HKVCA 私募投資
香港創業及私募投資協會
The Association for Private Capital in Asia

29th January 2020

Hon. Tara Rivers, JP, MLA
Minister of Financial Services and Home Affairs
3rd Floor, Government Administration Building,
113 Elgin Ave., George Town, Grand Cayman

CC: Hon. Alden McLaughin, Premier of the Cayman Islands
Eric Bush, Chief Officer, Ministry of International Trade, Investment, Aviation and Maritime Affairs, Cayman Islands Government
Dax Basdeo, Chief Officer of the Ministry for Financial Services, Cayman Islands Government

Dear Minister Rivers,

I write in my capacity as Chairman of the Hong Kong Venture Capital and Private Equity Association (HKVCA) Technical Committee. With its current membership standing at over 460 firms, the HKVCA has existed in Asia for over 30 years.

HKVCA members include 280 private equity firms (engaged in venture capital and private equity fund management and who invest across the entire Asia-Pacific region in all sectors of Asia's economies, from venture capital, growth and buyout to secondary transactions), pension funds, funds of funds as well as family offices. HKVCA's members also include 9 of the 10 largest global PE firms as well as small VC investors, combined managing a total of US$2 trillion in assets.

Many HKVCA members use vehicles formed and registered in the Cayman Islands and they have been voicing concerns about the Private Funds Bill that was published by the Cayman Islands Government on 9 January 2020.

The key concern raised by HKVCA members relates to the requirement for private funds to submit their audited accounts for sign off by a local auditor based in the Cayman Islands.

The reasons for this concern are as follows:-

1. Fees: private equity funds sponsored by Asian GPs tend to be much smaller than their US counterparts and accordingly Asian GPs are much more sensitive to the fund's expense ratio. Due to the highly subjective nature of fair valuation of private equity / venture capital investments, our members are concerned that the local auditor sign-off fees for private equity funds could potentially be substantially higher than those currently seen for mutual funds registered in the Cayman Islands, or potentially many of the new and directly competitive Asian closed-ended fund alternatives referenced below. Our members expect that the local audit firms in Cayman may insist on being heavily involved throughout the fair valuation process, rather than place appropriate reliance on the work of the firm actually performing the audit (which from a practical perspective, is going to be required to be carried out in Asia, for funds managed in the Asia region).

We understand that the local audit community in the Cayman Islands is on public record as having given categoric assurances to you that the requirement to submit the audited accounts of private funds for sign off by a local auditor in the Cayman Islands will not add to the total audit costs of private funds. If possible, HKVCA would like to be able to communicate any such assurance to our membership.

However, unchanged audit costs arising from local Cayman sign-off has not been the historical experience of our members, some of whom also operate mutual funds registered in the Cayman Islands and nor is it the expectation of the audit community here in Hong Kong, based on their experience of working with other local audit firms in similar kinds of "local auditor" arrangements for private equity funds and/or related asset-holding Special Purpose Vehicles in other jurisdictions, as significantly more time often needs to be spent by the local audit firm on the review of various complex investment valuation arrangements. Given the existing flexibility afforded to Cayman mutual funds in respect of their local audit sign-off arrangements in Cayman, the HKVCA and its members would respectfully request that there is a similar treatment afforded to the new local audit sign off arrangements for private funds registered in Cayman.

2. Timing: many of our members' funds are legally bound to provide their investors with audited accounts within 90 days of the end of their financial year. Our members are concerned that, if the local auditors in Cayman do become more involved in approving the audited accounts of private funds, they will not be able to finalise their fund NAVs and that the timetable for reporting these to investors will be adversely impacted.

Please do not underestimate the significance of this risk or the depth of concern among our membership; many investors in private equity funds are public pension funds, which themselves are bound by strict reporting rules and which have to calculate their own liabilities and make distributions in accordance with legal deadlines, based on NAVs reported by their GPs.

The clear opinion of our membership is that a local audit sign-off requirement makes the Cayman Islands a less attractive location to domicile a private equity fund.

3. Local Resources: whilst Cayman's requirement for a local audit sign-off has been a feature for quite some time in the hedge fund industry, the HKVCA membership has voiced concerns about the ability of local firms in the Cayman Islands to recruit and train at very short notice, sufficient staff with the skills, experience and knowledge needed to process several thousand newly-registered closed ended funds.

Our members are clearly of the view that significantly different skillsets are needed by auditors for a private equity / venture capital fund with substantially more complex investment valuation arrangements. Indeed, with the sudden additional human and technical resources that maybe required from local auditors in the Cayman Islands, if it is not possible for them to recruit the additional expertise needed to keep pace with the knowledge and experience of audit firms here in Asia, the HKVCA membership has concerns that smaller, boutique PE houses in Asia maybe unable to engage a suitable local auditor.

