

Hedge funds managers get taste for island life

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For much of its decade or so of existence, the Isle of Man's hedge fund sector has been largely based upon the servicing of funds domiciled in other jurisdictions, such as the Cayman Islands. But members of the industry believe that the legislative and regulatory changes introduced over the past few years have put the island in a strong position, not only to become a more important fund domicile but to build a significant base of fund management activity.

The steady growth in alternative fund business, alongside other areas of the financial services industry, has contributed to the build-up of a significant skills base among the island's fund administrators, law firms and accountancy and audit practices. Arguably this has prepared the ground for the establishment by fund managers of a substantive presence in the jurisdiction, although tax issues have probably played at least as big a role.

While the Isle of Man has been removing value-added tax on fund management and administration services, cutting its corporate income tax rate for most companies to zero, reducing personal tax rates and capping the maximum amount payable by individuals, the UK tax authority, HM Revenue & Customs, has been making life more uncomfortable for managers of alternative funds by questioning the authenticity of the arms-length basis on which they manage offshore-domiciled funds from London.

As managers come under pressure to demonstrate that their offshore presence consists of more than a third-party administrator and a registered office hosted by a law firm, the island's low cost base and open-door attitude toward management firms and their employees is starting to result in a number of business wins.

A handful of alternative managers have had a substantial middle- and back-office operations presence in the island for several years, including Laxey Partners, named after an Isle of Man town (it actually has its operations just down the coast in Onchan) and specialising in investment trust arbitrage, London-listed emerging markets specialist Charlemagne Capital, and marine-orientated fund manager Tufton Oceanic Finance.

But the authorities' efforts to revamp the jurisdiction's fund services offering has also been rewarded with the arrival of two start-up hedge fund managers at the end of last year, and while practitioners do not expect the capital Douglas to rival Mayfair any time soon, more could be on the way as uncertainty about tax issues in London persist.

The Smith Report, drawn up last year by representatives of the fund industry, the Isle of Man Financial Services Commission and the government's Treasury department, identified the potential for persuading London-based alternative fund managers to establish front- and middle-office functions on the island, with the help of relocation packages for incoming principals, grants to help cover the costs of office premises, hardware and recruitment, and a range of tax incentives for capital investment.

Says KPMG senior partner David McGarry: 'Making sure the Isle of Man was as attractive an offer as possible also meant some regulatory changes, particularly bringing in a new class of fast-track licence for hedge fund managers that already had a regulated entity, for instance by the Financial Services Authority in the UK.'

The newcomers are Pelham Capital Management, which established an office in the Isle of Man last October to launch its European long/short hedge fund, and Bridge Asset Management, a spin-off from Argo Capital Management, which was acquired by Absolute Capital Management at the beginning of 2007.

Bridge had already established its first fund, the Cayman-domiciled Bridge Global Opportunities Fund, an event-driven strategy that focuses on special opportunities in emerging markets. Over time, the firm plans to increase the size of its operation on the island as other strategies are added.

Says the firm's general counsel Mark Slater: 'Our previous connections with the Isle of Man had a lot to do with it - we knew the set-up and had someone who could work it for us. The grant was nice, but not as important as getting the fund set up. The process of gaining the requisite licences was extremely efficient and prompt. The prevailing can-do attitude and professionalism was impressive. Also, the government seemed keen to develop the island, and we thought it would be easier to employ people than in the Channel Islands or Ireland.'

Ross Turner, a director of Pelham Capital Management, says: 'The Isle of Man offers an investment-grade location for hedge fund managers, and the dual attractions of experienced staff and a competitive cost base make the island a perfect location for our growing business. Further attractions for us are the tax-neutral environment, strong regulatory reputation and close proximity to our London office, along with the shared time zone.'

Simon Harding, a partner with Dickinson Cruickshank, one of the Isle of Man's leading law firms for offshore and fund business, adds: 'The island's low-tax status, proximity to London, competitive operating costs and high quality of life make it a compelling and cost-effective environment for basing hedge fund operations, and considerably increase its appeal in the competitive offshore fund market as a jurisdiction in which to domicile specialist institutional funds.'

Although the new class of Specialist Funds does not require the use of an administrator or custodian on the island, the growing capacity and expertise of local administrators means that at least some of the fund servicing business is likely to go to Isle of Man providers. While Fortis Prime Fund Solutions and HSBC have between them taken up to 70 per cent of alternative funds business in recent years, the sector has also benefited from companies such as Caledonian Fund Services, part of a fast-growing administration group based in the Cayman Islands.

According to managing director Gordon Wilson, the island's fund services business enjoys a high reputation among clients for quality, which he attributes to factors such as lower staff turnover than in most competing jurisdictions. He says the freedom of Manx firms to bring in extra staff if required enables administrators to expand to meet increased demand without service standards slipping.

Brian Donegan, the Isle of Man government's director of foreign direct investment, says all the signs are that the island is now well positioned to achieve its goals in terms of domiciling new funds, expanding assets under administration and bringing in more substantive fund management operations.

While fund establishment business was quiet at the start of the year, activity has subsequently picked up, particularly among promoters of smaller funds with assets of up to USD50m. The Treasury's industry promotion division Isle of Man Finance continues to cultivate London-based fund lawyers, prime brokers and corporate advisers.

Says McGarry: 'We have made a big step up on the marketing side. Clearly the market's pretty difficult at the moment, but the number of new funds coming across my desk is still very strong. Raising awareness of the Isle of Man and what it offers has met with a very good response. We have done some international work in regions such as the Middle East, but I think we have a lot to go for nearer home.'

'London is still the major international base for hedge fund business, and we need to make sure we've exploited the opportunities there. We still find there is a lack of in-depth understanding of what the Isle of Man has to offer. I find that once a hedge fund manager has used the island for a fund and had it administered here, they will keep coming back again and again, because they are very happy with the quality of service they get.'

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