Cayman Islands
Assurance and Advisory Services

Technical Brief for Investment Funds

Accounting, Financial Reporting & Regulatory

Volume 5 – November 2012

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Introduction

Welcome to Volume 5 of the *Technical Brief for Investment Funds ("Tech Brief")*, a periodic newsletter developed by the Deloitte Cayman Investment Funds Technical Team.

The major accounting standard setting bodies have put out a number of new and proposed amendments and refinements to guidance over the last couple years, some of which are effective for December 2012 year ends, and several more which are effective on January 1, 2013. Some of the new requirements are relatively straightforward, while others may be much more complex to apply in practice, such as the new fair value measurement disclosures and disclosures relating to offsetting of assets and liabilities and master netting agreements. In this *Tech Brief,* we summarize some of the more significant new accounting and financial reporting requirements that investment funds and their managers will have to contend with.

As we introduced last year and discuss further in this *Tech Brief,* lawyers and others involved in the structuring of funds should have some level of awareness of certain of the new and proposed changes to US GAAP and International Financial Reporting Standards, particularly those that introduce or amend criteria for determining whether an entity is deemed to be an investment fund for financial reporting purposes, as well as separate amendments that may result in some investment managers having to consolidate certain of the funds they manage into the financial statements of the investment manager. Managers of some funds may seek changes to fund structures, agreements or governance processes in order to avoid undesirable reporting outcomes in certain circumstances.

On the regulatory front, there continues to be refinements to existing regulatory frameworks affecting the investment management industry, as well as some new requirements. In practice, we have observed that some in the investment management industry were unaware of certain changes, such as those to CFTC registration requirements that greatly expand the number of investment managers required to register with the CFTC. This *Tech Brief* summarizes the CFTC changes, as well as provides updates on various other regulatory matters.

Finally, we summarize some considerations in relation to fund liquidations in the Cayman Islands, and have embedded a link to a more detailed document that will be of use to practitioners. We have also included a sidebar discussion on alternatives to liquidation in circumstances where a fund manager is seeking a wind down of a fund with significant illiquid positions.

Links to our previously issued *Tech Briefs* are available at the end of this document. Readers might find it helpful referring to the previous versions of the *Tech Brief* in addition to this volume to obtain a more complete understanding of developments over the past year.

We welcome any comments or suggestions for future issues. Our contact details appear on the last page of this *Tech Brief*.

United States Generally Accepted Accounting Principles Update

Recent US GAAP Update – Amendments to ASC 820 *Fair Value Measurement* ("ASC 820") (amendments issued through the release of ASU 2011-04 *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*)

Status – For non-public entities, the amendments are effective for annual periods beginning after December 15, 2011. Non-public entities may apply the amendments early, but no earlier than for interim periods beginning after December 15, 2011.

Summary – The ASU provides amendments to ASC 820 as a result of convergence efforts between the FASB and the International Accounting Standards Board ("IASB"). In addition to wording and IFRS comparability changes, the ASU requires new disclosure of quantitative information about the significant unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy. In accordance with ASC 820, all quantitative information is required to be presented in a tabular format. To aid in applying these new disclosure requirements, an example table is provided within ASU 2011-04 to demonstrate how an entity may disclose such information. A modified and abridged version of this example of the additional disclosures follows on the table on the next page:

Example Disclosures - Quantitative Information About Level 3 Fair Value Measurements				
Security Type	**Fair Value**	**Valuation Technique**	**Unobservable Input**	**Range (Weighted Average)**
Residential mortgage-backed securities	$ 12,500,000	Discounted cash flow	Constant prepayment rate Probability of default Loss severity	3.5%-5.5% (4.5%) 5%-50% (10%) 40%-100% (60%)
Collateralized debt obligations	$ 3,500,000	Consensus pricing	Offered quotes Comparability adjustments (%)	20-45 -10% -+15% (+5%)
Credit contracts	$ 3,800,000	Option model	Annualized volatility of credit Counterparty credit risk Own credit risk	10%-20% 0.5%-3.5% 0.3%-2.0%

Some specific provisions of ASU 2011-04 are not required for non-public entities. These provisions include:

- Information about transfers between Level 1 and Level 2 of the fair value hierarchy and;
- information about the sensitivity of Level 3 securities to changes in unobservable inputs.

ASU 2011-04 also requires a reporting entity to disclose a description of the valuation processes used by the entity in determining Level 3 fair value measurements. This description may include, for example, how a reporting entity decides its valuation policies and procedures and how it analyzes changes in fair value measurements from period to period. ASU 2011-04 includes implementation guidance on factors a reporting entity may consider disclosing to meet this reporting requirement. Note that we have observed some confusion as to the distinction between valuation processes and valuation techniques. There has been a long-standing requirement to disclose information about valuation techniques used for Level 2 and 3 fair value measurements. The incremental disclosures required this year relate to a description of the valuation processes for Level 3 measurements. Valuation *techniques* are methods used to derive the fair value measurement (e.g., discounted cash flow approach, option models), whereas valuation *processes* relate to an entity's policies and procedures associated with the fair value measurements and methods they used to develop or test related information (e.g., disclosures of the responsible group and internal reporting procedures within the entity, methods used to develop and substantiate unobservable inputs).

Other matters within the amendments

Application of premiums and discounts in a fair value measurement- The amendments in this ASU clarify that the application of premiums and discounts in a fair value measurement is related to the unit of account for the asset or liability being measured at fair value. The amendments specify that in the absence of a Level 1 input, a reporting entity should apply premiums or discounts when market participants would do so when pricing the asset or liability. The amendments clarify that premiums or discounts related **to size** as a characteristic of the reporting entity's holding (specifically, **a blockage factor)** rather than as a characteristic of the asset or liability (for example, a control premium) are **not permitted** in a fair value measurement. Prior to this amendment, a reporting entity may have previously applied a blockage discount to a large holding that was included within Level 2 or 3. The amendments in this ASU prohibit the application of blockage discounts for all fair value measurements, including those within Level 2 or 3. Blockage discounts were not permitted for Level 1 measurements under existing guidance, so these amendments will have no effect on such measurements.

<u>Use of broker quotes or pricing services – fair value measurement disclosures</u> - In circumstances where a reporting entity uses broker quotes or pricing services as its primary basis for determining certain Level 3 fair value measurements, this ASU does not require the entity to create quantitative information for purposes of complying with the additional quantitative disclosure requirements regarding unobservable inputs, if such unobservable inputs were not developed by the entity. However, when providing this disclosure, a reporting entity cannot ignore quantitative unobservable inputs that are significant to the measurement and are reasonably available to the reporting entity.

