



## Jersey Financial Services Commission

Chief Executives (or equivalent)  
of all persons registered to conduct  
fund services business under the  
Financial Services (Jersey) Law 1998

30 April 2012

Dear Sir or Madam

### **Jersey Financial Services Commission (the "Commission") 2011 Overview of the Securities Division, Funds & Priorities for 2012**

This letter summarises the results of our fund on-site examinations made over the last year, the key findings and our on-site examination themes in the coming year. It also addresses the major objectives facing the Securities Division and the main issues it is seeking to deal with in 2012.

### **Launch of the Codes of Practice for Certified Funds**

The Codes of Practice for Certified Funds (the "Certified Funds Codes") became effective on 2 April 2012. The Certified Funds Codes can be viewed on the Commission's Website at [www.jerseyfsc.org](http://www.jerseyfsc.org)

Contrary to a recent press report, the purpose of the Certified Funds Codes is two-fold. The first is to incorporate the standard conditions attaching to certified fund certificates. The new style certificates are now considerably shorter and only include any conditions peculiar to a particular fund. The second purpose is to incorporate recommendations made by the IMF in 2003, to reduce the time for filing fund accounts from ten months to seven bringing the Commission more into line with other jurisdictions, and to track certain changes introduced by the International Organisation of Securities Commissions ("IOSCO") in its revised international Principles for Securities Regulation, notably the new principles on hedge funds.

The Certified Funds Codes incorporate the Jersey Expert Fund Guide, the Jersey Listed Fund Guide and the Open-ended Collective Investment Fund Guide, and those documents remain available to download separately from the Certified Funds Codes themselves. No changes of any substance have been made to the Guides.



PO Box 267 14-18 Castle Street St Helier Jersey JE4 8TP

T: +44 (0)1534 822000 F: +44 (0)1534 822002 **Regulatory Misconduct Whistleblowing Line: +44 (0)1534 887557**  
E: [info@jerseyfsc.org](mailto:info@jerseyfsc.org) W: [www.jerseyfsc.org](http://www.jerseyfsc.org) **Take command of your finances: [www.ProtectYourMoney.je](http://www.ProtectYourMoney.je)**





Chief Executive (or equivalent)

30 April 2012

---

### **Key Findings from 2011 Visit Programme**

The Funds Supervision Team (the “Team”) undertook 34 on-site examinations to regulated entities in 2011, 12 of which were themed examinations looking at all aspects concerning due diligence, including take on procedures generally, due diligence on the Investment Manager under the Jersey Expert Fund regime, due diligence when outsourcing or delegating functions, and due diligence in respect of AML/CFT<sup>1</sup>. A key aim of the on-site examination programme is to facilitate collaboration between Industry and the Commission resulting in clearer practical guidance being issued where appropriate. Each examination results in a report for the business in question based on information obtained during the examination.

Overall, the themed examinations in 2011 recorded a number of findings in respect of due diligence. The most common findings were in respect of AML/CFT including deficiencies in customer due diligence, a lack of a review process in that regard, and inappropriate reliance upon introducers and intermediaries.

Common themes emerging from last year’s examination programme include:

- a lack of appropriate due diligence on promoters and other parties in relation to new funds; and
- newly established fund services businesses (“FSBs”), and those without a track record in providing services to funds (for example a trust company business establishing a FSB) being unable to demonstrate proper understanding of the fund products and their respective duties in relation to the funds; and failure by some FSBs to recognise that the fund is their client, not the promoter.

Generally the Team identified:

- failures in demonstrating proper oversight and control of the assets of the fund by the board, in particular where there are multiple underlying entities or special purpose vehicles (“SPVs”) incorporated in many jurisdictions within the fund structure, and the various service providers to the fund including directors and service providers at each layer of the structure;
- failures in understanding the legal requirements of the relevant jurisdictions in which the SPVs are established;
- a lack of appropriate due diligence carried out in respect of the assets of the fund including joint venture parties in the structure of the fund;

---

<sup>1</sup> AML - the anti-money laundering provisions contained in the Proceeds of Crime (Jersey) Law 1999 and the Money Laundering (Jersey) Order 2008.

CFT - measures to counter the financing of terrorism under the Terrorism (Jersey) Law 2002.



Chief Executive (or equivalent)

30 April 2012

---

- failures by the board of the fund to consider fully, manage and understand conflicts of interest and independence issues;
- acting contrary to the fund offering documentation; and
- deficiencies in respect of the content and frequency of investor communications.

