Island sees new opening to attract hedge fund managers

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Industry professionals say that while Jersey's fund services sector is continuing to develop impressively, with a growing waiting list of would-be fund administrators seeking authorisation from the Jersey Financial Services Commission and few obvious signs so far of damage from the problems faced by many classes of alternative funds over the past year, the big opportunity opening up may be in attracting more hedge fund management businesses and their principals to the island.

Concern about the impact on managers of the European Union's proposed Directive on Alternative Investment Fund Managers and a series of tax measures in the UK that are perceived as hostile to the interests of what is by far the continent's largest hedge fund manager community is prompting cautious confidence that Jersey, along with probably Switzerland, would be a beneficiary of any significant exodus. Already a low-key but significant trickle of managers have made their way to the island, attracted as much by its quality of life as by tax issues.

These calculations are also being affected by continuing uncertainty about the Investment Management Exemption, the conditions under which UK-based managers of offshore funds can avoid the latter falling into the UK tax net, according to Tom Amy, head of the funds and SPV group at Volaw Trust & Corporate Services. Volaw, which is associated with law firm Voisin, provides corporate and governance services to a range of alternative funds and also provides administration to a number of fund vehicles. 'The expectation is that through their activity in the UK, more managers will find their funds themselves becoming subject to UK tax,' Amy says.

He argues that the introduction of Jersey's 0-10 tax policy, which brings the standard rate of corporate taxation for all Jersey companies to zero while some financial services companies and others will be taxed at 10 per cent, compounds the tax advantages. 'If managers come to the island, their employees will be taxed at 20 per cent on their worldwide income, there's no stamp duty, and as long as the employees have recognised skills they should get accommodation easily enough,' he says. 'And why live in a city when you can live on a nice warm island?

'The past 12 months have seen on average one fund manager of substance a month move to Jersey. In the past fund managers didn't have a physical presence in Jersey, with firms such as Volaw providing compliance, back office administration and support services. But that's now starting to change as actual management companies are being set up and groups are bringing their employees over.'

Nigel Strachan, head of business development for corporate clients in Jersey at Kleinwort Benson (Channel Islands), argues that the coming months and years offer a particularly good opportunity for the island because if history is any guide, the shakeout over the past 18 months particularly in investment banking may well lead to a new wave of entrants to the hedge fund industry.

'A number of investment bankers that have been laid off in the City have significant experience, and when the markets turn up again, they may look at setting up their own shops and raising funds,' he says. 'A number of hedge fund managers have already relocated to Zug in Switzerland to avoid UK tax, but Jersey offers a straightforward process to create management companies and fund vehicles.

'A potential manager could use one of two regimes to establish a fund, including the Expert Fund regime whose conditions include being an expert investor that understand the risks, and a minimum investment of USD100,000. That regime is regulated by the Jersey Financial Services Commission. The Unregulated Eligible Investor regime was launched more recently to offer an alternative to Cayman for investors of a minimum of USD1m who understand the risks.'

Strachan acknowledges that not being not regulated might be seen as a disadvantage in the current market environment where the emphasis is on more rather than less regulation, but he notes that Unregulated Funds offers benefits in terms of cost and speed of establishment, as well as great flexibility in terms of where the fund is administered and whether it is audited. 'If you want local administration expertise, you can use it, but it's not a requirement, so you could use Dublin or Malta,' he says.

He says a key attraction for managers would be Jersey's accessibility. 'One of the advantages is more than 40 flights a day to and from the UK as well as European destinations including Paris, Geneva, Zurich and Dublin, and being on London time is useful for dealings with the City,' he says.

Strachan argues that Jersey scores heavily with individuals seeking a better work-life balance, even among those used to big city life who might have scorned moving to a small island in their younger days. 'When you're in your 20s, Jersey isn't quite the same for night life and designer shops, but for those slightly older it offers good schools, a good health care system and short commuting distances, in addition to a dynamic and growing financial services industry.'

