

Cayman Islands Monetary Authority

PRIVATE SECTOR CONSULTATION



STATEMENT OF GUIDANCE FOR REGULATED MUTUAL FUNDS

CORPORATE GOVERNANCE

A. Introduction

1. Section 34(1)(a) of the Monetary Authority Law (2011 Revision) (as amended) ("MAL") states that –

After private sector consultation and consultation with the Financial Secretary, the Authority may –

- (a) issue or amend rules or statements of principle or guidance concerning the conduct of licensees and their officers and employees, and any other persons to whom and to the extent that the regulatory laws may apply;*

2. Requirements specific to the private sector consultation are outlined in section 4(1) of the MAL as follows:

When this Law requires private sector consultation in relation to a proposed measure–

- (a) the Authority shall give to each private sector association a draft of the proposed measure, together with –*
 - (i) an explanation of the purpose of the proposed measure;*
 - (ii) an explanation of the Authority's reasons for believing that the proposed measure is compatible with the Authority's functions and duties under section 6;*
 - (iii) an explanation of the extent to which a corresponding measure has been adopted in a country or territory outside the Islands;*
 - (iv) an estimate of any significant costs of the proposed measure, together with an analysis of the benefits that will arise if the proposed measure is adopted; and*
 - (v) notice that representations about the proposed measure may be made to the Authority within a period specified in the notice (not being less than thirty days or such shorter period as may be permitted by subsection (3)); and*
- (b) before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector*

associations, and shall give a written response, which shall be copied to all the private sector associations.

3. The Authority hereby seeks consultation and comment from the private sector associations concerning the proposed Statement of Guidance for Regulated Mutual Funds – Corporate Governance (SOG–MF).
4. Refer to Appendix A to review the proposed SOG-MF.
5. The Authority requests that regulated entities and interested parties submit their comments via their private sector associations.

B. Background

6. On the 14th January 2013 the Authority commenced a private sector consultation on Corporate Governance for the financial services industry ('January Consultation'). This January Consultation announced several proposals that focused on clarifying corporate governance practices expected from regulated entities and practitioners; modernising the corporate governance regulatory framework; and presenting corporate governance factors to be considered subsequent to this consultation.
7. Included in the proposals were amendments to the Statement of Guidance for Corporate Governance ('SOG'). This proposal recommended extending the application of the SOG to registrants and also suggested some amendments that sought to emphasize key corporate governance duties. In particular, the January Consultation sought views on whether the industry preferred generic guidance applying across all sectors of the financial industry or a sector-specific guidance.

Feedback to January Consultation

8. The January Consultation provided invaluable and constructive feedback from the industry on the SOG. The feedback originated primarily from directors¹ or directorship services providers, investors and industry associations. The common theme was strong support for providing guidance on corporate governance rather than implementing compulsory standards. Most respondents agreed with the Authority's views that guidance was an appropriate mechanism for a sophisticated industry that generally adopted acceptable standards.
9. In summary, the responses of the respondents to the SOG are as follows:
 - a. Many (74.5%) of the respondents supported updating the current SOG; however there was a noticeable request from the funds industry for a funds-specific SOG.
 - b. The majority of the respondents supported the proposal to retain a high-level principles-based approach to the SOG; however, this was contradicted with many respondents -

¹ Unless otherwise specified, references to 'director' denotes 'Operator' as defined in the Mutual Funds Law (2012 revision) or acting of fulfilling the function of director of alternate director (as defined in s3 of the Companies Management Law (2003 revision) of a mutual fund (as defined in the Mutual Funds Law).

including those supporting a principles-based approach - recommending more detail on director duties so as to clarify these duties.

- c. Although there was marginal support for a generic SOG, many of the respondents opined that a generic SOG was not suitable for all the sectors. Moreover, there was support from the funds industry for a funds-specific SOG. These respondents held that the SOG guidance was too generic and not suitable for the funds industry; believing a funds-specific SOG to be more beneficial to the industry.
- d. There was a consistent call for directors' duties to be detailed as some respondents confirmed that there is inconsistency in the industry on what directors' duties were. In addition, a number of respondents welcomed the addition of paragraphs 3-6 to the SOG as these clarified the duties of directors. No respondent opposed the addition of these paragraphs although one respondent advised that over formalising the director's duties may have the unintended consequences of limiting their scope. We agree with this view and have sought to refrain from compiling an exhaustive list of directors' duties.
- e. Apart from one, all the respondents agreed that there was no necessity to introduce compulsory standards as they thought market forces were sufficiently robust to encourage suitable corporate governance standards in the industry. However, on most occasions, this was prefaced by the call for greater transparency on the functions and capacity of the directors.
- f. A large proportion of the investors that responded suggested that a 'Code of Best Practice' on a 'comply or explain' basis was the best way forward. They considered this to be the most suitable mechanism for confirming what a director's duties are.

