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With a history of serving the private equity sector dating back at least 20 years, Jersey can boast a longer pedigree in the industry than most of its rivals. But one of its most important assets, say practitioners, is a proactive approach to encouraging business that represents a major step forward from a few years ago.

“There’s much more support for growing businesses here than in the past,” says Brendan McMahon, a financial services partner with PricewaterhouseCoopers. “I came 20 years ago from Ireland, a country that was very ambitious to grow a financial services industry, to Jersey, where the attitude was that we could turn the tap on or off if we needed to.”

Today the island has moved a long way from that ambivalent stance, says McMahon, who is also a private equity leader in PwC’s global investment management practice. “It’s very much a case of whatever the industry needs, we need to provide,” he says, citing the efforts made by Geoff Cook, chief executive of the industry promotional body Jersey Finance, to drum up business for the island. “He’s asking all the private equity houses for their view on what we’re doing in Jersey and what if anything we still need to do. We’re taking a very proactive role in engaging with our clients.”

McMahon says global industry confidence in offshore jurisdictions is a fragile construct, easily damaged and slow to rebuild, and he cautions that Guernsey’s public debate about the merits or otherwise of population growth may prove an obstacle to attracting new business. “We appear to have less constraints over employment growth than what we’re hearing in Guernsey,” he says. “When you talk about zero population growth, as Jersey did in 1990, it took 10 years to overcome. By contrast, the government now says it wants to grow the working
population by 500 per year, which is a lot of people in an environment like this."

That’s not to say Jersey has a perfect record of seizing opportunities. McMahon notes that it was Guernsey that stole a march on its neighbour some two years by reaching agreement with the Dutch authorities on recognition of Guernsey’s fund regulation as equivalent to that in the Netherlands. This allowed Guernsey vehicles to be listed on the Euronext Amsterdam exchange without undergoing further regulation, a status achieved by Jersey a year later.

In the meantime, however, the domiciling in Guernsey of KKR Private Equity Investors, Europe’s largest publicly-listed private equity vehicle, had grabbed the attention of the largest US buyout houses. "The listing of permanent capital vehicles is the main differentiating factor between the islands after KKR used a Guernsey structure to establish a vehicle listed on Euronext," McMahon says.

"KKR went out to raise USD1.5bn and they ended up with USD5bn. It was a bit of a faux pas on the part of the Jersey authorities that they never got around to responding to the Dutch. Because of the herd factor, after KKR did it, Carlyle, Apollo and a number of other large groups went to Guernsey on the back of that."

While Euronext and to a lesser extent the London Stock Exchange have garnered the headlines, there is a listing solution much closer to home for private equity funds domiciled in Jersey and Guernsey, according to Tammy Menteshvili, chief executive of the Channel Islands Stock Exchange, which was established in 1998 and now has a total of more than 2,400 listings. At least half of the securities listed over the past two years have been funds, a large proportion of them investing in alternative assets.

Menteshvili believes the benefits of listing in Amsterdam or London have been exaggerated.

"There was one very large deal on the private equity side that went to Euronext, KKR, and everyone assumed that this must be the way forward, but that doesn’t mean that what we have to offer isn’t as attractive,” she says. "We can raise that kind of interest from investors through our exchange just as well as any other.

"Not only can we raise capital here but we have secondary-market liquidity on a number of our funds. We have market-makers, an order book and most importantly an electronic settlement system, which at the moment is just a vague idea in people’s minds at some of these other exchanges like Euronext - which isn’t even a stock exchange, by the way, but an inter-dealer market like AIM."  

Menteshvili also notes that secondary market liquidity, one of the main arguments cited for listing on markets such as Euronext, can be very thin for listed private equity vehicles. Kohlberg Kravis Roberts has just announced plans to use its funds to buy shares in KKR Private Equity Investors to support its sagging share price. While its net asset value per share amounted to USD25.77 at the end of September, the vehicle’s share price had fallen to less than USD18 at the beginning of December.

Nevertheless, the trend toward listing of private equity vehicles and other alternative funds domiciled in the Channel Islands is likely to continue, and it has been boosted by the introduction in January this year of the Listed Fund Guide by the Jersey Financial Services Commission. Like the Expert Funds regime introduced in 2004, Listed Funds benefit from a streamlined approval procedure, with authorisation promised within three days, thanks to the fund’s administrator taking over the burden of due diligence from the regulator.

