

# HFMWEEK

SPECIAL REPORT

## BERMUDA 2012

### REGULATION

Examining the growing requirements for Bermuda's range of fund structures

### CONVERGENCE

The increasing popularity of insurance-linked securities

### TAX

Bermuda's efficient tax structure creates opportunities for fund managers



FEATURING Appleby // Business Bermuda // ISIS Law // ILS Fund Services // Pacific Fund Systems // Revelation Capital Management // PwC // Wakefield Quin



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he Bermuda Monetary Authority is Bermuda's integrated financial services regulator. The Authority has regulatory responsibility for a market that comprises an investment funds sector with an aggregate Net Asset Value of \$160bn; a banking sector with total assets of \$25.5bn; the Bermuda Stock Exchange with total market capitalisation of \$341bn; as well as 1,230 insurers with total assets of \$525bn (a market that wrote \$107.7bn in gross premiums).

Bermuda's risk-based regulatory framework has helped the island's asset management sector attract and retain quality business. In fact, this commitment to quality has been shared collectively between us as regulators and government, as well as the market.

The Authority continuously reviews its framework to ensure it remains practical and effective for the market we supervise. For Bermuda, this means maintaining consistency with international best practice, balanced with regulations that are workable for this market. Also, as well as monitoring global regulatory change, we contribute to that process where appropriate.

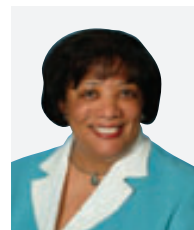
In recent years, changes made to Bermuda's framework have complemented the jurisdiction's evolving investment market. In April 2011, the Authority released guidance notes that facilitated the establishment of Islamic investment funds in Bermuda. These guidance notes were designed to help prospective applicants looking to establish Islamic funds to comply with Bermuda's funds regulations, specifically the Investment Funds Act 2006. The guidance notes confirmed that there was no impediment to establishing these types of funds under Bermuda's funds framework and in fact, complemented the jurisdiction's efforts to promote itself as a domicile of choice for Islamic financial products.

Additionally, at the end of December the Investment Funds Amendment Act 2011 and the Investment Funds (Specified Jurisdiction Fund) (Japan) Order 2011 were issued. These legislative developments allowed Bermuda to welcome funds targeting retail Japanese investors – subject to the requirements of the regulatory framework for funds.

The above are only the most recent examples of the Authority's efforts to ensure Bermuda maintains the highest possible regulatory standards, while at the same time creating an environment that does not hamper business development.

The Authority remains committed to supporting Bermuda's asset management sector, by maintaining our commitment to quality and practicality – to leading regulatory change while fostering financial stability in the Bermuda market.

## Marcia Woolridge-Allwood



### Marcia Woolridge-Allwood

is director of the Bermuda Monetary Authority's Banking, Trust & Investment Department. In this position, she has responsibility for supervising Bermuda's banks, deposit companies, trust and investment businesses, investment funds, fund administrators, money service businesses, and credit unions, as well as the Bermuda Stock Exchange.

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# A REVELATION IN BERMUDA

AS THE REVELATION SPECIAL SITUATIONS FUND ENTERS ITS EIGHTH YEAR OF OPERATION, *HFMWEEK* SPOKE TO FOUNDER CHRIS KUCHANNY TO DISCUSS THE RANGE OF FACTORS AFFECTING FUNDS IN THE EQUITY EVENT-DRIVEN SPACE



**Chris Kuchanny**

founded Revelation Capital Management Ltd in 2004 and launched the Revelation Special Situations Fund (formerly Osmium) in 2005. He had previously established and run Structured Equity Proprietary Trading at ABN AMRO, London. Chris also founded the charity Bermuda Cares and The Genesis Foundation, an entity focusing donations on sustainable projects, including education, health and business related charities.

**T**he Revelation Special Situations Fund was founded in March 2005 by Chris Kuchanny. It is a market neutral global event-driven hedge fund designed to generate high quality, uncorrelated absolute returns irrespective of prevailing conditions, boasting low volatility and a high Sharpe ratio. Revelation won the coveted Lipper Award in 2010 for "Best Hedge Fund over Three Years – Offshore – Event Driven Category" and has been featured in "Barron's Top 100 Hedge Funds". In March 2009, the fund was among the first in the world to offer a Gold Class, which stands alongside US onshore and offshore offerings in USD, GBP, EUR & SGD. *HFMWeek* talked to Chris Kuchanny to find out what has made Revelation such a success.

**HFMWeek (HFM): What is it you do from a trading or risk perspective that differentiates you from other equity event-driven funds in your space?**

**Chris Kuchanny (CK):** We have a global mandate to trade equity event-driven special situation trades and our investment process starts with a focus on situations where we believe there is some form of barrier to entry in prospective investments, such as complexity, which is likely to put off competing investors. We like situations where there are perceptions in the market about the outcome of events such as tax events and regulatory or competition rulings. We often focus on situations where we can trade in less well covered regions, with up to 20% or so of our trades in emerging markets and a lot of cross-regional trades. We find these situations tend to be less well covered because a lot of capital is geocentric (for example, just European, just US or just Asian), so cross-regional trades can fall off the radar. These are some of the things we think will tend to limit competing capital.

Typically, that should mean a better risk reward profile, and lower competition means a better upside, because fewer people are entering the spreads. This should also mean that if things go badly, there are fewer people exiting and the downside should be more limited.

**HFM: 2011 was generally a tough year for hedge funds across the board. How do you see 2012 shaping up for the industry in general? Have you made any changes to your trading strategy?**

**CK:** I've been trading the same way and with the same types of trades for 14 years. Since then, there have obviously been a lot of events that have happened in world markets. In general, I have made money every year except 2011. We have managed to limit our peak to trough drawdown to around 10% and relative to our best 12-month periods where we have achieved +23%, that's

a reasonable risk reward profile for the fund's seven-year track history.

For the industry, we've seen deep concern about the macroeconomic environment. Given the various issues, including with the eurozone, there is great concern and rightly so. The uncertainty is leading people to sit on cash or only invest in situations that are very clean and well understood – in other words, where there's an announced event and that event is coming shortly. The focus is on certainty and liquidity. But I believe all of that will lead to opportunities over the course of this coming year and onwards.

The first question is: "Is the macroeconomic environment going to pan out as negatively as people are expecting?" Our view is that there are going to be material bumps along the way, but the current policy tools probably have life left to run in terms of their efficacy. There will probably be short-term volatility, but other factors point towards strong returns in our space, such as reduced competition from fewer hedge funds and prop desks and a good strong backwind of events.

Revelation is well positioned now, as the fund has been going for more than seven years and people can see over a meaningful timeframe the type of return profile we have produced, which we believe is attractive and we see no reason why this cannot continue into the future.

**HFM: It is generally acknowledged that corporates are sitting on record high levels of cash on their balance sheets. What opportunities does this present for equity event-driven funds?**

**CK:** Corporate action trading is a core strategy for us and I think there is a lot of pent-up demand for corporate action activity from some of the world's biggest companies. We expect to see a steady flow of corporate action activity going forward, as companies sitting on record cash piles gain limited stability, while earning nothing from low prevailing interest rates. Activity tends to be a positive feedback loop and the trend of M&A and restructuring activity we're already seeing from some of the world's largest entities should continue.

The secondary effect is that if there is a pickup in M&A activity our competitors are even less focused on risk arbitrage, which tends not to be our primary focus due to the high level of competition. This typically reduces competition in our core strategies, which are things like holding companies, closed-end funds and share classes.

