

## Focus on developing innovative business solutions

By *Oliver.bradley*

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The hedge fund tide that once floated all boats threatened to sink them last year. A wave of redemptions, drawdowns and outright failures hit service providers hard both in onshore and offshore locations. Both constituencies are working hard to regain their former volumes and competition has become fiercer both between offshore jurisdictions and between offshore and onshore domiciles.

Although rivalry between offshore locations was rife before the crisis, competition with onshore domiciles is a new phenomenon and a direct result of measures in Europe and the US to force business back onshore where it can be taxed at local rates. The Alternative Investment Fund Managers Directive is a prime example. Peter Hughes, group managing director of Apex Fund Services, says: "Offshore locations are losing business to onshore and it won't stop until the uncertainty over the directive has ended. The terms of the directive are constantly changing and it is causing great confusion - funds can't decide whether to list onshore or offshore or both."

Uncertainty has led to the departure of a number of high profile companies listed on the Bermuda Stock Exchange, which has over 700 listed securities and a total market capitalisation of more than \$225bn. But Greg Wojciechowski, chief executive of the exchange, says the exodus headlines are misleading. "Companies are only moving their holding structures; this is corporate restructuring, not operational restructuring. They are keeping their presence and people in Bermuda - in any case, it would be too expensive for individuals to relocate to high-tax jurisdictions such as the UK."

The impact on Bermuda's fund industry has been less severe than in some of the other international financial services centres. Bermuda is also supported by other financial services activities - principally insurance and reinsurance - which have sustained the island's overall revenues. "I think Bermuda has probably weathered the crisis better than most," says Hughes. "Reinsurance is strong and growing, providing consistent revenues to the island." This is one of the reasons Fitch has given a AA+ rating for the island and Moody's awarded it a Aa2 rating. Wojciechowski says: "Bermuda has always taken a conservative approach - it has only licensed three or four banks and there is a strong regulatory culture for funds, insurers and the stock exchange."

The strong insurance sector has helped to sustain the fund environment through a tough period. "All sectors have benefited from the sound regulatory framework - we have put the work in to create the infrastructure," says Wojciechowski. "The expertise and structure we have here is world-class, similar to that of New York and London."

He believes Bermuda is now well positioned to foster the long-anticipated convergence between the insurance industry and the capital markets. Wojciechowski points in particular to the Insurance Amendment Act which came into force last year to establish special-purpose insurers (SPIs) as a new class of insurer in Bermuda. The Act recognises and facilitates the structure of insurance-linked securities such as catastrophe bonds. A listing on an internationally recognised stock exchange should make these securities more attractive for potential investors, which number international hedge funds, traditional fund managers and other large allocators of capital.

This kind of innovation is typical of the exchange's efforts to strengthen its position among the world's stock markets. It has also developed Launch 'n' List services to bring down the time taken to create and list a structure, while its Mezzanine Market - for high-tech and development stage companies - has also taken off with about 30 launches to date. The success of the Mezzanine Market will be followed up later this year with the launch of an associated international trading service for non-Bermudan entities.

The Bermuda Monetary Authority (BMA) has been active in protecting the interests of the island too. To shore up its insurance sector, it has committed to creating a Solvency II-like regime to prepare for

the advent of the European Union's new Solvency II rules which are likely to become the insurance industry benchmark when they are introduced at the end of 2012. The Bermudan finance minister, Paula Cox, outlined legislation in March that will give the BMA the legal power to become a group supervisor.

With an eye to appeasing the US and its major economic partners, the BMA has also recently taken steps to strengthen regulations aimed at preventing money laundering and terrorism financing. An independent Financial Intelligence Agency has also been established to monitor and identify suspicious transactions.

Marina Lewin, managing director of BNY Mellon Alternative Investment Services in Bermuda, says: "Most people would recognize that Bermuda is well-run and appropriately regulated."

But have the domestic institutions acted swiftly and decisively enough to defend the island's growing position in the funds sector? Andy Smith, executive vice president of Butterfield Fulcrum, says: "Other locations around the world have learned from Bermuda of years past when the island aggressively recruited financial services firms to set up shop."

He points to the dynamism of Geneva and Zurich, which pounced as soon as they realised that the UK tax regime was about to get tougher and that funds perceived themselves to be caught in an increasingly hostile environment. "Geneva and Zurich did a really nice job - they talked about their economic development programme, the square footage available, the benefits of relocating and so on. Hedge fund managers were welcomed with open arms."

Bermuda was previously similarly active, says Smith. "They were at every conference and would lay out the benefits of being in Bermuda. Admittedly it's hard to do when you're facing a systemic financial crisis, but it still needs to be done." One of the moves Bermuda has made to improve its standing, says Smith, is to make it easier to set up a special purpose vehicle than in many other jurisdictions.

Bermuda has started to rise to the challenge, creating a committee of stakeholders, including lawyers. Another committee is looking at how to amend the Investment Funds Act to make it more attractive to funds.

The BMA played a key role in having Bermuda removed from the "grey list" of OECD countries that were deemed to have poor standards of tax transparency. Despite this success and the signing of over 20 tax agreements with trading partner countries, Bermuda is still not regarded as whiter than white by the Obama administration.

The Bermuda Stock Exchange, among others, believes this is unfair. "The pressure that exists comes from our trading partners, who have issues with their own economies," says Wojciechowski. "We are a small nation competing with larger nations with bigger voices." Even though the US criticism is directed towards all offshore locations, not specifically Bermuda, the injustice is keenly felt by all on the island. "The fact is that Bermuda has been open and co-operative with its key trading partners," says Wojciechowski. We have had a treaty with the US as far back as the 1980s and currently have information exchanges with 21 countries."

Wojciechowski believes there is a fundamental misperception of Bermuda's role in the world economy. "We are not really offshore in the sense of a processing area." That Bermuda is not just a fund domicile is demonstrated by the fact that out of 400 funds listed, half are Bermudan while the rest are international. In addition, Bermuda services hundreds of funds in other jurisdictions. "We provide business support to our trading partners," says Wojciechowski. "We provide a real input to the US economy - about 40% of the property/casualty business in the US comes from Bermudan providers. The reinsurance business provides tens of thousands of US jobs."

The US-Bermuda Impact Study produced at the end of 2009 found that Bermuda was the biggest offshore supplier of reinsurance to the US and that there was \$60bn in trade between the two countries. "The Bermuda regulatory regime provides support to get product to market when the market needs it," adds Wojciechowski.

The complaint of many on the island is that the US authorities are looking at their tax revenues without taking account of the wider economic picture and the jobs that are being created. Meanwhile Bermuda - and other similarly affected offshore jurisdictions - is lobbying its most important trading partners and continues to develop services that not only match, but better, those in onshore locations.

As Wojciechowski says: "Our future success will depend on how we continue to develop innovative business solutions. Of all our competitors, I think we are better placed because of the hard work we have put in and the length of time we have been doing it."

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