"The Listed Fund Guide has taken off very well, because we are seeing a significant interest in getting funds listed, more so than at any time since the 1980s, when listing was part of the process of establishing funds for the retail market," says Richard Thomas,
a partner with law firm Ogier and chairman of the Jersey Funds Association. “Now we’re looking at it more for the institutional market. In addition, there are cases where fund promoters targeting the UK independent financial adviser market for investment through self-invested personal pensions require a listed product.”

While the KKR deal sparked a surge of interest from the US, most private equity business continues to flow to Jersey from the UK and other parts of Europe. “There was an influx of US groups, but there won’t be a flood of business,” says Horace Camp, managing director for fund administration for Kleinwort Benson in the Channel Islands. “In Europe, Scandinavia has always been a very attractive area for business and the UK remains a big source of promoters, but many fund administrators in Jersey or Guernsey have business from all over the world.”

Gary Clark, head of hedge fund services at Mourant International Finance Administration, the island’s largest administrator of alternative funds and one of the largest providers of services to private equity both in Europe and internationally, believes that the introduction by Jersey next year of unregulated funds will provide further impetus for the industry. This new type of fund, aimed at highly sophisticated investors and with a USD1m minimum investment, is not subject to ongoing supervision and does not require a Jersey-based administrator or even an audit sign-off.

Clark believes there will prove to be considerable appetite for this type of vehicle in the European time zones and that it will help Jersey to compete more effectively with the Cayman Islands, which are not only the world’s leading hedge fund domicile but home to a large if hard to quantify share of the world’s private equity structures. “If we’d had an equivalent product to Cayman 10 years ago, we’d have had a lot of these funds domiciled in the Channel Islands, for no other reason than it’s more convenient,” he says. “But that regime wasn’t there – Expert Funds were the first step.”

Even with completely unregulated products, he argues, Jersey’s reputation for being at the top end of the offshore jurisdiction quality spectrum will serve it well. “The island wants to lead international standards and maintain its reputation, but equally it needs to respond to the requirements of the market,” Clark says. “With a product that’s very open as to how it’s serviced, managers have a greater choice of service providers. Greater competition to provide services leads to better corporate governance and greater investor protection.”

Camp argues that both Channel Islands are likely to benefit from a blurring of the lines between alternative asset classes. “Private equity is changing,” he says. “We’re seeing convergence between what is a private equity fund, a property fund or a hedge fund as managers seek to do something different to deliver a return to their clients.” He believes that while in the past Guernsey was probably more closely associated with the private equity sector, Jersey has now made up the ground in terms of credibility as a domicile.

“Both domiciles have kept their regimes up to date, particularly with faster application processes, but another driver is the much stronger need for good corporate governance,” he says. “The mind and management issue has made Jersey and Guernsey far more attractive, because there is real infrastructure, genuine corporate governance and a pool of credible non-executive directors. In a world where corporate governance and mind and management offshore need to be real, the islands are more attractive than ever.”

Jersey has come a long way since 1987, when the Charterhouse buyout funds became the first group of private equity funds to be established on the island. Over the intervening years, McMahon notes, the island’s activities in the sector have grown in...
Private equity has been one of the cornerstones of Jersey’s dramatic emergence as a leading funds jurisdiction over the past four years, although it has been an integral part of its financial sector expertise for much longer. For the Mourant group, which is by far the largest fund administrator in Jersey through Mourant International Finance Administration, and also the foremost legal advisor to the sector with Mourant du Feu & Jeune, private equity has been a major driver of business growth in recent years.

Today the private equity side of the business is enormous, making Mourant probably the largest private equity administrator in Europe if not the world, thanks to a client base that includes many of the leading names in the industry, such as CVC and Axa. While all alternative investment sectors are flourishing in Jersey, private equity is probably the largest of all, ahead of property funds.

Alternative fund business has grown vigorously across all asset classes since the launch of the island’s Expert Funds regime in 2004. Over the past five years, the asset volume of funds serviced in Jersey has risen from GBP100bn to a new record of GBP221bn at the end of September. Over the past year the number of Expert Funds established in Jersey has grown by nearly 45 per cent to 349, with assets growing by 71 per cent to GBP43.5bn.

The past 12 months have seen both organic growth from existing clients and the arrival of new promoters for whom Jersey is becoming the domicile of choice, thanks to the combination of flexibility and high standards in its regulatory structure, and the growing expertise across the island in areas such as legal advice, audit, and administration and accounting services.

