Jersey Financial Services Commission

Jersey Private Fund Thematic Review
Q3 2020 – Q1 2021

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Contents

Executive Summary

In April 2017, the Jersey Financial Services Commission (**JFSC**) issued the Jersey Private Fund Guide (**JPF Guide**). Central to the regulatory and Anti-Money Laundering/Countering the Financing of Terrorism (**AML/CFT**) requirements of the JPF Guide is the role of a Designated Service Provider **(DSP)**. The DSP is a full substance Registered Person holding specified classes of business under the Financial Services (Jersey) Law 1998 (**FSJL**). Paragraph 6 of part G of the JPF Guide sets out the DSP's responsibility for a number of duties in relation to the relevant JPF[1]. These duties include:

1. making all reasonable enquiry, to ensure that the JPF meets all of the eligibility criteria referred to under part D of the JPF Guide, both on its establishment and, on a continuing basis;
2. ensuring that all necessary due diligence on the JPF and its promoter is carried out and ensuring the promoter of the JPF has put in place appropriate measures to ensure that all service providers to the JPF are fit and proper and can fulfil the tasks in a responsible, professional and suitable manner;
3. ensuring compliance with all necessary Jersey AML/CFT requirements applicable to the JPF;
4. completing and submitting the JPF application form and declaring in its capacity as DSP to the JPF and having made all reasonable enquiry, that the information provided in the JPF application form "is complete, true and accurate" to the best of the DSP's knowledge and belief;
5. completing and filing notice of material changes and notifying of certain incidences of non-compliance; and
6. completing and filing a JPF Annual Compliance Return (the **JPF Return**) which includes declarations made by the DSP regarding the JPF's ongoing compliance.

Further guidance on the JPF Return was published in June 2020[2].

The JPF thematic review examined the DSP's role in ensuring the JPF's compliance with the JPF Guide, the DSP's responsibilities and confirmations and in particular, those confirmations regarding the JPF's compliance with all necessary Jersey AML/CFT requirements. Noting that the JPF board of directors of the governing body (the **Board**) of the JPF remains primarily responsible for the JPF's compliance with the JPF Guide and the Jersey AML/CFT requirements.

At the time of planning the JPF thematic review there were 42 DSPs acting for 334 JPFs. The JPF thematic review had two work streams:

- 22 DSPs providing services to 255 JPFs (76% of all of the JPFs) were selected to answer a questionnaire; and
- Six of those 22 DSPs were selected for a more in depth examination visit. These six DSPs provided services to 148 JPFs (44% of all of the JPFs).

Examination findings demonstrated, that in most cases at the time of the examination, processes and procedures had been or were in the process of being put in place by the DSPs to ensure their own and the JPF's compliance with the JPF Guide and Jersey AML/CFT requirements.

Deficiencies were identified in the services provided by the DSP in ensuring the JPF was compliant with the Money Laundering (Jersey) Order 2008 (**MLO)** and the JPF Guide. The JFSC identified that the JPF Boards did not always hold the DSP accountable for not providing adequate services. The

[1] Part G, paragraph 6 https://www.jerseyfsc.org/industry/guidance-and-policy/jersey-private-fund-guide/

[2] https://www.jerseyfsc.org/industry/guidance-and-policy/jersey-private-funds-annual-returns/

majority of the Boards of the JPFs, which were subject to further review, had Jersey resident directors (in line with the JFSC's expectations) provided by the DSP or a company in the DSP's group. Also of concern was the number of JPF Returns filed confirming JPFs were compliant with all necessary Jersey AML/CFT requirements when this was not the case. Some DSPs had treated provision of services to the JPFs as an extension of their Trust Company Business (**TCB**) services, without factoring in the JPF was a relevant person under the MLO and therefore had its own AML/CFT obligations. There appeared to be a need for training in relation to the Boards of the JPFs, the DSPs and their staff, in relation to the requirements of the JPF Guide and Section 14 of the Handbook for the Prevention and Detection of the Money Laundering and the Financing of Terrorism (the **AML/CFT Handbook**)

There was a clear acknowledgement of deficiencies in most cases and remediation was already in progress.

