



# Jersey Financial Services Commission

Chief Executives (or equivalent)  
of all persons registered to conduct  
fund services business under the Financial  
Services (Jersey) Law 1998

27 April 2010

Dear Sir or Madam

## **Jersey Financial Services Commission (the "Commission") 2009 Overview of Securities Division & Priorities for 2010**

This letter summarises the results of our supervision visits made over the last year, the key findings, and our themes for supervisory visits in the coming year. It also addresses the major objectives facing the Securities Division and the main issues we shall be seeking to address.

### **Key findings from 2009**

The Fund Supervision Team (the "Team") conducted 16 visits to regulated entities in 2009. It was the first year that the Division was sufficiently staffed in order to undertake the visit programme in-house without having to rely on outsourcing.

The objectives of the themed examinations were:

- all aspects concerning the valuation of assets of a fund; and
- corporate governance and compliance with the Fund Services Business Codes of Practice (the "FSB Codes").

As in previous years, the Team was interested in gaining an insight into the practical measures implemented by industry to demonstrate compliance with the FSB Codes, and to identify areas of the FSB Codes where additional guidance or clarification may be desirable.



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Each examination resulted in a report for the business in question based on information obtained during the examination. A key aim of the programme was, and remains, facilitation of a collaborative process between industry and the Commission resulting in clearer practical guidance being issued where appropriate.

Overall, the findings indicate that some regulated entities should evidence decisions and independent oversight in order to document proper corporate governance. Shortcomings were observed both among managed entities and group structures comprising multi-licensed entities.

It was further noted that care should be taken by entities operating under multiple licences in order to appreciate fully the difference between regulatory frameworks. In particular, a number of regulated entities being familiar with the affiliation concept and financial resource requirements for trust companies have not appreciated that the trust affiliation concept is unavailable under the fund services business ("FSB") regime, and that each legal entity holding an FSB licence must satisfy the FSB Codes, the financial resource requirements, and so on, in their own right.

In addition to the findings outlined above, the Division has dealt with a significant number of fund revocations and mergers. Fifty-six FSB registrations were surrendered or revoked by request partly due to rationalisations but partly due also to market conditions.

### **2010 On-site Examinations**

The recent turmoil in financial markets has yet again brought to light the importance of independent valuations of fund assets as well as the fair treatment of investors, not least in connection with fund suspensions. During 2010 the Commission's themed examinations will continue to look at the valuation process.

### **Issues Arising**

During 2009 the Division became aware of three further issues.

The first relates to the Collective Investment Funds (Restriction of Scope) (Jersey) Order 2000 (the "Order"). This Order was originally introduced to make clear that securitization and repackaging special purpose vehicles were not collective investment funds and so were not caught by the Collective Investment Funds (Jersey) Law 1988. The Order was amended in 2003 to include non-equity shares within the scope of the exemption, including redeemable shares. Vehicles created for such purposes are processed by Registry rather than the Funds



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Authorisation Team. The obligatory investment warning clearly states that such vehicles are intended for financially sophisticated investors only, nonetheless the Division is concerned that investment in such vehicles is being offered to retail investors, with or without an amendment to the investment warning.

While the Order does not make it explicit that investment should only be made available to sophisticated investors, in our view the wording of the investor warning contained in the schedule to the Order clearly implies that it is indeed the spirit of the exemption. In order to put the matter beyond doubt, the Division is considering inserting express wording into the body of the Order to the effect that the exemption only applies to vehicles made available to financially sophisticated investors.

The second issue concerns the concession available with respect to the Fund Services Business Codes of Practice where the managed entity is an expert fund or materially equivalent expert fund. The concession permits such licensees to adopt the high level principles only and includes funds that are related to expert funds. The Division is concerned that the use of the concession in the context of related funds is going further than originally envisaged. In the Commission's view a related fund is one where two or more funds share some common attributes such as establishment by the same promoter, and the promoter's name is included in the title of the fund. Revised and updated FSB Codes will be published shortly for public consultation that will include a definition of a related fund for these purposes.

Lastly, we have noted the growing use of insurance "wrappers" or similar products whereby Jersey funds are included as underlying investments of these products. Our concern is that there may be inadequate due diligence performed on the fund by either the wrapper provider or the investment advisor resulting in their clients becoming indirectly invested in funds which are inappropriate. In short, retail investors are being put into expert funds. In the case of insurance bonds and similar type products which allow investments into a wide variety of funds, the product provider may be relying on the investment advisor to perform the due diligence and to determine the suitability of a particular fund for the underlying investor. From the fund's perspective this presents a number of issues as the fund may not be aware that the entity investing in the fund (the insurance wrapper provider) is effectively doing so on behalf of underlying clients and that such entity is also relying on the third party investment advisor to assess the suitability of the fund for the underlying client.



