

CAYMAN ISLANDS STOCK EXCHANGE NEWS

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Salomon Smith Barney first to utilise new CBO rules

Salomon Smith Barney has become the first international finance house to take advantage of the new CSX rules for listing Collateralised Bond Obligations.

Other CBO applications for listing are now under consideration and it is expected that the CSX tailor made rules will generate a considerable amount of top quality new business for the Exchange.

The market for CBOs and CLOs has grown dramatically in recent years and, as CSX Chief Executive Officer Ann Nealon explains in an article on the new rules on Page 3 of the Newsletter, it is expected that for this year alone the amount of business will easily top \$100 billion, with further growth anticipated in 1999.

CSX Chairman, Mr Anthony Travers, OBE, commented: "Cayman has been a forward jurisdiction in structured finance transactions for many years and these new rules from the CSX reflect the sophisticated approach required by major institutions.

"The amount of interest shown from the leading practitioners and their institutional clients in the international capital markets confirms that the CSX is on the right

track with its new specialist rules."

The Salomon Smith Barney listing is of co-issuers Cirrus Funding Ltd and Cirrus Funding Corp. The issuers have been incorporated for the sole purpose of issuing Senior Notes and Income Notes on pools of debt.

The Senior Notes will be non-recourse obligations of the co-issuers secured on a diversified portfolio of high yield corporate debt obligations. They will be rated Aaa by Moody's and AAA by S & P and will be guar-

anteed for interest and principal repayments under a financial guaranty insurance policy issued by Financial Security Assurance Inc.

The Income Notes are also secured on a pool of collateral debt securities but are subordinated to the Senior Notes in respect of principal and interest. The Income Notes are not rated and receive, as payment of interest and principal, all excess funds available for distribution.

Hedge funds lead the list

Hedge funds continue to be drawn to the CSX with the US\$1.5 billion Zweig-DiMenna Fund being the latest to list.

The fund is managed by Martin Zweig and Joseph DiMenna, who have built one of the most enduring partnerships in the investment world.

They have worked together for over 20 years and in that time have built up an exceptional investment record. An annualised return of 20.5% after fees has been achieved over the past 12 years.

Among other mutual funds to list over the past three months has been GLG Universal Investments Market Neutral Fund, Cosfund, and Sul America Fund Ltd's Lexus Class and Brazilian Fixed Income Class.

The debt issues continue to flow in and there are now 129 listed issuers on the Exchange taking the market capitalisation to over \$10 billion.

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CNC LISTS

Cayman National Corporation Ltd, parent company of Cayman National Bank, has become the first local business to seek a listing on the CSX.

The move by CNC, which has a market capitalisation of CI\$123.6 million, has provided a significant boost to the Exchange, which is seeking to develop its domestic profile.

The Corporation's President and Chief Executive, Mr. Eric Crutchley, said: "We are extremely pleased to be the first domestic listing on the Cayman Islands Stock Exchange.

"The benefits to the Corporation and the shareholders are numerous. With the recent enactment of the National Pensions Law, pension funds are required to hold securities listed on a stock exchange.

"The listing allows local pension funds the opportunity to hold the Corporation's stock in their security portfolio. It also provides us with additional international exposure and marketability."

CNC has been operating in Cayman for over 22 years and, through its subsidiaries, provides a wide range of financial services to the Cayman domestic market as well as international clients using either the Cayman Islands or the Isle of Man as a base.

In Cayman its subsidiaries are Cayman National Bank Ltd, Cayman National Property Holdings Ltd, Cayman National Securities Ltd, and Cayman National Trust Co. Ltd. The Corporation also has a 45% interest in Cayman General Insurance Co Ltd.

Stock Exchange Chief Executive Officer, Ann Nealon, said: "This is a tremendous milestone for the Exchange as we are determined to make a strong and positive contribution to the local business community.

"Since we launched last year we have been very successful in the international market place. We hope now to make an impact domestically."

The local listing agents for CNC were accountants Deloitte & Touche and Partner, Mr. Glen Wigney, said that his firm was committed to aiding the development of the Exchange.

"The Exchange has proved a great success and has become an integral part of the Cayman financial community. The listing of CNC is a significant chapter in its development. The Corporation has been an important client of ours for many years and we are very pleased to have been the listing agent for this listing," he said.

As CNC has applied to the Exchange for a listing facility only. Those interested in becoming shareholders in the company should contact Cayman National Securities.

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There are a significant number of listing applications now being considered. Chief Executive Ann Nealon is confident of a bright start to 1999.

