GAIM Ops
Cayman 2013

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Moving on from the global financial crisis, the Cayman Islands hedge fund industry is in excellent shape, as evidenced by the overwhelming response to this year's GAIM Ops Cayman 2013 conference, held at the Ritz Carlton. Given a record attendance with over 600 delegates, GAIM Ops Cayman 2013 was one of the largest conferences ever held in the Cayman Islands.

At such a crucial period for the industry, amidst waves of regulation from all corners of the globe, managers, chief operating officers, investors, attorneys, directors and a host of other service providers came together to discuss the key issues facing the sector.

Among the dominant themes were how hedge funds can handle the vast amounts of data coming from all directions, while on the regulatory front the number one topic was the impact of AIFMD and the consensus was that we are only now beginning to see just how widespread its impact will be. Other regulatory concerns surrounded being ready for FATCA and what to expect when the SEC come calling.

Above all, GAIM Ops Cayman is focused on operations and due diligence and there was plenty of insight into how the related risks should be approached. With a combination of speaker roundtables, private luncheons, the charity night and other special events, it truly was a memorable conference, that helped facilitate meaningful conversations between industry peers and advisors.

Deloitte, UBS and Walkers, the event partners of GAIM Ops Cayman, have produced this memento of the conference in order to capture some more of the key themes and we look forward to seeing you again next year.

Ingrid Pierce
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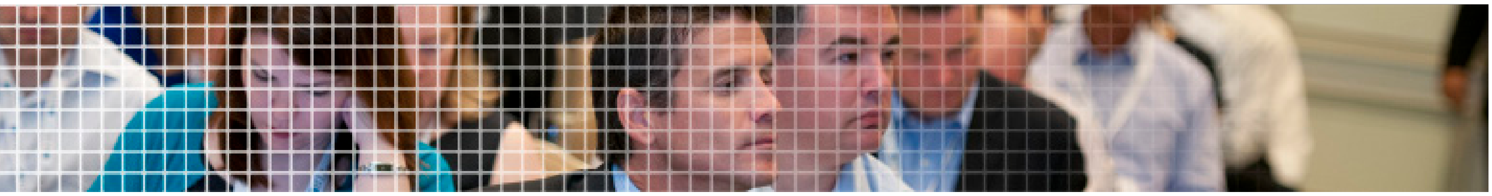


Perspectives on Governance in the New Regulatory Landscape

The keynote presentation on the opening day of GAIM Ops Cayman 2013 from Daniel Dashiell, Director Legal & Compliance at Blackrock, focused on the guidance that regulators should offer amid the waves of regulation impacting the hedge fund industry.

Corporate governance is right at the top of the hedge fund agenda, as the industry continues to evaluate the fallout from the Weavering scandal, while Cayman's regulator, the Cayman Islands Monetary Authority (CIMA), undertakes a wide-ranging consultation period on corporate governance standards.

Principles-based guidance on corporate governance should be given by regulators instead of binding rules, stated Daniel Dashiell, Director Legal & Compliance at Blackrock, in addition to encouraging greater transparency.

Numerous regulators around the world have taken notice of institutional investors' concerns regarding governance, in particular the number of boards that directors sit on and the level of expertise that some bring to the table. This has resulted in a number of papers published on the subject and Mr Dashiell said this is a great opportunity for hedge funds to address the image problem they have both with regulators and the public.

"Hedge fund clients do not just want good performance but they also want good governance," Mr. Dashiell told delegates on the opening day of GAIM Ops Cayman 2013. He said this was a good chance for funds to re-evaluate their historical values by updating governance standards. "Poor governance gives a reason for prospective investors not to invest with a prospective manager," he added.

The CIMA initiative on corporate governance is expected by some observers to include a potential online database of hedge fund directors. More transparency among Cayman directors is to be welcomed, according to Mr. Dashiell, adding that a centrally maintained database would help in regard to investor due diligence and transparency. Questions remain, however, in the area of whether such a database would list directors on a fund-by-fund basis or an all-encompassing list of the funds directors serve.

"Good governance is not an option but is a necessity in order for the hedge fund industry to grow," Mr. Dashiell said. "Our investors and regulators expect it."

In terms of the regulatory landscape currently in the process of being implemented, Mr. Dashiell commented that we are only just now seeing how wide ranging an impact that the AIFM Directive will have, adding that European investors will clearly expect enhanced disclosure.

Running through best practice proposals, Mr. Dashiell said there are no shortages of them, including the presence of independent directors, each with a range of expertise, such as administration and knowledge on the legal side. "One size does not fit all and both large and small funds can learn from each other, as each have their own challenges," he said. ■

What is New with the AIFMD

Jiri Krol – Director of Government and Regulatory Affairs, Alternative Investment Management Association (AIMA)

With its looming implementation deadline, Jiri Krol Director of Government and Regulatory Affairs at AIMA, updated us with the state of play and key implementation issues for the Alternative Investment Fund Managers Directive (AIFMD).

AIFMD is not a self-executing legislation; therefore, each European Union (EU) Member State must transpose AIFMD to its respective national law by July 22, 2013. It is expected that certain jurisdictions may be delayed in the completion of the transposition but key Alternative Investment Fund (AIF) and Alternative Investment Fund Manager (AIFM) jurisdictions should be more or less on time.

Given that AIFMD has a dual regime for marketing of AIFs, either into individual EU Member States through the national private placement or into all EU Member States through the EU-wide "passport", the AIFMD transposition of each Member State is being monitored by investors and fund managers.

The national private placement regime is one of the routes to market funds in the EU. However, it is an optional regime and not all EU Member States will have this regime available and each Member State has the ability to add local requirements. Although AIFMD's most significant point is to harmonise regulatory framework, under the national private placement regime, only the regulatory reporting requirements, marketing, investor disclosure requirements and annual reporting are harmonised. The rest of the requirements may diverge.