The private equity sector has enjoyed a boost from the introduction of streamlined authorisation procedures for closed-ended funds and, especially in the light of the renewed interest in stock market-listed alternative investment vehicles, from recognition of its regulatory regime by the Financial Markets Authority in the Netherlands, exempting Jersey-domiciled funds from the need for licensing when they list on Euronext Amsterdam.

Jersey is also benefiting from uncertainty about the future direction of UK tax rules, particularly regarding the status of non-domiciled individuals, to attract alternative fund managers keen to benefit not only from fiscal advantages and lifestyle benefits but from a can-do business culture. Meanwhile the island has adapted its own tax structure in order to create a sustainable long-term base for high value-added businesses to flourish.

The next step will be the launch at the beginning of 2008 of unregulated funds, which will see funds destined for highly sophisticated institutional investors exempted from ongoing supervision. Because these funds do not carry any requirement to use Jersey-based service providers, they will ease some of the constraints of a growing volume of business on a sector with limitations on the talent pool it can access; but the island is unlikely to miss out on sophisticated work in areas where it has proved it can compete with the best.

The constraints can also be eased by technology, and Mourant and its competitors are all investing in systems that will lessen the need for growing staff numbers. With the group’s alternative asset base rising by 50 per cent last year alone, with the majority of that growth coming in Jersey, it’s a strategy that’s already paying off.

By Gary Clark
tandem with the growth of European general partners and the ever-greater volume of funds at their disposal.

“We have seen many of the major players in the European market, such as CVC, Permira, Altor Equity Partners, Nordic Capital, Axa and Vision Capital, a cross-section of the industry from the large buyout houses to mid-cap firms and pure technology fund managers,” he says. “When CVC established its first fund here in 1996, it closed with commitments of around USD650m. A decade later, we’re seeing funds with committed capital of up to USD5bn. These are what one might call the more established European houses, but 10 years ago CVC was barely heard of, nor Nordic Capital, Altor or Doughty Hanson.”

Today the insistence by national tax authorities that funds demonstrate that management and control is genuinely being exercised in the offshore jurisdictions in which they are domiciled is prompting some private equity firms to establish substantial operations in Jersey. “A number of managers have chosen not to outsource their administration to third-party providers in the island but to create a real physical presence, like Nordic Capital, which has a lot of people on the ground now,” McMahon says.

“In contrast to 1990, when the policy was basically zero job growth, there are no real barriers to managers bringing people in if they want to expand their presence. Politicians are now saying that to grow our economy, we must support those sectors that are actually generating wealth for the benefit of everyone here. There’s a feeling now that Jersey is a place close to Europe from which you can manage operations.”

Members of the industry agree that the island benefits from having close links to European Union countries and organisations within them such as Euronext while remaining outside the EU. “There are a huge number of advantages,” says Jersey Finance technical director Robert Kirkby. “Most important is the absence of value-added tax on structuring fees when they are charged to the offshore vehicle by the partners doing the deal. That can be quite significant, especially given the higher rates of VAT levied by some EU member states.

“The EU Prospectus Directive is very prescriptive on how prospectuses should be drafted, but if you’re launching a private equity fund from Jersey you can adopt a much more pragmatic approach. There is flexibility in accounting standards - if you primarily have US investors, you can use US GAAP, or UK GAAP in the case of the UK. And while MiFID may not apply directly to private equity, it includes quite an onerous definition of a professional investor. The Jersey regulation provides much greater flexibility.”

The island could also benefit just as much, he believes, from the current plans of the UK government in a range of areas that affect the private equity industry, from the planned abolition of capital gains tax taper relief, which would have the result of raising the effective tax rate on a fund’s gains from 10 to 18 per cent, to the envisaged flat-rate tax on non-domiciled individuals, who are believed to include partners at many private equity firms.

“Things like the uncertainty over CGT and the non-domicile issue are an advantage for places like Jersey,” Kirkby says. “We’re always trying to attract people like hedge fund and private equity managers, and although tax is never the primary reason for them to move, it always contributes to the decision. Right now we are hearing reports of people looking to relocate their businesses as well as their own personal domicile and residence.”

