



Jersey Financial
Services Commission

THEMED VISITS - FINDINGS REPORT

PERSONS REGISTERED TO PROVIDE FUND SERVICES BUSINESS AS MANAGER OF A MANAGED ENTITY (“MoME”)

Issued: March 2009

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From PwC, Mark James was the partner responsible for the project and Chris Stuart, Director was the appointed Engagement Leader.

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1 Introduction

- 1.1 The Commission issued the Codes of Practice for Fund Services Business (the “**FSB Codes**”) on the 14 November 2007 to coincide with the transfer of the regulation of fund service providers from the Collective Investment Funds (Jersey) Law 1988 to the Financial Services (Jersey) Law 1998, as amended (the “**Law**”). As part of this process, the activity of acting as Manager of a Managed Entity (“**MoME**”) was introduced as a new class of Fund Services Business. All persons already acting as a MoME prior to 14 November 2007 became automatically registered to conduct this class of business under Article 9 of the Law.
 - 1.2 At the time of the introduction of the FSB Codes the Commission received submissions from industry concerning the extent to which the FSB Codes should apply to the activities of a managed entity (“**ME**”). As a result, the Commission agreed that the full detail of the FSB Codes need not apply to MEs in certain circumstances, namely:
 - 1.2.1 that the ME was established for the purpose of acting for an expert fund, related expert funds or materially equivalent funds; and
 - 1.2.2 that the ME had appointed a MoME.
 - 1.3 Provided that these criteria were satisfied, MEs would be able to adhere to the seven high level principles of the FSB Codes rather than being bound by the underlying detailed requirements. Those MEs following this treatment under the FSB Codes were issued with a set of standard registration conditions which imposed certain minimum requirements including, inter alia, record keeping requirements and the obligation to appoint a Compliance Officer.
 - 1.4 Following the introduction of this regime, the Commission received several requests from industry for guidance on aspects of the MoME class of business and the manner in which the high level principles of the FSB Codes might be interpreted in practice. As a result, it was considered appropriate to issue a draft guidance note (the “**Draft Guidance**”) to industry in September 2008.
 - 1.5 Prior to finalising the Draft Guidance the Commission decided to conduct a series of themed visits to persons registered to act as MoME with the aim of better understanding current market practice in this area and, in turn, gauging the appropriateness of the guidance.
 - 1.6 The objectives of the themed visits were:
 - 1.6.1 to gain an insight into the practical measures implemented by industry to demonstrate compliance with the FSB Codes;
 - 1.6.2 to highlight areas of good practice or inconsistencies within the industry when addressing the areas of the FSB Codes or the Draft Guidance; and
 - 1.6.3 to identify areas of the FSB Codes or Draft Guidance where additional guidance or clarification is needed by industry.
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- 1.7 Each visit resulted in a factual feedback report for the firm in question based on information obtained during these visits.
- 1.8 A key aim of the programme was to facilitate a collaborative process between industry representatives and the Commission resulting in clearer practical guidance being issued where deemed appropriate.
- 1.9 This summary report sets out the key findings from the themed visits as well as the comments received directly from practitioners and goes on to highlight areas where additional guidance or clarification was requested.

2 Summary of key findings

Overview

- 2.1 The overall impression gained from the themed visits was that the response of industry to the introduction of the FSB Codes and the subsequent Draft Guidance was positive and the proactive steps taken by the Commission to engage with industry including the programme of themed visits were welcomed. The programme was seen as a constructive process and it was felt that the themed visits were well-timed, giving MoMEs an opportunity to demonstrate how the FSB Codes and the Draft Guidance have been applied in practice and to provide feedback on any issues encountered.
- 2.2 PwC experienced a positive response from firms, who were keen to provide their thoughts on, and insights into the new regime.

The MoMEs

- 2.3 Fifteen MoMEs, which between them service approximately 75% of all registered MEs, were identified by the Commission to provide high industry coverage and a representative sample of the issues being encountered.
- 2.4 All MoMEs examined provided services to MEs which acted for expert funds or materially equivalent funds. As a result, these MEs were only required to follow the core principles of the FSB Codes. Some MoMEs also provided services to MEs which acted for unclassified funds and as a result these MEs were required to follow the FSB Codes in full.
- 2.5 Although services offered by MoMEs varied, common services provided by most included: administration support; director and Compliance Officer services; compliance support; registered office; administrative office and maintenance of books and records. In all but two cases (those being arrangements where services were being provided to fellow group entities) the role of the investment advisor to the underlying funds for which the MEs act was performed by a third party, typically the promoter of the structure. Administration services to the underlying funds for which the MEs acted was provided by most MoMEs with the exception of three, where a number of MEs outsourced this service to a third party.

Industry reaction to the FSB Codes

- 2.6 Varied responses were received from MoMEs concerning the introduction of the FSB Codes, the subsequent Draft Guidance and the stage each MoME had reached in establishing their compliance framework.
- 2.7 A number of the MoMEs that provided services to MEs acting for expert or materially equivalent funds took the decision to apply the full detail of the Codes to the MEs as they considered this a practical means of demonstrating adherence with the core principles. Some however felt that the wording of the Draft Guidance pushed them down the route of applying the FSB Codes in full to ensure compliance with the Core principles. Some respondents argued that the Commission should concentrate on regulating the MoME's

only and not offer any guidance on how ME's could document adherence with the high level principles of the FSB Codes.

