



## Jersey begins sweeping review and revamp of funds regulation

### Introduction

In the first step of a radical overhaul and rationalisation programme for Jersey fund regulation, on 1 August 2016 the Jersey Financial Services Commission (**JFSC**) and the States of Jersey (**Government**) issued a joint consultation on proposals for substantial amendment to Jersey's private funds regulation. The changes, if implemented, are the first step in an overhaul of the universe of regulation of investment funds in Jersey. Later in the year a consultation is expected on changes to the public fund regulatory environment and the introduction of a manager led product (the **JRAIF**) which will not be required to adhere to the Code of Practice for Jersey Certified funds (being supervised through its Alternative Investment Fund Manager (**AIFM**) and complying with the applicable sections of the Alternative Investment Fund Managers Directive). Next year, the JFSC and Government plan to review the effectiveness of investment fund related exemptions to the Financial Services (Jersey) Law 1998, as amended (**FSJL**) along with certain other supervisory aspects of related legislation.

### Private fund simplification

The first consultation proposes the rationalisation and consolidation of Jersey's private and unregulated fund sector with the:

- (1) Introduction of a Very Private Placement Fund (**VPPF**) guide;
- (2) Introduction of a new and universal professional investor definition;
- (3) Introduction of modern regulatory powers in the Control of Borrowing (Jersey) Law 1947 (**COBO Law**);
- (4) Phasing out COBO only funds; and
- (5) Phasing out unregulated exchange traded funds.

Each of these is discussed further below.

#### 1. Very Private Placement Fund Guide:

- (i) To date the JFSC has applied a policy that vehicles with 15 or fewer investors are characterised as Very Private Funds or Very Private Structures and has refrained from any product regulation of such vehicles save for a condition restricting offers and ownership to 15 investors. The managers of many of these vehicles have also benefitted from available exemptions from regulation under the Financial Services (Jersey) Law 1998. Little additional regulatory guidance has been publicly available. The VPPF Guide is intended to provide greater certainty with respect to the eligibility conditions and regulatory approach to the authorisation process for a Very Private Fund (to be rebranded a VPPF).
- (ii) The VPPF will benefit from a fast track 48 hour approval process.
- (iii) Clarity will be given in the distinction between a Very Private Fund and a Very Private Structure (which is not a fund). The JFSC will deal with all applications for consent for fund vehicles and the Jersey Companies Registry will deal with all applications for consent for non-fund vehicles.
- (iv) The VPPF Guide provides a very high degree of flexibility to the structures that are in scope. This includes not only vehicles incorporated or established in Jersey but also vehicles incorporated or established in a country or territory outside Jersey.

- (v) There is no requirement for a Jersey general partner, managing partner or trustee nor is there any regulatory requirement for the VPPF's governing body to appoint one or more Jersey resident directors.
- (vi) The VPPF will (as today) not be subject to regulatory conditions or compliance obligations (save in respect of the JFSC's sound business practice policy, as now).
- (vii) Only investors who have acknowledged in writing receipt and acceptance of a prescribed investment warning may invest in the VPPF.
- (viii) Only professional investors or eligible investors may invest in the VPPF. Direct investment by retail investors will be prohibited.
- (ix) Where a discretionary investment manager (that is a professional investor) invests in a VPPF on behalf of retail investors, it will not be necessary to look through the professional investor to the underlying investors for the purpose of the 15 or fewer test.
- (x) The following shall not be counted towards the 15 or fewer limit:
  - (a) Persons acquiring interests carrying solely management or control rights;
  - (b) Carried interest vehicles established for the sole purpose of sharing in the profits of the VPPF (each participant in the carried interest vehicle must be a "professional" or an "eligible" investor); and
  - (c) A general partner of the VPPF.
- (xi) The VPPF must appoint a Jersey resident designated service provider that is registered under Jersey's financial services regulatory laws.
- (xii) Regulatory consent fees will be payable that are consistent with the current Jersey Private Placement Fund Guide (note that the VPPF will not replace the Jersey Private Placement Fund).

