Cayman Islands
Assurance and Advisory Services

Technical Brief for Investment Funds

Accounting, Financial Reporting & Regulatory

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Introduction

Welcome to Volume 6 of the *Technical Brief for Investment Funds ("Tech Brief")*, a periodic newsletter developed by the Deloitte Cayman Islands Investment Funds Technical Team.

The major accounting standard setting bodies have put out a number of new amendments and refinements to guidance over the last couple years, many of which became effective in 2013, while others will be effective in 2014. Some of the new requirements are relatively straightforward, while others may be much more complex to apply in practice, such as the new disclosure requirements under IFRS and US GAAP relating to offsetting of assets and liabilities and master netting agreements, and the new IFRS fair value measurement disclosures. 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.

On the regulatory front, there are a number of developments that impact the investment management industry, including the AIFMD, FATCA and with CIMA. This *Tech Brief* discusses these as well as provides brief updates on a few 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.

United States Generally Accepted Accounting Principles Update

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

Status – 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

Summary - The amendments in ASU 2011-11 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 January 2013, the FASB clarified the scope of the offsetting disclosure requirements established by ASU 2011-11 by issuing ASU 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities* ("ASU 2013-01"). The scoping amendments in ASU 2013-01 limit the disclosures under ASU 2011-11 to recognized derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions.

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.

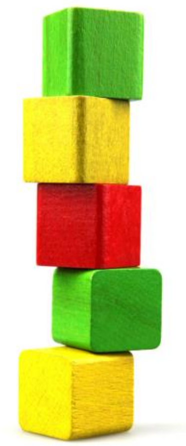
By way of background, generally speaking, under US GAAP, a reporting entity can elect to offset recognized financial instruments and derivative instruments relating to a specific counterparty where the reporting entity has a legally enforceable right to offset and the reporting entity intends to settle 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*.

Recent US GAAP Update – Amendments to Financial Services - Investment Companies (Topic 946) *Amendments to the Scope, Measurement and Disclosure Requirements* (amendments issued through the release of ASU 2013-08)

Status – The amendments in this ASU are effective for interim and annual reporting periods in fiscal years that begin after December 15, 2013. Earlier application is prohibited.

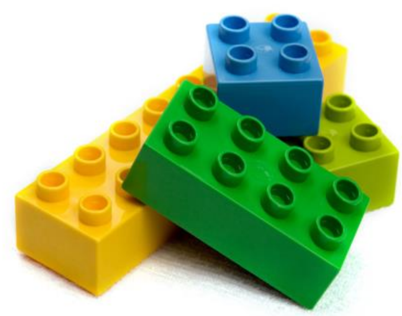
Summary - This ASU includes provisions that amend the existing criteria in ASC 946 *Financial Services – Investment Companies* ("ASC 946") for an entity to qualify as an investment company. Specifically, the criteria within the definition are expanded and additional implementation guidance is provided. An entity determined to be an investment company under the amended criteria would measure its investment assets and liabilities at fair value. With the amended definition, certain entities that are currently within the scope of ASC 946 may no longer be investment companies. Conversely, certain entities not currently with the scope of ASC 946 may be investment companies with the amendments.

The main provisions of this ASU are as follows:

- Change the approach to investment company assessment under ASC 946, clarify the characteristics of an investment company, and provide guidance for assessing whether an entity is an investment company;

- Require an investment company to measure non-controlling ownership interest in other investment companies at fair value rather than using the equity method of accounting.

- Additional disclosures: 1) the fact that the entity is an investment company and is applying the guidance in ASC 946, 2) information about changes, if any, in an entity's status as an investment company, and 3) information about financial support provided or contractually required to be provided by an investment company to any of its investees.



The new assessment process is a two-tiered approach, which requires an entity to possess certain fundamental characteristics, while allowing judgment in assessing other typical characteristics. In addition to these characteristics, an entity shall also consider its purpose and design.

The fundamental characteristics are:

- The entity does both of the following:
    a. Obtains funds from one or more investors and provides the investor(s) with investment management services
    b. Commits to its investor(s) that its business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income, or both

- The entity or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income.

The typical characteristics of an investment company are:

- It has more than one investment
- It has more than one investor
- It has investors that are not related parties of the parent (if there is a parent) or the investment manager
- It has ownership interests in the form of equity or partnership interests
- It manages substantially all of its investments on a fair value basis.