Overall, ASU 2011-04 amends ASC 820 to be more comparable with IFRS 13 *Fair Value Measurement* ("IFRS 13"); however, readers and preparers of financial statements should become familiar with the subtle differences between the two. Refer to the section on IFRS 13 in this *Tech Brief* for a further discussion of the significant differences between the amendments to ASC 820 under ASU 2011-04 and IFRS 13.

<u>Recent US GAAP Update</u> – Amendments to Balance Sheet (Topic 210) – *Disclosures about Offsetting Assets and Liabilities* (amendments issued through the release of ASU 2011-11)

<u>Status</u> – An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented.

<u>Summary</u> - The amendments in this ASU require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position.

Offsetting refers to the netting of certain assets and liabilities for purposes of presentation in the financial statements. Under US GAAP, in specific circumstances, an entity is permitted to elect to net certain assets and liabilities in the financial statements. However, differences exist between the offsetting requirements under US GAAP and IFRS, leading to potentially significant differences in the amounts presented in the statements of financial position prepared in accordance with US GAAP and amounts presented in those statements prepared in accordance with IFRS. As well, as the decision to offset under US GAAP is elective (i.e., an accounting policy choice), differences may exist in the amounts reported between like entities depending on whether offsetting is elected. These potential differences reduce the comparability of statements of financial position. As a result, users of financial statements requested that the differences should be addressed by the standard setters.

By way of background, generally speaking, under US GAAP, a reporting entity can elect to offset recognized financial instruments and derivative instruments relating to a specific counterparty where the reporting entity has a legally enforceable right to offset and the reporting entity intends to settle such instruments on a net basis. A reporting entity can also elect to offset derivatives and certain other financial instruments such as repurchase agreements where such instruments are part of a master netting agreement or similar arrangement (even if the reporting entity does not intend on settling on a net basis). (See IFRS section of this *Tech Brief* for the IFRS offsetting requirements.)

Under this ASU, an entity is required to disclose in its footnotes both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. The objective of this disclosure is to facilitate comparison between those entities that prepare their financial statements on the basis of US GAAP and those entities that prepare their financial statements on the basis of IFRS, as well as between US GAAP entities that may vary in their decision to elect offsetting.

To meet the objective in the preceding paragraph, an entity shall disclose at the end of the reporting period the following quantitative information separately for assets and liabilities that are within the scope of these amendments (regardless of whether the entity elects to offset or not):

a. The gross amounts of those recognized assets and those recognized liabilities

b. The amounts offset in accordance with the guidance in ASC 210-20-45 and 815-10-45 to determine the net amounts presented in the statement of financial position

c. The net amounts presented in the statement of financial position

d. The amounts subject to an enforceable master netting arrangement or similar agreement not otherwise included in (b):

1. The amounts related to recognized financial instruments and other derivative instruments that either:
   i. Management makes an accounting policy election not to offset.
   ii. Do not meet some or all of the guidance in either ASC 210-20-45 or ASC 815-10-45.

2. The amounts related to financial collateral (including cash collateral).

e. The net amount after deducting the amounts in (d) from the amounts in (c).

The information required above shall be presented in a tabular format, separately for assets and liabilities, unless another format is more appropriate. The tables on the next page are reprinted from ASU 2011-11 (Readers are advised to review the fact set accompanying this example within the guidance). This example illustrates the application of disclosures (a)–(e) above by type of financial instrument. Refer to ASU 2011-11 for additional detail. The example shows the presentation aggregated by financial instrument type. An entity may choose to present by financial instrument type for disclosures (a) to (c) above, and then by counterparty for disclosures (c) to (e) (Refer to ASU 2011-11 for examples).

Offsetting of Financial Assets and Derivative Assets

Description	(i) Gross Amounts of Recognized Assets		(ii) Gross Amounts Offset in the Statement of Financial Position		(iii) = (i) - (ii) Net Amounts of Assets Presented in the Statement of Financial Position		(iv) Gross Amounts Not Offset in the Statement of Financial Position: Financial Instruments		(iv) Gross Amounts Not Offset in the Statement of Financial Position: Cash Collateral Received		(v) = (iii) - (iv) Net Amount	
Derivatives	$	100	$	(90)	$	10	$	-	$	-	$	10
Reverse repurchase, securities borrowing, and similar arrangements		90		-		90		(90)		-		-
Other financial instruments		-		-		-		-		-		-
Total	$	190	$	(90)	$	100	$	(90)	$	-	$	10

Offsetting of Financial Liabilities and Derivative Liabilities

Description	(i) Gross Amounts of Recognized Liabilities		(ii) Gross Amounts Offset in the Statement of Financial Position		(iii) = (i) - (ii) Net Amounts of Liabilities Presented in the Statement of Financial Position		(iv) Gross Amounts Not Offset in the Statement of Financial Position: Financial Instruments		(iv) Gross Amounts Not Offset in the Statement of Financial Position: Cash Collateral Pledged		(v) = (iii) - (iv) Net Amount	
Derivatives	$	80	$	(80)	$	-	$	-	$	-	$	-
Reverse repurchase, securities borrowing, and similar arrangements		80		-		80		(80)		-		-
Other financial instruments		-		-		-		-		-		-
Total	$	160	$	(80)	$	80	$	(80)	$	-	$	-

In addition to the quantitative disclosures, an entity will be required to disclose a description of the rights of setoff associated with an entity's recognized assets and recognized liabilities subject to an enforceable master netting arrangement or similar agreement.

There are similar new disclosure requirements under IFRS, although the requirements for offsetting differ. See IFRS section of this *Tech Brief*.

Update on proposed US Accounting Standards Update – *Financial Services – Investment Companies: Amendments to the Scope, Measurement and Disclosure Requirements*

The proposed ASU was issued on October 21, 2011, and comments were due by January 2012.

Background

This proposed ASU included provisions that would amend the existing criteria in ASC 946 *Financial Services – Investment Companies* ("ASC 946") for an entity to qualify as an investment company. Specifically, the criteria within the definition would be expanded and additional implementation guidance would be provided. An entity determined to be an investment company under the amended criteria would continue to measure its investment assets and liabilities at fair value. (A nearly identical IFRS exposure draft was issued by the IASB in 2011, ED/2011/4 *Investment Entities*. A finalized amendment was issued by the IASB in October 2012. This finalized IFRS amendment differed in many respects from the IFRS exposure draft. See the IFRS section of this *Tech Brief* for details on the finalized IFRS amendments.)

Status

Separately, and in some cases jointly with the IASB, the proposed amendments were redeliberated by the FASB throughout 2012. Based on FASB meeting notes, some tentative decisions appear to have been reached. However, this process is fluid and tentative decisions may still change. At the time of writing this *Tech Brief*, the FASB's technical plan calls for a final ASU to be issued in the last quarter of 2012.

