

# **CONSULTATION PAPER NO. 1 2013**

## **MANAGED ACCOUNTS**

This consultation relates to the possible amendment of Jersey's regime in relation to the regulation of the activities of those involved in the management of managed accounts.



# CONSULTATION PAPER

The Jersey Financial Services Commission (the “**Commission**”) invites comments on this consultation paper. Heather Bestwick at Jersey Finance Limited (“**Jersey Finance**”) is co-ordinating an Industry response that will incorporate any matters raised by local businesses. Comments should reach Jersey Finance by 26 April 2013.

Responses should be sent to:

**Heather Bestwick**

Deputy Chief Executive and  
Technical Director  
Jersey Finance Limited  
4<sup>th</sup> Floor,  
Sir Walter Raleigh House,  
48-50 Esplanade,  
St Helier,  
Jersey  
JE2 3QB

Telephone: +44 (0) 1534 836000

Email: [heather.bestwick@jerseyfinance.je](mailto:heather.bestwick@jerseyfinance.je)

Alternatively, responses may be sent directly to Wyn Hughes at the Commission by 26 April 2013. If you require any assistance, clarification or wish to discuss any aspect of the proposal prior to formulating a response, it is of course appropriate to contact the Commission.

**Wyn Hughes**

Senior Manager - Funds Policy  
Jersey Financial Services Commission  
PO Box 267  
14-18 Castle Street  
St Helier  
Jersey  
JE4 8TP

Telephone: +44 (0) 1534 822189

Email: [w.hughes@jerseyfsc.org](mailto:w.hughes@jerseyfsc.org)

**It is the policy of the Commission to make the content of all responses available for public inspection unless specifically requested otherwise.**

# Glossary of terms

|                    |  |
|--------------------|--|
| Codes              | means Codes of Practice issued by the Commission.          |
| the Commission     | means the Jersey Financial Services Commission.            |
| the Commission Law | means the Financial Services Commission (Jersey) Law 1998. |
| flagship fund      | has the meaning set out in section 1.1.1 of this paper.    |
| FSB Codes          | means the Codes of Practice for Fund Services Business.    |
| FS(J)L             | means the Financial Services (Jersey) Law 1998.            |
| IB Codes           | means the Codes of Practice for Investment Business.       |
| Jersey Finance     | means Jersey Finance Limited.                              |
| managed account    | has the meaning set out on section 4.5.5 of this paper.    |
| Minister           | means the Minister for Economic Development.               |

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# 1 EXECUTIVE SUMMARY

## 1.1 Overview

- 1.1.1 A managed account is a portfolio of investments managed on a discretionary basis by investment managers who also manage, using a fundamentally similar investment strategy, the holdings of a fund – the “**flagship fund**”.
- 1.1.2 There is currently a requirement that businesses providing these services are registered to carry on both Fund Services Business and Investment Business under the FS(J)L.
- 1.1.3 This paper raises questions as to the appropriate form of registration and supervision required in relation to the persons providing investment management services in respect of managed accounts.

## 1.2 What is proposed and why?

- 1.2.1 It is proposed that the current regulatory regime in relation to the managers of managed accounts be reviewed and consideration given to making changes which will result in removing the requirement for dual registration under the FS(J)L (as both a Fund Services Business and an Investment Business) if it does not appear that any significant disadvantages would follow from such a change or that the disadvantages would be outweighed by the benefits. There is currently a requirement that the providers of the services of managing a managed account be registered for both Fund Services Business (because they provide services to the flagship fund) and Investment Business (because they provide investment management services to the owner of a managed account). This requirement of dual registration imposes an additional direct cost (in the sense of dual fees) and compliance burden (because of the need to monitor as to compliance with two sets of Codes, namely the FSB Codes and the IB Codes) on the managers of managed accounts. This requirement of dual registration is also widely perceived as being unhelpful.

## 1.3 Who would be affected?

- 1.3.1 Persons registered for Funds Services Business and/or Investment Business under the FS(J)L that provide investment management services in respect of managed accounts.

## 2 CONSULTATION

### 2.1 Basis for consultation

2.1.1 The Commission has issued this consultation paper in accordance with Article 8(3) of the Financial Services Commission (Jersey) Law 1998 (the “**Commission Law**”), as amended, under which the Commission “*may, in connection with the carrying out of its functions - ....consult and seek the advice of such persons or bodies whether inside or outside Jersey as it considers appropriate*”.

### 2.2 Responding to the consultation

2.2.1 The Commission invites comments, in writing, from interested parties on the proposals included in this consultation paper. Where comments are made by an Industry body or association, that body or association should also provide a summary of the type of individuals and/or institutions that it represents.

