

Gibraltar:

A Foothold for Hercules

in the world of hedge funds

by James Lasry, Hassans

Gibraltar through its introduction of Experienced Investor Funds and through the general revision of its fund regime has placed itself as a serious alternative fund jurisdiction. The significant global expansion in funds has put considerable pressure on established fund centres such as Dublin, Luxembourg and the Caribbean. These pressures have given rise to delays in fund establishment and greater selectivity by fund administrators creating a healthy overspill to other jurisdictions which had previously been unexploited.

There are a number of funds currently domiciled in Gibraltar and others that are administered from Gibraltar. A significant number of these are hedge funds registered in the Caribbean where the promoters require the administration to be carried out in the European time zone. Gibraltar has the major names in accounting services to provide audit and other support services as well as banks to provide custody services. High regulatory standards combined with the flexibility of a small jurisdiction and the availability of a quality infrastructure at low cost is increasingly making Gibraltar an attractive fund location.

Gibraltar is part of the European Union by virtue of its relationship with the UK. Gibraltar has transposed all relevant EU banking, insurance and investment services directives so that its financial services sector is firmly within the integrated structured financial services system contemplated by the EU. 'Passporting' of banking and

insurance services has been in place in Gibraltar for some years and financial services passporting was brought into effect in July 2003. This allows financial services firms and certain funds to offer their services and products throughout Europe on the basis of their Gibraltar licence.

THE GIBRALTAR REGULATORY REGIME

The Financial Services Ordinance, 1989, the Financial Services Ordinance (Collective Investment Schemes) Regulations, 1991, the Financial Services (Collective Investment Schemes) Ordinance, 2005, the Financial Services (Collective Investment Schemes) Regulations, 2006 and the Financial Services (Experienced Investor Funds) Regulations, 2005 effectively divide the types of licensing requirements on funds that may be

incorporated in Gibraltar into four categories: private funds, Experienced Investor Funds, non-UCITS retail funds and UCITS funds.

Private schemes

The recently passed Financial Services (Collective Investment Schemes) Regulations, 2006 codify what has been industry practice in Gibraltar for several years. In effect, a fund that is promoted to a restricted category of persons whose number is less than 50 is exempt from any licensing requirements and may be promoted to that category of persons in the following conditions:

- the offer is addressed directly to the identifiable category of persons by the promoter or his agent;
- the members of this category of persons are the only persons who may accept the offer;
- the offerees must have sufficient information in order to evaluate the offer; and
- the scheme will remain a private scheme for a year from the date of offer.

In practice, as long as the investors are friends, family or close clients of the promoters, or, perhaps, employees of a firm, a fund can establish itself as private scheme. Private funds in Gibraltar generally produce an offering document in order to ensure that the investors have sufficient information in order to evaluate the offer. Good corporate governance dictates that in addition to the production of annual audited accounts, private schemes engage the services of fund administrators and custodians where appropriate although there is no statutory requirement to do so.

Experienced Investor Funds

Probably the most exciting and competitive innovation in the Gibraltar fund industry is the possibility to set up funds for experienced investors that are highly versatile and lightly regulated. Experienced Investor Funds (EIFs) under the Financial Services (Experienced Investor Funds) Regulations, 2005 ('the EIF Regulations') are funds designed for professional, high net worth or

experienced investors. Investors in these funds must have a net worth in excess of €1,000,000 or invest a minimum of €100,000. An EIF may be set up in a matter of days. For authorisation to trade, it need only notify the Financial Services Commission (FSC) within 14 days of establishment. The notification is made by the administrator and is accompanied by the fund's offering documents and an opinion from counsel that the fund complies with the EIF Regulations. An EIF must have two Gibraltar-resident directors who are pre-approved by the FSC, a custodian or broker to hold its assets and a Gibraltar-based administrator. EIFs that are closed ended or invest in real estate do not require a custodian. EIFs must also produce annual audited accounts.

This is a niche area for funds currently in Gibraltar. EIFs do not have to go through the regular procedure for regulation and licensing but are structured both to ensure adequate investor protection and comfort and to allow for expansion. Set-up time and costs are quite competitive.