An investment company shall possess the fundamental characteristics, and, in most cases, all of the typical characteristics. To the extent the entity does not possess all of the typical characteristics, the entity shall apply judgment, considering all of the facts and circumstances, and determine how its activities continue to be consistent (or are not consistent) with those of an investment company. The implementation guidance within the ASU provides guidance in making this assessment, including, for example, how this assessment is made in a master-feeder structure.

Comparison to IFRS

Most of the concepts in this ASU are similar to amendments made to IFRS (see IFRS section of this *Tech Brief* for further discussion of those amendments), and therefore conclusions as to whether an entity is an investment company under US GAAP and IFRS should for the most part be the same. However, the amendments to IFRS were made primarily to provide a scope exception to the consolidation of controlled investees. In contrast, the amendments to US GAAP are for the purpose of clarifying the scope of entities that would apply the specialized investment company accounting and reporting guidance in ASC 946. IFRS does currently have comprehensive, specialized accounting and reporting guidance for investment companies. .

Recent US GAAP Update – Presentation of Financial Statements (Topic 205) *Liquidation Basis of Accounting* (amendments issued through the release of ASU 2013-07)

Status – The amendments in this ASU are effective for entities that determine that liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted.

The amendments apply to all entities that issue financial statements that are presented in conformity with U.S. GAAP except investment companies that are regulated under the Investment Company Act of 1940 (the 1940 Act).

Summary - The amendments require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (a) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties or (b) a plan for liquidation is being imposed by other forces (for example, involuntary liquidation). If a plan for liquidation was specified in the entity's governing documents from the entity's inception (for example, limited-life entities), the entity should apply the liquidation basis of accounting only if the approved plan for liquidation differs from the plan for liquidation that was specified at the entity's inception.

The entity is also required to accrue and separately present the costs that it expects to incur and the income that it expects to earn (both on an undiscounted basis) during the expected duration of the liquidation, including any costs associated with sale or settlement of those assets and liabilities. The entity shall make such accrual only if and when it has a reasonable basis for estimation.

Additionally, the amendments require disclosures about an entity's plan for liquidation, the methods and significant assumptions used to measure assets and liabilities, the type and amount of costs and income accrued, and the expected duration of the liquidation process.

Impact on investment funds:

Investment funds prepare financial statements that measure assets and most liabilities at fair value, and for the most part, the net recorded amounts might arguably approximate the "the amount of cash or other consideration that an investor might reasonably expect to receive after liquidation" (quotation from the ASU's Basis for Conclusions).

Strict application of the text of the guidance does present a number of practical issues and considerations for investment funds. Some considerations are relatively more straightforward, such as the accrual (and separate presentation) of disposal costs, such as commissions and other settlement fees. Other considerations are perhaps more contentious. For example, to what extent should an investment fund accrue for future management and performance fees, or for expected interest income or other periodic receipts over the liquidation period? Users and preparers of investment fund financial statements should monitor how the investment fund industry implements this guidance in practice. Regardless of the application of the guidance to specific accruals, the ASU provides that such additional accruals should be presented separately, and the methods and assumptions used should be disclosed.

International Financial Reporting Standards ("IFRS") Update

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.

Like ASC 820, IFRS 13 also 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 IFRS 13, all quantitative information is required to be presented in a tabular format. An example table of the new disclosures is as follows:

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%

IFRS 13 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. IFRS 13 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 IFRS 13

Use of last sales price for valuation - 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.

Application of premiums and discounts in a fair value measurement- IFRS 13 clarifies 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. IFRS 13 specifies 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. IFRS 13 clarifies 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.

Use of broker quotes or pricing services – fair value measurement disclosures - In circumstances where a reporting entity uses broker quotes or pricing services as its primary basis for determining certain Level 3 fair value measurements, IFRS 13 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

Comparison with US GAAP - 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:

- Sensitivity analysis – 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).

- 'Practical expedient' for investments in other investment funds – 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.

- Transfers between Level 1 and Level 2 of the Fair Value Hierarchy – 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.

- Effect of changes in unobservable inputs – 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.

Recent IFRS Update – Amendments to IFRS 7 – *Disclosures – Offsetting Financial Assets and Liabilities*

Status – 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.

Summary – 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 must 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.

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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). Note that the offsetting disclosure requirements under US GAAP apply only to recognized derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions. Under IFRS, there are no such limits to the scope, and therefore apply more broadly to all financial assets and liabilities.

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.

Comparison with US GAAP

The provisions of 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 FASB's plan is to issue a final ASU in the second half of 2014.

