



## The Isle of Man adopts new regulations – but will they work?

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The first of May 2010 saw the introduction of amendments to Isle of Man law intended to facilitate the use of a 'more regulated' fund structure by the alternative funds sector along the lines of a Guernsey B scheme. The Regulated Fund offers a structure with no prescriptive investor qualification requirements and no prohibitive minimum investment levels, with the aim of gaining recognition of equivalence in key quarters – such as the Irish Stock Exchange, which has now been confirmed. There has to be a *quid pro quo*. Mandatory requirements include: an authorised custodian (not necessarily based in the Isle of Man); an Isle of Man auditor, pre-approval of documents by the regulator; and vetting of directors.

While the opportunity to use more flexible, but still registered, structures (such as the Specialist Fund) will remain, the island is clearly going long on a world where investors expect more regulation, and accepts the cost and restrictions that go with it. Implicit in that philosophy is a belief that the regulatory tide is rising for domicile jurisdictions; that the operators whom you want to attract will inevitably be faced with equivalent requirements if they want the *imprimatur* of a credible domicile, allowing you to differentiate on service level or incremental product enhancements. On the face of it, the growth in the popularity of Ucits funds in EU locations (such as Luxembourg) among alternative managers suggests that this may be the case. But, without the carrot of market access, can the regulatory stick be wielded with the same vigour offshore?

The island has a track record of moving quickly on regulation, such as its early and rigorous adoption of 'know your customer' principles that are now universal, and the introduction of the Specialist Fund vehicle in the alternative arena.

The clamour for more regulation has been great and is a concept beloved of politicians. It is more sophisticated than mere law making; and, crucially, is less likely to alarm

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stakeholders who are employers and revenue generators. But in the world of mobile financial services, getting the level of regulation right is a difficult art.

This raises questions. What needs regulating in the alternative funds space? What form should that regulation take? The EU has in its sights the perceived systemic risk posed by the alternative sector by its use of leverage. By most accounts, it seems to be tilting at the wrong windmill; although there are undoubtedly a number of other (avowed and unavowed) collateral objectives to the Alternative Investment Fund Managers (AIFM) Directive. Experience suggests that the regulation of alternative funds should be focused on more prosaic areas. Ensuring they cannot be used to facilitate financial crime. Ensuring they cannot be sold to investors for whom they are unsuitable. Preventing fraud or loss of assets. Promoting transparency for investors and regulators. Promoting governance and accountability from investment managers.

The fight against financial crime is a given and the island stands alongside other reputable financial centres in this regard. Investor suitability can only ever be partially solved at the offshore end. Investor qualification requirements can be imposed in the jurisdiction of domicile; for an Isle of Man Regulated Fund there is also an obligation on the local licence holder to oversee promotional arrangements, but such requirements will never be bullet-proof. Given the prevalence of commission-driven sales arrangements in some metropolitan jurisdictions, the potential for mis-selling remains, but it would be a brave domicile that broke ranks to regulate such arrangements.

So far as governance issues are concerned, historically sunlight has been perceived as the best disinfectant. The requirement was for disclosure of risk. No custodian? No independent person on the board? No qualified audit? Conflicts of interest? Well, provided these details were disclosed, investors were to take responsibility for their own investment decisions. In common with many jurisdictions, the approach in the Isle of Man is now less *laissez-faire*. The addition of further obligations on licence holders, clearer board duties, a local audit requirement and bringing in independent directors, together with whistle-blowing obligations, adds up to a more structured, yet non-prescriptive, approach.

Has the Isle of Man got it right with its Regulated Fund? There is certainly enough in the detail of the regulation to deter the lax operator. Arguably there is also enough to deter the *bona fide*, but entrepreneurial, promoter. The benefits for investor perception should encourage those looking for a stamp of quality to use this vehicle. The key will be in ensuring that the interaction with the regulator at approval and vetting stage is efficient and collaborative in tone – time will tell.

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