Jersey Funds association spokesman Michael Rothwell says that while Jersey has no desire to actively poach fund management business from London, it is certainly becoming more attractive as a home for more substantial parts of the business. 'There has always been a certain amount of interest because Jersey is so well placed for previously UK-based managers, with sterling as a currency, English culture with French elements, the same time zone and fantastic transport links to London,' he says.

'Jersey has made a great play that the lifestyle offers a degree of sophistication and gourmet dining while also being a very pleasant alternative to living in the centre of London. Whether that's enough to attract high-flying hedge fund managers is a moot point, but we can only play up to our strengths. I wouldn't go as far as to say there's a long list of hedge fund managers ready to move, but clearly what's happened in the UK in terns of raising tax rates for wealthy individuals makes it a less attractive jurisdiction.'

Rothwell points out that the island already has a poster child in Altis Partners, which has enjoyed conspicuous success since relocating to Jersey several years ago. 'The firm brought out all the principals with their families, and have become great advocates for the island. As it happens, last year their hedge fund was something like the third best performer in the world, so it's been a great coup for Jersey. I wouldn't be surprised to see more firms doing something similar.'

Of course, the increasing insistence of tax authorities that fund managers demonstrate some substantive presence in the offshore jurisdiction where their funds are domiciled is an important factor, with several alternative management groups setting up operations over the past few years, including hedge fund managers Brevan Howard and CQS as well as private equity firm Nordic Capital.

Says Rothwell: 'It is practical to set up an operation in Jersey with staff on the ground. The time zone and transport links are good, which may not be the case for Caribbean jurisdictions, and there are probably tax advantages. We've certainly seen businesses set up in Jersey that previously would have had outsourced everything. You can't point yet to a massive influx of prominent hedge fund managers, but maybe what the chancellor has done in the UK will be the driver for one.'

The growth of management company operations continues to swell the pool of talent in Jersey's fund services sector, which continues to attract interest from start-up firms, administrators abroad that are eyeing the Jersey market, and other financial services players such as trust companies that are looking to extend their range of activities, despite the dampening effect of the recession on new business.

'The hedge fund industry has been significantly impacted by the downturn, and therefore there have been fewer new funds established,' says Edward Devenport, a partner with law firm Mourant. 'The emphasis among the type of funds that are coming through has moved toward distressed strategies, with a number of distressed debt funds and others investing in distressed oil and gas assets, but generally fundraising seems very slow.

'While we are receiving a fair number of new enquiries, they are taking a long time to come to fruition. The main theme over the past six months has been maintaining and restructuring existing funds that have run into difficulty because of the market environment. As long as managers are willing to be open with investors and treat them fairly, investors have responded. The difficulties have been around the area of redemptions, where some investors sense they are receiving less advantageous treatment than others, which has led to disputes.'

Robert Kirkby, the technical manager at industry promotional body Jersey Finance, says overall the sector has held up 'surprisingly well. This has again highlighted that Jersey's business is long-term. We don't see work falling off a cliff, because a lot of structures have been in place for years and will continue for years more. The value of assets inside structures may have declined, but a lot of our fees are linked to the structure rather than the asset value. Obviously there's been a slowdown in the creation of new structures across the board, an increase in litigation-type activity and a handful of redundancies, but nothing major apart from a couple of UK clearing banks.'

However, Kirkby does express regret that the launch of Unregulated Funds early last year, designed to carry a challenge to Cayman's dominant mutual fund vehicle, has been overtaken by the global financial crisis. 'There's been a flight to quality,' he says. 'We have already seen a number of funds migrate to the island, as people realised Jersey was much more highly regulated than other offshore jurisdictions.

'There's also a flight to regulation, as promoters and investors seek to have regulated products. As a result, Unregulated are probably not going to be used as much as we first anticipated. You could argue that the timing of their introduction could have been better. However, we've always argued that it's about offering a whole suite of products, because investors seek different levels of protection depending on their level of sophistication and wealth. Unregulated Funds are still there for anyone who wants to use them.'

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