

ISLE OF MAN

HFMWeek spoke to the main players in the Isle of Man funds industry about the island's accommodating regulatory structure, and the challenges ahead for this well-established fund centre

As a domicile, the Isle of Man has weathered recent industry hardships relatively well, due to its flexible regulation and well-organised fund structures. As the industry careers further into testing times, *HFMWeek* spoke to the principal members of two of the region's fund service providers regarding the current position of the jurisdiction. Peter Craig, director at PricewaterhouseCoopers, Isle of Man, expands on the domicile's offering in relation to hedge funds, while Philip Scales, managing director of IOMA Fund and Investment Management, highlights the emergence of opportunities within AIM-listed funds.

HFM Week (HFM): How do you see the Isle of Man's position as a domicile for alternative investment funds in relation to other domiciles?

Peter Craig (PC): The Isle of Man's product range more than matches the offering of competing jurisdictions. UK-based promoters and investment managers are attracted to the domicile due to its common law principles. The full range of vehicles that can be used as fund structures includes open-ended companies, protected cell companies and limited partnerships. Unlike Cayman, the island benefits from a European time zone; the 10-hour time difference between Dubai and Cayman can cause a 24-hour delay. Another advantage is capacity; the room for growth in our economy indicates the fund sector is well placed to thrive.

The Isle of Man is also an attractive place for the administration of funds from other domiciles. The many Cayman- and BVI-registered funds administered here enjoy the same advantages as the local funds.

Philip Scales (PS): Over the last seven

years, the Isle of Man has been popular as a centre for administering AIM and other listed companies. This is due to a number of factors: The Isle of Man is very well regulated but does not impose any undue regulatory burden over and above that required of a listed company; there is an excellent infrastructure of administrators, advocates, accountants and bankers, all of whom are familiar with the listed company environment; and company law is similar to the UK, so advisers are familiar with the structures used.

HFM: What types of new business have you seen setting up in the region?

PC: The Isle of Man launched two new fund categories earlier this year; the specialist fund and the qualifying fund. Over the past six months, market turmoil has prevented a significant amount of new fund set-ups. Any recent start-up funds have been created to take advantage of the current market conditions. Managers setting up may also be able to take advantage of lower tax rates while only being an hour's flight from London.

PS: AIM-listed companies have been used for a whole variety of reasons but I think the main areas of growth over the last few years has been in the renewable/sustainable energy area as well as property funds, of course. Although usually listed in London, the entities established are truly global and we see investments made in UK, Europe, India, the Far East and South America.

HFM: What opportunities does the Isle of Man domicile offer?

PC: There are huge opportunities for investors, fund managers and fund administrators. There are vehicles suiting a wide range of investment strategies and investor bases. Add to this



Peter Craig is a director at PricewaterhouseCoopers, Isle of Man, where he leads the alternative investment practice. His client base is focused within hedge funds and private equity. Peter is a committee member of the Isle of Man Fund Management Association.



Philip Scales is managing director of IOMA Fund and Investment Management Ltd, part of the IOMA Group. He has over 30 years' experience working offshore, primarily in corporate and mutual fund administration, and currently holds a number of directorships of listed companies.

our reputation for quality and our recent certification by the International Monetary Fund (IMF) as an Offshore Finance Centre of Excellence.

PS: The Isle of Man Financial Supervision Commission (FSC) and the Treasury have always been proactive in consulting with and listening to the fund industry. This way the regulatory environment has evolved in partnership which means any new ideas or products which require changes to regulations can be discussed with the FSC and, where needed, can be implemented quickly. The growth in the funds sector in recent years has been rapid and the increase in closed-ended funds has been a substantial contributor to the increase. The Isle of Man offers a good pool of qualified and experienced administrators as well as a growing number of individuals who

are able to act as non-executive directors of listed companies. These non-execs have good experience in acting as directors of public companies; they have a strong corporate governance ethos together with an excellent range of business skills.

HFM: What legislation or regulation do you expect to see appearing on the horizon in the coming year?

PS: In terms of the listed companies, I don't expect to see any major changes. Company law has gone through a substantial review and some changes are expected which will benefit listed companies. The recent introduction of the 2006 Companies Act and the creation of the New Manx Vehicle (NMV) has been very popular for listed companies. Although the NMV provides a simplified way in which a company can be run, listed companies that use the NMV will adopt the highest standards of corporate governance. However if the company does need to change the way it is operated, once appropriate approvals have been obtained, the changes can be affected quickly and at minimum cost.

PC: The Anti-Money Laundering Code has recently been revised but the requirements are largely unchanged. The island has the ability to enact legislation within a relatively short timescale should there be an opportunity and the industry works very closely with the government.

HFM: What challenges surround the valuation of companies in the current environment? How can problematic situations regarding illiquid assets be dealt with?

PC: The two main areas of concern are: the absence of broker quotes and suspensions of funds.