Cooperation arrangements

For a non-EU AIFM to market its AIF in any EU Member State, cooperation arrangements with respect to sharing of information must be in place between the regulators of the EU Member State and of the non-EU AIFM. If the AIF being marketed in the EU is a non-EU AIF, e.g. a Cayman fund, there should also be a cooperation arrangement entered into by the Cayman Islands Monetary Authority, on behalf of the Cayman Islands government and the regulators of each EU Member State through the European Securities and Markets Authority (ESMA).

Delegation

AIFMD allows the delegation of certain responsibilities of the AIFM, provided that certain conditions are met, one of which is the letter-box entity rule. EU Member State regulators will be assessing the AIFM delegation arrangements, including the substance of such delegation. The AIFM may not delegate its functions to the extent that the AIFM becomes a letter-box entity and no longer operates as the manager of the AIF.

Marketing

Upon the directive's implementation on July 22, 2013, there will be three ways to market funds in the EU – (1) reverse solicitation

route (i.e. passive marketing, or marketing at the initiative of the investor); (2) private placement route; or (3) full establishment of an EU AIFM that will give the AIFM the passport and full rights and delegation under the directive. Later on in 2015, the 3rd country passport will be available for non-EU AIFMs.
Reverse solicitation would generally not be caught by the AIFMD, as such, AIFMs marketing AIFs in the EU through reverse solicitation are not required to comply with AIFMD. However, clarity is needed as to the scope of reverse solicitation, i.e. when reverse solicitation ends, and active marketing begins. AIFMs should be able to clearly demonstrate that a particular investor invested in the AIF on the basis of a reverse solicitation in order to be scoped out from complying with AIFMD.

Remuneration

For each AIF marketed to EU investors, the AIFM must make the annual reports available to investors within six months after year end. Among other disclosures, the annual report must include remuneration disclosures detailing the following:

- Total amount of remuneration for the year, split between fixed and variable remuneration paid by the AIFM to its staff and the number of beneficiaries; and
- Aggregate amount of remuneration broken down by senior management and members of staff of the AIFM whose actions have a material impact on the risk profile of the AIF.

Key reporting obligations

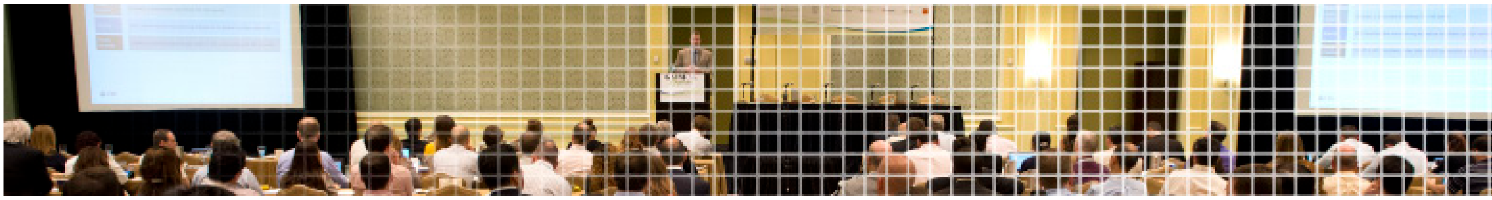
A non-EU AIFM is required to regularly report specified information to each EU Member State regulator where its AIFs are marketed. The reporting template is similar to the Form PF which United States-based managers will be familiar with. However, the reporting template under AIFMD is expected to have its differences from Form PF which may cause operational headaches for covered entities.

Depositary

The depositary rules are generally only applicable to managers of EU AIFs. The depository has the following responsibilities: (1) custody of AIF's assets; (2) monitoring of the AIF's cash flows; and (3) oversight of compliance by the AIFM and AIF. In relation to the custody of the AIF's assets, the depositary has a double liability: (1) liability on lost assets; and (2) liability for any other damages. In the case of lost assets, the depositary will not be held liable if it can prove that the loss has arisen as a result of an external event, beyond the depositary's reasonable control. To be eligible for appointment as depositary, the entity must be a (1) bank or credit institution; (2) an investment firm; or (3) other entity which is eligible to act as a depositary under the UCITS Directive.

Bottom Line - What should US managers (or any non-EU managers) be concerned with?

The US managers need to identify their EU investor base. If the US managers will be marketing in the EU, the US managers will need to figure out which EU Member State to market in through the private placement route. This will mean that the US managers will need to monitor the private placement regime to be implemented by each Member State and identify likely barriers or additional compliance requirements to be imposed by each Member State. Further, US managers need to consider that certain EU Member States may end up not making the private placement regime available, e.g. France, or may extend almost all rules of the AIFMD in the private placement regime, e.g. Germany. ■



General Market Outlook for 2013

Michael P. Ryan - Chief Investment Strategist at UBS Wealth Management, spoke on Day two of GAIM Ops Cayman 2013, looking at markets now and where they will be in the future.

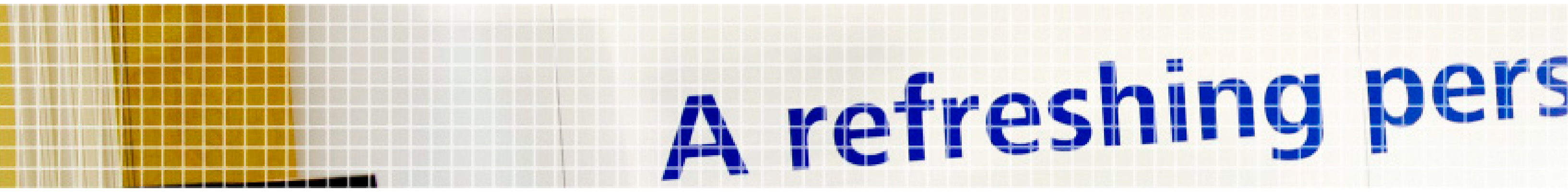
Michael P. Ryan, Chief Investment Strategist at UBS Wealth Management, provided a general overview of current global market conditions, as well as thoughts about where global markets might be heading over the short-to-medium term. His address touched on four key areas: the global macro-economic environment, preferred asset classes, appealing areas within the equity asset class, and appealing areas within the fixed income asset class.