Non-UCITS retail funds

The third category is the Non-UCITS compliant public fund. These funds are licensed by the FSC as opposed to the 'deemed authorisation' in the case of EIFs. The licensing procedure which normally takes between three and six months, involves the submission of the formation documents of the fund and its prospectus to the FSC along with application forms on the fund, its directors and, investment manager, if any. It is possible to structure these funds (as well as EIFs) as umbrella funds, hedge funds, feeder funds, funds of funds and mutual funds.

The requirements for licensing under the Financial Services Ordinances are basically that the company must have a paid up share capital of at least £50,000 and it must have at least two Gibraltar resident directors. The directors and managers must be 'fit and proper persons' and must have adequate investment experience in order for the FSC to consent to grant them a licence. Unlike with EIFs, all of the directors and managers must be approved by the FSC and not solely the Gibraltar-resident directors.

There are also various restrictions on the types of investments, however, it is possible (in the case of non-UCITS funds) to obtain derogations from these regulations by making a case before the Commissioner of the FSC. The end result is that these funds may, with consent from the FSC, invest in almost any type of investment including hedge funds, real property and even private equity. The advent of the Financial Services (Experienced Investor Funds) Regulations, 2005 will probably lessen the use of this category of fund, which heretofore was used for both retail and Experienced Investor Funds, as most of the uses of this type of fund can be attained through the EIF regime, save for the fact that EIFs are restricted to experienced investors.

Public funds (UCITS)

Where the intention of a public fund is to invest solely in 'transferable securities' namely stocks and bonds listed on a recognised European Community or other recognised stock exchange, a fund may be licensed in compliance with the European directives on Undertakings in Collective Investment in Transferable Securities (UCITS). These funds are generally, but not always, meant for retail investors. Since Gibraltar is in the European Union by virtue of Article 299(4) of the Treaty of Rome, it has been given the right to passport its financial services throughout Europe. Gibraltar UCITS funds may therefore passport their services within the European Union on the basis of their Gibraltar license. Unlike EIFs and non-UCITS retail funds, they must



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comply with the Financial Services Ordinance (Collective Investment Schemes) Regulations, 2006 with regard to investment restrictions and structure. Such funds must also engage European-licensed custodians and administrators.

PROTECTED CELL COMPANIES

Gibraltar's Protected Cell Company Ordinance, 2001 allows for the incorporation of protected cell companies (PCCs). PCCs enable the statutory segregation of assets and liabilities in different cells. Long used captive cell insurance companies, the PCC legislation allows a fund to be set up so that there is segregation of assets and liabilities in an umbrella structure (i.e. that includes different sub-funds) where it is essential to ensure that there is no liability contamination between sub-funds. Instead of the client relying on a purely contractual arrangement between shareholders, the legislative regime gives statutory basis for the segregation of assets that binds third parties as well. Sub-funds or cells can be used by separate clients or by one client wishing to promote several investment strategies. PCCs may be licensed as either EIFs for professional investors or as licensed funds for retail investors.

The establishment of a PCC as an EIF has become a popular method of structuring property funds in Gibraltar. Segregated cells are established either for specific property investments or for subscription over a certain time period for investment in multiple projects. Investment in PCCs is however by no means limited to property. A fund manager may establish a PCC as his or her business vehicle in order to provide a regulatory framework for investment. Individual cells may then be established according to investment strategy, geographical emphasis or even for certain clients such as insurance companies or pension funds that may require asset segregation under the terms of their own mandates. There is no limit to the number of cells a PCC may create.

LEGAL STRUCTURE

Funds in Gibraltar are usually structured as open-ended investment companies (OEICs) although it is also possible to structure them as unit trusts and limited partnerships.

The fund's constituting documents – the Memorandum and Articles, trust or partnership deed as the case may be – must be drafted to allow redemptions of shares at the prevailing net asset value (NAV) if the fund is to be open-ended. Typically, an OEIC fund will have ordinary shares that carry most voting rights and participation shares that carry economic rights. Participation shares are the units purchased by investors at the NAV. Although the participation shares usually do not have any voting rights, but they may have if desired by the promoters of the fund. The ordinary shares are normally issued to the investment manager or to the directors, depending on who manages the fund.

