Cayman Islands Hedge Fund Corporate Governance Survey

Commissioned by the Cayman Islands Monetary Authority

CAYMAN ISLANDS MONETARY AUTHORITY

Contents

Executive Summary

CIMA commissioned Ernst & Young Ltd. to conduct this survey as part of a wider effort to consult with local industry associations and other interested stakeholders on corporate governance proposals that aim to enhance and clarify the standards and provide greater transparency in the Cayman Islands financial services sector.

The survey sought views from the investment funds industry on the current corporate governance standards and practices and the regulatory framework pertaining to the Cayman Islands funds sector. The response was overwhelming, with more than 170 hedge fund managers, investors, directors and various service providers providing feedback, demonstrating that corporate governance practices underpin the viability of the sector.

Given that responses came from a cross section of stakeholders, it is hardly surprising that a wide range of opinions and suggestions emerged regarding the issues under discussion. For instance, although responses indicated that current corporate governance practices warranted improvements, there was no definitive conclusion on whether improvements should come by way of more standards or minor amendments to those currently in place. Further, an integral part of this survey centered on the topic of limits. In general, survey participants thought capacity was an issue for the sector, but were divided on whether implementing a limit would be of value to the investment funds sector. More respondents were in favor of a regulatory standard requiring the number of fund directorships held by a director to be disclosed.

Key highlights of the findings include:

- Directors' expertise/knowledge and independence are at the heart of corporate governance and considered to be the most important elements by those polled.
- Ensuring directors had sufficient time to apply themselves to every board was a concern for a large percentage of stakeholders, even directors.
- Investors are increasingly demanding more information to assess the robustness of corporate governance standards and frequently do not receive their requested information for due diligence purposes in all circumstances.
- While divided on whether setting a limit on directorships held would be beneficial to the fund sector, those in support of a limit were more in favor of a limit based on manager relationships.
- Of those stakeholders who wanted more transparency on the number of directorships held by directors, two-thirds preferred that this be divulged by way of a CIMA-managed database.

A great benefit of conducting this survey is that the compilation of results allows CIMA, and the sector at large, to see the dynamic and diverse opinions of the various stakeholder groups on a collective and segmented basis. The results reveal significant insight on the sentiments of stakeholders and show where commonalities exist or discords lie among them on the various matters polled.

It is CIMA's responsibility to regulate in a manner that meets international standards, taking into consideration diverging views of the investment funds sector and facilitating the continued well-being of this industry. The feedback received from the survey, together with the feedback received from the wider public consultation, will form an integral component of our considerations when finalizing future corporate governance standards and policy.

We are grateful to members of the industry who took advantage of this opportunity to contribute toward shaping the future of the investment funds regulatory framework in a manner that retains the Cayman Islands' position as the leading jurisdiction for investment funds formation.

Cindy Scotland
Managing Director
CIMA

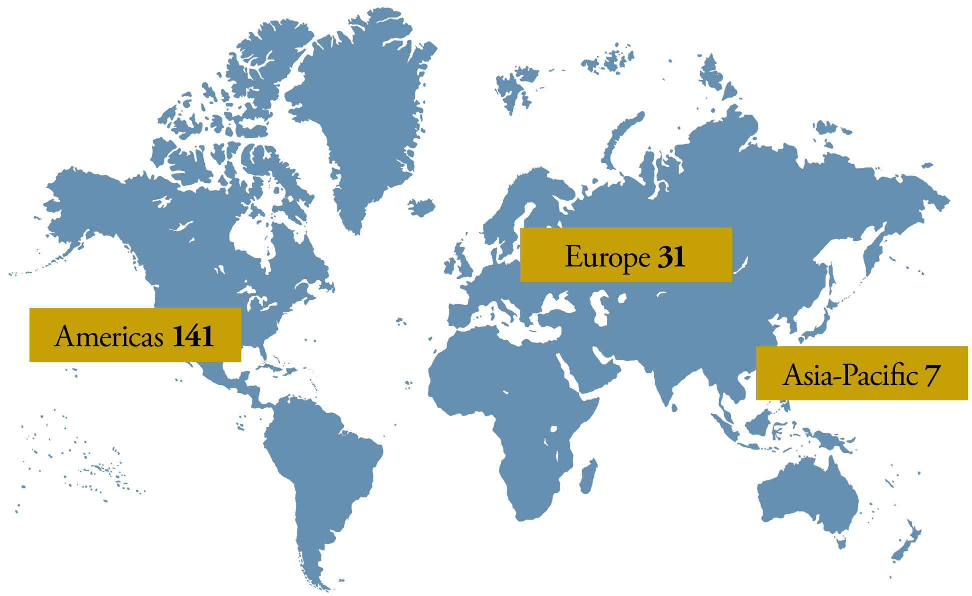
Methodology

Greenwich Associates conducted the survey between January and February 2013 with professionals in North America, the Cayman Islands, Europe and Asia-Pacific. There were 179 respondents to the survey; 143 completed the survey online and 36 by telephone.

The survey was commissioned by the Cayman Islands Monetary Authority to provide stakeholders in the Cayman Islands funds sector with an opportunity to communicate their views on particular aspects of corporate governance practices in the Cayman Islands and to record these insights and opinions. The scope of the survey encompasses the entire range of the diverse stakeholders in the sector, including hedge fund managers, investors, directors and service providers, such as administrators, lawyers, accountants and other business support service professionals.

The results of the survey are segmented in two parts: one detailing responses on corporate governance practices and one detailing responses to questions about limits on directorships.

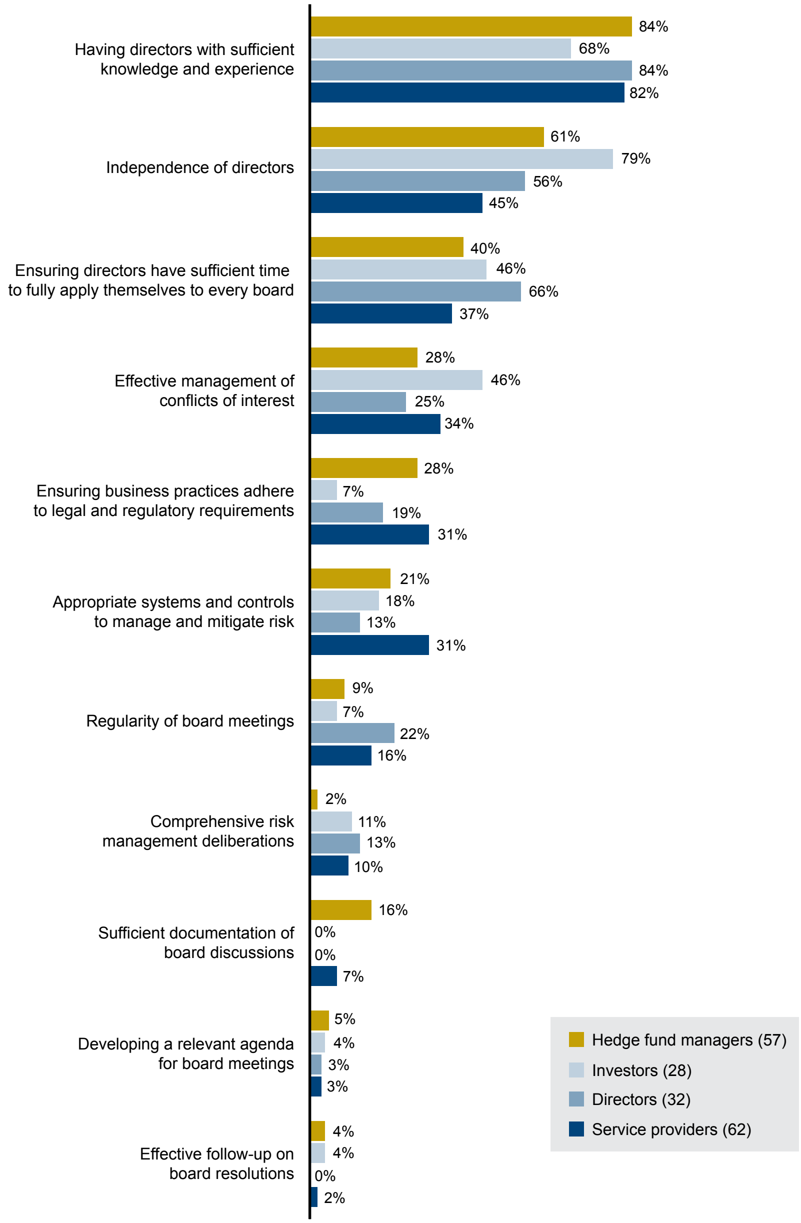
Respondent profile



Key Findings

Corporate Governance Standards

What do you consider to be the three most important elements when you are assessing the corporate governance practices of the board and directors of a Cayman Islands-domiciled fund?



Industry stakeholders are largely aligned on their views of current corporate governance practices

Hedge fund managers, investors, directors and service providers are generally consistent in what they consider to be the most important elements necessary to assess corporate governance practices of the board and directors of a Cayman Islands hedge fund.

Investors place more emphasis on the independence of directors and their ability to manage conflicts of interest compared to other stakeholders.

A greater percentage of directors noted the importance of having sufficient time to adequately dedicate themselves to every board on which they sit.

Director knowledge and independence are seen as key strengths, but director capacity is viewed as a weakness of the sector