Update on proposed US Accounting Standards Update – *Consolidation (Topic 810) – Principal versus Agent Analysis*

The proposed ASU was issued on November 3, 2011 and comments were due by January 2012. If this proposed ASU was finalized as drafted, some investment managers would have had to consolidate certain of their managed funds into the financial statements of the investment manager. Depending on the outcome of the redeliberation process, this may still be the end result for several investment managers.

Background

As discussed in prior *Tech Briefs,* in 2009 the FASB issued amendments to its consolidation standards which required a reporting entity, such as an investment manager, to perform a qualitative evaluation of its power and economics with respect to a "variable interest entity" (such as certain managed funds) to determine whether it should consolidate that variable interest entity (an investment fund is very often deemed to be a "variable interest entity" under existing guidance in ASC 810).

Based on concerns expressed by various parties on this potential outcome, and also because the International Accounting Standards Board was developing a standard that might lead to different conclusions for entities such as investment managers, the FASB issued in 2010 an amendment that deferred indefinitely the effective date of the amended consolidation requirements for interests in variable interest entities that are deemed to be investment companies under US GAAP.

The indefinite deferral provided temporary reporting relief to investment managers and similar entities with respect to their managed funds, and allowed the FASB to develop more specific guidance for evaluating whether a decision maker, such as an investment manager, is using its decision-making authority as a principal or an agent, and whether it should consolidate another entity. The proposed new guidance was contained in this proposed ASU.

The proposed amendments - principal versus agent assessment – consolidation – impact on investment managers

The amendments in this proposed ASU would rescind the indefinite deferral that previously existed for interests ("interests" is a broad term in this context, and includes fees) in certain entities, and would require all variable interest entities, including interests in investment funds, to be evaluated for consolidation under the revised guidance included in this proposed ASU. In addition, other amendments have the effect of requiring the same evaluation for interests in all entities, including investment funds that are not deemed to be "variable interest entities".

Generally, the effect of this proposed guidance in an investment management environment is that a manager would have to assess whether it is using its power over a fund primarily in the capacity of a "principal" or an "agent". Such analysis affects the determination as to whether an investment manager would have to consolidate the fund. Where the investment manager is deemed to be acting primarily for its own benefit (i.e., it is the "principal") then the investment manager would consolidate the fund. If the investment manager is deemed to be acting primarily for and the benefit of others such as investors (i.e., the investment manager is only an "agent" for the investors), then the investment manager would not consolidate the fund. The proposed ASU included guidance on the considerations a reporting entity would use in making this determination, including examples of consideration points in an investment management environment.

The guidance in the proposed ASU was similar, but not identical, to that within IFRS in the newly issued standard on consolidations, IFRS 10. (See IFRS section for a further discussion).

Status

As anticipated, the proposed ASU attracted substantial formal and informal commentary. The FASB has been redeliberating the proposed guidance and has reached some tentative decisions on amendments. There are still some further open items and refinements to be considered. The FASB anticipates the issuance of a further document (either a proposed or final ASU) in the first half of 2013.

International Financial Reporting Standards ("IFRS") Update

Recent IFRS Update – IFRS 10 *Consolidated Financial Statements* ("IFRS 10")

Status – IFRS 10 is to be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

Summary - IFRS 10 changes the basis of consolidation from the existing consolidation guidance in IAS 27 *Consolidated and Separate Financial Statements* ("IAS 27") and SIC 12 *Consolidation – Special Purpose Entities* ("SIC 12"). IAS 27 uses a governance/economic benefits model to determine whether one entity should consolidate another entity, whereas

SIC 12 uses a risk/rewards model. These two models place emphasis on similar but not identical factors, leading to inconsistencies in application. This is exacerbated by lack of clear guidance on which investees are within the scope of IAS 27 versus SIC 12. Entities vary in their application of the control concept particularly in circumstances in which a reporting entity controls another entity but holds less than a majority of the voting rights of the investee, and in circumstances involving agency relationships (such as in investment manager – investor relationship, where the investment manager acts partly or wholly on behalf of investors). One of the primary intents of IFRS 10 is to lead to more consistent application in practice.

IFRS 10 uses the concept of "control" as the single basis for consolidation, and if an investor "controls" an investee, the investor would consolidate the investee. IFRS 10 identifies three elements that must be present to establish control:

- Power over the investee (i.e. the investor has the rights that give it the current ability to direct the relevant activities of the entity that significantly affect the investee's returns). Examples of conditions of power might be voting rights or rights that exist under management agreements.

- Exposure, or rights, to variable returns from its involvement with the investee. Examples include rights to dividends or servicing fees under management contracts that depend on the performance of the investee.

- The ability to use its power over the investee to affect the amount of the investor's returns.

All three elements must be present in order to conclude that an investor controls an investee.

Impact on investment funds – On October 31, 2012, the IASB issued amendments to various standards, that have the effect of exempting 'investment entities' (to the extent they meet the prescribed criteria) from the application of the consolidation provisions of IFRS 10 to subsidiaries controlled by the investment fund. Instead, investment entities will be required to measure such investments at fair value through profit or loss. The details of these amendments are discussed in the next section of this *Tech Brief*.

Impact on investment managers – In practice, to a certain extent, whether IFRS 10 will impact whether an investment manager consolidates any investment funds it manages may depend on how IAS 27 and SIC 12 have been interpreted and applied historically. With respect to the new control criteria in IFRS 10, in most circumstances, an investment manager will have the first two elements of control discussed above with respect to a fund it manages: the investment manager typically will have the power to direct relevant activities of the fund through its management agreement, and the investment manager will have exposure to variability of returns (through management and/or performance fees, and/or through a direct investment). For an investment manager, the determination as to whether their power influences their returns will depend on whether the manager is deemed to be a principal or an agent. It can be anticipated that more investment managers will now be required to consolidate certain of their managed investment funds, as the guidance more clearly describes assessment criteria in principal-agency relationships. Additionally, IFRS 10 includes specific investment management examples in the application guidance (discussed below), and an investment manager's interest with respect to a fund may conform to the fact pattern contained in one of the examples that suggest consolidation would be more appropriate.

Discussion

In many circumstances, the assessment of control is straightforward, such as where an operating company owns the full voting shares of another operating entity. In an investment management environment, however, the assessment is not as straightforward, as the investment manager is granted decision-making rights to direct certain or all of a fund's activities through contractual arrangements and/or service agreements. The investment manager is said to be in a form of an 'agency relationship' with the investor(s) of the fund, and IFRS 10 contains guidance to determine whether the investment manager is acting primarily as a principal or as an agent for the investors of the fund. Where the investment manager is deemed to be acting primarily for its own benefit (i.e., it is the 'principal') then the investment manager 'controls' the fund and would consolidate the fund. If the investment manager is deemed to be acting primarily for and the benefit of others such as investors (i.e., the investment manager is only an 'agent' for the investors or principals), then the investment manager does not 'control' the fund and would not consolidate.

