

Great Britain

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'SECRECY IS HISTORY' – REGULATION SCRUTINISED



Raymond Baer,
Julius Baer Group

Raymond Baer used his recent valediction from Switzerland's Julius Baer Group to write the epitaph for his country's banking secrecy, declaring it "history". Most Swiss private bankers agree and say that 'offshore' in the sense of hidden untaxed wealth is also dead.

Siding with them are Berlin's and Washington's tax authorities, which bought lists of tax evaders hiding money in Switzerland, as well as London's, which joins them in forcing Bern to compel Swiss banks to remit unpaid tax overseas.

Baer called the tax remittance model agreed upon "inevitable", at least of a uniform effect, and better than disclosing clients' identities, which Bern has largely avoided – for now. But the pressure is still on the offshore model. London is fighting to enforce a 'most favoured nation' clause in its deal to ensure it wins terms no worse than Berlin's.

Vienna is also negotiating a tax deal, while Algirdas Semeta,

the European Commissioner for Taxation, has said he wants greater powers to strike similar agreements at the EU level.

The EC may move on this at its June meeting. Some financiers are furious, and say Bern has moved too slowly in securing deals for its banking community.

One alternative asset manager says: "For the past three years, Switzerland has been in denial, thinking the crisis of 2008 would be like any other crisis, where people say everything will change – then nothing changes. This time, it is different. Governments around the developed world must do something, or they will implode. Now people here are starting to wake up from thinking 'It will not affect us'."

François Reyl says the tax collection agreements for foreign clients Bern has signed with London and Berlin – yet to be ratified – pave the way for "some form of Europe-wide agreement following the example of the US".

Baer says Bern should be courageous in negotiating. "The history of international relations is primarily about respect and asserting one's interest, not friendships." However, one Bern wealth manager says: "We will capitulate to Brussels, just like we have to other countries."

Andre Keijsers says it is already

important for many private investors to have access to onshore, regulated products. "For the retail segment and small institutions it is more relevant to have regulated products."

A private banker adds: "Tomorrow, asset managers and private bankers will not only be money managers, but they will also have to have some concept of optimisation in terms of tax."

"You may have a good investment, but putting it in your portfolio may harm you because of the tax consequences. Is the fund 'in scope' or 'out of scope'? Today, you can put any product in a client's portfolio. Tomorrow, some may not be suited vis a vis his profile."

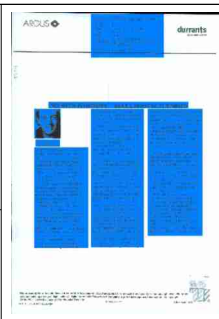
"A banker will live or die on the performance of products he picks, not tax advantages."

Alessandro Mauceri agrees. "People will have to look for the most tax-effective vehicle. Before, clients were investing in an offshore account that was not money investing money offshore."

"But tomorrow, the money from customers will be very much onshore. That will lead asset managers to look carefully where they invest the money of their clients in terms of tax."

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SECRECY: LONG FORGOTTEN

Europe's smaller jurisdictions offer 'compliant confidentiality'

"Tax authorities around the world have cottoned on to the fact that it is very difficult for banks to stave off demands for information about tax-payers' accounts," says James Lasry, a partner and head of the funds team at Gibraltar law firm Hassans.

He has advised the country's government and is instrumental in setting up the majority of Gibraltar's funds, including the first experienced investor fund and the first protected cell company fund.

As a result of what is in Gibraltar called the "troubles in Switzerland", more and more Swiss asset managers have been setting up parallel structures elsewhere in the eurozone.

"They are considering restructuring their business around Gibraltar and other EU centres that allow for passporting," Lasry confirms, describing discussions he has had with Swiss fund manager representatives in Gibraltar.

BENEFITS

The attraction of the smaller countries such as Gibraltar and Malta is that they offer EU funds passporting with potentially less onerous regulations than those operating in Switzerland.

Gibraltar, which last year made significant changes to its experienced investor funds (EIF) legislation to attract hedge fund managers and their management companies, is home to about 200 funds, with \$4.5bn in assets.

Banks present in the jurisdiction serving this sector include Credit Suisse, Lombard Odier, Société Générale, Barclays, Royal Bank of Scotland and Lloyds.