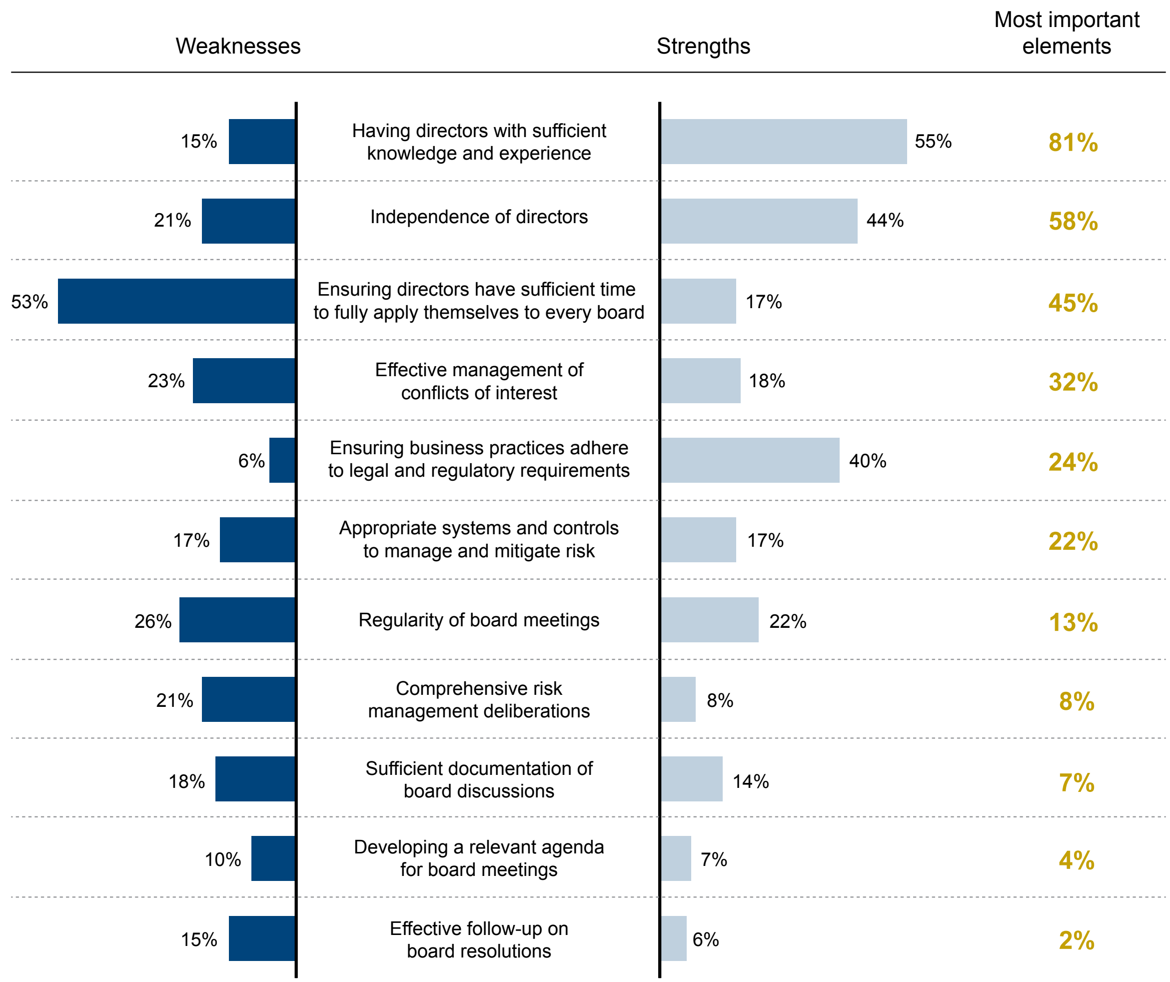
Director knowledge and independence were deemed to be the most important elements and are seen as net strengths of the sector.

Respondents are confident that business practices in the Cayman Islands funds sector adhere to legal and regulatory requirements, though only one-quarter rank it as one of the most important elements.

Director capacity — the third most important element — is perceived to be the sector's biggest weakness.

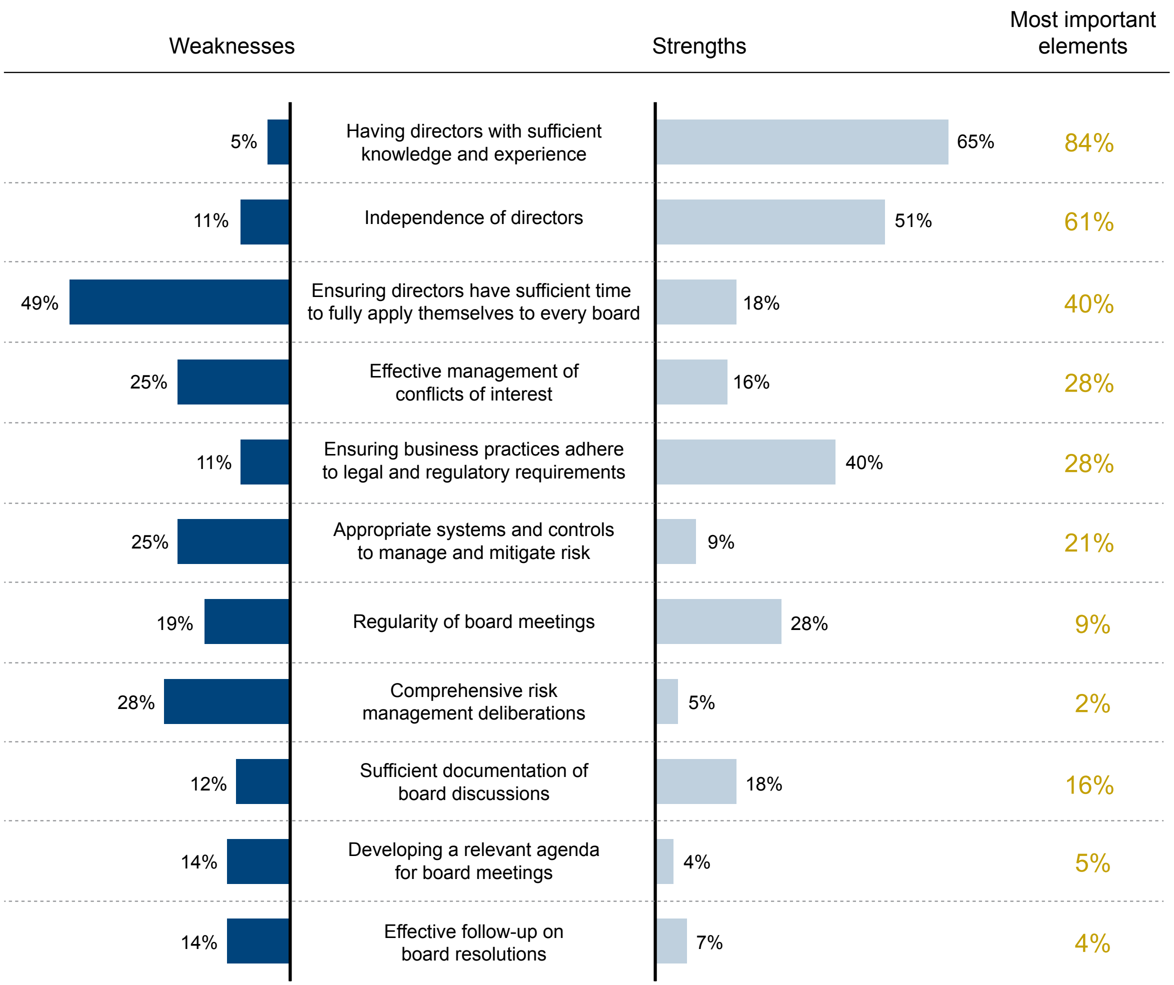
What do you consider to be the three most important elements, top strengths and weaknesses when assessing the corporate governance practices of the board and directors of a Cayman Islands-domiciled fund?

Assessing corporate governance practices — total (179)



What do you consider to be the three most important elements, top strengths and weaknesses when assessing the corporate governance practices of the board and directors of a Cayman Islands-domiciled fund?

Assessing corporate governance practices — hedge fund managers (57)



Hedge fund managers see knowledge and independence of directors as a strength and director capacity as a concern

Having directors with sufficient knowledge and independence are the two most important elements hedge fund managers use to assess corporate governance standards, and at least 50% of hedge fund managers listed them as a strength of the sector.

Hedge fund managers are also confident that business practices in the Cayman Islands adhere to legal and regulatory requirements, though that element is seen as less important than others in assessing corporate governance practices.

Hedge fund managers listed director capacity as the third most important element in assessing the sector's governance practices, yet they see it as the sector's biggest weakness.

Managing conflicts of interest and risk-management policies and deliberations were seen as weaknesses by about one-quarter of hedge fund managers.

Investors are also concerned about director capacity and are split on whether directors' independence is a strength or a weakness

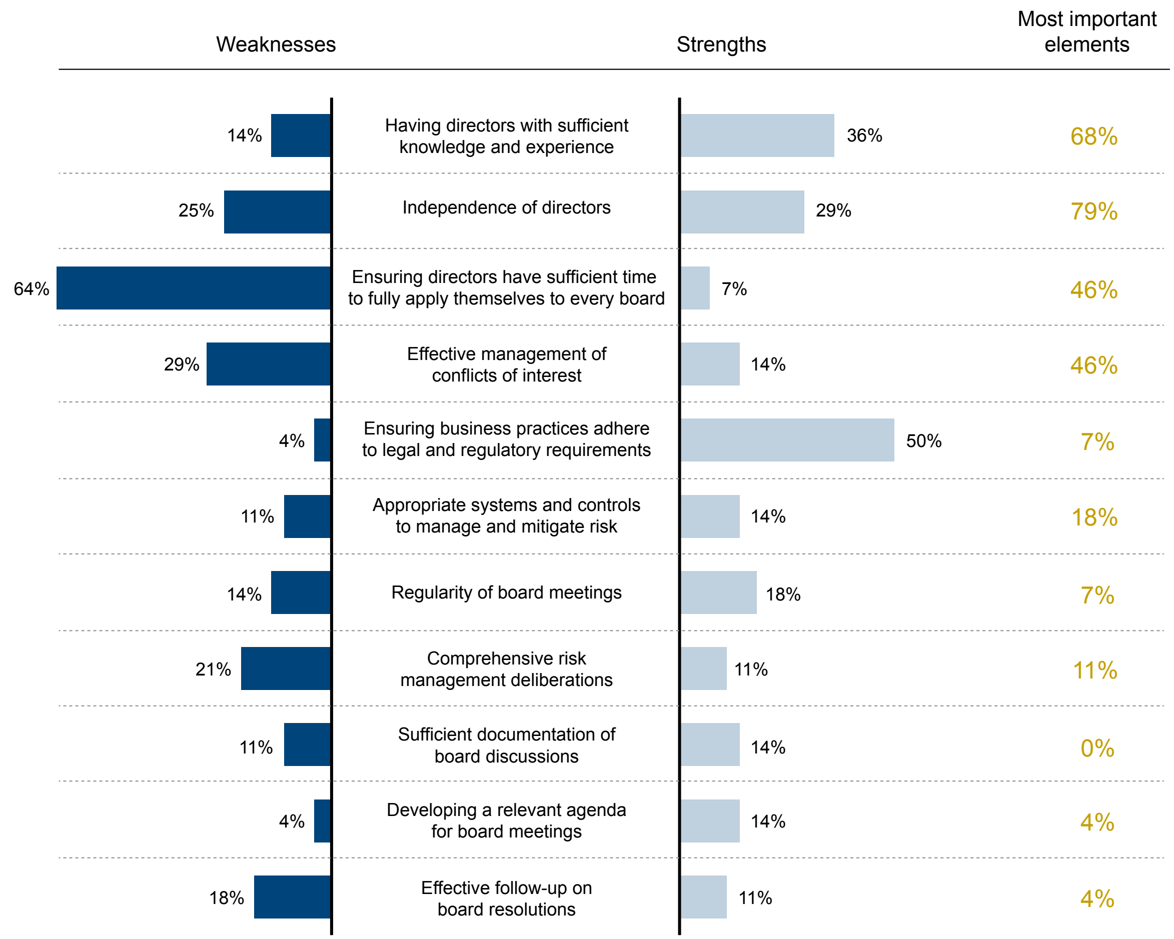
Directors' knowledge and experience is one of the most important elements for investors and is seen as a net strength. Other than that, only ensuring that business practices adhere to legal and regulatory requirements was viewed positively by a significant number of investors (though it was much less important overall).

Director independence is listed as the most important element, although as many investors say it is a weakness of the sector as say it is a strength.

Investors overwhelmingly believe that directors do not have enough time to dedicate themselves fully to each board, and a number also believe that there needs to be more effective management of conflicts of interest.