As with all examinations, Registered Persons were required to produce, and submit to the JFSC, a remediation plan designed to address the findings identified, which will be taken into consideration by the JFSC during deliberations regarding appropriate next steps.

The JFSC would like to thank the selected Registered Persons and their staff for their assistance during this thematic examination.

Scope and methodology

The purpose of this paper is to provide an overview of the findings and examples of good practice identified by the JFSC, both of which may apply to or be of use to other DSPs when assessing the adequacy and effectiveness of the services they provide to JPFs. The themed examination was conducted over four phases:

- A survey was sent to 22 DSPs;
- An information request was sent to six DSPs;
- A further information request was sent to each of the six DSPs for additional documentation, including documentation relating to specific JPFs and the investors of those JPFs; and
- A series of scheduled examinations were undertaken.

The information request sent out to the six selected DSPs, of which five were registered to carry on both TCB and Fund Services Business (**FSB**) under the FSJL, with one registered to carry on TCB only. The information requested was:

- Board minutes relating to the DSP role and/or the JPFs;
- AML/CFT compliance reports relating to the DSP role and/or the JPFs;
- The DSP's Business Risk Assessment (**BRA**);
- Policies, procedures, checklists and any other supporting documents in relation to the provision of specified services to the JPF;
- JPF compliance testing results; and
- List of all JPFs and specific information required in relation to each of those JPFs.

Additional information was requested regarding 18 (2 - 4 JPFs per DSP) specific JPFs, chosen based on the existence of higher risk factors, such as:

- DSP's customer risk assessment on the JPF and supporting documentation;
- Structure chart of the JPF;
- Due diligence and risk assessment on the JPF's promoter;
- Details of promoter assessment of fitness and propriety of service providers;
- JPF AML/CFT compliance testing and monitoring results;
- List of all investors in the JPF and specific information required in relation to each of those investors;
- An indication of where AML/CFT Reliance and Exemptions had been used;
- DSP's service agreement with the JPF;
- Copies of any outsourcing agreements where JPF outsourced AML/CFT compliance to another entity other than the DSP;
- JPF Board minutes including compliance reports;
- JPF BRA;
- JPF's financial statements if audited; and
- Further information was also obtained in relation to selected investors.

Using the information provided the JFSC reviewed and assessed:

- The DSP's governance and oversight of the provision of DSP services, particularly looking at the DSP Board minutes and compliance reports;
- The DSP's AML/CFT compliance considering its BRA and Customer Risk Assessments (**CRAs**) in relation to its JPF customers;
- Whether the policies and procedures the DSP had designed prior to becoming a DSP enabled it to meet its obligations as DSP and ensure the JPFs would be and would continue to be compliant with the JPF Guide and AML/CFT requirements;
- How the DSP had met its DSP responsibilities and was effective in monitoring the JPF's compliance with the JPF Guide and AML/CFT requirements;
- Specifically what monitoring and testing had been undertaken by the DSP to enable it to submit the JPF's Annual Compliance Confirmation;
- How the Board minutes and compliance reporting to the DSP Board demonstrated the JPF was in compliance with the JPF Guide and the Jersey AML/CFT requirements. Plus the same documentation for the selected 18 JPFs.

- Using a risk based approach a total of 31 investor files were selected for an in-depth review. As part of these reviews Investor due diligence, Investor (customer) risk assessments and risk ratings were considered.

Using the documentation provided, together with the information obtained during interviews with Principal and Key Persons and employees of the Registered Person, separate examination reports were issued to the DSPs.

JPF Guide and AML/CFT requirements

Part G, paragraph 6 of the Jersey Private Fund Guide

The JPF Guide imposes specific duties upon the DSP that are set out at part G, paragraph 6 of the JPF Guide.