## **2. Universal Professional Investor Definition:**

- (i) Currently there are a number of non-retail investor definitions, applied in a variety of regulatory circumstances in Jersey.
- (ii) Subject always to any application in Jersey of the "professional client" definition within the meaning of Annex II to MiFiD II for the purpose of implementation of MiFiD I, MiFiD II and AIFMD in Jersey, it is proposed that a single common Professional Investor Definition be adopted for domestic Jersey law and regulation. Initially this will be in respect of the private fund sector and, subject to further consultation, extended to the public fund environment.
- (iii) The proposed definition of "Professional Investor" is based principally on that used currently for an "expert investor" in the Jersey Expert Fund Guide and is set out in the appendix to this note.
- (iv) Helpful clarification is given in respect of administrative or founder interests, carry interests and involuntary acquisitions (e.g. arising on transmission as a result of the death of an investor), as well as the treatment of family office and employee incentive arrangements.

## **3. Introduction of modern regulatory powers in the Control of Borrowing (Jersey) Law 1947 (COBO Law):**

- (i) There is uncertainty under the existing law as to the extent of the regulatory powers available to the JFSC under the COBO Law.
- (ii) To put the point beyond doubt it is proposed that the COBO Law be amended to include modern regulatory supervision, enforcement and co-operation powers in line with the powers that are available to the JFSC under the laws relating to public funds.
- (iii) This will require changes to the principal law, the detail of which will be subject to a subsequent consultation.
- (iv) The launch of the VPPF Guide (discussed above) is not dependent upon these amendments to the COBO Law being in force.

## **4. Phasing out COBO only funds:**

- (i) Analysis from recent years shows a considerable decline in demand for the traditional COBO only fund in Jersey, following the introduction of more attractive alternatives including the Jersey Private Placement Fund.

- (ii) As a result the JFSC proposes phasing out the COBO only fund with effect from 1 January 2017. Any existing COBO only fund will continue in operation until the end of its natural life or may apply to the JFSC to convert into a VPPF, a Jersey Private Placement Fund or a public fund.

## 5. Phasing out Unregulated Exchange Traded Funds:

- (i) As at 30 June 2016, there are 24 unregulated exchange traded funds and the statistics show a decline in their popularity over recent years. This, together with enforcement matters raised by the JFSC in relation to certain Unregulated Exchange Traded Funds has resulted in the proposal that new notifications for Unregulated Exchange Traded Funds will no longer be accepted from 1 January 2017. Any existing unregulated exchange traded fund may continue in operation until the end of its natural life or convert to another fund classification.

The consultation is open for comments until 12 September 2016.

### Conclusion

Appleby welcomes these proposals and those yet to be consulted upon. The rationalisation and simplification of the fund regulatory options in Jersey, in the most simple terms, will boil down to very private placement funds for 15 or fewer professional investors, private placement funds for professional investors and a reduced number of public fund variants, including (a) a manager led product where regulatory observance will be the responsibility of the manager, the Jersey Registered Alternative Investment Fund (**JRAIF**) and (b) an improved Expert Fund. All of this will sit alongside Jersey's AIFMD compliant regime (recently endorsed by ESMA) for funds which are to be marketed in the EU/EEA. Each of these sectors will be the subject of modern, concise and clear regulatory guidance.



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## Appendix

### Definition of a “Professional Investor”

1. A “professional investor” is:
  - (a) a natural or legal person, partnership, trust, or other unincorporated association whose ordinary business or professional activity includes, or it is reasonable to expect that it includes, acquiring, underwriting, managing, holding or disposing of investments <sup>15</sup> whether as principal or agent, or the giving of advice on investments;
  - (b) an individual who has a net worth, or joint net worth with that person’s spouse or civil partner, greater than one million United States dollars (or the equivalent of that amount in another currency) excluding that person’s:
    - (i) principal place of residence; and
    - (ii) any rights under a contract of insurance;
  - (c) a body corporate, partnership, trust, or other unincorporated association which has assets available for investment of not less than one million United States dollars (or the equivalent of that amount in another currency);
  - (d) a person who is authorised to carry on fund services business, trust company business or investment business within the meaning of the Financial Services (Jersey) Law 1998, as amended, or a person who is authorised in another jurisdiction to carry on materially equivalent services by way of business, to or in connection with a Fund (a “**Relevant Service Provider**”) and any Associate thereof or a co-investment entity in which a Relevant Service Provider or Associate thereof is participating in relation to a Fund;
  - (e) a person who is a senior employee, director, partner, expert consultant or shareholder of or to a Relevant Service Provider or an Associate thereof, who acquires an interest in a Fund as part of his remuneration or as an incentive, benefit or reward for acting in such a role;
  - (f) a person who is a senior employee, director, partner or expert consultant of or to a person referred to in sub-paragraph 1.a. above;
  - (g) a carried interest scheme or arrangement established in relation to a Fund;
  - (h) a family trust settled by or for the benefit of one or more persons referred to in sub-paragraphs 1.e. or 1.f. above or their spouses, civil partners or dependants;
  - (i) a trustee of an employment benefit or executive incentive arrangement/scheme established for the benefit of one or more persons referred to in sub-paragraphs 1.e. or 1.f. above or their spouses, civil partners or dependants;
  - (j) a government, local authority, public authority or supra-national body in Jersey or elsewhere;
  - (k) a body corporate, partnership, trust, or other unincorporated association of which, every member, partner or beneficiary is a ‘professional investor’ (within the meaning of this paragraph 1.);
  - (l) a ‘professional client’ within the meaning of Annex II to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments; or
  - (m) where an application is made to the Jersey Financial Services Commission (**JFSC**), such other natural or legal persons as the JFSC may deem appropriate on a case by case basis.

