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Developments in Jersey structuring and governance

Growing use of Jersey private funds and recent best practice

Jersey private funds (JPFs) continue to be a key product in the jurisdiction's fund offering. Recent figures from the Jersey Financial Services Commission (JFSC) show that the number of JPFs grew by almost 100 in 2020 reaching 403, asserting their continuing appeal to investors. It is also worth noting that JPFs are increasingly being used for open-ended, as well as closed-ended structures.

One key feature of the JPF regime is the requirement to have a Jersey-based regulated designated service provider (DSP) with substance. In most cases the DSP also acts as the fund administrator, although this may not always be the case and will depend on the asset class and strategy. A DSP has certain specific duties in relation to a JPF, having responsibility for:

- Ensuring eligibility criteria are met
- Carrying out all necessary due diligence in relation to a JPF and its sponsor
- Complying with Jersey's anti-money laundering (AML)/CFT requirements
- Notifying to the JFSC any material changes or events and, if audited, any qualified audits
- Submitting an annual JPF compliance return

This reliance on the DSP enables an increased speed to market for a JPF, on the basis that the DSP is responsible for carrying out most of the due diligence process.

On 29 March 2021, the JFSC issued the results of its thematic review of DSPs to ensure compliance of JPFs with the JPF Guide and the DSPs' responsibilities regarding compliance with Jersey AML/CFT requirements.

The JFSC cites the following as examples of best practice:

- Tabling an annual compliance checklist for consideration by the JPF's board before the DSP files the JPF return
- Adopting a compliance monitory plan carrying out formal business risk assessments;
- Conducting a full DSP review of policies and procedures to ensure all JPF Guide and AML/CFT requirements are considered
- Ensuring the administration agreement between DSP and JPF clearly details all responsibilities
- Ensuring the JPF's board minutes cover compliance reports, record the appointment of a MLRO and a MLCO and consider the DSP's performance

- Maintaining records to demonstrate training of board members and the DSP's directors and staff concerning the JPF Guide and the AML/CFT Handbook

As a result of the thematic review, further updates to the JPF Guide are anticipated which are likely to increase the operationalisation of key processes.

Governance, substance and extension to self-managed funds and partnerships

COVID-19 accelerated certain trends, and one fundamental trend is the rise of governance and substance as a core element of running a fund management operation in Jersey.
Driven in part by the remote fundraising environment of the past year, investors are asking more questions of managers, while lawyers and service providers are spending increasing amounts of time on due diligence questionnaires and operational governance assessments.

Economic substance regimes have increasingly been seen as a key element in demonstrating governance.

Jersey's Economic Substance Law regime (the ES Law), first implemented in 2019, provides that if a Jersey company is both tax resident and performs a 'relevant activity' in Jersey, then it must also demonstrate that it has substance in Jersey by (i) being 'directed and managed' in Jersey, (ii) having adequate people, premises and expenditure in Jersey, and; (iii) conducting core income generating activities in Jersey.

The ES Law provides that 'fund management business' is a relevant activity and includes core income generating activities such as taking decisions on the holding and selling of investments, calculating risk and reserves, taking decisions on currency or interest fluctuations and hedging positions, and reporting to investors and regulators. 'Fund management business' is, however, defined so that responsibility falls on the functionary acting as the manager of the fund, rather than on the fund itself.

This approach focuses on the entity carrying out the effective management, whether a key functionary to unincorporated vehicles (such as Jersey limited partnerships and Jersey unit trusts) or the fund manager, acting for funds which outsource management to a third-party manager, who would fall within the scope of the ES Law and, therefore, are required to satisfy the 'economic substance' criteria.

The existing ES Law has not previously applied to corporate funds themselves, however on 10 February 2021, the Government of Jersey adopted amended legislation to clarify the way in which the ES Law will apply, with effect from 1 January 2021, to self-managed corporate funds, where no separate manager is appointed, which will now be required to comply with the 'economic substance' requirements.