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.

Regulatory Update

Regulatory Update – Alternative Investment Fund Managers Directive ("AIFMD")

The AIFMD provides an EU framework for the regulation and oversight of alternative investment fund managers. AIFMD and the detailed "Level 2" Regulations were transposed (or are in the process thereof) into national legislation of the EU member states effective July 22, 2013. There is a one-year transitional period from July 22, 2013 to July 22, 2014; generally this transitional relief will be available to AIFMs that were already marketing in the EU before July 22, 2013. EU AIFMs shall take all necessary measures to comply on a timely basis and shall submit an application for authorization within 1 year (i.e. by July 22, 2014). Non-EU AIFMs (within the same timeframe) shall ensure they have taken the necessary measures to comply with NPPR rules, including reporting to EU regulators in member states where they market their funds.

The scope of AIFMD is far reaching and directly impacts many investment managers. It not only regulates EU AIFMs but also impacts non-EU AIFMs by virtue of managing EU AIFs or marketing their AIFs to EU investors. For non-EU AIFMs, significant changes relate to potential restrictions on the marketing of their AIFs as well as reporting and transparency requirements. For EU AIFMs, who will be required to fully comply with all aspects of AIFMD, the impact is even greater.

There is a sub-threshold exemption for AIFMs with AUM of EUR100 million or less; however, even these AIFMs are subject to registration and some regulatory reporting. Also, it is important to note that regulatory AUM includes the notional amounts underlying derivatives and is consequently likely to be higher than net asset values for some AIFMs.

Common Acronyms

AIFMD	Alternative Investment Fund Managers Directive	**EU AIF**	AIF authorized, registered, or registered office in an EU MS
AIFM	Alternative Investment Fund Manager	**MS**	Member State
AIF	Alternative Investment Fund	**Non-EU AIFM**	An AIFM with its registered office outside of the EU
AUM	Assets Under Management	**Non-EU AIF**	An AIF with its registered office outside of the EU
EU	European Union	**NPPR**	National Private Placement Regime
EU AIFM	AIFM with its registered office in an EU MS	**PP**	Private Placement

Non-EU AIFMs

If a non-EU AIFM manages an EU AIF or markets an AIF in EU member states, then it is scoped into certain aspects of AIFMD.

Marketing and Distribution – National Private Placement Regime

As summarized in the table below, non-EU AIFMs marketing non-EU AIFs in EU member states may do so under the national private placement regime (NPPR or PP). With respect to PP rules, the AIFMD permits each member state to introduce rules beyond the AIFMD minimum requirements; such rules may restrict or eliminate the option for non-EU AIFMs to market their AIFs in certain EU member states. The status of each member state's national legislation is very fluid and AIFMs are urged to consult with their advisors to understand the current state of affairs.

Currently, NPPR is the only marketing and distribution channel available to non-EU AIFMs. From 2015-2018, the EU passport may become available to non-EU AIFMs, in co-existence with the NPPR during this three-year period. After 2018, NPPR is intended to be brought to an end, with all AIFMs distributing under the passport and complying fully with all aspects of the AIFMD.

	2013	2015	2019
Non-EU AIFM / Non-EU AIF (e.g. Cayman fund) (no EU marketing)	No direct impact	No direct impact	No direct impact
Non-EU AIFM / Non-EU AIF (e.g. Cayman fund) (EU marketing)	PP	PP or EU passport	EU passport
Non-EU AIFM / EU AIF (no EU marketing)	MS discretion	MS discretion / Full compliance	Full compliance
Non-EU AIFM / EU AIF (EU marketing)	PP	PP or EU passport	EU passport
EU AIFM / EU AIF (Non-EU manager uses an EU management company and acts as a portfolio delegate)	EU Passport	EU Passport	EU Passport

Reporting and Transparency

While non-EU AIFMs are scoped out of other areas of the AIFMD, non-EU AIFMs must nevertheless comply not only with the marketing and distribution requirements but also with the transparency and reporting requirements. These requirements are three-fold: reporting to the competent authorities of the home or host member state of the AIF; disclosure to investors; and an annual report.