- 2.8 The most common approach was to perform gap analysis on the registered person's existing compliance arrangements to identify areas where changes to procedures were required or where additional MoME services would be needed to assist ME's compliance with the FSB Codes.
- 2.9 A number of the MoMEs visited had been registered to provide other regulated services, such as Trust Company Business, for a number of years. Prior to the introduction of the FSB Codes, the existing policies and procedures in place at these MoMEs were heavily influenced by the compliance requirements associated with their existing registrations. As part of these existing policies and procedures, the MoMEs had already established a formal compliance review programme aimed at monitoring regulatory requirements both within the MoME and also the entities to which they provided services. At the dates of the themed visits, policies and procedures were in the process of being amended to address the specific requirements of the FSB Codes in the majority of cases. In some cases, the MoMEs were introducing new compliance programmes specific to the FSB Codes to run alongside their existing compliance programme.
- 2.10 At the dates of the themed visits the MoMEs were, in general, at an advanced stage of implementing the changes to their existing compliance frameworks and were going through the process of presenting these changes to the ME boards for formal adoption. All such MoMEs expect to complete this process shortly. Ten MoMEs had fully implemented the changes while two had concluded that their existing compliance framework was sufficient.
- 2.11 Following the introduction of the FSB Codes, a number of MoMEs also commenced a process of informing the ME boards of their obligations under the FSB Codes and initiated discussions regarding the increased level of services required from the MoME to assist ME's in meeting their regulatory obligations.
- 2.12 During discussions held with senior management at the MoMEs, PwC was able to obtain a general impression of how organisations viewed the regulatory framework¹ and the impact they expected it to have on their own business and on fund services business in Jersey as a whole.
- 2.13 Some MoMEs embraced the regulatory framework and saw the FSB Codes as a tool for them to demonstrate to both existing and potential clients the quality of corporate governance they could provide. Some also felt that in the current economic environment it was important for the industry in Jersey to be able to point to a strong regulatory environment when discussing Jersey as a jurisdiction to potential clients.
- 2.14 Other MoMEs showed a very different view of the current framework and expressed the following concerns:

¹ Taken to include relevant regulatory laws and subordinate legislation, anti-money laundering legislation and guidance and such Codes, policy statements and guidance as may be issued by the Commission from time to time.

- 2.14.1 MoMEs had encountered clients who had questioned the need for regulatory requirements at the ME level given that the MoMEs themselves were already regulated persons. These MoMEs were seeking clarity from the Commission of the rationale for regulation at the ME level.
- 2.14.2 MoMEs expressed concern over the increased cost of compliance resulting from the introduction of the FSB Codes. One MoME noted an increase in costs of over three times that of providing similar services in 2006. MoMEs expressed concern over the commercial competitiveness of fund services business in Jersey in comparison to other similar jurisdictions where they felt regulation was less onerous. One MoME with offices in another jurisdiction was considering referring new ME structures to other jurisdictions in future to avoid the perceived layering of regulation at the ME level.
- 2.14.3 A number of MoMEs expressed concern that they may be dedicating more resources to updating their compliance framework than their competitors in Jersey and some were considering differentiating the levels of service provided to MEs to allow for a more commercially viable approach.

Key industry concerns

- 2.15 Although, in general, industry had a clear view of what procedures they had in place to demonstrate compliance with the FSB Codes, there were a number of key areas where industry were looking to the Commission for clarity or additional guidance.
- 2.16 These areas can be summarised into the following key headings:
 - 2.16.1 clarity over the expected level of due diligence to be performed by the ME on the MoME;
 - 2.16.2 clarity over the level of ongoing monitoring to be undertaken by the ME to ensure that the processes, controls and activities at the MoME level are sufficient to allow the ME to meet its obligations under the FSB Codes and the manner in which such should be documented;
 - 2.16.3 clarity in respect of what sort of “lighter touch” could be applied when only following the core principles. Some MoMEs felt that the current Draft Guidance and the format of directors declarations under Financial Services (Fund Services Business (Accounts, Audit & Reports)) (Jersey) Order 2007 (“the **Order**”) leave little scope to apply a “lighter touch”;
 - 2.16.4 greater clarity in relation to financial resource requirements;
 - 2.16.5 clarity in relation to the requirement for Continuing Professional Development (“**CPD**”) to be undertaken by directors of the ME. In particular, many MoMEs were unclear as to the expectation for non MoME provided directors some of whom may not hold professional qualifications that would require CPD to be undertaken; and

- 2.16.6 confirmation of whether the Commission expects that the Compliance Officer of a ME will physically attend all ME board meetings.
- 2.17 The detailed findings section of this report provides the background to each of the key areas together with the Commission's responses.
- 2.18 In addition to the above broad themes identified during the programme, there were also some more specific views expressed by a small number of those visited as follows:
- 2.18.1 One MoME has made a conscious decision to avoid providing directors to the ME where possible - they considered themselves able to maintain adequate oversight through regular communication and also by acting as company secretary.
- 2.18.2 There would appear to be an issue being encountered when a MoME is looking to resign as MoME to a specific ME. The MoME appointed board members might have resigned but the MoME must remain in place until the ME finds a replacement. There is a concern that a MoME remaining in office in such circumstances may not have sufficient oversight to allow it to fulfil its obligations in the interim period.