The determination of whether an investment manager is acting primarily as a principal or as an agent is based on an assessment of the facts and circumstances. IFRS 10 provides some criteria that can be examined in making this determination, such as:

- The scope of their decision making authority over the investee;
- rights held by other parties;
- the remuneration to which it is entitled (including whether it is commensurate with the services provided and whether any non-standard terms are included);
- their exposure to variability of returns from other interests held in the investee; and
- the rights of a single party to remove the investment manager.

IFRS 10 provides examples to aid in assessing whether an investment manager is deemed to control an investment fund it manages. The series of examples provide an iterative fact pattern, with each successive example adding an additional fact. With respect to a hedge fund, the examples suggest that an investment manager with an interest in a fund consisting solely of a typical hedge fund management fee structure (the examples use a 2% management fee and 20% performance fee) might not consolidate the fund, but a manager with this fee structure coupled with a significant direct investment in the fund (the example uses a 20% investment interest) might be suggestive that the manager is acting as the principal of the fund and would consolidate the fund. There are other factors that should be analyzed as well, and the examples together with the full application guidance discuss these factors. There is no 'bright-line' test; the determination will require judgment.

Many contend that a scenario where a fund manager consolidates a fund it manages renders the financial statements of the fund manager less meaningful. Upon consolidation, the full assets and liabilities of the underlying fund are brought onto the books of the investment manager, and the management and performance fees are eliminated as a consolidating entry.

<u>Comparison with US GAAP</u>

The provisions of issued IFRS 10 are similar to the provisions of proposed amendments to US GAAP that were contained within the proposed Accounting Standards Update – *Consolidations (Topic 810) – Principal vs Agent Analysis.* This proposed ASU was issued in November 2011, with comments due in early 2012. As a result of comments received by the FASB, the FASB is redeliberating the provisions of the proposed ASU. At the time of the writing of this *Tech Brief,* the content of a revised proposed or final ASU has not been finalized by the FASB.

Recent IFRS Update – *Investment Entities – Amendments to IFRS 10, IFRS 12 and IAS 32*

Status – The amendments are effective for annual periods beginning after January 1, 2014. However, earlier application is permitted. Note that given that the effective date of these amendments is a year later than the effective date of the new consolidation guidance (IFRS 10, which is effective in 2013), it is anticipated that many investment funds will adopt these amendments early to enable the investment fund to be exempted from applying the new consolidation requirements to investee entities which the investment fund is deemed to control.

Summary - The amendments provide for an exemption from consolidation of subsidiaries under IFRS 10 for entities which meet the definition of an 'investment entity', such as certain investment funds. Such entities would instead measure their investment in particular subsidiaries at fair value through profit or loss. The guidance within these issued amendments differs in many respects from the exposure draft issued by the IASB in 2011 (ED 2011/4 *Investment Entities*).

The amendments define an 'investment entity' as an entity that:

- obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both, and
- measures and evaluates the performance of substantially all of its investments on a fair value basis.

An entity is required to consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. The amendments provide that an investment entity should have the following 'typical' characteristics:

- more than one investment
- more than one investor
- investors that are not related to the entity or other members of the group containing the entity
- ownership interests, typically in the form of equity or similar interests (e.g. partnership interests), to which proportionate shares of the net assets of the investment entity are attributed.

If an entity does not meet one or more of these typical characteristics, it is required to justify and disclose how its activities continue to be consistent with that of an investment entity. Additional guidance is provided in determining whether an entity is an investment entity, such as the impacts of being involved in the day-to-day management of an investee or providing investment-related services to third parties, the nature of the entity, and how the entity measures and manages its financial liabilities. The application guidance also includes an example of a typical master-feeder structure, with a conclusion (based on the fact pattern presented) that no feeder funds in such structures would need to consolidate the master fund.

The types of entities which may meet the definition of an investment entity include most investment funds, including mutual funds, private equity and venture capital structures, pension funds and sovereign wealth funds.

Where an entity meets the definition of an investment entity, it is not permitted to consolidate its subsidiaries and is required to measure its investments in those subsidiaries at fair value through profit or loss. However, an investment entity is still required to consolidate a subsidiary where that subsidiary provides services that relate to the investment entity's investment activities.

The amendments also:

- introduce new disclosure requirements related to investment entities in IFRS 12 *Disclosure of Interests in Other Entities* and IAS 27 *Separate Financial Statements;*
- provide a scope exemption for investment entities from IFRS 3 *Business Combinations* (meaning such entities do not need to apply business combination accounting to the acquisition of subsidiaries);
- include various consequential amendments to numerous other standards.

The amendments do not introduce any new accounting requirements for investments in associates or joint ventures. IAS 28 *Investments in Associates and Joint Ventures* already permits an investment fund to measure investments in associates and joint ventures at fair value through profit or loss in accordance with IFRS 9 or IAS 39, and the IASB expects that investment entities would apply these

Recent IFRS Update – IFRS 13 *Fair Value Measurement* ("IFRS 13")

Status – IFRS 13 is to be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

Summary – IFRS 13 defines fair value, establishes a single framework for measuring fair value, and requires disclosures about fair value measurements. IFRS 13 does not require any new fair value measurements and does not intend to establish valuation standards or practices outside of financial reporting. IFRS 13 conforms in most respects to a similar existing accounting standard under US GAAP, ASC 820 *Fair Value Measurement*.

Similar to ASC 820 under US GAAP, the primary purpose of IFRS 13 is to establish a single, consistent standard for defining, measuring and disclosing information on fair value. Prior to IFRS 13, such fair value concepts were dispersed throughout various multiple standards.

Amongst other new disclosure requirements, IFRS 13 will increase the amount of detail that needs to be disclosed within the fair value hierarchy table. An entity will be required to disaggregate its classes of financial assets and liabilities by their nature, characteristics and risks. The resulting disclosure will generally require greater disaggregation within the fair value hierarchy table than the line items presented in the statement of financial position. Such disaggregation is similar to the existing requirements under US GAAP in ASC 820. IFRS 13 *Illustrative Examples* provides sample disclosure of the hierarchy table under IFRS 13. Similar to ASC 820, the example shows financial assets disaggregated by such categories as industry, strategy, and underlying risk, among others.

One fair value measurement aspect of IFRS 13 might change how some investment funds measure the fair value of their portfolio. IFRS 13 eliminates the requirement for entities to use bid prices for asset positions and ask prices for liability positions. Such pricing is permitted, but not required. In practice, many investment funds reporting under IFRS have used the last price to measure fair value, leading to differences between practice and the existing IFRS measurement requirement to use bid and ask prices. Where such differences are significant, some funds have even used a dual net asset value approach, using last price for ongoing operations, and bid and ask prices for financial reporting. Some investment funds may choose to early adopt IFRS 13 to eliminate these differences.