Control of Borrowing (Jersey) Order 1958

Each JPF is issued with a consent under the Control of Borrowing (Jersey) Order 1958 (a COBO Consent) which requires the JPF to comply with the JPF Guide.

Money Laundering (Jersey) Order 2008 & the AML/CFT Handbook

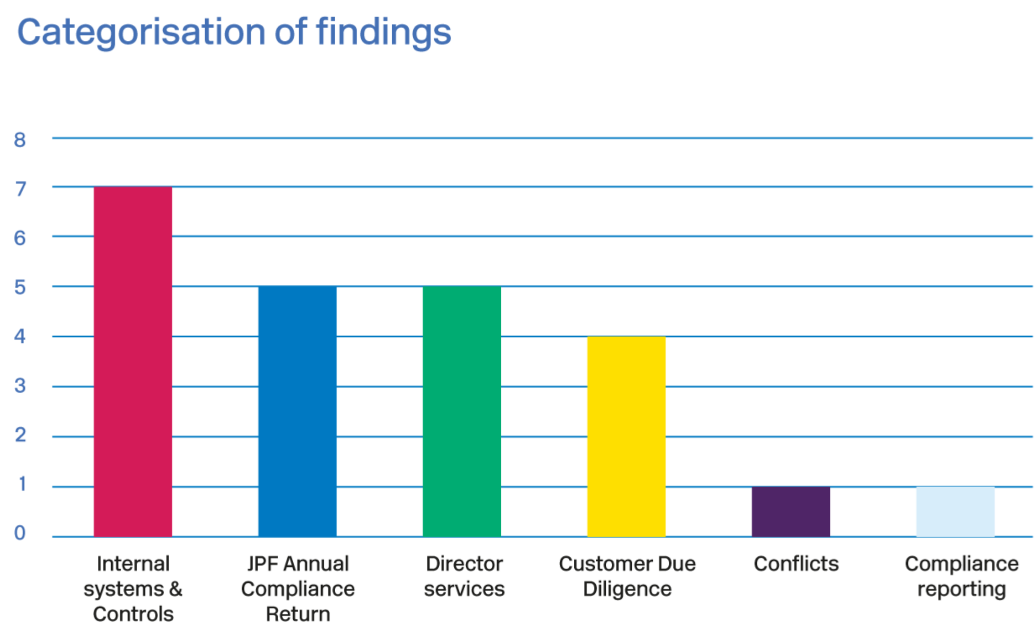
The AML/CFT Handbook at Section 14 provides guidance to funds and fund operators that are persons carrying on financial services business in or from within Jersey as defined at Article 1(1) of the MLO as relevant persons (Relevant Person) The DSP is a relevant person under the MLO and where the JPF is a relevant person under the MLO it must comply with AML/CFT obligations imposed by the MLO.

Codes of Practice

Where the DSPs are TCBs providing trust company business services to the JPFs, they are subject to the TCB Code of Practice.

Key findings

The findings from the thematic examination have been categorised into themes and these are shown in the graph below.



Internal Systems & Controls

Five out of the six DSPs examined had findings in this area which included:

- The Board of the DSP not demonstrating they understood the responsibilities of the DSP in relation to JPFs in accordance with the JPF Guide or that the JPFs were Relevant Persons under the MLO and that consequentially, each JPF was subject to specific AML/CFT requirements;
- Lack of training by the DSP of directors and employees involved in providing DSP services on the JPF Guide and Section 14 of the AML/CFT Handbook;
- Both the DSPs and the JPFs had inadequate policies and procedures which led to areas of non-compliance with the MLO, including failure of the JPF to appoint an MLRO and MLCO in accordance with the MLO;
- Unacceptable delays (in some cases over 12 months) in tabling the DSP BRA to the DSP Board, to take into consideration the provision of services to the new JPF product type and/or not keeping the BRA up to date;
- No written agreement between the JPFs and relevant DSP from the setup of the JPF, setting out the services to be provided by the DSP in line with the JPF Guide. Where there were such agreements, in some instances, the contracted services were not being provided to the JPF by the DSP, such as facilitating Board meetings quarterly;

- Reviews and record keeping not being undertaken in line with policies and procedures such as:
    - CDD deficiencies flagged but not followed up; and
    - Key documents being left undated.