Despite uneven growth, economies globally continue to rebound from the 2008 financial crisis, with the United States leading the recovery process. Overall, the US housing market appears now to be on a strong upward trajectory, with US entrepreneurship at its highest level in over a decade. These factors, along with increasing US energy independence, have led to greater labor mobility and increased consumption in the US. Globally, while Eurozone growth remains tempered, growth in emerging markets – particularly China, India, Brazil, and Russia – continues to accelerate. Inflation has been kept in check globally, despite central banks continuing their willingness to provide liquidity to markets, and uncertainty as to how central banks will unwind their bigger balance sheets caused by such accommodative policies on liquidity.

All of these factors are leading to a strengthening macro environment overall, and as such, Mr. Ryan suggested that a "pro risk" bias may be beneficial to investors. In addition to the improving macro environment, Mr. Ryan pointed out that while the equity markets have reached new absolute highs, those highs are more modest when compared to earnings, and in US dollar terms, emerging markets have yet to participate in the equity rally that's happened in the US since the beginning of 2013 because the same degree of deleveraging seen in the US has not taken place in emerging markets. As a result, in the equity space, opportunities may exist in US small- and mid- equities in global cyclical industries such as technology and industrials, and in emerging markets.

In fixed income, companies have been increasingly willing to use leverage, particularly to fund share buy-backs and dividends. High yield offerings (relative to the historically low yields on US Treasuries) represent a significant percentage of the total yield available from fixed income; because of those low yields on US government debt and the perceived quality of high yield corporate bonds, liquidity in the high yield corporate bond market remains good, and opportunities continue to exist in that space, particularly in emerging markets.

In summary, while the last few years have seen macro-economic factors exert outsized influence on investment decisions, with the global macro environment stabilising and global growth rebounding, now may be an excellent time for investors to shift to a "pro risk" strategy, and take advantage of opportunities that may exist in emerging markets, corporate high yield debt, and global cyclical equity.



How FATCA Will Change the Global Asset Management Business Forever

Denise Hintzke - Global FATCA Leader – Deloitte

The U.S. based Foreign Account Tax Compliance Act ("FATCA") was enacted in 2010 as part of the Hiring Incentives to Restore Employment ("HIRE") Act and aims to improve tax compliance involving U.S. persons with foreign financial assets and offshore accounts. As an information reporting regime, FATCA focuses on the identification and reporting of U.S. investors rather than potential withholding on recalcitrant and non-participating investors. The obligations inherent within FATCA will be largely based on the interplay between the final regulations, released by the U.S. Treasury Department and Internal Revenue Service ("IRS") in January of this year, and the Intergovernmental Agreements ("IGAs") to which some countries have and will be entering. This was one of the points emphasised by Denise Hintzke, the Global FATCA Leader for Deloitte, during a presentation on the impact of FATCA on the Asset Management Industry.

Ms. Hintzke noted that, in drafting the final regulations, Treasury and the IRS adopted a risk-based approach which sought to eliminate unnecessary burdens, build upon existing practices and obligations, and minimise operational costs associated with collecting and reporting FATCA information. The regulations require Foreign Financial Institutions ("FFIs") to conduct additional due diligence to identify investors and report U.S. investors, and signals a move towards global information sharing, exemplified by the issuance of the model IGAs.

Through collaboration with foreign governments, the IRS issued two model IGAs. Model 1 IGA isolates FATCA rules to be governed and enforced locally, in many cases predicated on the final regulations. Model 1 FFIs will not be required to appoint a Responsible Officer, though a similar role may exist, and will not enter into an FFI Agreement with the IRS – reporting lines will instead use the local government as an intermediary. Model 2, on the other hand, will be more closely aligned with the final regulations, requiring FFIs to sign an FFI Agreement and report directly to the IRS.

As IGAs are bilateral agreements, they facilitate the exchange of information without the need for a tax information exchange treaty. IGAs provide a mutually beneficial relationship which remove legal impediments, allow alignment and coordination with reporting requirements under local legislation and reduces the cost of compliance for FFIs. An IGA provides FFIs with relief from closing accounts held by recalcitrant accountholders, and exceptions from withholding. The reciprocity of certain agreements also provides the added benefit of an automatic two-way flow of information between the IRS and the respective jurisdiction. Yet, Ms. Hintzke noted, this flow of information may, in some instances, extend to multiple jurisdictions.

Ms. Hintzke further noted that IGAs may complicate the application of FATCA for organisations that operate in multiple jurisdictions. Article 1 of the model IGA sets out the definitions under the agreement. With respect to investment entities, the final regulations align the definition of an FFI with Article 1 of the IGA by including entities which "invest, administer or

manage funds, money or other financial assets on behalf of other persons". However, the final regulations provide for a broader definition of an FFI than what is contained within the IGAs and further expand and modify certain categories of deemed compliant status. The result of these differences is another layer of complexity for multi-jurisdictional organisations.

There are also certain provisions within the final regulations which prove more beneficial to an FFI than what is contained within an IGA. Such a benefit is exemplified by the requirement under Appendix 1 of the model IGA for each investor to self-certify as opposed to the reliance on the identification of U.S. indicia within the final regulations. On this note, the model IGA contains a 'most favoured nation' clause allowing countries to include or amend existing clauses of their IGA based on those found in IGAs of other countries. The model IGA also generally permits FFIs based in countries with an IGA to use any "more generous" provision of equivalent IGAs, should such provision prove to their benefit.