Generally speaking, the guidance within IFRS 13 is substantially the same as ASC 820. Some of the main differences between the two standards are as follows:

- <u>Sensitivity analysis</u> – IFRS 13 requires a qualitative sensitivity analysis for Level 3 measurements. Under ASC 820, non-public companies are exempt from reporting a qualitative sensitivity analysis for Level 3 securities. IFRS provides no such exemption. Note that IFRS requires, under a separate standard, IFRS 7 *Financial Instrument: Disclosures*, a sensitivity analysis to changes in market risk factors (for which there is no equivalent under US GAAP).

- <u>'Practical expedient' for investments in other investment funds</u> – ASC 820 provides for a 'practical expedient' that allows, in specific circumstances, for an entity with an investment an investment fund to measure such investment at the reported net asset value without adjustment. IFRS 13 does not have a similar provision.

- <u>Transfers between Level 1 and Level 2 of the Fair Value Hierarchy</u> – IFRS 13 requires disclosure of transfers between Levels 1 and 2 of the fair value hierarchy. Under ASC 820, such disclosure is not required for non-public entities.

- <u>Effect of changes in unobservable inputs</u> – IFRS 13 requires an entity to disclose the effect of changes to significant unobservable inputs if changing one or more of the inputs would change fair value significantly. No such disclosure is required under ASC 820.

<u>Recent IFRS Update</u> – Amendments to IFRS 7 – *Disclosures – Offsetting Financial Assets and Liabilities*

<u>Status</u> – An entity shall apply these amendments for annual periods beginning on or after January 1, 2013 and interim periods within those annual periods. An entity shall provide the disclosures required by those amendments retrospectively.

<u>Summary</u> – Similar to amendments to US GAAP on offsetting (discussed elsewhere in this *Tech Brief*), the amendments require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position.

In the US GAAP section of this *Tech Brief*, we discussed the general offsetting requirements under US GAAP. Under IFRS, a reporting entity <u>must</u> offset financial instruments and derivative instruments where there is a legally enforceable right of offset, and the reporting entity intends on settling net (or simultaneously). This contrasts with US GAAP where offsetting is elective when conditions exist. As well, under US GAAP, a reporting entity can also elect to offset derivatives and certain other financial instruments such as repurchase agreements where such instruments are part of a master netting agreement or similar arrangement (even if the reporting entity does not intend on settling on a net basis). Under IFRS, there is no similar requirement with respect to master netting or similar agreements.

The quantitative and qualitative disclosure requirements with respect to offsetting are similar to US GAAP. Refer to the US GAAP section of this *Tech Brief* for examples (as well as to the Application Guidance section within IFRS 7).

Regulatory Update

Regulatory Update – Registration of advisers with the U.S. Commodity Futures Trading Commission ("CFTC")

In early 2012, the CFTC announced the adoption of amendments to its rules governing 'commodity pool operators' (definition discussed below) and commodity trading advisers under the US Commodity Exchange Act. Of particular importance to private investment fund managers is the elimination of the registration exemption afforded under CFTC Rule 4.13(a)(4), which essentially allowed a commodity pool operator to be exempt from registration with the CFTC if all the investors in the commodity pool were considered "qualified eligible persons". This exemption was available regardless of the level of futures (or other covered transactions) activity. Commodity pool operators will now generally have to register with the CFTC unless they qualify for a *de minimus* exemption, which is discussed further below.

Commodity pools and commodity pool operators

An investment fund is considered a 'commodity pool' if it engages, directly or indirectly, in any futures activity, as well as in certain commodities and over-the-counter foreign exchange transactions and swaps that are subject to CFTC jurisdiction (collectively, such positions are termed 'commodity interests'). Therefore, even if the investment fund enters into a single contract, it is considered a commodity pool. The operator (typically the investment manager) of the commodity pool is considered a 'commodity pool operator'. The commodity pool operator must register with the CFTC unless it qualifies and applies for an exemption.

The *de minimus* exemption

CFTC Rule 4.13(a)(3) provides for a *de minimus* exemption if the commodity pool engages in only limited activity in commodity interests. Amongst other requirements, to be eligible for this exemption, investors in the commodity pool must all be "accredited investors" (or certain other specific investors). A commodity pool qualifies for the *de minimus* exemption if it meets one of the two following tests:

- The 5% 'Margin' test – the aggregate initial margin and premiums required to establish its commodity interest positions (determined at the time the most recent commodity interest position was established) does not exceed **5%** of the liquidation value of its portfolio (after taking into account the unrealized profits and losses on such positions); **or**

- The 100% 'Notional' test - the aggregate net notional value of the fund's commodity interest positions (determined at the time the most recent commodity interest position was established) does not exceed 100% of the liquidation value of its portfolio (after taking into account the unrealized profits and losses on such positions)

A commodity pool operator seeking to use this registration exemption must actively apply for such exemption. There are no grandfathering provisions.

Fund of funds

Fund of funds face particularly challenging issues with respect to the CFTC rules because they do not usually direct the investment activities of the investee funds and may have limited transparency into investee funds. A fund of funds generally is deemed a commodity pool (and the investment manager of the fund of funds a commodity pool operator) if any of its underlying funds hold commodity interests. A fund of funds is eligible for the *de minimus* exemption on a look-through basis, but with possible limited transparency into underlying funds throughout the operating period, the manager of the fund of funds may find this challenging to ascertain. The manager of the fund of funds may try to seek affirmation from the underlying investee funds that they do not invest in commodity interests (beyond the *de minimus* limit), or face registration.

While fund of funds managers face compliance challenges, the CFTC, in our view, equally faces enforcement challenges. We will monitor how this plays out over the coming year(s), and perhaps a degree of relief or further practical guidance might be forthcoming from the CFTC in the future with respect to fund of funds. Since finalization of its rules, the CFTC has put out some guidance and we anticipate that more will be forthcoming.

Reporting and other requirements

Registered commodity pool operators have initial and ongoing reporting and other requirements. Some reporting and disclosure relief is provided for commodity pool operators with foreign commodity pools (pools organized offshore with only non-US investors), and for commodity pools with investors which are all “qualified eligible persons”. However, such commodity pool operators must still register with the CFTC.