What do you consider to be the three most important elements, top strengths and weaknesses when assessing the corporate governance practices of the board and directors of a Cayman Islands-domiciled fund?

Assessing corporate governance practices — investors (28)



"There should be more transparency

with respect to the number of directorships (and relationships with managers) and 'independence' qualifications for diretors, which would mitigate conflicts of interest. But the guiding principle should remain investor choice rather than specific rules-based regulations."

— Investor, Americas

"Any statement of best practice or guidance on corporate governance standards should apply to all fund types

including partnerships and trusts that are funds and not just corporate entities. These standards need to address disclosure so that investors can make informed decisions but should not set hard criteria as that would limit flexibility and could make Cayman less attractive for investors."

— Service Provider, Americas

Directors are also concerned about capacity and regularity of board meetings

A majority of directors believe that knowledge and independence of directors are key strengths of the Cayman Islands funds sector.

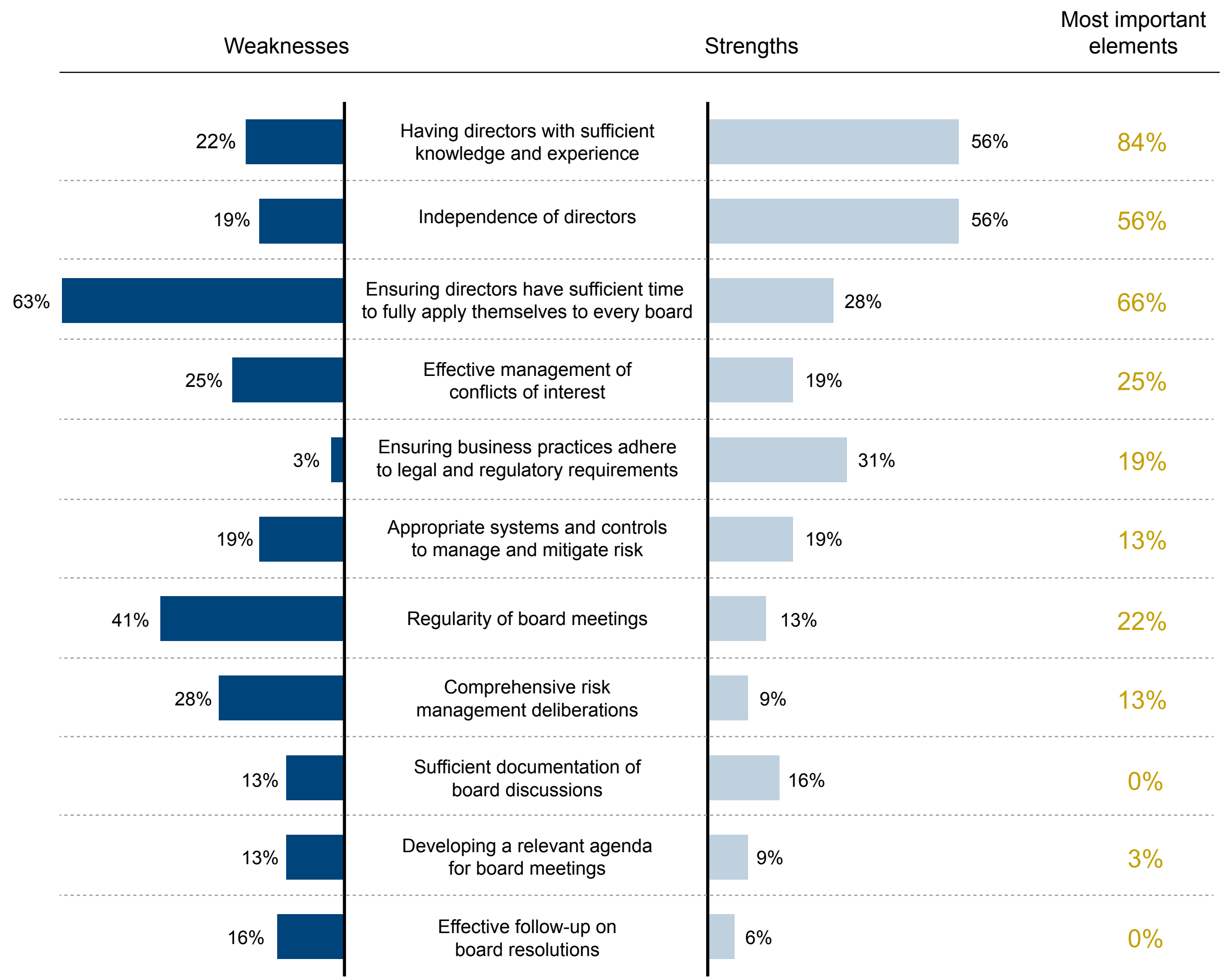
A significant proportion of directors see capacity as a very important element but also view it as the biggest weakness in the sector — in fact, to the same extent as investors do.

Directors see regularity of board meetings as a weakness as well. Overall, this is seen as the second biggest weakness in the sector.

On a net basis, more directors believe that the sector's governance practices may not be effective at managing conflicts of interest than see it as a strength.

What do you consider to be the three most important elements, top strengths and weaknesses when assessing the corporate governance practices of the board and directors of a Cayman Islands-domiciled fund?

Assessing corporate governance practices — directors (32)



What do you consider to be the three most important elements, top strengths and weaknesses when assessing the corporate governance practices of the board and directors of a Cayman Islands-domiciled fund?

Assessing corporate governance practices — service providers (62)

Weaknesses		Strengths	Most important elements
21%	Having directors with sufficient knowledge and experience	55%	82%
31%	Independence of directors	39%	45%
47%	Ensuring directors have sufficient time to fully apply themselves to every board	15%	37%
19%	Effective management of conflicts of interest	21%	34%
5%	Ensuring business practices adhere to legal and regulatory requirements	40%	31%
11%	Appropriate systems and controls to manage and mitigate risk	26%	31%
31%	Regularity of board meetings	23%	16%
10%	Comprehensive risk management deliberations	10%	10%
29%	Sufficient documentation of board discussions	10%	7%
8%	Developing a relevant agenda for board meetings	7%	3%
15%	Effective follow-up on board resolutions	2%	2%

Service providers are also concerned about director capacity, but less so than other sector stakeholders

Service providers view directors' knowledge and experience as the most important element necessary to assess corporate governance standards and view them as a net strength of the sector. No other element was mentioned as being important by more than half of the service providers.

Service providers are also concerned about director capacity, though to a lesser degree than other stakeholders are.

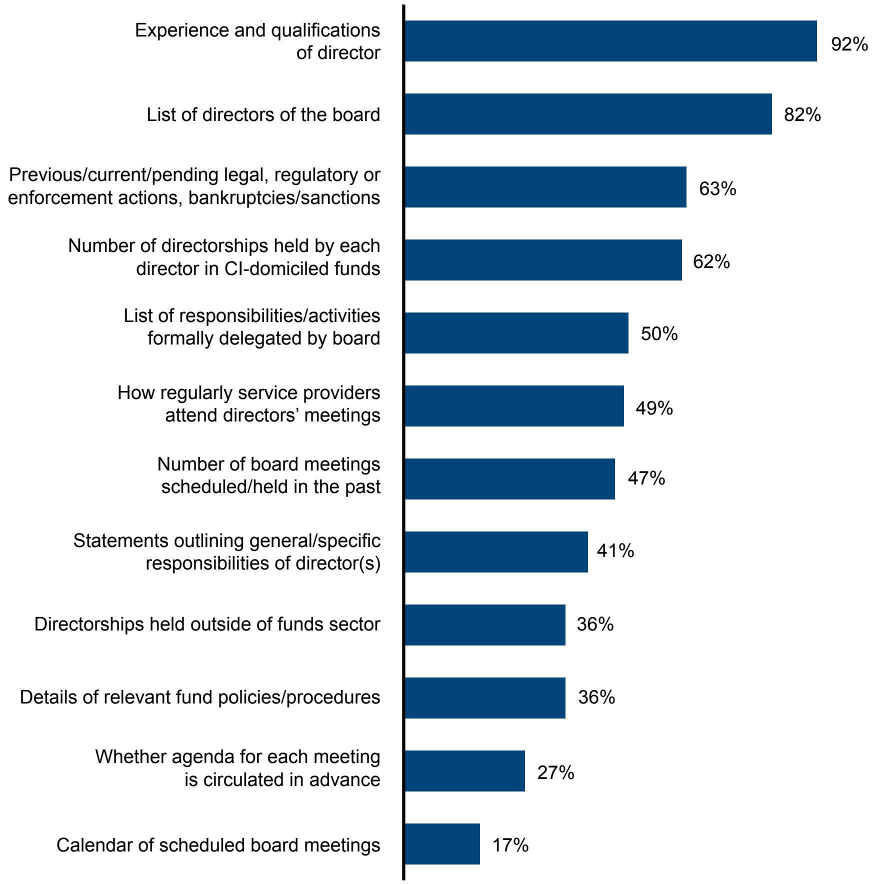
“It is not a situation where one size fits all.

Funds and directors should be transparent and disclose to investors if asked the question. If there is no transparency or the replies are unacceptable to the investor, the investor still has the option to invest or not to invest.”

— Director, Americas

What information is needed to assess the robustness of the corporate governance standards in a Cayman Islands-domiciled fund?

Robustness of corporate governance standards



Total = 179 respondents

Detailed information on the directors is key in assessing corporate governance standards

Almost all respondents want to know who the directors are and their relevant qualifications and experience in order to assess the robustness of corporate governance standards.

Approximately two-thirds of respondents consider information on legal or enforcement actions — whether previous, current or pending — and the number of directorships held by each director as important information for their corporate governance due diligence process.