Nonetheless, FFIs within IGA jurisdictions will still need to register with the IRS and be issued a Global Intermediary Identification Number ("GIIN") which will need to be verified on an annual basis. It is expected that this process will be the same as that used by FFIs in non-IGA jurisdictions which will undergo a paperless registration process, facilitated by a secure online web portal. In rare cases wherein FFIs must register manually, Form 8957 will need to be used. The portal will further facilitate the information management of registering entities, allow these entities to agree to the terms of or make the required representations for their status where appropriate, and communicate with the IRS.

Furthermore, compliance with FATCA requires participating FFIs to establish policies and procedures sufficient for the FFI to satisfy the requirements of the FFI Agreement. A Responsible Officer appointed by the FFI will need to certify, on penalty of perjury, that such policies and procedures are in place and that the organisation is compliant with FATCA. The compliance programme, which may be subject to an external audit as may be required by the IRS, will need to be periodically reviewed to ensure that the FFI continues to meet its obligations during the certification period.

To conclude, the inherent differences contained within the final regulations and the model IGAs provide added difficulty to entities in complying with FATCA requirements. Ms. Hintzke's presentation served to highlight some of the main areas of complexity which the global asset management industry must face in addressing FATCA compliance. Going forward, entities will need to look at the legislation dominating the jurisdiction in which they are operating in order to understand the definitions and reporting requirements applicable to them. Whilst the final regulations and model IGAs have been released and provide substantial direction for FATCA compliance, additional guidance, amendments and forms are anticipated in the coming months which will build on the provisions currently delineated.

PANEL

Current Trends in Corporate Governance

Panel moderated by Eric Lazear, Head of Operational Due Diligence - FQS Capital Management, with panellists James Newman, Director - Barclays Wealth and Investment Management and Scott Lennon, Managing Director - 19º North Fund Services, Ltd.

Following introductions of the panel, assembled to present the institutional investors' point of view and that of the independent director, Eric Lazear provided a brief summary of the corporate governance landscape in the alternative investment industry. He noted that prior to the financial crisis in 2008 there was a relatively low level of interest in corporate governance, however more recently institutional investors have become highly focussed on independent oversight and governance issues. With that background the following general topics were discussed:

Recent changes from a director's point of view

Scott Lennon stated that the main changes he has observed were related to the documentation and mechanics of how funds work, e.g. with respect to implementing side pockets and/or gates. He also noted the increase in personal interviews and due diligence on directors from investors, which now takes up a substantial part of an independent director's time.

Changes in the make-up of board composition between independent and non-independent directors were also discussed, with the overwhelming trend towards more independent directors on a fund's board. The panel noted that the mix of experience and background of boards was changing, with directors possessing differing skill sets now actively being sought.

Have expectations of investors changed?

James Newman hoped that the answer to the question was a resounding yes. He argued that in the aftermath of the financial crisis there was more that directors could have done and that investors were now increasingly focussed on the roles and responsibilities of their independent directors.

Duties/responsibilities of directors

Despite helpful recent guidance, confusion still exists as to what duties a director can delegate. Director's duties themselves are clearly defined through their fiduciary duties, the Companies Law and statutory duties. However, the question remains how you execute those duties and which can be delegated? Directors have a responsibility to oversee core aspects of a fund and significant activities cannot be delegated away. For example the role of the investment manager is clearly to invest, but directors are expected to oversee that process.

Scott Lennon noted that investors also need to take increased responsibility for the documents they sign and be focussed on the terms they agree to. Directors have responsibilities to protect investors but cannot alter the terms under which they have invested. It was noted that the offering document is a statutory document – if the terms are not commercial, the director can provide feedback to the investment manager along those lines, but ultimately they are not responsible if investors subscribe to those terms.

CIMA's transparency initiative

Eric Lazear asked the panel whether they agreed with the recent proposals from the Cayman Islands Monetary Authority. He noted that the survey commissioned by CIMA was not yet available and therefore all interested parties were still keenly waiting for this information to be provided.

Scott Lennon noted that CIMA are trying to respond to demand in the marketplace. The Cayman Islands Directors Association ("CIDA") has had significant input in the process and has polled its members and offered their feedback. One of the key features of the Cayman Islands is the dominance of professional investors, therefore retail regulation is not appropriate or required. Improvements in transparency can be made, but no wholesale change is required. Any change could result in unintended consequences that may actually be detrimental to the jurisdiction if not carefully thought through.

James Newman asked whether the changes would increase protection for investors. He noted that there are specific confidence/perception issues affecting offshore jurisdictions that need to be addressed. Therefore, he argued, guidance and real instruction on how directors should operate in the hedge fund industry is required.

The panel agreed that CIMA's involvement provides an opportunity to improve the corporate governance model, and that increased transparency is clearly beneficial. To maintain its competitive advantage the Cayman Islands must be responsive to the fund industry whilst maintaining adequate (but not overbearing) regulatory oversight.

Discussions then moved to the proposed database of directors. It was noted that if there is no public database provided, the private sector will inevitably develop one and the information will naturally flow out into the market place. James Newman noted that a public database would be helpful; however any database should cover all service providers, not just directors. Confidentiality issues were discussed and it was agreed that other service providers would need to be comfortable with the available search terms.

Number of fund directorships

The evocative topic of fund directorship numbers was then approached. Scott Lennon noted that directorships are not a homogeneous product; therefore the number is not of benefit without an accompanying explanation. A database cannot provide this information therefore there is the risk of the information being taken out of context.

