



SOME FACTORS TO BE CONSIDERED WHEN ESTABLISHING AN OFFSHORE FUND (to be read in conjunction with the Questionnaire)

There are many different factors that have to be considered and many decisions that have to be made before an offshore fund can be established. We comment on and discuss some of these factors below, which should be considered in conjunction with the Questionnaire, and are therefore referenced by the relevant Question number.

Name of Parent Company/Fund (Reference Question 1)

In many cases the "Company" will also be the "Fund" and have the same name - however if it is intended to establish a multi-share, i.e. an umbrella type of fund, then the Company should perhaps have a more generic name (e.g. "Unique Managed Funds Ltd") and the Sub-Funds more specific names (e.g. "The Unique Bond Fund", "The Unique Futures Fund" etc).

Proposed Objective of the Fund (Reference Question 2)

"Capital Appreciation", in this context, means a roll-up or non-distributor fund - i.e., a fund in which all the trading and investment profits are added to the NAV, together with any net interest or net dividend income and investors benefit by an increase in the NAV and realise their profit when they redeem their shares. "Income", in this context, means a fund that distributes dividends, which may be all, or a portion of, the ordinary income (dividends and interest less operating costs) or may include some trading profits or capital gains as well.

Fund of Funds (Reference Question 3.2)

Both the management and the administration of a Fund of Funds brings with it certain unique characteristics, particularly with regard to the timing of subscriptions by investors and redemptions and subscriptions by the Fund of Funds into underlying funds, as well as the basic problem of valuing the fund on a timely basis.

Estimated Valuations

The main problem with valuing a Fund of Funds within a specific time period is the difficulty that can occur in obtaining final valuations of the funds that comprise the underlying assets of the Fund of Funds. Usually, it is possible to obtain good valuations within the first two weeks of the month following the Valuation Date, but some funds, for whatever reason, can be late in supplying their valuation.

All administrators are reluctant to use estimates, but sometimes it can facilitate efficiency and a prompt valuation of the Fund of Funds. For example, if a Fund of Funds is invested in, say, 20 underlying funds, 2 of which are consistently late in providing their final valuations, then those two funds will represent circa 10% of the assets. In these circumstances, the administrator may, subject to the agreement and approval of the manager and the auditor, utilise an estimated valuation for the 2 delinquent funds and issue a valuation of the Fund of Funds on the basis of those estimated valuations. The administrator would only be prepared to do this if, historically, the managers of the delinquent funds had provided estimates which were confirmed by the administrator of those funds, at a later date, without any material change (say, less than 10 basis points) and that this had been the case for a period of 6 months/12 months/2 years, or whatever is deemed acceptable.

It can be seen that, if there was a difference of 10 basis points or less on the two funds between the estimate and the final, that difference would only affect the overall Fund of Funds by 100th of percent (10 basis points on 10% of the assets), which is not material in terms of the valuation of the Fund of Funds as a whole, even in the context of any redemptions or subscriptions that may have been made.

Accordingly, as a matter of pragmatic convenience, some managers of Funds of Funds will permit estimated valuations to be used, subject to specific restrictions *and* to disclosure of the practice within both the Offering Memorandum and the Administrator's Agreement. Furthermore, there should be some reference to the potential risk that this practice could have, in the event of a major difference between the estimated and final prices of the underlying fund on the Fund of Funds' valuation.

Borrowing

A Fund of Funds may need borrowing facilities to provide:

- i) Bridging finance to cover the gap between the date of receipt of subscriptions from an investor, which could arrive a day or two after the deadline for subscriptions into the funds that form the underlying assets of the Fund of Funds. In these circumstances, the manager may deem it prudent to have a borrowing facility to enable it to invest the subscription monies prior to receipt;
- ii) A similar bridging facility may be utilised to cover the shortfall that can occur in the event of a redemption of an underlying fund asset and the date of receipt of those redemption monies, which can often be four to six weeks after the redemption date. If a borrowing facility was not available, the fund could find itself underinvested to the extent of the value of the redemption in hand. A borrowing facility enabling a total or large proportion of the anticipated redemption proceeds to be invested in other underlying funds as assets of the fund would eliminate this shortfall;
- iii) Some Fund of Funds managers like to leverage their investment portfolio and will require financing for that purpose;
- iv) Some Fund of Funds, which may invest in funds designated in a different currency to the Fund of Funds, may wish to instigate a Currency Hedging Overlay Programme and require credit lines to avoid having to liquidate small positions to meet margin calls.

Transactions

Some Managers of Funds of Funds prefer to take full responsibility for handling the purchases (subscriptions into) and the sales (redemptions out of) of shares, units or partnership interests to the underlying funds in the Fund of Fund's portfolio. Other Managers require the Administrator or the Custodian to handle all such transactions, for which the Administrator or Custodian will charge a fee. A normal procedure would be for the Manager to agree deadlines for giving trading instructions with either the Administrator or the Custodian and for that Manager to then give written instructions to the Administrator or Custodian, as appropriate. The "deadlines" for giving such instructions to the Administrator or Custodian will have to take into account the notice periods for the underlying funds which the Administrator or Custodian, in turn, will have to comply with.

Investment Restrictions (Reference Question 4)

The regulatory authorities in certain jurisdictions will impose specific investment restrictions. For example, The Irish Stock Exchange will impose specific investment restrictions for Funds applying to obtain a listing on the Exchange. However, for funds targeted at professional investors, compliance with such restrictions as may be imposed is not particularly onerous.

Nevertheless, even for unlisted funds, Custom House would recommend that a clear policy, including restrictive limits, relating to matters such as extent of leverage, diversification, credit status of counterparties etc., should be imposed by management as a matter of prudence and common sense.

"New Issues" (formerly "Hot Issues") (Reference Question 5)

If the Fund is to invest in "New Issues" (previously designated "Hot Issues"), it will be necessary to verify whether each of the investors in the Fund are deemed "restricted" or "unrestricted" investors. In very simple terms, a "Restricted" investor is an investor who may or could have "inside" knowledge because of

the investor's occupation. "Restricted" investors may not participate in the profits (or losses) relating to a New Issue investment, subject to certain exemptions (such as restricted investors comprising less than 10% of the total fund), as a result of legislation passed late 2003/early 2004. Full disclosure of this should be made in the offering documents and, as this is essentially an SEC compliance matter, Custom House would recommend that the Fund's compliance, in this regard be guided by the Fund's US attorney.

Soft Dollars (Reference Question 6)

If the fund, or its management, benefit in anyway from Soft Dollar arrangements, this must also be fully disclosed in the offering documents.

Structure of Funds (Reference Question 7.1)

Custom House would recommend that the fund be established with the ability to be a multi-share fund because it will cost no more at the outset and will provide the facility to issue different classes of shares in the future.

The standard offshore fund that Custom House recommends is a multi-share company with the Class A Shares issued as Voting Shares and all subsequent classes of Shares issued as Non-Voting Shares.

Class A Shares

The holders of the Class A Shares have all the votes and their shares are usually held on behalf of the management or promoters of the company for administrative convenience, but will have no participation in the assets of the fund(s), except to the extent of the initial capital subscribed for the shares.

Class B and other Classes of Shares

The Class B Shares, which will be issued to investors in the Fund, will have no voting rights. However they will participate equally in the Net Assets of the Fund and Company relating to the Class B Shares on liquidation and in dividends and other distributions as declared.

This structure is purely for administrative convenience and saves having to organise expensive shareholders meetings for all investors, or having to obtain proxies from a widely dispersed shareholder network.