Even if the UK proposals are rescinded or amended, he argues, the uncertainty they create can be equally damaging for London. “When that happens, people look at structuring their business in other ways,” Kirkby says. “You never want to go down that route, because once people start thinking about a change they may well decide to go through with it. We think that could have some benefits for Jersey.”
Private equity funds business in Jersey is set for a further boost when new unregulated fund categories are implemented early in 2008. The attraction of Jersey to the private equity community has been growing since the introduction of the Expert Fund Guide in 2004, which streamlined the regulatory approval process. This served as a springboard for an increasing number of fund promoters to domicile their alternative investment fund vehicles in the island and has helped consolidate its reputation as a premier centre for funds business.

A number of leading private equity houses, including 3i, CVC, Cinven and Nordic Capital, now have operations in Jersey. Feedback from recent visits to London has indicated that the island is recognised for its credible and experienced fund administrators and for the quality of its regulation and strength of its legislation.

The introduction of unregulated fund categories can only add to the jurisdiction’s flexibility. Promoters using the new regime will not need to seek regulatory approval when applying to set up a fund in either the Unregulated Eligible Investor Category or Unregulated Exchange Traded Category.

Consultations continue with the Jersey Financial Services Commission to fine-tune the proposals, but there will be no requirement for a Jersey-domiciled administrator, directors or custodian and, significantly, no audit requirement. Jersey will be the first European jurisdiction to offer this level of flexibility to the private equity community.

Unregulated Funds will be suitable for professional and expert investors and those who have taken appropriate professional advice. Prominent investment warnings will indicate that such funds are unregulated, and existing funds will not be able to transfer to the new regime.

Professionals in Jersey believe the new categories will appeal to promoters particularly where speed in bringing the product to market is essential. For the private equity market, the Eligible Investor Unregulated Fund will offer an easier set-up process and avoid the delay of regulatory approval as notification requirements are minimal.

The latest additions to the island’s fund capabilities come as the net asset value of Jersey funds under administration rose by more than 30 per cent to GBP221bn during the 12 months to the end of September. More than half of all assets – GBP113bn – are in alternative funds, and the 349 Expert Funds approved since 2004 account for GBP43.6bn.

The unregulated fund categories are the latest in a string of enhancements introduced to maintain the island’s competitiveness in the alternative funds sector, after consultation with the industry and with support from the financial regulator.

The Non-Jersey Domiciled Fund Guide allows local functionaries to act for non-Jersey domiciled funds under a streamlined authorisation process. This offers promoters the choice of domiciling their funds elsewhere but still taking advantage of the island’s administration or custody capabilities.

Earlier this year the Listed Fund Guide introduced a fast-track authorisation process for closed-ended collective investment funds that are to be listed on recognised stock exchanges or markets. The guide is set to build on a marked increase in the number of listed alternative asset funds established in Jersey.

Jersey’s fund industry believes these changes will make the regulatory system more transparent and more efficient. The combination of a flexible regime, a strong and growing administration and custodian sector, the ability physically to locate the manager in Jersey and the ease of travelling to and from the island has made it the jurisdiction of choice for many alternative asset managers.

Record year for Jersey funds

By Beverley Le Cuirot
Of all the factors driving private equity business to Jersey, industry participants say, one of the most important is the quality of its administration services, built on a foundation of expertise accumulated over more than a decade and starting when the industry had a much lower profile - and considerably less cash at its disposal - than today.

“The general interest in private equity is obviously driving significant investment, with USD108bn raised in Europe last year, and Jersey is getting its fair share of that,” says Robert Kirkby, technical director of the industry promotional agency Jersey Finance. “In recent years Jersey has been very much open for business, which has allowed us to build an excellent skill base of the administration side of private equity, where we were historically considered slightly weak.

“Over the past couple of years there’s been considerable investment in administration skills and in private equity systems, as well as increasing awareness of private equity on the part of the law firms. We haven’t done anything radical, such as a new regulatory framework for private equity or attracting large numbers of buyout houses to set up in the island, but we’ve taken a much more pro-active and business-friendly approach.”

Kirkby notes that groups such as Mourant, which in addition to being the leading legal adviser to Jersey-domiciled funds is also by
Pioneering exchange offers new benefits

By Tamara Menteshvili

Long before the recent boom that has made private equity investment known around the world, the Channel Islands Stock Exchange has led the field as one of the first stock exchanges in Europe to allow the listing of interests in limited partnerships. Today the CISX has a number of these listings, particularly from the Scandinavian region, where this type of structure has been used by pension funds to invest in asset classes such as property and for mezzanine financing.