All four stakeholder groups agree as to what information is needed to assess corporate governance practices

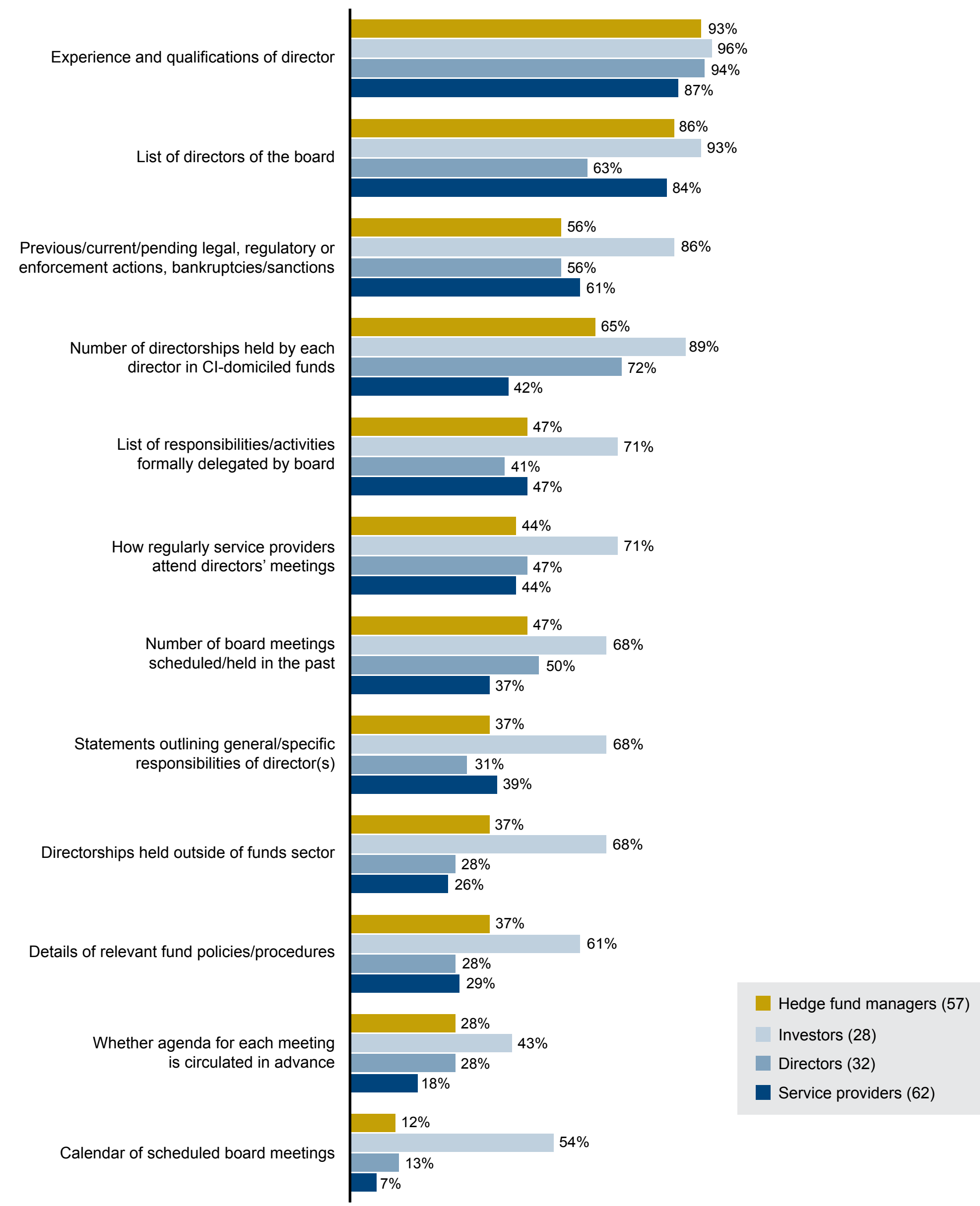
Each segment generally has the same expectations about what information is needed to assess corporate governance practices. However, whereas nearly all investors and hedge fund managers would like a list of directors of the board, only two-thirds of directors believe it is necessary.

Overall, investors are seeking more information across a wider array of issues than managers or directors would suggest is necessary.

And nearly all investors want to know the number of directorships held by each director and any previous, current or pending legal or regulatory actions involving the directors.

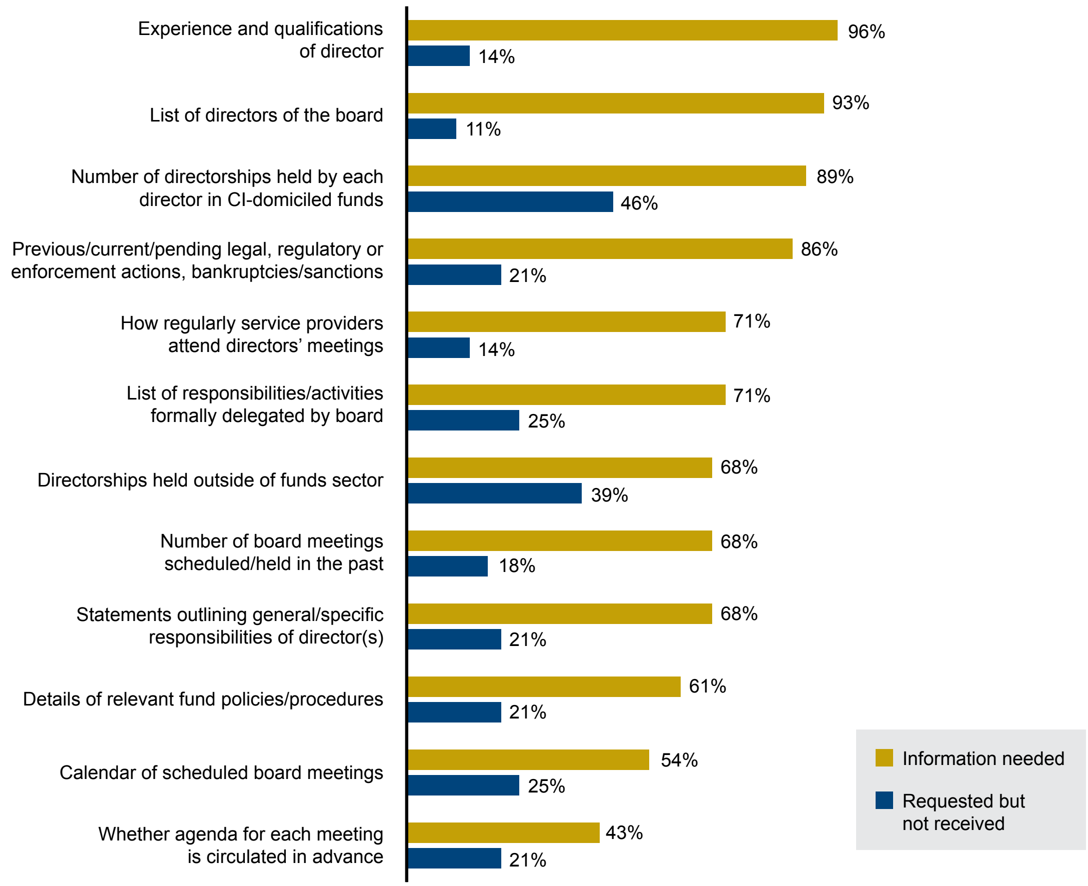
What information is needed to assess the robustness of the corporate governance standards in a Cayman Islands-domiciled fund?

Assessing robustness of corporate governance standards



What information is needed to assess the robustness of the corporate governance standards in a Cayman Islands-domiciled fund? As an investor, when assessing the robustness of the corporate governance standards of Cayman Islands-domiciled funds, what information do you request and not receive?

Assessing robustness of corporate governance standards — investors (28)*



* Second question asked of investors only

Half of investors do not receive requested information regarding number of directorships held

Though investors request a wide range of information, they also receive most of it.

However, nearly half of investors do not receive information on the number of directorships held by each director, which may lead to questions about director independence, conflicts of interest, and their capacity to dedicate themselves to each board.

Hedge fund managers are more confident about current corporate governance practices than are investors, directors and service providers

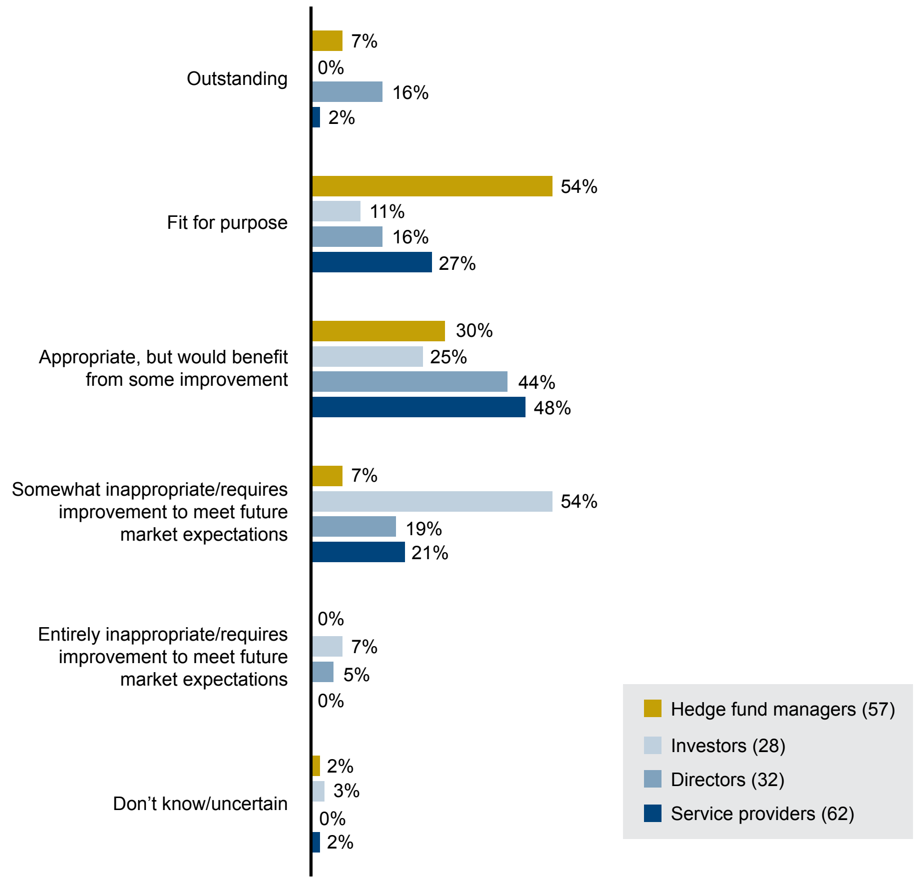
Nearly two-thirds of hedge fund managers think that corporate governance practices in the sector are fit for purpose.

Investors seem to be more cautious; more than 80% believe that corporate governance practices could benefit from improvement, with half saying that they are at least somewhat inappropriate.

Furthermore, two in three directors and service providers recognize room for improvement.