**HFM: How do you look at risk, either between the various strategies you trade or geographically?**

**CK:** First we limit the drawdown risk on a strategy by strategy basis by looking at each of the trades as a risk versus reward scenario, determining what the upside is,



what the downside is and looking for the probability mispricing. We look at managing single-event drawdown risk to a typically low 2% on a single event and then we also limit the correlation risk. This is one of the advantages of having a strategy that is relatively diversified in the global event-driven space; we are diversified by country, sector and by sub-strategy, so we try to minimise the effect of any one event causing multiple losses across the portfolio.

Many of our peers seem to have moved away from the core strategies traded by the fund and have ended up being quasi-long funds. We haven't changed our investment universe and remain disciplined in minimising delta exposures by hedging on both a portfolio and a trade-specific basis. This means we are typically highly uncorrelated to the equity markets. One of the things everyone is looking for is uncorrelated absolute returns and I think we've proven our ability to generate just that over time.

**HFM:** You were one of the first funds globally to offer a 'Gold Class', charging performance fees only on the underlying fund's performance. What has been the response and what types of investors do you find attracted to the class?

**CK:** The response was generally positive and the returns on the Gold Class have been strong. We launched the Gold Class in February 2009, doubling investors' money in dollar terms by the end of 2010 and from inception until today the total return has been more than +112% in dollar terms. The Gold Class has allowed investors to invest in gold and the fund, by denominating their investment in the fund in gold, without facing additional fees and without any reduction in return profile due to leverage factors.

It has been innovative, highly successful and has allowed us to think forward to other potential products that may be related to this. My view is that given the risk of excessive government debt loads to fiat currencies, over coming years what you denominate your investment in will be more important than what it is actually invested in.

**HFM:** What are your plans for the coming years? Why did you base Revelation in Bermuda in the first place?

**CK:** We'll be focused on the three R's; returns, returns, returns. We have to make sure our core strategy makes back last year's loss and goes on to make high quality returns. We have also seen investor demand for similar products, so we may end up launching a focused single strategy fund that takes advantage of our experience and excess capacity in one of the multiple equity special situations strategies employed by the fund. I also have ideas which relate to capital preservation and expanding on the Gold Class concept.

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For now we aim to keep the fund around the \$400m-500m mark. Given my prior experience, I am confident that the end capacity could be materially higher, but want to prove it with returns first. We want to make sure that any other products do not diversify us away from the core of what we do: innovative absolute return strategies.

Before I came to Bermuda, I was employing a global trading strategy from London and was finding the Asian time zone very hard to cover from Europe and was looking for a better base. The Bermuda time zone suits us very well and is well connected, being close to the East Coast of the US and Europe. There are obvious advantages from a tax and lifestyle perspective too. We believe Bermuda has taken the right approach, with strong infrastructure and regulation. There are very few places in the world where the offering for asset managers is as attractive as it is in Bermuda. ■





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# FORM PF FROM A TECHNOLOGY PERSPECTIVE

JAMES ELDERSHAW OF PACIFIC FUND SYSTEMS EXPLAINS THE PROCESS HEDGE FUNDS MUST GO THROUGH WHEN FILING FORM PF ALONG WITH TECHNOLOGICAL CONSIDERATIONS



**James Eldershaw**

is a director of Pacific Fund Systems Limited (PFS). PFS' PFS-PAXUS hedge fund accounting and administration application is installed in more than 50 fund administrator sites and administers more than \$300bn in net assets.

**T**he SEC and CFTC have now adopted the final rules for Form PF reporting, although many practical issues remain. In terms of the hedge fund industry, the key points are :

- The form must be lodged by SEC registered investment advisors.
- Advisors advising less than \$150m do not have to file Form PF. Advisors with between \$150m and \$1.5bn are required to file Section 1 only annually. Advisors with more than \$1.5bn ("large hedge fund advisors") must file Section 1 and Section 2 quarterly, except for private equity funds, which have received an exemption to file annually. Note that the asset brackets mentioned apply to "regulated assets", which is different from NAV and looks at just the asset side of the balance sheet.
- Private equity funds and liquidity funds have slightly different reporting requirements and may be required to complete Section 3 or 4.

Some commentators have described the Form PF filings as being the equivalent of a colonoscopy for hedge funds. Indeed, the number and range of questions asked is so extreme that I suspect that someone responsible for completing the filing would probably prefer to undergo the aforementioned procedure than calculate it manually. For example, Section 1 involves a minimum of around 120 questions to be answered, although that number will need to be multiplied out by the number of strategies, funds in the group, portfolio composition, types of investors. It is quite possible that a medium sized fund group of simple to moderate complexity that is not a large advisor will have to answer in the region of 200-400 questions for Section 1.

Section 2 may typically require several hundred further questions to be answered depending on how many times the base question list is multiplied out by the number of strategies/funds/instruments traded.

## MANUAL VS AUTOMATIC

Ultimately, it is the manager of the fund that is responsible for making the filing and whose signature is on it. Given that managers would prefer to be managing their

portfolios instead of doing extensive regulatory reporting, it is likely that the majority, particularly those only filing Section 1, will look to their administrators to complete the filing for them. We suspect that large advisors who are required to complete Section 2 may well end up hiring permanent staff to complete the reporting, although for efficiency reasons they will still want as much of the reporting to come from back office systems as possible. Large advisors who use multiple administrators will also most likely have to compile the report themselves as any one of their administrators will not have all the data and the XML file structure is not conducive to a merge of multiple XML files.

We estimate that around 80% of Section 1 can be completed from data stored in our PFS-PAXUS fund accounting/share registry application, although given the subjective nature of some of the questions, all data is likely to require some manual review.

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WE SUSPECT THAT LARGE  
ADVISORS WHO ARE  
REQUIRED TO COMPLETE  
SECTION 2 MAY WELL END  
UP HIRING PERMANENT  
STAFF TO COMPLETE THE  
REPORTING  
”

As it is our objective to automate as much of this as possible, we have added a significant amount of additional data storage for this purpose. For example, the filing requires a fund to submit its "strategy" according to a specific predefined list issued by the regulatory authorities. This strategy may be slightly different from that used by the market place, and therefore requires additional data storage at a fund level to automate it.

## FULL COVERAGE

The range of questions in Form PF covers not just the invested portfolio, but also investors in the

fund. For example, the residency of investors, the investor type (individuals, institutions, government, pension plans) have to be reported. It also requires separate reporting of gross and net performance and by implication the storage of performance fees. Section 2 requires an analysis of investor liquidity that covers redemption frequency and gates. In this respect, a site with an integrated portfolio and share registry system is in a superior position to automatically calculate a much greater proportion of the required responses than a site that employs multiple systems.

Administrators will need to ensure that large amounts of standing data, including the new data added specifically for Form PF, are accurately maintained. For example, the



country of residence and entity type of an investor may have been unimportant for accounting purposes, but will now have to be accurately maintained. In our PFS-PAXUS development, we are adding additional diagnostic procedures to help identify missing or bad Form PF data.

The Section 2 filing requires extensive additional information, much of which can only be obtained from risk management systems. We expect that many administrators will not provide the Section 2 service, given that risk management is not normally a part of the fund administration service. Even where an administrator does have a subscription to a risk management system, there will be judgement calls involved in both Section 1 and Section 2 that will require extensive manager involvement in the filing. In such a case, the filing may become a collaborative effort between the manager and the administrator whereby the administrator provides the responses that it can complete and the manager does the remainder.

#### SUBMISSION

Form PF must be filed electronically via Finra's website. The filing can be either by manual entry of data through the browser or submission of an XML file. Given the large number of questions we believe the browser option to be impractical and subject to user input error.