JPF Annual Compliance Return

The JPF Return is required to be completed and filed by the DSP annually in respect of the JPFs they act for. Five out of the six DSPs examined had findings in relation to the JPF Return which included:

- Giving confirmations that the JPFs were compliant with all necessary Jersey AML/CFT requirements when:
    - No or inadequate testing or reviews had been undertaken in respect of the JPFs before providing the confirmation that they complied with the requirements;
    - There were instances when the JPFs were not compliant with all necessary Jersey AML/CFT requirements for example:
        - no formal appointment of the MLRO and MLCO; and
        - appropriate policies and procedures had not been adopted and/or followed.
- Inadequate checks had been made in relation to promoter due diligence; and
- Submitting incorrect investor numbers for multiple JPFs.

It was identified that on a number of occasions, JPF Returns had been completed giving inaccurate confirmations over a number of years without the DSP identifying this fact.

Director Services

In the majority of cases the DSPs provided Jersey resident directors on the board of the governing body of the JPF, or group companies of the DSPs acted as corporate directors in directorship roles on the JPF governing body. Five out of the six DSPs examined had findings in this area which related to issues with the JPFs where:

- The JPF directors neither understood nor demonstrated practical application of their duties as directors in relation to the AML/CFT requirements of the JPF product type;
- The JPFs were not compliant with Jersey AML/CFT requirements, examples include:
    - Inadequate BRAs which were too generic and did not adequately address the inherent risks posed by investors from higher risk jurisdictions or who had PEP connections;
    - Lack of demonstrable compliance monitoring plans (**CMPs**) in place for the JPFs;

   - Lack or infrequent compliance reporting to the Board of the JPF so it could not be demonstrated that the JPFs were compliant with the JPF Guide and Jersey AML/CFT requirements; and
   - Where issues had been identified by the CMP and these were not resolved.
- The JPFs not being compliant with the JPF Guide, such as investors not acknowledging the disclosure statement in writing.

Customer Due Diligence

As JPFs are customers of the DSPs, the DSPs are required to undertake CDD on the JPF and its customers (investors) where this forms part of the DSPs services. Three out of the six DSPs examined had findings in relation to CDD, such as:

- The CRAs undertaken by the DSPs on the JPFs did not adequately reflect the risk of the fund investor base or the fund promoters;
- Not recognising that an ultimate beneficial owner could have significant control of a Relevant Person through levels in an ownership chain regardless of the effective ownership percentage; and
- Shortcomings regarding information and records of source of funds in relation to higher risk investors.

Compliance Reporting

A DSP acting for JPFs entered into administration agreements, where the schedule of services to be provided included quarterly compliance reporting to the JPF Board. Compliance reports were not tabled until sometime after the establishment of the JPFs, and when reports were tabled, it could not be evidenced this continued on a quarterly basis. In some instances, the directors on the Board of the JPFs could not provide adequate explanation as to why the services contained within the administration agreements were not being provided. This included directors provided by the DSP or DSP group companies.

Conflicts

A DSP group company acted as a corporate director to a number of JPFs, however, the recorded declaration of interests in the minutes of the meetings of the Board of the JPFs did not adequately record that the corporate director was a member of the same group as the DSP. It was also noted that some of the individuals representing the corporate director at JPF Board meetings were directors of the DSP. The Board of a JPF is responsible for ensuring that all contracted services are received satisfactorily and that the JPF is compliant with the JPF Guide, which is a condition on the COBO Consent issued to it. In some instances, the services provided by the DSP to these JPFs led to non-compliance with statutory obligations and regulatory requirements.