3 Commission's response to the key findings

- 3.1 The Commission's response to the individual points raised as part of the visit programme is provided in section 6 of this report.
- 3.2 In summary the Commission intends to revise and finalise the Draft Guidance to:
- 3.2.1 clarify certain structural arrangements in relation to MoMEs;
 - 3.2.2 re-emphasise that responsibility for compliance with the regulatory regime rests with the ME, notwithstanding that it has contracted the services of a MoME;
 - 3.2.3 clarify that the indicative benchmark for compliance with the high level principles of the FSB Codes which appears at Appendix 1 of the Draft Guidance is in no way binding and that MEs may determine their own means of demonstrating compliance with the high level principles;
 - 3.2.4 set out the Commission's expectations in relation to CPD conducted by the directors of MEs acting for expert or equivalent funds;
 - 3.2.5 provide additional guidance on conflicts of interest, Compliance Officer arrangements and corporate governance; and
 - 3.2.6 publish guidance in relation to the Order forthwith.
- 3.3 Overall, the Commission was encouraged by the progress made by MoMEs in implementing the requirements of the FSB Codes. MoME activities will remain a key part of the Commission's supervisory focus and this process has proved very helpful in gauging current practices and understanding the impact of the regulatory requirements from the MoMEs' perspective.

4 Next steps

- 4.1 The overriding impression gained from the programme is that industry is keenly awaiting the publication of this report and the finalisation of the Guidance. The Commission intends to publish finalised Guidance by 31 March 2009.
- 4.2 In the event that you have any comments on this report in advance of the Guidance being finalised then please do not hesitate to contact Darren Boschat at the Commission using the following contact details by not later than Friday 20 March 2009:

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5 Methodology

- 5.1 To assist with the themed visit programme, the Commission appointed PwC as an agent under Article 10 of the Financial Services Commission (Jersey) Law 1998 to examine 15 businesses registered to act as MoMEs. Between them the 15 MoMEs service approximately 75% of the persons registered as MEs in Jersey.
- 5.2 The themed visits encompassed discussions with management and employees and an examination, on a sample basis, of appropriate written procedures and records. The visits were conducted between 8 October and 9 December 2008 and focussed on the following key areas of the FSB Codes and Draft Guidance:
- 5.2.1 Provision of Services by a MoME;
 - 5.2.2 Conflicts of interest;
 - 5.2.3 Corporate governance;
 - 5.2.4 Compliance Officer Arrangements; and
 - 5.2.5 Directors' Declarations
- 5.3 Prior to commencing the themed visits, a questionnaire was completed by each MoME which was used to gather information and to refine the scope of the visit. The visits commenced with an initial meeting with representatives of the MoME and the MEs. This was followed by a more detailed meeting to discuss the questionnaire and the areas of focus. The remainder of each visit consisted of an inspection of procedures manuals and documentation and a number of follow up discussions, typically with the Compliance Officer and other representatives from the MoME.
- 5.4 The information obtained during this process was summarised and cross referenced to the specific aspects of the FSB Codes and the Draft Guidance to be covered by the programme. This information was used to produce a factual findings report prepared for the Board of each MoME. The factual findings report formed the basis for discussions with representatives of the MoME and has been used to provide the detail within this summary report.

6 Key findings and responses

6.1 MoME Arrangements

6.1.1 Structural issues

Summary Finding	Commission Response
<p>a) Respondents sought clarification upon whether a ME can have more than one MoME.</p>	<p>The Commission is of the view that such an arrangement would result in confusion and must therefore be avoided. It is ultimately for the ME to determine who it is appointing as its MoME and for the MoME to acknowledge this role. If in any doubt, the Commission would tend to regard the business that has supplied the ME with its Compliance Officer as performing the role of MoME.</p> <p><u>Action</u> Draft Guidance to be amended to clarify this point.</p>
<p>b) Respondents were concerned that the Draft Guidance suggests that a MoME should itself be registered to provide the same services as the MEs for which it acts and pointed out that this will not always be the case in practice.</p>	<p>It was not the Commission's intention that a MoME need be registered to conduct the same classes of business as the MEs for which it acts. However, the Commission will take into account the MoMEs general level of competence in relation to the activities carried on by MEs.</p> <p>For example, a MoME may not possess specialised investment expertise, however, in providing services to a ME that acts as an investment manager the Commission would expect that the MoME has staff with sufficient expertise to adequately monitor the functions performed by the ME including those that are outsourced.</p> <p><u>Action</u> Whilst the Draft Guidance is considered to be sufficiently flexible as it stands, the Commission will amend 2.4.3 to read "...the MoME's own level of competence in relation to the classes of fund services business carried on by the ME..."</p>

Summary Finding	Commission Response
<p>c) Respondents pointed out that some parties (e.g. the promoter) might provide certain services to a ME from outside of the Island and queried whether a MoME registration would be required in these circumstances.</p>	<p>The Law would not require that a person conducting these services outside of the Island be registered. In such circumstances the MoME should be aware that these services are being provided by a third party and the ME should be in a position to oversee and monitor the service provider.</p> <p><u>Action</u> 2.2 of the Draft Guidance will be amended to refer to services provided “in Jersey”.</p>
<p>d) There was some debate among respondents as to whether it is necessary to distinguish between “core” and “ancillary” services for the purposes of the Draft Guidance.</p>	<p>The purpose of distinguishing between core and ancillary services in the Draft Guidance was to assist industry in establishing which services might ordinarily be undertaken by a MoME and indicating which of those services were considered most important to enable a MoME to properly discharge its responsibilities.</p> <p><u>Action</u> The visit program has demonstrated that this concept is broadly understood in that the extent of services provided by MoMEs tended to be appropriate. Accordingly, the Commission sees no need to make this distinction in the Guidance and will instead provide a list on “indicative services”.</p>