As an explanation for the non-technically oriented, an XML file can be considered similar to a text file in which individual "tags" are followed by the data that the tags refer to. XML is a robust format; however, editing a raw XML file can be difficult, even for technically proficient users. In the case of Form PF it is difficult to edit it in conventional text or XML editors because it is structured with sub tags and repetitive tags, such as questions that repeat for each type of strategy or fund in the group. Any direct editing of an XML file also risks bypassing valida-

tions that can be done by the software that created the XML file. In this sense, it is best to have as many validations as possible in the software that creates the XML file so that issues are identified prior to any submission being rejected by Finra.

From a technical perspective, the approach we are taking in PFS-PAXUS is to (a) generate as much of the data as possible automatically and store it in conventional format (for example, non XML) in PFS-PAXUS; (b) provide an editor application within PFS-PAXUS by which users can change or enter additional data; and (c) automatically produce the XML file at the last stage of the process. We will also be storing a history of filings and 'remembering' manually entered data for future filings. The filings will also be made available on the PFS-PAXUS Web portal to facilitate direct manager input and review. ■

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THERE WILL BE  
JUDGEMENT CALLS  
INVOLVED IN BOTH PART  
1 AND PART 2 THAT WILL  
REQUIRE EXTENSIVE  
MANAGER INVOLVEMENT  
IN THE FILING  
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# Bermuda: The Premier Jurisdiction

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With long-standing, solid regulatory standards and a position of transparency and cooperation, Bermuda has become a world-leading jurisdiction in the financial services sector. Bermuda's extensive TIEA network and our position as Vice Chair of the OECD Global Forum are testament to our robust and effective regulatory policies. Bermuda is a prudent and profitable place to do business.

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# WHY BERMUDA SHOULD BE YOUR JURISDICTION OF CHOICE

ANDREA MONIZ-DESOUZA AND ALEX ERSKINE OF APPLEBY (BERMUDA) LIMITED EXPLAIN WHY BERMUDA'S PRUDENT REGULATION, EXCELLENT FUND ADMINISTRATION SERVICES AND INNOVATIVE PRODUCTS MAKE IT ONE OF THE LEADING OFFSHORE FINANCIAL CENTRES



## Alex Erskine

is a partner and the group team leader of Appleby's Funds & Investment Services team, practising in the areas of corporate and commercial law, and specialising in advising on structuring and operating investment vehicles.



## Andrea Moniz-DeSouza

is an associate on Appleby's Funds & Investment Services team, focusing on the establishment of investment vehicles and advising on company and partnership formation.

**B**ermuda, once known more for its pink beaches and rolling golf courses, has evolved into a sophisticated offshore financial centre, continuing to compete hard for clients in the funds and investments space. Bermuda is now one of the world's leading international financial centres, being a sophisticated and dynamic tax neutral jurisdiction of choice for insurance, reinsurance, fund, asset finance and companies seeking to list on internationally recognised stock exchanges.

Over recent years, Bermuda has made legislative and policy changes to make fund registration quicker, easier and cheaper. The jurisdiction is nimble and adept, and through a constant and dynamic review of its legislation by government in conjunction with the private sector, it continues to look to, inter alia, encourage fund incorporations while protecting its excellent and well regarded reputation.

Bermuda enjoys a thriving investment business sector and continues to be a significant offshore presence in the international fund industry. As at the end of 2011, the net asset value of funds domiciled in Bermuda was \$159.51<sup>1</sup>.

Bermuda has an array of fund structures available, consisting of companies, partnerships, unit trusts, private act structures, infrastructure funds, segregated accounts and insurance-linked securities. There are also unregulated funds and closed-end funds.

Bermuda's innovative fund business products continue to evolve, making it the jurisdiction of choice.

## PRINCIPAL REGULATORY FRAMEWORK

The Investment Funds Act 2006, as amended (the "IFA"), the Investment Business Act 2003 and the Companies Act 1981 (the "Companies Act") provide the framework for regulation and supervision of the funds and securities industries in Bermuda. The IFA regulates open-ended funds incorporated in Bermuda and provides for four classes of authorised investment funds:

(i) institutional fund;

(ii) administered fund;

(iii) specified jurisdiction fund (a newly created class, which permits investment by funds domiciled in jurisdictions that require legislation recognition – as of 18 December 2011, the Minister has made regulations to recognise Japan, permitting investments by Japanese retail funds); and

(iv) standard fund.

Investment funds are prohibited from being operated in or from Bermuda unless they are authorised or exempted under the IFA. The requirement to be authorised or exempted does not apply to investment funds that are deemed to be private (if the number of participants is 20 or fewer and if the promotion, communication and offer to participate in the investment fund is restricted and is not made to the general public).

An investment fund may apply to the Bermuda Monetary Authority (the "Authority") for an exemption from authorisation if it is open only to "qualified participants"; it is administered by an administrator, which is recognised by the Authority (the administrator does not need to be situated in Bermuda); it has appointed an auditor, investment manager, registrar, custodian and/or prime broker (which may be waived on application to the Authority); and it has an officer, trustee or representative resident in Bermuda with access to its books and records.

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BERMUDA ENJOYS A  
THRIVING INVESTMENT  
BUSINESS SECTOR AND  
CONTINUES TO BE A  
SIGNIFICANT OFFSHORE  
PRESENCE IN THE  
INTERNATIONAL FUND  
INDUSTRY  
”

## STRUCTURES

- Mutual fund companies – the formation and operation of mutual fund companies are governed principally by the Companies Act. Mutual fund companies are limited liability companies incorporated by registration (approved by the Authority) or private act. They may be set up with limited or unlimited duration. The constitution of a mutual fund company may provide various classes of shares, which may be created and offered separately.
- Unit trusts – the formation and operation of unit trust funds are governed by the trust deed by which they

are established. The trust deed is entered between the management company that (or whose affiliate) is promoting the vehicle and the trustee. A unit trust fund has no separate legal personality. No governmental consent or approval is required to form a unit trust fund. All that is required is settlement of the terms of the unit trust fund deed and execution of the deed by the trustee and the management company. However, approval from the Authority is required to issue the units in the unit trust fund.

- Partnerships – the formation and operation of partnership funds are governed by the Limited Partnership Act 1883, the Exempted Partnerships Act 1992 and the partnership agreement. Exempted partnerships usually consist exclusively of partners who do not possess “Bermudian status” within the meaning of the Bermuda Immigration and Protection Act 1956. Partnership funds are constituted by a partnership agreement entered into between the management company which (or whose affiliate) is promoting the vehicle as general partner and one or more limited partners. Limited liability status is conferred on a limited partnership by registration, and partnership funds may be established for a fixed term or with unlimited duration. Partnership funds are incorporated by submitting an application to the Authority.

## INNOVATIVE PRODUCTS

### Segregated Accounts

Bermuda was one of the first jurisdictions to pass segregated accounts legislation enabling companies to legally separate the assets and liabilities of one account from the assets and liabilities and from creditors of other accounts within the same company. Under the provisions of the Segregated Accounts Companies Act 2000, a mutual fund company may be registered as a segregated accounts company enabling it to create different share classes, each representing a segregated portfolio of assets. Where a multi-class structure is desired with a separation of liability between classes, it is no longer necessary to incorporate multiple companies in an umbrella form. Instead, a single segregated accounts company may be incorporated with segregated accounts representing each share class. Such accounts enjoy a statutory division of liability, effectively ring-fencing each segregated account from the general liabilities of the company, and from other segregated accounts.

