



Fund Finance

2018

Second Edition

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glg global legal group



CONTENTS

Preface	Michael C. Mascia, <i>Cadwalader, Wickersham & Taft LLP</i>	
Introduction	Jeff Johnston, <i>Fund Finance Association</i>	
General chapters	<i>Hybrid and asset-backed fund finance facilities</i> Leon Stephenson, <i>Reed Smith LLP</i>	1
	<i>Subscription line lending: Due diligence by the numbers</i> Bryan Petkanics, Anthony Pirraglia & John J. Oberdorf III, <i>Loeb & Loeb LLP</i>	11
	<i>Derivatives at fund level</i> Peter Hughes, Danny Peel & Charlie Bischoff, <i>Travers Smith LLP</i>	22
	<i>One size does not fit all: Subscription facilities as a global financing tool for investment funds of various types</i> Jan Sysel, Jons F. Lehmann & Sabreena Khalid, <i>Fried, Frank, Harris, Shriver & Jacobson LLP</i>	33
	<i>Common ground: Achieving a commercial result for borrowers and lenders</i> Mary Touchstone & Julia Kohen, <i>Simpson Thacher & Bartlett LLP</i>	43
	<i>Investor views of fund subscription lines: The ILPA guidelines and the market response – Patricia Lynch & Thomas Draper, Ropes & Gray LLP</i>	53
	<i>Enforcement: Analysis of lender remedies under U.S. law in subscription-secured credit facilities</i> Ellen Gibson McGinnis, Erin England & Richard D. Anigian, <i>Haynes and Boone, LLP</i>	60
	<i>The rise of private equity secondaries financings</i> Samantha Hutchinson & Mathan Navaratnam, <i>Dentons UKMEA LLP</i> Helen Griffiths, <i>Investec Bank plc</i>	81
	<i>1940 Act issues in fund finance transactions</i> Marc Ponchione, <i>Allen & Overy LLP</i>	90
	<i>Recent developments in fund financing: Hybrid facilities, insider leverage and overcall limitations</i> Meyer C. Dworkin & Samantha Hait, <i>Davis Polk & Wardwell LLP</i>	98
	<i>Fund finance: An ‘offshore’ perspective</i> Alex Last, Danielle Roman & Robert Duggan, <i>Mourant Ozannes</i>	103
	<i>Equity commitment facilities: A primer</i> Michael C. Mascia & Tim Hicks, <i>Cadwalader, Wickersham & Taft LLP</i>	113
	<i>Credit facilities secured by private equity interests and assets held by debt funds</i> Matthew K. Kerfoot, Jay R. Alicandri & Christopher P. Duerden, <i>Dechert LLP</i>	118

General chapters (continued)

<i>Comparing the European, U.S. and Asian fund finance markets</i> Emma Russell, Zoë Connor & Emily Fuller, <i>Haynes and Boone, LLP</i>	128
<i>Umbrella facilities: Pros and cons for a sponsor</i> Bronwen Jones, Richard Fletcher & Kyrstin Streeter, <i>Macfarlanes LLP</i>	137
<i>Side letters: Pitfalls and perils for a financing</i> Thomas Smith, Margaret O'Neill & John W. Rife III, <i>Debevoise & Plimpton LLP</i>	146
<i>Designing subscription facilities to account for limited partner preferences</i> Manu Gayatrinath, Benjamin Berman & Keely C. O'Malley, <i>Latham & Watkins LLP</i>	156
<i>Overview of the fundraising and fund finance market in Asia</i> Nicholas Davies, <i>Appleby</i> & Maggie Ng, <i>Linklaters</i>	165