6.1.2 Agreements

Summary Finding	Commission Response
<p>a) For the majority of MoMEs, the original agreements documenting the relationship between the ME and the MoME and the services to be provided were drafted prior to the introduction of the FSB Codes. There was inconsistency across the MoMEs as to how much these agreements were subsequently updated following the introduction of the FSB Codes.</p>	<p>The Commission would expect that any new MoME engagement should be subject to a formal agreement setting out, inter alia, the extent of services to be provided and termination arrangements. Any existing agreements should be reviewed in order to determine whether they remain appropriate and updated if necessary.</p> <p>As a general point, the Commission would regard it as a matter of good corporate governance for any agreement to be updated in order to reflect any change in the</p>

Summary Finding	Commission Response
	<p>regulatory framework and/or the services provided.</p> <p><u>Action</u> The Draft Guidance will be amended to provide additional guidance in this area.</p>

6.1.3 Due diligence

Summary Finding	Commission Response
<p>a) The extent of initial due diligence performed by the promoter of the ME structure on the MoME was inconsistent, as was the level of documentation maintained.</p> <p>MoMEs requested clarity on:</p> <ul style="list-style-type: none"> • the respective obligations of the ME and the promoter with regards to due diligence procedures performed on the MoME prior to accepting the MoME as a service provider; • the obligations of the ME board in demonstrating their involvement and how this can be evidenced; and • the expected level of documentation to be maintained by the ME. 	<p>The Commission expects due diligence on the MoME to be conducted by the person entering into an administration agreement. Where the ME has been newly established, this will often be the promoter of the fund. In the case of a ME wishing to transfer to a new service provider, the due diligence exercise might be undertaken by the promoter or by the ME itself.</p> <p><u>Action</u> The Commission does not consider it necessary to introduce prescriptive requirements in this regard. It was noted that some ME boards have chosen to ratify the agreement established by the promoter with the MoME as a means of affirming that the services appear sufficient to satisfy their requirements in conjunction with the services delivered by other providers or by the ME itself. Such an approach appears reasonable in the circumstances.</p>
<p>b) Industry was unclear as to which party is expected to perform due diligence on behalf of the ME when the role of MoME is transferred from one party to another.</p> <p>Clarity is being sought in respect of which parties are expected to perform due diligence on a prospective MoME prior to transfer and what documents should be maintained to demonstrate this.</p>	<p>To the extent that the ME is undertaking the due diligence and appointing a new provider, a practical approach might be for any non MoME directors on the ME board to take responsibility for performing due diligence on the proposed new MoME. Where there are no non MoME directors on the ME board, the responsibility would logically fall to the promoter of the ME structure.</p> <p><u>Action</u> The Commission does not consider it</p>

Summary Finding	Commission Response
	necessary to introduce prescriptive requirements in this regard but will amend the Draft Guidance to include the above quoted practical examples.

6.1.4 Monitoring

Summary Finding	Commission Response
a) There was inconsistency in the extent and nature of monitoring of the services provided by the MoMEs to the MEs. MoMEs requested clarity on the practical application of this requirement given that many of the day to day monitoring procedures were in practice performed by the MoME on behalf of the ME.	The Commission would suggest that a practical approach would be for key risk indicators to be agreed between the MoME and ME and for these to be monitored by way of periodic compliance reports to the ME board. <u>Action</u> Draft Guidance to be amended to provide additional guidance in this area.
b) There was inconsistency in the level of monitoring of the ME risks by the ME boards. MoMEs requested guidance on the level of monitoring to be performed by the ME and the extent that this can be undertaken by the MoME.	The Commission would regard it the responsibility of the ME board to monitor its business risks notwithstanding that the monitoring of such risks may often be delegated to the MoME and reported upon via compliance reports to the ME board. <u>Action</u> Draft Guidance to be amended to provide additional guidance in this area.
c) Some respondents questioned how a ME can be expected to oversee its staff when functions are being undertaken on its behalf by the MoME or other service providers.	The Commission would consider this requirement to be discharged by way of the ME monitoring the services provided to it by its MoME in accordance with finding (i) above. <u>Action</u> Draft Guidance to be amended to clarify this point.

Summary Finding	Commission Response
d) Respondents sought the Commission's view as to when 3.1.3 of the FSB Codes (the requirement to establish a separate risk management function) is likely to be relevant to a ME.	<p>The Draft Guidance already states that this provision is unlikely to be relevant to a ME. However, MEs may seek guidance from the Commission on a case by case basis if they are in any doubt as to the relevance of this provision to their business.</p> <p><u>Action</u> None</p>

6.2 Corporate Governance

6.2.1 Board arrangements

Summary Finding	Commission Response
a) The visits revealed that responsibilities are not being apportioned among the directors of the MEs. Respondents questioned whether it was necessary to do so.	<p>Whilst the Commission would expect ME boards to be able to demonstrate that they have considered their responsibilities and accountabilities collectively, it would acknowledge that it may not be necessary to assign individual responsibilities to the directors of ME boards provided that they do not also serve as the Compliance Officer, Money Laundering Reporting Officer or Money Laundering Compliance Officer.</p> <p><u>Action</u> Draft Guidance to be amended to clarify this point.</p>
b) There was some confusion as to whether it is the Commission's intention that the responsibility for a MEs corporate governance should fall to the MoME.	<p>A MoME needs to be aware of the actions being taken by a ME as a means of assessing any risk that may arise to its own business. However, the responsibility for corporate governance rests squarely with the board of the ME.</p> <p><u>Action</u> Draft Guidance to be amended to clarify this point.</p>