### Insurance Linked Securities

With the recent introduction of legislation to create Special Purpose Insurers, which were developed to provide cost-efficient and regulated corporate vehicles for fully funded insurance transactions, Bermuda has seen an increase in interest in new funds investing in insurance-linked securities (ILS). Large institutional and pension fund investors are increasingly attracted to the prospect of returns not correlated with the equity markets. ILS funds are also being formed covering areas beyond the typical natural catastrophe risk type to life insurance and man-made events. ILS funds may invest in a variety of insurance-related instruments but typically there is a mechanism to ‘trans-

form’ the reinsurance instruments into securities which can be invested in by the fund without exposing the fund to the need to itself license as an insurer under applicable insurance regulations.

The Bermuda Stock Exchange (BSX) issued a press release concerning the volume of catastrophe bonds and ILS that the exchange now plays host to, confirming that at the end of 2011, the value of listed cat bond and ILS securities listed on the exchange reached over \$3bn.

## ANTI-MONEY LAUNDERING/ANTI-TERRORIST FINANCING

Bermuda’s anti-money laundering/anti-terrorist financing legislation and Tax Information Exchange Agreements, the OECD’s recognition of Bermuda on its ‘white list’ of co-operative and compliant jurisdictions, along with the regulatory enforcement provided by the Authority, has ensured that Bermuda is a leader in international anti-money laundering/anti-terrorist financing measures, and reinforces the jurisdiction’s status as a premier offshore jurisdiction.

Bermuda is one of the industry’s leading offshore financial centres, remaining committed to attracting quality funds by offering innovative products, demonstrable political stability, excellent fund administration services, and prudent regulation of the investment industry. ■

<sup>1</sup>Bermuda Monetary Authority – Regulatory Updated April 2012



# A TOP JURISDICTION FOR INSURANCE-LINKED SECURITIES

**BRIAN DESMOND AND ANDRE PEREZ OF ILS FUND SERVICES DISCUSS THE POPULARITY OF INSURANCE-LINKED SECURITIES WITHIN THE ALTERNATIVE FUND COMMUNITY AND WHY BERMUDA HAS EMERGED AS A MARKET LEADER IN THIS SPACE**



## **Brian Desmond**

is a director and founding member of ILS Fund Services Ltd, a fund administration company dedicated to providing ILS funds with fund administration, independent valuation and transformer services. Brian is a chartered accountant and also serves as COO of a Bermuda based fund administration company named ISIS Fund Services, Ltd.



## **Andre Perez**

is a director and founding member of ILS Fund Services Ltd. He is also the CEO of The Horseshoe Group, an independent insurance manager and advisor with locations in Bermuda, the Cayman Islands, Ireland and the US. Andre has more than 20 years of experience in insurance, reinsurance, and alternative risk transfer.

It would be difficult not to argue that the traditional financial markets have been volatile in recent years and that many fund managers have been losing sleep trying to navigate through the market inconsistencies. Now more than ever, fund managers are looking for alternative investment opportunities whether that is with new asset classes or investment strategies.

An asset class that has been around for more than a decade, but has not been widely spoken about in the hedge fund space until recently, may be the answer fund managers have been looking for. Insurance-linked securities (ILS), more widely known as the convergence market (between the insurance and capital markets) which offer fund managers diversification that is uncorrelated to the traditional markets. ILS has weathered the financial crisis fairly well, although not completely unscathed, which has attracted the interest of fund managers as well as institutional investors.

Capital markets and the (re)insurance industries have held a long standing mutually beneficial relationship. Over recent years, this relationship has strengthened and evolved with the establishment of new financial products. These new financial products, including securitisations, have created new investment opportunities for fund managers and have also provided (re)insurance companies with different tools to manage risk and to increase capacity. Because of this, many expect the ILS market to grow in popularity.

Bermuda as a jurisdiction is poised strategically well to take on the new regulatory, fund administration, accounting, insurance management and legal nuances that will certainly come with the rise in popularity of ILS. Bermuda is considered to be the center of reinsurance expertise and is also a market leader in the alternative investment fund industry. For these two reasons alone, Bermuda is the natural jurisdiction for the convergence of capital markets and (re)insurance.

## **THE APPEAL OF CONVERGENCE**

Fund managers have been looking for alternative asset classes to increase their funds' performance and attract investor money. ILS has appeared as some fund managers' 'pot of gold' during the recent market volatility as the returns have been relatively strong and stable for the past 10 years and generally uncorrelated to traditional finan-

cial markets. For example, whether the wind blows or the ground shakes is uncorrelated with the US or the global financial markets.

Unlike traditional debt and equity, direct reinsurance investments often include both legacy issues and operational risk of the underlying company, while ILS products, such as catastrophe bonds (cat bonds), can provide rated debt instruments that are more cleanly tied to specific portfolios of natural catastrophe risk such as windstorm and earthquake. Sidecars can provide equity like investments but are also tied to specific portfolio risk and for limited duration. Industry Loss Warranties (ILWs) further provide investment opportunities in clearly specified property risk tied to industry-wide losses (index or non-indemnity).

Over the past 10 years, cat bonds have proven to be much less volatile than stocks, corporate and high yield bonds and have produced greater returns, so better returns with less volatility is certainly a key driver of interest in cat bonds. Also, as the proceeds from the issuance of the cat bond are held in trust, this means that the investor (hedge fund) does not have to worry about counterparty risk with the bond's sponsor.

## **BERMUDA, A NATURAL JURISDICTION CHOICE FOR CONVERGENCE**

There are only a handful of jurisdictions that cater to the convergence market. They are Bermuda, the Cayman Islands, Ireland and Switzerland. Bermuda has emerged as the convergence market jurisdiction of choice for several reasons including: (1) the country being one of the largest (re)insurance markets in the world and also a leading centre in the international investment fund industry; (2) the industry has the full support of the Bermuda Monetary Authority (BMA) and the Bermuda Stock Exchange and thus has strong, yet flexible, regulations that have been put in place to demonstrate the country's commitment to, and also to gain the trust of, investors who invest in this asset class; (3) Bermuda has highly qualified professionals that have the expertise necessary to navigate through the ever evolving asset class; and (4) Bermuda has been an innovator in creating legal structures that are tax efficient and able to capitalise on the traditional strong returns of the ILS asset class.

In 2009, the BMA passed legislation making it easier to invest in ILS by creating Special Purpose Insurers (SPIs).



SPIs were created to provide a capital efficient and appropriately regulated and streamlined corporate vehicle for fully collateralised insurance transactions, mainly catastrophe bonds and sidecars. SPIs have been proven to be very useful for these and other fully funded and sophisticated products.

#### EMERGENCE OF SERVICE PROVIDERS DEDICATED TO ILS

Service providers based in the ILS jurisdictions have been quick to adapt their service offerings to the particular ILS structural and accounting nuances that have emerged since this asset class gained popularity in the alternative fund community. Tax considerations, valuation/administration and the ease of stock exchange listing of the underlying ILS assets are the areas that are most widely focused on with this particular asset class. With the surge in popularity of ILS, it is hugely important for all services providers (for example, accounting firms, law firms, the listing exchanges, independent valuation agents, fund administrators) to be well versed in this space so that they can adapt to the evolving fund and security structures, tax changes, accounting nuances, and changes in the (re) insurance industry.

Service providers based in Bermuda have an advantage to being well-versed in ILS simply because the country has been heavily involved in the (re)insurance and alternative fund markets for over 30 years. For the reasons mentioned above, Bermuda based service providers have been able to adapt and alter their service offerings to cater to ILS funds and at times, have created new companies that cater specifically to ILS funds or insurance management. This ingenuity is another reason why Bermuda has emerged a leader in this space.