Country chapters

Australia	Tom Highnam, Rita Pang & Victoria Johns, <i>Allens</i>	172
Bermuda	Tonesan Amisshah & Sally Penrose, <i>Appleby</i>	184
Brazil	Fernando J. Prado Ferreira & José Paulo P. Duarte, <i>Pinheiro Neto Advogados</i>	191
Canada	Michael Henriques, Michael Davies & Kenneth D. Kraft, <i>Dentons Canada LLP</i>	199
Cayman Islands	Simon Raftopoulos, Benjamin Woolf & Anna-Lise Wisdom, <i>Appleby</i>	206
England & Wales	Samantha Hutchinson & Adam Pierce, <i>Dentons UKMEA LLP</i>	213
France	Philippe Max, Guillaume Panuel & Meryll Aloro, <i>Dentons Europe, AARPI</i>	223
Germany	Patricia Volhard, Klaudius Heda & Lennart Lorenz, <i>Debevoise & Plimpton LLP</i>	231
Guernsey	Jeremy Berchem, <i>Appleby (Guernsey) LLP</i>	237
Hong Kong	Fiona Cumming, Patrick Wong & Natalie Ashford, <i>Allen & Overy</i>	244
India	Jayesh H & Aditi Bagri, <i>Juris Corp, Advocates & Solicitors</i>	252
Ireland	Kevin Lynch, Kevin Murphy & David O'Shea, <i>Arthur Cox</i>	256
Jersey	James Gaudin & Paul Worsnop, <i>Appleby</i>	264
Luxembourg	Vassiliyan Zanev, Marc Meyers & Antoine Fortier, <i>Loyens & Loeff Luxembourg S.à r.l.</i>	273
Mauritius	Malcolm Moller, <i>Appleby</i>	283
Netherlands	Gianluca Kreuze, Sabine A. Schoute & Michaël Maters, <i>Loyens & Loeff N.V.</i>	289
Scotland	Hamish Patrick, Rod MacLeod & Andrew Kinnes, <i>Shepherd and Wedderburn LLP</i>	296
Singapore	Jean Woo & Lifen Tang, <i>Ashurst ADTLaw</i>	302
Spain	Jabier Badiola Bergara & Luis Máiz López-Teijón, <i>Dentons Europe Abogados, S.L. Unipersonal</i>	310
USA	Jan Sysel, Ariel Zell & Flora Go <i>Fried, Frank, Harris, Shriver & Jacobson LLP</i>	317

Jersey

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Overview

An international financial centre (IFC) of choice for global investments into the UK and Europe, as of Q2 2017 (30 June) Jersey was home to approximately 1,141 funds with an aggregate of net assets under management of GBP 263.4 billion placed in 1,963 separate pools.¹ In comparison, figures as at Q3 2016 (30 September) showed a total of 1,125 funds with an aggregate of GBP 237.3 billion of assets under management, placed in 2,001 separate pools.

Apart from normal fluctuations typical in the funds market, these figures indicate that while the number of funds and pools has slightly diminished over these two quarters, assets under management have increased by GBP 25 billion. This trend is consistent with the wider market, and Jersey's fund-friendly regulatory approach, which helps to push investments and maintain solid investor confidence despite prolonged global economic and political uncertainty.²

There are many reasons for the continuing confidence in Jersey: as an IFC, the island has been economically and politically stable for decades and in 2017 Jersey was awarded "International Financial Centre 2017" at the Wealth Briefing European Awards 2017.³ This award acknowledges the leading role Jersey has carved out for being close to the pulse of upcoming regulatory changes, such as the OECD's "Base Erosion and Profit Shifting" framework (BEPS) or the EU's "Alternative Investment Fund Managers Directive" (AIFMD), and steps it has taken in recent months to overhaul the private fund regime on the island.

While Jersey still ranks behind the big onshore fund jurisdictions such as Ireland, Luxembourg and Delaware and some of the offshore ones like the Cayman Islands⁴ with regard to number of funds or assets under management, the island remains a very popular choice for real estate, hedge and private equity funds. Jersey has been commended for its proactive stance in adopting global compliance standards by the European Securities and Markets Authority (ESMA), the OECD, EU and the IMF as a well-regulated IFC. ESMA has confirmed on a number of occasions that there are no objections to Jersey being granted the AIFMD "passport",⁵ allowing Jersey funds to conduct business in all EU member states, but, primarily as a result of Brexit, final approval is still awaited. This gilt-edged reputation becomes increasingly important to fund managers, promoters and investors, who wish to ensure that their fund is domiciled in a business-friendly jurisdiction, which not only protects and grows their assets, but also protects their reputation.

In addition, BEPS and AIFMD increased the importance of substance for funds and fund managers, with much more need to demonstrate an economic reality where the relevant expertise and people who manage the fund and hold the assets are based locally. This gives Jersey, with its 13,000-strong financial sector workforce (over 2,000 directly specialising

in funds matters⁶) and well-developed local infrastructure, an edge over competitor jurisdictions who have adopted more of a brass-plate approach, and who may not be able to comply with substance requirements as readily as Jersey.

Notwithstanding Brexit's suppressing influence on activity generally, the weak pound has led to a significant increase in the number of market participants using Jersey as a base for rest-of-the-world transactions, particular those based in the US.

Fund formation and finance

Fund formation: More clarity for private funds in 2017

Jersey regularly revisits its existing regulatory toolbox in order to make sure that it can offer products which the financial services community needs to conduct international business effectively.