Gibraltar's reforms could not have been more timely. Gilbert Licudi, the new Gibraltar Financial Services Minister, said: "We want to make Gibraltar one of Europe's premier

jurisdictions for the establishment of hedge funds."

The government scrapped a rule requiring a fund and its administrator to be based in the same place, replacing it with an authorisation system. The regulations also allow funds to redomicile to Gibraltar.

All the major European jurisdictions have signed up to the international norms on tax information exchange. They therefore commit to share information under certain terms agreed with other regulatory bodies.

In fact, according to Peter Niven, chief executive of Guernsey Finance, the promotional agency for the island's finance industry: "Guernsey has never had banking secrecy enshrined in its law, unlike several European centres, where they have had secrecy for many decades, if not longer.

"What Guernsey does ensure, as do all major banking centres, is the principle of confidentiality of client records."

Malta abandoned its offshore status in the early 1990s, when most legislation was aligned with EU legislation. Since 2004, it is also a member of the European Union and, since 2008, the eurozone. Jersey, Guernsey and the Isle of Man, though outside the EU, have always been quick to conform with international standards on tax information exchange.

Geoff Cook, head of Jersey Finance, the body that promotes the island's financial services industry, says: "We have been where most countries are heading on transparency and 'compliant confidentiality', as I like to call it, for many years."

He says Jersey has "always co-operated on criminal matters and embraced voluntary information exchange on request through the OECD in 2002".

To date, Jersey has signed 28 Tax Information Exchange Agreements, while Guernsey has signed 35.

John Spellman, adviser to the Department of Economic Development at the Isle of Man government, says: "The Isle of Man doesn't have banking secrecy and prides itself on its international standards of transparency and exchange of information.

"We have a network of Tax Information Exchange Agreements the agreed OECD standard measure – in place with our international partners.

"We also automatically exchange information with EU countries, making the Isle of Man one of the first non-EU countries to do this."

SETTING STANDARDS

Spellman adds: "Numerous international assessments have found the Isle of Man to be at the forefront of standards of best practice in tax regulation.

"In a recent report to the G20, the OECD concluded that the Isle of Man is one of only eight reviewed jurisdictions found to have all elements of effective information exchange in place. This places the Isle of Man alongside Australia, France, India, Ireland, Italy, Japan and Norway."

Niven concludes: "In terms of the future of secrecy, I believe it is true to say that there has never been a place for this. Those few jurisdictions that have had secrecy within their banking systems are now moving inexorably towards the standards that reputable

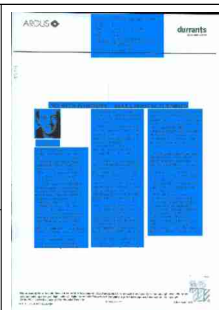
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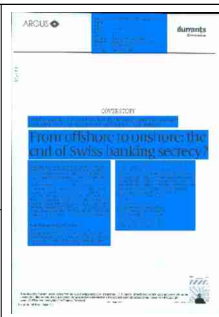
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*Geoff Cook, head
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Fund managers tell David Walker regulatory change may damage their offshore fund model, but it will not kill their industry

From offshore to onshore: the end of Swiss banking secrecy?

Switzerland has long been an offshore haven in the heart of Europe, often running money in offshore funds for anonymous clients. As such, its fund managers did not have to submit to formal regulation by their Financial Market Supervisory Authority (FINMA), while few did.

That is about to change, as FINMA drafts rules – some say the harshest in Europe – to bring its fund managers onshore. Brussels is following suit via the EU Alternative Investment Fund Managers Directive (AIFMD). Early drafts of FINMA's partial revision of the 2006 funds law (Kollektianlagegesetz – KAG) have shocked managers in Zurich and Geneva. But even if the final law kills offshore investing, managers say Switzerland's fund industry will survive. Indeed, they add, they were already shunning the offshore model, to the benefit of their clients, well before FINMA's latest actions.