Reporting to competent authorities - The regulatory report filed with the competent authorities contemplates both the AIFM and the AIFs it manages/markets in the EU. Under PP, AIFMs report to each relevant member state regulator. Reporting covers information such as principal markets traded, types of instruments, investment strategies, risk profile, stress testing, leverage, and so on. The form is similar to, but not the same as, Form PF in the U.S., and the reporting is generally more frequent. As summarized in the table below, the frequency of regulatory reporting ranges from annually to quarterly based on the AIFM's AUM. Where previously ESMA had required all AIFMs in scope to report by January 31, 2014, it has now taken a more flexible approach to the phasing in of reporting, following comments by industry. The likely effect of this clarification is that AIFMs will not be expected by national regulators to report until they are registered (in the case of private placement) or become fully authorized (in the case of the EU passport). Once an AIFM is required to report, the first reporting period starts from the first day of the following quarter and runs until the end of that relevant reporting period. The length of the first reporting period will depend on reporting frequency, which is determined by the level of regulatory AUM managed. For example, an AIFM subject to half-yearly reporting obligations that has information to report as from February 15 would have an initial reporting period running from April 1 to June 30, and would be required to report by July 31. However, ESMA leaves the final decision to the national regulator in each EU member state to define the first reporting date.

The regulatory reporting frequency and dates are as follows:

	Regulatory AUM threshold	Reporting Frequency	Reporting Period	Report due by *(an additional 15 days provided for fund of funds)*
AIFM reporting	< €100 million < €500 million unleveraged with 5 year lockup	Annual	Jan to Dec	Last business day of January
	> €100 million to €1 billion	Half-yearly	Jan to Jun Jul to Dec	Last business day of July and January
	> €1 billion	Quarterly	Jan to Mar Apr to Jun Jul to Sep Oct to Dec	Last business day of April, July, October and January
Reporting for specific AIF types	Each AIF > €500 million	Quarterly	Jan to Mar Apr to Jun Jul to Sep Oct to Dec	Last business day of April, July, October and January
	Each unleveraged AIF investing in non-listed companies and issuers in order to acquire control	Annual	Jan to Dec	Last business day of January

Disclosure to investors - Periodic disclosure to investors is required to provide transparency to such items as risk management, leverage, valuation procedures, description of fees, liquidity, and side letters or other special arrangements. The medium for this communication is at the discretion of the AIFM and might be a wrapper added to the offering memorandum, investor newsletters, or investor pages on the AIFM's website. The frequency of this disclosure is generally upon initial subscription into the AIF, whenever there are material changes, and, at a minimum, at the same time as the annual report is made available.

Annual report - The annual report, which must include the audited financial statements, will also include a report on the AIF's activity and performance during the year, a review of risks and uncertainties, and disclosure of remuneration related to either the AIFM's entire staff or of those staff involved in the activities of the AIF, or on a proportionate basis. The annual report must be made available to investors annually no later than 6 months following the AIF's fiscal year end.

EU AIFMs

EU AIFMs managing the funds will market and distribute vis-à-vis the EU passport. In exchange for full distribution access across all member states in the EU, they are required to fully comply with all aspects of the AIFMD and, in addition to the reporting and transparency requirements discussed above, will also have to satisfy a host of other requirements including (but not limited to) capital requirements, risk management, leverage, valuation, use of a depositary, and remuneration restrictions. While discussing each of these requirements is beyond the scope of this article, it is worth expanding on three in particular.

Valuation - The process for valuation of assets and calculation of the net asset value should be functionally independent from the portfolio management and the remuneration policy of the AIFM. If the AIFM performs that valuation task internally, measures must be taken to ensure that conflicts of interest are prevented and that undue influence on the employees is prevented. If an external valuer is appointed, the external valuer shall provide professional guarantees to demonstrate their ability to perform the valuation function. The AIFM retains responsibility for proper valuation and the calculation of the AIF's net asset value.

Depositary - The AIFMD introduces a regime whereby a depositary separate from the AIFM must be appointed to exercise depositary functions with respect to safe-keeping of the AIF's assets. The depositary should be in the same country as the AIF. The oversight and safekeeping duties are now more prescriptive, with a new level of strict liability and onerous requirements. There is also a new cash flow monitoring duty that will involve the depositary duplicating the administrator's daily reconciliations.

Remuneration - Remuneration restrictions are of particular interest to AIFMs. The AIFMD prescribes that there must be an appropriate balance between fixed and variable remuneration, 50% of variable remuneration should consist of shares of the AIF or equivalent, at least 40-60% of variable remuneration should be deferred over a minimum period of 3-5 years, and variable remuneration should be subject to downward adjustment based on financial performance. The remuneration restrictions are applicable to the AIFM's senior management, control functions, various departmental heads, and members of the governing body. There must also be a remuneration committee that includes non-executive members and an independent chair.