The Exchange, which earlier this year marked the approval of its 2,000th security admitted to the Official List, is widely used for the listing of a range of alternative fund structures, including property and hedge as well as private equity funds. In addition, it has also established a specialisation in truly alternative funds that invest in a diverse range of assets; the CISX already lists the first wine fund, two art funds, a forestry fund and a tree fund.

But just as important to the private equity industry is the Exchange’s role in providing a tax-efficient means for UK private equity to finance acquisitions. Over the past four years, issuers in England and Wales have been responsible for more than GBP30bn in debt listings on the CISX.

The listing of debt on a recognised stock exchange, as the CISX is by the UK tax authorities, exempts UK issuers from withholding tax on interest payments to investors outside the UK, a provision known as the Quoted Eurobond Exemption. This is important given the role of debt in private equity acquisition structures and the use of so-called payment in kind notes (PIK Notes) to pay interest in order to minimise cash payments during the life of the loan.

While these payments in kind trigger tax deductions for the issuer, withholding tax becomes payable, hence the importance of the Quoted Eurobond Exemption to mitigate this liability. Since the exemption is applied to interest paid as opposed to accrued, it means unpaid interest that accrued before the listing of the debt can escape the tax if it is paid subsequently.

As well as the CISX, various other stock exchanges within the European Union are recognised for the purposes of the exemption. However, because the Channel Islands are not members of the EU, issuers are not subject to a wide range of European legislation including the Prospectus Directive and the Transparency Directive.

This means, for example, that there is no requirement to prepare accounts according to International Financial Reporting Standards, with all the additional costs and complexity that entails; the Exchange offers issuers the flexibility to use US or UK GAAP instead. This is on top of flexibility in other areas, such as continuing obligations, and the speed and efficiency that gives the Exchange an advantage in terms of listing turnaround time.

The Exchange benefits, of course from practical advantages such as being in the right time zone to serve European issuers, but it also offers an impressive and comprehensive track record, the imprimatur of recognition from tax and regulatory authorities in other jurisdictions, and the ability to offer efficient trading infrastructure and genuine market liquidity.

This matters to issuers seeking investors who may not invest in securities unless they are fully listed on an exchange with full recognition status, and the number speak for themselves - at the end of November the CISX had some 2,400 listings, around 80 per cent of which are on a primary basis.
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In a world of increasing onshore regulation, new private equity funds being established offshore are likely to provide further ammunition for the industry’s critics. However, Jersey’s reputation and attitude to reform may help to silence their concerns.

Private equity is increasingly seen as a mainstream asset class. The industry has grown significantly over recent years and has a track record of delivering excellent returns to its investors. It is also seen by its proponents as a force for good, creating value and growth in the wider economy.

It is therefore of some concern that the industry is under such fierce attack. In a rather sinister portrayal, it is accused of stripping portfolio companies of their assets and employees and loading them with debt. It has also come under fire recently for paying too little tax and being under-regulated.

As a result, private equity firms are quickly realising that it is important to fully engage all their stakeholders, be they governments, tax authorities or members of the public, if they are to run some of the largest businesses in the world.

It has never been so important for the industry to demonstrate to the outside world that it is committed to reform and the interests of all its stakeholders. A primary way to do this is through the choice of jurisdiction when establishing new funds. It will be vital for private equity fund managers to choose the right jurisdiction in order to maintain credibility. Selecting a co-operative and transparent offshore regime will naturally help this cause.

Jersey recognises that the investment fund landscape is continually changing, particularly for the private equity world. In response, it has committed itself in recent years to overhauling its financial services industry and the way it conducts business. This includes a revised legal framework, an ever more effective local regulator, an almost completely revised tax regime, and continued development of its highly skilled workforce.

The objective of all of this has been to build a reputation for quality. Jersey takes very seriously its standing as a jurisdiction of repute among the many financial services centres in the world. It has engaged all its stakeholders outside the island, including the UK government, the International Monetary Fund, the Financial Action Task Force, the Financial Stability Forum and the European Union. Through co-operation and transparency, it now has a relationship with all these organisations that is benign and positive.

This is exactly the kind of business climate that the private equity industry is currently in search of. Amid the regulatory turmoil in the onshore world, fund managers will naturally look for jurisdictions that are credible and transparent when establishing new funds. As an offshore jurisdiction, Jersey offers the appropriate level of regulation and tax neutrality for investors and general partners alike.