4. Language and Timezone: when considering the involvement of a local audit firm in any review of asset values, a specific additional concern for Asia (and in particular Hong Kong, mainland China, Japan and Korea) is that of language and timezone.

HKVCA members manage thousands of portfolio companies operating businesses in the Chinese, Korean and Japanese languages and auditors need to be able to read and speak those (and other) languages in order to read reports, supporting materials and to discuss any issues and questions with internal or external valuers, as well as having a practical understanding of the markets in which such portfolio companies operate.

In Hong Kong and mainland China, audit firms have staff from all over Asia and so typically are able to provide functional coverage for the most common Asian languages such as Chinese, Korean and Japanese. Concerns were therefore raised by HKVCA members about how local auditors in the Cayman Islands can in practice be involved in fair value reviews. This concern (in conjunction with the timing issue noted in point 2 above) is further exacerbated by timezone, particularly as between Hong Kong, China and the Cayman Islands which runs approximately 12 hours behind these jurisdictions. Our members already find this timezone to be problematic when attempting to obtain timely local input in Cayman and these new arrangements in our view would become unworkable, assuming the local audit sign-off was to become more involved. Naturally, to the extent that the local auditors can get comfortable with the valuation review process undertaken by the firm performing the audit in Asia, without overly questioning or repeating such work, fund managers may continue to have confidence in Cayman's private funds platform.

Whilst we understand that the Private Funds Bill is in its final stages and is likely to be enacted at the end of January, the HKVCA Technical Committee believes that the Cayman Islands Government and Cayman Islands Monetary Authority still has the opportunity to reduce the adverse impact of this new law by implementing the following measures in the subsequent regulations that implement this new legislation:

a. working with local audit firms in the Cayman Islands to assist with the practical implementation of this new law to minimise or prevent any duplication of work performed by audit firms in Asia, with a view to minimising the impact on timing of completion of audits as well as total audit fees, in line with the current degree of involvement by local Cayman audit firms sign off obligations for Cayman mutual funds. This is a priority for the HKVCA and its members and we sincerely hope you can see the necessity for this in order to ensure Cayman remains competitive and practically operational as a leading private equity jurisdiction, particularly in Asia.

b. phasing in the implementation of the local sign-off requirement by reference to a fund's committed capital, which would correspond to the internal resources of the fund manager (e.g. 31.12.21 for funds over US$5bn, 31.12.22 for funds US$1bn to US$5bn, 31.12.23 for funds US$500, to US$1bn, then 31.12.23 for others).

c. Exempting existing private funds nearing the end of their term from the need to register under the Private Funds Bill altogether, e.g. where current NAV is less than 20% of total original committed capital.

d. Exempting private funds from the need to register under the Private Funds Bill altogether where the costs of local auditor sign-off would significantly impact the expense ratio, e.g. where total committed capital is under US$100m.

The HKVCA Technical Committee has been working very closely with the Hong Kong Government on the launch of Hong Kong domiciled Limited Partnerships and Hong Kong is expected to enact this legislation later this year. Singapore has also recently launched its own local product targeted at private funds, namely the Singapore Variable Capital Companies (SVACC). Both regimes are designed to compete with the Cayman Islands.

To be fully transparent with you, HKVCA members have commented favourably about the availability of these two new options for fund establishment (which were not available previously) and generally recognise a wider momentum to move their funds onshore, so HKVCA would expect that, going forward, the Cayman Islands Government does not wish to give the private equity community any additional reasons not to consider the Cayman Islands as a viable option as a fund domicile.

I, together with other representatives of the HKVCA Technical Committee, would be happy to provide further information and to discuss these points if you wish to do so.

Yours sincerely

John Levack
Chairman, HKVCA Technical Committee

Established in 1987, the HKVCA's mission is to encourage a vibrant venture capital and private equity industry in Asia while promoting the role of member firms in value creation, innovation and economic development. The HKVCA provides a forum for networking and experience sharing for its members; promotes industry professional ethics, international best practices and standards; and represents the views of its members before governmental and other relevant bodies.

HKVCA represents more than 460 corporate members, including 280 private equity firms across all types – including 9 of the 10 largest global PE firms as well as small VC investors, managing a total of US$2 trillion in assets. These firms are engaged in venture capital and private equity investments in the Asia-Pacific region at all levels – from venture, growth, buyout, secondary, to pension, funds of fund, family offices, etc. It is estimated (by AVCJ) that there are close to 600 PE/VC firms based in Hong Kong making this the largest center for cross-border PE/VC in Asia.
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