6.2.2 Span of Control

Summary Finding	Commission Response
<p>a) There was inconsistency in how the adequacy of the span of control within the ME was assessed upfront, and subsequently monitored and maintained.</p> <p>MoMEs requested clarity on who is expected to ensure that there is an adequate span of control in place within the ME both at inception and on an ongoing basis.</p> <p>Respondents also questioned how compliance with the span of control requirements is appropriate given that some roles are being fulfilled by staff provided by the MoME.</p>	<p>The Commission would expect the ME board consider the adequacy of its span of control and to re-assess this in the event of changes to the board, staffing provided by the MoME or a significant change in business activities.</p> <p>The Commission would also wish to clarify that the span of control requirements may be satisfied in whole or part by means of staff provided to the ME by the MoME.</p> <p><u>Action</u> Draft Guidance to be amended to clarify this point.</p>
<p>b) One respondent suggested that the fact that the Commission has approved a principal person should be sufficient for the ME to regard them as competent.</p>	<p>The Commission does not accept this argument. It is for the board of a registered person (whether a managed entity or otherwise) to assess the competence of its staff and senior management. The Commission conducts a fit and proper assessment of principal persons as part of its regulatory function but this must not be considered a substitute for the registered person conducting its own assessment.</p> <p><u>Action</u> None.</p>

6.2.3 Conflicts of interest

Summary Finding	Commission Response
<p>a) It was noted that there was inconsistency in the manner in which conflicts of interest policies were documented at the ME level, and in the methods used to monitor those potential conflicts.</p> <p>MoMEs requested clarity on the expected level of documentation required at the ME level with regards to conflicts of interest.</p>	<p>A practical means of addressing this would be for MEs to formally adopt the MoMEs policy and procedures documents and supplement these with further ME specific documents if deemed necessary. The MEs could consider having a standing agenda point at each ME board meeting for directors to disclose any potential conflicts.</p>

Summary Finding	Commission Response
	<p><u>Action</u> Draft Guidance to be amended to provide additional guidance in this area.</p>
<p>b) MoMEs were unclear how to practically address inherent conflicts caused by providing director and Compliance Officer services to the MEs where the individuals providing the service acted in the same capacity for the MoME.</p> <p>Clarity was sought in respect of the Commission's expectations as to what evidence needs to be maintained to demonstrate that such conflicts of interest are being addressed.</p>	<p>The Commission would suggest that, as a minimum, there should be a documented policy setting out areas of likely conflict and what steps may be taken in the event of such conflicts arising.</p> <p>Inherent conflicts should be identified and tabled. Where appropriate, policies and procedures should reflect how they are mitigated.</p> <p>It was noted that some MoMEs have already introduced practical measures to address this issue by splitting the compliance roles where the size of the MoME permits (i.e. the MoME retains its Compliance Officer and a separate Compliance Officer is appointed to ME boards), or by ensuring the ME board has an enhanced level of oversight of any individual performing a dual role.</p> <p><u>Action</u> Draft Guidance to be amended to provide additional guidance in this area.</p>

6.3 Compliance arrangements

Summary Finding	Commission Response
<p>a) A number of ME's had no requirement for Compliance Officers to attend ME board meetings.</p> <p>A lack of consistency across industry indicates a potential need to clarify the Commission's expectation of the level of contact ME Compliance Officers should have with the ME boards.</p>	<p>The Commission would anticipate that a Compliance Officer should have direct access to board meetings of the ME notwithstanding that he/she may not attend the board in person. In either event, the Compliance Officer should be in a position to submit compliance reports directly to the full board either in person or in writing. The Commission would expect the use of such access to be documented in the board minutes.</p> <p><u>Action</u> Draft Guidance to be amended to clarify this point.</p>

6.4 Compliance with the FSB Codes

6.4.1 Compliance with the high level principles of the FSB Codes

Summary Finding	Commission Response
<p>a) Some respondents were concerned by Appendix 1 of the Draft Guidance and suggested that it would have the effect of imposing the full weight of the FSB Codes on MEs by the “back door”.</p>	<p>Appendix 1 of the Draft Guidance sets out an indicative benchmark of how a ME might go about demonstrating compliance with the high level principles of the FSB Codes.</p> <p>In providing this guidance, the Commission was responding to direct requests from registered persons and their auditors for clarification of how the Commission might interpret the high level principles in practice.</p> <p>Appendix 1 of the Draft Guidance has been provided in this spirit but the Commission would emphasise that the guidance is non binding and that it is open to a ME to demonstrate compliance with the high level principles by such means that it considers appropriate to its own business. The Commission will always consider such arrangements in the context of the ME and the activities that it is engaged in.</p> <p><u>Action</u></p> <p>The Commission considers it helpful to retain Appendix 1 of the Draft Guidance but will revisit the wording to ensure that the status and application of the Guidance is clear and that it allows for sufficient flexibility.</p>
<p>b) Some respondents argued that certain provisions of the FSB Codes should apply to the MoME rather than the ME. The responsibility to retain records was cited as an example.</p>	<p>These requirements need to be enforceable against the ME albeit that the Commission acknowledges that the MoME will often be attending to these requirements on the MEs behalf.</p> <p><u>Action</u></p> <p>None.</p>

Summary Finding	Commission Response
c) Some respondents argued that the high level principles treatment under the FSB Codes should be available to all managed entities irrespective of whether they act for expert or retail funds.	<p>The Commission has concluded that a differential treatment for fund services businesses acting for retail funds may not be in adherence with international standards and, accordingly, no change is proposed at this time.</p> <p><u>Action</u> None.</p>