The fund can be managed by its directors or by investment managers. Investment managers that manage funds in or from Gibraltar require a licence from the FSC in Gibraltar to do so. Directors who manage a fund do not require any specific licensing, save for the Gibraltar resident directors in EIFs who must be approved to act as directors of such funds. Most funds have personal rather than corporate directors who hold regular board meetings in order to ensure that management and control is fully exercised in Gibraltar.

Third party investment managers must be authorised to provide such services in their jurisdiction of operation. It is noteworthy that licensed European investment managers or advisers, whose licences conform with the European Investment Services Directive passport their services into Gibraltar. The anomaly that UK investment firms faced in this regard whereby they could not passport into Gibraltar due to the fact that the UK and Gibraltar are part of the same Member State albeit separate jurisdictions was rectified in July 2006.

Gibraltar funds can be structured as closed funds as well, thus locking investors in for a determined amount of time, usually subject to one or more extensions. These are usually used for private equity or property funds where investment is deal-specific rather than being intended to allow for constant buying and selling of investments by the fund.

Gibraltar funds may also be listed on a variety of exchanges. A stock exchange is currently being established in Gibraltar to allow for fund and company listing.

TAXATION AND CONFIDENTIALITY

Licensed funds in Gibraltar (including EIFs which are 'deemed authorised') are exempt from income and company tax in Gibraltar upon receipt of a certificate from the Commissioner of Income tax. There are no capital gains, gift or wealth taxes in Gibraltar. Stamp duty of £10 is payable on the increase of authorised capital.

Gibraltar is committed to preventing money laundering and it was the first jurisdiction to implement an anti money-laundering regime for all crimes. As with any regulated entity, the fund must know the identity of each investor by obtaining a passport copy and utility bills showing his or her residential address along with a supporting reference from a lawyer, accountant or banker. This information is protected by common law confidentiality. As regards third parties, it is possible for the shareholder to remain anonymous on the corporate register by registering the shares in the name of a nominee. The nominee will then hold the shares in trust for and under the direction of any particular investor and his or her name will not be disclosed in any public register.

CUSTODIANS, FUND ADMINISTRATORS AND NAVS

Investments may be made by the fund's custodian or, in some cases, directly by the fund. EIFs that are closed

ended do not require custodians. Brokers that are authorised to hold client assets may act as depositaries of a fund's assets. Although several banks in Gibraltar have ample experience and capabilities in providing this service, banks and brokers from other jurisdictions may be used to carry out this function.

The fund must be administered by a licensed fund administrator. In the case of an EIF, the administrator must be Gibraltar-based. Subscriptions and redemptions are typically made directly through the administrator with the consent of the directors.

Where the assets of the fund are publicly traded securities, the administrator can usually produce the NAV of the fund and distribute it to shareholders. The NAV will be the figure at which shares are purchased and redeemed by shareholders.

Where the fund holds private equity such as shares in private companies, real estate or chattels, an NAV must be compiled by competent valuers such as accountants or valuation firms. Redemptions of shares in such funds are often restricted in time and scope so that the directors or managers may have ample opportunity to properly dispose of any such assets in order to redeem shares.

AUDITORS

Fund administrators generally provide management accounts as part of their package of services. EIFs and public funds must be audited by an auditor registered in Gibraltar. Although UK GAAP is often used as the accounting standard for funds, there is a movement in the industry toward International Financial Reporting Standards (IFRS). This will eventually become mandatory.

CONCLUSION

Gibraltar is fast becoming a serious alternative to the Caribbean as a fund jurisdiction. The advent of the EIF

Regulations has given a tremendous boost to the Gibraltar funds industry as it is now possible to set up a fund, be it a hedge fund, a property fund or even a fund of funds, for professional or experienced investors quickly and efficiently. EIFs can be set up as PCCs thus allowing the simplicity of one vehicle for a variety of segregated investment strategies. The reform in retail fund legislation that implements the UCITS II and III directives is likely to attract retail funds that can be passported throughout Europe while remaining in a fiscally efficient jurisdiction. Gibraltar's effective and efficient regulatory regime, its position in the European Union and its favourable fiscal treatment of funds are geared to make it a competitive alternative fund jurisdiction.



**James Lasry is a Partner at
Hassans in Gibraltar.
For further information, please
telephone +350 79000 or
e-mail: james.lasry@hassans.gi**