



Swimming at each end of liquidity's tempting pool

For managers maybe wavering and drowning in demands for daily NAVs from liquid strategies, to those struggling to find administrators to help with the illiquid instruments, the BVI's administrators have something to offer, says David Walker...



By good design or by serendipity, the BVI offers a range of administrators, ranging from niche players in liquid markets to those able to value illiquid instruments, and local players to global juggernauts.

At one end is Folio Administrators, who as well as catering to the traditional hedge fund strategies, is seeing some of its clients using dynamic allocation between more- and less-liquid assets in quite innovative ways.

ILLIQUID INNOVATIONS

"The manager will take money in via two share classes, and they may buy a lot of listed public companies," says Daniel Cann, director at Folio Administrators Limited.

"When a private-equity deal comes up, they may sell the listed security and will invest in the private-equity deal and put it in the side pocket, and depending on when people come in and depending on different offerings people will get access to different private deals.

"It's a very clever way for managers to keep the liquidity to buy these private-equity deals and when

the liquid investments go to IPO, they give investors the option of pulling some of their money out."

Calum McKenzie, head of corporate services at Folio, notes hedge fund managers "are clearly prepared to try just about anything, and often experts in one field are educating themselves in another, or bringing people in to enlarge their company because if merger arbitrage, for example, is not doing well they can get into something else.



Daniel Cann, Folio Administrators (above)

"We have already seen the movement of all the top law firms to the British Virgin Islands and all the audit firms and it would be great to see some of the big administration firms back here as a result."

"Multi-strategy is what we are seeing coming through with one less layer of fees than funds of

funds," he says. McKenzie also notes a change in the make-up of the investor base for hedge funds. "It's not just about wealthy individuals, it is more long-term money from institutions looking to diversify and dampen their risks, so the multi-strategy funds are more popular.

"We also see that the better funds introduce more lock-ups," he says, mirroring once again the illiquidity theme prevalent in so much of the industry.

Banking CEO, said part of Fortis's strategy was to give it presence it what had become a "key financial centre in the Caribbean."

Michael Kane, head of Fortis's BVI office, added "Fortis and HFS complement each other, both geographically and in terms of product offering and corporate culture. Our customers will benefit from Fortis's size and financial clout, its state-of-the-art technology as well as a broader product offering and high service standards."

More administrators and banks coming to the BVI is a development Cann says Folio Administrators welcomes. "We have already seen the movement of all the top law firms to the BVI and all the audit firms and it would be great also to see some of the big administration firms back here as a result," he says.

While Fortis's move may see the BVI hedge fund administrative workload shared between more players, Cann notes Folio's activities in helping managers are not limited to BVI funds – Folio administrators and helps establish Cayman funds as well.

SWIMMING IN DEEP WATERS

While much of the industry speaks of a slide down the liquidity curve, hedge fund administrator International Financial Administration (BVI) Ltd, the BVI's third-largest after Fortis and Folio in number of funds under administration and largest by number of individually managed funds, is doing things a little differently.

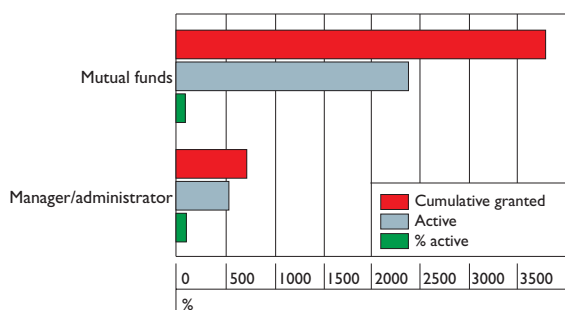
Derek Adler, co-founding member with Sam Bratchie of IFA Group in Warwickshire, UK (which is subcontracted to carry out funds'

While Folio serves its clients from its Tortola offices, with branches in London and Hong Kong, a new entrant to the BVI scene has also brought an international flavour to the local administration industry – Fortis Prime Fund Solutions.

Earlier in 2005, Fortis made the move by buying Hedge Funds Services (HFS), which was then the BVI's largest fund administrator.

At the end of 2005, HFS had approximately €2bn assets under administration, in 104 funds from 53 different managers, according to figures from Fortis. Showing the BVI's links with the US market, 90% of its clients were based in the US. Filip Dierckx, Fortis's Merchant

BVI MUTUAL FUNDS



Source: BVI Financial Services Commission



net asset values by IFA BVI), says the BVI can build a niche for itself in serving commodity and futures funds that can offer better liquidity than other hedge fund strategies.

As part of its goal of taking on clients from this portion of the hedge fund market, IFA BVI has 50% ownership of the newly established administration business, IFA USA, located at the hub of the futures industry, Chicago.

"A lot of the funds we see (in the BVI) have come out of the US, so it is a good place to set up a presence," he explains, adding he has ambitions for the BVI to take a slice out of the preference US managers have historically showed for Bermuda and Cayman.

(This could also, over time, tilt the BVI's reliance away from resting to such an extent on large funds, funds of funds and traditional portfolios, Adler says, as well as its reputation as being a centre for the incorporation of trusts.)

"For managed futures, the big administrators around the world find it difficult and expensive to hire staff or software to cope (with the liquidity and pricing), they've become so big that, to provide daily net asset values, it is no longer cost-effective to handle the smaller funds," Adler says.