As a result, Jersey is continuing with its plans to introduce a manager-led fund product called the JRAIF (see para below, 'JRAIF') and the Jersey Financial Services Commission (**JFSC**) (the island's regulatory body) has simplified and completely overhauled the existing private fund and unregulated fund landscape.

The 'Jersey Private Fund Guide', published by the JFSC, sets out the eligibility criteria for a Jersey Private Fund (**JPF**). From April 2017, the JPF replaced all existing private and unregulated fund vehicles (including Very Private Funds, Private Placement Funds (**PPFs**) and COBO-only funds) none of which are now available for new funds. Existing funds may continue in their current form until the end of their natural life, or may apply to the JFSC to convert into a JPF.

The Jersey Private Fund Guide provides greater clarity on the authorisation process for a private fund in Jersey, specifically in relation to the eligibility conditions and regulatory approach needed, when a fund is offered to 50 or fewer investors. It introduces a fast-track 48-hour approval process for such funds and allows a JPF to be closed-ended or open-ended (subject to the 50 or fewer investor test).

Eligible investors include those who invest or commit no less than GBP 250,000 (or currency equivalent); holders of non-participating interests; holders of management/founder interests; and holders of interests giving an entitlement to performance fees for the management team. Direct investment by retail investors is prohibited and all investors must acknowledge in writing the receipt and acceptance of a prescribed investment warning. These new requirements form the basis of a universal "professional investor" definition which will be utilised across all Jersey funds and replace existing definitions, which vary slightly from regime to regime.

Taking security over fund assets

The fund structures most commonly used in Jersey are companies, limited partnerships or unit trusts. Depending on the vehicle used for the fund, the powers of the fund manager and the terms of the constitutional documents for the fund, it may be necessary to obtain prior consent from shareholders, partners, trustees or custodians before security can be granted over fund assets.

In some cases, a fund may be structured in such a way that granting security is prohibited or that only certain assets may be covered or certain types of security be given. However, it is usually possible to negotiate amendments to the articles of association, partnership agreement or trust instrument if all parties concerned deem it in the best interest for the proper performance of the fund that security should be granted.

Security is documented in a security interest agreement (**SIA**) and governed by the Security

Interests (Jersey) Law 2017. Perfection requirements for a Jersey law-governed security depend on the security: documentary intangibles like negotiable instruments or bearer securities are perfected by possession; investment securities (including shares) or security over bank accounts is perfected by control over the relevant account or investment; or security interests in receivables are registered on the Security Interests Register (**SIR**). The most common form for security perfection is registration. Where possible, it is also best practice to perfect by means of control as this has preferential treatment in terms of priority. Perfection by control is usually obtained only in respect of bank account security in fund finance transactions, as it is not possible to perfect security over call rights by control and share, and unit security (where control is possible) is not common as a result of the heavy involvement required of the investors.

A registration fee of currently GBP 150 is payable for each security registered on SIR. No other stamp duties, taxes or registration fees are due in Jersey for the taking and registration of security. With regard to funds, lenders commonly take as transaction security:

Examples of security

Collateral	Market practice comment	Usual perfection method(*)
Call rights	Investors are usually notified of the security interest and asked to sign an acknowledgment of the notice. The acknowledgment acts as "estoppel" argument, but is not required to perfect the security interest.	SIR registration
Bank accounts	Notice and acknowledgment from the account bank are usually obtained. The account bank acknowledges that it will not agree to the creation of any other security interest in the accounts. In this context, a "bank account" could be a deposit account or a portfolio/securities account.	Control over bank account and/or SIR registration
Shares	Notices and acknowledgments are generally obtained. Share certificates and blank share transfer forms are delivered at completion. The entity granting security may be asked to annotate its register of members by inserting a notice that security has been granted over the shares.	SIR registration or, in the very rare case of bearer securities, possession
Units (for unit trust structures)	Notices and acknowledgments are generally obtained. Unit certificates and blank unit transfer forms are delivered at completion.	SIR registration
Contract rights regarding a custodian agreement	Notice is served on the custodian and acknowledgment obtained. This is important so that the custodian agrees to follow the instructions of the secured party as regards the underlying collateral. This is generally combined with a security over any relevant portfolio/security account.	Possession of agreement which assigns the contractual rights + possession of the custodian's acknowledgment

(*) *Perfection by taking control is usually achieved by:*

Perfection by taking control of a bank account is achieved by:

- the bank account being transferred into the name of the secured party;
- the secured party also being the account bank;
- the account bank agreeing in writing to the instructions of the secured party; or
- the assignment of the bank account to the secured party.