Examples of good practice

The following practices were identified by the JFSC to show where Registered Persons have a good understanding of the requirements. These include:

- An annual compliance checklist tabled to the JPF Board regarding the JPF's compliance with the JPF Guide and AML/CFT requirements. The DSP making reference to the JPF's annual compliance checklist prior to filing the JPF Return with the JFSC;

- Where the DSP scheduled the quarterly Board meeting prior to filing the JPF Return with the JFSC, to ensure the information in the return was accurate and the JPF Return had been completed correctly. As part of this process the Directors reviewed and agreed the JPF Return after considering the JPFs CMP and if any compliance issues had been reported in relation to the JPF;
- Where the BRA of the DSP clearly refers to the role of the DSP and the duties imposed on the DSP by the JPF Guide;
- The DSP undertook a full review of its policies and procedures and updated them to meet the requirements of the JPF Guide including applicable AML/CFT requirements; and
- JPF DSP/Administration agreements that detailed the DSP services which reflected the duties of the DSP as set out in the JPF Guide.

Additional examples of good practice the JFSC would expect to see reflected in the JPF Board minutes include:

- Compliance reports being a standard agenda item;
- The appointment of the MLRO and MLCO clearly recorded in the initial Board minutes of the JPF; and
- Consideration by the JPF Board of the services the DSP has contracted to provide to it against the DSPs duties set out in the JPF Guide. As well as whether the DSP is adequately and effectively delivering these services.

The JFSC would also expect records to be available showing that all individuals connected to JPFs, such as the Board members and key persons of both the DSP and the JPF and the DSP staff, have received training in relation to Section 14 of the AML/CFT Handbook and the JPF Guide.

Survey

The survey was sent to 22 DSPs and their responses indicated they provided services to 260 JPFs.

Total JPFs	Number of JPFs that apply Jersey AML/CFT standards	Number of JPFs the DSP provides AML/CFT compliance services to	Total Jersey JPFs[3]	Total Non-Jersey JPFs	JPFs that are Alternative Investment Funds
260	256	257	237	23	59

Data from the JFSC's records shows that 211 of the 260 JPFs were limited partnerships which makes 81%. JFSC data also shows that 194 of the 211 JPFs that were limited partnerships were either Jersey limited partnerships or were non Jersey limited partnerships with Jersey general partners.

DSP JPF corporate governance

Questions were asked to see how the DSPs had adapted their internal corporate governance, compliance framework and policies and procedures to deal with JPFs and the additional obligations imposed by the DSP role.

Number of DSPs	Yes	No
Since assuming the role as DSP, do the Board minutes of the DSP make reference to JPFs and the DSP role?	15	7
Do the compliance reports of the DSP make reference to JPFs and the DSP role?	12	10
Does the business risk assessment of the DSP have a section(s) dedicated to JPFs and the DSP role?	6	16

Of those 16 DSPs where the BRA did not have a section to cover the JPFs and the DSP role, 10 indicated they were in the process of updating the BRA to include one. The JFSC identified two main concerns with the responses in the table above:

1) The DSPs are required to complete and file JPF Returns confirming that the JPF is compliant with requirements of the JPF Guide. These requirements include part D paragraph 9[4], which stated, "The DSP and, to the extent applicable, the governing body of the JPF are required to comply with all relevant provisions of the Money Laundering (Jersey) Order 2008 (MLO) and, for the avoidance of doubt, a JPF is a specified Schedule 2 business for the purposes of the Proceeds of Crime (Jersey) Law 1999 and the Proceeds of Crime (Supervisory Bodies) (Jersey) Law 2008".

   The DSP is required to give confirmations regarding the JPF's compliance with the JPF Guide and AML/CFT arrangements. Therefore, where there is no mention of the JPFs and/or the

[3] Includes JPFs that are non-Jersey LPs where the GP is a Jersey entity.