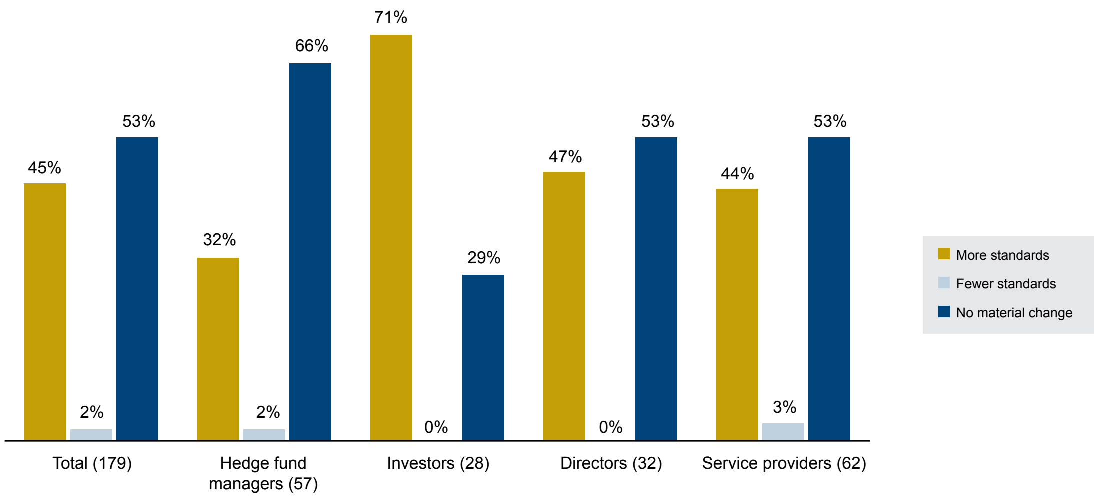
Relative to your expectations and objectives, do you consider the corporate governance practices of the Cayman Islands funds sector to be:

View of corporate governance practices



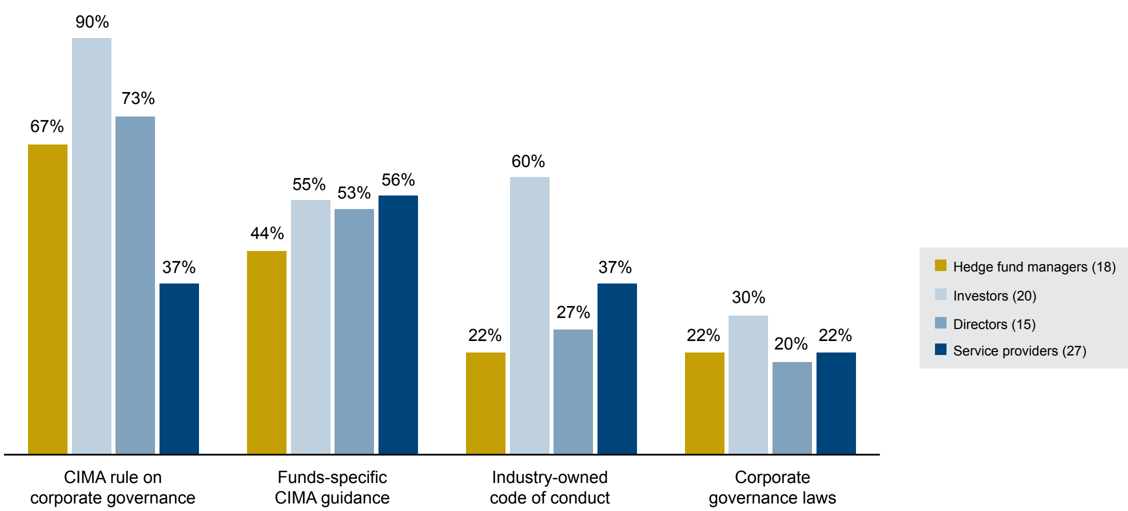
Do you believe the Cayman Islands funds sector requires more, fewer or no material changes to current corporate governance regulatory standards?

View on change in governance standards



If you support more standards, what type of standards would benefit the Cayman Islands funds sector the most?

Type of standards desired



On balance, investors want more standards while hedge fund managers do not. Directors and service providers are split.

As investors are the most adamant that corporate governance standards are not fit for purpose, they are also the group pressing the most for more standards.

Hedge fund managers, on the other hand, are more confident that current standards are sufficient, and only one-third think that there should be an increase.

Directors and service providers are split 50/50 on the need for more standards.

There is general agreement that standards should come in the form of a CIMA rule or fund-specific CIMA guidance. However, a significant number of investors would also support an industry-owned code of conduct.

Independence is driving desired minimum standards

Among those that support minimum standards, a majority of respondents in each segment favor minimum standards on independence.

Investors tend to favor more minimum standards than other types of respondents.

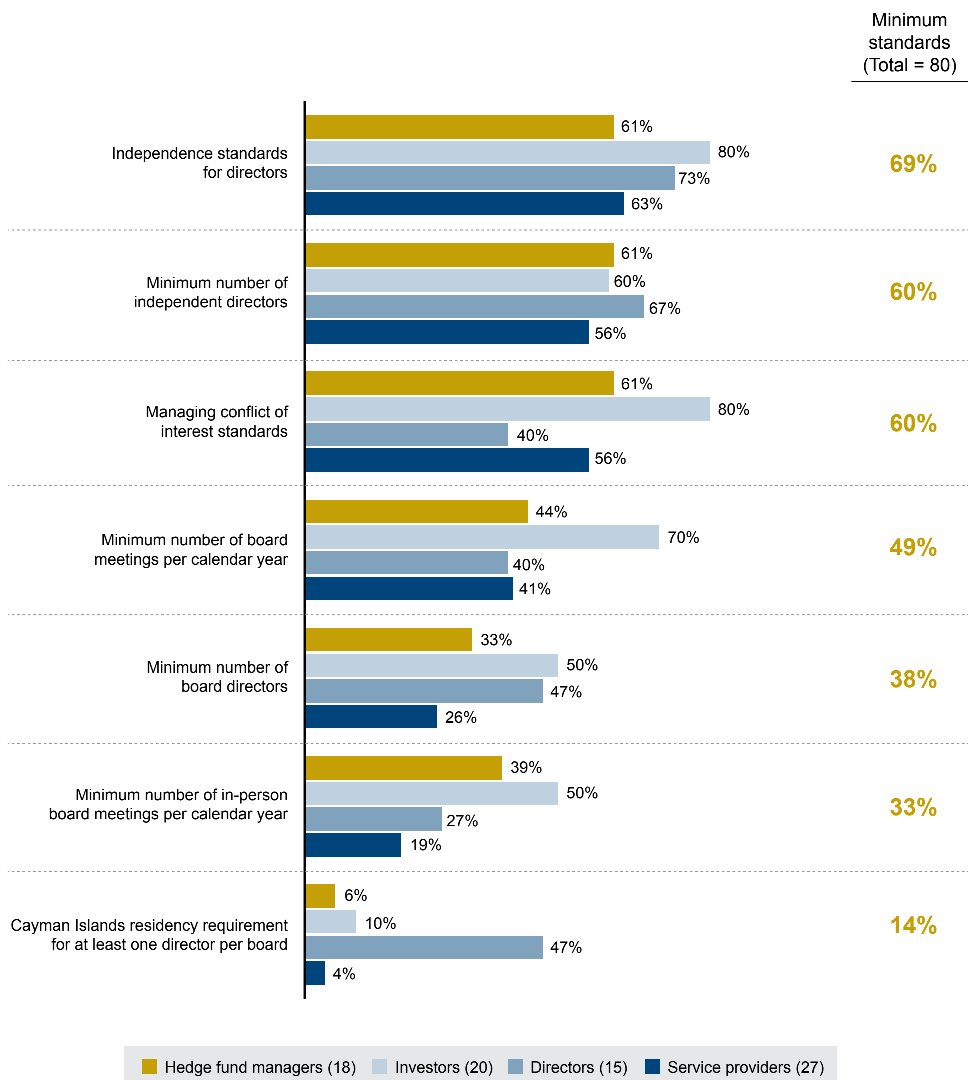
Four out of five investors and a majority of managers and service providers favor standards to help manage conflicts of interest. Fewer directors favor such standards.

A large majority of investors would also like to see standards set for the minimum number of board meetings per year.

Though directors also think capacity is an issue for the sector, nearly half still want a Cayman Islands-residency requirement for at least one director per board.

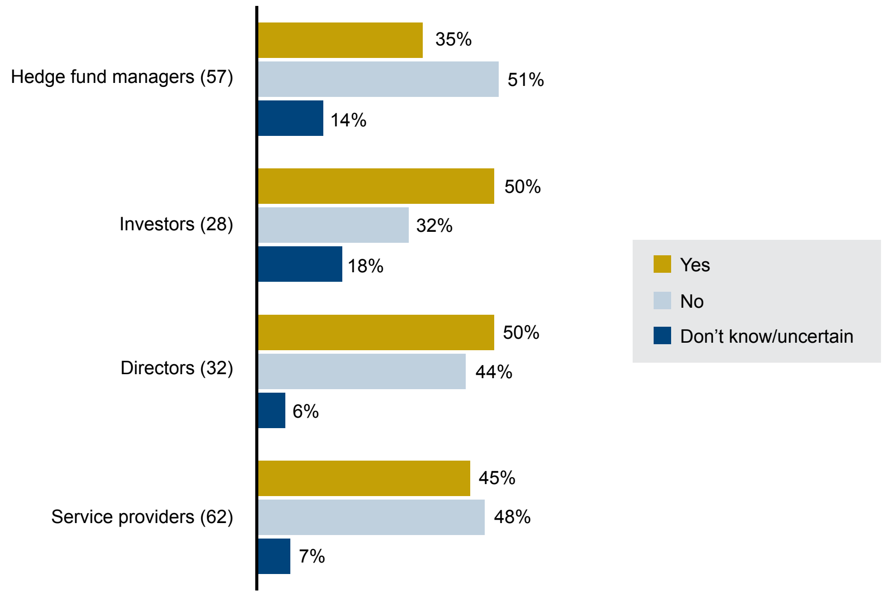
If you support more standards, what minimum standards would benefit the Cayman Islands-domiciled funds sector?

Minimum standards to benefit Cayman Islands-domiciled funds sector



When considering the independence of a director, is it important to implement regulatory standards requiring a director to hold positions for more than one manager, or that no more than 50% of their revenue relate to one manager (25% when the services are provided by a company) or to implement an "independence" standard similar to this?

Important to implement regulatory standards regarding director positions held



There does not seem to be a clear consensus as to whether there should be standards on how much of a director's income relates to one manager

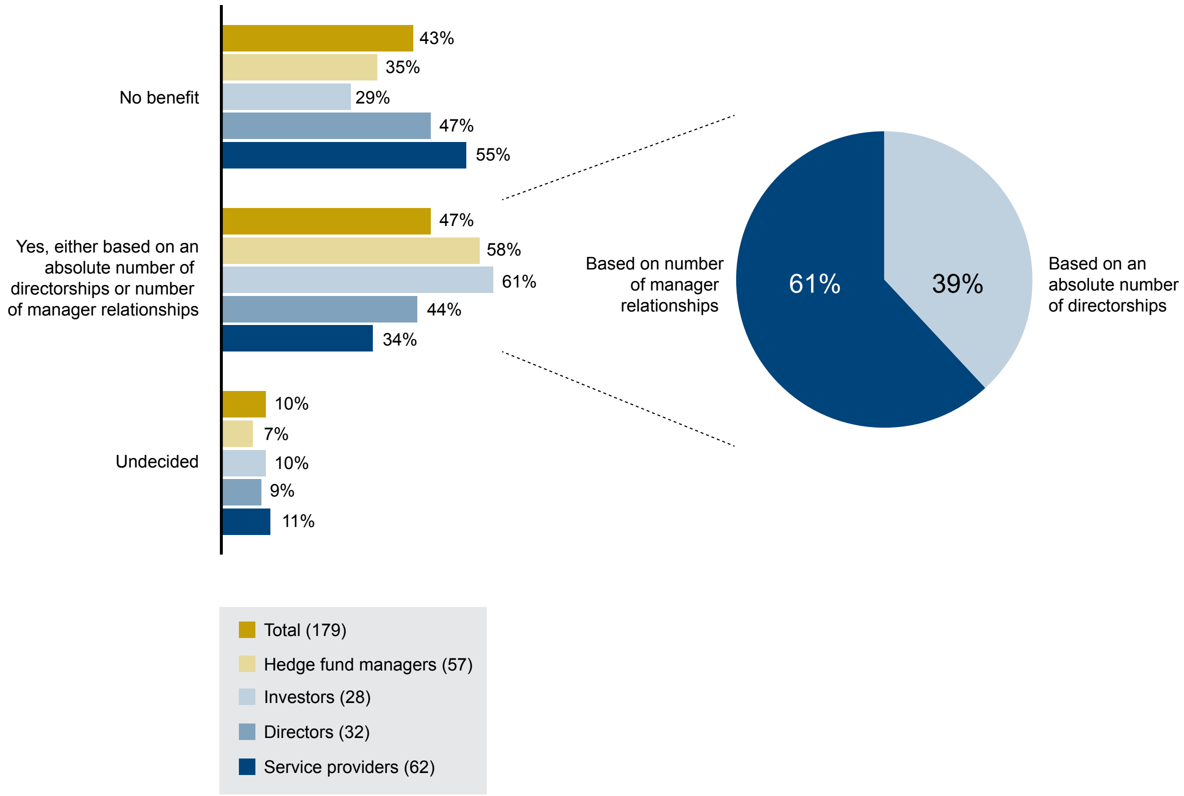
Respondents are evenly split between whether there should or should not be regulatory standards around requiring that a maximum of 50% of a director's revenue relates to one manager.