C. Purpose of the SOG-MF

- 10. The proposal is to issue a sector specific Statement of Guidance that will apply to all mutual funds regulated by the Authority. The SOG-MF seeks to provide guidance on the role of a mutual fund director with a particular focus on confirming the primary duties - including those set out in the *Weaverling* judgement - applicable to the directors of a fund.
- 11. The Authority expects mutual fund directors to oversee or direct a regulated mutual fund in accordance with established corporate governance standards. This proposal strives to set a benchmark for corporate governance standards by providing clarity on what the primary director duties are and to simultaneously guide directors and directorship services providers on the corporate governance standards.
- 12. The feedback received to the January Consultation suggested that there were discrepancies in the industry as to what the duties of a director are. In addition, there was clear support for s3-6 (director's duties) of the SOG proposed in the January Consultation.

13. The Authority anticipates that guiding the industry by detailing the primary duties of mutual fund directors will not only reinforce current standards but also improve them. Should these objectives be met, it is envisaged that market confidence will be enhanced; thereby protecting the reputation of the jurisdiction as a financial centre.

D. Compatibility with Authority's functions and duties (s6 of MAL)

14. This consultation proposes new guidance on corporate governance standards for the mutual funds industry to complement the Authority's current supervisory and regulatory instruments. In accordance with section 4(1) of the MAL, the Authority consults with industry on this proposal and explains the reasons why the Authority considers the proposal compatible with the Authority's functions and duties under section 6 of the MAL.

15. The regulatory function is a principal function of the Authority listed in section 6(1) of the MAL. This function includes, *inter alia*,

'the function to regulate and supervise financial services business carried on, in or from within this jurisdiction in accordance with the MAL or other regulatory laws'.

In addition, section 29(2)(b) of the Mutual Funds Law (2012 revision) (as amended) ('MFL') provides that the Authority shall, *inter alia*, 'be responsible for supervision and enforcement in respect of persons to whom this Law applies,...'. Furthermore, section 30(1)(d) of the MFL stipulates the Authority may take any or all of the supervisory or enforcement actions specified in section 30(3) of the MFL if the direction and management of a regulated mutual fund has not been conducted in a fit and proper manner. In accordance with section 34(3) of the MAL, this Guidance relates to section 30(1)(d) of the MFL by providing guidance on the governance standards expected from a regulated mutual fund.

16. Section 6(2) of the Monetary Authority Law ('MAL') requires the Authority to, *inter alia*:

- (a) *act in the best economic interests of the Islands;*
- (b) *promote and maintain a sound financial system in the Islands;...*

17. In section 6(3) the MAL stipulates further that "In performing its regulatory functions and its co-operative functions, the Authority shall, in addition to complying with the requirements of subsection (2)":

- (a) *endeavour to promote and enhance market confidence, consumer protection and the reputation of the Islands as a financial centre;*
- (b) *endeavour to reduce the possibility of financial services business or relevant financial business being used for the purpose of money laundering or other crime;*
- (c) *recognise the international character of financial services and markets and the necessity of maintaining the competitive position of the Islands, from the point of view of both*

consumers and suppliers of financial services, while conforming to internationally applied standards insofar as they are relevant and appropriate to the circumstances of the Islands;

- (d) recognise the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;*
- (e) recognise the desirability of facilitating innovation in financial services business; and ...*