"When the Russia crises broke in August the financial world stood still but since mid-November business has really started to pick up once again," she said.

"Our listing facility for funds wishing to take advantage of the recent changes to NASD rules governing "hot issues" is proving very worthwhile. Our refined rules for listing CBO's and CLO's are proving to be of interest to institutions in New York who are active in this market"

As to the coming months, Ms Nealon said the Exchange was constantly looking at its rules to ensure that the demands of the international capital markets and equity markets are being fully satisfied.

Rules governing the listing of Global Depositary Receipts have been drawn up and will soon be published and listing rules for warrants are also being considered.

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Bank of Butterfield lists Global Blue Chip Fund

Bermuda-based Bank of Butterfield has listed its newly created open-ended Global Blue Chip Fund on the CSX.

The Fund, whose principal objective is to achieve long-term capital growth by investing in international "blue chip" equities, is operated solely by Bank of Butterfield International (Cayman) Ltd.

The Bank's Investment Services department is the Fund's investment advisor and draws on the resources of the Butterfield Investment Group.

Butterfield Asset Management, Bermuda, currently has over US\$2 billion under management while its Cayman operation currently manages in excess of US\$250 million.

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CSX TAKEOVER CODE

The CSX has published its own Takeovers Code in order to boost its attractiveness to offshore closed-end mutual funds.

The move should prove to be a major benefit to the global mutual funds industry, which has faced problems in the past because offshore closed-end funds that are listed on, for example, the London Stock Exchange are not covered by UK takeover rules. This has resulted in concerns by some investment managers that their offshore funds may be susceptible to unregulated hostile bids.

The issue was highlighted by the controversial takeover of the Cayman-based GT Chile Growth Fund by Regent Pacific Group of Hong Kong which fell outside the British takeover code despite the fact the closed-end Chile fund was listed on the London Stock Exchange.

The Cayman Exchange has now published its own Code offering protection for Cayman and other offshore companies as long as they are listed in the Cayman Islands.

CSX Chief Executive Ann Nealon said: "The new regulations offer the protection of a comprehensive takeovers code for offshore companies, including closed-end funds, which they may not have had in the past.

"Now if offshore companies listed in London also list in Cayman, the shareholders will be afforded the full protection of a takeover code which is very similar to that applied by the Takeovers Panel in London.

The new Code applies to any company listed on the Cayman Exchange, whether on a primary or secondary basis, irrespective of whether or not that company is resident in the Cayman Islands. However, it does not apply to open-ended mutual funds.

It covers all takeover and merger transactions where control, which is defined as 30% of voting rights of a company, is obtained or consolidated and applies to all parties involved in the transactions.

CBO RULES

The Cayman Islands is a leading offshore financial centre for structured finance transactions, including securitisations and other forms of asset backed securities issues. The number of such transactions involving offshore Cayman Islands Special Purpose Vehicles ("SPVs") continues to grow as does the market for offerings of collateralised bond obligations ("CBOs") and collateralised loan obligations ("CLOs").

CBOs and CLOs are not new products but a form of securitisation that is growing in popularity. In a typical CBO or CLO structure, an offshore SPV will issue debt securities collateralised or secured by an underlying portfolio of bonds or loans. The SPV will often issue the collateralised debt securities in a series of rated tranches, with an unrated equity tranche as the subordinate level of obligation. The most senior tranche will be designed to hold the least credit risk and the highest credit rating, and the unrated equity tranche will have the most risk (but should yield a positive return in low default environments). The off-balance sheet Cayman Island's SPV is used to make the issuer bankruptcy remote, thereby focusing the performance risk of the rated securities on the underlying assets and not on the bankruptcy risk of affiliated entities, the sponsor or the asset manager. The use of an SPV thereby helps to maintain the rating separation between the issuer and the seller and may provide credit enhancement. Credit risk is minimised in these transactions through the diversification of the portfolio and the prioritising of cash flow to the various tranches.

The principal reason for listing securities is to attract investment from institutional investors who may be prevented by

home jurisdiction regulation or applicable investment policy from investing in unlisted securities. Certain favourable tax and accounting treatments may also only be available to investors in their home jurisdiction, if such securities are listed on a stock exchange. Accordingly, many CBO and CLO offerings to non-U.S. investors are listed on a stock exchange in order to ensure maximum appeal to prospective investors.

The issuance of CBOs and CLOs has soared over the last three years, from \$12 - 14 billion in 1996 to an estimated \$108 billion in 1998, as a result of increased interest from both sellers and investors.

