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August 2012

Private Equity in Bermuda – So Much More

Inspired by Bermuda's unofficial national anthem, Bermuda Is Another World, the Island's Department of Tourism recently launched its new marketing slogan: So Much More. Bermuda's offshore competitors in international finance might have once cynically suggested that this refers to the amount of time and cost required to establish an offshore vehicle in Bermuda, but actual experiences of sponsors and operators in recent years, particularly those in the private equity industry, have laid this notion firmly to rest.

A report published in May this year by Ernst & Young [1] revealed that senior executives of private equity firms are optimistic about the number of deal opportunities which will be available over the next year. For an industry which endured a difficult time in the early years of the global economic downturn, this expression of confidence combined with the level of private equity deal activity seen so far in 2012 is a clear indication that the industry is on the path to recovery. The most successful private equity firms in recent years have been those which have been willing to explore opportunities, make use of innovative ways to finance and structure their deals and identify new paths to growth. Innovation is naturally drawn to a commercially flexible and responsive environment and private equity promoters have found that offshore jurisdictions offer the best fit for this approach, with Bermuda now well-established as a top-shelf offshore domicile of choice.

Long associated with the insurance, asset finance and mutual fund industries, observers with an eye on offshore developments will have noticed that Bermuda is increasingly chosen as domicile for the full range of offshore entities, amongst which is a burgeoning portfolio of private equity vehicles. By introducing two central

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1 [1] http://www.ey.com/GL/en/Newsroom/News-releases/News_Private-equity-executives-remain-confident

features of the jurisdiction - product and infrastructure - this article will provide an insight into why promoters who have in the past journeyed to other offshore jurisdictions to establish their investment vehicles are more likely now to take the shorter trip to Bermuda for their offshore requirements.

First, let's look at the product. Private equity vehicles established in Bermuda usually take the form of limited partnerships or exempted limited companies, although they may also be structured as unit trusts mostly favoured by the Asian investment market. A Bermuda company is a separate legal entity distinct from its members and may be incorporated within 24 hours with the capacity, rights, powers and privileges of a natural person. A private equity fund organised as a closed-ended mutual fund company may also be registered as a segregated account company in order to ring-fence the assets and liabilities attributed to a particular segregated account from the assets and liabilities attributed to other segregated accounts of the company. Having this option available in Bermuda allows promoters to achieve legal segregation of assets and liabilities without needing to incorporate a separate company for the purpose, thus avoiding the additional costs and administrative burden involved with establishing and operating multiple legal entities.

The limited partnership, which may also be established within a few business days, continues to be the most popular vehicle for private equity structures. This is primarily due to its fiscal transparency and also because it is generally subject to a lesser degree of regulation than a company. Closed-ended private equity funds (either companies or limited partnerships) are excluded from the Investment Funds Act 2006 of Bermuda (the "IFA") and are therefore not regulated by the Bermuda Monetary Authority. If open-ended mutual fund companies have less than 20 participants and do not advertise their offer to the public, they are also deemed private and are excluded from the IFA. Bermuda's partnership legislation does not attempt to regulate the affairs of a limited partnership to a great extent with the effect that the operation of the partnership is primarily left to agreement between the partners. The legislation has also been amended over the last few years to ensure that it remains “industry friendly” as a structure suitable for private equity funds.

One option that private equity promoters have found particularly attractive with a Bermuda limited partnership is that, as with a limited partnership established in Delaware, a Bermuda partnership may elect to have separate legal personality. This election puts to rest any uncertainty that the partnership continues to exist regardless of whether all the partners die or are declared bankrupt, or there is a change in the constitution of the partnership. The option of electing to have separate legal personality is also advantageous where a partnership has entered into loan

facility arrangements and has granted security; any change of limited partners will not affect the arrangements and avoids the requirement of having to novate contracts upon a change of partners. This has been well-received by promoters of limited partnership vehicles that are party to ISDA contracts and have loan facilities secured by the right to call limited partnership capital. In competing jurisdictions with limited partnerships without separate legal personality, issues arise when applying the insolvency set-off principles due to the requirement for mutuality in relation to debits and credits to be set-off. The mutuality requirement will be affected by changes in respect of partners of the partnership established in these jurisdictions as a result of admissions or withdrawals or by operation of law as a consequence of the dissolution, bankruptcy or death of a partner.