#### CONCLUSION

ILS, or more specifically, the convergence market, has gained popularity in recent years especially with fund managers. The traditional financial markets have been tumultuous over the past five years and caused fund managers to look at alternative asset classes that could generate alpha and ultimately attract investors.

ILS has emerged a popular asset class for several reasons but mostly due to the investment risk-adjusted returns being uncorrelated to traditional financial markets. Bermuda, which is familiar with both the (re)insurance and alternative fund industries, is excellently positioned to emerge as a market leader in the ILS space for years to come. With its talented pool of professionals, a strong yet flexible regulatory environment, and overall reputation as being a market leader in this space, Bermuda will continue to be considered a top jurisdiction for ILS. ■

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BERMUDA IS THE NATURAL  
JURISDICTION FOR THE  
CONVERGENCE OF CAPITAL  
MARKETS AND  
(RE)INSURANCE  
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# ESTABLISHING YOUR OFFSHORE PRIVATE EQUITY FUND IN BERMUDA

RODERICK FORREST OF WAKEFIELD QUIN EXPLAINS WHY BERMUDA HAS BECOME THE SAVVY MANAGER'S CHOICE FOR ESTABLISHING INVESTMENT FUND STRUCTURES



## Roderick Forrest

is a senior counsel at Wakefield Quin Limited, with a practice focused on investment funds, private equity structures and partnerships, as well as securities and capital markets transactions. Rod provides services to clients ranging from world leading hedge fund groups to single manager start-up funds.

**B**ermuda continues to prove itself an attractive jurisdiction for the establishment of investment fund structures, whether open-ended, closed-ended or retail schemes. In recent years, with the development of its legal framework under the Investment Funds Act (IFA) 2006 and streamlining of the regulatory regime led by the Bermuda Monetary Authority (BMA), Bermuda has become a highly advantageous jurisdiction in which to domicile investment funds. The vast majority of funds domiciled in Bermuda are institutional in nature. Institutional funds enjoy great flexibility in selection of service providers provided they meet certain minimum criteria. For example, there are no local administration, audit or custody requirements. Investment managers may also qualify for exemption from regulation by the BMA and, provided they continue to meet the straightforward criteria for exemption, need make no filings with the BMA or any regulator other than to certify that they continue to qualify for an exemption.

With an optimised regulatory regime in Bermuda, experienced and professional staff at the BMA and increasing fees in most offshore jurisdictions, the perception that other popular offshore jurisdictions are more efficient and cost effective are no longer accurate. Investment funds in Bermuda are incorporated within 24 hours and approved by the BMA usually within a working week. The regulatory regime in Bermuda is scaled to reflect the risks of the different types of funds. As is described below, the regulations are pragmatically applied enabling Bermuda to preserve its reputation as a high-quality offshore jurisdiction while not overburdening investment funds with unnecessary costs and regulation.

While some new entrants to the industry who are not familiar with the advantages of Bermuda may follow the well-worn paths to Cayman and British Virgin Islands

for their offshore funds, those managers who have experience with funds domiciled in Bermuda return for their new investment structures, reporting to be impressed with the service and attention they receive and the lower costs in Bermuda. Many new markets are opening up to Bermuda, with managers based in Brazil, Russia, India and China ('BRIC' jurisdictions) and other financial centres (outside of the traditional client bases of New York and London) such as Switzerland and Hong Kong, increasingly finding Bermuda to be a good choice of jurisdiction in which to domicile their investment funds.

For the purposes of the IFA, an investment fund is

defined as a structure in which the participants have a right to have their units redeemed at a price in accordance with the fund's constitution. Given that a closed-ended fund does not confer such redemption rights on its participants, they are not considered 'investment funds' under the laws of Bermuda. This enables closed-ended funds to be established as exempt from regulation under the IFA, giving investment managers great freedom in their choices as to how the fund should operate and invest. Managers enjoy full latitude in structuring the operations of their fund, and may tailor their reporting and governance to their target investors who may, for example, draw comfort from the independence of any administrators, custodians and auditors appointed

by the fund rather than from requirements or structures imposed by regulation.

Closed-ended funds are generally structured in Bermuda as limited partnerships or companies. If the structure is a typical private equity structure with capital commitments being made at the outset and capital calls, up to the amount of that commitment, being made during the life of the entity, a limited partnership is most commonly used. A company is, however, equally as suitable. If the fund is to be capitalised at the outset

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and investors are to be locked in until liquidity events are achieved or for an indefinite period, we would see a company being used for such a structure. The establishment costs of both entities are similar.

Also worth highlighting is the regulatory regime as it relates to investment managers established in Bermuda, whether of a closed-ended or open-ended fund. Unless such investment management companies have offices and employees in Bermuda, they are not subject to Bermuda's Investment Business legislation. A Bermuda company acting as investment manager to a private equity structure or investment fund, whether based in Bermuda or elsewhere, may be incorporated as a straightforward Bermuda private exempted company. It does not have to register or be licensed under the investment funds or investment business legislation. In the event that it does have an office and employees in Bermuda, so long as it is providing services to investment funds catering to institutional and sophisticated investors, it will qualify for an exemption from licensing. As a jurisdiction for incorporating an investment management company, Bermuda represents an attractive and inexpensive solution in comparison with many other jurisdictions.

While the current world economic climate continues to be the driver of change and development in the

investment funds industry, leading to greater regulation, there are benefits on the flip side. Bermuda's government is acutely aware of the importance of the island being a welcoming, efficient and effective place for investment businesses from abroad to domicile their offshore operations. Restrictions on renewal of work permits for employees to be based in Bermuda have been relaxed, applications for work permits can be fast tracked, and the costs of employing staff in Bermuda and running an office are falling. New initiatives are being considered to make it easier for businesses, such as investment managers, to locate all or part of their business in Bermuda. Although in the past Bermuda has been seen as an expensive place to establish an office, it is pricing itself at a level where it can now compete.

Bermuda enjoys many competitive advantages as an offshore jurisdiction for the establishment of investment funds. In addition to the regulatory and operational factors discussed above, the proximity to the east coast of the United States, with flight times under two hours to many gateways, ease of travel to London, the political and legal stability offered as a UK Territory, an educated workforce and a sophisticated infrastructure all combine to make Bermuda a wise choice for your next offshore investment fund. ■



Sometimes it takes a leap of faith  
to venture into uncharted territory

ILS Fund Services is a Bermuda licensed fund administrator catering to funds investing in insurance-linked securities (ILS). The joint venture between The Horseshoe Group and ISIS Fund Services capitalizes on the strengths of its founders so that the Company can offer ILS clients comprehensive fund administration and valuation services.

**Why ILS Fund Services:**

- ▶ Only dedicated ILS fund administration company to offer both independent valuation and fund administration services to ILS funds based in Bermuda, the Cayman Islands, BVI, and the U.S.
- ▶ Founded by two companies with extensive experience in fund administration and the reinsurance and ILS markets
- ▶ Professional staff comprised of qualified (re)insurance and fund accountants, seasoned fund administrators, actuaries, underwriters, claims adjusters and former ILS bankers, brokers and licensed securities representatives
- ▶ Ability to offer transforming services through The Horseshoe Group's affiliate Horseshoe Re.



# BERMUDA: WHAT SETS US APART AS AN INTERNATIONAL FINANCE DESTINATION?

SCOTT WATSON-BROWN OF PWC EXPLAINS THE APPEAL OF BERMUDA TO ASSET MANAGERS AT A TIME WHEN MANY CEOs ARE ANTICIPATING STRUCTURAL AND STRATEGIC CHANGES



**Scott Watson-Brown**

leads the PwC Asset Management practice and has over 17 years of experience in public practice, with 13 years providing quality audit and advisory services to clients in the alternative investment industry in the US, UK and Bermuda markets. He is a member of both the Institute of Chartered Accountants of Bermuda and Australia.