One of the reasons for this upsurge in popularity is that US banks have been under pressure to increase shareholder value by managing their capital more efficiently. To do this they need strong balance sheets and well defined financial and risk management policies. CLOs have provided a means of restructuring their balance sheets by offloading low-yielding assets. Repackaging such obligations has allowed the banks (the sellers or originators) to free up capital and boost their return on equity. CBOs on the other hand appeal to collateral managers who wish to increase their assets under management. Investor appetite for such securities has also increased.

Traditionally the seller or originator's needs were the central focus of the structuring activity. Alternative approaches are now being pioneered with CBOs and CLOs being tailored to meet the needs of investors. The transactions are often structured with one or more asset classes and one or more portfolio manager selected to achieve the objectives of specific investors. More recently, actively managed CBOs have become popular. In such CBOs the manager is given

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the flexibility to trade or re-balance the portfolio within specific parameters.

The CSX offers a number of advantages as a listing facility for CBOs and CLOs. The CSX understands the commercial reality of these specialist products and is therefore able to adopt a sophisticated approach with respect to the listing requirements it imposes and the documentation required for a listing. In the majority of U.S. sponsored offerings, the applicable provisions of U.S. securities law and regulation ensure that disclosure requirements are set at a level which is intended to provide investors with sufficient information. In such cases, the information in the offering memorandum will generally satisfy the disclosure requirements of the CSX's listing rules.

In relation to CBOs and CLOs the CSX imposes the following conditions for listing:

For all issues of asset backed securities, a trustee or other appropriate independent representative must be appointed to represent the interests of the holders of the debt securities. The trustee must have rights of access to appropriate information relating to the assets.

The CSX will need to be satisfied that the entity appointed to manage or service the portfolio of assets has adequate experience and expertise. The CSX will consider the managers' track record and experience in the light of the particular role being contemplated. The CSX will ask for details of the value of assets under management and, where appropriate, may also ask for details of key personnel of the investment manager to be disclosed in the offering memorandum.

The listing rules require the investment manager to provide periodic reports on the performance and credit quality of the underlying

portfolio for the benefit of the trustee. These provisions reflect current market practice. Very often the trustee will appoint an independent firm of reporting accountants to carry out agreed procedures with respect to such financial information. An SPV issuer is not required to prepare audited financial statements under Cayman Law. For cash flow CBOs it would be unnecessarily onerous to impose such a requirement, particularly as the portfolio of investments would have to be marked to market. For market value deals, where the investments are being marked to market, audited financial statements are often prepared in any event.

The debt securities must be freely transferable except to the extent that any restrictions are agreed by the CSX. The CSX will approve transfer restrictions that result from the securities not being registered under certain securities laws provided such restrictions are adequately disclosed. The securities must be cleared and settled through a recognised clearing system. However, the CSX is prepared to accept alternative clearing and settlement arrangements where the securities are being privately placed with a small number of institutions or high net worth individuals to facilitate compliance by the issuer with the provisions of the U.S. Investment Company Act of 1940.

The CSX listing requirements emphasise disclosure of relevant information in the offering memorandum, without imposing unnecessarily onerous demands. The CSX's approach recognises that the institutional investors in such securities are sophisticated with expert knowledge of the type of product in which they are seeking to invest. Provided disclosure is adequate, investors are in a position to assess the commercial risks they are assuming. In most cases a listing is sought to satisfy regulatory requirements, capital adequacy tests or to enable the investor to take advantage of certain tax or accounting treatments. Furthermore, the market in these securities is highly illiquid and once acquired they are usually held by investors until maturity.

Unlike many other exchanges the CSX

has no requirement in the listing rules for a listing agent to be appointed in connection with an application to list specialist debt securities. This means that the arranger or the issuer's legal advisers (whether or not registered as listing agents) may deal directly with the CSX's listing department

The CSX is aware of the time pressures under which issuers and their advisers in the debt securities market operate and will make every effort to accommodate an issuer's timetable. The CSX is committed to providing a timely and efficient listing service and guarantees to provide comments on the first draft of a listing application within five days of its receipt and to provide comments on further drafts within three days of receipt. With commitment on both sides to expediting the listing process, one can realistically expect it to take 10 – 14 days to approve a CBO or CLO listing application.

The fees levied by the Exchange for CBOs and CLOs are competitive with other established Eurobond exchanges and comprise a one off listing fee of US\$2,500 and an annual fee of US\$1,000.

This is an abridged version of an article written by Ms Nealon for the International Financial Law Review. A full version can also be found on the CSX web site.