Investors tend to be modestly more in favor of such a regulation while hedge fund managers are modestly opposed. Service providers are evenly split.

Limit on Directorships Held

Would a limit on the number of directorships held (whether based on an absolute number or number of manager relationships) by a director in the Cayman Islands funds benefit the Cayman Islands funds sector?

Impact of limit on number of directorships held



Managers and investors believe a limit on the number of directorships held would benefit the sector

About half of the respondents believe that a limit on the number of directorships held would benefit the sector, including about 60% of hedge fund managers and investors.

For those stakeholders who think a limit would be beneficial, more think that limit should be based on manager relationships rather than the number of directorships held. Hedge fund managers typically prefer this limit to be driven by the number of manager relationships, while investors are evenly split.

Directors are more evenly split, with the same number of directors opposing a limit as supporting one.

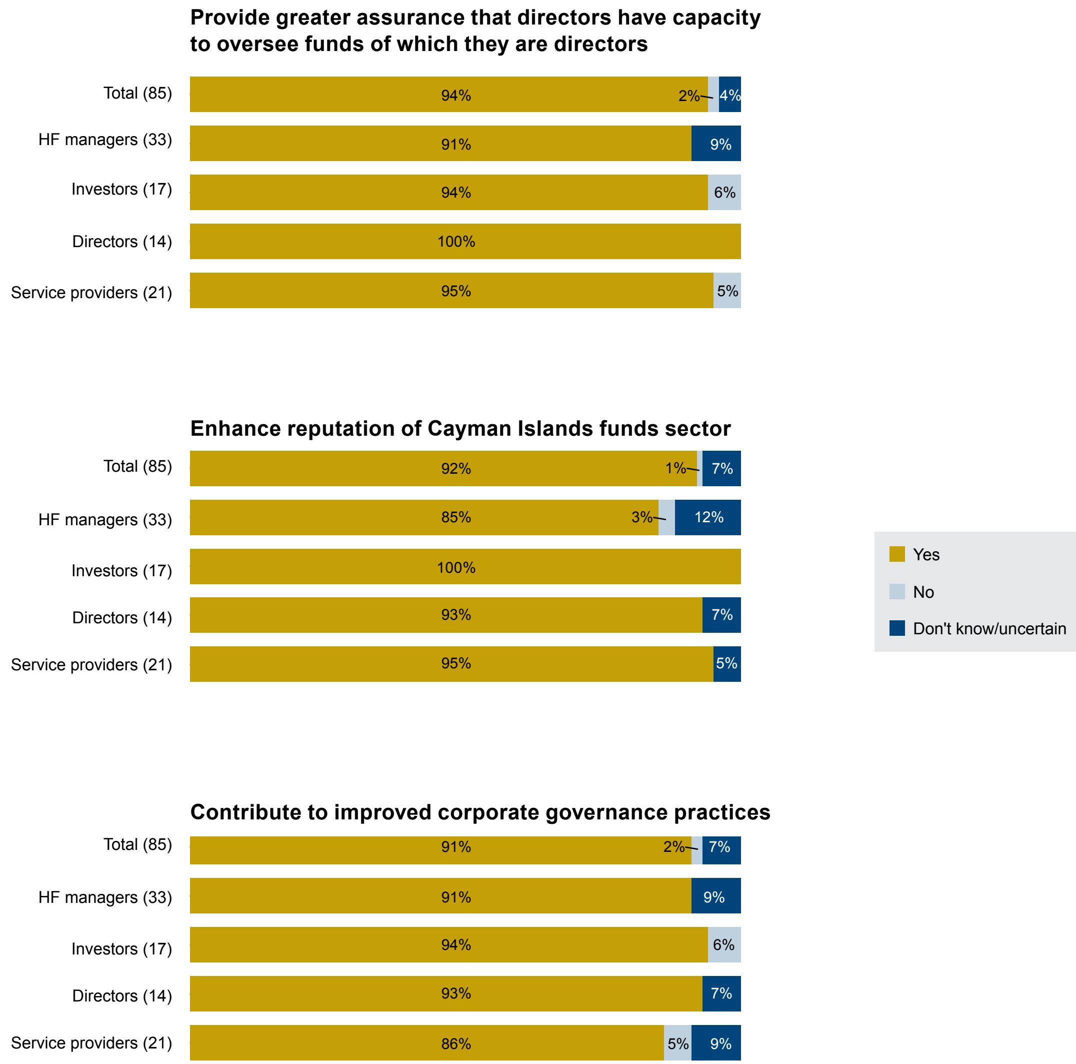
The majority of service providers, however, do not feel that a limit would benefit the sector.

Limits are seen as a means to ensure sufficient director capacity and improve the reputation of the sector …

Of those that agree there should be a limit, nearly all respondents believe that limits on the number of directorships would have three main benefits: ensuring sufficient director capacity, enhancing the reputation of the sector and improving corporate governance practices.

If you support a limit, do you think a limit on directorships (whether based on an absolute number or number of manager relationships) in Cayman Islands funds would have one or more of the following effects on the Cayman Islands funds sector?

Effects of limits on number of directorships held



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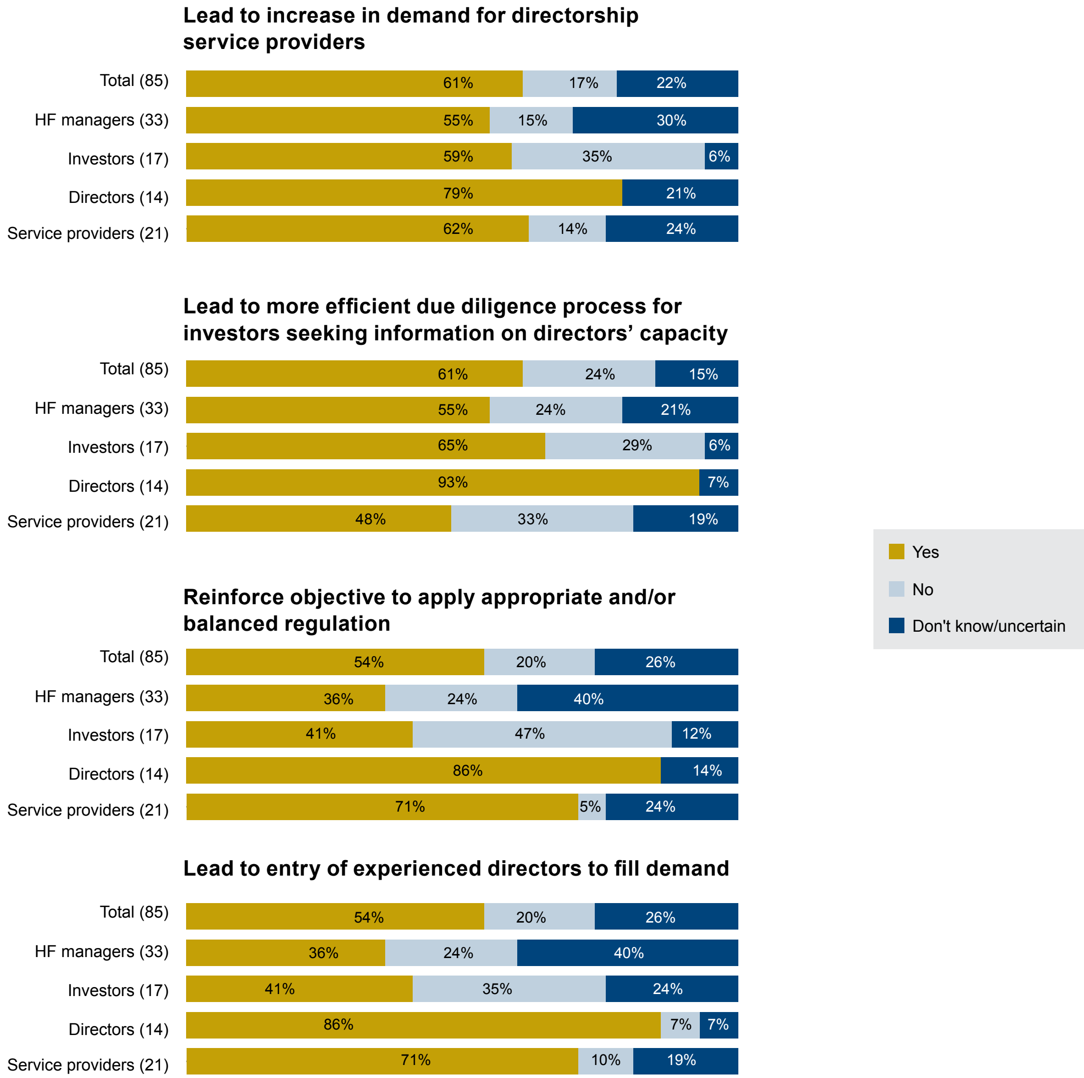
Effects of limits on number of directorships held



… and a majority of respondents see additional benefits of limits on directorships

A smaller majority of respondents point to a number of additional benefits of a limit on directorships.

Interestingly, most expect an increase in demand for directorship service providers, yet there is clearly some uncertainty among hedge fund managers and investors that increased demand would lead to the entry of additional experienced directors.

Directors and service providers believe that limits will reinforce the objective to apply appropriate and balanced regulation, and directors believe they will make due diligence on director capacity more efficient.

Perceptions of limits vary across stakeholder groups

There is little conformity in views on what limits are reasonable.

Among those respondents who felt a limit should be based on the number of manager relationships, hedge fund managers tend to cluster around lower ranges than do other types of respondents, with 70% supporting a limit of fewer than 20.