Perfection by taking control of a securities or custody account is achieved by:

- the account being transferred into the name of the secured party;

- the secured party also being the intermediary; or
- the intermediary agreeing in writing to agree to the instructions of the secured party.

In relation to investment securities, perfection can be achieved by:

- the secured party being registered as the holder of such securities; or
- the secured party being in possession of the relevant instrument or certificate.

Lending to funds in Jersey

In general, there is no legal or regulatory impediment to lending to funds in Jersey. The fund manager and directors of the fund can agree limits and restrictions in the constitutional documents of the fund and the investment manager agreement, if they so choose. In particular, the ability of the fund manager to borrow additional sums or grant security over the fund's assets is an important commercial point to consider.

Under the previous private and unregulated funds regime (which still represents the vast majority of funds), there are no regulatory restrictions on borrowing for Very Private Funds, funds under the Private Placement Funds Regime, and Unregulated Funds. The same is also true for JPFs.

For Expert Funds, Listed Funds and Eligible Investor Funds, no legal restrictions are set in stone but the JFSC reserves the right to additional scrutiny if the fund is permitted to borrow money in excess of 200% of its net asset value.⁷

Unclassified Collective Investment Funds are regulated by the JFSC, which provides guidance on borrowing restrictions of the following fund types:⁸

Guidance on borrowing restrictions

Fund type	Limits on borrowing
General Securities Fund	Not more than 25% of the fund's total net asset value.
Fund of Funds	May borrow up to 10% of its total net asset value, but only on a temporary basis for the purpose of meeting redemption requests or defraying operating expenses.
Feeder Fund	May borrow up to 10% of its total net asset value, but only on a temporary basis for the purpose of meeting redemption requests or defraying operating expenses.
Money Market Fund	May borrow up to 10% of its total net asset value, but only on a temporary basis for the purpose of meeting redemption requests or defraying operating expenses.
Warrant Fund	May borrow up to 10% of its total net asset value, but only on a temporary basis for the purpose of meeting redemption requests or defraying operating expenses.
Real Property Fund	May borrow for the purpose of purchasing real property and for short-term purposes like defraying expenses or facilitate redemption. The maximum aggregate amount which may be borrowed is 35% of the total net asset value. Borrowing for the purpose of purchasing real property must not exceed 50% of the purchase price of the real property. For real property funds with a net asset value of less than GBP 5 million, and esp. during the early life of the fund, some relaxation from the above limits may be granted by the JFSC.
Futures and Options Fund	To be discussed with the JFSC.
Guaranteed Fund	To be discussed with the JFSC.
Leveraged Fund	To be discussed with the JFSC.

Fund finance market – latest thoughts: Substance

In light of BEPS, AIFMD and the Panama Papers, the funds world (not only in IFCs) sees a continued focus on substance. In order to take advantage of appropriate tax benefits, regulatory exemptions or reduced compliance burdens, it is more and more important that funds and fund managers can demonstrate substance. This means that there is also more importance on what the economic reality of a corporate structure looks like, where fund managers, administrators and key decision-makers are based, where economic value is being created and to whom relevant staff report.

Questions of physical location become important:

- Where do senior personnel involved in the fund’s management reside?
- Where is portfolio and risk management undertaken?
- Where are the meetings being held at which the decisions for day-to-day running of the business are made?

It is also worth looking closer at Article 82 AIFMD,⁹ which aims to curb the use and abuse of letterbox entities: it is more important than ever for alternative investment fund managers to retain staff of sufficient experience, seniority and decision-making power to conduct the business of running the fund successfully. They should also provide their own oversight instead of only taking instructions from an onshore manager. Senior management functions should not be relinquished to other decision-makers, wherever they are based.

It is also vital that any amount of delegation the fund manager may deem appropriate is not so much that it could be argued the fund manager has “by a substantial margin” divested itself of the key functions which make it the fund manager. When delegating, the fund manager must also ensure that it does not lose “[...] *contractual rights to inquire, inspect, have access or give instructions to its delegates or the exercise of such rights becomes impossible in practice.*” (Article 82.1(c) AIFMD).

As a “substance” jurisdiction, Jersey’s financial services and legal industry is very well developed and has the necessary manpower and expertise to show the required degrees of substance. Proactive legislation also ensures that where required, Jersey will insist on relevant personnel and business vehicles being based in Jersey while still remaining open for global flexibility and administrative ease wherever possible.