But what sets it apart is the emphasis it places on continuing reform and the quality of its reputation, both of which are so high on the agenda for the private equity industry. Jersey’s image positively lends credibility to those setting up funds in the island. This is why it is becoming the offshore location of choice for private equity fund managers.
of administering private equity funds, but argues that Jersey has caught up and may be better equipped for future growth because of the government’s willingness to countenance an increase in the island’s working population, an issue that is still the subject of vigorous debate in Guernsey.

“We’re starting to see a trend of Jersey service providers administering more Guernsey funds than in the past,” MacCallum says. “Guernsey still continues to provide compliance and registered office facilities, and all the things that are required by law, but much of the actual administration may be carried out in Jersey. A lot more Channel Islands firms are working together across the two islands, but there’s definitely more capacity in Jersey.”

Kirkby says that with limited administration capabilities available in many of the European countries that are home to private equity firms, Jersey has an opportunity to capitalise by extending its own fund servicing capabilities, and the flexibility of the island’s immigration policy is an important factor. “When the right people need to be recruited, they will be admitted if they match our needs,” he says.

Another factor, he argues, is the ability of service providers to gear up with technology that enables them to process higher volumes of business more quickly and efficiently. “A lot of administrators are making very significant investment into new systems to make their existing work more efficient,” he says. “Some of those investments are in seven figures, which is an indication of how confident they feel about the future.”

Bill Gibbon, head of the funds group at law firm Voisins, says: “Jersey has had to persuade the world that its administrators are sufficiently sophisticated. The island has always had experienced administrators, going back to the days of the retail fund industry. It has slightly relaxed its housing policy, which could encourage more administrators to come to the island, and it has the ability to attract specialists in a way that other island jurisdictions may find more difficult.”

The costs of building up staff and sophisticated IT systems would appear to favour the bigger, longer established administrators, but the nature of private

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**Far the island’s largest administrator, have been active in the private equity sector for more than 10 years. “We have a particularly strong depth and breadth of experience now,” he says.**

The Channel Islands suddenly found themselves in the spotlight as a private equity centre in the US, following the USD5bn listing on Euronext Amsterdam of the Guernsey-domiciled co-investment vehicle KKR Private Equity Investors in May 2006. However, much of Jersey’s growth so far has come from the expansion of activity by general partners in Europe.

“London obviously has a big private equity industry, and Europe is really picking up as well,” says Nick Stevens, a senior manager with KPMG in Jersey. “Historically a couple of big private equity firms established their funds here because there was tax neutrality, along with very few legal requirements for private equity structures. The administrators who had their accounts have grown and developed with them over time.”

His colleague Heather MacCallum, an executive director at KPMG, adds: “There are some qualified and very experienced people here who understand that business and are used to dealing with private equity structures. It’s got out to the outside world that this is something Jersey’s very good at, and more funds are coming in.”

She acknowledges that if anything Guernsey has perhaps a longer track record...
equity, with its highly complex legal structures and transactions and relative lack of one-size-fits-all processes, continues to attract new specialist players.

MacCallum believes there’s still plenty of scope in Jersey for niche players, especially as across the alternative investment industry big institutions reassess their client rosters and seek where possible to focus on their biggest and most profitable relationships, and indeed specialisations. “After growing for 10 years or so, several of the leading administrators have taken on so much business and filled their offices with so many people that they can’t take on any more work,” she says.

“What they want to do is concentrate on the most profitable business and perhaps leave behind some of their high-maintenance small clients. Niche players are starting to build business as they get some of this secondary market. And even some of the big players are questioning whether they can be everything to everyone. Can they really afford to invest in the technology and the teams to do both hedge funds and private equity funds well?”

People remain very important in private equity administration, cautions Horace Camp, managing director for fund administration for Kleinwort Benson in the Channel Islands, making it difficult for the big international financial service providers to get the lock on the business they enjoy in areas such as custody.

“The global consolidators like State Street and Citi are dipping their toes in to pick up more of the ancillary business, but it’s much harder to put private equity into a sausage machine,” he says. “It’s a more bespoke process that’s much harder to break it up into small elements. Private equity funds can move very slowly or very fast, and you need people who can react.