6.4.2 Financial Resources

Summary Finding	Commission Response
<p>a) MoMEs considered the monitoring and reporting requirements in respect of Adjusted Net Liquid Assets (“ANLA”) calculations at the ME level to be unwarranted and the requirements of the FSB Codes to be inconsistent with other regulatory requirements.</p> <p>MoMEs requested clarity on the need for ANLA calculations to be performed by the ME and an explanation of inconsistencies between the requirements of the FSB Codes and the requirements in place for other regulated business.</p>	<p>In the Commission’s view, the FSB Codes and the Draft Guidance provide sufficient scope for the board of a ME acting for expert or equivalent funds to determine their own financial resources requirement. The ANLA calculation may be used as a guide but the key is that the ME board have considered their financial resources requirement and documented these discussions and their rationale for determining the appropriate level for their own circumstances.</p> <p><u>Action</u> Despite the above, there appears to be confusion in the industry and as such the Commission will reaffirm in the Draft Guidance that, for MEs acting for expert or equivalent funds, the ANLA calculation is simply a non-prescriptive guide and that it is for the board of the ME to determine an appropriate level of financial resources to meet their own requirements and document the rationale behind the decision taken.</p>
<p>b) MoMEs have experienced anomalous results when applying the calculation method as set out in the First Schedule of the FSB Codes.</p> <p>MoMEs requested that the Commission revisit the calculation method as presented to industry and to confirm whether the precise methodology is appropriate to all MoMEs.</p>	<p>The FSB Codes already provide for a registered person to seek guidance from the Commission in the event that any aspect of the FSB Codes creates an anomalous result.</p> <p><u>Action</u> The Commission would invite any MoME experiencing such difficulties to approach the Commission for guidance.</p>

6.4.3 Professional Indemnity Insurance

Summary Finding	Commission Response
<p>a) The majority of MoMEs visited were unclear as to why Professional Indemnity Insurance (“PII”) was required for ME directors even where they were covered by other insurance arrangements.</p> <p>Additional guidance has been requested in respect of:</p> <ul style="list-style-type: none"> • whether additional PII is required when ME directors are already covered by MoME policies; and • whether directors and officer’s liability insurance would be allowable in place of PII. 	<p>In the Commission’s view, the FSB Codes and Draft Guidance allow sufficient scope for the board of the ME to determine what extent of insurance cover they require provided that they document their rationale and such rationale is considered reasonable.</p> <p><u>Action</u></p> <p>The Draft Guidance will be amended to reaffirm that it is for the directors of MEs to determine what level of cover is appropriate for their business.</p>
<p>b) Some respondents pointed out that most MoMEs do not provide PII to the ME and that the ME instead either obtains its own cover or relies on an existing group policy from the Promoter.</p>	<p>This point is noted. The Draft Guidance does not prescribe that a MoME should provide PII it merely observes that this is a service that it might provide.</p> <p><u>Action</u></p> <p>None.</p>

6.4.4 CPD

Summary Finding	Commission Response
<p>a) Some MoMEs have experienced difficulties in evidencing CPD for directors on the ME boards who were not supplied by the MoME.</p> <p>MoMEs requested clarity on:</p> <ul style="list-style-type: none"> • the respective obligations of the MoME and ME in evidencing CPD. • the type of CPD required by ME directors who are not finance professionals. • whether CPD is required for non-Jersey directors. 	<p>The Commission would acknowledge that MEs acting for Expert Funds or equivalent may represent a distinct case in that:</p> <ul style="list-style-type: none"> i/ Staff or directors provided by a MoME will already be subject to separate CPD requirements within their own business; ii/ The funds are only available to sophisticated investors who are able to form their own view of the competence of senior management as disclosed in any prospectus or offering document.

Summary Finding	Commission Response
	<p>In view of the above, the Commission considers that an acceptable approach would be for the ME to be able to demonstrate (either through board minutes or otherwise) that all directors had received and acknowledged periodic updates in relation to relevant changes in the regulatory and anti-money laundering requirements.</p> <p><u>Action</u> The Draft Guidance to be amended accordingly.</p>

6.4.5 Procedures

Summary Finding	Commission Response
<p>a) Some respondents pointed out that it is not always appropriate for the ME to adopt the MoME's procedures in full.</p>	<p>The Commission acknowledges this point and would clarify that it is up to the ME whether it wishes to adopt the MoME's procedures in whole or in part or whether it will develop its own procedures. Likewise, it is up to the MoME whether it wishes to make all or part of its procedures available to the ME.</p> <p><u>Action</u> The Draft Guidance to be amended accordingly.</p>

6.5 Compliance with the Financial Services (Fund Services Business (Accounts, Audit & Reports)) (Jersey) Order 2007

6.5.1 Director's declarations

Summary Finding	Commission Response
<p>a) There was inconsistency in the formats used by industry when completing director's declarations required under the Order.</p> <p>MoMEs requested guidance on whether a final agreed template exists for director's declarations.</p>	<p>The Commission intends to issue separate guidance in relation to the Order which will address this point. The guidance will be issued shortly.</p> <p><u>Action</u> This point will be clarified in the guidance to be issued in relation to the Order.</p>

Summary Finding	Commission Response
<p>b) There was inconsistency across MEs as to whether they report breaches of the full FSB Codes in the declaration where the ME is only required to comply with the core principles.</p> <p>MoMEs requested clarity as to whether there is an expectation for ME boards which act for expert funds or materially equivalent funds to report breaches of the full FSB Codes when they are only required to apply the core principles of the FSB Codes.</p>	<p>The Commission would emphasise that it is for the MEs to apply discretion when deciding whether to report breaches of the full FSB Codes when only required to comply with the core principles of the FSB Codes.</p> <p>If a registered person is in any doubt as to whether a matter is disclosable he may seek guidance from his auditor and/or the Commission.</p> <p><u>Action</u> This point will be clarified in the guidance to be issued in relation to the Order.</p>
<p>c) There was a lack of consistency in the procedures performed by MEs prior to signing a declaration and the level of assistance given by the MoMEs with these procedures.</p> <p>Clarity is being sought in respect of whether there is an expectation for specific procedures to be performed by MEs prior to signing a declaration, or whether reliance can be placed on monitoring and other procedures performed throughout the period.</p>	<p>The Commission would expect MEs to apply discretion on the level of additional procedures to be performed prior to signing a declaration. However, we would expect that evidence be maintained in order to demonstrate how the ME directors gained comfort with the MEs compliance prior to signing. Such evidence may include a breaches log and compliance reports prepared for the ME board during the financial year in question.</p> <p><u>Action</u> This point will be clarified in the guidance to be issued in relation to the Order.</p>

