Channel Islands show solidity in turbulent times

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The investment industry, like the financial world as a whole, may be suffering from the impact of the credit crunch, stock market slump and global economic downturn, but the private equity sector in Jersey and Guernsey appears to have fared better so far than many other areas of activity - which is down as least in part, members of the industry say, to the islands' internationally-respected regulatory structures, long years of experience and breadth of professional expertise.

The Channel Islands have been developing expertise in traditional and alternative fund services for more than four decades and private equity has been a steadily growing part of the mix, especially in Guernsey, for at least 20 years. Over that period, says Graeme McArthur, managing director of Northern Trust International Fund Administration Services (Jersey), the industry has become steadily more global in character - which has benefited both the islands and the range of firms active in the market, from international giants like Northern Trust to highly specialised players such as International Private Equity Services.

Ipes, which was acquired in September by its management in partnership with - appropriately - mid-market private equity firm RJD Partners, is one of a new breed of niche firms whose success is taking them out of their home market, in this case Guernsey, having recently established offices in London and Jersey and with Luxembourg on the radar. The firm's launch in Jersey also typifies an important trend in the Channel Islands over the past 12 months, the growth of new administration firms to meet the desire of many fund promoters to maintain close relationships and receive personalised service from their providers.

Both islands, but especially Guernsey, have benefited substantially from the private equity boom over the past few years. Peter Niven, chief executive of industry promotional agencyLimited Guernsey Finance, notes that the value of private equity funds under management and administration in Guernsey has risen by no less than 400 per cent over the past four-and-a-half years.

During the second quarter of this year, private equity assets serviced in Guernsey grew by nearly GBP1bn, some 2.5 per cent, to reach GBP36.2bn in 226 funds, despite a 10 per cent decline in private equity fundraising across Europe this year. Jersey had GBP18.9bn in private equity assets at the end of June, according to Chris Hickling, head of fund operations at Investec Administration Services in Guernsey.

Jersey has lagged behind its neighbour as a centre for private equity industry but it is catching up fast, according to McArthur and his colleague Joel Haskins, head of private equity in Jersey. 'It is seen as a stable environment with a strong long-term reputation, with the legal structures that the industry needs for partnerships, and a legal environment with well-documented case law and statute that provides a degree of certainty if problems arise in the future,' McArthur says.

'There's a wide range of regulation available including the very light touch Expert Funds, the new Unregulated Funds and private arrangements, and outsourcing is possible from Jersey, although it's less important with private equity where clients often prefer funds to be domiciled and serviced in the same jurisdiction. But a lot of it is down to knowledge and expertise, among law firms and auditors as well as administrators. Jersey has been in the international fund administration space for more than 30 years and is well regarded for its capability to service alternative assets such as real estate and private equity.'

It's not yet clear to what extent the Unregulated Fund regimes introduced in February this year will be used by the private equity industry, but the innovation - openly acknowledged as a weapon to help Jersey challenge the Cayman Islands as a domicile for funds aimed at sophisticated investors - will help to strengthen international awareness of the island's growing maturity as a funds jurisdiction, according to Tom Amy, head of the funds and SPVs group at Volaw Trust & Corporate Services and Bill Gibbon, a partner at the Voisin law firm.

'The Unregulated Fund is the latest extension of Jersey's strategy to focus on niche, sophisticated products for high net worth and institutional investors rather than retail funds,' Amy and Gibbon say. 'With eligible funds able merely to notify the Jersey Financial Services Commission of their establishment, rather than going through a full authorisation process, the speed and simplicity of the system strengthen Jersey as a jurisdiction of choice for alternative investments such as private equity funds.'

In fact, they note, the Unregulated Fund regime has just been made more user-friendly to the private equity sector thanks to a legislative amendment that effectively places limited partnerships (and unit trusts) on the same footing as corporate fund vehicles. Henceforth, the general partner to an unregulated fund that is a limited partnership, where the general partner is a special purpose vehicle, is now exempt from registration for fund service business under the Financial Services (Jersey) Law, provided that the SPV's registered office is provided by a regulated entity such as a Jersey administrator. This means that private equity partnerships, which previously were subject to regulation of the general partner structure, can now enjoy the same flexibility and ease of establishment benefits of corporate unregulated funds.

It would be a mistake, however, to exaggerate the importance of rivalry between the two islands, especially when an increasing number of custodians, administrators accountants and law firms have offices in both Jersey and Guernsey and in many cases run the Channel Islands businesses as a single operation. 'We are a Channel Islands law firm, and the Channel Islands compete with the rest of the world,' says Daniel O'Connor, a senior associate in the corporate group with Carey Olsen in Jersey.

'The regulatory regimes are not that dissimilar, the philosophy is not dissimilar, and if a client comes to our law firm we can advise them as to the most appropriate jurisdiction, if any of the nuances between the islands mean that one or other would suit them. We don't really see ourselves as being in competition. What's good for Guernsey is good for us.'

Another factor that has been particularly driving the deepening as well as widening of private equity business in both Jersey and Guernsey over the past couple of years is the growing pressure from tax authorities in countries such as Germany, Switzerland and the UK on the many alternative investment managers that use offshore vehicles to minimise tax 'leakage' for themselves and their investors. HM Revenue & Customs in particular has been demanding evidence of substantial activity in offshore jurisdictions to rebut the assumption that funds, management companies and other parts of the structure should be taxable in the UK.

'Taxation risk will increasingly feature as private equity managers invest further afield and seek to maximise returns at fund level without exposing their investors or their holding structures to successive layers of tax,' says Kevin Mundy, head of client solutions for UK offshore business at BNP Paribas Securities Services.

'Mitigation through well-structured and acceptable practices will be key, as will the need for well-defined investment flows and the timely provision of accurate information in order to consolidate investment and fund performance. The islands have been supporting tax-neutral or tax-efficient structures for many years and continue to develop tax treaties with a number of other countries in order to facilitate these requirements.'

A combination of tax considerations and operational issues, but sometimes also personal preferences, is prompting a range of private equity managers to increase their presence on the ground in the Channel Islands, according to Joe Truelove, head of business development for corporate clients at Kleinwort Benson in Guernsey. 'Jon Moulton of Alchemy Partners had all his funds administered in the island, and decided he might as well move here,' Truelove says.

'A lot of larger fund managers have established physical locations here too. When managers reach a certain size and scale, quite a few particularly private equity managers have set up their own offices and recruited their own staff.' According to Lipper, the Guernsey-based administration operations of two private equity firms, Apax Partners (USD34.2bn) and EQT Fund Managers (USD17.1bn), accounted for more than 18 per cent of all fund assets serviced in the island at the end of June.

These developments play to the islands' strength in intellectual capital rather than 'industrial' number-crunching functions, which are often outsourced to jurisdictions where large numbers of staff are more readily available, according to Horace Camp, an executive director with administration firm Anson Group in Guernsey. 'We lead in mind and management and in corporate governance, which is essential,' he says. 'There are more cases of HMRC challenging London-based managers, so it's very important to ensure you have mind and management offshore. The infrastructure is here to prove it.'

The islands' reputation for probity and legal systems that inspire confidence play an important role in attracting business, especially in an economic environment that has put scapegoating of offshore jurisdictions back in favour among politicians throughout the world. 'Blue-chip firms will only go to jurisdictions that have equally blue-chip arrangements, otherwise they will risk their own reputation being dragged through the mire,' Truelove says.

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