IFA focuses on the mark-to-market hedge fund area, although it does have real estate, and mortgage-backed securities funds, and traditional funds, including some run out of Dubai.

While Adler also considers becoming involved in administering Shariah-compliant funds, he notes some infrastructure is required first for this area of finance to take off.

AN INDUSTRY POORLY SERVED

Derek Adler cites two examples of where hedge fund administrators can do a better job. The first is a straightforward hedge fund trading perhaps once per month in simple securities, "the kind of fund that can attract big money," but whose administrator has "got away with charging large fees on a job that actually does not need a lot of time as their fee is based on assets," Adler says.

SMALLER FISH, SAME BIG POND

The other type of fund potentially being mis-served by its administrator is a fund of funds "unless the administrator for the master fund is the same as the sub-funds, then there is potentially a fiduciary issue as you are totally reliant on

the sub-administrators issuing a correct and timely net asset value.

"One of the matters for smaller managers setting up a fund is they want to manage the money and the big pain is the administration side, and they can pass it off. That lightens (their) workload and puts the onus on the administrator." To help start-ups further, IFA has established a fee structure to stagger the set-up fees and ongoing administration fees, and has lower fees for smaller funds.

HIGH AND MIGHTY

Adler's move to the world of hedge fund administration came after frustration at the service being offered to the asset-management industry by administrators he dealt with.

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Derek Adler, International Financial Administration (BVI) Ltd (below)

"I have worked with many administrators as an asset manager, but as they get bigger, they find they cannot deliver the level of service to smaller hedge funds that smaller funds need. The problem with a lot of administrators is they have grown rapidly, particularly over the past five to 10 years, and the emerging hedge funds and funds of funds have made this worse," he says.

"At IFA, we look at things the big groups are not interested in, for example, derivatives and futures and single start-up funds.

"There is a huge market for funds that are \$50m or less. If you have \$500m you can go to the large firms and they'll take care of you, but if you don't have that much, they're not as interested.

"At IFA, we are very happy to sweep up the crumbs that the big boys are not interested in. That has worked very well in the US because it is potentially a huge futures industry there. I believe the BVI has to get itself into an area Cayman and Bermuda are not focused on, such as FX, futures and derivatives." Adler's

second reason for moving into administration – and one reflected by many smaller managers and other administrators in IFA BVI's niche – is that of the 'ignored small-to-mid-sized manager'.

Adler says IFA BVI's growth has been measured as Adler has avoided the same kind rapid-fire asset-under-administration increase that have caused the same types of problems at administrators Adler has complained about in his former life.

"I didn't want to see myself owning a company that becomes like all the companies I complain about," he says.

Having the NAV calculation based in the United Kingdom obviates some of the staffing problems offshore service providers can face

of winning and keeping top staff from onshore firms or offshore competitors, where the visa situation in the offshore centre may make this difficult.

"Here (in Warwickshire), we can hire staff who tend to be people who've been in accounting or bookkeeping, and are looking to get back into working, and find accounting for hedge funds rather sexy," Adler says.

NO SHORTAGE OF STRIKERS

While he says being UK-based can help the NAV-calculators recruit well-qualified staff, it does not seem Folio Administrators based in the BVI has problems finding accountants to find fair net asset values for its hedge fund clients.

William Harris, director at Folio, notes hedge fund administration is a "very specialised operation, it is a labour-intensive task, so there's no point in trying to do a volume business or in us employing people who are not properly qualified for the job." Folio has more than 20 people in the British Virgin Islands office, he says. He notes

most employees at Folio are qualified accountants, and "most post-five-years qualified."

As is often the case on the major offshore centres, Folio has found skilled professionals from the major accounting firms on the islands, on which KPMG, Deloitte, Baker Tilly, BDO and RSM all have a presence.

The additions to Folio Administration Limited's skill base will be required, given the fact Cann expects about 20% growth of its assets under administration every year, on top of a business with more than \$3.5bn under administration already.

Folio currently provides full administration services to more than 120 funds and sub-funds.

With a range of service providers offering administrative services, but with more than 3,000 hedge funds to serve, a key question for the British Virgin Island's administration community is whether mandatory local fund administration will ever come about.

Ruth Chadwick from the FSC notes the industry as it stands would be hard pressed to handle all the BVI-domiciled funds, and one should add to this the overflow from the already-burdened Cayman Islands administration industry.

However, for allocators who are concerned that British Virgin Islands funds may not have external administrators given the workload on those already there, Robert McIntyre, a partner at Maples & Calder in the British Virgin Islands, says it is rare to come across a fund where the manager is also administrator.

"Most of the time, there is an independent administrator involved, and always offshore," he says.

"That's not to say that if you had an application in for a small private fund, provided they were from a recognised jurisdiction, the Financial Services Commission may be prepared to accept the management and administration being done by the same entity."

Robert Briant from lawyers Conyers, Dill & Pearman, adds that while BVI law does not require a local administrator, a "properly crafted fund" will have "an administrator in a recognised jurisdiction."

If the administrator is the same as the investment manager, then the fund will be subject to greater scrutiny, he adds.



Derek Adler, International Financial Administration (BVI) Ltd (below)



Calum McKenzie
Folio