

International plaudits help Jersey fight its corner

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Created 06/10/2009 - 16:08

Jersey's private equity industry still faces anxious times ahead as the European Union deliberates over the content of its proposed Alternative Investment Fund Managers Directive. But the jurisdiction can at least take heart from the robust seal of approval it has received from international bodies in recent months for its regulatory rigour and willingness to embrace international standards on tax transparency and exchange of information.

The draft AIFM directive unveiled by the European Commission at the end of April came as a severe disappointment to the industry, which was braced for the inevitability of tighter regulatory scrutiny of its activities but hoped that the EU would come up with a framework that was proportionate in the burdens it imposed on operators and did not discriminate against managers and funds based in non-EU jurisdictions such as offshore financial centres.

Instead the draft adopted a one-size-fits-all approach covering any funds, alternative or not, that did not fit the union's Ucits template for retail investment vehicles, appeared wilfully to disregard the particular characteristics of sectors such as private equity and property funds, and proposed a three-year waiting period before funds domiciled outside the EU could gain access to a newly-established internal market, on condition of an "equivalent" regulatory status that was not defined.

"There has been a political imperative to push this through a lot faster than was originally intended," says Robert Kirkby, technical director with the industry promotional body Jersey Finance. "This caused a significant issue in terms of the drafting, and unfortunately the authors weren't up to speed with how the various industries, including hedge funds, private equity and real estate, actually worked, so there have been a number of inadvertent drafting errors that are quite material."

Initially the draft directive was regarded as a disaster by the alternative fund industry in Jersey and other offshore centres. But as the dust has settled, and signs have emerged that there is a willingness among at least some EU governments and European Parliament members to re-examine the premises of the first draft, the early anxiety has given way to a more sanguine view of the likely impact on the offshore fund sector.

"The current draft seems to have been put together very quickly, and the industry consultation is almost happening after the event," says Ben Robins, head of the funds team at law firm Mourant du Feu & Jeune. "Everyone in the industry knows there will be a directive, but we're increasingly confident it will be legislation that will work, preserving the good elements of the status quo and dealing with those elements that perhaps needed looking at. People in Jersey are very relaxed about more transparency, although they are concerned about the directive's more protectionist elements."

Kirkby notes that members of the industry in Jersey have contributed to lobbying efforts underway with the European Commission, the UK Treasury and some of the other EU member states including Sweden, which holds the EU presidency for the second half of this year and is overseeing a revised draft of the directive expected to see the light of day in the course of October.

"A huge amount of work is going on behind the scenes to try to reach some form of compromise that takes into account the actual operating issues these asset classes have," he says. "For example, the European Private Equity & Venture Capital Association has been sharing with the relevant people their understanding of the industry so that they can appreciate fully how it works and therefore how the draft directive can be revised accordingly."

Nigel Strachan, head of business development for corporate clients in Jersey with Kleinwort Benson, an administrator of alternative funds, says the industry's major issue is the proposed temporary bar on non-EU based funds being marketed within Europe, but argues that the entire legislation is

misconceived. "The problem is it's a kind of backlash, an ill-conceived response to the financial crisis, and to the perception that there was a lack of regulation in the alternative fund industry," he says. "Now the knee-jerk response is to over-regulate the industry and control it within Europe in quite a protectionist way.

"We don't believe it genuinely helps the people it ultimately aims to protect. Those who invest in alternative assets such as private equity, mezzanine debt and hedge funds are sophisticated investors that understand the risks. The directive seems to be aimed at protecting the man on the street, but the investors in most of the funds we administer are largely institutional and don't need the additional cost of unnecessary bureaucracy and red tape burdening the fund's performance."

The problem for Jersey's industry at the moment in responding to the draft directive is that it is "a moving target", admits Tom Amy, head of the funds and SPV group at Volaw Trust & Corporate Services, but he insists that whatever the ultimate outcome of the discussions within and outside the EU, Jersey has no choice but to meet whatever conditions are put in place for access by outside funds to the European market.

"The overriding issue is the equivalency standards," he says. "We need to make sure we meet those standards, whatever they are. Historically Jersey has demonstrated that it will always seek to comply with the highest international standards, so I don't think there's any doubt we will achieve this - it's just a question of how challenging that process will be. Hopefully the requirements will be somewhat less severe than in the first draft."

Amy adds that the industry also hopes that the three-year lock-out period, which would effectively restrict its access to the EU market, does not appear in the final legislation. His colleague Kate Anderson, head of the funds legal team at the associated law firm, Voisin, points out that this provision is now coming under fire from institutions such as pension funds: "They are arguing that the lock-out period will be detrimental to European investors and will increase risk by reducing the pool of assets they can invest in."

Adds Kirkby: "A number of investors like large pension funds have started to say that this will hit diversification and costs will rise considerably. This has got people thinking because pension funds don't use these vehicles for tax purposes - how can they, they're tax-neutral? - and if they are saying they are worried, that's something to take heed of."

Still, there is concern that the uncertainty over the directive has dampened the incipient recovery underway for private equity and alternatives generally in Jersey. Says Robins: "We were starting to see evidence of some green shoots over the past few months, but with the EU directive, we sense that people are sitting on their hands, waiting for what we hope will be a compromise that will soften the potential impact and give people greater confidence. Unfortunately those green shoots have probably been dampened by that element of market uncertainty."

Ian Moore, chief executive of fund administration and corporate services provider Moore Management, notes that in the early days rumours circulated that some law firms in London were advising clients not to use Jersey because of the uncertainty, but he adds: "I'm confident that it's all changing and that Jersey's equivalence in regulation will be recognised."

At the least, there is growing confidence that Jersey may finally be escaping the conflation between tax-neutral fund jurisdictions and tax havens for private wealth that have dogged the island for years despite its efforts to adopt the standards put forward by the Organization for Economic Co-operation and Development on tax transparency and exchange of information.

"Time and again we've seen tax equated with regulation and regulation with tax," Kirkby says. However, Jersey's efforts were finally rewarded in April when the OECD placed Jersey on its 'white list' of jurisdictions that have both accepted the standards and taken substantial steps to implement them. In Jersey's case this meant having signed not only the minimum of 12 tax information exchange agreements with OECD members and other countries required to demonstrate implementation, but continuing to negotiate the signing of further Ties.

Jersey's commitment to compliance with international tax standards was also recognised in September when Colin Powell, the States of Jersey's advisor for international affairs, was invited to become one of four vice-chairmen of a new peer review group established by the OECD's Global Forum on Tax Transparency and Exchange of Information.

The group will draw up terms of reference for a process to assess how effectively the international standards of transparency and exchange of information for tax purposes are being implemented by jurisdictions. Says Powell: "This position is further confirmation that Jersey is seen by the international community as a co-operative jurisdiction and as a member of the community of nations committed to the international principles of transparency and information exchange."

The island's financial community is also quietly basking in the satisfaction of a highly complimentary report from the International Monetary Fund as part of its Financial System Stability Assessment programme. Although the glowing review was not unexpected, fund industry members hope that the IMF's explicit endorsement of Jersey as a member of the "top division" of international finance centres will not only allay investor concerns about offshore jurisdictions but allow the island to benefit from any flight to quality.

Jersey Finance chief executive Geoff Cook notes: "The IMF has given Jersey's finance industry a ringing endorsement for the quality of its regulation and legislation, the transparency of its regulatory processes and the robustness and resilience of its banking system. Ill-informed critics should recognise that the standard of Jersey's financial services regulations and supervisory capabilities are either ahead of, or on a par with, those of both EU member states and G20 countries, and that criticisms of Jersey for failings in this regard hold no weight whatsoever."

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