Additional Classes of Shares can be issued, if required, to create additional Sub-Funds to provide for, inter alia:

- a) different currency denominations;
- b) different investment policies or risk profile;
- c) different types of fund structure (guaranteed, closed-end, etc);
- d) different asset classes;
- e) different investment advisors;
- f) different fee structures.

Shareholders who subscribe for each additional Class of Share (Class C, Class D, etc.) will participate in those assets of the Sub-Funds that relate to the specific Class of Share subscribed for. Thus the assets of the Company will be divided into specific Sub-Funds relating to each specific Class of Share.

Protected/Segregated Cell Companies

Several jurisdictions permit companies to be established with separate Segregated Protected Cell structures ("Protected Cell Structure"). These were originally created for insurance companies, but have now become available for umbrella type fund companies. The rules relating to such companies provide protection by segregating one fund (or cell) from any cross-collateral risk of losses generated in another fund (or cell), should that fund (or cell) suffer losses in excess of its assets.

On the face of it, the Protected Cell Structure is a very good and efficient way of achieving cross-collateral protection, however, it must be stressed that, whilst the law permits the structure and, therefore, endorses the protection offered in the jurisdictions in which such legislation exists, there have been, as far as we know, no test cases in those jurisdictions. More importantly, there have been, as far as we know, no test cases in the EU, the UK or the USA involving such companies, where the Protected Cell Structure is not a recognised structure under European, UK or US company law. There is, therefore, the possibility that, if a case arose and jurisdiction was claimed or, indeed, taken by the courts outside the domicile of the fund, that those courts could disallow the cell structure protection.

Accordingly, we would suggest that, even if you use the Protected Cell Structure, you should also insert a Subsidiary Trading Company (see Question 8) under each cell.

It has to be stated that the only sure way to eliminate the cross-collateral risk between two Sub-Funds, is to establish separate stand-alone fund companies.

Choice of Entity

Ultimately the choice of legal entity will depend upon a number of factors, including, inter alia, the type and residence of the investors and personal preferences of the clients.

Closed End Funds (Reference Question 7.2)

Often Closed End Funds are created because the assets which the Fund will invest in are illiquid, such as real estate, private equity, distressed securities and venture capital. This can lead to valuation problems. It is, therefore, essential that a clear valuation policy is established, and described in the offering documentation. It is also preferable that an independent valuer is retained and that the valuation policy and procedures are pre-approved by the Fund's selected auditor.

Master-Feeder Fund (Reference Question 7.3)

If it is intended to permit US tax payers as investors in the fund, it is probable that you will need to segregate the US tax payers from the non-US and US tax exempt investors, by establishing a US Domestic Limited Partnership (or an Offshore Limited Partnership) to accommodate the US tax payers. You will then probably want to use a Master/Feeder Fund structure.

A Master Feeder structure can consist of two entities - the Master Fund, which will be one US Domestic Partnership (for US taxpayers) - into which the Offshore Fund will invest. However, many investors would prefer the "triangular" Master Feeder fund structure.

This is an arrangement whereby a subsidiary trading company would be established as the "Master Fund", into which both the Offshore Fund (for non-US and US tax exempt investors) and the Domestic or Offshore Limited Partnership (for the US tax paying investors) will invest. This "Master Fund" would be a subsidiary trading company with only these two shareholders.

If you do not want to accept US tax payers immediately, but intend to do so at some time in the future, it makes sense to establish a subsidiary trading company, which will become the Master Fund, at the outset, in order to avoid the hassle and expense of having to open up new brokerage accounts in the name of the Master Fund and transfer all of the open positions from the Offshore Fund account to the Master Fund account, at a later date.

Equalisation (Allocation of Incentive Fee) (Reference Question 7.4)

Historically, incentive fees have been paid to Investment Managers on the basis of new net profits of the Fund. These are usually paid either annually or quarterly and continue to be paid so long as profits exceed the previous "high water mark", which is either the initial or launch price, or the NAV per share at which the last incentive fee was paid. However, if the NAV declines from that previous high water mark, the Fund must recoup that loss before any new incentive fees are paid. This has been standard practice for many years - however it is not equitable, either for the Investment Manager, or for investors, depending on the circumstances and to ensure the equitable allocation of the incentive fee between shareholders, some form of "Equalisation" must be used.

A number of methods of accounting for incentive fees have been developed, which achieve an equitable allocation, of those fees, but unfortunately create substantial confusion in shareholders' minds. Probably the simplest procedure would be to structure the Fund as a partnership and allocate profits, losses and fees on a partnership basis, using capital accounting methods. However, although this is acceptable to US investors, who prefer partnerships primarily for tax related reasons, most non-US investors generally dislike the partnership structure - also for tax reasons.

Other than using partnerships, the two most common ways of achieving equality are using one of the "Equalisation" methods, which all utilise very complex accounting formulae or the "Series of Shares and Consolidation" method, which is more cumbersome, but also easier to understand.

(For a full explanation of Equalisation, see the Custom House Website - "Equalisation - What it is, Why it is Necessary, How it Works").

Subsidiary Trading Companies (Reference Question 8)

Subsidiary trading companies may be used for asset protection or tax planning purposes:

- a) The Memorandum & Articles of Association of the Company and the Offering Memorandum will provide for the segregation of the assets of each Sub-Fund and the protection of the individual shareholder's interest in the assets of their specific sub-fund. In order to add a further layer of protection, albeit at extra cost, a separate limited liability trading company can be incorporated for each Class of Share. The assets subscribed to each Class of Share or Sub-Fund will be invested into its designated trading company. This is strongly recommended if the Sub-Fund in question is trading on margin or otherwise on a leverage basis, and is thus vulnerable to losses in excess of assets.

If the trading is done in the name of the Company and not through a subsidiary, the creditors, who would normally be the Fund's Prime Broker or other trading counter-party, could claim against the assets of the other Sub-Funds of the Company. This risk is avoided if the trading is carried out through a limited liability subsidiary trading company. Thus, in the event that the trading for one Sub-Fund, through its own subsidiary company, resulted in substantial losses, these losses would be contained within that subsidiary company and, because of its limited liability, could not pass through to other Sub-Funds of the Company and penalise the shareholders in those other Sub-Funds.

(It should be noted that the protection provided by utilising subsidiary trading companies will not eliminate the possibility of a disgruntled shareholder suing the Company for bad performance and, thereby, putting shareholders of other Sub-Funds of the same Company at risk. The only way to ensure absolute separation from such a liability is by establishing each of the Sub-Funds as an entirely separate legal entity, so that each sub-fund is a stand-alone fund in its own right. This obviously adds to the cost.)

- b) The withholding tax consequences of investment in some jurisdictions can be alleviated by investing through a company incorporated in another jurisdiction with a favourable double taxation treaty. In these circumstances it is often more efficient to establish a subsidiary trading or investment company in the favourable jurisdiction, whilst incorporating the Fund in another jurisdiction more suitable for an offshore fund (for example a Mauritian subsidiary for a BVI, Cayman or Bahamian domiciled fund, investing in India).
- c) It should be noted that such subsidiary trading companies will incur registered agency, government, administration and directors fees, as applicable, depending on the jurisdiction of the company.

Jurisdiction & Domicile of the Fund (Reference Question 9)

- a) There is a wide choice of jurisdictions to choose from, including: Ireland and Luxembourg and after May 1st, 2004, Malta, within the European Union; the traditional UK offshore centres of the Channel Islands (Jersey and Guernsey) and the Isle of Man; and other locations, including, inter alia, Anguilla, the Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands and the Turks & Caicos Islands.