**W**ith financial markets in crisis once again and many firms predicting a decline in the global economy<sup>1</sup>, asset management firms are focusing on a number of issues including managing risk and driving down costs, as well as fighting the economic uncertainty, tweaking their strategies, managing their talent and assessing the impact of changes in the regulatory environment.

As asset managers continue to focus on these issues, the potential efficiencies in their corporate structure should be considered. PwC's 15th *Annual Global CEO Survey* noted that 70% of CEOs were anticipating changes to the organisational structure and 73% were anticipating changes to strategies for managing talent.

Bermuda is considered a strong choice for asset managers as they look to provide options and opportunities for their business and their people. It is a recognised and sophisticated financial hub with convenient access to global capital. Bermuda has a long history of delivering on the qualities so critical to building an effective global business structure and has acted as a headquarter location for not only insurance companies, but globally recognised asset managers that have been present in Bermuda for more than 40 years and continue to have significant operations based there.

The island's talent pool provides the right people with the right industry experience and expertise. The tax re-

gime is efficient and beneficial for both corporations and individuals. Underpinning all these benefits, the government is committed to the growth and expansion of the asset management industry and the regulator has a globally respected reputation of developing robust regulation, which is innovative, with the appropriate level of oversight.

Recent managers that have moved to the island have pointed to the infrastructure in place, the ease of setting up operations and the open communications with the regulator, government and service providers.

## REPUTATION AND EXPERIENCE

Bermuda is a self-governing British overseas territory and offers a secure and stable business environment. The legal and judicial systems are independent and based on English common law, with a right of final appeal to the Judicial Committee of the Privy Council in the United Kingdom. While Bermuda's corporate law is largely based on the UK's corporate law, it also includes provisions that are derived from other commonwealth jurisdictions or that are unique to Bermuda. Compa-

nies also have the opportunity to create private legislation by petitioning the Bermuda Parliament to create private legislation specific to the governing of their business.

Demonstrating its reputation as a first-class international finance jurisdiction, the Organisation for Economic Co-operation and Development (OECD) placed

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AND EXPERIENCED  
INDEPENDENT DIRECTORS  
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Bermuda on its 'white list' in 2009 and Bermuda was vice chair of the OECD's Global Steering Committee and hosted the OECD Global Forum in 2011.

### ROBUST REGULATION

Bermuda's asset management industry is regulated by the Bermuda Monetary Authority (BMA), with legislation that provides a statutory basis for regulating the establishment and operation of funds and certain asset managers. The BMA's regulation also provides for the licensing and supervision of Bermuda fund administrators.

Regular dialogue between Bermuda's international business and government encourages regulations that are innovative, while preserving the highest standards of conduct. This approach to regulation has supported the development of new financial products, including capital/insurance convergence structures and Islamic Finance solutions.

### TOP TALENT

Bermuda has an extraordinary concentration of intellectual capital with globally recognised service providers and experienced independent directors that are highly skilled, well educated, industry focused and who have a proven history of working collaboratively. Bermuda's professionals have a history of dealing with international structures and complex products, while their experience working with emerging markets can provide a high level of customised service.

### TAX NEUTRAL

Another reason why asset managers choose Bermuda for their key operations is that it provides an efficient tax structure, both at the corporate and personal level. Bermuda's tax efficiencies create an opportunity for the establishment of global fund platforms and locally based asset management and advisory functions. ■

<sup>1</sup> PwC 15th Annual Global CEO Survey, highlighted 50% of 125 asset management CEOs surveyed believed the global economy will decline.

## LET PWC HELP UNLOCK THE VALUE OF BERMUDA

By leveraging our Bermuda-based, multi-disciplinary asset management team, we can help you create the value you are looking for. Our professionals have strong knowledge and understanding of the local market and the wider global asset management industry. We know your business and can quickly assemble a hands-on, partner-led team that can help you with various fund strategies and corporate structures. This enables us to develop an effective approach to address your needs. Our Bermuda team's expertise, combined with our strong links with PwC member firms in London and New York, means we are best placed to provide the value and timely advice you require from a trusted business advisor. We will work with you to make sense of the issues and challenges of the current uncertain economic climate as well as the increasing regulatory burden you face.

We are about building long-term relationships with our clients, which means we are looking to grow and learn through every step of your business cycle. Whether it's advising on structuring, valuation, evaluation of complex tax scenarios, or simply delivering an audit as efficiently as possible, our motivation is to align our delivery and expertise to best realise your immediate and long term business objectives. PwC has extensive experience working closely with a number of local and global service providers. Together, we are known for rolling up our sleeves and focusing on realistic and timely plans to ensure your transition to the island is a seamless one for you and your business.



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# CONVERGENCE – A NEW STRATEGY FOR INVESTMENT?

SHARON A BEESLEY, MARCO MONTARSOLO, AND JANE WALKER OF ISIS LAW EXPLAIN WHY BERMUDA'S SOPHISTICATED SERVICE PROVIDERS, CONCENTRATION OF TALENT AND REGULATORY FRAMEWORK MAKE IT WELL-EQUIPPED TO PROVIDE THE MOST INNOVATIVE PRODUCTS IN THE INSURANCE AND FUND SECTORS



**Sharon A Beesley**

is a co-founder of ISIS Law, the CEO of ISIS Limited and one of the co-founders of the ISIS Group. She practices in all areas of corporate law with particular expertise in investment funds, structured finance, joint venture structures and mergers and acquisitions.



**Marco Montarso**

is a co-founder of ISIS Law. He practices in all areas of corporate law and his experience includes a wide scope of corporate work such as continuations, IPOs, exempted partnerships, aircraft leasing, structured finance, insurance captives and mergers and acquisitions.



**O**ver the years, Bermuda has steadily enhanced its reputation as a substantive and internationally respected offshore centre for the investment fund industry. Bermuda is well positioned to assist with the ongoing development of the offshore investment industry with more than 2,000 different investment products registered in, and operating from, Bermuda as well as many global administrators operating from Bermuda. Given recent global economic market uncertainty and inconsistent returns in the traditional markets, hedge fund managers and investors have been driven to explore new markets and alternative investment vehicles. One option that is gaining momentum is the use of insurance-linked securities (ILS), which are particularly attractive as they offer diversification coupled with the prospect of returns, which are not correlated with the financial markets leading to convergence between the funds and insurance industries.

## INSURANCE-LINKED SECURITIES

Bermuda is home to one of the world's largest reinsurance markets and is considered to be the centre for catastrophe reinsurance expertise providing more than 50% of the worldwide property catastrophe capacity. This makes Bermuda the natural place for the development of sophisticated and innovative insurance and investment products such as ILS. ILS funds are a natural hedge to the equity markets and listing them on the Bermuda Stock Exchange (BSX) gives them further security. They offer a straight-

forward and cost effective mechanism for the transfer of reinsurance risk to the capital markets. Investors in ILS are able to receive attractive rates of return in exchange for bearing the risk of specified natural disasters, such as hurricanes or earthquakes, life insurance or man-made events, for example terrorism.

The Bermuda ILS market has seen rapid expansion over the last couple of years, most notably with the recent listing approval of Everglades Re Ltd, a Bermuda based special purpose insurer, which is the vehicle for \$750m of catastrophe bonds linked to hurricane reinsurance cover for its sponsor Florida Citizens Property Insurance (Citizens). Not only is the Everglades listing the largest ever single peril catastrophe bond deal but it is also the first time that state-run Citizens has come to the ILS market. Another example of Bermuda being utilised by a US state-run insurer to transfer some of its risk to the capital markets and indications is that there is similar business in the pipeline.