6.6 Other

Summary Finding	Commission Response
<p>a) One respondent argued that in circumstances where a MoME was providing services to a ME which acted for an unregulated fund then it would be more appropriate for the relationship to be governed by the trust company business Codes of Practice.</p>	<p>Certain fund service providers acting in relation to an unregulated fund are afforded an exemption from registration under the Law provided that they have appointed a MoME.² The Commission is of the view that such relationships should be subject to FSB Codes notwithstanding that the extent of services provided may differ from case to case.</p>

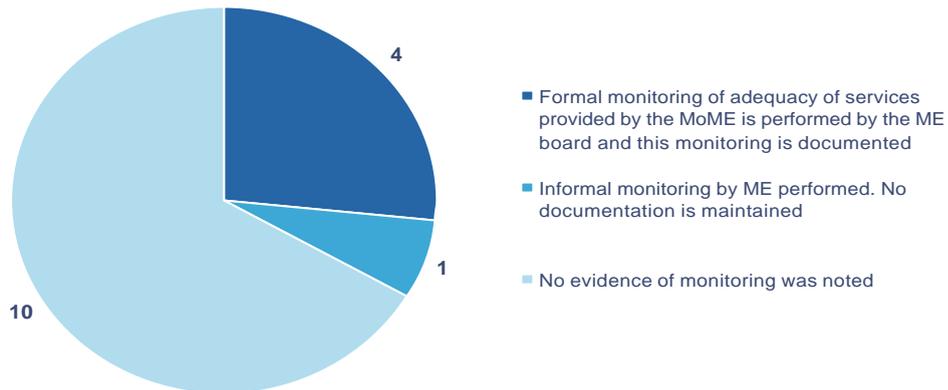
² The exemption is provided at paragraph 3C under the Second Schedule of the Law.

Summary Finding	Commission Response
	<p>There is a danger that placing MoME activities conducted in relation to unregulated funds within the trust company business regime would cause unnecessary duplication for practitioners and also prove unhelpful for supervisory purposes.</p> <p><u>Action</u> None.</p>

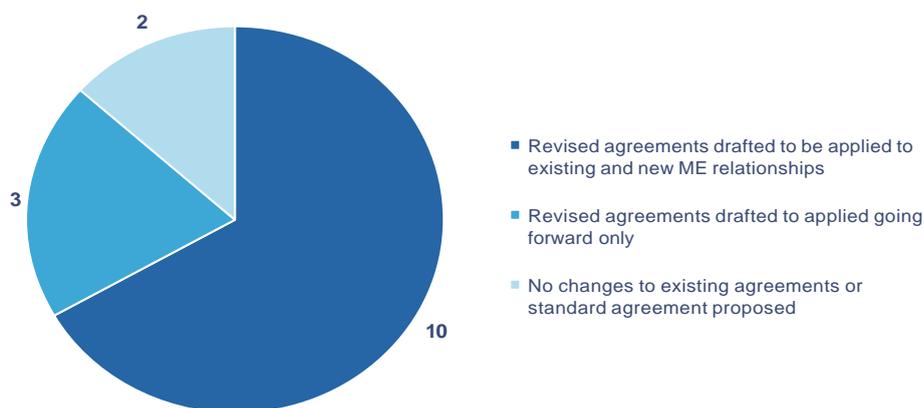
7 Statistical Analysis

7.1 The following diagrams provide a statistical analysis of the key findings from the programme of visits.

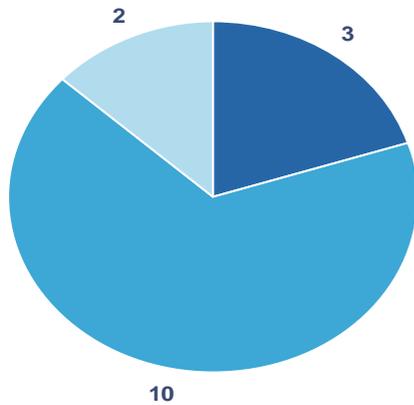
Monitoring of MoME services



Agreements

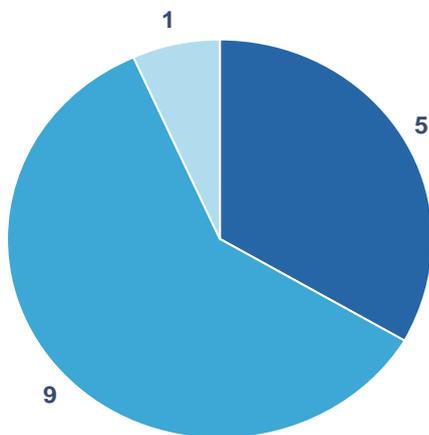


Due diligence performed on MoMEs by promoters of ME structures



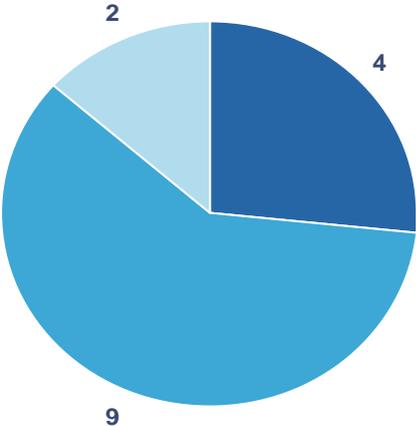
- Extensive of due diligence performed. Examples of procedures include the promoters holding detailed discussions with the MoME and the directors to be provided, and formal ratification of the MoME as a service provider at the first ME board meeting.
- A degree of due diligence performed, but no evidence of formal ratification by the ME board noted
- Limited due diligence performed