In addition, the election to have separate legal personality ensures that the members of the partnership avoid potential exposure arising in certain common law jurisdictions as a result of the application of conflict of laws principles. Where the partnership has not elected to have separate legal personality under the laws of its jurisdiction of establishment, the law of the jurisdiction in which the partnership carries out its business is more likely to treat the partnership as merely a contractual relationship between the partners rather than an entity in its own right. This can have unintended and undesirable consequences for the liability of its limited partners. By establishing a Bermuda limited partnership and electing to have separate legal personality, the limited partners can ensure that their limited liability will not be compromised in this way.

Competing jurisdictions would claim that Bermuda is slower and more costly than its competitors. Comparative analysis shows this to be incorrect. The time it takes to establish a private equity structure, as well as the set up and ongoing maintenance costs involved, are now directly comparable with, or less than, those of equivalent structures in other leading offshore jurisdictions, many of which have seen an increase in fees in recent years.

The second central feature is the Island's infrastructure. Bermuda enjoys a sophisticated telecommunications system, an abundance of professional service providers, as well as economic and political stability. There are in excess of 450 lawyers currently admitted to the Bermuda Bar, a number of who specialise in structuring private equity funds and are adept at working closely with their counterparts in the major financial centres in North America, Europe and the Far East. The 'Big Four' accounting firms have been established in Bermuda for over 40 years and there are an increasing number of fund administrators with the expertise and experience to service the valuation and ongoing administrative requirements of

private equity funds. In addition, the Bermuda Stock Exchange is now a leading, fully electronic, offshore securities exchange that specialises in the listing and trading of capital market instruments. Also, there are a number of international banks located on the Island, so credible alternatives exist on the Island in relation to raising debt and capital financing.

Private equity houses interested in maintaining a physical presence on the Island have found that, in recent years, work permit restrictions are more relaxed for their key management employees and that the costs of employing staff and occupying premises in Bermuda are falling to levels comparable with competing jurisdictions. In addition, for those that do decide to take up residence on the Island, Bermuda offers a good stock of desirable yet increasingly affordable houses and apartments suitable to rent or buy, all within an easy commute to its capital, Hamilton, as well as a selection of high quality schools.

Bermuda also enjoys tax neutrality – there is no income or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by a Bermuda company or its shareholders, other than shareholders ordinarily resident in Bermuda. In addition to the tax benefits, promoters recognise that the jurisdiction provides a robust regulatory, anti-money laundering and tax information exchange and double tax treaty network regime whilst enabling promoters to manage investment strategies and objectives without the restrictions and reporting requirements imposed by onshore regulators. Furthermore, Bermuda is not subject to the increasingly onerous onshore regulatory environment exemplified by the Alternative Investment Fund Managers Directive to be introduced in the UK and other European Community member states from 2013.

As well as Bermuda's regulatory and infrastructure advantages, the Island enjoys a proximity to the major international centres of commerce which is geographically unique. Located in a time zone one hour ahead of New York and Toronto and four hours behind London, Bermuda provides easy access to major airports in Europe and North America, being less than two hours flight time from many US gateway cities and around seven hours from London.

Bermuda's enduring relationship with international business, its progressive regulatory environment and the government's appetite to maintain the jurisdiction as an efficient place to do business have combined to make the jurisdiction an offshore domicile of choice for private equity business. For offshore private equity promoters, just as for those who come to the Island for a vacation, Bermuda does indeed offer so much more.

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This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

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