THE DRAFT EXPLAINED

Under the draft, Swiss managers face compulsory regulation from mid-2013. The country's CHF1.4trn fund industry defended itself robustly at its March conference. It urged FINMA and politicians not to make the draft rules even more severe than AIFMD, which itself aims

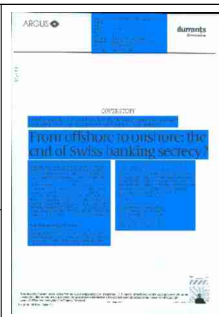
to regulate EU managers of alternative offshore funds from mid-2013.

For EU authorities to allow Swiss managers to distribute their alternative funds freely on the continent, FINMA regulation only needs to be equivalent to, not surpass, AIFMD, according to the president of the Swiss Funds Association Martin Thommen. He and SFA members fear their industry will be over-regulated and lose managers because of a 'Swiss finish' by FINMA – being even more 'thorough' than AIFMD.

"A few of Switzerland's KAG provisions are more limiting than the corresponding EU rules and, in an 'own-goal', [they] throw good established Swiss initiatives overboard," Thommen says. Key worries for the Swiss Funds Association include:

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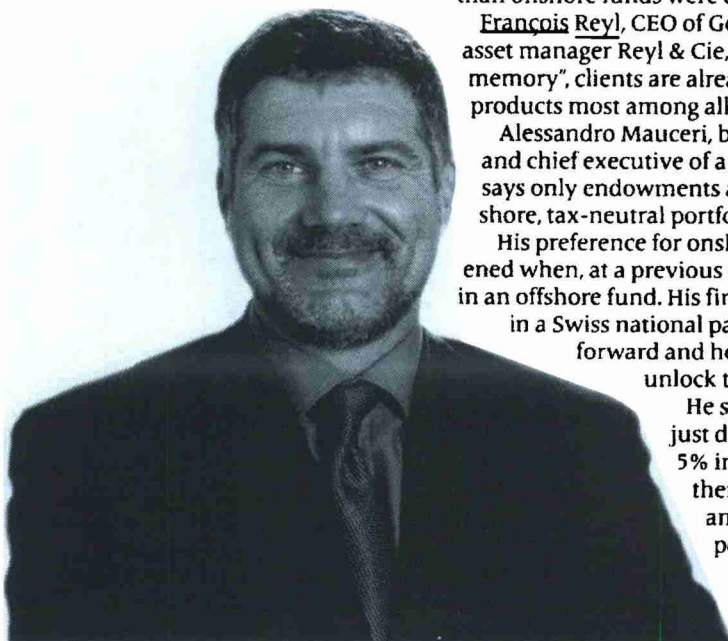
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**Alessandro
Mauceri, Axiom**



- Costs of regulation and small independent managers migrating overseas to avoid them, rather than rejoining larger Swiss groups;
- Swiss managers only being able to distribute their funds to countries with which FINMA has co-operation agreements, and;
- The same agreement requirement for foreigners to sell funds into Switzerland.

At the same time, many fund managers say their clients – Swiss and foreign – already wanted them to manage cash onshore – in Ucits funds, for example – before FINMA began to consider how best to subject the whole industry to onshore standards and transparency levels.

This was because of often severe corporate governance failings since 2008 in offshore funds, such as gating redemptions and Bernard Madoff's shocking fraud.

Many investors argue Ucits funds would solve these, plus satisfy a thirst for greater transparency and liquidity, than offshore funds were compelled to offer.

François Reyl, CEO of Geneva-based private bank and asset manager Reyl & Cie, says with 2008 "fresh in their memory", clients are already buying regulated Ucits products most among all product types.

Alessandro Mauceri, board chairman of Axiom Fund and chief executive of a Genevan multi-family office, says only endowments and foundations will prefer off-shore, tax-neutral portfolios.

His preference for onshore vehicles was strengthened when, at a previous employer, he had money gated in an offshore fund. His firm went so far as to advertise

in a Swiss national paper for co-investors to come forward and help oust the fund's board and unlock the money.

He says: "Managers that had said just days before they had less than 5% in private or illiquid investments then had 30% or more in them, and [locked client assets in a] side pocket. They had lied, but the reality was in unregulated funds they did not have to disclose.

"The hedge fund industry

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makes sense. Although in an offshore unregulated vehicle, it does not make sense any more. It showed all its limitations in 2008."