2.2.2 To assist in analysing responses to the consultation paper, respondents are asked to:

2.2.2.1 prioritise comments and to indicate their relative importance; and

2.2.2.2 respond as specifically as possible and, where they refer to costs, to quantify those costs.

### 2.3 Next steps

2.3.1 If the result of the consultation is to proceed with managed accounts in the manner consulted upon in this paper the next step will be to seek a Ministerial Decision (from the Minister) to instruct the Law Draftsman to create a new class of Fund Services Business under the FS(J)L - manager of a managed account - and to create an exemption for a person registered in respect of that class of business from the requirement also to be registered in respect of Investment Business.

## **3 THE COMMISSION**

### **3.1 Overview**

3.1.1 The Commission is a statutory body corporate established under the Commission Law. It is responsible for the supervision and development of financial services provided in or from within Jersey.

### **3.2 Commission's functions**

3.2.1 The Commission Law prescribes that the Commission shall be responsible for:

- 3.2.1.1 the supervision and development of financial services provided in or from within Jersey;
- 3.2.1.2 providing the States, any Minister or any other public body with reports, advice, assistance and information in relation to any matter connected with financial services;
- 3.2.1.3 preparing and submitting to the Minister recommendations for the introduction, amendment or replacement of legislation appertaining to financial services, companies and other forms of business structure;
- 3.2.1.4 such functions in relation to financial services or such incidental or ancillary matters:
  - as are required or authorised by or under any enactment, or
  - as the States may, by Regulations, transfer; and
- 3.2.1.5 such other functions as are conferred on the Commission by any other Law or enactment.

### **3.3 Guiding principles**

3.3.1 The Commission's guiding principles require it to have particular regard to:

- 3.3.1.1 the reduction of risk to the public of financial loss due to dishonesty, incompetence, malpractice, or the financial unsoundness of persons carrying on the business of financial services in or from within Jersey;
- 3.3.1.2 the protection and enhancement of the reputation and integrity of Jersey in commercial and financial matters;
- 3.3.1.3 the best economic interests of Jersey; and
- 3.3.1.4 the need to counter financial crime in both Jersey and elsewhere.

# 4 Questions in relation to Managed Accounts

## 4.1 Provision of Services to Managed Accounts

- 4.1.1 Market developments have led to the development of a method of managing investments known as “managed accounts”. The purpose of this consultation paper is to seek views on how the managers of such accounts that provide their services in or from within Jersey should be regulated and supervised.
- 4.1.2 A managed account is an investment portfolio managed as a discretionary portfolio by the manager of a fund - the flagship fund. Whilst the investment strategy is the same as, or substantially similar to, the investment strategy of the flagship fund, there will be differences in organisation and there may also be minor differences in investment strategy between the managed account and the flagship fund. Managed accounts have become increasingly popular over the last few years because it is perceived that they have advantages over, or lack some of the disadvantages of, the related flagship fund.
- 4.1.3 The potential advantages of a managed account over the related flagship fund include the following:
- 4.1.3.1 The managed account makes it possible for an investor to be exposed to assets without his ability to withdraw from that exposure being affected by a decision of the manager to impose a “gate” or “suspension”; in circumstances of reduced marketability of holdings (or times of extreme volatility in prices) a manager may have the power, or a duty, to impose restrictions on withdrawals from the fund which it manages. The effect of this is that an investor may not be able fully to realise his holding in a fund (or as much of it as he might desire) when he wishes. Of course, even holding assets within a managed account cannot isolate the investor from the undesired consequences of reduced marketability, or volatile prices, but at least his freedom of action is affected only by market conditions and not by any decisions in relation to co-investors.
- 4.1.3.2 The managed account enables increased and/or improved information flow. An investor in a managed account may wish to receive information in a different form, at more frequent intervals and/or which is more up-to-date than the periodic reports provided to investors in a fund.
- 4.1.3.3 The managed account enables the use of custodians and/or other service providers other than the service providers used for the flagship fund.

