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The Perils of Investment Management in Perilous Times



February 10th, 2009
New York, NY



The “Liquidity Crunch” of 2008

- 19% Average performance decline and loss of approximately \$600 billion of assets
- Substantial amount of fund closures and restricted redemptions in 2008
- Motivations to restrict



Impact of Market Events

- Investments in mortgage derivatives and other asset backed securities
 - Assets written down
 - Valuations uncertain
 - Performance declines
 - Flood of investor redemptions



Impact of Market Events (cont.)

- Managers' concerns
 - Forced asset sales into depressed, illiquid markets
 - Close fund or restrict liquidity
- Other market factors
 - Investor redemptions
 - Redemptions by fund of fund investors
 - Deleveraging at fund of funds level
- Flood of redemptions at fund level regardless of performance and strategy



Decision Points for Fund Managers and Fund Directors

- Is fund viable as going concern?
- Options include:
 - Wind-down
 - Gates
 - Suspensions
 - Side pockets
 - Synthetic side pockets
 - In-kind distributions
 - Restructuring



Communications to Directors, Investors, Service Providers and Regulators

- Involve directors as early as possible
- Provide clear communications to investors
- Communicate all key decisions to regulators
- Ensure all service providers are on the same page
- Update disclosures as necessary
- Incorporate lessons learned

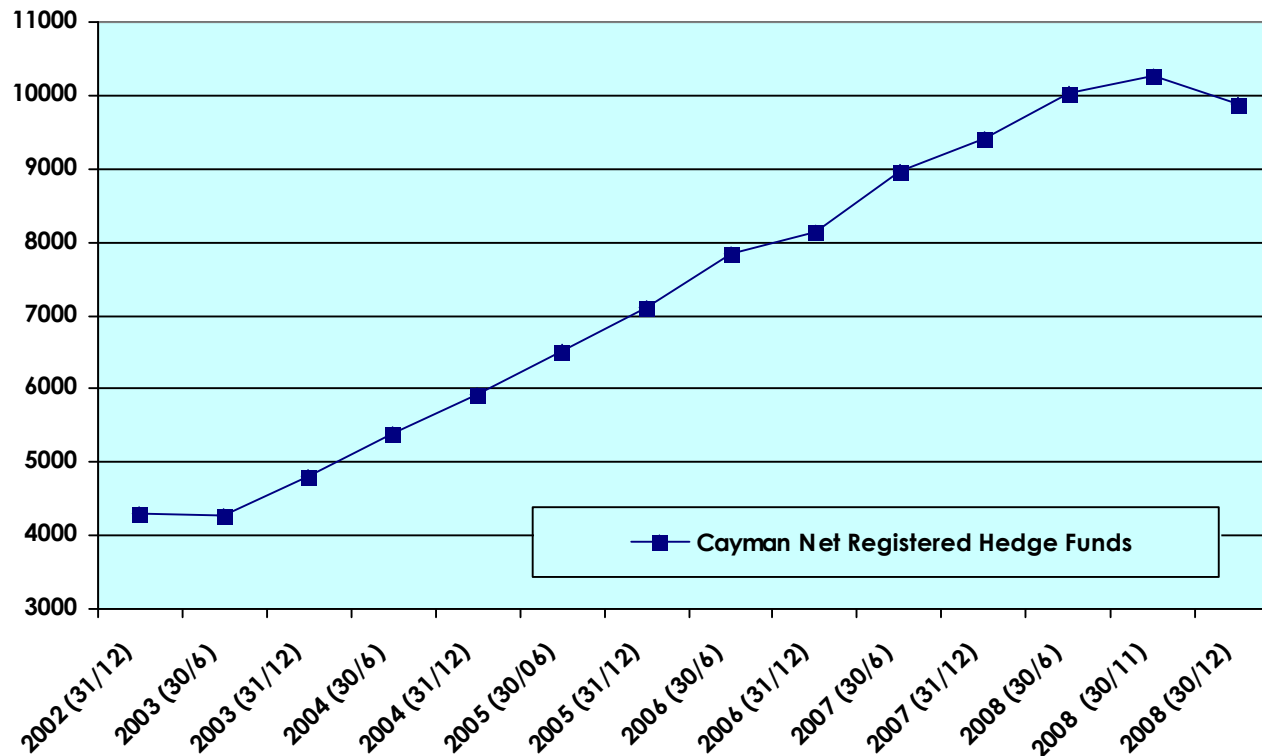
Overview

- Distress – Walkers Experience (Current Trends)
- Gottex Funds v Stewardship
- Strategic Turnaround Master Partnership
- Cayman – Offshore Directors
- Companies Law Amendments 2009 – Merger & Consolidation
- Exempted Limited Partnership Law Amendments 2009

2008 Year End Trends

	Lock-Up	Gate	Suspension	Re-Structure	Wind-up	De-Register
Q3	1	1	26	7	8	0
October	0	4	22	51	32	10
November	1	3	23	35	61	17
Dec	1	5	42	26	49	53