Some of these jurisdictions require resident management companies to be established and all impose different levels of regulatory control. Fees and costs can vary widely in different jurisdictions. Some jurisdictions will be precluded because of marketing considerations.

Depending on the type of fund and the targeted investor, for most alternative investment and hedge funds, Custom House will in all probability recommend either the British Virgin Islands or the Cayman Islands as an appropriate jurisdiction of domicile, or, if a European Fund is required, Jersey or Malta - although Custom House are quite capable, if required, of establishing and administering funds incorporated in most of the other jurisdictions.

Anguilla, which is a lightly regulated jurisdiction, is a suitable low-cost alternative for single investor or family office funds, which are established for risk management or other fiscal reasons and are not intended to be offered to third party investors.

b) BAHAMIAN, BRITISH VIRGIN ISLANDS ("BVI"), AND CAYMAN ISLANDS ("Cayman")

International preference for the Bahamian, BVI and Cayman funds reflects the relative speed, efficiency and cost effectiveness of both establishing and operating a fund in these jurisdictions. Perhaps the most efficient of this group is the Cayman Islands whereas the Bahamas can take the longest time. Custom House has developed close relationships with its attorneys in these jurisdictions, as a result of which the operation of funds, established in these jurisdictions and administered by Custom House, is run at a high level of efficiency, that is perhaps rare in the Caribbean.

The regulatory restrictions imposed in these jurisdictions provide considerable flexibility. It is Custom House's belief that investor protection can be fully provided for by:

- i) ensuring that the Memorandum & Articles of Association ("Mem & Arts") are professionally written and, where necessary, restrictive;
- ii) ensuring that the Offering Documentation complies with the Mem & Arts, gives full disclosure of the risks and contains strong controls, checks and balances and such restrictions as are necessary to protect investors; and
- iii) the appointment of a financially sound and reputable Custodian or Trustee Bank; and
- iv) the appointment of a leading firm of auditors who are experienced in the type of investments in which the fund will invest.
- v) An additional layer of investor protection can be provided if the fund obtains a listing on the Irish Stock Exchange (see below).
- vi) Each of these jurisdictions impose effective anti-money laundering regulations, although you should appreciate that, because Custom House is based in Dublin, Custom House falls under the regulatory jurisdiction of the Irish Financial Services Regulatory Authority - IFSRA - (formerly the Central Bank of Ireland) and therefore all funds that Custom House acts for have to comply with Irish anti-money laundering regulations, which are probably even more comprehensive than those of the Caribbean jurisdictions.

NB: *Please note that regulation in the Caribbean is constantly changing and continually subject to review. Accordingly, the information given herein below must not be relied upon until verified.*

Authorised and Regulated funds in the Bahamas

The Investment Funds Act, 2003 ("the Act") of the Bahamas, characterises Bahamian Mutual Funds as being one of "SMART", "Professional" or "Standard" or "Recognised" funds.

A “SMART” Fund

The “SMART” Fund, which has effectively replaced the Exempt Fund under Bahamian Mutual Fund regulations, is designed to be a very flexible fund but still must comply with any written rule of the Commission establishing the parameters or requirements in respect of the category, class or type of investment fund. The Commission may establish those parameters and requirements with regard to a SMART Fund as it deems fit and shall make rules establishing parameters and requirements in respect of each category, class or type of investment fund that it may approve as a “SMART” Fund.

A Professional Mutual Fund must comply with the following:

- (i) It must either have a minimum investment level of US\$50,000, or currency equivalent, or the shares, or units are listed on an approved stock exchange. (The Irish Stock Exchange would be acceptable, although the Irish Stock Exchange would require a minimum investment of US\$100,000, or currency equivalent).
- (ii) The Mutual Fund should be registered with the Securities Commission of the Bahamas, (the “Securities Commission”), the regulator of Mutual Funds in the Bahamas.
- (iii) The current offering documentation should be filed with the Securities Commission.
- (iv) The Mutual Fund must pay the Government’s annual registration fees.
- (v) The Mutual Fund must have its accounts audited annually by an auditor approved by the “Licensor”. The Licensor could be either the Securities Commission or a Mutual Fund Administrator with an Unrestricted Mutual Fund Administrator’s License.

A Recognized Foreign Fund includes Funds that are Bahamas-based but have a nexus (which is provided for in the act) to a prescribed jurisdiction. This type of fund is required to be registered with the Securities Commission.

A Standard Mutual Fund is a fund that does not meet the definitions of a SMART, Professional or Recognized Mutual Fund and is, therefore, required to obtain a license as a “Standard Mutual Fund”. The application and procedures for obtaining a license as Standard Mutual Fund are more onerous than those for a Professional fund, as would be expected for a fund that is capable of being marketed on a retail basis.

Custom House has been licensed as a Restricted Mutual Fund Administrator by the Securities Commission, and, accordingly, the Securities Commission would be the Licensor for any Fund established in the Bahamas, for clients of Custom House.

Public, Private and Professional Funds in the BVI

The Mutual Funds Act 1996 (as amended) of the British Virgin Islands was introduced in January 1998. Under the Act, funds are categorized into three different types - Public Funds, which must be ‘registered’, Private, and Professional Funds, both of which must be ‘recognized’.

In simple terms a Public Fund is, as the name implies, a fund that is sold to the public - effectively a retail fund. It goes without saying that the requirements and restrictions for registering such funds are more onerous than the requirements for recognizing a Private or Professional Fund. However, they are not as difficult to comply with, as would be the case in Ireland or Luxembourg.

A Private Fund is one, which is restricted to no more than fifty investors, or one, which specifies that it is to be offered to investors on a “private basis” - a Private Placement. It must be noted that a clear definition of a “Private Placement” has not been made under the Act, however guidelines published by the regulatory authorities in the BVI shortly after the Act came into force indicates that an offering to as many as three hundred persons could still be regarded as being on a

“private basis” and, furthermore, such an offering should be to prospective investors who have been identified before the fund is launched.

Therefore, although there are some grey areas within the definition of a Private Fund, the one certain way of ensuring that the fund is deemed a Private Fund is to comply with the limitation to fifty shareholders.

A Professional Fund is one that is only offered to “Professional Investors” and where the majority of investors subscribe not less than US\$100,000 (or currency equivalent).

A “Professional Investor” is one whose ordinary business involves the acquisition or disposal of property of the same kind as the property (or a substantial part of the property) of the fund. ‘A Professional Investor’ can also be a person who has signed a declaration that he (or she), either individually, or jointly with his or her spouse, has a net worth in excess of US\$1,000,000 (or currency equivalent) and that he or she consents to being treated as a professional investor.

Closed Ended Funds are not regulated in the BVI, but may not use the word “Fund” in their name.

Single Investor Funds are exempted from regulations.

It should be noted that if a management or investment management company is established in the BVI, then that company will also have to be licensed under the Act. If the company has been established purely to act as manager or investment manager of certain identifiable private or professional BVI funds, then compliance with the regulations is simpler than would be the case if the entity were acting for a Public Fund or wished to act for an unrestricted number of funds.

For further details of the Mutual Funds Act, 1996 (as amended) of the British Virgin Islands, please see the separate section on the Custom House Website.

Licensed, Administered, Registered and Exempted funds in the Caymans

The Mutual Funds Law of the Cayman Islands, which was introduced in 1993 and revised in 1996 and 1999, characterises Mutual Funds as either “Licensed”, “Administered”, “Registered” or “Exempted” Funds.