Going forward, and in keeping with other Jersey fund structures, these self-managed funds will need to provide supporting evidence to show how they satisfy these requirements in their annual tax return. The test for whether a self-managed fund is performing a 'relevant activity' will relate to the fund management activities that it performs and is intended to mirror the requirements applied to other companies performing fund management business. Although self-managed funds will be within the scope of the ES Law, they will not be required to satisfy the 'directed and managed' test in recognition of Jersey's funds regulatory regime, which already requires regulatory substance on the island. Consequently, a self-managed fund will not satisfy the economic substance test if it fails to comply with the relevant regulatory regime.

Revenue Jersey has also clarified that it would expect the 'taking of decisions on the holding and selling of investments' should always be carried out by the self-managed fund itself, evidenced through frequent and robust consideration by the fund board. While the self-managed fund will be assessed against the same core activities for fund management business as a third-party manager, Revenue Jersey has acknowledged that the self-managed fund will not in practice receive a separate income stream arising from fund management activities.

Substance for partnerships

The Government of Jersey has also confirmed its intention to extend the economic substance legislation to partnerships performing a 'relevant activity' around the 1st July 2021, to fulfil a commitment to the EU Code of Conduct Group for Business Taxation. Notably, partnerships that are funds are expected to remain entirely out of scope.

The expectation is that a new economic substance test for relevant partnerships (excluding funds) will follow the approach for companies as closely as possible. However, Revenue Jersey recognises the challenge of applying an economic substance test to partnerships as there is no international concept of tax residence for partnerships. In addition, when compared to companies, there is a much greater variety of governance and management arrangements found in partnerships which makes it challenging to construct a single test suitable for general application.

Limited partnership law

Jersey's existing limited partnership law (LP Law) is undergoing a review by an industry working group, in conjunction with Jersey's government and the JFSC, with a view to agreeing enhancements to the LP Law to augment the limited partnership's attractiveness, flexibility and usability, to ensure it remains the vehicle of choice for funds and investment vehicles.

The headline changes proposed include, in summary:

- Extending the entities, which may act as general partners (GPs)
- Making, wherever possible, the LP Law, subject to limited partnership agreement (LPA), to allow more flexibility for GPs and investors to agree their own terms, particularly concerning access to partnership records, GPs' and limited partners' (LPs) rights and obligations, return and clawback of LPs' contributions and third-party rights
- Expanding the safe harbour provisions to enhance the limited liability protection afforded to LPs
- Enhancing the winding-up and dissolution provisions

An empowering provision to allow for the introduction of cellular limited partnerships by regulationsIt is anticipated that the proposed amendments to the LP Law will be lodged with, and approved by, the States Assembly before the end of 2021.

ESG developments

In response to international reforms in relation to environmental, social and governance (ESG), the JFSC has carried out two consultations on proposals to enhance disclosure and governance requirements for investment funds committing to sustainable investments.

The proposals to enhance various codes of practice and the Jersey Private Fund Guide to ensure that investments are not inappropriately labelled as sustainable, also known as 'greenwashing'. The proposals aim to increase clarity around sustainable investments, enhance consumer protection and contribute towards the goal of meeting international standards. Clarifications are anticipated which will require funds with environmental, sustainable or socially responsible investments to put policies and procedures in place to support the credentials of the fund's investments.

The requirements include:

- Issuing a public statement (such as a prospectus) in respect of sustainable investments
- Implementing an investment management process to (i) verify and document the ESG elements in the due diligence process by way of recognised taxonomy and; (ii) carry out an annual review to ensure the continued compliance
- Adopting appropriate corporate governance and organisational measures to monitor the investment management process, including access to resources with appropriate skills and experience and implementing appropriate reporting lines.

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The requirements are anticipated to be contained in relevant Codes of Practice and guides issued by the JFSC and will potentially affect and impose new obligations on Jersey funds, as well as foreign funds with Jersey service providers, which commit to ESG investing; and regulated investment managers advising funds with ESG investment strategies.

At the same time, the EU's Sustainable Finance Disclosure Regulation (SFDR), requires pre-contractual and periodic disclosures at an 'entity' and 'product' level which will, include Jersey firms which are non-EU AIFMs within the meaning of the Alternative Investment Fund Managers Directive. The exact extent to which SFDR will apply to non-EU AIFMs remains subject to clarification requested by the European Supervisory Authorities with the European Commission. It is anticipated that further guidance will be issued in due course.

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