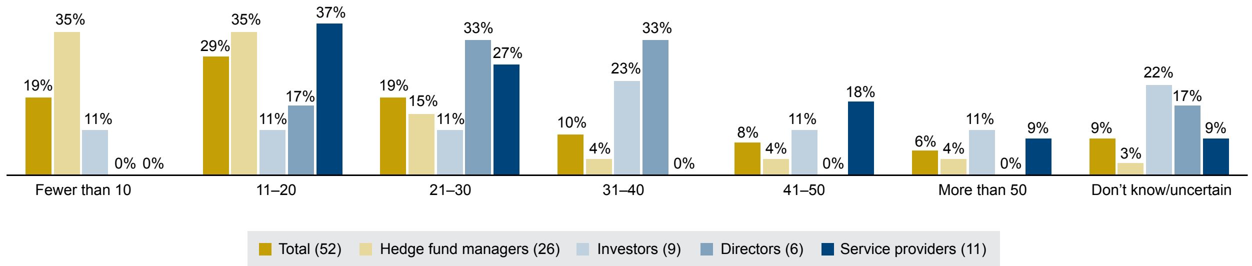
Directors cluster between limits of 20 and 40 manager relationships, service providers between 11 and 30, and investor responses are more diverse.

Of the respondents who supported a limit based on the number of directorships, investors seem to support lower limits than other types of respondents, with 75% stating that they'd like to see it set at fewer than 25.

Hedge fund managers tend to prefer a higher limit (26–50) of directorships.

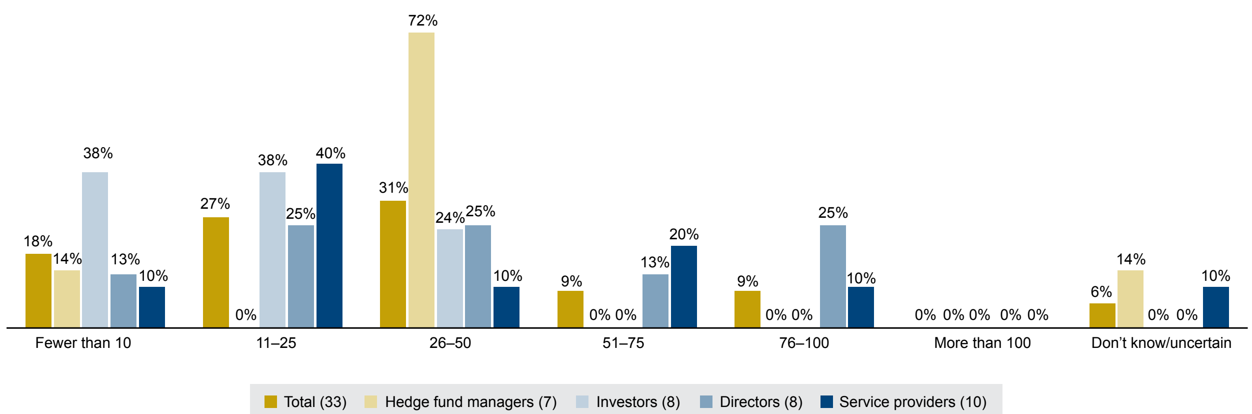
If you support a limit based on number of manager relationships, what do you consider to be a reasonable limit?

Reasonable limit on number of manager relationships



If you support a limit based on an absolute number, what do you consider to be a reasonable limit?

Reasonable limit on number of manager relationships



"The investors' perception of the directorship industry will improve.

Transparency will improve as well. It will also address investors' concerns about the ability of directors to properly fulfill their duties and protect investors' interests if they sit on too many boards."

— Hedge Fund Manager, Europe

"Transparency will be better over hard limits.

No two hedge funds are alike and investors and managers simply need enough information to ask informed questions and make informed decisions. The use of corporate directorships to get around any transparency requirements would be a massive step backwards and would further support the criticism of Cayman directors not adding any substantive value to hedge funds."

— Investor, Americas

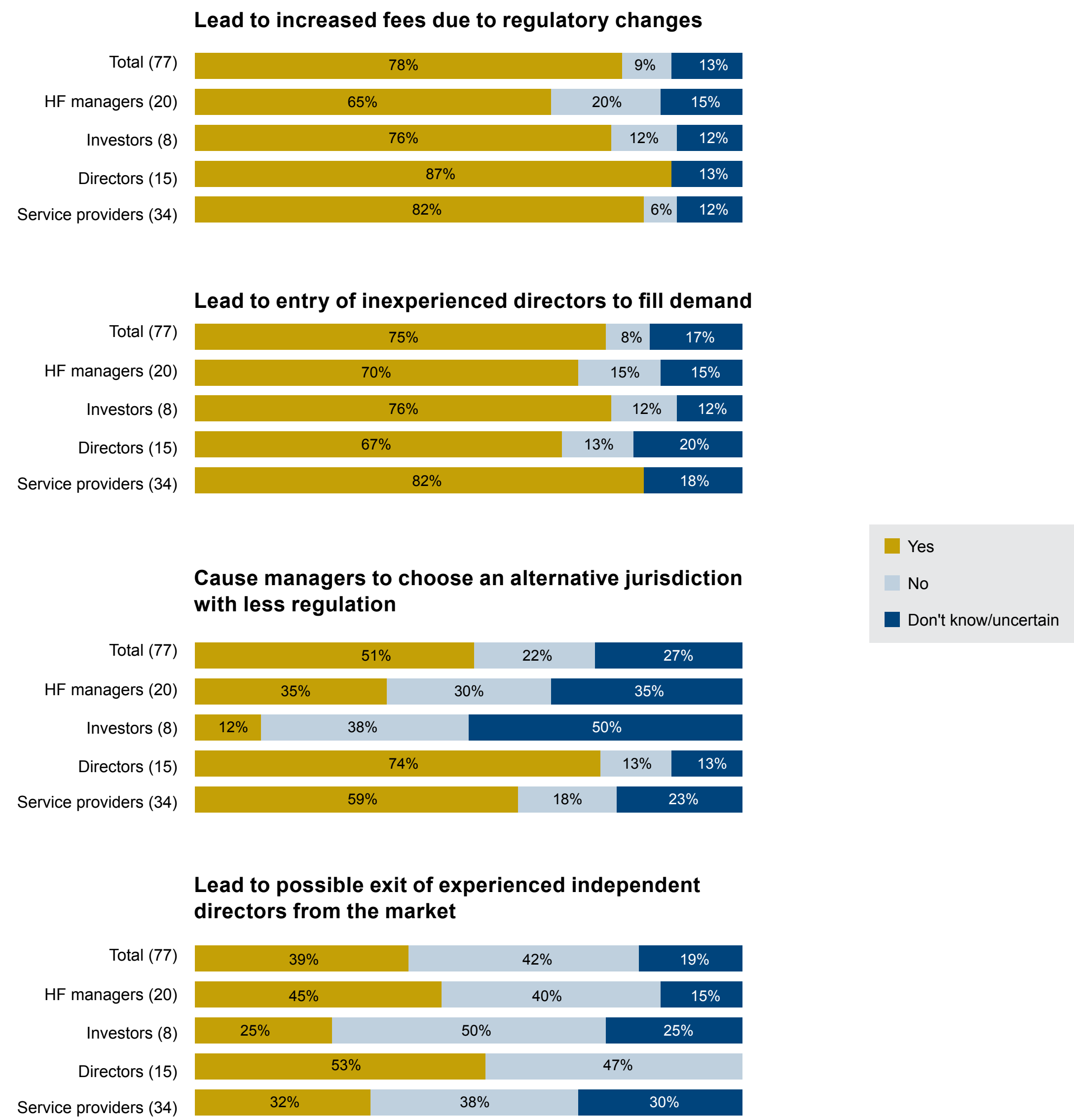
For those who oppose limits, increased fees and entry of inexperienced directors are the biggest concerns

Hedge fund managers, investors and directors overwhelmingly believe that limits on the number of directorships would increase fees and lead to inexperienced directors entering the sector.

There is a split among hedge fund managers as to whether limits would cause them to choose alternative jurisdictions, but this is a significant concern for directors.

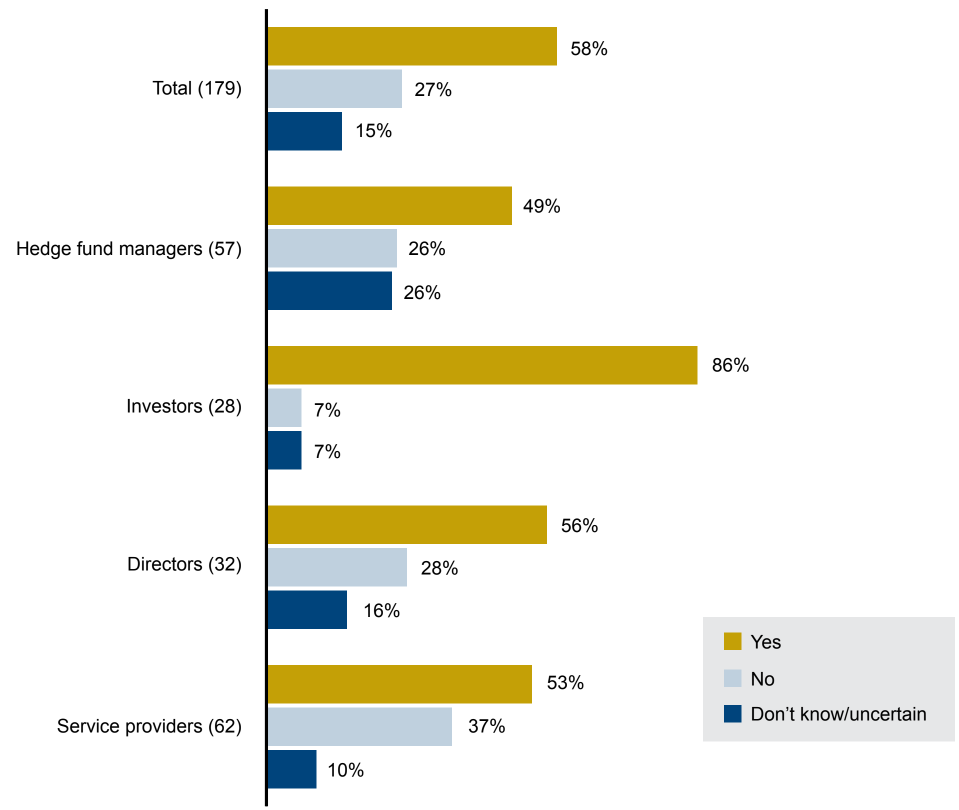
If you do not support a limit, do you think a limit on directorships in Cayman Islands funds would have one or more of the following effects on the Cayman Islands funds sector?

Negative effects of limits on number of directorships held



Would the Cayman Islands funds sector benefit from having a regulatory standard or requirement compelling funds to divulge to investors the number of fund directorships held by their directors?

Regulatory standard or requirement to divulge number of directorships



Most are in favor of a requirement to divulge the number of fund directorships held

Approximately half of hedge fund managers and directors support a requirement to divulge the number of directorships held by a fund's directors. However, a quarter are still against such a proposal.

As director capacity is investors' number one concern, almost all support a requirement to divulge the number of directorships held.

