as such - not a practical or reasonable expectation. Most of these respondents suggested that 'continuously' be replaced with 'regular' or 'periodic'. One respondent agreed that requiring an Operator to act 'on a continuous basis' may be unduly burdensome given the Operator will be relying on periodic board meetings and reports in exercising its supervisory function. However, the respondent added that there may be a need for Operators to be proactive rather than reactive and Operators should not rely solely on interactions at board meetings. This respondent suggested that the Authority replace the	The Authority agrees with the assertion that - in the main - most directorship positions of regulated funds are non-executive positions. The Authority also agrees that these non-executive roles do not, in normal circumstances, entail a continuous monitoring of the operations of the fund. Consequently, the Authority will review and amend the wording to better reflect the high level oversight function of an Operator. Notwithstanding this amendment, the Authority reiterates the courts finding in *Weavering* where Justice Jones holds that it is not sufficient for an Operator to adopt the position of an 'automaton'. The Authority agrees with the respondent's view that Operators should be proactive rather than reactive – regularly enquiring into the operations of the

	wording and use "on an on-going basis' to signify that Operators are required to do more than just rely on board meetings but not go so far as to require impractical levels of supervision such as hourly/daily monitoring.	fund. The Authority further agrees that it is not sufficient for the Operator to rely solely on interactions at board meetings. The Authority does not perceive this to result, in normal circumstances, in a constant daily monitoring but rather a structured and regular enquiry to establish whether the Operator is comfortable with the manner the fund is operating.
DISTINCTION BETWEEN 'OPERATOR' AND 'BOARD'		
6.	Six respondents commented that there was inconsistent treatment of 'Operator' and 'board' - some added that there didn't seem to be a need for the distinction. Contrasted to that, one respondent suggested amending the MFL to define the "Board" and duties of the board as a whole, as distinct from the duties of individual Operators. The respondent did consider some of the Operator duties to apply to the board as a whole and so clarification around the role and duties of the individual Operators as distinct from the role of the board as a whole was necessary.	The Authority agrees and accepts that there should be more consistency in the referrals to 'Board' or 'Operator'. The Authority also agrees that there is a distinction between the board as a collective and an Operator as some oversight duties apply to the board as a collective whereas some duties apply to individual Operators. The Authority has reviewed the references to 'board' or 'Operator' in the SOG-MF to ensure that the references are relevant, appropriate and consistent.
	One respondent said that a significant percentage of funds are now exempted limited partnerships of unit trusts and, accordingly, suggested changing references to "s/he", "boards" and "board meetings" to the more generic term to "Operator" and "Operator meetings".	The Authority has reviewed whether this proposal is workable and decided not to implement it as the Authority considers it important to retain the distinction between a board as a collective and the Operators as individuals. The Authority has, however, decided to define the board as 'governing body of the fund'.
	A respondent held that it was not clear whether the SOG applied to boards of directors of (1) general partners of exempted limited partnerships and (2) trustees of unit trusts. While some general partners are organised as Cayman Islands exempted companies (which have a board of directors), in many cases general partners are organized as Delaware LLCs which have no board of directors but rather a managing member or members. If the SOG is intended to apply to the governing body of the general partners which are	The Authority acknowledges the point raised and will amend the SOG-MF to ensure that the board or its equivalent is captured.

	organised as Delaware LLCs (or other body corporates which do not have a board of directors) perhaps the SOG-MF should refer to the "governing body of the Operator".	
CONFLICTS OF INTERESTS		
7.	Six respondents suggested amending section 4.4 to require the Operator to ensure that his/her conflicts of interest are documented, appropriately disclosed, managed and monitored rather than requiring the Operator to adopt a particular policy. The respondent felt that such a requirement would be cumbersome as it would need to take into account the conflicts of interest policies required to be adopted by the fund's service providers, including the investment manager. Three respondents confirmed that most offering documents of a fund include a section on conflicts of interest, including how they should be managed. These respondents queried whether the conflicts of interest policy should be a separate document or whether describing the policy in the offering documents would suffice. Two respondents suggested that normally only the investment manager has a conflicts of interest policy, not the board. One respondent held that the SOG-MF does not go far enough in dealing with conflicts of interest. The respondent encouraged the Authority to further address the Operator's duties regarding conflicts of interest. Particularly in relation conflicts of interest between the investment manager and shareholders when such conflicts have not previously been disclosed to, and consented to, by shareholders.	The Authority considers there to be a number of separate and different potential conflicts of interests that could arise within the structure and operation of a fund. There is the potential conflict of interest of the Operators themselves. The Operator must always act in the best interests of the fund that s/he oversees; however the Operator himself/herself may have other interests outside the fund that could potentially conflict with the interests of the fund. It was this conflict of interest that the Authority was referring to in section 4.4. Apart from the Operator's potential conflicts of interest are the potential conflicts of interests of each service provider in relation to the fund. The Authority was not expecting the board to document these conflicts of interests in its conflicts of interest policy. The Operator should seek reassurances from service providers that conflicts of interest are being manage and were they cannot be managed whether this warrants the service provider being replaced and, if so, to replace the service provider. The Authority does not accept that only the investment manager could have conflicts. The Authority has reviewed the comments and accepted that formally requiring a documented conflicts of interest policy is not aligned with current industry practices. The Authority also accepts that the majority of funds contract in the offering documents how conflicts of interest shall be managed. Therefore, the Authority has decided not to require a formal documented conflicts of interest policy for the board. The