Ultimately, the valuation of securities rests with the directors who set out the procedures to be followed should valuation techniques need to be applied. The directors need to retain the documentation to demonstrate that they have taken all reasonable steps to arrive at their decision. They also need to consider the level of disclosure in the financial statements.

Some of the current solutions used are: redemption gates, suspending the fund, creating side pockets or writing down the assets.

There is no right answer for every situation and the directors have to con-



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As a result a number of companies are seriously undervalued. However, as global markets recover, a number of these companies will offer very good investment opportunities. We therefore expect to see greater interest in using listed companies as investment vehicles once economies start to show signs of recovery.

HFM: What challenges do you see the jurisdiction facing as we enter 2009?

PC: Worldwide, the industry faces a difficult year, with investor confidence low and little good news coming out of the markets. We must be alert to risk misstatements in financial reporting and also be mindful of the operational risks in producing a valuation. Also, third-party administrators must obtain reliable and adequate documentation to support trades and valuations. Overall, I think the Isle of Man is very well placed to expand the current investor base; our goal is to continue to offer a welcoming environment for smaller funds and new set-ups.

PS: Clearly, 2009 is going to be a difficult year. Administering listed companies throws up a number of challenges, such as ensuring the assets maintain value, dealing with a diverse and active shareholder base and providing the strong levels of corporate governance that go with this. However, the experience that firms such as ours have gained over many years of administering both traditional funds as well as listed companies means we are well placed to face the difficult challenges ahead. ■

sider what would be in the best interests of the fund and the shareholders.

Where funds have created side pockets as a way of ensuring a degree of parity between shareholders, there are downsides to their use:

- How many side-pockets you can create.
- The asset still needs to be valued and included in the financial statements.

Also, redemption gates restrict the amount of funds which can be redeemed at any one redemption point. Using the gate allows the investment adviser more time to dispose of investments in order to meet liquidity. This may not be popular with investors expecting funds immediately.

PS: This is a problem affecting the entire funds industry. In the case of listed companies the price is driven by the market. However, a number of AIM companies have experienced difficulties with illiquidity in their shares which in turn has driven prices down.

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Gordon Wilson of Caledonian Fund Services believes that a balance between necessary, yet flexible, regulation has been struck within the Isle of Man's fund and fund-manager offerings

Amid the worldwide storm ravaging the hedge fund industry, the Isle of Man is boldly perched; ready and willing to take full advantage of any opportunities. A review in 2007 of its fund offering and of its fund manager offering has paved the way for the industry going forward.

"I think the Isle of Man has a compelling offering," says Gordon Wilson, managing director of Caledonian Fund Services (Europe), who believes that a balance between necessary, yet flexible, regulation has been struck within the domicile's fund and fund-manager offerings.

"We have the specialist fund for hedge fund managers and an exempt fund structure for family offices," he explains. "We also have a fund manager offering comprising of a regulated Isle of Man-domiciled manager entity which has been tailored to the needs of the hedge fund industry."

In these turbulent times, there is increasing demand from investors and counterparties for heightened levels of regulation and, according to Wilson, the Isle of Man was ahead of the curve in its recent actions.

As he puts it: "While we are by no means resting on our laurels; we have built a solid foundation and are keen for more business".

Control environment

Recent times have called for more rigorous monitoring of the internal workings of a fund, and this is something that, Wilson believes, Caledonian Fund Services has excelled at.

"Hedge funds and their investors recognise that the control environment in which fund accounts are prepared needs to be subject to external testing and review," he says.

Caledonian has recently achieved the industry standard SAS70, following a systematic audit of its processes and control environment.

"SAS70-compliant processes and procedures provide assurance for fund managers choosing a particular administrator and for investors investing in particular funds" says Wilson.

Independence

Another attribute is the focus within the domicile on independent administration.

"Every regulated fund in the Isle of Man has always had to have an independent



Gordon Wilson was appointed managing director of **Caledonian Fund Services (Europe)** in August 2005. Prior to joining Caledonian, Gordon was a director with Deloitte in the Cayman Islands specialising in contentious hedge fund investigation and liquidation.

administrator, so it is something we are familiar with," he explains. "You are now seeing some very large investors, particularly those thinking of investments in funds managed in the US, insisting on an independent fund administration before they make an investment."

Objectivity and independence of the administration processes, specifically net asset valuation calculation, is something Wilson believes is of increasing significance in these times of distress.

For Caledonian, this objectivity and independence is provided within a boutique-style service; one that offers specialised client-specific service founded upon best-in-class technology.

It is in this area that, according to Wilson, Caledonian has an edge over larger fund administrator businesses as the industry goes forward.

In looking forward, Wilson is optimistic. "It is widely anticipated that there will be higher levels of regulation in the banking sector and this will be good for funds," he says. "Funds will inevitably play a larger role in the allocation of risk capital as banks are forced by regulation to pursue lower risk strategies."

In turn, the demands for high levels of independence over fund accounts and high standards of governance and controls will be good for both the Isle of Man and for organisations like Caledonian. ■



Striking the right balance