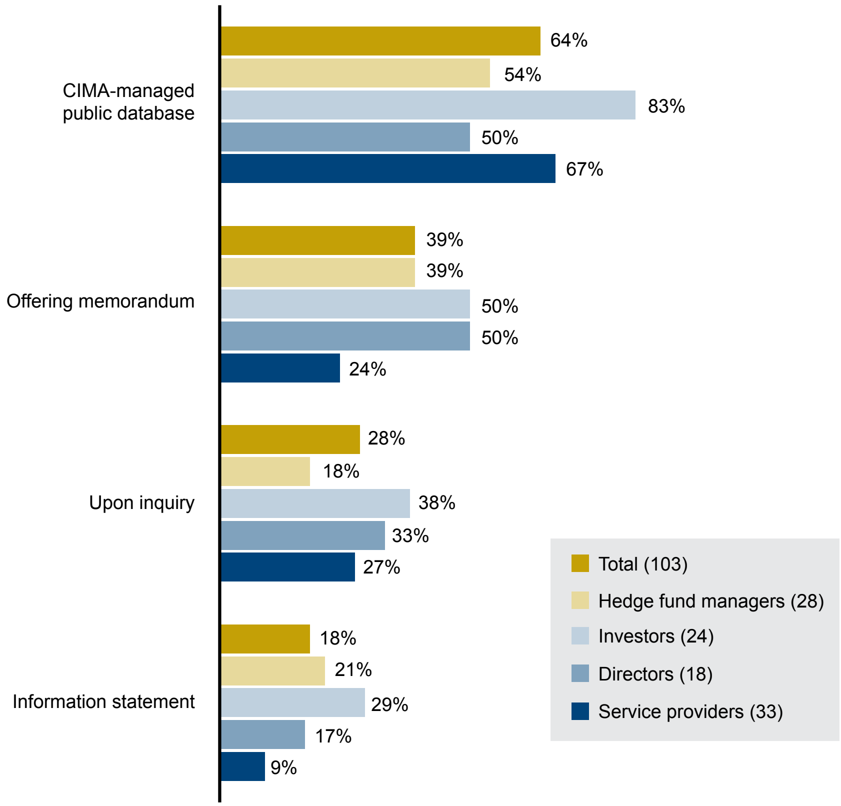
“I would want the number of directorships made public

and let the investors decide on the number they are comfortable with. I believe CIMA should regulate (require) relevant transparency and then let the market decide on any limit.”

— Administrator, Americas

If you agree that the number of directorships held should be divulged, what do you consider to be the most effective and efficient method of communicating this information?

Methods of communication



A CIMA-managed database is the preferred method of communicating

Most stakeholders who think the number of directorships should be divulged want the information to be stored in a CIMA-managed database.

However, a smaller, but nevertheless significant, number of respondents cited an offering memorandum, upon inquiry, and an information statement as acceptable ways to communicate this information.

There is no clear consensus on whether notification of changes needs to be legally mandated

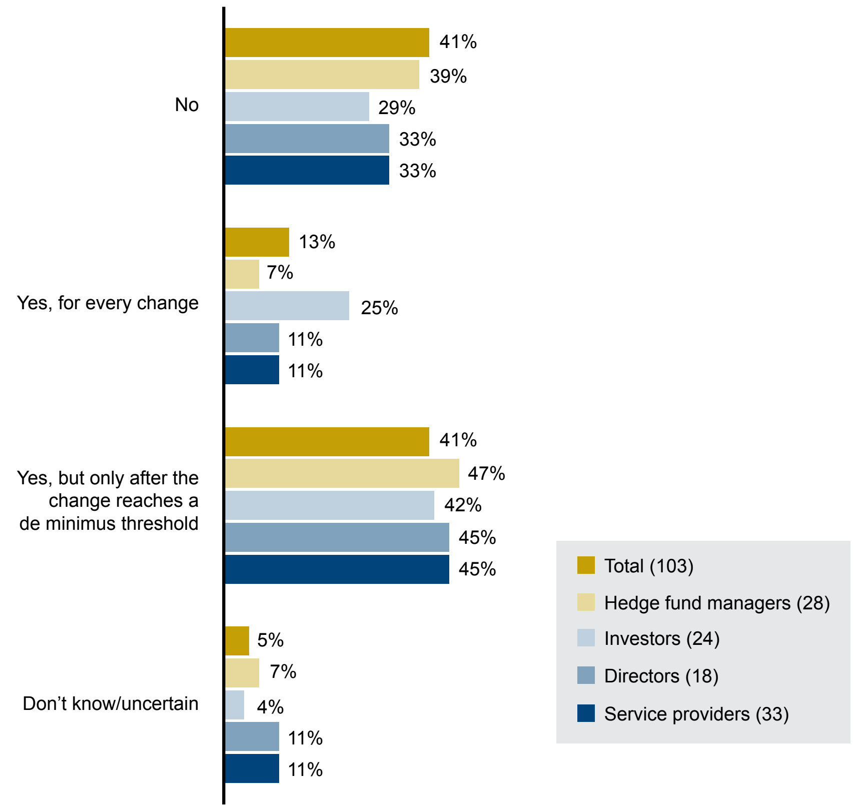
A slightly larger proportion of respondents favor notification, though 40% still oppose such a requirement.

For those who support notification, most believe that notification should only come when the change reaches a de minimis threshold (generally 5—10).

Investors want to be updated more frequently, with one-quarter supporting notifications after every change.

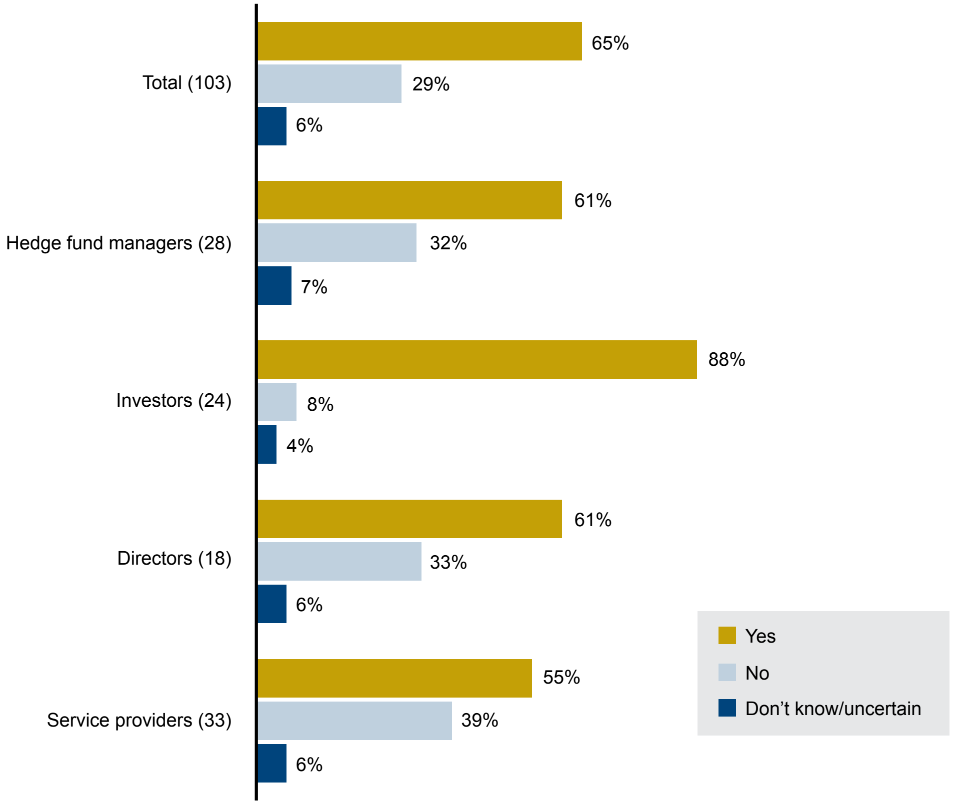
If you support divulging the number of directorships, and if the number of directorships were communicated in the offering memorandum and the stipulated number of directorships changes, do you think this change should be accepted as a change that materially affects the information in the offering memorandum, thereby activating a legal requirement in the Mutual Funds Law to report the change to CIMA within 21 days?

Change in number of directorships reported to CIMA



If you support divulging the number of directorships held, do you think there should be a periodic update to investors on the total number of directorships held?

Periodic updates to investors on number of directorships



Most respondents, however, favor routine updates

More respondents favor a periodic update on the number of directorships held by a fund's directors rather than notification based on changes.

Investors are overwhelmingly in favor of this requirement. Hedge fund managers and directors generally support this as well, though to a lesser extent.

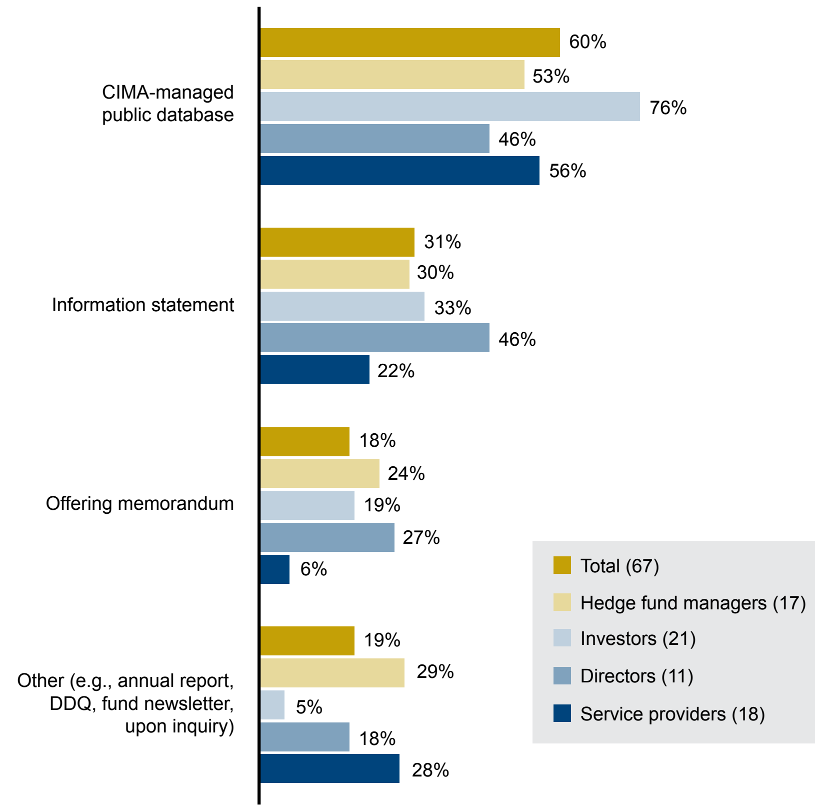
There is a clear preference for a CIMA-managed database for periodic updates

A majority of respondents who support periodic updates favor a CIMA-managed public database providing updates from funds on the number of directorships held by their directors.

Fewer prefer the updates in the form of an information statement, an offering memorandum or other form.

If you support periodic updates, in what form should the update be provided?

Methods of communication



“It is important to have the information available.

As directors are registered with CIMA with each new fund registration, a CIMA database could be configured to update automatically. There should be a requirement of each director to check and confirm the accuracy of his or her entries at least annually. Directors’ on-line biographies should also show the number, as these are more easily updated.”

— Director, Americas

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