# Service providers see Guernsey bouncing back from downturn

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The impact of the global financial and economic downturn on the alternative fund industry is starkly illustrated by a significant decline in the total assets of funds under management and administration in Guernsey in the first quarter of 2009, but the island's fund service providers believe the jurisdiction will be well placed to recover once a global rebound kicks in.

At GBP175.9bn, the total value of funds domiciled or serviced in Guernsey fell by GBP27.9bn over the 12 months to the end of March, a decline of 13.7 per cent. Most of the drop came in the first three months of 2009, which saw full assets slip by GBP24.5bn (12.2 per cent), according to the Guernsey Financial Services Commission.

The regulator says the decline is largely down to a decrease in hedge fund assets since the end of last year - presumably mostly down to redemptions - but that a rebound in global equity markets after the end of March, which helped to produce hedge fund returns averaging as much as 5 per cent in May, are set to have restored the industry to growth during the second quarter.

Peter Niven, chief executive of promotional agency Guernsey Finance, points out that although the industry performed robustly in the final months of 2008 in the face of extremely difficult market conditions, the value of fund assets was always expected to slump in the short term given the fragility of investor confidence.

'During the first three months of the year a certain amount of new business was still coming through but clearly this was at lower levels than in the last two or three years when we had record flows,' he says. 'We saw good ideas being proposed across a range of different asset classes but many investors were waiting for further falls in global asset values before coming back into the market. The positive news is that there is undoubtedly greater confidence around at the moment. As a result we expect to see the value of funds in Guernsey growing during the second quarter.'

In the meantime, Niven says the island's fund services sector is doing as well as can be expected. The one significant setback in the administration and custody sector, which comprises a broad array of firms ranging from large international banks to niche providers, has been the announcement of 50 redundancies in HSBC's securities services business (along with the complete closure of its Isle of Man administration business) as it refocuses operations in Luxembourg.

'Such actions are normal for this stage of the economic cycle,' he says. 'Firms are looking at what they are doing where and whether they are duplicating or triplicating their processes. In HSBC's case they decided to build on their centre of excellence in Luxembourg. But we have a very tight job market, and people with a grounding in the finance industry may find opportunities, for example, in the fiduciary and corporate services areas. And it has dispelled some of the complacency that may have grown up during the boom years.'

Niven adds: 'Normally a recession would take six to nine months to filter through to somewhere like Guernsey, but we are now seeing it a reduction in the volume of business and some redundancies, and I'm sure there will be more to come when people look more closely at their costs.

'We must make sure we batten down the hatches, but at the same time continue marketing efforts to ensure that when the business does come back, we are in pole position. It's important to be out there talking to people in the bad times, not just hoovering up all the business in the good times. We've redoubled our efforts at GuernseyFinance to be out there talking to people and keep the pot boiling.'

Stephen Cuddihee, a director of alternative fund administrator Praxis Fund Services, reports that the firm is starting to see signs of confidence creeping back into the market. 'The flow of new business has slowed to a steady trickle over the past 12 months, but recently the number of enquiries has begun to increase again,' he says. 'There are opportunities in the current environment. The issue is the conversion rate. People have great ideas, it's whether they can get the finance or get the investors interested in their product.'

Praxis has some USD2.6bn in assets under administration including property, private equity funds, hedge funds and funds of hedge funds following the acquisition of Investec Administration Services at the beginning of this year. In part because of the resources constraints in Guernsey, but also to control costs and attract business from a wider range of fund jurisdictions, Praxis has opened an outsourcing operation in Malta and is waiting for regulatory approval for the opening of an office in Luxembourg.

'The hedge fund industry has suffered like any other asset class over the past 12 to 18 months, and we've seen a fair bit of restructuring within the industry, but that's not unique to hedge funds,' he says. 'While hedge funds neither caused nor played a significant role in the crisis, which was predominantly a banking issue, the industry is going through an evolutionary process in which there will be winners and losers.

'A Darwinian process of natural selection is underway, from which will emerge stronger, healthier hedge fund managers with new strategies. Some of the strategic models fund managers generally were running have been significantly tested, and some of them broken, by the crisis. Our existing hedge fund clients have experienced issues in the past 12 months with investors, but a lot of them have stabilised and are beginning to attract new money.'

Joe Truelove, head of business development for corporate clients with Kleinwort Benson, says that most new business generated this year has come from existing clients. 'So far this year very few new funds have been launched, and few new promoters are coming to the island,' he says. 'I don't believe it's an issue with the jurisdiction, simply that people can't raise funds. Some managers have funds that are going into liquidation, and for others we are still in place as the administrator but valuations have stopped and dealing has been suspended. However, in some cases we have stepped in as a traditional custodian where prime brokers are exiting the business.'

Alan Brint, head of corporate and institutional business for the British Isles at RBC Wealth Management, says that while the market in the Channel Islands has been difficult in recent months, RBC is benefiting as a custody provider from the notable stability exhibited by the Canadian banking industry during a period where some of the biggest names in the US and Europe have been dependent on government funding to maintain their capital solidity.

'Over the past six to eight months we've seen significant outflows of investor money from both Jersey- and Guernsey-domiciled funds,' he says. 'As a result gates and other corporate mechanisms have been put in place by fund of funds sponsors to stem the flow of redemptions or at least slow it over more manageable time periods. That has caused additional complexity in terms of fund administration, particularly on the corporate secretarial side. We have also seen the appetite for credit refocus primarily on funding to pay redemption proceeds while underlying assets are being liquidated.'

Brint says RBC enjoys a healthy new business pipeline, but in many cases timing remains uncertain. 'Fund sponsors and investment managers are still looking to launch new products, but their ability to specify a launch time is severely limited as a result of lack of risk appetite by investors,' he says. 'However, I think we will see that appetite return, when new business prospects will start coming to fruition and when time to market shortens.

'On the fund custody side a number of large corporates are looking to take advantage of RBC's strength in the marketplace. There is a flight to security and safety, and Canada's historically conservative approach historically on credit has obviously paid off in that none of its banks have needed government bail-outs.'

Industry leaders hope that one element in the recovery may be an increased flow of alternative managers opting to move themselves and all or part of their business to Guernsey, taking advantage of the island's attractive personal income tax structure and the reduction to zero of the corporate tax rate last year - especially after the UK announced that it would raise its top income tax rate to 50 per cent from next year.

'Guy Hands [of private equity firm Terra Firma] came last year, well before the tax announcement, and [Alchemy Partners'] Jon Moulton has also come, creating momentum that we're trying to build on,' Niven says. 'With our zero corporate tax rate and a tax cap for individuals of GBP100,000, it's well worth the move - plus London, Paris and Switzerland are all easily accessible.'

Carrying out investment management in Guernsey is by no means an outlandish concept, according to Richard Hodgetts, who manages the Absolute Return Plus fund of funds for Collins Stewart Asset Management in Guernsey. Far from being handicapped by not being among the cluster of hedge fund managers in London's West End, he notes that last year the fund was down less than one per cent after turning its back on the industry's received wisdom that the best opportunities lay in niche, boutique funds. 'Taking your fund and manager ideas purely from the cocktail party circuit is quite dangerous,' he says.

'It's very easy to talk to managers on the phone, and many of the larger houses bring their managers over here regularly. However, it's probably easier for us to get to London than a manager in, say, Bristol. Like everyone else, we go on-site to talk to managers, compliance officers and everyone we need to speak to. Just because we're on an island doesn't mean we shirk our responsibilities as an international fund with international investors.'

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