Offshore funds and hedge funds

What are offshore funds and hedge funds?
Offshore funds and hedge funds are collective investment schemes that are subject to no or only partial regulation and supervision. Hedge funds are free to choose the asset classes, markets – including high-risk countries – and trading methods they employ. They often have aggressive strategies and work with investment techniques that decouple investment performance from the performance of the underlying markets.

What risks are associated with offshore funds and hedge funds?
Managers of offshore funds and hedge funds often enjoy maximum flexibility in their investment decisions and are normally not bound by the rules on liquidity, redemption, avoiding conflicts of interest, fair pricing, disclosure and use of leverage that apply to conventional funds. They also have limited liquidity.

Offshore funds
In general, a distinction is made between collective investment schemes domiciled in countries with strict legislation – such as Switzerland or the EU – and those domiciled in countries with comparatively relaxed legislation – such as the Cayman Islands or British Virgin Islands. The former are referred to as onshore funds, and the latter as offshore funds.

Hedge fund
Many offshore funds are hedge funds. Despite what their name suggests, hedge funds do not necessarily have anything to do with hedging. Indeed, they sometimes take on very high levels of risk in order to obtain an above-average return. Hedge funds include forms of investment funds, investment companies and partnerships that use derivatives not just for hedging but also for investment, and that are able to engage in short selling or take on significant leverage by borrowing.
As with other types of collective investment schemes, a hedge fund's performance often depends on the expertise of a single person – the manager – or a small group of key individuals. Incorrect decisions or the loss of such people can have a direct impact on the hedge fund's performance. The dependence on a single fund manager can be reduced by, for example, investing in a fund of funds or multi-manager fund. Funds of funds invest their capital in a number of target funds. Multi-manager funds, meanwhile, are spread across a number of fund managers covering a range of investment styles, markets and financial instruments.

Funds of funds and multi-manager funds
Investment funds that invest in other funds (target funds) rather than individual securities are known as funds of funds. The target funds can invest in a wide range of securities.
Multi-manager funds spread their investments among a number of fund managers covering different investment styles, markets and financial instruments. Investors can achieve a higher level of risk diversification by investing in funds of funds and multi-manager funds, but the costs are generally higher due to the costs generated by the various underlying funds.
Investors should also bear in mind that certain categories of funds of funds and multi-manager funds domiciled in countries with strict legislation on collective investment schemes may follow strategies that are to some extent similar to those of offshore and hedge funds.

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This information sheet contains an extract from the brochure “Risks Involved in Trading Financial Instruments” published by the Swiss Bankers Association (SBA), the complete version of which can be consulted at www.swissbanking.org or on the Bank’s website (www.corner.ch).

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Before making any investment decision, we invite you to consult a financial advisor and to examine carefully all documents and information available for each financial instrument (prospectus, basic information sheet, term sheet, etc.).

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