2003 -2008 Cayman Net Registrations



Gottex Funds v Stewardship - Background

- Bermuda Case
- Gottex Funds made timely full redemption request for 31 March
- Payment deadline 12 May
- Articles and PPM gave power to pay redemptions in-kind by distributing assets of the fund having a value equal to the redemption price
- On 12 May the fund declared a trust for the purpose of pooling assets
- Fund tendered “Participation Notes” to the Gottex Funds in purported satisfaction of redemption price

Gottex Funds v Stewardship - Judgment

- Participation Notes were not assets
- Participation Notes had not been distributed
- Participation Notes did not have value equal to redemption price
 - Not transferable or negotiable
 - No more than derivative instruments created by the fund

Gottex Funds v Stewardship - Implications

- Decision of lower court in Bermuda
- Facts distinguishable from more commonly used corporate synthetic side pocket structures
- Probably correct that Participation Notes were not assets
- Judge's reasoning that Participation Notes did not have value equal to redemption price open to argument

Gottex Funds v Stewardship - Implications

- **New funds**

- Include side pocket mechanism
- Disclose possibility that redemption in-kind may comprise interests in an SPV
- Address manner of valuing assets on a redemption in-kind

- **Existing funds**

- Ensure assets to be distributed are assets of the fund
- SPV shares to be transferable
- Value assets to be distributed realistically

Strategic Turnaround Case - Background

- **Cayman Islands Court of Appeal Case**

- Timely full redemption request
- Payment deadline 30 days from redemption date
- “Redemptions” suspended after redemption date but before payment deadline
- Articles permitted suspension of “redemption of shares”
- PPM permitted suspension of payment of redemption proceeds
- Redeeming shareholder petitioned to wind up fund on grounds it was unable to pay its debts as they fell due or it was just and equitable that the fund be wound up

Strategic Turnaround Case - Judgment

- On redemption date, redeeming shareholder became a creditor
- Ranked above non-redeeming shareholders but behind outside creditors
- Suspension of redemptions was valid to suspend payment of redemption proceeds
- Redeeming shareholder still a member until name removed from register and redemption proceeds paid
- Redeeming shareholder bound as a member by majority of fund's articles
- Redeeming shareholder had no locus to present a winding up petition as debt not presently due and payable

Strategic Turnaround Case - Implications

- Redemption date affects status of redeeming shareholder
- Possible to suspend payment of redemption proceeds prior to payment deadline
- Doubt as to which articles bind redeeming shareholder and whether entitled to exercise rights under articles
- Include clear power to suspend payment of redemption proceeds
- Consider prompt removal of redeeming shareholder from register (and payment of redemption proceeds) following redemption date
- Consider provisions to fix date on which redeeming shareholder ceases to be entitled to rights

Cayman – Offshore Directors

- Developing role of the Offshore Director – greater professionalism
- Increasing pool of Offshore Directors to select from
- CIMA concerns about the number of directorship's held by some individuals
- General warning re Directors provided by Investment Managers
- Anything looming on the horizon? - time to check Indemnity Clauses in Investment Management Agreements

Companies Law Amendments – Merger and Consolidation

- Expected in Q1 2009
- Substantially agreed in principle between private sector and government
- Seek to be more user-friendly and quicker than similar statutory arrangements in other jurisdictions
- Most likely to be appealing to companies that are solvent and do not have very complicated share classes and debt financing arrangements
- Applies to Cayman companies and combination of Cayman and foreign companies (Cayman company or foreign company as the survivor)
- Existing scheme of arrangement provisions to be retained

Companies Law Amendments – Merger and Consolidation

- Directors - written plan of merger or consolidation, statement of assets and liabilities, affidavit containing certain specified information and undertaking to give notice to shareholders and creditors within 21 days of merger/consolidation
- Shareholders - resolution to approve (group company exception)
- Speed - no advance notice requirement - merger/consolidation can be effected immediately upon submission of required documentation or any date within the following 90 days
- Law will provide for the transfer of all property and liabilities to the new/surviving company and preservation of pre-existing claims and proceedings

Exempted Limited Partnership Law Amendments

- Expected in Q1 2009
- Still under discussion between private sector and government – revised draft imminent
- Expected to include ability to register foreign partnership to serve as GP of Cayman ELP
- Formal procedure to “migrate” a Cayman ELP
- May include statutory recognition of either (i) a standard of “gross negligence” or (ii) contractual stipulation of foreign law concept
- Extension of safe harbor limited liability provisions

Exempted Limited Partnership Law Amendments

- Access to register of partnership interests and register of mortgages expected to be more limited
- Transfer of LP interests - ability to contract out of GP consent
- Variation of GP's statutory standard of care "unless otherwise specified in the partnership agreement" - may follow Delaware "good faith and fair dealing" formulation
- Expected to include statutory recognition of certain penalty clauses
- New insolvency regime
- PoA/execution as a deed
- Clearer provisions for LPs to become bound by LPA



The SEC

- Securities markets in 2008
- The SEC has been very active
- Efforts to regulate and enforce against the hedge fund industry
- The Madoff case
- Spawned litigation against the funds

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Trends for the Fund Industry in 2009

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