A Licensed Fund is a fund that has a Mutual Fund Licence and also, either has a registered office in the Cayman Islands, or, in the case of unit trust, has as its trustee a trust company licensed under the Cayman Islands Banks and Trust Companies Law. The Cayman Islands Monetary Authority, which is the issuer of such licences, is responsible for the supervision and regulation of Mutual Funds and Mutual Fund Administrators. Before issuing a licence, the Cayman Islands Mutual Fund Authority (CIMA), will carry out appropriate due diligence and satisfy itself that all parties involved with the fund are fit and proper persons, of sound reputation and also have sufficient experience and expertise to carry on the business of the fund.

An Administered Fund is a fund, which has appointed a Licensed Mutual Fund Administrator, to provide its principal office in the Cayman Islands. The Licensed Administrator takes upon itself the responsibility to confirm and satisfy itself that all of the persons involved in the promotion, management and administration of the fund are suitable, fit and proper, have sound reputation and sufficient experience and expertise. Where a Licensed Administrator takes on this responsibility it is not necessary for the fund to be separately licensed by the CIMA.

A Registered Fund is a fund that obtains a Certificate of Registration from CIMA and can avoid applying for a mutual fund licence or appointing a resident Licensed Administrator, providing that, either the minimum investment is US\$50,000, or its currency equivalent, or that its shares, units or partnership interests are listed on a recognized stock exchange, which includes the Irish Stock Exchange - but, again, the Irish Stock Exchange will require a minimum investment of US\$100,000, or currency equivalent.

An Exempted Fund, under Cayman Islands Law, is one that:

- a) does not have to be registered or file any information whatsoever with CIMA;

- b) does not have to be licensed under the Mutual Funds Law; and
- c) is not required to appoint a Licensed Mutual Fund Administrator.

In order to achieve exempt status the fund must have no more than 15 shareholders, unit-holders or partners and those shareholders, unit-holders or partners must have the power, by majority in number, to appoint and remove the Directors, Trustees or General Partners, as this case may be.

In this context it is worth noting that an “investor” means the legal entity which is the registered shareholder, unit-holder or partner. Cayman Law does not consider the number of beneficial owners of that entity, when calculating the total the number of shareholders. Thus an Exempted Fund could have one of ten shareholders, which is, itself, a fund of funds, and even though that one shareholder might have 100 shareholders, it would still be considered a single shareholder for the purposes of the Mutual Funds Law.

c) JERSEY

In early 2004, the Jersey Financial Services Commission (the “Commission”) introduced the Expert Fund as a new classification for Collective Investment Funds.

The Expert Fund framework was designed to provide a flexible “fast track” procedure for the establishment of funds in Jersey targeted at sophisticated, institutional and high net worth investors. The new framework benefits from a lighter regulatory approach and can be established in a short timeframe as a result of a new streamlined authorisation process in Jersey. Accordingly, the Expert Fund is an ideal vehicle for Hedge Funds.

The Expert Fund is intended to cater for the demand by “Expert Investors” (as defined below) for a more flexible and less restricted fund, on the basis that the Expert Investor is both willing and able to assess the risk for himself and bear the economic consequences of such an investment. The important feature of the framework is that the Commission relies on self-certification of compliance by the local Jersey functionary of the Expert Fund within the Commission’s lines, rather than close examination of the structure and documentation relating to the fund when established. Investor protection is provided by a duty of full disclosure of the material facts, and a requirement that each Expert Investor must sign an acknowledgement of receipt of the prescribed form of investment warning.

An Expert Investor is defined in the classification guide as:

- a) as a person, partnership or other unincorporated association or body corporate, whose ordinary business or professional activity includes, or it is reasonable to expect that it includes, acquiring, underwriting, managing, holding, or disposing of investments, whether as a principal or agent, or for giving of advice on investments; or
- b) an individual who has a net worth, or joint net worth with that person’s spouse, greater than US\$1,000,000 excluding that person’s principal place of residence; or
- c) a company, partnership, trust or other association of persons which has (or which is a wholly owned subsidiary of a body corporate which has) assets available for investment of not less than US\$1,000,000, or every member, partner or beneficiary of which falls within the definition of an Expert Investor; or
- d) a functionary to the Expert Fund or an associate of a functionary to the Expert Fund; or
- e) a person who is an employee, director, consultant or shareholder of or to a functionary of the Expert Fund or an associate of a functionary to the Expert Fund, who is acquiring an investment in the Expert Fund as part of his remuneration or an incentive arrangement or by way of co-investment; or
- f) any employee, director, partner or consultant to or of any person referred to in paragraph (a) above; or
- g) a trustee of a family trust settled by or for the benefit of one or more persons referred to in paragraphs (e) or (f) above; or
- h) a trustee of an employment benefit or executive incentive trust established for the benefit of persons referred to in paragraphs (e) or (f) above or their dependants; or

- i) a government, local authority, public authority or supra-national body in Jersey or elsewhere; or
- j) an investor who invests a minimum of US\$100,000.

Interestingly the Commission take the view that those involved in organizing and providing services to an Expert Fund should be encouraged to invest in the fund and is therefore prepared to be flexible in extending the definition of an Expert Investor to cover any other types of what they describe as “carried interest investors”.

Expert Funds can take any form of legal structure recognised by Jersey law. Thus, they can be companies, limited partnerships or unit trusts and may be open or close-ended.

There is a requirement that the Fund entity have at least two Jersey resident directors with appropriate experience. If established as a partnership, then the general partner must be a Jersey entity with at least two Jersey resident directors with appropriate experience. Similarly, a trustee of a unit trust must be a Jersey entity with at least two experienced resident directors.

There are no mandatory investment restrictions that apply to Expert Funds, although the investment strategy must be clearly explained in all of the offering documents. Similarly, there are no restrictions imposed as to the level of borrowings or gearing, providing the maximum level is stated in the offering document. In the event that borrowing or gearing is above 200% of net assets, then details of the strategy and risks must be fully disclosed to the Commission within the application form for the Expert Fund and the Commission reserves the right to make further enquiries before authorising the fund. An Expert Fund must also provide annual audited financial accounts.

The Commission imposes certain restrictions with regard to service providers, which include:

(i) Investment Manager

Obviously, the Investment Manager of an Expert Fund should have relevant experience and preferably be established in an OECD member state, or associate member state and be regulated in that state. If this is not the case, then prior approval by the Commission to act as an Investment Manager and certain criteria are imposed. However, if the Investment Manager does not meet all of the criteria they may approach the Commission on a case-by-case basis and the Commission may give some derogation, providing adequate protection is offered to the investors (and Jersey’s reputation).

(ii) Distributors

The Commission requires the same qualifications for Distributors, except for the relevant experience with regard to the investment management. Any Jersey entity acting as a service provider will have to be licensed or authorized by the Commission and this is done by the granting of a permit under the Collective Investment Funds (Jersey law of 1988), as amended.

(iii) Manager/Administrator

Every Expert Fund must appoint a Manager or Administrator having staff and a physical presence in Jersey and therefore licensed in Jersey. Having said that, Jersey resident administrators are permitted to delegate certain aspects of the administration of the fund to administration companies outside Jersey, such as Custom House. If such delegation occurs, then the Jersey Administrator must ensure that it not only holds the necessary records to comply with Jersey regulations but that the non-Jersey administrator complies with all of the restrictions and requirements of a Jersey Administrator.

(iv) Custody

The Expert Funds must have adequate safe custody arrangements and for the most part these would be expected to be provided by a Jersey resident Custodian. However, that is not absolutely necessary and of course with Hedge Funds the custodial aspect is usually provided by the Prime

Broker, which will not be resident in Jersey. This is acceptable to the Commission providing they have a minimum credit rating of A1/P1.