Key developments in the Jersey fund landscape

Loan-originating funds (LOF)

The popularity of LOFs (which offer to act as third-party lenders and provide alternative sources of capital) continues to grow with a number of jurisdictions introducing specific regulatory treatment to match demand. It is estimated that since 2010, the number of funds engaged in lending activities has risen steadily and looks to become about 20% to 30% of the lending market.¹⁰

In Jersey, provided that the JFSC is satisfied that the fund will not provide capital to people or other financial institutions, the regulatory treatment of LOFs is flexible but the JFSC will likely require that:

- the fund was established as an “Expert Fund” under the Jersey Funds Guide;
- it is a closed-ended fund;
- it does not lend to natural persons, its own management, depositaries or other investment funds;

- it complies with the JFSC's Sound Business Practices Policy; and
- it includes in its offer document the appropriate risk warnings and complete details about its credit procedures, permitted activities and their risks, eligible borrowers, stress testing, liquidity, leverage, diversification and periodic investor reports.¹¹

As each LOF is likely to be different, the JFSC will assess on a case-by-case basis.

Crypto-currency funds

Research suggests that crypto-currencies form an independent asset class with unique characteristics, making them particularly attractive for investors with an interest in the Fintech market.¹² A further example of Jersey funds' creativity when considering alternative asset classes is the successful world premiere listing of Jersey-based fund "Global Advisors Bitcoin Investment Fund plc" on the Channel Islands Securities Exchange,¹³ a fund established with the blessing of the JFSC.

Virtual currencies like Bitcoin are still often poorly understood by the law and regulators and therefore met with varying degrees of scepticism or refusal of regulatory approval. Against this trend, Jersey regulators are keen to build on the island's strong reputation as a Fintech hub. This is well illustrated by its recent adoption of a specific regulatory regime for virtual currencies and those who provide virtual currency exchange services¹⁴ while incorporating a turnover-based sandbox to ensure innovation in these key areas is not stifled.

Jersey continues to monitor and engage with regulatory developments in Australia, Canada, Germany, Hong Kong, the UK and the US, all countries which have decided to take a proactive approach to crypto-currencies and harness their economic potential.

JRAIF

In consideration of AIFMD and reacting to the demand for fund products which saw Luxembourg successfully take off with the Reserved Alternative Investment Fund (**RAIF**), Jersey reviewed its fund landscape and has taken steps to introduce the Jersey Registered Alternative Investment Fund (**JRAIF**) later in 2017/18, which is expected to provide investors with an impressive new vehicle, which can flourish even further once the AIFMD passport is granted.

Under AIFMD, the regulatory focus switched from regulation of the fund to regulation of the fund manager. However, this also introduced the risk of "double regulation", where a fund and its manager are both required to comply with regulatory demands, adding administrative cost, delay and complexity. As a non-EEA jurisdiction, Jersey is not as affected by this as e.g. Luxembourg or Ireland but, given Jersey's strong commercial links to EU member states, it is important to not only offer AIFMD-compliant regulatory regimes but also fund products that make the best out of that regime.

Being a manager-led product, the JRAIF is aimed at professional and sophisticated investors and will be supervised directly by the alternative investment fund manager, who in turn is authorised and supervised by the JFSC. Unlike in other fund structures, with the JRAIF the alternative fund manager is responsible for ensuring the JRAIF's compliance with the AIFMD. This also means that no JFSC approval, either prior to launching the fund or thereafter, will be required. The JRAIF will not be required to adhere to the code of practice for certified funds.

It is thought that the JRAIF provides a pragmatic compromise between appropriate regulatory supervision of financial vehicles and providing relief to investors, who are often stuck with the costs of dual regulation and compliance. After all, a fund is essentially a pooling vehicle and if that vehicle has been set up and is managed by an appropriately regulated and supervised fund manager, there is little need to add additional regulatory

requirements to the vehicle itself. Furthermore, it should not be forgotten that not only the fund manager is regulated but the fund's and fund managers' lawyers, bankers, accountants, custodians and administrators are also regulated persons.

The year ahead: A glimpse into the future of Jersey funds for 2018/19

If 2016 and 2017 showed us anything, it was how tough it is to make any accurate predictions about politics, trade, regulatory matters or market developments.

However, a few points may influence fund activity further:

Firstly, as a non-EEA country, Jersey funds can offer their investors separate regimes, depending on whether they wish to access EU capital or not. A choice exists between fully EU/EEA independent regimes, targeted "private placement regimes" with individual EU countries, or, once the AIFMD passport is granted, full access to EU member states under AIFMD. However, some EU countries like Germany have already indicated that "private placement regimes" will have to go once passporting rights are in place.¹⁵ If this comes to pass (and for which countries) remains to be seen.

