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Next step in Jersey's sweeping review and revamp of funds regulation

Introduction

Further developments in the radical overhaul and rationalisation programme for Jersey fund regulation were announced on 15 March 2017. The Jersey Financial Services Commission (**JFSC**) and the States of Jersey (**Government**) issued a joint feedback paper on their consultation on proposals for substantial amendment to Jersey's private funds regulation and published the new Jersey Private Fund Guide. The changes are the next 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). In addition 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 measures announced on 15 March 2017 are the rationalisation and consolidation of Jersey's private and unregulated fund sector with the:

1. Introduction of a Jersey Private Fund (**JPF**) guide effective 18 April 2017 and exclusion of private non-fund structures from authorisation by the JFSC;
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 of Private Placement Funds (**PPFs**), Very Private Funds (**VPFs**) and COBO only funds; and
5. Phasing out unregulated exchange traded funds.

Each of these is discussed further below.

1. Jersey Private 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. Further, investment funds offered to and owned by more than 15 but up to 50 investors were subject to a comparatively light touch regulation as COBO only funds. The managers of many of these vehicles have also benefitted from available exemptions from regulation under the Financial Services (Jersey) Law 1998. The JPF Guide will provide greater certainty with respect to the eligibility conditions and regulatory approach to the authorisation process for a private fund in Jersey offered to 50 or fewer investors as discussed below.

(ii) The JPF will benefit from a fast track 48 hour approval process.

(iii) A JPF may be closed-ended or open-ended (subject to the 50 or fewer investor test).

(iv) Clarity is given in the distinction between a Jersey 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 Registry will deal with all applications for consent for non-fund vehicles. For these purposes a JPF is defined as "a private investment fund involving pooling of capital raised for the fund and which operates on the principle of risk spreading". Holding companies and joint venture arrangements are expressly excluded from the scope of the JPF Guide. Further, arrangements between persons who are connected by a family connection and incentive arrangements between persons connected by an employment connection also will not be treated as JPFs. Club deals for single assets which do not operate on a principle of risk spreading will similarly be out with the scope of the JPF Guide.

(v) The JPF 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.

(vi) There is no requirement for a Jersey general partner, managing partner or trustee nor is there any regulatory requirement for the JPF's governing body to appoint one or more Jersey resident directors.

(vii) There is no requirement for the prior approval of the promoter by the JFSC (as the designated service provider will be responsible for diligence on the fit and proper nature of service providers to the JPF).

(viii) There is no requirement for an offering document or auditors.

(ix) The JPF will be subject to limited regulatory conditions or compliance obligations relating to compliance with the JPF Guide, a cap on the number of investors and a condition that there shall be no change in the designated service provider (see below) without consent of the JFSC.

(x) Only investors who have acknowledged in writing receipt and acceptance of a prescribed investment warning may invest in the JPF.

(xi) Only professional investors or eligible investors may invest in the JPF. Direct investment by retail investors is prohibited. Eligible investors include those who invest or commit not less than GBP250,000 (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.

(xii) Where a discretionary investment manager (that is a professional investor) invests in a JPF on behalf of investors who are not professional investors, it will not be necessary to look through the discretionary investment manager to the underlying investors for the purpose of the 50 or fewer test.

(xiii) The following shall not be counted towards the 50 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 JPF (each participant in the carried interest vehicle must be a "professional" or an "eligible" investor); and

  (c) A general partner of the JPF.

(xiv) The JPF must appoint a Jersey resident designated service provider that is registered under Jersey's financial services regulatory laws. The designated service provider will be required to confirm to the JFSC on establishment and on a continuing basis the satisfaction of the JPF criteria and that the service providers to the JPF are fit and proper.

(xv) Applications for consent under the JPF Guide will be accepted the JFSC from 18 April 2017. An application fee (subject to consultation) for a JPF will be payable to the JFSC in the sum of £1070. An annual fee will be payable in the sum of £500.

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.

(v) The professional investor definition will be introduced in respect of JPFs from 18 April 2017 and is intended to be extended to cover public funds in due course.

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, which Government will progress.

(iv) The launch of the JPF Guide (discussed above) is not dependent upon these amendments to the COBO Law being in force.

4. Phasing out PPFs, VPFs and 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 of the introduction of the JPF regime the JFSC will not be accepting applications for COBO only Funds, PPFs or VPFs from 18 April 2017. Any existing PPF, VPF or COBO only fund will continue in operation until the end of its natural life or may apply to the JFSC to convert into a JPF 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.

Conclusion

Appleby welcomes the implementation of the proposals originally announced last year. The rationalisation and simplification of the fund regulatory options in Jersey, in the most simple terms, will boil down to private funds for 50 or fewer professional investors which must comply with the JPF 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 whether as principal or agent, or the giving of advice on investments (except in the circumstance where paragraph 5 of this Annex A applies);

  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 Jersey Private Fund (JPF) (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 JPF;

  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 JPF 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 JPF;

  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.

2. For the purposes of this Annex A:

  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. "**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 JPF that is structured as a corporate vehicle (such as non-redeemable founders' or management shares);

b. founder or nominal interests in a JPF 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 JPF that is structured as a unit trust,

which are created or issued to facilitate:

i. the formation and structuring of the relevant JPF;

ii. to exercise voting and/or management rights in respect of the relevant JPF; or

iii. to give entitlement to performance related fees or dividends as part of remuneration arrangements for management or advisory entities to the relevant JPF or their personnel; or

d. the transfer of any interest in a JPF 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 JPF as prescribed in the Jersey Private Fund Guide (JPF Guide). However, in the case of sub-paragraph 3.d. above, it is expected that paragraph 1. of this Annex A 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 JPF as prescribed in the JPF Guide.

4. Professional investors, investors who make an acquisition in accordance with paragraph 3. Of this Annex A, and those investors that make the minimum initial investment in or commitment to a JPF as prescribed in the JPF Guide are deemed able to evaluate the financial risks of a JPF and to bear the economic consequences of investment in a JPF, including the possibility of the loss of their entire investment.

5. Any discretionary investment manager acquiring an interest in a JPF, directly or indirectly, for or on behalf of one or more persons who are not professional investors must be satisfied that such