Why Jersey?

The question that the fund promoters will probably ask is why choose Jersey over the BVI, Cayman Islands or Bahamas, for example. Are there cost advantages? Are there reputation advantages?

The main advantage of a Jersey fund is that investors in certain markets, particularly the EU, the Middle East and UK, consider that, Jersey has a long established reputation as a clean, well-regulated and efficient offshore jurisdiction. Furthermore, Jersey funds have, in the past, been recognised and registered in Switzerland, which is not the case with BVI, Bahamian or Cayman funds. The legal and banking facilities available in Jersey are first class and, on balance, we believe that many investors from the jurisdictions mentioned above may feel more comfortable with a Jersey Expert Fund than they would be with a fund from one of the Caribbean jurisdictions.

The costs of establishing and operating a Jersey fund are likely to be higher than the cost of establishing and operating a Cayman fund.

d) MALTA

Malta provides an interesting new opportunity for hedge fund managers. Over the past ten years Malta has developed a flexible but efficient financial services regulatory environment, which could be considered similar to that in the Cayman Islands. Thus it is now possible to establish a hedge fund in Malta that would be very similar to a hedge fund established in the Caymans, although a stronger requirement in Malta is that the investment manager must be regulated in an acceptable jurisdiction.

The main difference between Malta and the Caribbean Centres and one that is likely to put Malta at a distinct advantage is the fact that on 1st May 2004, Malta was admitted to full membership of the European Union. Therefore it is now possible to establish a flexibly regulated hedge fund within a member state of the European Union.

e) REPUBLIC OF IRELAND

Although it can take longer and will be more expensive to establish a fund in Ireland rather than the Caribbean, the application and approval procedures in Ireland are probably easier, quicker and cheaper to complete than would be the case in Luxembourg, which is the only other comparable heavily regulated "offshore" financial centre, within the EU.

An Irish "Offshore" fund must be approved by the Irish Financial Services Regulatory Authority ("IFSRA") and meet at least the following criteria:

- The Manager and Investment Manager must be authorised and licensed by IFSRA
- The fund must appoint an Irish Custodian or Trustee Bank
- The Promoters must show substantial experience, expertise and provide first class references for the directors and the Investment Managers of the fund.

A futures or derivatives fund, targeted at professional or institutional investors, will be required to impose a minimum subscription level of €100,000 per investor. Retail futures or derivative funds are permitted, subject to a minimum subscription level of €10,000, but are subject to tighter restrictions.

IFSRA has published a series of "Notices", which describe conditions imposed in relation to both UCITS and Collective Investment Schemes, or funds, other than UCITS. These Notices describe in some detail the general regulation of funds and the responsibilities and obligations of the various service providers to those funds, as well as going into specific detail with regard to venture or development capital, money market, property or real-estate and futures and options

funds - both capital protected and leveraged structures - as well as feeder, umbrella, closed end funds and funds of funds.

The general borrowing and investment restrictions which IFSRA imposes on all funds may be modified or replaced by the Notices applicable to particular types of fund, such as property and real-estate funds, or feeder funds. The conditions and restrictions relating to investment objectives, investment policies, borrowings and leverage may be disapplied with regard to funds that are to be sold to professional investors only, in whole or in part, on a case by case basis. Such funds must have a minimum subscription level of €125,000, or currency equivalent.

However these restrictions will be disapplied in full in respect of funds that are being sold solely to “Qualifying Investors” - these are referred to as Qualifying Investor Funds or QIFs. However all other provisions contained in the Notices, which do not relate to investment objectives, investment policies or the level of borrowing or leverage employed apply in full to QIFs, unless specific derogations are granted by IFSRA. For a fund to qualify as a QIF the minimum subscription must be €200,000 or its currency equivalent. Furthermore institutions may not act as nominees for individual investors investing less than €250,000 each.

A “Qualifying Investor” is defined as any natural person with a minimum net worth (excluding their main residence and contents) in excess of €1,250,000 (or currency equivalent) or any institution or entity, other than a natural person, which owns or invests on a discretionary basis at least €25,000,000 (or currency equivalent) or the beneficial owners of which are Qualifying Investors in their own right.

Copies of IFSRA’s Notices are available from Custom House.

f) OTHER JURISDICTIONS

As stated above, Custom House can assist in the establishment of a fund in any preferred or appropriate jurisdiction and are experienced in working with clients’ own legal advisors.

Irish Stock Exchange Listing (Reference Question 10.1)

A listing on the Irish Stock Exchange has similarities to a listing on the Luxembourg Stock Exchange. Apart from the added credibility and comfort factor to investors, a listing on a recognised stock exchange is also a pre-requisite for investment by some institutional investors and pension funds. A listing does not mean that the price of the shares is traded across the market by a market-maker, nor that the price can be manipulated. The shares will be bought (subscriptions) or sold (redemptions) on the basis of the NAV per share (plus a spread to allow for any initial charges if applicable) on the designated dealing day.

It is not necessary for a fund to be Irish domiciled to apply for a listing. Custom House has assisted in the successful application for listing the shares of a number of Bahamian, BVI and Cayman funds, which were established and are administered by Custom House. The Irish Stock Exchange will list the shares of retail funds domiciled in an EU Member state, the Channel Islands, the Isle of Man, Bermuda and Hong Kong. However, funds domiciled in most other “offshore” jurisdictions must be organised as “sophisticated investor” funds. To obtain a listing on the Irish Stock Exchange, such a “sophisticated investor” will have to meet certain criteria, which currently include:

- a) minimum subscriptions of US\$100,000 per shareholder;
- b) management must be able to show experience and expertise and that they are “proper persons”;
- c) in addition, the Investment Advisors and/or Trading Managers are normally required to either be regulated and authorised in an “acceptable” jurisdiction or have a minimum of US\$100 million under management, although the Irish Stock Exchange will permit some relaxation of this requirement in certain circumstances, such as limiting the fund to “Professional Investors”, as defined by the Irish Stock Exchange;
- d) there must be two independent directors (independent of the Promoters and Management);and

- e) the application must be sponsored by a sponsoring member firm of The Irish Stock Exchange. Custom House can recommend a choice of Sponsoring Member Firms, each with great experience in sponsoring funds seeking a listing on The Irish Stock Exchange.

It should be noted that, although the Irish Stock Exchange do requires funds to meet their criteria, they can be flexible with regard to the definition of the experience and qualification of the investment management team. If there is any doubt that the investment manager will qualify, Custom House would recommend that their names be submitted for pre-approval, so as to avoid the expense of preparing a full listing application, if approval is not given.

For full detailed information with regard to listing funds' shares on The Irish Stock Exchange, please review the section "Listing on The Irish Stock Exchange" on our Website.

Other Stock Exchange Listings (Reference Question 10.2)

It is also possible to list the shares of a fund on, inter alia, the Bermudan and Cayman Island Stock Exchanges and several other stock exchanges are introducing, or have introduced, this facility. For further information, please contact Custom House.

Capital Structure (Reference Question 11)

Except for exempted Bahamian or Cayman funds, whose shareholders must have the voting power to remove management, Custom House recommends the multi-share structure, (see "Structure of Funds" above). The "A" Class Voting Shares are usually issued to, or held on behalf of, the promoter or management, but are usually under the control of (i.e. voting proxies are given to) Management. This is for administrative convenience - for example, it avoids the cost and administrative problems involved with issuing proxy forms and other documentation for every Shareholders' Meeting.

The "A" Class Shares do not participate in the assets of the Fund. The "B" and any subsequent - "C", "D", etc - Class of Non-Voting Shares are issued to investors and participate in the assets of their relevant sub-fund.