18. In the last few years international organisations have called for enhanced corporate governance standards from the financial services industry. This call has resulted in a large number of international financial centres revising their Corporate Governance codes, laws and/or regulations to accommodate the international developments². These amendments occurred in various forms, including laws, regulations, Codes of Conduct and guidance.
19. More particularly, in September 2011 the International Organisation of Securities Commission updated its Objectives and Principles of Securities Regulation paper (last updated in 2002). The IOSCO recommendations now include a greater focus on the corporate governance standards expected from fund managers and funds themselves. Two amendments, in particular, signal an increased emphasis on corporate governance standards. The first being Principle 24 now requiring the regulatory system to set governance standards for Collective Investment Schemes³. The second amendment is the introduction of a new principle (Principle 28) recommending that regulatory standards should ensure that hedge funds and/or hedge funds managers/advisors are subject to appropriate oversight. Principle 28 and the accompanying methodology speak to organisational and operational standards as well as disclosure and conduct of business standards that should apply to funds, imposing many of the governance obligations via the fund manager's management of funds and some on the fund directly.
20. Being a leading international financial centre that adopts internationally applied standards insofar as they are relevant and appropriate to the circumstances of the Cayman Islands is an essential factor in promoting a sound financial services sector and maintaining its leading position. To continue promoting this strength it is important for the Authority to continuing being aware of international standards and applying them where they are relevant and appropriate to this jurisdiction. It is in the interests of the industry and its continued strength to remain cognizant of international standards and apply them where appropriate and necessary.

Coupled with these international developments has been the institutionalisation of the funds industry with an increasingly greater proportion of assets invested in Cayman Islands' funds being derived from institutional investors. These institutional investors have more advanced demands regarding the corporate governance standards a fund is adopting. These demands have brought with them a more

² See page 3-5 of the January Consultation.

³ Collective Investment Schemes are informally referred to as 'retail funds'.

sophisticated due diligence process to ascertain whether a fund is adopting suitable standards. With these investors forming an increasingly greater proportion of assets invested in funds, their expectations continue to be an important factor in a fund's operations. Any consideration on the protection and viability of the funds sector should include the requirements of these investors. However, it is critical to ensure that the industry is capable of tailoring its operations to meet the demands of all categories of investors and while it is anticipated that more robust corporate governance standards would be welcomed by all, feedback regarding the proposals in the draft SOG that includes the reaction of investors other than institutional investors would be helpful.

21. It is notable that the CIMA-Commissioned Survey results⁴ support the view that the funds industry in this jurisdiction would benefit from some improvement in the corporate governance standards in the industry. 86% of investors, 68% of fund directors, 96% of service providers and 37% of fund managers all thought the industry would benefit from some improvement on corporate governance practices.
22. Considering these factors the Authority maintains that the SOG-MF will fulfil a number of objectives, namely:
 - a. Promoting and enhancing market confidence by confirming and clarifying the corporate governance standards required from mutual fund directors;
 - b. Recognising the international character of the financial services sector by reviewing international developments on corporate governance and ascertaining what was appropriate and relevant to apply in the jurisdiction so as to maintain its position as a leading international financial centre;
 - c. Protecting the reputation of the financial services industry of the jurisdiction by explicitly confirming the corporate governance standards expected of mutual fund directors; thereby guiding the sector to continuously adopt international-accepted standards; and
 - d. Acting in the best economic interests of the jurisdiction by recognising the transformation of the certain stakeholders in the sector and facilitating the adoption of corporate governance standards that accommodates the expectations of the institutional investors without detracting from the advantages the sector has for private investors and fund managers.
23. The Authority proposes linking the SOG-MF to the Authority's powers under the Mutual Funds Law (2012 Revision). To achieve this, the Authority intends proposing to the Cayman Islands Government an amendment to section 30(1) of the Mutual Funds Law to include a new sub-paragraph (f) which would read as follows:

"a regulated mutual fund is in non-compliance with the Money Laundering Regulations, or any guidance issued by the Authority in relation to Money Laundering Regulations, or any other rules, statements of principle or guidance, issued by the Authority

⁴ http://www.cimoney.com.ky/about_cima/about_feed.aspx?id=2147484012

pursuant to section 34(1) of the Monetary Authority Law (2011 Revision)."

E. Implementation in other jurisdictions

24. A jurisdiction comparison showed all the comparative jurisdictions researched as having some form of corporate governance standards. All these jurisdictions have legislation stipulating governance standards supported by supervisory powers that enables effective supervision and enforcement of these standards. This legislation, as a minimum, sets out the fiduciary standards and common law applicable to directors. All the jurisdictions supplement their legislation with regulatory standards – either in the form of a compulsory Code of Conduct or rule and often some guidance providing advice on the legislative and regulatory obligations.
25. In the 24 months subsequent to the onset of the Financial Crisis, the BVI Financial Services Commission, the Central Bank of Ireland, the Jersey Financial Services Commission, the Bermuda Monetary Authority, the Guernsey Financial Services Commission, the Bahamas Financial Services Board and the Isle of Man Supervision Commission all updated their Corporate Governance codes, laws and/or regulations to accommodate the international developments.