<sup>15</sup> “Investments” for the purpose of this definition includes, but is not limited to, investments as defined in the Financial Services (Jersey) Law 1998, real estate, foreign exchange transactions and cash.

2. For the purposes of this Appendix:

(a) "Associate" means:

- (i) in relation to a legal person, any legal person which is a subsidiary or a holding body of that legal person or a subsidiary of any such holding body and any individual, partnership or other unincorporated association or firm which has direct or indirect control of that legal person and any legal person which is directly or indirectly controlled by any such individual, partnership or other unincorporated association, or firm; and
- (ii) in relation to an individual, partnership or other unincorporated association, means any legal person directly or indirectly controlled by that individual, partnership or other unincorporated association.

(b) "Fund" means a Jersey Expert Fund, a Jersey Private Placement Fund or a Jersey Very Private Placement Fund (as appropriate).

(c) "Guide" means the Jersey Expert Fund Guide, the Jersey Private Placement Fund Guide or the Jersey Very Private Placement Fund Guide, as amended from time to time (as appropriate).

(d) "holding body" and "subsidiary" shall have the meanings set out in the Companies (Jersey) Law 1991, as amended.

3. The acquisition of:

- (a) non-participating units in a Fund that is structured as a corporate (such as non-redeemable founders' or management shares);
- (b) founder or nominal interests in a Fund that is structured as a limited partnership; or
- (c) any founder or nominal interests equivalent to those referred to in subparagraphs 3.a. and 3.b. above, in a Fund that is structured as a unit trust,

which are created or issued to facilitate:

- (i) the formation and structuring of the relevant Fund;
- (ii) to exercise voting and/or management rights in respect of the relevant Fund; or
- (iii) to give entitlement to performance related fees or dividends as part of remuneration arrangements for management or advisory entities to the relevant Fund or their personnel; or
- (d) any interest in a Fund where the transfer has been involuntarily, such as on the death or bankruptcy of a registered holder, in the absence of provision in the constitutive documents, to the personal representatives or trustee in bankruptcy,

shall be permissible notwithstanding that the person acquiring the same does not fall within paragraphs 1 or 5 or does not make the minimum investment in or commitment to the relevant Fund as prescribed in this Guide. However, in the case of sub-paragraph 3.d. above, it is expected that paragraph 1 of this Appendix will apply on a transfer to a new beneficial owner once the administration is complete or that the new beneficial owner will make the minimum investment in or commitment to the relevant Fund as prescribed in this Guide.

- 4. Professional investors, investors who make an acquisition in accordance with paragraph 3. of this Annexure A, and those investors that make the minimum initial investment in or commitment to a Fund as prescribed in this Guide are deemed to be able to evaluate the financial risks of a Fund and to bear the economic consequences of investment in a Fund, including the possibility of the loss of their entire investment.
- 5. Any discretionary investment manager acquiring an interest in a Fund, directly or indirectly, for or on behalf of one or persons who are not professional investors must be satisfied that such investment is suitable for the underlying investor, and that the underlying investors are able to bear the economic consequences of investment in the relevant Fund, including the possibility of the loss of their entire investment.