		SOG-MF has been amended to adopt this change and to confirm that Operators must monitor and manage their conflicts of interest.
BOARD MEETINGS AND MINUTES		
8.	Seven respondents felt there is no need to prescribe a mandatory number of board meetings a year. Two of these respondents stated that prescribing a mandatory number of board meetings a year did not necessarily enhance governance standards. One respondent added that they considered this an arbitrary number. Respondents suggested either that the recommendation be reduced to one board meeting a year or that the Authority set a 'general expectation' of 2 boards meetings a year in order to give the Operator sufficient flexibility to hold more or less meetings each year depending on the circumstances of the fund in question. One respondent suggested it may be helpful to clarify in the SOG-MF that board meetings may take place in person or by conference call. One respondent suggested that the SOG-MF recommend a minimum number of one face-to-face or teleconference call board meetings per year. Three respondents recommended that the SOG-MF suggest it is best practice to keep a record of attendees at any board meeting and a record of material decisions and/or considerations. Another respondent added that that Operator should be able to ensure that minutes are kept rather than having a provision which implies that the Operator itself must perform that function. A respondent requested that the Authority reassess the scope of application of the requirement (for a minimum of two board meetings a year) to trustees of unit trusts. The respondent held that it was not current practice for trust corporations acting as trustees of a unit trust to hold board meetings in performing their role as an Operator. The respondent commented that these	There were a few respondents who did not see the need for a minimum number of board meetings per year. The only reason provided for this was that it reduced the flexibility available to Operators in deciding what the appropriate number of meetings per year was. One respondent suggested that introducing a minimum number of board meetings per year would not necessarily result in enhanced corporate governance standards. We have found that boards who meet regularly tend to be better informed and be better placed to oversee a fund. Operators have also informed us that they have been on boards that, for various reasons, increased the regularity of their board meetings; and on such occasions the Operator had noticed the board was in a better position to oversee a fund proactively. Some respondents suggested that rather than setting a minimum number of board meetings per year that the Authority set a 'general expectation' of at least two meetings a year. Doing so would not be an accurate reflection of the Authority's expectations. Most funds meet approximately four times a year. The Authority has also seen situations where boards are meeting only once a year. The Authority considers one meeting a year to be insufficient for the diligent oversight of a plain vanilla fund. We consider the guidance to have at least two meetings per year to be reasonable and we expect these meetings to be in person or a via teleconference or telephone call.

	trustees organized their in-house procedures differently.	
COMMUNICATING WITH CIMA AND INVESTORS		
9.	Respondents were generally agreeable to the SOG-MF recommending open communication with the Authority and the fund's investors. However, most respondents held that the guidance as it currently stood was too wide and it should therefore be limited. Three respondents suggested that there may be circumstances where it would be inappropriate for an Operator to have fully open communications with investors, whether for legal or regulatory reasons or otherwise. These respondents suggested that the section be redrafted to obligate the Operator to communicate matters that it is properly able to disclose. One respondent queried whether it should be the Operator that is required to communicate with the investors rather than the manager. This respondent also queried whether the Operator should be communicating every detail to the investor. Regarding communicating with the Authority, respondents had a similar stance in that the guidance was too wide and a materiality threshold should be introduced to section 7.1. One respondent said that the current guidance would require the Operator to inform the Authority of non-compliance with the laws, regulations, rules and standards imposed around the world if they are applicable to the fund. It added that this should be restricted to non-compliance with Cayman Islands' laws, regulations and rules only.	The Authority accepts the responses received and agrees that the Operator should only disclose information that it is properly able to disclose. The Authority has reviewed the SOG-MF and redrafted this section to narrow the scope of application. Investors have been critical of the amount of information being received from Operators. They added that in some circumstances they struggled to receive any information from the Operators. The Authority considers providing relevant and appropriate information in accordance with the legal and regulatory boundaries within which they operate to be an important component of a well operated fund. The Authority considers this an important guide to regulated funds as they could be better at advising or updating the Authority on matters that a regulator should be made aware of. This includes being informed not only of non-compliance with Cayman Islands laws and regulations but non-compliance with any laws or regulations pertaining to the fund. Nevertheless, the Authority has reviewed section 7.1 and sought to provide more guidance on when a regulated fund should be communicating with the Authority.