Other specific findings are set out below.

*Voting control conflicts and best interests of all shareholders*

Fund boards should be mindful of the inherent conflict arising where voting control is wholly or partly held by the Promoter/Investment Manager/Investment Advisor of the fund. The board should consider fully, manage and understand those conflicts of interest and independence issues, and should have contingency plans and safeguards in place for the fund and the interests of all shareholders where, for example, the Promoter/Investment Manager/Investment Advisor exercises its control inappropriately to the detriment of the fund and its shareholders.

*Promoters with limited or no track record*

Fund boards and FSBs should be diligent when considering Promoters/Investment Managers/Investment Advisors with respect to their limited or no track record in acting for funds in general; the nature of the underlying asset classes; the jurisdictions to be invested in, or the complexity of the proposed structure generally. For example, due consideration should be given, but not be limited, to whether the Promoter has sufficient financial resources to manage the fund through its life, the past and current performance of funds the Promoter has previously acted for, whether any funds it acts for have been suspended, and whether fund raising has been successful in the past, in particular whether any funds it has launched have failed or struggled to raise the minimum placing size.

*Executive Committees*

The Commission takes this opportunity again to remind licence holders of its expectations concerning governance. As you will be aware, Core Principle 3 of the FSB Codes of Practice requires that:

**A registered person must organise and control its affairs effectively for the proper performance of its business activities and be able to demonstrate the existence of adequate risk management systems.**

It has been noted that an increasing trend in the larger organisations or more complex groups for executive functions of the regulated business to be overseen by executive committees that include persons who are not directors of the registered person. This may result in individuals



Chief Executive (or equivalent)

30 April 2012

---

acting in an executive role but who have not been approved by us to be principal persons of the registered person. The Financial Services (Jersey) Law 1998 imposes a requirement for principal persons to obtain the prior consent of the Commission before acting as such, *including directors or persons fulfilling an equivalent role*.

In circumstances where there are multiple registered persons within the group, in addition to the above issues, this may also result in a breach of paragraph 3.1.7 of the FSB Codes of Practice where it requires:

**If providing services defined in Article 2(10)(c) of the Law (namely acting as trustee, custodian or depositary), the registered person must ensure appropriate independence of its business arrangements with a Fund and other fund services business providers to that Fund.**

In order to avoid such situations arising, it is preferable for executive committees to either comprise only members of the board of directors of the registered person, or to be established by each of the boards of the registered persons within the group to sit beneath these registered persons and comprise only members of the board of directors of the registered person, related registered persons, or key persons. Where independence issues arise at the executive committee, there should be a clear policy on potential conflicts and how they should be managed.

Generally, the Division has dealt with a significant number of fund revocations and mergers over the past year. In addition, 38 FSB registrations were surrendered or revoked by request partly due to rationalisations but also due to market conditions. A further eight new fund applications were withdrawn before a certificate was issued.

The Team continued to manage a number of serious forensic investigations in conjunction with the Commission's Enforcement Division.

### **2012 On-site Examinations**

The due diligence theme for 2011 will be continued in 2012 with a focus on take-on procedures generally, due diligence on the investment manager under the Jersey Expert Fund regime, and due diligence when outsourcing or delegating functions. The Team may decide to consider all these areas or alternatively just to concentrate on one or two aspects. Moreover, while half of the planned examinations will focus on specific areas, the Team will, where appropriate, cover wider aspects of a registered person's business operations.

As highlighted in the 2011 Dear CEO letter, examination findings will be based on the facts presented to the Commission prior to and during the on-site examination itself.



Chief Executive (or equivalent)

30 April 2012

---

The Commission does not consider material presented to it subsequently in relation to the examination report although such material will be taken into account for the purposes of the remediation plan. Furthermore, the Team will continue to provide the relevant business with a draft examination report; however, the Commission shall only consider comments on the draft relating to our reporting of the facts as they are presented during the examination.

### **Issues Arising**

During 2011, the Securities Division became aware of the following issues relating to funds and FSBs.

