

# Over 10,000 Funds Registered in Cayman Islands

The popularity of the Cayman Islands as the choice of jurisdiction for domiciling hedge funds has been reinforced by the latest quarterly figures released by the Cayman Islands Monetary Authority (CIMA), showing there were 10,037 funds registered as at 30 June 2008, compared to 8,972 for the same quarter in 2007. The British Virgin Islands (BVI) also affirms its place as an alternate second choice of domicile with 3,338 active fund vehicles being regulated by the Financial Services Commission (FSC) for the period ending March 2007.

The passing of the 10,000 barrier, which takes into account the number of registrations cancelled, is significant given the difficult and volatile operating environment currently being experienced by the investment and finance sectors worldwide, and thus highlights the strength of the alternatives funds market and market confidence for the offshore funds market when considering the domicile of choice.

A shift from traditional investment strategies has also become evident, and it is noted that a large number of new funds are being regularly formed focusing on special opportunities presented by the holders of distressed securities and debt liquidating their positions.

Beyond the well known regulatory and tax efficiencies of domiciling mutual funds offshore, the attraction of the Cayman Islands and the BVI as the domicile of choice is heightened as both are 'recognised jurisdictions' for the purposes of the Financial Action Task Force, with know-your-client standards equivalent to or higher than many onshore jurisdictions. Further, the FSC was welcomed in 2007 as an ordinary member of the International Organization of Securities Commissions (IOSCO) in recognition of the BVI's "robust international cooperation framework and its long-standing commitment to comply fully with international standards".

## Side-Pocketing Hard-To-Value Assets

While the statistics above reinforce the utility of hedge funds as a vehicle and refuge for channelling investments, the number of hedge funds in distress has also increased. Panicked investors seeking redemptions have caused 'runs' on the capital of some funds, which has naturally lead some fund managers to exercise redemption gates and/or suspensions of redemptions altogether. Fund managers have also been faced with the difficulty of holding hard-to-value securities, leading to the suspension of subscriptions and fund operations in some instances, due to the inability to determine the net asset values of shares (NAV).

To this end, side-pockets are increasingly being utilised by fund managers, whereby the hard-to-value securities are separated from the balance of the fund's readily valued assets, thus allowing NAV's to be calculated for the non side-pocketed assets. A separate class of shares are typically issued for the side-pocketed assets, and such shares will be normally be non-redeemable by an investor until such time as the fund manager or directors otherwise determine.

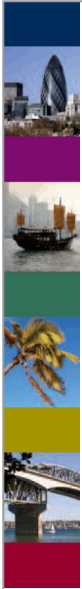
Provisions for creating side-pockets are not usually included as a matter of course. However in light of the volatile capital markets, promoters and their legal advisors should consider including provisions in the constitutional documents of all funds to allow the fund to convert equity interests into non-redeemable interests (whether units, shares or partnership interests) without the need to obtain the prior consent of investors. It is also suggested that such a provision be linked to an extreme trigger so that, for example, the side-pocketing provision could only be invoked if a suspension of redemptions has been invoked. In this way, the provision would not be a tool to enable strategy drift by the fund, but would be a mechanism to assist a fund in preserving value in a falling market and may facilitate the de-leveraging and run-off of afflicted parts of a fund's portfolio.

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