Such views led Mauceri to create a Ucits framework. By December 2010, it launched a rules-based, diversified fund of Ucits managers, based on an index maintained by Swiss manager Alix Capital.

Louis Zanolin, Alix's founder, says the contraction of the offshore model does not equate to the death of the Swiss fund industry, but to its transfer with much the same strategies to an increasingly transparent environment.

THE UPSIDE OF REGULATION

Andre Keijzers, head of corporate strategy at Gottex Fund Management Holdings, says his firm feels "regulation is a positive thing", though so far the vast majority of Swiss managers are outside the regulatory net.

Gottex would also be comfortable with FINMA regulating Swiss managers in general, Keijzers says, but notes a few important caveats.

He says some form of *de minimis* rule allowing very small managers not to be caught up "would be practical". The AIFMD contains some partial exclusions – for instance, for funds with less than €100m, or €500m for unleveraged funds with long-term investment horizons – but none is currently foreseen for the Swiss rules.

Keijzers adds FINMA's proposal to compel managers to have a local distribution partner in Switzerland with certain liabilities and overly strict rules is something that "could deter foreign managers from distributing in Switzerland".

In the case of funds of funds, this could act to the advantage of larger players such as Gottex, which is able to shoulder such extra requirements. He says: "It may raise barriers to entry to Switzerland for smaller funds of funds, which may want to distribute, but find hiring local representatives may not be cost competitive."

Keijzers expresses concern, however, about the currently envisioned concept to stop newly regulated Swiss managers from distributing funds overseas, unless FINMA has co-operation agreements with the foreign watchdog.

He notes this would be harsher than AIFMD, which only prevents inbound distribution where such co-operation agreements are not in place. He points to potential difficulty for Swiss managers selling funds in Asia or the Middle East.

But if FINMA seeks to govern the outbound distribution of Swiss managers' funds, Keijzers says: "That would surely restrict the distribution efforts of Swiss managers."

Thommen dubs such a move "damaging protectionism that does not create any market access for us [and] no added value for investor protection. International standards are to be adhered to, but the [Swiss funds law] should not be transformed unnecessarily into an 'EU corset for the whole world'".

One option for Swiss managers – if foreign distribution becomes dependent on agreements between FINMA and foreign watchdogs – would be for those disaffected managers to move their distribution of non-EU strategies, along with the management of them, outside Switzerland.

This would be reverse a recent trend of UK hedge fund managers feeling the UK and its 50% top personal income tax rate. Managers agree such a reversal is possible.

"That would have a major impact on the workplace and jobs within Switzerland," says one manager. "If it became impossible for us to sell funds to countries we wanted

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Private banker

to target, we would have little choice but to move," said another manager.

Given all this, Keijzers says Switzerland "should create a level playing field with the EU and be reciprocal, but not go that much further than AIFMD".

He adds that the regulatory burden could become great for smaller Swiss managers. He foresees smaller managers "grouping together or in consortia, or providers of regulatory services providing very well-regulated frameworks that a manager plugs his funds into".

"People will need to add to their resources if they do not already have them in place," he says, "and some may underestimate what it means to be regulated because they have not been [regulated] before."

Reyl says: "Regulation will mean higher capital constraints, higher regulatory burdens and higher IT and compliance costs, it is ongoing, and only going in one direction. For some players who have not anticipated this evolution, it will be difficult to effect the changes as and when forced to."

M&A is another possible outcome for Switzerland's fund

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community. While this may not suit those small managers forced to join larger groups that are more able to pay bills of compliance, it could well bring benefits to larger managers and consolidators.

One private banker said: "We are ready to speak with small teams looking for a suitable new home. We think 40% or more of Swiss asset managers are such small groups."

Keijzers says: "Larger firms such as Gottex could benefit if smaller players team up with larger players where the

unit costs of a regulatory framework are much lower."

Gottex already has experience of M&A, having brought together \$150m of funds of funds from New York's Constellar Capital two years ago.

A lot now depends on how effectively FINMA can strike co-operation agreements with counterparts around the world – not just with those in Europe, but also with those in the USA and equivalents in the Caribbean centres where many offshore funds are based. ■

A lot now depends on how effectively FINMA can strike

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