- 4.1.4 Bodies corporate or individuals that wish to obtain access to the investment skills of a manager, which is the manager of a flagship fund, will do so by setting up a managed account to be managed by that manager.
- 4.1.5 **Do you agree that it should continue to be possible for managed accounts to be managed in or from within Jersey? Please give your reasons.**

## 4.2 Current Legislative Regime

- 4.2.1 Current legislation has the effect that the manager of a managed account has to be registered for two types of business under the FS(J)L – namely, as a Fund Services Business (by reason of its activity in managing a Collective Investment Fund) and as an Investment Business (by reason of undertaking investment business by managing the investments of the owner of the managed account). This imposes an additional burden, and cost, on the registered person and there is a question whether any (or sufficient) benefit follows from the requirement for registration for two types of financial services business.
- 4.2.2 **Do you agree that no benefit is obtained by requiring the managers of managed accounts to be registered for two types of business under the FS(J)L in respect of the same activities? Please give your reasons.**

## 4.3 Managed Entities

- 4.3.1 The Commission's current position is that managing managed accounts may not be carried on by managed entities – that is, entities which do not have a fully staffed presence in Jersey but which operate by using the services provided by another registered person which is permitted to provide those services, namely, the Manager of a Managed Entity. That is because it is current Commission policy that Investment Business may not be carried on by a managed entity.
- 4.3.2 There is a view that it might be appropriate to permit managers of managed accounts to establish themselves as being managed initially by a manager of a managed entity but on the basis of an agreed timetable as to the date by which those managers expect to be stand-alone entities. The following requirements would need to be met:
  - 4.3.2.1 the managed entity would have to be managed by a manager holding a Class ZK licence (manager of a managed entity);
  - 4.3.2.2 the directors/employees with responsibility for the day-to-day management of the assets and resident in Jersey and in relation to whom the Commission has no objection would need to be an integral part of the business of the promoter (that is, the business behind the managed entity);
  - 4.3.2.3 the span of control requirements would need to be satisfactorily dealt with; and

- 4.3.2.4 a business plan would need to be provided to the Commission which was acceptable to the Commission and which made adequate arrangements in relation to a timescale for the operation to become stand-alone; in this regard it is unlikely that a period of longer than 12 months for the entity to become stand-alone would be acceptable to the Commission.
- 4.3.3 In arriving at the suggestion set out in section 4.3.2 the Commission has sought to balance the position of new businesses, which will need to bear the cost of establishing full presence, with that of full-presence managers of managed accounts, which have already incurred costs in establishing in Jersey.
- 4.3.4 **Do you agree with the approach outlined here in relation to managed entities? In particular, have you any views on the period within which a managed entity carrying out this activity would be expected to change into a full presence? Please give your reasons.**

## 4.4 Proposals

- 4.4.1 The creation of a new class of Fund Services Business - “manager of a managed account” - under the Financial Services (Financial Services Business) (Jersey) Order 2009;
- 4.4.2 The creation of an exemption of the manager of a managed account(s) from the requirement to register for Investment Business in respect of its activities in relation to a managed account(s);
- 4.4.3 The insertion of a definition of “managed account” in Article 1 of the FS(J)L; and
- 4.4.4 The amendment of Article 2(10) of the FS(J)L to provide that a person carries on fund services business if by way of business the person is the manager or investment manager of a managed account.
- 4.4.5 **Do you agree with the approach outlined here? If you do not, would you please state your reasons and make alternative suggestions?**

## 4.5 Matters connected with the Proposals

- 4.5.1 The creation of an exemption would not be unprecedented as there is already an exemption (set out in paragraph 3A of Part 1, Schedule 2 of the FS(J)L) from the requirement for Investment Business registration for those holding a Fund Services Business registration; subject to law drafting advice it is possible that the new exemption would be brought into existence by the creation of an additional class of Fund Services Business by the amendment of the Financial Services (Financial Services Business) (Jersey) Order 2009.
- 4.5.2 For this purpose the Commission envisages that a managed account should have the meaning set out in paragraph 4.5.5 below.

- 4.5.3 The effect of these changes would be that a business wishing to carry on the business of managing managed accounts would need to be registered as a Fund Services Business although it could continue, if it wished, also to be registered as an Investment Business.
- 4.5.4 The appropriate size for a managed account is for consideration. The Commission seeks views as to the minimum size but suggests that somewhere in the region of US\$ 5 million to US\$ 10 million might be appropriate. In the absence of a required minimum for a managed account there is a risk that such accounts might be set up for investors who do not have the sophistication or resources to assess for themselves the risks which are associated with establishing a managed account.
- 4.5.5 The Commission's proposed definition of a managed account is:
- 4.5.5.1 **"managed account"** means a portfolio of assets beneficially owned by only one beneficial owner;
  - 4.5.5.2 of not less than US\$ 5,000,000 (or its equivalent) (but see question 8) at the commencement of its management;
  - 4.5.5.3 managed on behalf of another person by a person (the "Registered Person") registered to undertake fund services business as manager; and
  - 4.5.5.4 managed as a discretionary portfolio pursuant to an investment strategy that is the same as or is substantially similar to that of a fund (the flagship fund) or part thereof of which the Registered Person is already the manager, investment manager or investment adviser.
- 4.5.6 **Do you agree with the Commission's suggested definition of a managed account? If not, would you please state why not and suggest an alternative definition?**
- 4.5.7 **Do you agree that the manager of a managed account should be permitted to continue to be registered as an Investment Business, if it wishes, notwithstanding its registration as a Fund Services Business?**
- 4.5.8 **Do you agree to the creation of a new class of Fund Services Business - manager of a managed account? Please give your reasons.**
- 4.5.9 **Do you consider a minimum size for a managed account to be appropriate? If so, would you please indicate the level, which need not be within the range of US\$ 5 million to US\$ 10 million mentioned above.**