James Newman noted the expertise of investors in performing due diligence and argued that investors would go beyond the headline number. The point was made that detailed due diligence questionnaires typically ask directors to disclose the number of fund boards they sit on and therefore the value of a database was debatable, especially when set against the cost of maintaining the database.

Mr. Newman also suggested that consolidated numbers from CIMA would aid experts with limited resources; however users need to appreciate that different directorship models exist.

When the question was asked what the numbers are going to be used for, Mr. Newman said that it was just one data point he would use when evaluating a director, and served as a baseline to help investors ask further questions and drill deeper.

In summary, the panel agreed that the marketplace was evolving and that ultimately participants in the industry would determine the best way forward. The Cayman Islands remains the premiere fund jurisdiction, and therefore CIMA should look to fine tune the existing model without strict new regulations being required.

What does the future hold for independent directors?

The panel agreed that understanding exactly what services directors offer will be a key theme for the future, along with increased transparency. The Cayman Islands fund industry came through the financial crisis well and protected investors effectively. The process clearly works and no wholesale changes are required. Any form of statement of responsibilities and director framework must be considered against what is actually in the best interest of the Cayman Islands and the users of its fund industry.

Cracking the Codes of Deception: How to Spot a Liar

Pamela Meyer, author of LieSpotting: Proven Techniques to Detect Deception

Last year there was $3.5 trillion of fraud perpetrated globally. Deception is serious business. But a lie has no power by its mere utterance. This is a cooperative act. One must believe a lie for that lie to affect the decisions made. If you don't want to be deceived, you have to ask yourself what you are hungry for because you can be deeply attracted to liars if they're offering what you want.

We all lie. Research shows we lie more to strangers than to coworkers because when people know us there is a relationship to protect. Extroverts lie more than introverts. Men lie eight times more about themselves to boost themselves. Women lie equally as much but more to protect others. We lie to our spouse once in every ten interactions! White lies might be harmless. But high stakes lies affect the decisions we make. Deception detection trained experts can detect the lie 90% of the time. The rest of us can spot a lie about half the time. But liars leak cues when they try to deceive so if you know the codes of deception, you just might spot a liar.

Body language can tell us a lot. Someone telling a lie might exhibit artificial qualities like looking you in the eyes too much, pasting on a fake smile, or being too rigid in their posture. Or nervous habits like lip biting, playing with hair or clothing, hand ringing, or excessive sweating might become apparent. Keep in mind though that these actions need to be compared to a baseline for that person's normal behavior and any single behavior is not necessarily an indicator that the person is lying. Watch for clusters of at least two or three of these behaviours.

There are also verbal indicators to watch for. Someone telling a lie might use unnecessarily formal language. Or when asked a direct question, a liar might respond with qualifying language such as 'expected', 'probably', 'should be able to', 'relatively' or 'but'. Or they might not answer the question at all, providing you entirely different information than you asked for. Other times liars tend to be too specific, offering too much detail, such as, "I did not rob that bank at gunpoint last Tuesday". Whereas a truth teller is often broader in his statements, for example, "I have never stolen anything in my life". Someone telling a lie is usually prone to using euphemisms and avoid the 'bad' words to describe something that happened, like "I didn't hurt that woman" instead of "I didn't strangle that woman to her death".

Attitude and overall behavior can also offer clues as to whether someone is truthful or lying. An honest person generally has a cooperative attitude, gets steadily angry if wrongly accused, tells the emotional parts of her story first, and recommends strict punishment for wrongdoer. Contrast this against the liar, who becomes either combative or withdraws, has a flash of anger but then plays it cools, tells his story in strict chronological order, and recommends lenient punishment for the wrongdoer.

Stalling is associated with deception. Spontaneity indicates truthfulness. The first few seconds are key because facial micro expressions flash through in a microsecond. Contempt flares up as an asymmetrical sneer where just one side of the mouth moves. Or there is a discrepancy between words and body action, such saying "no" but nodding the head "yes", or a tentative shoulder shrug, while saying "yes, I'm sure".

So the next time you're doing due diligence on a new investor, service provider or investment manager, do it face to face. We rely so much on modern technology that we miss the opportunity to hear the whole message, to spot these codes of deception. Can you spot the lie? You are now armed and dangerous… but be careful. Don't openly judge, don't attack people; pursue the facts and get to the truth and build trust. ■

About Pamela Meyer: Pamela Meyer is founder and CEO of Calibrate, a leading deception detection training company, and of social networking company Simpatico Networks. She holds an MBA from Harvard, an MA in Public Policy from Claremont Graduate School, and is a Certified Fraud Examiner. She has extensive training in the use of visual clues and psychology to detect deception.

PANEL

Accounting and Auditing Updates

Panel moderated by Joe Fisher (Partner, Deloitte & Touche LLC), with panelists Ben Breda (Vice President, Hedge Fund Solutions Group, Blackstone) and Daniel Florek (Senior Manager, Deloitte & Touche).

Featuring among the discussion topics in this panel were the US SEC Investment Adviser Custody Rule, updates to US Generally Accepted Accounting Principles ("US GAAP") and International Financial Reporting Standards ("IFRS"), and the FASB / IASB joint project on investment companies.

Recently issued Risk Alerts from the SEC have identified financial statement disclosure deficiencies in audited financial statements that are being used to satisfy the audit provision option of the Custody Rule, including the following:

1. Financial statements prepared on another basis of accounting must include a reconciliation to US GAAP or include all required US GAAP disclosures;
2. The audit must be performed in accordance with US Generally Accepted Auditing Standards by an auditor registered with the Public Company Accounting Oversight Board;
3. Financial statements must be distributed to all investors within 120 days (180 days for a fund of fund) of year end.

4. Final audits must be performed on liquidating funds.

If the audited financial statements are not US GAAP compliant, they will not satisfy the audit provision option of the Custody Rule.