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

As we introduced in our 2012 *Tech* Brief, 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.

In late 2012, the CFTC provided some temporary relief to fund of funds operators (subject to certain conditions), providing an extension to registration until the later of June 30, 2013, or six months after the date that the CFTC issues guidance on the application of the trading limits to fund of funds. This temporary relief recognized that such operators may not be able to determine its indirect exposure to commodity interests until all of its underlying investee funds make that determination. As of the date of the writing of this *Tech Brief*, the CFTC has not issued the guidance and therefore fund of funds operators are still provided this relief (subject to certain conditions).

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 2013) to this guide can found here: NFA Easy Reference Guide

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

In our previous *Tech Briefs*, 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.

The SEC's frequently asked questions on the preparation of Form PF are periodically updated. A number of frequently asked questions have been added over the last year, and can be found at SEC Frequently Asked Questions on Form PF

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, and opinions as to when the rules will be finalized vary greatly. 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. 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, 2013), 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

Over the past few years, the Foreign Account Tax Compliance Act ("FATCA") which was enacted under the Obama administration in March 2010 has gained significant attention. As the first step towards a global reporting regime, FATCA requires foreign financial institutions ("FFIs") to enter into agreements with either the United States or their local government (under Model I inter-governmental agreements ("IGAs")), and all non-financial foreign entities ("NFFEs") that are not excepted under the regulations to report and/or certify their ownership. This new reporting and withholding regime will ultimately impact current account opening processes, transaction processing systems and "know your customer" procedures utilized by financial institutions. Subsequent to the announcement of FATCA by the United States, other foreign governments have expressed an interest in developing similar 'FATCA-type' reporting regimes.

Cayman Islands and FATCA

United States - On August 13, 2013, the Cayman Islands Government announced that it has concluded negotiations with the United States on a Model I IGA. A Model I IGA will require Cayman FFIs to report directly to the Cayman Islands Tax Information Authority rather than to the IRS. Both governments have initialed the agreements to indicate their intent to sign them. They have noted that the official signing will be held as soon as possible, after which the texts will be publicly available.

UK and others - On November 5, 2013, the Cayman Islands and the UK signed a 'FATCA'-type IGA, preparing the way for Cayman to automatically share financial information with the UK on UK taxpayers who hold Cayman Islands accounts.

Under the IGA, financial institutions in Cayman will report information on financial accounts that are substantially owned by persons with UK tax-reporting obligations, to the Cayman Islands Government. Cayman's Government will then forward the information to the UK

In September, the G20 supported the OECD in presenting a single global standard for automatic information exchange by February 2014, and in finalizing the technical implementation aspects by mid-2014.

Updates to key US dates

In July 2013, the IRS released Notice 2013-43 which essentially pushed back the FFI Registration Portal opening and extended the majority of the FATCA deadlines established by the final regulations by 6 months. Since the release of Notice 2013-43, the IRS has met their revised deadline of August 19, 2013 for the soft launch of the FFI Registration Portal where FFIs now have a chance to start setting up their profiles and adding entities without actually committing to signing or registering, until January 1, 2014. On or after January 1, 2014, FFIs will be able to finalize their registrations through April 25, 2014 to appear on the first IRS FFI list to be posted on June 2, 2014.

Generally, all prior deadlines related to the FFI agreement effective date, the global intermediary identification number ("GIIN") registration deadlines for the first list, the last date to register for GIIN before withholding begins, the effective date of FFI agreement for registrations before withholding begins, and the transition period for affiliated group rule have been pushed back 6 months. The IRS also extended other compliance deadlines including withholding, onboarding, and preexisting account remediation by 6 months. This extension will be applied to current and future FATCA IGAs through the coordination provision added to recent IGAs and the new models recently released. IGAs signed before the coordination provision was added will adopt the provision through the most favored nations clause included in all IGAs. Another extension that was unexpected and also applies to current Chapter 3 documentation is the 6 month extension of the expiration for withholding certificates and documentary evidence set to expire at the end of this year. These extensions were a welcome relief to entities impacted by FATCA given the delay in IGA signings and the delay in registration guidance. A summary of the impacted deadlines is included in the on the next page.