Monitoring of conflicts



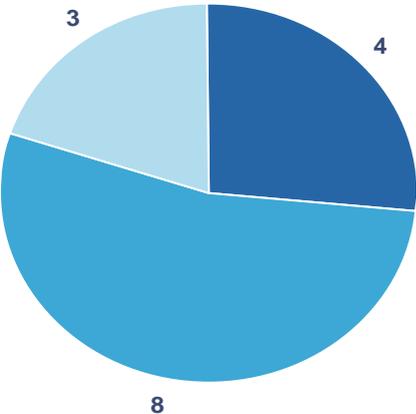
- Extensive monitoring of conflicts of interest at the ME level was noted. Examples of procedures include a requirement for ME directors to declare potential conflicts at each ME board meeting
- A degree of monitoring of potential conflicts of interest was noted
- No specific monitoring of conflicts of interest was noted

Conflicts of interest identified



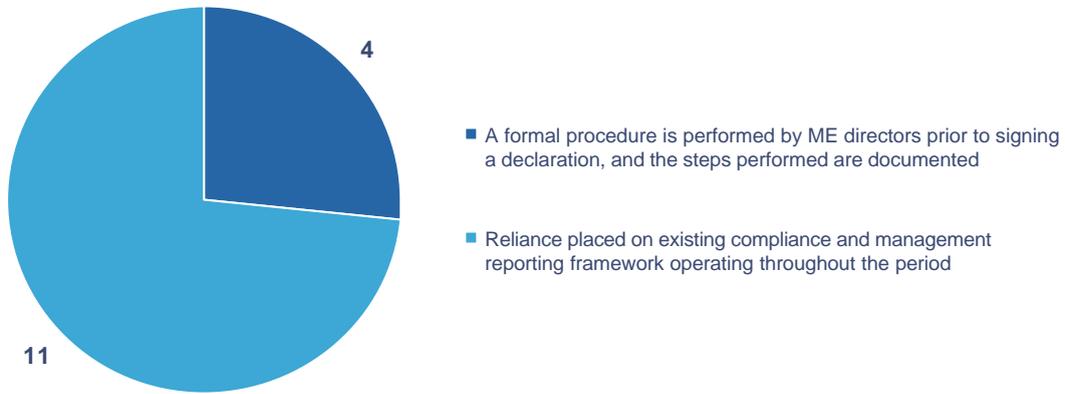
- Only limited conflicts, such as dual roles of ME/MoME directors and Compliance Officers noted
- Some additional conflicts identified such as additional dual roles or directors holding shares in underlying funds for which the Mes act
- A high level of conflicts were identified. For example company secretaries acting as a director to the ME or ME directors acting as compliance officer

Monitoring of the span of control



- Formal periodic monitoring performed by the ME board
- A degree of monitoring noted. Not specifically carried out periodically by the ME board
- No specific monitoring noted

**Procedures performed prior
to signing a directors' declaration**



8 Conclusions

- 8.1 The Commission has found this exercise very useful in gauging current practices and better understanding the impact of the regulatory requirements from the perspective of those subject to them.
- 8.2 In terms of current industry practices, the Commission was encouraged to note the progress that has been made by MoMEs in adapting their existing arrangements to conform with the new requirements. Whilst this process is clearly still ongoing, the visits and resultant feedback reports will provide a helpful basis from which to proceed with our supervisory relationship with the firms in question.
- 8.3 We also hope that the exercise has provided an opportunity for those firms that were examined to reflect upon their current arrangements and to raise any questions or concerns that they might have with the visit team.
- 8.4 Turning to the broader policy aims of this exercise, it was our intention to obtain feedback on the FSB Codes and the Draft Guidance in order that they might be refined where necessary. Whilst the Commission is of the view that the overall objectives of the Draft Guidance remain appropriate, this exercise has indicated that it is necessary to:
- 8.4.1 clarify certain structural arrangements in relation to MoMEs;
 - 8.4.2 re-emphasise that responsibility for compliance with the regulatory regime rests with the ME, notwithstanding that it has contracted the services of a MoME;
 - 8.4.3 clarify that the indicative benchmark for compliance with the high level principles of the FSB Codes which appears at Appendix 1 of the Draft Guidance is in no way binding and that MEs may determine their own means of demonstrating compliance with the high level principles;
 - 8.4.4 set out the Commission's expectations in relation to CPD conducted by the directors of MEs acting for expert or equivalent funds;
 - 8.4.5 provide additional guidance on conflicts of interest, Compliance Officer arrangements and corporate governance; and
 - 8.4.6 publish guidance in relation to the Order forthwith.
- 8.5 The Commission intends to publish finalised Guidance for MoME by 31 March 2009. In the interim, any comments on this report may be provided to the Commission using the contact details provided at section 4.2.
- 8.6 In closing, the Commission would once again like to thank all of those firms that participated in this exercise either by way of a visit or by providing comments in writing.