

# According to Regulations

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Andrew Weaver, May 2009

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Some may think that, in the current global economic climate, investment funds practitioners in the Island would be too busy dealing with issues arising from falling net asset values, credit and liquidity restrictions, compliance with banking covenants, portfolio company and tenant insolvencies, investor redemption requests, counterparty insolvency risk and the like to consider the further development of Jersey's fund regulation regime.

Nothing could be further from the truth. In spite of the enormous amount of legislative and regulatory development that has occurred in the funds industry in Jersey in the last 18 months, both the regulator and the industry are working together to further enhance and develop the Island's offering to the global funds industry.

To summarise some of the more important developments over the last 18 months or so: in November 2007 the regulation of fund functionaries in the Island (other than in respect of recognised funds) was transferred from the framework of the Collective Investment Funds (Jersey) Law 1988 ("CIF Law") to that of the

Financial Services (Jersey) Law 1998 ("FS Law"). Consequential developments included the introduction of codes of practice for fund functionaries (FSB Codes), legislation governing the preparation of accounts and appointment of auditors to fund functionaries, legislation covering financial services advertising, the introduction of an unregulated fund classification and, so far as our regulator the Jersey Financial Services Commission is concerned, the conduct of inspection visits by the IMF and the UK FSA. In addition, the Commission undertook a series of themed inspections of persons registered under FS Law to provide fund services business as a manager of a managed entity ("MOME") and have prepared and issued in April 2009 guidance notes for such class of business. All of these developments took a substantial amount of time and effort from both the JFSC, representatives of the States, and industry participants. None of these parties are resting on their laurels however.

Ongoing projects to further enhance and develop Jersey's fund services industry include the following items:

- Proposals for the introduction of codes of practice for funds holding certificates issued pursuant to the CIF Law – the Jersey Financial Services Commission is intending to publish the consultation paper shortly.
- Industry discussions through the Jersey Funds Association with the Jersey Financial Services Commission are continuing in relation to the Commission’s policy on outsourcing.
- Collective Investment Fund Prospectuses: currently two pieces of legislation govern prospectuses which may be issued by collective investment funds in Jersey (other than recognised funds), the Collective Investment Funds (Unclassified Funds) (Prospectuses) (Jersey) Order 1995 and the Companies (General Provisions) (Jersey) Order 2002. Proposals are being considered to revoke the former order, disapply the latter to collective investment funds and replace both insofar as they apply to collective investment funds, with a single order governing all prospectuses that may be issued by Jersey funds holding certificates under the CIF Law.
- In addition, continuing development is anticipated of the Control of Borrowing (“COBO”) regime.

## **MANAGERS OF MANAGED ENTITIES**

The 2007 migration of regulation of fund functionaries from the CIF Law to the FS Law introduced a new class of registered person, the manager of a managed entity. The FSB Codes issued at the same time include provisions concerning the role of MOME. In March 2009 the Commission published a summary findings report arising from themed visits on persons providing MOME services and in April 2009 the Commission issued guidance notes for MOME’s taking into account input from industry and the results of the on-site inspections. Appleby’s experience has indicated that there has been a degree of confusion amongst practitioners in the Island regarding the role and obligations imposed and the application of the codes of practice on managed entities acting for expert funds or

materially equivalent funds. Some of the experiences of Appleby’s clients have been reflected in the Commission’s findings report and further have had an effect on the terms of the guidance note issued by the Commission.

Those functionaries in the Island providing MOME services would do well to have close regard to the findings report and the guidance recently issued. It should be noted that when considering an application for registration from a functionary which will not be able to meet all of the Commission’s requirements as to real presence in the Island, the Commission is likely to treat such a functionary as a managed entity and will require such managed entity to appoint a MOME. Most commonly this arises where a company is established to act as the general partner or manager of an expert fund, related expert funds or materially equivalent funds. Such managed entity will, by virtue of its registration, be required to comply to some degree with the FSB codes and typically a MOME will provide support in relation to that compliance. For Jersey-based functionaries, there are a number of key features which arise out of the MOME/managed entity relationship. Under the FSB Codes the MOME is obliged to pay due regard to the risks that might arise from performing its role as MOME as part of the MOME’s own corporate governance. The MOME (as with all functionaries) must have in place clearly defined procedures to provide for oversight in order to address the principles of risk-management, to make an assessment of the risks present in its business and document the ways in which those risks are monitored and controlled. It should be noted that oversight of the monitoring and control of risk within its business will also be the responsibility of the managed entity and in its findings report the Commission has suggested that key risk indicators be agreed between the MOME and the managed entity and that these be monitored by way of periodic compliance reports to the managed entity board. The Commission considers it to be the responsibility of the board of the managed entity to monitor its business risks notwithstanding that the day-to-day monitoring of such risks may often be delegated to the MOME.

It is not uncommon for the MOME to supply a compliance officer to the managed entity. The Commission has identified a potential for conflict of interest where the compliance officer for the managed entity is also the compliance officer for the MOME, especially where the compliance officer for the managed entity is to prepare reports on work that has been performed by the MOME. The Commission has expressed that it would be appropriate for details of any such conflicts of interest to be tabled for discussion by the board of the managed entity and, where appropriate, the managed entity should implement policies and procedures that reflect how the conflicts will be mitigated. At a minimum the Commission anticipates that a managed entity will maintain a documented policy setting out areas of likely conflict and what steps may be taken in the event of such conflicts arising.

It will be a condition of a managed entity's registration under the FS Law that the managed entity shall appoint a compliance officer. The Commission anticipates that such compliance officer will have direct access to board meetings of the managed entity and should be in a position to submit compliance reports directly to the full board either in person or in writing. The use of such access should be documented in the board minutes, and it is recommended that compliance reporting should be included as an item on the standing agenda for regular board meetings of the managed entity.

It will be clear from the foregoing that managed entities can no longer have regard solely to the operational aspect of their business (i.e. their activities in relation to the underlying fund) but must also have regard, in a regulated environment, to the features of their own business as it may relate to the environment in Jersey and on a larger stage. Simple reliance upon the services of a service provider in Jersey will no longer be sufficient, the board with the support of its compliance officer must pay close attention to procedures and policies including the services provided by Jersey-based functionaries.

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