## 4.6 Applicable Codes

- 4.6.1 The suggestion in relation to the applicable Codes is as follows: A business which is registered to carry on Fund Services Business should be required to follow the FSB Codes in relation to its work in respect of managed accounts. A business which is registered to carry on Investment Business should be

required to follow the IB Codes in relation to its work in respect of managed accounts. This will clarify which Codes are applicable and lead to the logical position that a business should comply, in respect of all its activities relating to managed accounts, with whichever of the Codes applies to the type of business which it is registered to carry on. If a business chooses to be registered both for Fund Services Business and for Investment Business it should follow both sets of Codes. The exemption of a business from the requirement to be registered for Investment Business (and hence from the requirement to follow the IB Codes) would have the effect that the holder of a managed account managed by a business registered only for Fund Services Business would have the benefit of the protections given by the FSB Codes only.

- 4.6.2 **Do you agree with the suggestion that the Codes which are required to be followed (the FSB Codes or the IB Codes) should depend on the kind of business for which the manager of the managed account is registered (and, if registered for both types of business should follow both sets of Codes), in the way outlined above?**

## **5 COST BENEFIT ANALYSIS**

### **5.1 Costs to Industry**

5.1.1 Some increase in costs to Industry may result from changes to simplify the regime in relation to managed accounts. However, whilst an application fee and an annual fee will be payable in respect of the new class of Fund Services Business a business would be relieved from the requirement to pay a registration fee in respect of Investment Business, unless it chose to remain registered for Investment Business also. The simplification of the regulatory regime should, however, lead to a reduction in administrative costs. A business that has not previously registered under the FS(J)L which applies to be registered to carry on the activity of managing a managed account would need to make only one application and pay only one application fee.

### **5.2 Costs to the Commission**

5.2.1 It seems unlikely that any significant increase in costs to the Commission will result from any changes which are decided to be made to simplify the regime in relation to managed accounts.

### **5.3 Benefits**

5.3.1 The simplification of the regime, if made, should lead to a reduction in the administrative burden on Industry and potentially increase the amount of managed account business, and the number of providers of this service, in Jersey.

## 6 SUMMARY OF QUESTIONS

| REFERENCE | QUESTION  |
|-----------|---|
| 4.1.5     | Do you agree that it should continue to be possible for managed accounts to be managed in or from within Jersey? Please give your reasons.  |
| 4.2.2     | Do you agree that no benefit is obtained by requiring the managers of managed accounts to be registered for two types of business under the FS(J)L in respect of the same activities? Please give your reasons.   |
| 4.3.4     | Do you agree with the approach outlined here in relation to managed entities? In particular, have you any views on the period within which a managed entity carrying out this activity would be expected to change into a full presence? Please give your reasons.  |
| 4.4.5     | Do you agree with the approach outlined here? If you do not, would you please state your reasons and make alternative suggestions?  |
| 4.5.6     | Do you agree with the Commission's suggested definition of a managed account? If not, would you please state why not and suggest an alternative definition?   |
| 4.5.7     | Do you agree that the manager of a managed account should be permitted to continue to be registered as an Investment Business, if it wishes, notwithstanding its registration as a Fund Services Business?  |
| 4.5.8     | Do you agree to the creation of a new class of Fund Services Business - manager of a managed account? Please give your reasons.   |
| 4.5.9     | Do you consider a minimum size for a managed account to be appropriate? If so, would you please indicate the level, which need not be within the range of US\$ 5 million to US\$ 10 million mentioned above.  |
| 4.6.2     | Do you agree with the suggestion that the Codes which are required to be followed (the FSB Codes or the IB Codes) should depend on the kind of business for which the manager of the managed account is registered (and, if registered for both types of business should follow both sets of Codes), in the way outlined above? |

# APPENDIX A

## List of representative bodies who have been sent this consultation paper.

- Alternative Investment Management Association
- Jersey Finance Limited
- Jersey Funds Association