Summary

The CFTC rules and interpretation thereof can be complex, and to the extent a fund manager engages in any such activity, either directly, or indirectly through another investment vehicle in which it invests, the fund manager should seek advice from its legal counsel. As an aid to understanding the myriad of operator and pool exemptions, some practitioners have found an ‘easy reference guide’ to the CFTC (Part 4) exemptions produced by the National Futures Association to be very useful. A link (which is live as of November 2012) to this guide can found here: NFA Easy Reference Guide

Regulatory Update – US- Dodd-Frank Act – private fund registration and other requirements – an update

In our prior two issues of the *Tech Brief*, we covered in some detail the new SEC registration requirements for private fund advisers (links to prior editions of the *Tech Brief* can be found at the end of this issue). As of October 2012, approximately 1,500 additional private fund advisers have registered as a result of the amended requirements, bringing total private fund advisers registered with the SEC to approximately 4,000.

Some observed areas of uncertainty

For the most part, those within the investment management industry are aware of the new initial and ongoing reporting and other requirements. We have observed a few areas of uncertainty, two of which are discussed below.

One matter causing some confusion is the definition of 'regulatory assets under management', and in particular, the treatment of short positions, derivatives, repurchase agreements and other financial instruments for purposes of calculating regulatory assets under management. The SEC had indicated in their implementing rules that regulatory assets under management is meant to be gross assets without deduction of "any outstanding indebtedness or other accrued but unpaid liabilities". With this definition, there was some uncertainty as to what should be considered 'indebtedness' or 'unpaid liabilities' (for example, is a liability for securities sold short considered 'indebtedness'?). The SEC updated their frequently asked questions (related to Form ADV and the IARD) in February 2012 to indicate that a private fund should use gross assets as reported on its balance sheet. Therefore, for example, the value of any securities sold short would not be deducted. As a further clarifying point, a short position in a derivative instrument that is in an unrealized gain position (and therefore included within assets on the balance sheet) would be included in the assets under administration calculation.

Another area of observed confusion is the concept of an "exempt reporting adviser". Confusion perhaps is rooted in the label itself, but, in short, an exempt reporting adviser is an adviser that is exempt from registration, but is subject to certain reporting requirements. By way of background, the SEC has provided specific (non-mandatory) exemptions from registration with the SEC for certain private fund advisers with less than $150 million in assets under administration and to certain managers of venture capital funds. Advisers who would otherwise have to register with the SEC because of the general registration requirements, but are exempt from registration because they are relying on either the private fund adviser or venture capital adviser exemptions, are termed "exempt reporting advisers" by the SEC. Although exempt reporting advisers will not have to register with the SEC, they will still be required to file, and periodically update, reports with the SEC using the same Form ADV as registered advisers. Exempt reporting advisers, however, will only have to complete a subset of items on the Form ADV, including, amongst other matters, basic identifying information of the adviser, owners and affiliates, and information about the private funds that the adviser manages.

Regulatory Update – US - Dodd-Frank Act: Confidential Private Fund Risk Reporting Rule and new Form PF – an update

In our previous *Tech Brief*, we described new information reporting required by certain private fund advisers in a new form called 'Form PF.' By way of background, in October 2011, the SEC and the CFTC approved a joint rule, the Confidential Private Fund Risk Reporting rule. This rule, which implements certain sections of the Dodd-Frank Act, requires certain advisers to hedge funds and other private funds to report information for use by the newly established Financial Stability Oversight Council in monitoring risks to the U.S. financial system. The reporting of such information is through a new form called Form PF.

Refer to our prior *Tech Brief* for further details, but readers are reminded that the reporting requirements for 'smaller private advisers' commence for periods ending after December 15, 2012, with initial reporting required by March 2013 ('larger private advisers' had an earlier required initial reporting date).

Readers should also refer to the SEC's frequently asked questions on the preparation of Form PF, which are periodically updated: SEC - Form PF Frequently Asked Questions.

Regulatory Update – US - Dodd-Frank Act: Volcker Rule Restrictions – an update

In our prior *Tech Briefs*, we have discussed the 'Volcker Rule'. By way of background, the so-called 'Volcker Rule' components (colloquially termed the 'Volcker Rule' after a similar set of rules proposed by Paul Volcker, a former US Federal Reserve Chairman) of the Dodd-Frank Act dictate that, subject to rules and certain exceptions, any "banking entity" (generally defined as an insured depository institution), and any affiliate or subsidiary of any such entity, will generally be prohibited from engaging in 'proprietary trading' (as defined), will have limits placed on ownership interests in hedge funds and private equity funds, and will be prohibited from sponsoring a hedge fund or private equity fund. The Volcker Rule applies to US banking organizations, regardless of where the trading or activities are centered. For non-US banking organizations, the Volcker Rule is applicable for any trading and fund activities in the US, or activities outside of the US if such activities involve offering securities to any US resident.

The intention was for the provisions of these rules to be finalized by July 2012. This time period has passed without finalization, but it is anticipated by many that the rule might be finalized in the next few months. After the rule is final, it is anticipated that a transitional period will give banks until July 21, 2014 to conform their activities to the rule, unless the period is extended by the rulemakers.

Regulatory Update – US - SEC Custody Rule – an update

In previous editions of our *Tech Brief,* we touched upon amendments that were issued by the SEC to the custody requirements of Rule 206(4)-2 under the Investment Advisers Act of 1940 (the "Custody Rule"), which were intended to increase protections for investors who entrust assets to advisers who are registered with the SEC. The amendments to the Custody Rule contain a number of key provisions related to: independent verification, internal control reports, delivery of account statements, additional disclosures and qualified custodians.

In relation to the Custody Rule, custody refers to an investment adviser holding, directly or indirectly, client funds or securities or having any authority to obtain possession of them. Custody in the context of the Custody Rule refers to more than just physical custody, and most advisers to investment funds are deemed to have custody of investors' invested capital.

A number of clarifying frequently asked questions and answers have been developed by SEC staff in relation to the Custody Rule. We referred to some of these in our 2011 and 2010 *Tech Briefs*. Some further additional frequently asked questions have been added over the last year, the majority of which relate to various aspects of auditor independence.

The Custody Rule can be found at the following link: SEC Custody Rule

The frequently asked questions can be found at Staff Responses to Questions About the Custody Rule

A sidebar - Eligible auditors of funds managed by SEC registered advisers

In order for a fund adviser registered with the SEC to use the audited financial statements to satisfy certain of its requirements under the Custody Rule, the adviser must engage an independent auditor that is **both** a) registered with the Public Company Accounting Oversight Board ("PCAOB") and b) subject to regular inspection by the PCAOB.

Any audit firm can register with the PCAOB, but only certain audit firms are subject to inspection by the PCAOB. If an auditor isn't subject to inspection, the PCAOB has no authority to inspect the audit firm. An audit firm is subject to inspection if it either audits an "issuer" (an issuer is a public company that is required to file reports with the SEC or that has filed a registration statement with the SEC for a public offering of securities), or plays a "substantial role", as defined, in the furnishing of an audit report with respect to an issuer.

