



JERSEY FINANCIAL SERVICES COMMISSION

From the office of the Director General

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Chief Executives
of all Functionary
Permit Holders

Our Ref.: DC/RG

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Dear Chief Executive,

Jersey Expert Fund Regime - Effective Due Diligence

I am sending this letter to the Chief Executives (or equivalent) of all of the Functionary Permit Holders under the Collective Investment Funds (Jersey) Law 1988 ("CIF Law"), via the Principal Contacts of those Permit Holders.

The Jersey Expert Fund regime has now been in place for just over two years and I wish to take this opportunity to give the industry some feedback on key regulatory issues arising from the current regime.

The regime allows industry a fast track application process (72 hours from receipt to approval) and I am pleased to report the Commission has a 100% success rate in meeting this target upon receipt of all required information. Since the Expert Fund regime started in 2004 the Commission has approved over 200 funds and this year we continue to receive an average of 12 applications per month. This level of growth is a reflection of the activity and competitiveness of Jersey entities and we are pleased to note that the feedback from industry on how the Expert Fund regime is working on the whole is very positive.

Looking forward, the industry has requested further enhancement of the Jersey Funds regulatory regime to accommodate market developments.

In an effort to respond to these requests, the Commission issued two consultation papers in February 2006, one on the de-regulation of Non Domiciled Funds and the second on the proposed transfer of the regulation of fund functionaries from the CIF Law to the Financial Services (Jersey) Law 1998. A number of other initiatives are also under discussion.

Personal data provided to the Commission - a data controller as defined in the Data Protection Law - will be used by the Commission to discharge its statutory, administrative and operational functions. Further information may be found in the Commission's data protection policy, copies of which are available on request from the Commission and which may also be found on www.jerseyfsc.org.

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I hope you agree these developments continue to demonstrate the Commission's willingness to work with industry to reduce the regulatory burden on the funds industry within Jersey, where it is possible to do so without undermining the reputation of the Island as a centre of excellence, or the capacity of the Commission to fulfil its duty to protect investors' interests.

The purpose of this letter is to state clearly that if regulatory gate-keeping controls are to be lightened it has to be done on the assurance that the industry, as a responsible body, will apply the required checks and balances itself. This increases the importance of proper industry discipline in carrying out the necessary due diligence.

It is of concern therefore that the Commission has now had some exposure to cases where certain industry members have not applied sufficient rigour to their responsibilities under the Expert Fund application process. The most serious area of failure is where in some cases the declarations made by the investment manager and countersigned by the fund functionary have been found to be unreliable.

In particular, the Commission has identified a number of cases where disciplinary sanctions or adverse information available from professional bodies or regulatory authorities have not been detected or disclosed. Such information clearly has a bearing on the fitness and propriety of persons connected with an Expert Fund.

A key component of the current Expert Fund regime is the reliance placed by the Commission on the due diligence undertaken by the administrator, manager or trustee leading the Expert Fund application (the "Jersey Based Functionary").

It should be noted in this connection that the Jersey Based Functionary is required under the Expert Fund Guide to make a declaration that the information provided to the Commission about the application and in any supporting documents (including the confirmation of the investment manager under paragraph 2.9 of the Guide) is accurate, complete and correct to the best of the Jersey Based Functionary's knowledge. In the Commission's view, this requires proactive due diligence enquiries on the part of the Jersey Based Functionary.

In order to fulfil its responsibilities for due diligence in respect of the investment manager under paragraph 2.9 of the Expert Fund Guide, and to limit the risk to itself of reputational or other damage from an undesirable business relationship, the Jersey Based Functionary should not rely on third party or introducers' due diligence, but should carry out the following steps (or such steps as the Jersey Based Functionary believes will deliver an equivalent result):

1. Confirm with the investment manager that, before signing the written confirmation required under paragraph 2.9 of the Expert Fund Guide, it has read, understood and carefully considered paragraphs 2.7 and 2.8 of the Guide and that it is able to satisfy the relevant requirements (or, if not, what requirements cannot be satisfied);



2. Confirm through its own due diligence to the extent reasonably possible, and record, that there appears to be no information in the public domain in a relevant jurisdiction¹ that calls into question whether the investment manager meets the requirements in paragraphs 2.7 and 2.8 of the Expert Fund Guide. This might involve a search through internal and external data sources readily available to the Jersey Based Functionary, including media, internet search facilities, regulatory or other official websites and commercial databases to which the Jersey Based Functionary may subscribe. In particular, the Jersey Based Functionary should be trying to satisfy itself that:
 - 2.1 The investment manager (and its principals) do not appear to have had or been subject to any relevant criminal convictions, disciplinary sanctions or adverse findings by any professional body or statutory authority;
 - 2.2 The investment manager is established in an OECD member state and is regulated in that state (for example by checking the website of the regulator in that jurisdiction or obtaining documentary evidence of authorisation);

NB: *The due diligence must be conducted regardless of whether or not a derogation has been granted to enable a Non regulated or Non OECD investment manager to act in respect of the Expert Fund.*

3. Review the experience of the investment manager to seek to ensure that it is relevant to the fund in question;
4. Identify each of the principal persons of the investment manager and verify that the Commission's span of control requirements are met;
5. Ensure that any exceptions to the requirements in paragraph 2.7 and 2.8 are brought to the Commission's attention if the application is to be submitted.

If an investment manager has previously been granted consent to establish an Expert Fund by the Commission, the Jersey Based Functionary should consider, and record, whether it can rely on such previous consent without further verification, or whether it is necessary (for example, because of the passage of time) to carry out fresh due diligence as described above. In either case, confirmation should be sought from the investment manager that there has been no material change in the information most recently provided to the Commission.

Jersey Based Functionaries should now review their due diligence procedures in respect of Expert Funds if they are involved in this business and report to the Commission any adverse findings in relation to those procedures and the action that has been taken to address such findings. Where procedural gaps are identified, consideration should also be given as to whether this raises concerns in relation to particular Expert Funds with which the Jersey Based

¹ A "relevant jurisdiction" includes the jurisdiction in which the investment manager is established and other jurisdictions with which the investment manager (and its principals) are known to have connections.



Functionary is involved and whether these concerns should also be reported to the Commission.

The Commission treats due diligence failures very seriously as we have a statutory duty to protect the reputation of the Island and investors' interests. The Commission has various powers at its disposal to use if significant or repeated failures in due diligence are discovered. In particular, the Commission may consider the suspension of a Jersey Based Functionary's access to the fast track authorisation process if it is found not to have properly fulfilled its responsibilities for conducting due diligence.

The Commission will run a series of themed examinations over the coming months to review the conduct of due diligence in respect of Expert Funds.

Yours sincerely,

David Carse
Director General