26. Jurisdiction Comparison

This table depicts the legislation/rules and/or guidance or Code of Conduct applicable to the funds industry in the listed jurisdictions.

Jurisdiction	Compulsory Standards		Voluntary Standards	
	Legislation	Rule	Code of Conduct	Guidance
Bermuda	x			x ⁵
British Virgin Islands	x			x
Guernsey	x	x	x ⁶	
Ireland	x		x ⁷	
Isle of Man				x
Jersey	x		x	
United Kingdom	x	x		x

⁵ The Bermuda Monetary Authority are consulting on a Corporate Governance Policy that consists of principles and underlying guidance. It is not applicable to investment funds but is applicable to fund administrators and fund managers.

⁶ Code of Corporate Governance

⁷ Industry Association Code

F. Estimation of significant costs and benefits

a. Costs

18. The key objective for proposing the SOG-MF is to confirm with fund directors what it expected of them in overseeing a fund by expressly set out the primary duties currently applying to directors of a regulated mutual fund. It is envisaged that most, if not all, of the guidance confirms expected and established practice; long-standing common law fiduciary obligations; and those recently proclaimed in *Weaving*. Therefore, there should be minimal impact on the functions of those entities and directors currently functioning in accordance with accepted practice.
19. With the impact expected to be negligible and no new obligations or standards being implemented, the Authority does not expect the proposal to create additional complexity or uncertainty on what the regulatory expectations are. In fact, by clarifying what the directors' duties are, the Authority expects there to be more certainty in what the corporate governance requirements are.
20. Is it possible that some directors and directorship providers may initially seek advice on what the duties entail and may decide to conduct some training upon the gazetting of the guidance. It is envisaged that this will probably be concise training for the industry, especially where the practitioners have in-depth experience of directorship roles.
21. The costs to the Authority have largely emanated from the consultation process. The Authority does not expect any tangible impact on its supervisory operational costs as assessing and supervising corporate governance standards is currently part of our supervisory process.

b. Benefits

22. The SOG-MF will extend current guidance to registered and administered funds; thus requiring these entities to adopt standards that previously applied to licensees only. Requiring these entities to adopt these standards will enhance the reputation of the jurisdiction.
23. The January Consultation feedback confirmed there were material differences on what the director's duties are and that this lack of clarity reduced efficiencies in the market and increased costs such as prolonging the due diligence process. Clarifying these expectations should make the due diligence (and oversight functions) more efficient; and in doing so, reduce operational costs for the funds.
24. International organisations reviewing and updating their recommendations necessitated a review of our corporate governance standards if we want to apply international standards. However, it also requires the Authority to conduct a second leg to the assessment by ascertaining whether the standards are appropriate and relevant to the circumstances of our jurisdiction. Most comparative jurisdictions have modernised or enhanced their corporate governance subsequent to the 2007/2008 financial crisis. By clarifying our corporate governance

expectations in a funds-specific guidance, the Authority continues to recognise the international character of the industry by updating its corporate governance framework in a manner that strikes a good balance between allowing market forces to continue being a key factor in the sector and applying supervisory oversight that is not overly burdensome. Functioning in accordance with international developments allows the jurisdiction to consolidate its position as a leading international financial centre.

25. The Authority considers this proposal as beneficial to the Cayman Islands, its standing in the international financial services sector and its reputation. The Authority also considers these amendments essential to the continued soundness and stability of the industry.
26. The Authority considers the benefits of these proposed measures to significantly outweigh their costs.

G. Comments and Consultation

27. The Authority seeks consultation through written comments and representations from the private sector associations concerning the issues detailed above.
28. The Authority must receive representations by 17H00, Friday, 16th August 2013.
29. Comments and representations must be addressed to

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30. The Authority shall have due regard to any representation made by the private sector associations. The Authority shall provide a written response collating the feedback received and the Authority's position on this feedback. This response shall be copied to all relevant private sector associations only.