RISK MANAGEMENT		
10.	Three respondents considered that the industry would benefit from further guidance in section 8.1 on how a fund or its board could practically demonstrate compliance with the risk management guidance. A further three respondents suggested that the guidance in section 8.1 was too wide and it could therefore become overly burdensome. One respondent believed that the risk management section should be strengthened as the oversight function included oversight of the risk management function. Two respondents suggested removing the risk management section in its entirety as the SOG-MF refers to the Operator being responsible for overseeing and supervising the activities of the fund – the respondent held that as this should include risk management, there should be no need to refer to risk management separately.	The Authority considers risk management to be an important component of a regulated mutual fund's oversight function and considers it beneficial to remind Operators of their duty to oversee a fund's risk management function. The Authority will retain the risk management provision but has amended to provision to clarify the Authority's expectations.
GENERAL		
11.	A number of respondents to the corporate governance consultation in January 2013 welcomed the addition of the Weavering principles to the SOG. In this Consultation one respondent agreed including the Weavering principles in the SOG-MF, whereas one respondent advised that including the Weavering principles risked continual amendment where the court opined on corporate governance.	The *Weavering* principles provide useful guidance on the governance expectations of an Operator. The Authority has included these principles in the SOG-MF as the Authority considers them to be fundamental components of the function of an Operator. Although, the Authority acknowledges there may be further judicial pronouncements on *Weavering*, the Authority does not envisage the retention of these principles in the SOG-MF conflicting with any forthcoming potential judicial announcements.
12.	Two respondents said it would be helpful if the SOG-MF refers to	The authority has reviewed the SOG-MF and provided some

	how an Operator might satisfy itself of certain things, particularly those functions an Operator would normally delegate.	further guidance on how certain expectations could be met. For the reasons set out above, the Authority has restricted these amendments to prevent the guidance from becoming too prescriptive.
13.	Four respondents recommended amending the SOG-MF to reflect the duties owed by an Operator to a fund's creditors when a fund approaches insolvency.	The Authority has refrained from making these additions as legislation and the common law set out the legal obligations of an Operator in such circumstances.
14.	A respondent suggested incorporating section 5.14 into section 5.2 and held that it was sufficient for the board of directors of a fund to have "collective knowledge and experience".	The Authority agrees with the view regarding the board having "collective experience and knowledge" and has made the suggested amendment.
15.	A respondent queried whether the SOG-MF is the appropriate place to provide guidance to directors on the Authority's expectations surrounding disclosures on the number of relationships and directorships appointments a director might hold.	There is merit to such a provision; however the proposed public database will provide information on the number of directorships held. Thus, the database is intended to provide the appropriate market disclosure such a provision could achieve. Therefore, it would pragmatic to assess the effect the database has on providing pertinent and appropriate information to the industry before deciding whether such a provision is needed. The Authority has explained its objectives and strategy on capacity in its feedback to the January Consultation on Corporate Governance. The Authority will review its approach two years after implementation of the database.
16.	One respondent commented that the IOSCO international standards are intended to fill the gap where no national standards exist. It added that the Authority had inappropriately and without rationale relied upon the IOSCO Principles as a basis for reform of Fund Governance. It questions the accuracy of the Authority's view suggesting that IOSCO's recommendations expect higher corporate	Admittedly, international standard setters, including IOSCO, have amended or enhanced their standards; however the Authority has not solely relied on the amendments to the IOSCO Principles as the rationale for corporate governance reform.

	governance standards from hedge funds. The respondent does not see this as the intention of the IOSCO amendments and instead contends that the IOSCO Principles rests almost exclusively on hedge fund managers/advisers and their exposure or contribution to systemic risks in the financial markets. The respondent adds that the IOSCO Principles' focus is decidedly not on the protection of hedge fund investors by imposing greater fiduciary duties on hedge fund directors - essentially, only Key Question 8 has any direct bearing on a hedge fund and, by extension its directors, and even that provision applies equally to the hedge fund's manager.	There are a number of factors that initiated the Authority's corporate governance review. The funds industry sector has evolved internationally over the last few years and the Authority considered it prudent to review the suitability of the regulatory expectations with regard to corporate governance practices in the funds industry. Aligned with this, the Authority, through its supervisory work, has recognised corporate governance practices that do not always meet the standard expected from regulated entities. It should also be clarified that rather than serving as a reserve set of guidelines where no standards exist, the IOSCO Principles provide a broad general framework for the regulation of securities. IOSCO seeks to provide sufficient guidance to regulators as to the core elements of an essential regulatory framework for securities activities. The methodology is designed to provide IOSCO's interpretation of its Principles and give guidance on the conduct of a self-assessment or third-party assessment of the level of Principles implementation by a jurisdiction or regulator. The IOSCO Principles seek to accommodate the differences in the laws, regulatory framework, and market structures among its member jurisdictions.