

# GIBRALTAR

**As a well-established financial domicile with all the benefits of EU membership, Gibraltar's reputation and rock-steady regulatory system make it well placed to capitalise on the current financial downturn. *HFMWeek* finds out how the hedge fund industry in the region is adapting to change**

## INTRODUCTION



GIBRALTAR IS A self-governing and self-financing parliamentary democracy within the European Union. We enjoy passporting rights throughout the EU in all financial services matters, including banking, investment services, insurance, insurance mediation and reinsurance. Gibraltar-licensed financial services firms therefore have access to a market of close to 500 million people.

Significant political developments include a new constitution, which came into effect in January 2007, as well as historic agreements that were reached between Gibraltar and Spain in September 2006.

A landmark ruling from the European Court of First Instance on 18 December 2008 endorsed Gibraltar's right to continue to be fiscally sovereign. As already announced by the government, the corporation tax rate will drop to 10%, commencing on 1 July 2010. Taxation on investment income has been abolished for all residents and occupational pensions are similarly not taxable.

While of course not immune to the turbulence in the global markets, the economy of Gibraltar remains strong. Public finances were, once again, in healthy surplus last year and employment levels again broke new records. Almost all the sectors of the economy had a successful year and are poised to

enjoy further success this year. Income taxation rates continued to fall significantly for all taxpayers.

Gibraltar has a highly-diversified economy, the principal contributors being financial services, tourism, shipping and bunkering, and e-gaming. Fiscal surpluses are used to lower taxes, reduce borrowing and invest in public infrastructure projects. Government revenues finance, inter alia, free education to university level, free healthcare and affordable housing schemes.

Public debt is at a historic low of 12% of GDP as compared to the EU convergence criteria maximum benchmark of 60%.

Gibraltar was the first EU jurisdiction to offer protected cell companies (PCCs) legislation in conjunction with passporting throughout the EU and, as a result, Gibraltar PCCs are being used extensively in insurance company and experienced investor fund structures.

Robust yet responsive regulation, combined with a strong professional infrastructure, has underpinned the momentum of the financial services sector.

The International Monetary Fund (IMF) further endorsed Gibraltar's robust regulatory environment and anti-money laundering regime in a second report published in May 2007.

The government is confident that Gibraltar's economy is better placed than most to face and steer successfully through the effects of current economic challenges.

**James Tipping, finance centre director, Ministry of Finance**



**David Wahnnon** was previously senior audit manager at PWC Gibraltar. He is presently managing director of **Capita Financial Administration (Gibraltar)** and serves as a director for various funds including some listed on stock exchanges.



**Joey Garcia** is part of the commercial team at **Isolas** focusing on private client work, funds, company law and trusts. He was called to the Bar in 2004 and represents the fifth generation of Isolas lawyers to come through the family firm.

## VITAL STATISTICS

Source: Gibraltar Financial Services Commission

**10%**  
Corporation tax (by June 2008)

**\$14.4bn**  
Total assets under management

**\$10.2bn** in banks

**\$4.2bn** in investment firms (March 2008)

**\$6.1bn** in collective investment schemes (Dec 2007)

### HFMWeek: What are Gibraltar's strengths as a fund jurisdiction?

**David Wahnnon (DW):** The advantages Gibraltar offers as a jurisdiction for funds are as follows:

- Significant funds are serviced.
- Key players in the market support the credibility of the jurisdiction.
- A unique environment where professionals work very closely with each other.
- The regulator is approachable, co-operative and in touch with the needs of the business community.
- The ease of setup and flexibility of the experienced investor funds.
- Ease of re-domiciling funds.
- Cost effectiveness.
- Advantages as EU member of allowing passporting financial services into Europe.
- Ability to use the parent-subsidiary directive.
- Eager for business and able to provide a good service.

**Joey Garcia (JG):** Gibraltar is firmly regulated by its Financial Services Commission (FSC), which has a statutory obligation to match the regulation of the FSA. However, Gibraltar's unique advantage is that it also forms part of the EU which gives access to passporting rights to Gibraltar-licensed service providers, along with a number of unique structuring opportunities. Furthermore, given the negative and sometimes unfair associations with the term 'offshore', it is important for individuals doing business in Gibraltar, and perhaps even more important for their clients, to understand that Gibraltar has fully implemented all EU legislation and is obliged to continue to do so in the future. Given the current market and the move to quality and well-regulated jurisdictions, this is a big plus for Gibraltar.

It has been essential for the FSC to find the balance between encouraging growth while maintaining enough control to ensure the good standing of the financial services sector, and this is something that has been achieved through the Gibraltar Experienced Investor Fund model. Gibraltar is often seen as a niche provider of fund services and its strength is being able to offer competitive pricing models within a regulated framework that offers clear advantages as well as comfort to potential investors.



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a highly competitive position. The decision has been a clear endorsement of Gibraltar's independence from the UK in terms of its tax regime and, as such, Gibraltar can now be sure to maintain its advantage as a small, fast-moving jurisdiction that is able to react and adjust quickly on its own terms.

