

European directive looms large as Jersey contemplates future

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The European Commission's proposed Directive on Alternative Investment Fund Managers unveiled in May is just the latest in a long line of external developments that have complicated Jersey's efforts to reinvent its financial services industry through the development of expertise in the servicing, governance and even management of alternative funds.

Arguably that process can be traced back more than 20 years to the European Union's first Ucits directive which, by creating a streamlined regulatory regime for cross-border retail funds, was probably the largest single factor in the shrinking of Jersey's international long-only fund sector to a niche business today comprising just a handful of players.

On the way the island has endured repeated inspections by an alphabet soup of self-appointed regulatory organisations including the Organisation for Economic Co-operation and Development, the Financial Stability Forum, the Financial Action Task Force and, most recently, the International Monetary Fund, as well as a series of reviews ordered by the UK government over the past decade.

But to date Jersey has survived the procession of external assessors pretty much unscathed, indeed better than that - in April the OECD ranked the island (along with fellow crown dependencies Guernsey and the Isle of Man) in the top category of jurisdictions that have not only committed to international standards of transparency and exchange of information on tax matters but that have made substantial progress in putting those principles into practice.

True, the OECD's test for compliance on the part of international financial centres is a fairly mechanical one - to have signed at least 12 bilateral tax information exchange agreements. However, it is a benchmark that has up to now proved beyond not only rival fund jurisdictions in the Caribbean but OECD members Luxembourg and Switzerland.

While the uniqueness of the crown dependencies' status in the same category as the leading economies of Europe and North America may not last - Bermuda has subsequently been 'white-listed' after reaching the finishing line of 12 tax agreements - for now it is helping Jersey to proclaim the rigour of its regulatory system and its willingness to act as a good international citizen, qualities that arguably are set to become much more important for promoters of funds and, crucially, many of the institutions that invest money with them.

'Jersey's inclusion on the OECD's white list following the G20 summit in April is a significant differentiator from other jurisdictions, and it's recognition that is appreciated by investors,' says Edward Devenport, a partner with law firm Mourant du Feu & Jeune. 'It was no big surprise for Jersey to be included, because it has supported international moves on tax transparency for a very long time, and has been entering into tax information exchange agreements since 2002.'

Noting that the process of negotiating the agreements also allows Jersey to obtain other benefits, notably the removal of discrimination against business from the island in various areas of the financial services industry, Devenport adds: 'The existence of these agreements does not seem to be putting off investors or promoters, partly because the tax information exchange agreement framework does not operate on the basis of fishing expeditions. It's not automatic disclosure of tax information' - unlike the Isle of Man's new position under the EU Taxation of Savings Directive.

But the big challenge ahead, practitioners agree, will be the planned EU directive that aims to regulate alternative fund managers based within the EU, whatever the domicile of their funds, and whose first draft was published by the European Commission in early May. Amid complaints from the industry that its measures will place an intolerable burden on managers as well as from some

European politicians who believe the legislation will be too easy to evade, the Commission is conducting a swift consultation exercise before the directive returns to the political arena for negotiation in the autumn.

Although there is widespread concern that the legislation will have the overall effect of driving alternative business out of offshore centres and into EU domiciles, there is a certain degree of confidence in Jersey that its well-respected regulatory structure and seals of approval from international watchdogs may enable it to obtain equivalent status with EU jurisdictions under the directive, although this will obviously depend on the final form of the text.

Says Devenport: 'The impact of the directive is not yet clear because it's a moving target that will be subject to quite a lot of change between now and the date it comes into force. The general consensus is that there may be opportunities for Jersey. As currently drafted, it is important that Jersey is recognised as having a regulatory system for fund managers equivalent to EU standards.'

'Jersey has regulated fund managers since 1988, and with the exception of Unregulated Funds all its fund products are regulated, a more rigorous position than several other jurisdictions. Insofar as the directive will impact most of the jurisdictions with which Jersey competes, the feeling is that we are in quite a good position. There remain many uncertainties about the directive, but Jersey has every intention to engage with the European Commission at an early stage to ensure that its regime is recognised as equivalent.'

His relative confidence is shared by Michael Rothwell, a spokesman for the Jersey Funds Association, who points out that the directive is likely to be finalised and implemented more speedily than is the norm for EU legislation. Rothwell, who heads the Jersey fund administration business of Bank of America-owned LaSalle Global Trust Services, says the island should continue to emphasise its high international standing.

'The best Jersey can do is reiterate its standpoint that our regulation is second to none, and certainly equivalent to that of any other well-regulated jurisdiction,' he says. 'So if the EU allows equivalent jurisdictions to have a foot in the door as far as marketing within the EU is concerned, Jersey should be well placed to meet that requirement. The output from the G20 summit and the conclusions of the OECD, which effectively put Jersey in the top tier of regulated jurisdictions, verifies that.'

Robert Kirkby, technical director of industry promotional agency Jersey Finance, rues that that EU has chosen to move ahead with legislation rather than following the conclusion of April's G20 summit in London (and organisations such as the International Organization of Securities Commissions) that the alternative fund business is a global industry that would best be regulated through internationally co-ordinated and consistent measures.

'As a jurisdiction Jersey is committed to embrace the highest standards of international regulation, and following the events of the past 24 months we recognise that some changes do need to place and we are happy to introduce them,' Kirkby says. 'Our overriding concern about the EU Directive on Alternative Investment Fund Managers in the first instance is that we believe it essential to do this on a global, as opposed to just an EU basis.'

'If you believe that vehicles such as hedge, private equity and commodity funds are responsible for systemic risk - I believe they are probably not - you need to regulate them on a global basis, because those funds are global in reach. That was the commitment made at the G20 summit, so it would be good to see the EU joining Iosco and the SEC and other bodies around the world to adopt the same standards. That makes it a lot easier not only for investors, who are the key people to protect, but all parties involved including regulators and governments.'

Kirkby says that on first reading of the draft, there are three key areas in which Jersey will need to fulfil the EU's conditions to be recognised as a third country with an equivalent level of regulation. 'The first is equivalent anti-money laundering measures to those in the EU directive, which we already have. A number of EU states already recognise this and the remainder have said they will broadly commit to that once our IMF report is out [due imminently]. We believe that ticks the box, if you will.'

'In the next area, tax information exchange, we believe our tax information exchange agreement programme should put us in a very good position. We already have Tieas with France, Germany, Ireland and we're negotiating with Spain and Italy.

'The final element is implementing equivalent regulation. We're a pretty nimble jurisdiction, so we believe that once the directive has bedded down and the corresponding regulations are out, we can put it in place pretty rapidly. We already have a pretty strong regulatory framework for funds anyway, so it shouldn't be that onerous. Finally, we have the regulatory links as well, because we're a signatory to the losco treaty.'

What is raising concern among many offshore jurisdiction is the prospect of a three-year 'lock-out period' following implementation of the directive before outside jurisdictions could obtain recognition as equivalent and gain access to the EU market on the same terms as managers domiciled within the union. For now it remains unclear under what terms alternative managers could continue to access EU-based investors, if at all, but Kirkby hopes that the waiting period will disappear from the final legislation.

'Managers with funds outside the EU may be able to continue to do what they are doing at present, which is fine for existing funds, but promoters of new funds would be unlikely to domicile them in a territory unless they knew it had equivalence, and the way the directive is drafted, it looks as though you can't get equivalence until the end of that three-year period,' he says. 'We would like to clarify that position because we're sure it wasn't what the drafters intended.'

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