In addition to discussing the new standards and updates, the US GAAP / IFRS standards section of the panel discussion provided some observations and advice to the audience:

- It is important to understand the differences between IFRS and US GAAP; a large foreign investor could request their own SPV fund and may require IFRS financial statements;
- The majority of standards and updates being released are being driven by the convergence of IFRS and US GAAP;
- When new accounting pronouncements are issued, review the pronouncement, establish a plan for implementation of the disclosure, and obtain auditor signoff on the planned implementation of the new disclosure as early as possible.

The US GAAP standards update recapped Accounting Standards Update ("ASU") 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs ("ASU 2011-04"), and discussed ASU 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities ("ASU 2011-11"), as amended by ASU 2013-01, Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities ("ASU 2013-01") and ASU 2013-07, Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting ("ASU 2013-07"). Comparison, where applicable, to the relevant IFRS standard or update, was also discussed.

The ASU 2011-04 recap highlighted disclosure deficiencies identified in SEC staff comments, including the following:




1. Lack of disclosure of all significant unobservable inputs;
2. Valuation process of the reporting entity not disclosed;
3. Lack of fair value bifurcation in instances where multiple valuation techniques were used for the same investment type;
4. Weighted average not disclosed adequately.

IFRS 13, Fair Value Measurement and Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27) (effective January 1, 2013), ("IFRS 13") is the IFRS equivalent of ASC 820, including the ASU 2011-04 updates. IFRS 13 and ASC 820 differ in that IFRS does not allow for private company exemptions to certain disclosures, and no "practical expedient" equivalent exists in IFRS when valuing investments in private investment funds.

Regardless of whether an entity has presented derivatives gross or net, either approach will likely result in additional disclosures as a result of ASU 2011-11 (effective fiscal years beginning on or after January 1, 2013). The scope of ASU 2011-11 was clarified in ASU 2013-01; that ASU 2011-11 only applies to derivative instruments accounted for under ASC 815, Derivatives and Hedging. Trade payables and receivables have been scoped out. The panelists noted that similar changes have been made to IFRS 7, Financial Instruments (effective fiscal years beginning on or after January 1, 2013); however IFRS 7 requires disclosure for trade receivables and payables.

ASU 2013-07 (effective for annual reporting periods beginning after December 15, 2013), has clarified the requirements in regards to liquidation accounting and financial statement presentation and disclosure. Entities applying the liquidation basis of accounting must accrue all expected income and costs that they will incur during liquidation provided that they have a reasonable basis for estimating these amounts. The panel suggested that estimation of these costs should be done in conjunction with the investment team, Cayman and US counsel, accounts payable, and service providers. The ASU does not include guidance on liabilities.

IFRS 10, Consolidated Financial Statements (effective January 1, 2013), evaluates control based on three criteria: power, exposure, and ability to use power to affect returns using a principal versus agent analysis. The end result is that there will likely be more consolidations of funds for investment managers.

The objective of the joint FASB / IASB investment company project is to define an investment company and provide measurement requirements for an investment company's investments.

For US GAAP, a proposed ASU was issued in late 2011, which included a definition of an investment company. Based on the proposed definition, many fund structures would not have qualified as an investment company, and therefore would have triggered certain consolidation requirements. As a result of several industry comment letters, this ASU was sent back for deliberation. Based on the FASB's minutes, they will be defining an investment company consistent with the IASB with the exception of the fair value management requirement. The redrafted ASU has not yet been released*.

For IFRS, Investment Entities (Amendments to IFRS 10, IFRS 12, and IAS 27) (effective January 1, 2014), provides a definition for an investment company and scopes out entities that qualify as investment companies from consolidating their investments and / or subsidiaries. This guidance also concludes that feeder funds in a master – feeder structure would not need to consolidate the master fund. It is important to note that this is the first investment company guidance issued under IFRS. ■

*Note: ASU 2013-08 Financial Services - Investment Companies was released in June 2013

PANEL

General Counsel Panel – Is Your Organisation Prepared

Moderated by Ingrid Pierce, Global Managing Partner – Walkers, the General Counsel Panel featured: Helaine Rosenbaum Dryden, General Counsel & Chief Compliance Officer – Episteme Capital Partners (US) LLC, C. Martin Meekins, General Counsel & Chief Compliance Office – Empyrean Capital Partners LP, Eric Komitee, General Counsel – Viking Global Investors LP and Peter D. Goldstein, Chief Compliance Officer and General Counsel – Buckingham Capital Management Inc.

With the waves of global regulation currently being implemented in the hedge fund industry, the first question of how managers can keep up with this challenge was answered by Helaine Rosenbaum Dryden, General Counsel & Chief Compliance Officer – Episteme Capital Partners (US) LLC, who stated that the regulatory picture has resulted in multiple deadlines looming at the same time and a piecemeal approach to gathering information from the industry. The process should be managed, she said, by working on training with senior managers and principals on how regulation will affect the business. Seminars are useful, as is peer-to-peer networking to see how others are developing responses, she said.

Ms Rosenbaum Dryden felt that summaries and briefings from law firms were very helpful as a first source of analysis, however they were often too broadly written. "We need to know how to apply this to our own business and our size of staff," she said, adding that the advice would typically come from the firm's counsel.

Eric Komitee, General Counsel – Viking Global Investors LP, commented that with new regulation there is no history of interpretation, while the law firms themselves are often waiting for information from regulators, therefore there was a need to spend more money on advice. The Alternative Investment Fund Managers Directive (AIFMD) was held up as a case in point, with disagreement surrounding what actually constitutes marketing in Europe. Mr Komitee said that the more you try and drive a consensus at the outset, the more conservative the result.