**HFM: Evaluating and monitoring operations have become increasingly important. What are the key legal challenges and pitfalls for hedge funds in the current financial climate?**

**JG:** The main challenge facing the hedge fund industry will be the issue of regulation and how this is balanced alongside the flexibility required by most managers in the industry. Although hedge funds will probably be more willing to clearly document the investment approach, policy and risks in order to offer greater transparency to investors, the threat, internationally, is of regulatory overkill. Against a backdrop where investors may need ready access to cash, another challenge exists in ensuring that the fund is capable of balancing capital preservation with liquidity. Selection of a jurisdiction where counterparties to the fund are licensed in order to offer investors greater security within an environment of strong but flexible regulation has become a paramount concern.

**DW:** The nature of hedge funds and the current climate brings significant exposure from litigation largely due to lack of disclosure, transparency is-

**HFM: Now that the European Court of First Instance has annulled the European Commission's decision that the proposed reform of corporate tax in Gibraltar constitutes unlawful state aid, what does this mean for Gibraltar-based funds?**

**DW:** Gibraltar-based funds were exempt from taxes under existing legislation already, so nothing much has changed here. It will, however, become very attractive for investment managers wishing to have a European base with low taxes, good weather and better quality of life.

**JG:** The favorable ruling handed down by the European court is expected to accelerate the growth of the financial services sector by offering clarity for companies and funds operating within the jurisdiction. The government of Gibraltar has effectively put into place a compromise solution acceptable to the EU while also keeping Gibraltar in

sues, conflict of interest and integrity in pricing and valuation. Independent pricing and valuation of funds and their underlying securities is a key issue. The administrator here has an important fiduciary role to play. Documentation and disclosure become key in ensuring any legal risk is catered for with appropriate disclaimers/mitigating actions. More so, the proliferation of hedge funds in conjunction with the current climate is likely to increase government and regulatory oversight on not only the investment management companies but related service providers such as administrators.

**HFM: The current economic climate has seen the US and Europe place offshore domiciles under greater scrutiny. To what extent has this affected Gibraltar?**

**DW:** Gibraltar is a well-regulated finance centre, as it has demonstrated in all the independent reviews carried out by bodies such as the IMF on the local regulator.

As a member of the EU, Gibraltar is bound by the Savings Directive and therefore co-operates fully with other member states of the EU. In 2008, Gibraltar was ranked 26th in a list of 69 leading finance centres around the world in the Global Financial Centres Index published by the City of London Corporation. This is based on an online survey of 1,236 business professionals, who provided a total of 18,878 assessments. Gibraltar was also ranked in the top 20 centres for e-readiness. It is therefore in a good position to face any challenges.

**HFM: What lessons have been learnt from the credit crisis?**

**DW:** It is too early to assess the full impact of the credit crunch other than investors continued desire to stay in very safe investments and cash. The high level of redemptions and the loss in value of investments has had a profound effect on the market and made many think long and hard about both their investment strategies and their operating models. Many have been put out of business and this will clearly present interesting opportunities for consolidation, which in the short term will mean fewer but stronger players in the market. Importantly, the problems have highlighted the need for greater levels of controls, monitoring and diversification to better mitigate the



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potential effects of market downturns such as the one experienced in 2008.

**HFM: What are the main challenges facing the Gibraltar fund industry in 2009?**

**JG:** The main challenge facing the Gibraltar fund industry will be the world's financial market conditions in general and the effect that this has on new business. However, this has also opened up opportunities for smaller sized funds and managers to set up boutique funds for an established client base or an identified category of investors. It is clear that there will be opportunities within the markets and within new sectors of development but as always the question of timing and flexibility will be fundamental. The Gibraltar solution allows for a fund to be set up extremely quickly and, if the fund is structured as a protected cell company (PCC) (an umbrella fund), new cells or sub-funds can be set up as and when required for new offerings to

be made. In this sense, the jurisdiction is very well positioned.

Gibraltar will need to continue to be innovative and to evolve, introducing new products and services to the funds marketplace. This will always be tempered with a level of regulation that ensures the continued development of Gibraltar's reputation as an international financial centre. In the most recent Global Financial Centres Index published by the City of London, which takes factors such as regulation and taxation, access to customers, supply of skilled workers and responsiveness of government to business needs into consideration, Gibraltar was positioned three places behind Washington DC, two behind Dubai, and one behind Amsterdam (25th overall) while also sitting four places above the BVI, 12 places above Monaco and 21 above Madrid.

**DW:** In a small and emerging market such as Gibraltar which is facing more competition from other offshore centres, attracting funds to the jurisdiction will be a great challenge in the current market conditions, where investments are hard to come by.

Offshore centres such as Cayman, BVI, Bahamas and Bermuda continue to attract funds and stay competitive and a range of fast emerging centres such as Malta, Channel Islands pose a challenge while the likes of Luxembourg and Dublin remain as dominant players in the EU space.

The key will be driving a differentiation strategy and coming up with a unique selling point that will ensure Gibraltar is picked among the players. ■