This multi-share structure enables the company to become, de facto, an umbrella fund, with each sub-fund representing a different class of share and perhaps, offering an investment opportunity, for example, in a different currency, asset class, or investment strategy.

Bearer Shares

We do not advocate the use of Bearer Shares for funds, or, for that matter, investment management companies, because of the potential risk of abuses in the context of money laundering offences. In this regard Custom House will not act as administrator for any fund that issues bearer shares, except in very controlled circumstances. This could be where the shares are held by a clearing corporation, or a third party nominee of high repute, subject to specific declarations of trust, so that the nominee is aware of the identity (and bona fides) of the beneficial owners at all times.

Subscriptions (Reference 13.1)

Normally subscription monies must be received within banking hours on either the Dealing Day, which is the first day of the new month, or on the Valuation Day, which is normally the last Business Day of the previous month. However, in the case of Funds of Funds, sometimes subscription monies have to be received several days before the Valuation or Dealing Days. This is to enable the Manager to invest new subscriptions into the underlying fund assets of the Fund of Funds. Otherwise the subscription monies may lay 'fallow' for the first month that the investor has subscribed, unless the fund has a bridging loan facility, which enables it to borrow against anticipated subscriptions and utilise the borrowings to make the investments in the underlying funds.

If subscription monies are required both before the month-end and before shares have been issued to the new investor, then there must be a disclosure of this fact in the Offering Memorandum and the potential risk therein described in the "Risk Factors" section of the Offering Memorandum.

Redemptions (Reference Question 13.2)

It is important to remember that the liquidity of the fund and the notice period for redemptions must provide adequate time for the Investment Manager of that fund to liquidate assets to meet redemption requests. This is particularly important with Funds of Funds, which may be invested in other funds that have a long redemption lead in time. For example, a 30 day redemption notice period will be insufficient if the fund is itself invested in funds that need 30 days or more notice.

Minimum Holding Period (Reference Question 13.3)

Apart from the natural instinct of management to discourage redemptions, the requirement for a minimum holding period is often necessary for those funds where the portfolio has to be structured over a period of time and any early redemptions would disrupt that portfolio to the detriment of other shareholders. In such cases an Early Redemption Fee may be levied and it would usually be paid into the fund and become an asset of the fund to compensate the remaining shareholders for such disruption.

Year-End (Reference Question 14)

Most funds establish their financial year-end to match the calendar year-end at the 31st December. This has many practical advantages, but one, quite substantial disadvantage - timeliness of receipt of the annual audit. With the plethora of hedge funds that have been established over the past several years, all audit companies in jurisdictions that host hedge funds are stretched and suffer a huge log-jam in the first three to six months of the year, because every fund under the sun wants a 31st December year-end. Many of these funds have strict deadlines for the audit, either laid out by the Irish Stock Exchange, their regulator or within their Offering Memorandum. Often, this log-jam can be avoided if the financial year-end of the Fund is set at, say, the 31st March, 30th June or even the 30th September, because the audit companies will have more staff available, certainly in June and September, to concentrate on the Funds' audit than they will have with a 31st December date.

Fractional Shares (Reference Question 15)

Custom House normally recommend that for open-ended funds fractional shares be issued if required, as this enables round sums to be invested. For example, if the offer price is \$23.56 and an investor wishes to invest \$100,000, the investor would receive 4,244.48 shares. If fractional shares were not issued, then a refund of \$11.36 would be due. This balance could be retained by the fund, or the Manager, but most investors ask for it back, even though it would cost more in bank and time charges to administer such payments than the actual payment is worth.

Share Certificates (Reference Question 16)

Most funds do not issue certificates to the Shareholders and usually the share purchase contract confirmations are considered and accepted as "good title". Some investors require share certificates and therefore Custom House recommend that they be available, but only if requested, for which there will usually be a charge payable by the shareholder.

As mentioned above, Custom House will not, as a general rule, act for funds that issue bearer shares, because of the potential for abuse of such instruments in the context of anti-money laundering regulations.

Manager/Investment Manager (Reference Questions 18.1/18.2)

The management and control of a fund company initially lies in the hands of the directors, although, ultimately, it lies with the holder of voting shares. The directors will usually delegate the administration and the investment management of the fund to third parties and appoint an Administrator and an Investment Manager.

Sometimes a Manager is appointed who will be responsible for appointing the Investment Advisor(s) and the Administrator. The Manager will have responsibility for the management of the fund company, although the directors will always have the power to remove the Manager in extreme circumstances.

Often, an Investment Manager is sometimes appointed instead of a Manager, with responsibility limited purely to the management of the fund's assets. The Investment Manager may also delegate and appoint

one or more separate Investment or Trading Advisor(s), as would be the case with a Multi-Manager Fund utilising managed accounts (see below).

It is less common to appoint both a Manager and an Investment Manager.

The questions referenced (c), (d) and (e) are important if it is intended that the fund is going to be listed on The Irish Stock Exchange. The Investment Manager will be automatically approved if it is regulated by a “recognised regulatory authority”. *(Please review the section “Listing on The Irish Stock Exchange” on our Website)*. Alternatively, an Investment Manager that is not regulated by a recognised authority will usually be approved if they have US\$100 million (or currency equivalent) of third party discretionary money under management, or in some cases, if the fund is restricted to “Professional Investors”.

Investment Advisors and Trading Managers (Reference Question 19)

If the fund is a multi-manager fund, it is usual to appoint an Investment Manager who will select, supervise, oversee and ultimately be responsible for the individual Investment Advisor(s) or Trading Manager(s) who may be appointed by the Investment Manager, or by the company on the recommendation of the Investment Manager.

Administrator (Reference Question 20)

Custom House will act as the Administrator.

Custodial Arrangements (Reference Question 21.1)

The choice of Custodian will depend on the structure of the Fund. For example, a traditional Custodian will not be required if the Fund operates through a suitable Prime Broker, or uses a combination of a Clearing Broker and Cash Manager (see below).

Custom House can recommend a choice of suitable Custodians. The choice will depend on the expected start up size and eventual target size of the fund, expected levels of trading activity etc. Smaller start up funds may find their choice limited, because some of the larger Custodian Banks will only take on funds with a high initial NAV.

Payment Bank (Reference Question 21.2)

Most Prime or Clearing Brokers will not accept subscriptions from individual investors in a fund (except for partnerships), because of regulatory restrictions. It must be remembered that the client of the Broker is the fund, not the individual investor, therefore, it will be necessary to appoint a Payment Bank, into which all subscriptions will be paid and out of which all redemptions, distributions, fees and expenses will be paid.

Some Payment Banks will charge a set up fee (usually circa \$2,000) and an annual service fee (also usually circa \$2,000 p.a.). The bank may also require a legal opinion (for which an additional fee will be payable), that the company is in good standing and is authorised to open the account.

Cash Manager and Trust Bank Accounts (Reference Questions 22.1/22.2)

Custom House recommends that, particularly for commodities and futures funds, but also for any funds with large cash balances, consideration is given to the appointment of a Cash Manager. The Cash Manager will have responsibility for investing any surplus monies in the fund, such as cash balances over and above that required by the Clearing Broker or FCM to maintain margins on the fund's positions in the markets.

The reasoning behind this recommendation, (which is discussed in greater detail in the paragraph below entitled “*Advantages of the Cash Management Programme*”), relates primarily to the limited security that may be provided by the “Customers’ Pooled Segregated Accounts” into which the fund’s surplus monies will be deposited at an FCM or Clearing Broker, in accordance with CFTC regulations.