#### *Managed Entities acting solely for Unregulated Funds*

In December 2011, the Board of Commissioners considered the position where a managed entity proposes to act *solely* in respect of Jersey unregulated funds within the meaning of the Collective Investment Funds (Unregulated Funds) (Jersey) Order 2008 (the “**Unregulated Funds Order**”). The Board felt there was insufficient delineation between the activities of the entity registered to conduct FSB under the Financial Services (Jersey) Law 1998 (usually a special purpose vehicle), and management and control of the fund to the point where supervising the entity could encompass overseeing the fund as well. As the funds were unregulated, investors might well perceive the Commission’s role in respect of the funds to be greater than the Unregulated Funds Order permits when considering whether to invest. The Board concluded that it would be inappropriate for the Commission to supervise the entity concerned where it is only concerned with unregulated funds. Accordingly, the Commission will not register an entity for FSB where its only activity is to act for unregulated funds.

#### *COBO only Funds*

Concerns have been expressed about the controls and monitoring exercised in respect of COBO only funds. Such funds are not certified under the Collective Investment Funds (Jersey) Law 1988 and may be undertaken by entities registered to conduct trust company business under the Financial Services (Jersey) Law 1998. The Commission issued a Dear CEO letter on 14 October 2011 addressed to trust company businesses giving examples of findings in respect of COBO only structures. The Dear CEO letter can be viewed on the Commission’s website at [www.jerseyfsc.org](http://www.jerseyfsc.org). FSBs that are also engaged in COBO only activities are requested to take note of the comments made in the letter and to take remedial action where necessary.



Chief Executive (or equivalent)

30 April 2012

---

*Annual Declarations and Auditors' Reports on the Annual Declarations*

A Dear CEO letter was issued on 16 March 2012 in respect of annual declarations under the Financial Services (Fund Services Business (Accounts, Audits and Reports)) (Jersey) Order 2007. The letter can be viewed on the Commission's website at [www.jerseyfsc.org](http://www.jerseyfsc.org)

*Adjusted Net Liquid Assets and Expenditure Requirements ("ANLA")*

The impact of the financial crisis over the past few years has been evident in the financial results of many local FSBs, notably with a number of registered persons falling below the 130% notification/110% compliance thresholds in their ANLA calculations.

It is disappointing to note the length of time taken by a number of registered persons to notify the Commission of these breaches in their ANLA position. The FSB Codes of Practice currently require the registered person to calculate the position as appropriate to the business, but at least on a quarterly basis. The Commission would expect this to be completed shortly after the period end and any required notifications made immediately to the Commission. The observance or non-observance of the timing of these notifications will be considered relevant to the question of mitigation or aggravation.

Detailed remediation plans are essential at times of non-compliance. The Commission expects remediation to occur as soon as practically possible and it is not acceptable simply to rely on the economic climate to improve. Immediate action is required when breaches occur and this is most likely to require cash injections via capital increases or subordinated loans (in the format outlined in the Codes).

In addition to the above findings, the Commission remains concerned that some entities are not complying fully with their obligations when valuing fund assets, and are not ensuring title to such assets belongs to the fund. These matters were raised in the Dear CEO letter issued last year.

**Operations**

The Division has undergone significant restructuring in order to cope with the increasing level of new policy work, particularly the latest initiatives launched by the European Union, and a dedicated team has been created to work on matters of funds policy headed by David Banks. Mike Jones, Deputy Director, is concentrating full time on the EU's Directive on Alternative Investment Fund Managers ("AIFMD"). Working with him and on other aspects of EU policy issues is Wyn Hughes, Senior Manager, and Barbara Kasinski-Moignard, Manager. Barbara is also reviewing the EU's "Green Paper" on shadow banking and its potential impact on Jersey,



Chief Executive (or equivalent)

30 April 2012

---

and the impact of revisions to the Markets in Financial Instruments Directive (“MiFID II”). A revised structure chart is available on the Commission’s website under the Funds tab.

The Funds Authorisation User Group continued to meet during the year to discuss issues arising on the funds authorisation process, and changes to procedures were proposed and implemented.

### **Policy matters for 2012**

The revised Objectives and Principles of Securities Regulation were published by IOSCO in April 2011. Following the economic crisis, IOSCO amended its Objectives and Principles in certain key areas such as the specific inclusion of hedge funds, and a tightening of the key principles applicable to all funds generally. The Principles are seen as a cornerstone of international securities regulation and are generally regarded as the benchmark by which compliance with international standards is measured. The Division has been able to incorporate any necessary changes in the Codes of Practice for Certified Funds.