[4] https://www.jerseyfsc.org/industry/guidance-and-policy/jersey-private-fund-guide/

DSP's role in the Board minutes of the DSP and/or the compliance reports of the DSP, this raises questions regarding the authority and basis on which the JPF Return is made.

2) Section 2.3 paragraph 10 of the AML/CFT Handbook, which is mandatory for DSPs as regulated persons states "The Board must conduct and record a business risk assessment. In particular, the Board must consider, on an on-going basis, its risk appetite, and the extent of its exposure to money laundering and financing of terrorism risks "in the round" or as a whole by reference to its organisational structure, its customers, the countries and territories with which its customers are connected**, its products and services, and how it delivers those products and services.** The assessment must consider the cumulative effect of risks identified, which may exceed the sum of each individual risk element. The Board's assessment must be kept up to date." [Bold text added for emphasis]

The JPF is a specific product and the JPF Guide imposes specific DSP duties in relation to AML/CFT compliance by the JPFs. To ensure JPFs operate in accordance with the JPF Guide and that the DSP complies with the specific duties imposed at Part G of the JPF Guide, DSPs must implement appropriate policies and procedures The JFSC identified that nine of the 22 DSPs questioned did not specifically address part G of the JPF Guide within policies and procedures.

Number of DSPs	Yes	Partially	No
Do the DSP's policies and procedures cover the DSP role and responsibilities as set out in Part G of the JPF Guide?	13	8	1

Where JPFs have 16 to 50 investors, the DSP providing services to them is required to have the FSB class of business. It was envisaged that the FSB would have experience providing services to public funds which could be applied to the operation of private funds. The responses show that as anticipated, the vast majority of FSBs are in fact using their public fund FSB policies and procedures in relation to private funds.

Number of DSPs	Yes	Partially	No	N/A
If the DSP has a registration as a Fund Services Business under the FSJL are the same policies and procedures used for JPFs as public funds (save for any modifications for the DSP role)?	15	2	2	3
If the DSP has a registration as a Fund Services Business under the FSJL, do the same staff provide services to JPFs as public funds?	18	1	-	3

JPF Directors

The JPF Guide states in part C "Whilst there is no explicit requirement for the mind and management of a JPF (including a non-domiciled JPF) to be in Jersey, the JFSC would ordinarily expect, in the majority of cases, for one or more Jersey resident directors to be appointed to the board of a JPF's governing body."

The survey showed 72% of the JPFs have Jersey resident directors provided by the DSP. Almost half of the JPFs have Jersey resident directors not provided by the DSP and approximately 40% of those directors hold Class G registrations under the FSJL.

JPF Testing

Number of DSPs	Yes	Partially	No

Number of DSPs	Yes	Partially	No
Does the DSP test whether the JPFs it provides services to (as the DSP), comply with the JPF Guide (noting the obligations imposed on the DSP by the JPF Guide, particularly Part G, paragraph 6)?	14	6	2

Where the question was answered "partially" or "no" an explanation was requested. Responses included that the funds were dormant or new, the DSPs were undertaking a revision of their policies and procedures and/or their CMP to enable testing to take place and one DSP indicated that their current testing framework dealt with the majority of the requirements.

JPF AML/CFT equivalence

Three DSPs indicated they did not check AML/CFT equivalent standards are applied, two of which act for Jersey JPFs. The remaining DSP who acts for a non-Jersey JPF advised that "AML/CFT measures were all conducted by the [DSP] this has not separately been contemplated."

Number of DSPs	Yes	No
When the DSP undertakes a customer risk assessment on the JPFs, is it assessed whether AML/CFT standards equivalent to Jersey standards are applied by the relevant JPFs?	19	3

According to the survey responses, no DSPs had assessed JPFs as applying AML/CFT standards that were not equivalent to Jersey AML/CFT standards.