Question 22.1 is specifically directed at the question of the “Cash Manager” and does not address the choice of a Trust Bank. This is because the choice of the Trust Bank will usually depend on the choice of Cash Manager and will reflect the custodial relationship that has been established by that Cash Manager with a particular money-centre bank. It is important to maintain this relationship in order to get full advantage of

the enhanced returns that the Cash Manager is able to generate on its substantial aggregated trading volume. Unless the proposed fund is anticipated to be very substantial, the selection of a different Trust Bank will add to the Cash Manager's operating costs. Such increased costs will, of course, be passed on to the fund and reduce the yield earned on the cash balances.

Advantages of the Cash Management Programme

It should be noted that Custom House believes that the primary advantages of utilising a Cash Management Programme are threefold:

- i) Increased security through elimination of certain third party and/or counterparty risks; and
- ii) Enhanced returns, represented by the improved yield over standard broker rates, generated by the Cash Manager; and
- iii) Reduction in operating costs, because of the elimination of the requirement for a separate Custodian and /or Payment Bank and, therefore, the elimination of custodial fees.

For further detailed information, please review the section headed "Cash Management Programme" on our Website.

Registrar & Transfer Agent (Reference Question 23)

This would normally be Custom House, although the Custodian, or a local law firm or trust company in the jurisdiction of the fund could act, if preferred.

Auditor (Reference Question 25)

The Auditor should preferably have offices in Ireland, although funds seeking US tax paying investors should ensure that the Auditor can provide the "K1s" and any other reports in the manner and format necessary to meet US tax reporting requirements.

The introduction of the CHARIOT reporting platform has made communication with auditors very much more efficient.

If there is no preference, Custom House can recommend a selection of Auditors, from whom quotations can be obtained.

The Cayman Islands require Licensed, Administered or Registered Cayman Funds to have a Cayman resident auditor sign off on the audit, which adds to the cost of the audit.

Officers and Directors of the Fund (Reference Question 26)

Custom House would normally recommend that at least three directors be appointed, two of which will be representing:

- a) The Promoter or Investment Management;
- b) The Administrator (Custom House).
- c) The appointment of a representative of Custom House and a third offshore director is suggested for administrative convenience.

The appointment of a director representing the management or promoters of the fund, has two advantages:

- Firstly, in today's environment of corporate governance, directors of companies and especially investment companies, including the most remote of offshore fund companies, have very definite and clear responsibilities. Failure to exercise these responsibilities can result in severe financial and indeed criminal penalties. Therefore, investors will derive comfort from seeing that a representative of the promoter and or the investment management team is on the Board and is "standing up to be counted".

- The second reason for requiring a third director is to ensure the company's tax neutrality. If Custom House is asked to provide a director, that director will be a resident of Ireland and, if he is the sole director or only one of two directors, the Irish Tax Authorities could claim that the company was being 'managed and controlled' in Ireland and therefore liable to taxation in Ireland. A similar situation could occur in the UK, if a UK resident director was appointed as a sole director, or as one of only two directors.

With this in mind, Custom House recommends that at least three directors be appointed, providing each are resident in a different jurisdiction. Furthermore, Directors resident in Ireland or the UK should be precluded, by Board Resolution or the Articles of the Company, from taking any unilateral management decisions whilst actually physically sited in Ireland or the UK and no meetings should be held in either country. A director who does execute any documentation, or carry out any duty for the company whilst physically in Ireland or the UK, should only do so if absolutely necessary and then only if specifically authorised and instructed to do so by the Board, with such instructions minuted.

If a Custom House representative is appointed we recommend that an "Alternate Director" from Custom House also be appointed for administrative convenience.

It should also be noted that if an Irish Stock Exchange Listing is required, it will be necessary to appoint two independent directors. In this context, "independent" is a director who is not involved in the management of the assets or the promotion of the shares of the fund. A Custom House director would qualify as independent. A corporate director cannot act as an "Independent" director for Irish Stock Exchange compliance purposes.

Company Secretary

Custom House can and usually will act as the Company Secretary, providing corporate secretarial services for the fund. In order to ensure that in carrying out its duties, Custom House is providing a service, rather than taking any unilateral management decisions, it will be made clear in the Board's minutes that its duties are specified by the Board and that it is acting under the Board's instructions.

Clearing Systems (Reference Q. 27.1)

If it is anticipated that the fund will be sold to institutions, and particularly European institutions, we would recommend that the fund be registered with one of the clearing systems referred to under Q. 27.1 and thereby the fund's shares will acquire an ISIN or similar (i.e. CUSIP, SEDOL) number, which most institutions prefer for internal accounting purposes.

Price Discovery (Reference Question 27.2)

Many funds and, especially retail funds, publish their share prices in the Financial Times (FT), the International Herald Tribune (IHT) and/or other financial publications appropriate to the targeted investor, such as The Gulf Times or The South China Morning Post. However, there are many free data services, which publish prices. Many of these are specialist services, which target hedge funds and alternative investment funds.

In recent years, it has become apparent that, unless the publisher is a major investment house with a large number of funds, it is not proved to be good value to publish a fund's share price in the Financial Times or the Herald Tribune. The costs are high and, particularly in the Financial Times, details are published of so many funds that it is extremely difficult to find and identify one particular fund. Therefore, there is little publicity value and, for most investors, it is easier to get the information from another data source or CHARIOT (see below).

Bloomberg and ValuLink

We recommend that the share price of the fund be supplied to Bloomberg and ValuLink, who are endeavouring to create price sources for alternative investment and hedge funds. This is particularly valuable for institutional investors and funds of funds who may otherwise find it difficult to obtain price information on their fund investments, electronically.

CHARIOT (Reference Question 27.3)

In April 2003 Custom House introduced CHARIOT (“Custom House Accessible Reporting In Open Technology”), which is the Custom House secure web-reporting platform.

CHARIOT has been designed to enable both Investors and Managers to gain access to selected reports, on a fully confidential, password protected web-platform. The Manager will have access to some 60, or so, reports and will be able to drill down from the basic reports (P&L, Balance Sheet, Portfolio Report, Shareholder Register, et al) to get the information behind them.

The information provided to investors will be subject to approval by the Manager and would normally consist of performance data for the fund and a copy of the client’s own statement and historical data (confirmations, etc.), as well as a report from the Investment Manager, if provided by the Manager.

CHARIOT has also proved a valuable tool for assisting funds’ auditors when carrying out the annual audit of the fund.

CHARIOT is now provided to all Funds as part of the Registrar and Transfer Agency or Shareholder Services package.

Risk Monitoring/Analysis (Reference Question 28)

In today’s market environment, there is a much-increased demand from investors in hedge funds, as well as credit providers, or lenders to hedge funds, for independent risk monitoring, or analysis and, as a result, increased transparency.

Custom House does not offer an in-house risk monitoring service, but it is capable of feeding the necessary data, or arranging for the necessary data to be fed, to independent consultant risk monitors, or analysis and, when the consultant has analysed the fund’s portfolio and determined the fund’s risk profile, Custom House can distribute that report to the fund manager and/or selected investors, credit providers or lenders, as and when required.

If a fund manager has an existing relationship with an independent consultant, Custom House will build an interface between their PAXUS system and the consultant’s system, to enable efficient transfer of the data required. If the fund manager does not have any such relationship, Custom House can make introductions to one or more consultants such as “RiskMetrics” so that the Manager can hold its own ‘beauty parade’.