“Often structures are so complex that while administering any single element of a private equity fund is very simple, administering and understanding all of it is very difficult, particularly ensuring that the money flows correctly from one entity into another, and that transactions are completed on time. It isn’t sending a ticket out to a broker to buy a hedge fund in Cayman. It can be an enormous amount of work, and at 1am when the final documents are coming through from the lawyers, it takes a different mindset.

“The advantage of the Channel Islands is that because they’ve done private equity for at least a generation, they have people who understand it. It’s a good place for corporate governance, and with the new regulatory regimes it’s now possible to get structures up and running in a short space of time. Finally, both islands like private equity business because it suits the high value-added model, rather than the ‘stack ‘em high, sell ‘em cheap’ approach.”

The private equity administration industry is facing the challenge of moving beyond providing a simple book-keeping service to offer deeper and more sophisticated offerings, according to Brendan McMahon, a financial services partner with PricewaterhouseCoopers in Jersey and private equity leader in the firm’s global investment management practice.

He is encouraged by the growth of the Jersey industry through the arrival of specialist firms from other jurisdictions, such as Alter Domus, which was created in 2001 from the spin-off of PwC’s Luxembourg-based corporate, trust and payroll business, Saltgate, another group with Luxembourg connections, and International Private Equity Services from Guernsey, as well as moves
by Northern Trust to bring in people to bolster its Jersey operations.

McMahon also notes that whereas in the past the industry tended to be self-contained and inward-looking, today many administrators – Mourant in the lead – have an increasingly global outlook. “They are moving to develop international networks that provide support services to promoters as they themselves go global,” he says. “Those clients may have operations in London, Luxembourg and Singapore, and need a service provider that understands their business and provides services in those jurisdictions.

“Ten years ago many of the new private equity houses were very much focused on building a European presence and perhaps setting up offices in eastern Europe. Now they are looking at the emerging markets and at the US, and administrators are responding to that by building their own global networks. Mourant is now in Singapore, Hong Kong, New York, San Francisco, London and Luxembourg. Aztec is already in Guernsey and Luxembourg as well as Jersey.”

However broad their international sweep, administrators must – along with their clients – deal with the specific challenges of the private equity business. “One of the biggest issues is often managing the tax profile of the vehicle,” Kirkby says. “They require high-quality non-executive directors as well as administration, and these functions must all be carried out in the right location in terms of their legal framework.”

He observes that as in the hedge fund industry, reporting and valuation are increasingly keen topics among investors and regulators. “Private equity firms are being asked to account on a more regular basis and to provide valuations quarterly, rather than six-monthly or annually,” Kirkby says. “That creates challenges in valuing a real business – it’s much easier by comparison for hedge funds to value instruments where there’s a market for them.”

Accounting standards are a constant theme, although Jersey’s legal framework is more flexible than most, allowing firms to choose between International Financial Reporting Standards (IFRS) and US and UK Generally Accepted Accounting Principles (GAAP), as well as to modify standards where this makes sense.

“Private equity firms that account in US GAAP, for example, are facing challenges from a provision known as known as FIN 48 (Financial Interpretation Number 48), which covers the treatment of tax risk and tax exposure,” Kirkby says. “It’s quite a challenging accounting standard. Some of the valuation standards are not so much causing concern as making people scratch their heads on how these should best be addressed.”

Says McMahon: “We’ve had 10 years experience of becoming familiar with what statistically are the major reporting environments. Most of our larger funds here have been accounting under US GAAP for the past few years, but there is a degree of flexibility that you can apply that allows exceptions to US GAAP or IFRS. If particular sections of GAAP are nonsensical, for example consolidation, you can typically carve them out.”

Administrators are also getting to grips with the new codes of practice for fund services business published last month by the industry regulator, the Jersey Financial Services Commission, consisting of high level principles for the conduct of fund services business, together with more detailed requirements in relation to each principle. The codes have been issued as part of the regulations accompanying the transfer of regulation of fund functionaries from the Collective Investment Funds (Jersey) Law 1988 to the Financial Services (Jersey) Law 1998, a change approved by the States of Jersey in early November.

The codes of practice also reflect the shift in responsibility for conducting due diligence on funds and their promoters from the regulator to service providers under the Expert Funds and subsequent regimes. Says MacCallum: “Jersey has already brought in codes of practice for fiduciary and investment businesses, and it’s now done the same for fund functionaries. In the past it was the product that has been regulated, but now it’s the fund manager and administrator. The codes of practice bring them up to the same regulatory level as other firms on the island that conduct fiduciary and investment business.”