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Potential issues include:

1. The Fund is unaware of the ultimate beneficial owner.
2. The ultimate beneficial owner may not be a suitable investor.
3. The ultimate beneficial owner may not be fully informed of their interest in the underlying fund and may not receive reports, accounts, etc.
4. There may be undisclosed conflicts of interest particularly where the wrapper provider or investment advisor promotes or has an interest in the funds.

It is essential that where a fund is being sold through wrapper products, appropriate consideration is given to the issues identified above so that additional risks are addressed.

### **2010 Major Objectives**

Although specific objectives are set down in the Commission's Business Plan for this year, two matters in the international scene could have a significant impact on the development of domestic policy. The first is the proposal by the International Organization of Securities Commissions ("IOSCO") of which Jersey is a full member, to update its Objectives and Principles of Securities Regulation. This is seen as a cornerstone of international securities regulation and is generally regarded as the benchmark by which compliance with international standards is measured. Following the economic crisis, IOSCO is amending its Objectives and Principles in certain key areas such as the specific inclusion of hedge funds, and a tightening of the key principles applicable to funds generally. The amendments are currently in draft so what this means for Jersey remains unclear but, as we are committed to matching international standards, changes to the way in which we regulate funds and fund services businesses may be unavoidable. Fortunately we are already prepared for some of the more likely changes coming our way with the introduction of codes of practice for certified funds (the "Funds Codes"). These should address many of the matters currently under consideration at an international level. We shall continue to monitor developments closely.

The second issue on the international scene is the EU's draft Directive on Alternative Investment Fund Managers. Industry is also engaged in monitoring developments in this area and we continue to liaise closely on how the Directive is evolving and how we should respond. Again, the FSB Codes and the Funds Codes may have significant impact on how Jersey is treated under the Directive.

Discussions continue on updating the Collective Investment Funds (Recognized Funds) (Rules) (Jersey) Order 2003 in consultation with industry and the other designated territories. The



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Commission is involved in meetings with the JFA working party together with representatives from the Law Draftsman's Office and Economic Development. A meeting is arranged with the FSA at the end of April to discuss the latest proposals before formally submitting the changes to the FSA/HM Treasury for approval.

Progress continues to be made with merging the two Orders dealing with prospectuses for Jersey certified funds, namely the Collective Investment Funds (Unclassified Funds) (Prospectuses) (Jersey) Order 1995 and the Companies (General Provisions) (Jersey) Order 2002. The intention is to have just one Prospectus Order, provisionally called the Collective Investment Funds (Certified Funds - Prospectuses) (Jersey) Order 201-, that will apply to all Jersey certified funds, including funds established as limited partnerships and closed-ended unit trusts. In future, the Companies (General Provisions) (Jersey) Order 2002 will apply only to non-fund public companies, and the Collective Investment Funds (Unclassified Funds) (Prospectuses) (Jersey) Order 1995 will be revoked. The consultation exercise was concluded in August 2009 and the Commission will be publishing a position paper in the near future, including a revised version of the Order.

As mentioned above, progress also continues with the finalisation of the Funds Codes. These Codes were the subject of a public consultation exercise that concluded last October. The Commission is close to finalizing its response to the comments received from industry and will be issuing a Feedback Statement shortly. In the interim, meetings have been held with a joint working party from Jersey Finance and the Jersey Funds Association on detailed revisions to the Codes. Following publication of the Feedback Statement, there will be further consultation on the date of introduction of the Codes, although precise timing may well be dictated by the implementation of the EU Directive on Alternative Investment Fund Managers, and the revised Principles of Securities Regulation by IOSCO.

With regard to the Commission's policy on outsourcing, the Jersey Funds Association and Jersey Finance Limited have established a working party to review the policy and to recommend changes insofar as it applies to fund services business. Draft amendments have now been received by the Commission and these are being considered. The intention is to introduce the changes during the course of this year.

Other areas where the Securities Division will have significant input include the funds specific section of the AML Handbook, the draft Fund Services Business Client Assets Order and the Non-domiciled Fund Guide. In the light of industry's comments on the Funds Codes, the Commission will be producing a closed-ended collective investment fund guide to complement the OCIF Guide.



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In summary, last year saw the final phase of the development of the Securities Supervision Team and the first year in which we were able to conduct our supervision visit programme without relying on outsourcing. It is encouraging to see standards rising although the supervision visits have revealed a number of areas where there is further scope for improvement. In addition, there are a number of specific matters highlighted above which we shall continue to monitor closely.

This year may well be quite eventful with the outcome of the EU AIFM Directive debate due shortly, and the final form of the revised IOSCO principles due in the summer. The Division will continue to engage with all interested parties in formulating its response to these developments.

Yours faithfully,

**David Banks**  
**Director, Securities**