Marketing - Tax and Legal Advice (Reference Questions 29/30)

The requirement to retain legal and tax advisors when establishing the fund will depend on both where the fund is being established and where the fund is being marketed. To a lesser extent, but no less important, legal advice may be necessary, depending upon where the investment management is being carried out, particularly if that is being carried out in the UK.

It is obviously prudent that the Memorandum & Articles of Association and Offering Documents of the fund be reviewed by a lawyer practising in the jurisdiction in which the fund is domiciled and that is arranged by Custom House, when establishing a fund company for its clients, as a matter of standard practice, as part of its turnkey package.

The appointment of additional lawyers and tax advisors should be considered on a case-by-case basis. For example, if it is intended that the fund will be sold to US investors, it should be noted that, subject to certain restrictions, most US tax-exempt investors, which include charities and foundations, as well as pension plans, would usually prefer to invest in the offshore fund to avoid the risk of generating Unrelated Business Taxable Income (“UBTI”). In any event, it is important that a US attorney be appointed to review and, where necessary, issue a supplement to the Offering Memorandum for the offshore fund for US tax-exempt investors. The US attorney will review a number of items including, inter alia:

- a) The description of restrictions that exist and the exemptions that can be applied to US investors;

- b) Tax opinion both as to the potential liability, if any, for US tax on the fund and also US tax considerations for US persons;
- c) The preparation of a special subscription form for US persons; and
- d) The registration, if required, of the fund under the Blue Sky laws in the individual States of the US in which prospective US investors will reside.

If, on the other hand, it is intended to accept US taxpaying investors, then it would be better to establish either a US or an offshore partnership for US tax paying investors, because they will, for the most part, require a partnership investment which enables them to look through the fund for tax purposes. In these circumstances, it will probably be wise to establish a Master Feeder structure (see Q. 7.3 above).

It goes without saying that a US attorney should be retained to either review or, indeed, prepare the Private Placement Memorandum for the US tax payer partnership.

Another example of a situation where it would be prudent to appoint a US attorney would be if the fund is likely to invest in “New Issues” (formerly “Hot Issues), because it will be necessary identify whether the shareholders are “restricted” or “unrestricted”. In this situation it is prudent to appoint a US Attorney to oversee the vetting process, in order not to fall foul of US regulations.

Legal advice should also be sought in the case of UK resident investment advisors or investment managers, in order to ensure that their activities do not jeopardise the fund’s tax status with regard to potential UK tax liability.

Custom House has developed relationships with attorneys in the Bahamas, Bermuda the BVI, the Cayman Islands, Ireland, the UK and the US and both Jersey and Malta, as well as Mauritius, Cyprus and Labuan, should subsidiary trading companies be needed to take advantage of applicable double taxation treaty benefits.

Similarly, promoters of the fund and placing agents and/or sales agents should also take professional advice with regard to their activities in marketing the shares of the fund in whatever jurisdiction they may be operating. As the regulatory requirements and restrictions vary from country to country, it is obviously more practical for the promoter or sales agents (rather than the fund) to be responsible for ensuring their compliance with such regulations, on a case by case basis.

Public Relations and Advertising (Reference Question 31)

If required, Custom House will prepare a Press Release, announcing the launch of the Fund and distribute this to the international investment press, data services and relevant associations as appropriate. No press release will be issued without prior approval of the client.

Translations (Reference Question 32)

Custom House strongly recommends that if any document has to be translated, it is first translated by one interpreter from English into the subject language and then re-translated back into English, by a different interpreter, to be sure that nothing is “lost” or “misrepresented” in the original translation.

Fees/Sales Commissions/Initial Charges (Reference Question 33)

Custom House recommends that, if sales commissions are to be charged, they should be in the form of a Front End Load rather than an Initial Charge (which is deducted from the assets of the fund - a system common with UK unit trusts). This means that the sales commission never becomes part of the fund’s assets and that the shares issued to subscribers will be issued at the offer price (excluding any Front End Load). The shareholder will of course pay the full offer price, plus Front End Load, into the fund’s subscription account, from which the commissions will be paid to sales persons, or whoever is designated to receive those commissions, prior to the actual subscription being paid into the fund’s operating account and becoming an asset of the fund.

Initial Charges, as stated above, are deducted from the subscription. This can cause complications in the event that the directors wish to give discretion on the amount of commission to be paid by a particular investor.

Early Redemption Fees (Reference Question 34)

If there is no Sales Commission levied on subscriptions, and the Manager or Promoter has to subsidise sales commissions to introducing brokers, an Early Redemption Fee is sometimes charged. In such cases Early Redemption Fees are often levied on a time reducing basis. For example, it could be 5%, if an investor's holding is sold in the first year, reducing by 1% each year that the investor holds the position. Thus there would be no redemption fee charged after 5 years. It has to be said that, in the age of the no-load fund, this is no longer a common practice, except for some retail products.

On the other hand, the Manager or the Board of the fund may levy an Early Redemption Fee specifically to discourage early redemptions (within perhaps six or twelve months), because early redemptions can disrupt both the portfolio and the investment strategy of the fund. Such an Early Redemption Fee can also discourage investors from "trading" the fund - i.e. selling on a rise in the hope of repurchasing on a dip. In these circumstances, Early Redemption Fee charges, which can range from 1% to 3% or 5% of the shareholder's redemption proceeds, are usually payable to the fund, for the benefit of the remaining shareholders, whose portfolio has been disrupted.

Discretion to waive and "side letters"

Sometimes the Directors, or the Manager, of a fund, may have discretion to waive Early Redemption Fees and do so in accordance with a pre-agreed "Side Letter" with particular investors. As a matter of policy, we would urge caution in using such discretion and, indeed, entering into such Side Letters, when the result is that some shareholders of the same class of share end up being treated differently to other shareholders, which breaks one of the basic tenets of company law. If such discretion is taken, it can lead to situations where other shareholders feel 'hard done by' and in turn lead to legal action.

An Early Redemption Fee may also be charged if the redemption notice is given late.

Supplementary Information Required (Reference Question 37)

Much of the information required here with regard to CVs of the various parties involved will be adequate under the due diligence requirement (see Question 38 below), however, we do need full information on the history and track record of the Investment Manager and other service providers, as well as a full description of the investment objectives, strategy, philosophy, restrictions, trading policies, etc., for inclusion in the Offering Memorandum and is more efficient to provide it with the Questionnaire. This information will also make it easier for us to estimate the administration costs and fees, because we will have a better understanding of the complexity, volume of trading and activity of the fund.

Due Diligence and References (Reference Question 38 and Appendix 1 of Questionnaire)

In recent years the regulatory requirements with regard to corporate governance and the completion of due diligence procedures by service providers in the financial services industry have grown substantially. Therefore, it is incumbent upon service providers such as the administrators, custodians, brokers, auditors and others, to 'know their clients' and, in order to properly carry out this due diligence, they must obtain and take up references and obtain detailed background information on the persons and companies involved in the promotion and management of the proposed fund. The information required to complete the due diligence file is detailed in Appendix 1 of our Questionnaire and will include, inter alia; full information on any individual person involved, as well as for corporate entities, financial statements and confirmation that they are properly regulated and in good standing in their own jurisdiction, as well as statutory documentation, such as the Memorandum & Articles of Association.

Please note that we will not be able to form the company, nor appoint the legal advisor in the country of jurisdiction, the auditor, or any of the other service providers, including banks, prime brokers, etc., unless we have all of this information available. It should also be noted that some of the service providers will not accept copies of notarised or certified copies of documentation that we may have on file and, therefore, it may be necessary to get more than one set.

If you would like a copy of our questionnaire or further information on the Custom House Offshore Fund Service, please contact:

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