If an auditor is not subject to inspection pursuant to the two circumstances above, the auditor is ineligible to perform the annual audit for purposes of the Custody Rule. Note that auditing funds of an SEC registered adviser does not make an auditor subject to inspection, as the funds are not deemed to be an 'issuer'.

[Note: Deloitte Cayman Islands is registered with the PCAOB and is subject to inspection by the PCAOB. There are six other audit firms in the Cayman Islands that are registered with the PCAOB (as of November 1, 2012), four of which are subject to inspection by the PCAOB (based the PCAOB website)].

Under the revised Form ADV to be completed annually by the registered adviser, the registered adviser is required to positively affirm whether the independent public accountant is registered with, and subject to inspection by, the PCAOB.

Regulatory Update – US - Foreign Account Tax Compliance Act ("FATCA")

Background

In March 2010, the *Hiring Incentives to Restore Employment* ("HIRE") Act was signed into law in the US which included provisions of FATCA. The purpose of FATCA is to impede the use of foreign accounts by U.S. persons/taxable entities for the purpose of evading U.S. taxes.

At a high level, FATCA will require foreign financial institutions ("FFIs"), including investment vehicles, which receive any U.S. source income (directly or indirectly) to either have an information reporting agreement with the U.S. Treasury ("FFI Agreement") or be subject to a withholding tax equal to 30 percent on any withholdable payment. A withholdable payment includes U.S. sourced interest, dividends and other profits as well as the gross proceeds from the sale or disposition of any assets that could produce interest or dividends from U.S. sources (including total return swaps on U.S. entities).

Under an annual FFI Agreement, the FFI will need to obtain information from each of its account holders to determine if it is owned by U.S. persons/taxable entities and report information to the U.S. Treasury relating to those U.S. accounts. The FFI will also be required quarterly to calculate and publish its pass-through payment percentage, based on the ratio of its US assets to total assets.

Recent update

A number of updates and implementing notices have been issued by the IRS since FATCA was announced. Most recently, on October 24, 2012, the IRS released Notice 2012-42 delaying certain FATCA requirements. The notice presents new timelines for due diligence, withholding and documentation requirements, as well as guidance on gross proceeds and grandfathered obligations. The following are the key timeline changes announced:

- FFI Application – The deadline for entering into an FFI agreement has been deferred until December 31, 2013 (pushed back from June 30, 2013).

- New Accounts - The requirement to implement new account onboarding procedures has moved to January 1, 2014 for U.S. 'Withholding Agents', 'Participating FFIs', and 'Registered Deemed-Compliant FFIs' (pushed back from January 1, 2013 for U.S. Withholding Agents and July 1, 2013 for Participating FFIs and Registered Deemed-Compliant FFIs).

- Pre-existing Accounts –
    - Pre-existing entity account documentation for clients identified as 'Prima Facie FFIs' has moved to June 30, 2014 for U.S. Withholding Agents, Participating FFIs, and Registered Deemed-Compliant FFIs (pushed back from December 31, 2013 for U.S. Withholding Agents).
    - Preexisting entity account documentation for clients not identified as Prima Facie FFIs has moved to December 31, 2015 for U.S. Withholding Agents, Participating FFIs, and Registered Deemed-Compliant FFIs (pushed back from December 31, 2014 for U.S. Withholding Agents and June 30, 2015 for Participating FFIs and Registered Deemed-Compliant FFIs).
    - Preexisting individual account documentation for high value clients has been generally pushed back to December 31, 2014 for Participating FFIs (pushed back from June 30, 2014).
    - Preexisting individual account documentation for non-high value clients has been generally pushed back to December 31, 2015 (pushed back from June 30, 2015).

- Withholding -
    - There is no change to income withholding which begins on January 1, 2014.
    - Gross proceeds withholding now begins on January 1, 2017 (pushed back from January 1, 2015).
    - There is no change to foreign pass-through withholding which begins no later than January 1, 2017.
- Reporting -- Participating FFIs will be required to file the information reports with respect to the 2013 and 2014 calendar years not later than March 31, 2015 (pushed back from September 30, 2014).

Summary

The FATCA implementation process is evolving, with regulations being issued periodically. Deloitte has a dedicated team of FATCA professionals to assist those with implementation issues. For up to date information on FATCA, please visit the Deloitte FATCA Resource Library at the following link: Deloitte FATCA Resource Library

Regulatory Update –CIMA – Mutual Funds (Amendment) Bill 2011 – registration of master funds - update

In December 2011, the Cayman Islands Legislature passed The Mutual Funds (Amendment) Law, 2011, with the intent of requiring Cayman Islands domiciled master funds with one or more Cayman-regulated feeders to register with the Cayman Islands Monetary Authority ("CIMA").

Subsequent to the passing of the amendments in December 2011, there was uncertainty by some with respect to the requirements to register Cayman master funds that had only a single feeder, as some legal practitioners took the view that a master fund that had only a single feeder fund did not meet the definition of a "mutual fund", and were advising their clients that such master funds did not require registration. However, CIMA never intended that single-feeder master funds would be excluded from the scope of these amendments, as the impetus for the amendments was a desire by CIMA to include within its direct regulatory oversight the entity with the trading activity (i.e., the master fund) associated with a Cayman regulated feeder fund.

To clarify this matter, on February 15, 2012, the Ministry of Finance of the Cayman Islands Government issued a release indicating that both the Government and CIMA disagreed with this interpretation (made by some) and that their expectation was that Cayman master funds with one or more Cayman-regulated feeder funds would be registered. To avoid any further ambiguity, the Government announced that it intended to draft a further amending bill to the Mutual Funds Law to ensure absolute clarity that a master fund with even one regulated feeder fund must be registered with CIMA. It was expected that this further amendment would be taken to the Legislative Assembly before the end of March 2012. However, this expected clarifying amendment wasn't taken to the Legislative Assembly by such date, and on March 20, 2012, the Government announced that it needed more time to consider the amendments further. The Government did announce in August 2012 during its budgetary process that it still intends on introducing the amending clarifying legislation during its current fiscal year. In the meantime, many single-feeder master funds have registered with CIMA, as this will be unambiguously required once the clarifying legislation is finalized

A sidebar – strengthening regulation in the Cayman Islands – master funds and other unregistered funds

The amendments to the Mutual Funds Law are intended to strengthen the regulatory regime for master-feeder structures, closing an anomalous regulatory gap that existed for such structures. Prior to this amendment, under the provisions of the then existing Mutual Funds Law, only the Cayman feeder, which is the entity that undertakes only distribution activity, is typically registered and directly regulated; the Cayman master fund, where the investing activity occurs, is typically not. Further, the investors in any non-Cayman feeders, despite having their entire investment capital ultimately within a Cayman investment vehicle, receive no Cayman regulatory benefit, whether direct or indirect. Requiring registration of master funds will close this gap, and make Cayman's legislation in this area similar to most other offshore jurisdictions.