The Everglades deal has brought the values of ILS listing on the BSX to \$4.25bn, of which \$3bn have been listed in the last year. Important catalysts for the growth in this sector have been the Bermuda Monetary Authority's revised regulations to make Bermuda a more attractive domicile for these securities and in particular the introduction of a new class of insurance company, the Special Purpose Insurer (SPI) in 2009. The SPI provides a cost efficient and more lightly regulated corporate vehicle for insurers and reinsurers wanting to issue fully funded insurance transactions such as ILS and in particular catas-



trophe bonds. An alternate vehicle for investment in ILS is through an investment fund company. In both cases the same regulator (namely the Bermuda Monetary Authority) is their supervisory body, which is one of the reasons why Bermuda has been able to develop innovative and often complex products.

Initiatives by local service providers include a joint venture between the Horseshoe Group and ISIS Fund Services Ltd., which have teamed up to launch ILS Fund Services Ltd., a Bermuda exempted and licensed fund administrator dedicated to funds investing in insurance-linked securities.

ILS Fund Services Ltd. provides a range of services to administer ILS funds including pre-launch advisory services, portfolio valuation services specific to ILS, fund accounting and investor services, transformer services, financial statement preparation and audit coordination and registered office and corporate secretarial services.

The joint-venture will capitalise on the strengths of its founders. Horseshoe Group will build on its global expertise in insurance-linked investment structures such as catastrophe bonds, sidecars, transforming vehicles and collateralised reinsurance to deliver superior valuation services to ILS Fund Services' clients. Similarly ILS Fund Services can benefit from ISIS Fund Services' expertise as a fund administrator.

#### SEGREGATED ACCOUNTS COMPANIES

Another option for investment funds is to make use of a segregated accounts company (SAC) structure to ring fence investments and property. Regulated by the Segregated Accounts Companies Act 2000 (SAC Act), a SAC is a flexible structure that allows any asset that is linked to a particular segregated account to be held as a separate fund exclusively for the benefit of the holder of that account. Assets in such account are for all purposes protected from the general shareholders of the SAC and also from the general creditors of the SAC who are not creditors of that particular segregated account.

Thus in the context of an umbrella fund as a SAC, it may issue shares in classes and the proceeds of issue would be included in the assets of the account (for example, the sub-fund linked to those shares). If shares are issued by a SAC and are not linked to a segregated account then



**Jane Walker**

is a senior corporate attorney with ISIS Law Limited in Bermuda. She practises in the areas of corporate and commercial law, as well as international finance, advising on all aspects of corporate financing, structuring and related transactions including aviation and insurance matters.

such proceeds would comprise an asset of the SAC's general account.

A major benefit of a SAC is that it enables a number of entities to be registered under one SAC to achieve within a single company what could otherwise only be achieved by incorporating a holding company and subsidiaries or by private act, as the SAC Act allows a statutory division of accounts so that the assets of one account are protected from the liabilities of the other accounts. The only additional costs associated with a company registered under the SAC Act are the annual fees of \$280 per segregated account subject to a maximum annual fee in the aggregate of \$1,120. Such fees are significantly less than standard incorporation fees or fees involved in the passing of a private act. Within the fund industry, this will prove particularly useful for clients wishing to establish master feeder fund structures, structures providing for multiple classes of shares or any structure where legal segregation of assets is desired. The SAC could also have an application in the convergence market in relation to ILS whereby different series of notes could be issued through different segregated accounts or as a vehicle for an insurance partnering agreement where a fund manager enters into a sub-advisory agreement with an established reinsurer for the outsourcing of underwriting expertise in relation to a portfolio of reinsurance contracts for a risk reward based return. Wider use of SACs could include protection of a number of different types of asset, for example, intellectual property rights that the owning entity wishes to ring fence from one another.

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BERMUDA HAS STOOD THE  
TEST AS A JURISDICTION  
OF CHOICE AND HAS NOW  
BECOME A WORLD LEADER  
IN THE CONVERGENCE  
MARKET  
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#### TAX INFORMATION EXCHANGE AGREEMENTS (TIEAS)

The report of the Peer Review Group from the Organisation for Economic Cooperation and Development (OECD) has consistently credited Bermuda with its work in the area of tax transparency and cooperation through TIEAs. Bermuda is also the vice-chair of the OECD Global Forum.

#### CONCLUSION

With its excellent reputation and track record in the reinsurance and asset management markets Bermuda has stood the test as a jurisdiction of choice and has now become a world leader in the convergence market. The Bermuda government and the private sector are continuing to work together closely in order to reinforce and strengthen Bermuda's reputation as a leading offshore financial centre. Their aim is to create a favourable environment for the effective and cost efficient establishment of innovative investment products, which evolve in line with market demand by ensuring that the regulatory framework is adapting to the evolution of the structures being created to allow investors the opportunity to seize market opportunities.

The combination of its sound regulatory framework, sophisticated service providers, extraordinary concentration of talent in the insurance and fund sectors physically based in Bermuda and the ability to offer a wide range of financial products, which can be listed on the BSX, illustrates that Bermuda is well equipped to provide a platform for the most innovative products to the fund industry. ■



# A SOPHISTICATED JURISDICTION FOR HEDGE FUND DOMICILIATION IN TODAY'S MARKET

CHERYL PACKWOOD OF BUSINESS BERMUDA DISCUSSES THE IMPORTANCE OF ANTICIPATING CHANGING MARKET CONDITIONS AND THE RANGE OF SERVICES AVAILABLE IN BERMUDA



## Cheryl Packwood

received her Bachelor of Arts degree cum laude from Yale University and a Juris Doctorate Degree from Harvard Law School. She joined Business Bermuda in October 2006 and is one of the most recognisable offshore representatives promoting Bermuda as a domicile at home and abroad.

**A**ny seriously rational approach to portfolio allocation must recognise that hedge funds have become a permanent trend, not a passing phase.

While many investment fads are of the “here today, gone tomorrow” variety, hedge funds will be here today and here tomorrow – for many good reasons.

Their favourable underlying dynamics include the continued expansion of global investment and global trade, which opens new opportunities for producing attractive long-term results.

These new dynamics also pose a challenge to the backward-looking investment strategies of many traditional investors. In particular, it challenges their assumption that a passive approach to investment in government bonds can still make as much sense in a period of rock bottom interest rates as it did in the long years of the secular trend of declining inflation and the associated drop in bond yields.

Historically low interest rates today mean that this 30-year long trend has ended. A continued belief in the power of passive bond and equity portfolio allocations would now condemn investors to inadequate long-term results.

Only high quality active investment management can deliver in the new climate the results that investors require. Fortunately, a new world of investment tools has come into being to redress the balance of the old.

Prominent among them are an impressive range of hedge funds. Now, more than ever, hedge funds can make up the difference in a global economy, in which the factors that drove asset market pricing for 30 years are no longer the force they used to be.

Bermuda has been among the first of the international jurisdictions to fully recognise the importance of hedge funds in the changed climate. Although Bermuda was already a pre-eminent domicile for conventional global funds, we have sought to be forward-looking and welcoming to new developments that can make a difference to the financial wellbeing of investors and their advisers. Innovative hedge funds, we believe, have a strong sense of the future about them and deserve sensible encouragement from fund domiciles.