Secondly, Jersey became a BEPS Associate on 19 June 2016 and committed to country-by-country reporting standards. Legislation on country-by-country reporting for BEPS came into force on 21 December 2016.¹⁶ Jersey has also recently signed the OECD Multilateral Convention on the prevention of BEPS, alongside more than 60 jurisdictions, which will allow Jersey to strengthen its tax treaty network.¹⁷ This is a further indicator that Jersey remains committed to BEPS' and AIFMD's substance requirements. Funds in Jersey (if they aren't already) will increasingly have to be mindful of where their key decision-makers are located, risk-management takes place, assets are held and employees and management reside. It is also thought that Jersey as a reputable "substance jurisdiction" will become increasingly attractive to investors who wish to access the EU markets using the benefits of offshore vehicles and expertise without needing to worry about regulatory or reputational concerns onshore.

Thirdly, President Donald Trump made statements to the effect that he supports further de-regulation of the US funds market, in particular by repealing or heavily amending the Dodd-Frank Act and the Volcker Rule.¹⁸ Since such statements, the Treasury Department has released a report recommending a reworking of such rules that were put in place after the financial crash of 2008. This would lead to many advisers of private funds no longer being required to register with the Security and Exchange Commission. It is unclear whether deregulation in the US would have a tangible competition effect on funds in jurisdictions like Jersey, which comply with higher regulatory and compliance standards than President Trump favours. But as IFCs like Jersey are very much global businesses, any such development deserves to be carefully monitored.

Lastly, Brexit: while Jersey is neither part of Great Britain nor an EU member state, it enjoys close links with both.¹⁹ From a funds perspective, the close working relationship between Jersey's financial sector and the major players in the City of London is important. Any substantial disadvantage the UK's finance industry may suffer would require Jersey to adopt appropriate protective measures, including a further strengthening of its ties with the Middle East, Asia and key EU member states like Germany, Italy and France as well as the US. The fund landscape may also be somewhat re-shaped if more financial services businesses move from London into Luxembourg, Dublin, Frankfurt or Paris.

Media coverage of Britain's preparation for Brexit is extensive but unfortunately, neither the conduct of the British media nor the British government allows for a reasoned and well-

grounded opinion at present. It is very much in Jersey's interests that the Brexit negotiations deliver a beneficial outcome for all parties concerned.

* * *

Endnotes

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**James Gaudin****Tel: +44 1534 818 337 / Email: jgaudin@applebyglobal.com**

James Gaudin is a partner within the Corporate department and leads the structured finance team in Jersey. He specialises in all areas of offshore corporate, finance and restructuring work.

His extensive experience covers banking and asset finance, real estate investment structures, public and private debt and equity issues, securitisations, repackagings and initial public offerings, as well as structures involving Jersey limited partnerships and unit trusts. More recently, James has advised on some of the largest corporate restructurings to have occurred in the Jersey market. He also advises banks and other global financial institutions in relation to the Jersey elements of complex cross-border insolvencies.

Prior to joining Appleby in August 2010, he spent six years in the capital markets and structured finance team at a Jersey-based offshore firm, before joining another major offshore firm where he was a group partner and head of corporate in Jersey. Before returning to Jersey, James worked with Hemmington-Scott in London for four years, latterly as Head of Treasury and Banking.

James was recognised in 2017 by *The IFLR1000* as highly regarded in the areas of finance and corporate. Clients told *The IFLR1000* that James is “first class”, “very good” and “really helpful and commercial”. James has also appeared in *The Legal 500 UK 2016* recommended lawyer list. He has been commended by *The Legal 500* for his “practical advice”, “availability” and “excellent responses”.

James has contributed to numerous publications, and regularly presents to conferences, seminars and clients. He also participates in numerous industry steering and consultation groups.

**Paul Worsnop****Tel: +44 1534 818 225 / Email: pworsnop@applebyglobal.com**

Paul Worsnop is an Associate in the Corporate department in Jersey and works closely with James Gaudin, servicing both fund managers and lenders in connection with high-value, secured and unsecured, capital call facilities. In the past 12 months, he has advised in relation to over €5bn of finance provided to funds established in Jersey.

Paul joined Appleby in June 2016 from a leading international law firm and has an active practice in general funds advice and corporate and real estate finance.

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