	FATCA Compliance Action Items	Old Date	New Date
General Compliance	Registration Portal Projected Opening Date	July 15, 2013	August 19, 2013
	GIIN Registration Deadline for first 2014 list	October 25, 2013	April 25, 2014
	First 2014 GIIN list	December 2, 2013	June 2, 2014
	Last date to register for GIIN before withholding begins (1)	December 31, 2013	June 30, 2014
	Effective date of FFI Agreement for registrations before withholding begins	December 31, 2013	June 30, 2014
	Transition Period for affiliated group rule	January 1, 2016	No Change
New / Preexisting Accounts	USWA and FFI begin new account onboarding	January 1, 2014	July 1, 2014
	Cutoff date to determine preexisting account population (2)	December 31, 2013	June 30, 2014
	Initial account balance determination date for de-minimis rules and high value account rule	December 31, 2013	June 30, 2014
	USWA/FFI complete preexisting Prima Facie FFI accounts	June 30, 2014	December 31, 2014
	USWA/FFI complete all other preexisting entity accounts	December 31, 2015	June 30, 2016
	FFI complete preexisting high value individual accounts	December 31, 2014	June 30, 2015
	FFI complete all other preexisting individual accounts	December 31, 2015	June 30, 2016
Withholding	Begin income withholding (excludes certain offshore payments of U.S. source income)	January 1, 2014	July 1, 2014
	Begin offshore U.S. source income payment withholding	January 1, 2017	No Change
	Begin gross proceeds withholding	January 1, 2017	No Change
	Begin foreign pass-through payments withholding	January 1, 2017	No Change
Reporting	Calendar year(s) to report for U.S. Account reporting	2013 & 2014	2014 (for U.S. account identified by December 31, 2014)

(1) Verification of a GIIN is not required for a Model 1 FFI prior to January 1, 2015. Model 1 FFIs will be able to register and obtain a GIIN beginning on January 1, 2014 but will have additional time beyond July 1, 2014 to register and obtain a GIIN to be included in the FFI list before January 1, 2015

(2) For participating FFIs it may also be the effective date of the FFI agreement if different than June 30, 2014. For registered deemed-compliant FFI it is June 30, 2014 or the date the FFI registers and receives a GIIN.

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) Law 2012 – registration of master funds - update

Background

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.

2012 Amendments

In December 2012, the Mutual Funds Law was amended such that registration of a Cayman Islands master fund is required if a Cayman Islands regulated feeder fund conducts more than 51% of its investing in that master fund either directly or through an intermediary entity. Generally speaking, the amendments are not intended to capture intermediary entities or closed ended funds; however, an assessment may have to be made in more complex structures that involve trading subsidiaries, holding companies, liability blocker entities etc.

Master funds affected by the amendments had until March 1, 2013 to register with CIMA.

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

The amendments to the Mutual Funds Law over the last two years are intended to strengthen the regulatory regime for master-feeder structures, closing an anomalous regulatory gap that existed for such structures. Prior to these amendments, under the provisions of the then existing Mutual Funds Law, only the Cayman feeder, which is the entity that undertakes only distribution activity, was 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.

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: Voluntary liquidation of regulated Cayman Islands funds - Considerations for all Stakeholders

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 – realization agent services

Our Financial Advisory ("FA") group within Cayman is continuing to serve funds in run-off in many innovative ways. Typically these engagements involve some form of asset realization mandate for funds with still significant assets that are illiquid or have liquidity restrictions and/or side pockets. Our services are engaged by investment managers and directors, across a diverse range of investment strategies, who wish to avoid liquidating positions in secondary market transactions, recognizing that potentially more value can be driven from a portfolio over time by adopting a low cost run-off strategy.

Our FA group can provide an alternative to the standard liquidation service by acting as a "Realization Manager" or "Agent", typically involving some form of restructuring of the corporate group and setting up a special purpose entity to facilitate an orderly wind down process. In such a structure, our FA group will report to investors, make recommendations as to how and when the underlying investment positions should be realized and relieve the investment managers of the difficulties and risks associated with valuing illiquid positions. Each scenario is reviewed on its own merits and a bespoke, efficient solution can be developed and implemented by the FA group. (continued on the next page….)

This process can keep the investment manager involved via the investment manager becoming a director of the new entity with various controls written into the company's articles. In addition, through the transaction of establishing the special purpose entity, investors may have an opportunity to realize their investment immediately rather than retaining it throughout the duration of the run off period.

Our FA 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, and subsequently undertakes 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

Archive: Volume 4 – December 2012 Technical Brief for Investment Funds

Tech Brief Volume 5

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Further information can be found at the following link: Emerging Managers

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