The role of institutions such as Business Bermuda is to anticipate changing market conditions and respond to them sooner rather than later. We are well placed to do

so because for many years we have invested in all the support services needed to handle sophisticated client needs with the highest standards of quality and efficiency. Our risk-based regulation is flexible as well as trustworthy. Bermuda has demonstrated over the years an aptitude for innovation in the type of international products and services offered. We maintain regular dialogue with Bermuda's international business community to make sure our laws and regulations are practical and unobtrusive, as well as preserving the highest standards of conduct. We relate well to the innovative mindset of hedge funds, which regularly prove themselves adept at developing alternative strategies and structures to meet new circumstances.

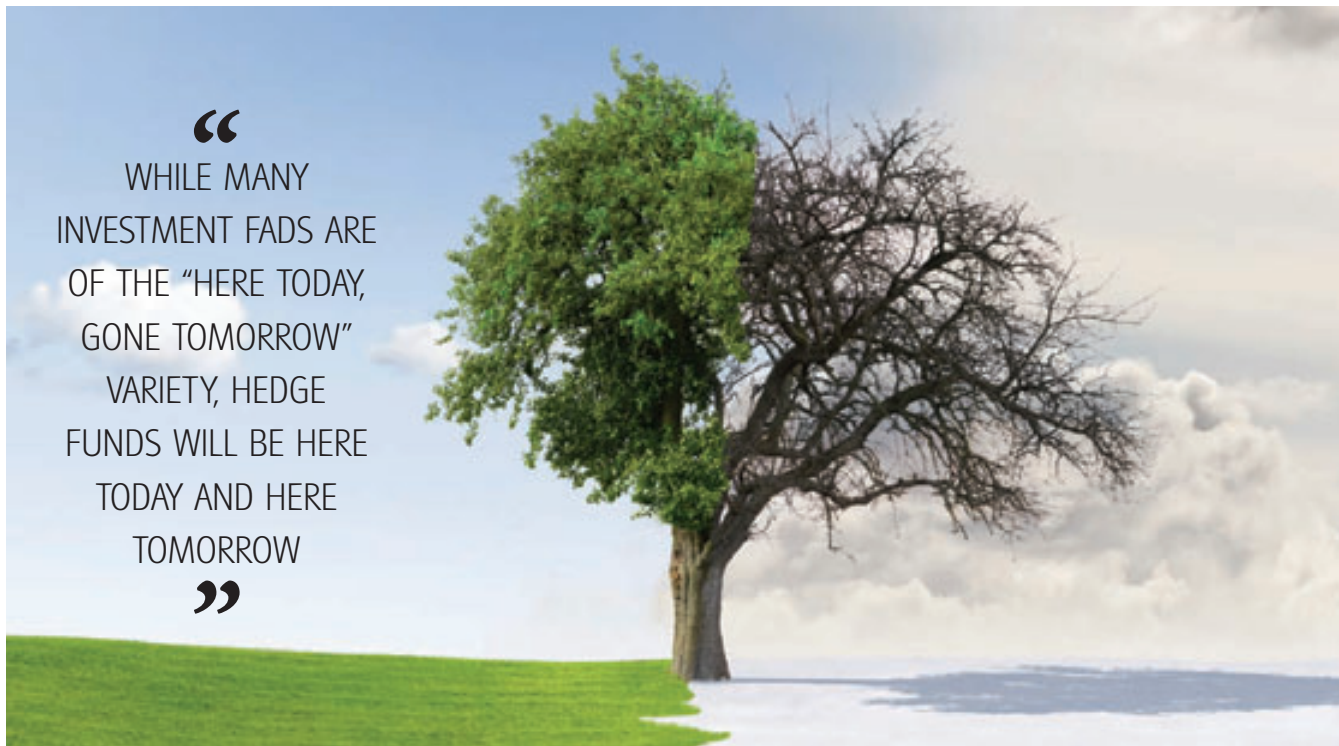
We never take anything for granted and have regularly taken action to eliminate restrictions and improve efficiencies of doing business on the island. As an example, Bermuda has been home to large insurance-linked securities hedge funds. These are funds that focus on event driven investments – such as catastrophic bonds – and provide investors with a proven uncorrelated asset class. For these funds, the manager and fund administrator may be based in Bermuda with direct access to the reinsurance industry based in Bermuda.

The quality of Bermuda's “know your customer” (KYC) regime, in force since the 1930s, has won praise from the US State Department, which has ranked Bermuda in the lowest risk category for money laundering and terrorism financing globally. Our levels of transparency have similarly been praised by the OECD for exceeding international standards.

An illustration of Bermuda's risk-based approach to regulation has been the licensing of Bermuda-based fund administrators, a process that includes on-site visits, as well as supervision of operations and financial reporting.

The broad range of services Bermuda offers to hedge funds includes fund administration, incorporating NAV preparation, corporate secretarial, directorships and transfer agency functions, legal and audit services, IT solutions and independent directorships.

But, undoubtedly, for many hedge fund clients the most notable advantage Bermuda has over any other international jurisdiction is the access it provides to the reinsurance industry. As well as the availability of a highly skilled professional workforce to support fund administrators, the presence of a sizeable reinsurance industry in Bermuda has resulted in the availability of a large number of quanti-



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tative experts in Bermuda. Their presence is invaluable for administrators and managers when dealing with the more complex asset classes.

For example, Bermuda has more actuaries per capita than any other jurisdiction in the world. This confers obvious advantages in designing and structuring complex instruments.

Bermuda has achieved a mass of administrative and financial services expertise, including large clusters of accountants, lawyers, investment bankers and directors. I doubt if any competing jurisdiction comes near to matching this concentration of intellectual capital.

Bermuda is regarded as a centre of excellence in administration services for investment funds, irrespective of where the funds are actually based. One reason for this enviable reputation has been the establishment of niche administrators providing sophisticated, tailor-made services for each individual client.

Bermuda's financial and political stability have increased in salience in the past few years, because so many countries around the world have encountered either financial or political crises – or both. Bermuda, by contrast, is a haven of political stability and financial strength – with economic growth surpassing the US and UK even before those countries ran into banking and real estate difficulties. In the current global market environment, Bermuda is benefitting from the flight to quality, transparency and predictability.

Another frequently decisive factor in weighing where to locate a hedge fund operation is Bermuda's easy accessibility to and from New York and London. Daily flights are available to these and other eastern seaboard and European cities.

Yet another factor are the potential tax benefits available for Bermuda-domiciled companies. Bermudian companies are not subject to corporate, income, capital or dividend tax, while individuals are not subject to personal taxation. A pleasant and peaceful lifestyle for families in an idyllic climate adds to Bermuda's competitive attraction.

More mundanely, we are also keeping comfortably ahead of the game in terms of the convergence between the IFRS and US GAAP. Bermuda law allows the adoption of internationally recognised accounting standards. The evolution of Bermuda's legal and regulatory regime in accordance with best international practice gives us the flexibility as a jurisdiction to adapt to new international developments and to provide appropriate structures for our resident businesses.

If we needed one word to summarise the 'Bermuda difference', it would be 'partnership'. We set out to make business easier and more profitable to transact by our process of public-private partnerships. We like to describe this as "red carpet, not red tape". It includes making incorporation easy, handling work permits efficiently and providing a variety of recruitment and relocation experts to assist with incoming residents. Bermuda's speed to market empowers funds to launch and list in as few as seven days.

Our partnership philosophy extends to working cooperatively with other governments. Thus we have, for example, tax information exchange agreements with no fewer than 34 other countries, half of which are European.

We achieve all this while keeping costs among the lowest in the world. It is not by accident that Bermuda is increasingly a magnet for hedge funds from many jurisdictions. ■





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