Martin Meekins, General Counsel & Chief Compliance Office – Empyrean Capital Partners LP, felt that there was some value in the work done by industry groups and bar associations, noting that the New York Bar takes an active role in engaging with regulators, but you do have to filter through the noise. "It is a better utilisation of scarce resources to piggyback on the folks in the industry such as the MFA and the New York Bar who have already spent some money."

Talking more generally about the role of the GC, Mr Meekins said it was a varied one and whether you are a leader of the firm or just managing the compliance process, there was a need to get things done in order to help the front office execute the business decisions of the firm. "We have European market rules, reporting requirements and FATCA. Only the general counsel can formulate the strategy, hone it and execute it," he said.

Ms Pierce of Walkers then asked the panel how they take all of this information and importantly, come to the right decisions.

Peter Goldstein of Buckingham Capital Management, said that the general counsel is hit with everything from potential legal issues with the air conditioning to securities regulation, AIFMD and marketing issues. "People want an answer and they don't know it's not that simple," he said.

Martin Meekins of Empyrean suggested that firms without a general counsel will spend lots more on advice. "People specialise and the same course of action isn't always the best," he said.

Ms Pierce also asked the panel about the SEC examination process and the best procedures to prepare, with time, energy and costs involved to ensure that employees are ready.

Capital Partners Eric Komitee of Viking Global Investors told delegates that Viking prepared extensively and fully understood that this is not a 'one size fits all' situation. "We went with the 'more is more' approach, expecting a fully-fledged, across the board exam," he said, while Helaine Rosenbaum Dryden of Episteme also noted the importance of making sure all the firm's staff are aware that auditors are currently on site.

Peter Goldstein of Buckingham Capital Management explained that their last SEC exam lasted four months, with seven examiners on site every day during that period. He went on to say that if the SEC get the feeling that you have something to hide, then you are going to be in trouble. Staff coming into contact with the SEC examiners need to be instilled with the 'Four Cs': Credible, Cooperative, Cordial and Careful. "Be diligent and forthright," he added. "Even if you are not very well prepared, showing you have a process in place will go a long way.

PANEL

What's next for Form PF?

Julia Dixon, Managing Principal, Titan Regulation - Brian Guzman, General Counsel, Partner, Indus Capital Partners, LLC - Thomas King, Chief Financial Officer, Nantahala Capital Management - Fizza Khan, Senior Attorney and Managing Director, CounselWorks LLC

What has been the experience so far?

There was a lot of panic and uncertainty in the initial stages of the Form PF process. In addition the definitional stage was a challenge; it was a challenge to get groups within the firms to work together in the beginning.

The SEC was very understanding and flexible in their approach. The SEC understood the challenges that firms were facing in the initial stages of the process. A good example is how the SEC allowed small firms to define how they managed derivatives. The publishing of responses to Frequently Asked Questions was very helpful.

Some firms decided to handle the process internally to be better able to deal with due diligence questions relating to the Form.

Where do Service providers fit in?

Demand for vendors is based on specific needs of entities; if a fund manager is complex then completing the form internally might be better. This is an entity level decision that is largely driven by complexity rather than size. Complex clients need to develop a solid understanding of the process to be able to deal with due diligence and audit questions.

Small firm clients requested for a program from service providers to help them deal with filings. Service providers can help small firms save time.

How has the process been managed internally?

Execution requires major departments within the firm to participate. The best approach is to have a team with subject matter experts from each department working together and meeting regularly.

What to expect from the SEC going forward?

It is possible that the SEC will look to change some of the focus and questions. SEC will also continue releasing FAQs. SEC might start looking at exposure as opposed to focusing on notional balances.

Where are Form PF expenses going to be allocated?

As the process evolves it is expected that costs will also begin to come down and the allocation question will go away. In the meantime it is a grey area but firms should exercise caution and absorb some of the costs. Fees can be a burden on small firms as they do not have the cushion to absorb costs. There are several factors working against passing through of costs to investors for example legacy funds where Offering memorandums do not permit allocation of costs to investors. Large firms who developed the infrastructure to handle Form PF internally incurred costs. A few firms have been able to pass through costs to their investors.

Risk aspects; are they a precursor for more regulation of risk in the future?

Factors point towards a road of more regulation of risk, however finding commonality on how to do this might be a number of years away. There is no generally accepted method of tracking risk and it might evolve to regulating at institutional as opposed to at a systemic level. The Form PF provided a lot of information on risk to the SEC; it will take time for the SEC to digest this information.

How do you ensure consistency between Form ADV and Form PF?

Best approach is to form a team made up of all the departments in the firm, to work on both Form PF and Form ADV, this collaborative effort ensures the information is consistent.

Providing the Form PF to investors?

It is premature at this stage to provide the Form to investors. There are differing interpretations to questions so it might be difficult for investors to perform meaningful comparisons between firms. Once there is uniformity it will be useful to provide investors with the Form PF. Investors will continue to demand transparency and all signs are pointing to more disclosure.

One thing you would do differently?

Time planning is essential, some small firms underestimated the time required to fully complete the form. The process was a significant moment, although not a mountain as initially thought. Some of the panic in the initial stages was not warranted.

How can you rely on Fund Administrators?

Although the Investment Manager has the ultimate responsibility, fund administrators have been very helpful providing some of the information required to complete the Form. Administrators maintain the official books and records and therefore have some of the required information. Smaller firms rely on administrators a lot more than larger firms who have the infrastructure and the tools to maintain accounting and risk information. It is important for the Manager to fully understand assumptions and be in control of the process.

PANEL

ODD Issues for Emerging Managers

Panel moderated by Christopher Montclare, COO of Fintan Partners, with panelists Simon Fludgate, Head of Operational Due Diligence at Aksia and Joseph I. Ivaszuk, Operational Due Diligence Manager and Chief Compliance Officer at Federral Street Partners

Montclare

The session will consist of each panelist giving real world examples of their Emerging Markets experiences. There are language and cultural barriers and many ways for things to go wrong in the Emerging Markets. There is also great opportunity for higher returns and also things that the Emerging Markets can teach first world countries.