The Jersey Private Placement Fund regime was launched on 25 January 2012. Discussions on the new regime started in the summer of 2011 and so the whole concept from inception to launch, including approval by the Board of Commissioners, was achieved in less than six months.

The Division remains very actively involved in addressing issues arising from the AIFMD. Meetings have been held with the European Securities and Markets Authority (“ESMA”) on the scope of co-operation agreements between EU member states and third countries such as Jersey, and the Division meets regularly with the Channel Islands Brussels Office (“CIBO”) on events and developments relating to the AIFMD at the level of the EU Commission. High level and productive meetings have been held by the Commission with prominent EU officials in Brussels, the FSA in London and ESMA in Paris. Industry is also engaged in closely monitoring developments in this area and the Commission regularly participates in Industry’s AIFMD Project Oversight Board.

As mentioned above, the Commission is considering the EU’s Green Paper on Shadow Banking (available on the EU website at: <http://ec.europa.eu> and will be responding on the regulatory aspects. The Green Paper contains proposals affecting a whole range of areas including regulation of securitisation structures, money market funds and exchange traded funds. The Commission recently attended an open forum debate in Brussels organized by the EU for all interested parties to consider the proposals. The Commission urges FSBs to consider the Green Paper and welcomes views on it before the deadline for 1 June 2012.



Chief Executive (or equivalent)

30 April 2012

---

Discussions continue on updating the Collective Investment Funds (Recognized Funds) (Rules) (Jersey) Order 2003 in consultation with Industry and the other designated territories. Further meetings have been held with the FSA and HM Treasury on the future of the Recognized Fund regime following implementation of the AIFMD. The situation is being kept under review and progress in this area will be communicated to Industry.

Work on the new Collective Investment Funds (Certified Funds – Prospectuses) (Jersey) Order 2012 is now complete and the Order is currently with the Minister for Economic Development. The actual date for implementation will be discussed with Jersey Finance and the Jersey Funds Association, although it should be borne in mind that the Order only becomes effective six months from the date the Order is made by the Minister. Simultaneously with Order being made the Commission will write setting out our views on draft prospectuses and on the level of detail to be included where sub-custodians are used.

Other areas where the Securities Division will have significant input include the funds specific section of the AML Handbook, the draft FSB Client Assets Order and the Non-domiciled Fund Guide. In the light of Industry's comments on the Certified Funds Codes, the Commission will be producing a closed-ended collective investment fund guide to complement the Open-ended Collective Investment Fund Guide.

The Commission has prepared term sheets with respect to changes to the regulation of managed accounts and they are currently being reviewed by Industry.

The Commission has issued Consultation Paper No. 4 2011 proposing revisions to all supervision Codes of Practice, including those for FSBs, in order to ensure greater consistency across each Supervision Division. A Feedback Paper is in the course of preparation.

Consultation Paper No. 1 2012 was issued on 1 February 2012 setting out proposed increases in the fees charged by the Commission for registering FSBs and issuing fund certificates. A Feedback Paper will be issued shortly. Both Consultation Papers are available on the Commission website at [www.jerseyfsc.org](http://www.jerseyfsc.org)

Given the volume of policy work currently undertaken by the Division, discussions have been held with Jersey Finance and the Jersey Funds Association regarding the order of priority for the matters in hand following completion of the Certified Funds Codes, the Certified Fund Prospectus Order and the Private Placement Fund regime. It is agreed the AIFMD is a priority although other matters should still be progressed wherever possible, including a review of the regulation of managed accounts, consideration of Industry's proposals to revise the Expert Fund regime and the treatment of personal questionnaires, and further work on the draft Fund Assets Order.





Chief Executive (or equivalent)

30 April 2012

---

### 2012 Main Objectives

In summary the main objectives for funds in 2012 are to:

- advance the on-site examination programme;
- continue working on the AIFMD and consider the impact of the Level 2 requirements;
- work towards reaching agreement on the scope of co-operation between Jersey and the EU under the AIFMD;
- monitor developments in respect of the EU's proposals on shadow banking;
- consider proposals to improve the Expert Fund regime; and
- advance proposals in respect of managed accounts.

In addition, the Division shall continue its close liaison with Industry and its work to ensure the fund authorisation process is as streamlined and efficient as possible.

The Division shall also continue engaging fully with its international counterparts and liaising closely with Industry on all matters relating to fund development and supervision.

Yours faithfully,

**David Banks**  
**Director, Securities**