JPF AML/CFT Outsourcing

The responses of the DSPs regarding how many JPFs outsourced any aspect of their AML/CFT compliance indicated that 96% of the JPFs the DSPs provided services to outsourced AML/CFT compliance to their DSPs. It is noted that 9% of the JPFs that the DSPs act for are non-Jersey JPFs.

JPF product

Number of DSPs	Increase	Same	Decrease
Over the next 12 months, does the DSP anticipate the number of JPFs it provides services to will remain the same, increase or decrease?	17	4	1

One reason given for the number of JPFs remaining the same was that the DSP was not actively marketing JPFs. The DSP indicating a decrease was due to a fund winding up as it did not launch.

Conclusion

The JFSC is concerned that at the time Registered Persons became DSPs and commenced providing services, in many cases the DSPs were unable to demonstrate that they had implemented adequate and effective internal systems and controls (including policies and procedures) to comply with the duties and obligations imposed by the JPF Guide and the AML/CFT requirements.

The cornerstone of the JPF Guide, which was subject to extensive consultation with Industry, is that the Jersey regulated Service Provider (the DSP) makes confirmations/declarations to the JFSC regarding the JPFs it acts for, and on this basis the JPF is authorised by the JFSC on a fast track basis, with this also factored into the JFSC's supervisory approach.

The 23 examination findings have demonstrated that there are examples of both the DSPs and the JPFs they act for not being compliant with the JPF Guide and the MLO. Five out of the six DSPs had filed JPF Returns where the JPF was not fully compliant with the JPF Guide and/or the MLO.

The JFSC relies on DSPs being open and co-operative and ensuring that when the DSP gives confirmations/declarations regarding the JPFs they provide services to that such confirmations/declarations are supported by effective systems and controls.

All DSPs should consider their own arrangements in relation to the JPF Guide; the AML/CFT Handbook, in particular Section 14; the TCB Code of Practice and the findings of this paper. Where necessary the DSPs should consider enhancing systems and controls, so that they are able to demonstrate full compliance. JPFs should also undertake a similar exercise in relation to the JPF Guide and AML/CFT requirements.

The JFSC has already committed to undertaking a review of the JPF Guide and will consider comments made by Industry in the survey; and how the findings of this paper can be factored into the review. The JFSC will continue to review DSPs and JPFs compliance with the regulatory framework when conducting examination activity, and will consider its next steps to testing how future amendments to the JPF Guide are implemented.

Glossary of terms

AML	Anti-Money Laundering
BRA	Business Risk Assessment
Board	the Board of Directors of the governing body
CDD	Customer Due Diligence
CFT	Countering the Financing of Terrorism
CMP	Compliance Monitoring Plan
CRA	Customer Risk Assessment
COBO	Control of Borrowing (Jersey) Order 1958
COBO Consent	A consent issued under the Control of Borrowing (Jersey) Order 1958
Codes	Codes of Practice for Investment Business /Fund Services Business /Trust Company Business
DSP	Designated Service Provider
FSJL	Financial Services (Jersey) Law 1998
AML/CFT Handbook	Handbook for the Prevention and Detection of the Money Laundering and the Financing of Terrorism
JFSC	Jersey Financial Services Commission
JPF	Jersey Private Fund
JPF Guide	Jersey Private Fund Guide
JPF Return	JPF Annual Compliance Return
MLCO	Money Laundering Compliance Officer
MLO	Money Laundering (Jersey) Order 2008
MLRO	Money Laundering Reporting Officer
Registered Person	A person registered by the JFSC under Article 9 of the *FSJL* to carry on financial service business as defined under Article 2 of the *FSJL*; Within this report, *Registered Persons* are also *Relevant Persons* with the term *Registered Persons* being used for readability.
Relevant Person	Means a person carrying on financial services business in or from within Jersey as defined at Article 1(1) of the MLO. Within this report, *Relevant Persons* are also *Registered Persons* with the term *Registered Persons* being used for readability.