Fludgate

Fludgate tells the cautionary tale about Political Risk, regarding Hermitage Capital Management ("Hermitage") and its experience in Russia.

In 1991 communisim fell in Russia and all its public companies were privatised. As a result of the privatizations 22 oligarchs effectively seized control of the Russian economy. Around 2000, they owned about 40% of Russian GDP. Bill Browder set up Hermitage Capital Management to invest in these newly private companies.

Hermitage was very successful as the companies increased greatly in value. In 1998 the Russian financial crisis occurred and Hermitage started taking an activist position in such companies as Gazprom, Surgutneftegaz, and Sberban and exposing management corruption. When the corruption came to light the share prices fell and Hermitage made more money from its short positions.

In 1999 Putin came to power. Putin initially liked Hermitage as its activist positions gave the impression that government was helping the fight against corruption. These companies were still partly state-owned companies.

In 2003 Mikhail Khodorkovsky, the owner of Yukos, was arrested on tax fraud. This got the other oligarchs worried and they began to get closer to Putin.

In 2005 Hermitage had about $4bn in assets under management. Bill Browder slipped into Russia and ran a story on Gazprom. He then moved all the assets of the fund outside Russia.

In January 2007 Bill Browder met Medvedev in Davos and said he wanted to get back into Russia.

In June 2007, 50 police officers raided the Hermitage offices on the pretence of tax offences. They took all the formation documents of the fund. Nine lawsuits were filed against Hermitage by a shell company. Hermitage didn't know about the lawsuits or that fraudulent lawyers were appearing in court purporting to represent Hermitage and pleading guilty to all counts for hundreds of millions of dollars. They were able to do this because they had the corporate documents that were taken by the police in the raid. The man behind the shell company that filed the lawsuits was a convicted murderer.

Hermitage filed complaints continually up until 2008 when they were told that a $230m tax refund had been paid to them and that the Russian authorities claimed Hermitage had committed tax fraud. Any money that had been paid out of course had gone to the fraudster. Everyone to do with Hermitage fled the country except for one lawyer who stayed.

In October 2008 the lawyer filed a complaint against the police officer who stole the Hermitage corporate formation documents.

In November 2008 the lawyer was arrested and sent to jail for tax fraud. In jail he was pressured to sign documents admitting he had committed tax fraud even though the statute of limitations was exceeded from his purported crimes. The lawyer refused to sign the documents and was moved from worse to worse prisons. Eventually he died in prison.

What followed was a series of tit-for-tat laws passed in the US and Russia, e.g. 2013 Russia banned the adoption by US citizens of Russian babies. The US then banned from the US 16 people who were associated with the case and froze their assets. Russia then banned 18 people from the US who were associated with George W Bush.

Bill Browder's investors did not lose money though as he had moved all his money out of Russia in time. He has made a video of the incident and put it on YouTube.

Ivaszuk

In Asia it's critical to do background checks, navigate the language barrier, and be aware of political risk.

Ivaszuk's firm did a background check for a client and found the man was clean. Later an internet search showed the man was mentioned in a book and the book said he had served time in prison. When questioned, the man said he was detained for three months. He was the CIO at a securities firm. Chinese government officials came in and took over the firm. While they "investigated" the firm's activities the man went to jail. He was later released.

In some emerging markets there is no separation of duties. Ivaszuk has seen firms where the person buying and selling positions is the same person who values the positions.

It is important to know who the Directors are and who the key service providers are. In Mauritius they need to use local service providers and therefore you need to do a lot more research on them to ensure they are ok.

The principle of doing a lot of due diligence work when dealing with emerging markets applies.

In some emerging markets the concept of Compliance is foreign. It just doesn't exist.

Montclare

In Asia Operational Due Diligence is not valued. Firms hire lots of young people and then let them burn out because they know they can easily replace them. This has led to there not being strong senior people.

South America, by comparison, is a pleasant surprise. They have a very strong Operational Due Diligence culture. This goes back to the days of hyper inflation in the '60s and '70s and their desire to protect the common citizen. It has meant that they have a better bank system than in the US. They have spent a lot on technology and infrastructure and also have built strong regulations regarding banking. There is a cohesive relationship between the regulator and the banks.

The South American legal system is very strict regarding banking. The US and British systems are very loose by comparison. This is due to the use of Roman law which is very prescriptive. It means that things take a long time to happen as the goal is to protect people.

Overall Montclare is very impressed with South America from an Operational Due Diligence perspective.

Fludgate

In South America there is daily liquidity for locals but foreigners have longer liquidity terms.

Montclare

The government wants to protect the people of Brazil. They want to control inflation and employment.

Ivaszuk

In 2009 the stock exchange in Iraq had about 88 companies on it and of those only about 15 were of any size and traded regularly. The National Bank of Kuwait offered custody and support to companies on the stock exchange of Iraq.

Malta is 90 miles north of Libya. It's the smallest EU member state. The government has passed favourable financial legislation. 50 double tax treaties have been signed. The financial services industry is 12% of GDP. ■

QUESTIONS FROM THE FLOOR

Question

What opportunities have you found in Africa?

Ivaszuk

Hasn't found many opportunities they like. This is due to the geo-political risks.

Question

How do you find the regulatory rules in each emerging market?

Fludgate

Hire local lawyers. The rules tend to be vague and the tax rules are vaguer. You have to do your own due diligence.

Montclare

It took 3 years for his firm to do its first deal in South America. Talk to as many people as possible. Experience on the ground is vital.

GAIM Ops Cayman 2013

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