As a regulated fund, the operator of the master fund will be required to annually complete a Fund Annual Return ("FAR") for the master fund. The FAR is filed electronically by the auditor of the fund, together with fund's financial statements. With the FAR for master funds, CIMA will now be able to accumulate general operating and financial information on such funds, and periodically report aggregate industry information regarding master funds.

Additionally, the audit reports on financial statements of registered master funds are required to be issued by an auditor resident in the Cayman Islands and approved by CIMA, similar to the requirement for all other regulated funds. Under the Cayman Islands Mutual Funds Law, auditors have certain obligations to report matters to CIMA with respect to a regulated fund, including, amongst other matters, suspicions that the fund is operating in a manner prejudicial to its investors and creditors, is not maintaining sufficient accounting records, or is carrying on its operations in a fraudulent or criminal manner. An auditor failing to make such report is subject to financial penalties and potential disqualification from serving as auditors of Cayman regulated entities. Such sanctions and penalties would largely be ineffective if levied on non-Cayman firms. Additionally, non-Cayman auditors are unfamiliar with this reporting process and do not have the working history with CIMA to have built up an awareness of the types of matters that are typically reported. Going forward, investors will thus be afforded the additional protections that come with direct Cayman auditor involvement with the master funds.

In the future, other regulatory gaps may be addressed by CIMA as well, such as scoping in all open-ended investment funds into mandatory registration. Currently, open-ended funds with fifteen or less investors are not required to be registered, although many opt to voluntarily register. Many argue that the fifteen-investor threshold is arbitrary, and a fund with, say, 10 investors is fundamentally the same as a fund with 16 investors, and that all investors in open-ended pooled investment vehicles should have the benefit of the same regulatory oversight, including the attendant investor protections. (continued next page…)

Another gap is with respect to liquidating funds. Currently, there is no requirement to have a final audit of a fund's financial statements upon liquidation (an annual audit is only required at each fiscal year end date of the fund). This contrasts with other regulatory bodies such as the SEC, which requires a final audit upon liquidation. The SEC contends that a final audit is an important control to protect investors' assets at a time when they may be particularly vulnerable to misappropriation. We are not aware of any current formal or informal proposals to close such gaps.

Fund liquidations – Cayman Islands considerations and alternative solutions

Stakeholders of investment funds domiciled in the Cayman Islands may periodically encounter circumstances where a fund has reached the end of its operating life. Typically a fund will realize its investments and redeem its shareholders prior to being placed into voluntary liquidation. Stakeholders may be unfamiliar as to the process, timing and other practical issues relating to a Cayman voluntary liquidation. Various decisions and considerations need to be contemplated by the investment manager, directors, administrator, legal counsel and auditors.

To aid practitioners in understanding the voluntary liquidation process, our Deloitte Cayman Financial Advisory Services group has developed a helpful document *Voluntary liquidation of regulated Cayman Islands Funds – Considerations for all stakeholders.* This document can be found at the following link: Guidance for Voluntary Liquidations in the Cayman Islands

Any questions practitioners might have regarding the voluntary liquidation process can be addressed to the Deloitte Cayman professionals listed in the document above.

A sidebar - Illiquid asset solutions – soft wind downs

Our Financial Advisory Services ("FAS") group within Cayman is continuing to see a significant increase in funds in run-off losing critical mass and stakeholder appetite to provide ongoing support. Typically these will be fund of funds or single fund entities with still significant, but highly illiquid assets, or side pockets remaining. We continue to be approached by investment managers and directors who do not wish to liquidate positions in secondary market transactions, recognizing that potentially significantly more value can be driven from a portfolio over time by adopting a low cost run-off strategy. Managers now have an alternative to the standard liquidation through setting up special purpose entities to facilitate the wind down process. Managers elect to hold the existing structures for future use and setup a separate Cayman entity with specific governing documents to facilitate an orderly wind down. This process can be an efficient solution as most, if not all, service providers can be consensually terminated with an oversight or realization manager taking on these roles. In such a structure, our FAS group will report to investors and relieve the investment managers of the difficulties and risks associated with valuing illiquid positions. The revised structure also allows for the investment manager to stay involved with the wind down, by being appointed as a director in the new structure, with various controls written into the company articles. (continued next page…)

Our FAS group is involved in the realization of over 100 side pockets, regularly meeting underlying investment managers to monitor and challenge the underlying realization strategies and assumptions. Recently they have been involved in a transfer of a full portfolio and set of shareholders into a revised structure, providing immediate liquidity options and formulating a plan for long-term realization projections. They have also undertaken a number of secondary market portfolio and individual position transactions.

Archived editions of *Tech Brief*

Archive: Volume 1 – September 2009 Technical Brief for Investment Funds

Tech Brief Volume 1

Archive: Volume 2 – February 2010 Technical Brief for Investment Funds

Tech Brief Volume 2

Archive: Volume 3 – December 2010 Technical Brief for Investment Funds

Tech Brief Volume 3

Archive: Volume 4 – December 2011 Technical Brief for Investment Funds

Tech Brief Volume 4

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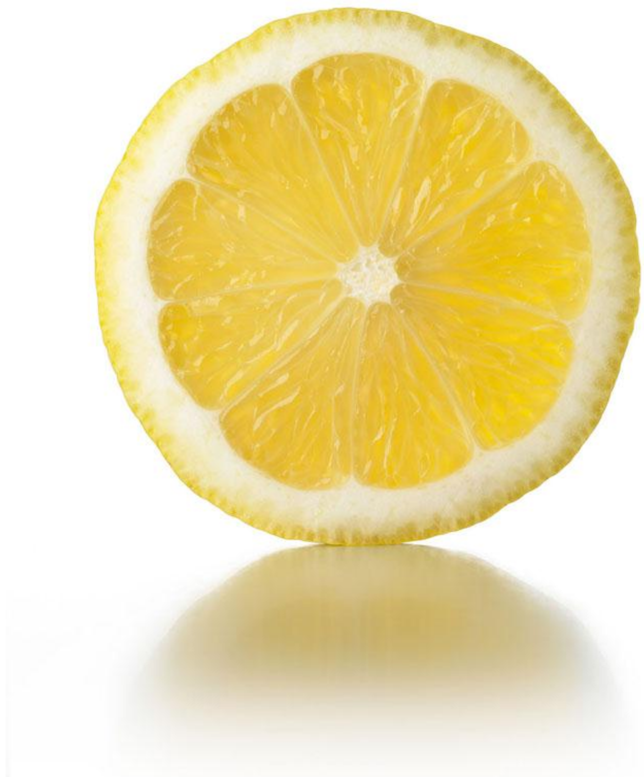

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