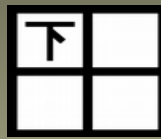


**GAIM
CAYMAN 2009**

**Taking a Global Look at Risk Control –
What are the Internal and External Structures That
Need to Be in Place?**

**David Mapley
Shimoda Capital Partners
Luxembourg / Cayman Islands**

www.shimoda-ltd.com



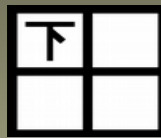
Presentation Contents

Introduction

Risk categories

- Investment / Trading Risk - Leverage, Liquidity & Stress-testing
- Credit Risk Control - Too Big to Fail?
- Operational Risk - Front/Middle/Back Office Segregation
- Financial Reporting Risk – Valuation Independence
- Auditor Risk – Large & Slow, Small & Fast
- Jurisdictional Risk – “COMI” Centre of Main Interest
- Taxation Risk – COMI Implications
- Marketing Risk – Agency and Regulator Issues
- Product Risk – Fully Understood?

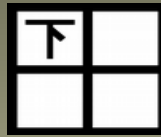
Summary & Implications for Cayman Islands



Introduction

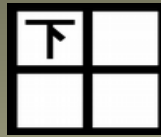
- 1. Regular fund sector collapses**
 - Asia 1997
 - Russia 1998
 - Dot-com 2001
 - Sub-prime 2007
 - Madoff et al.. 2008

- 2. Global War against Risk - is anyone winning?**
 - Investors? “Safe Haven” to Dante’s Inferno!!!
 - Governments? G20 & Black-lists
 - Regulators & Law Enforcement? Headless chickens....
 - Rating Agencies? Above redress?
 - Managers? Crushed by overheads and reporting..
 - Support Service Providers? Pay-as-you-go, yes please....



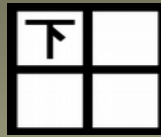
Risk Categories - Investment / Trading Risk

1. Are risks fully understood – Front Office, Middle Office, Back Office, different perspectives?
2. Who monitors leverage and liquidity?
3. Cross Default and Umbrella Clauses?
- 4). Rating Risk – Are ratings worth the paper they are written on?
- 5). Stress testing the investment portfolio



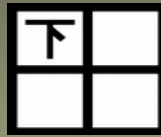
Risk Categories - Credit Risk Control

1. **Counterparty risk – too big to fail?**
2. **Ratings (again..) – downgrades when it is too late!!**
3. **Segregated vs Co-mingled accounts**



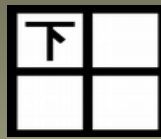
Risk Categories - Operational Risk

- 1. Are Front Office, Middle Office, Back Office truly independent?**
- 2. Are Front Office, Middle Office, Back Office truly co-ordinated?**
- 3. Are Service providers on the same page as the Fund?**



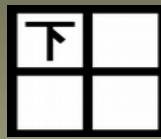
Risk Categories - Financial Reporting Risk

1. Who really compiles the NAV?
2. “Look-back” audit risk – time delay from NAV to audit
3. Securities pricing independent, or possible?
4. Reported Performance subject to shock external risks, e.g. rating downgrades (again..)



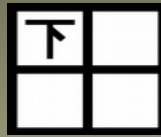
Risk Categories - Auditor Risk

- 1. Large & Slow, Small & Fast**
 - Big name provides respectability/recognition, but slow!!!
 - Small firms can move quicker, but concerns re. name recognition! (N.B. Madoff situation...)
- 2. Now over-caution could lead to bigger delays, NAV backlogs etc..**



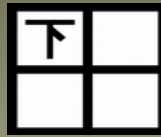
Risk Categories - Jurisdictional Risk

- 1. How to keep offshore funds offshore?**
 - Ten Commandments
 - Centre of Main Interest (“COMI”) is where?
- 2. US Treasury Secretary pragmatism – relaxed rules**
August 1997, President Clinton’s Taxpayer Relief Act of 1997
- 3. Shortage of skilled personnel – US/EEC depth**
CITCO, HSBC/Bank of Bermuda set up in the USA
- 4. USA rulings – Bear Stearns, Basis, where was COMI?**



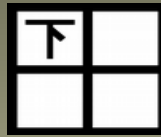
Risk Categories - Taxation Risk

1. Now the taxman is hungry, there are deficits to feed...
2. If a judge can't establish a COMI offshore, then why should the IRS??
3. G20 initiatives to bash off-shore financial centres, easy to win votes with the disaffected populus
4. "if it moves tax it!!!"
 - New York State and NBA basketball games
 - Wembley 2010 and European Champions League
 - Liechtenstein



Risk Categories - Marketing Risk

- 1. Are your marketers able to fully present on investment risk?**
 - Does the Manager fully explains risks to marketers?
 - Can the marketers understand the risks enough to explain them
- 2. How are marketers kept honest? Churn vs burn..**
 - “I sell the fund to earn a Sales Charge, not identify risks”
- 3. Can regulator’s help? – simple, standardised statements**
 - Wouldn’t this save time, money and resources??
- 4. Investors focus on returns, not risks..**
 - Greed blinds all!!
 - Coloured charts vs boring legal disclaimers
- 5. Eligible vs Knowledgeable investors !!**
 - “A fool and his money are soon parted..”



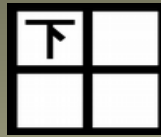
Risk Categories - Product Risk

- 1. Structure of Product fully understood?**
 - What exactly am I investing in?
 - And what assumptions provide for the investment case?

- 2. Mechanics of fund – invest/redeem/suspend**
 - How does the fund work in practice?
 - Can I rely on the administrator?

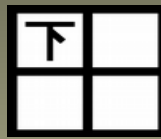
- 3. Stress-testing the fund – innocuous clauses**
 - Illiquidity issues
 - Leverage changes and response
 - Cash management in what?

- 4. Shareholder Rights**
 - Can we take control, can we vote?
 - What rights do I actually have?



Summary

1. **The World is now re-examining risk!!**
2. **Previous assumptions have been challenged**
3. **The Fund Industry will be hampered for years**
4. **Smart Managers will always attract Smart Money**
5. **Regulators need to work with, not punish the industry!!**



Implications for Cayman Islands

- 1. Need to market/promote role as global team player**
 - Image vs reality
 - Keep up to date on global risk developments
- 2. Attract and facilitate residency of experienced expats**
 - Switzerland vs Cayman
 - “Go it alone” → “Going backwards..”
 - Risk paradigm shifts start elsewhere..
- 3. Recognise two-facedness of governments**
 - Off-shore financial centres are easy prey
 - Compliance risk vs return
- 4. Encourage “10 Commandments”**
 - Transactional management, investments reviewed/executed locally
 - Directors (non-boiler-plate..) with global experience
 - Local Board meetings, shareholder communications, bank accounts
 - Local service providers