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GLOBAL GUIDE

HEDGE FUNDS

in British Virgin Islands, Cayman Islands, Guernsey and Jersey

The law in key jurisdictions worldwide

- Essential legal questions answered
- Analysis of critical legal issues

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Hedge funds in the British Virgin Islands: regulatory overview

Clinton Hempel
Carey Olsen

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HEDGE FUNDS

Market overview

1. What is the structure of the hedge funds market? What have been the main trends over the last year?

The regulatory regime applicable to investment funds in the British Virgin Islands (BVI) differentiates between open-ended and closed-ended funds. Most hedge funds are open-ended funds, regulated under the Securities and Investment Business Act 2010 (SIBA). Open-ended hedge funds are regulated by the Financial Services Commission either as private funds, professional funds, public funds, approved funds or incubator funds. As at 31 March 2017, there were just over 1,500 funds recognised or registered under SIBA. The majority of these are recognised as professional funds (1,046), followed by private funds (354), public funds (51), approved funds (42) and incubator funds (29). Professional funds require an initial investment of at least US\$100,000 subject to certain exemptions. BVI funds are predominantly used as non-retail funds.

Regulatory framework and bodies

2. What are the key statutes and regulations that govern hedge funds in your jurisdiction? Which regulatory bodies regulate hedge funds?

Regulatory framework

Open-ended hedge funds are governed by the Securities and Investment Business Act 2010 and the Mutual Funds Regulation 2010. The Financial Services Commission is the regulator for open-ended hedge funds.

Private funds. A private fund is restricted to either:

- Having no more than 50 investors.
- Only making an invitation to subscribe for or purchase fund interests on a private basis.

Professional funds. In relation to a professional fund:

- Fund interests can only be issued to professional investors (*see below*).
- The initial investment for all investors (other than exempt investors) cannot be less than US\$100,000 or the foreign currency equivalent.

A professional investor is a person:

- Whose ordinary business involves, whether for that person's own account or the account of others, the acquisition or disposal of property of the same kind as:
 - the fund property; or
 - a substantial part of the fund property.
- Who has signed a declaration that he or she:
 - whether individually or jointly with his or her spouse, has net worth in excess of US\$1 million or its foreign currency equivalent; and
 - consents to being treated as a professional investor.

Exempt investors comprise:

- The manager, administrator, promoter or underwriter of the fund.
- Any employee of the manager or promoter of the fund.

Approved funds. An approved fund is restricted to having:

- No more than 20 investors.
- A maximum net asset value of US\$100 million.

Incubator funds. An incubator fund is restricted to having:

- No more than 20 investors.
- An initial investment for all investors of at least US\$20,000 or the foreign currency equivalent.
- A maximum net asset value of US\$20 million.
- A maximum lifetime of two years (with a possible extension of one year) after which:
 - the fund must be converted to either a private fund, a professional fund or an approved fund; or
 - the business of the fund must be terminated.

Regulatory bodies

The Financial Services Commission (FSC) is the regulatory body for open-ended funds, including public funds.

3. How are hedge funds regulated (if at all) to ensure compliance with general international standards of good practice?

All regulated funds must submit their financial statements to the Financial Services Commission (FSC) within six months of the financial year end of the fund.

A public fund must have at all times appointed an investment manager and an administrator, which must satisfy the FSC's "fit and proper" criteria. There is no requirement for either the investment manager or the administrator to be located in the BVI. An investment manager or administrator generally satisfies the FSC's fit and proper criteria if it both:

- Carries on business in a recognised jurisdiction (the FSC has issued a list of recognised jurisdictions, comprising 41 of the most widely used financial services centres).
- Meets the local requirements to carry on the business including, where applicable, holding any licence (however, if there is no local requirement to hold a licence, this does not prevent the functionary from satisfying the FSC's fit and proper criteria).

An investment manager or administrator requires a licence under the Securities and Investment Business Act 2010 (SIBA) if it is a BVI entity or has a physical presence in the BVI.

Risk

Public funds must comply with the corporate governance and high level principles for business under the Public Funds Code 2010. Private funds, professional funds, approved funds and incubator funds are not subject to the same level of supervision by the FSC as public funds. Therefore, the requirements considered necessary for the protection of investors that apply to public funds do not apply to private funds, professional funds, approved funds and incubator funds. As a result, investing in these funds can be riskier for investors than investing in a public fund.

Valuation and pricing

Public funds must adopt detailed pricing and valuation policies. Details of the policies must be made available to investors in public funds.

Under the Public Funds Code 2010, the assets of a fund must be valued using market prices. Also, where practical, the valuation of an asset must be checked against a primary and secondary source. Assets for which there is no readily available market price can be valued using pricing models to determine fair value if the use of the pricing model has been approved by the fund's governing body.

Public funds must establish and maintain:

- A clear and comprehensive policy (or policies) for the valuation of the fund property.
- Sufficient procedures to ensure that the valuation policy is effectively implemented.

The public fund must ensure that the valuation policy and procedures:

- Are fully and clearly documented.
- Are appropriate for the nature, size, complexity, structure and diversity of the fund and the fund property.
- Comply with the requirements of the Public Fund Code 2010.
- Are consistent with the provisions concerning valuation in the fund's constitutional document and prospectus.
- Are carried out by parties that have the appropriate level of experience and competence to properly fulfil their roles.

A public fund must ensure that the valuation and net asset value (NAV) functions are undertaken by the fund's administrator or a third party valuation service provider, independently of the fund's governing body and other functionaries. The governing body of a public fund must also ensure that the persons controlling the fund's manager (or who are otherwise responsible for carrying out the fund's investment function) are independent from the persons controlling the fund's administrator (or who otherwise have responsibility for the valuation function). To ensure that there is sufficient independence in applying the fund's valuation policy, a segregation of responsibilities must be ensured between the parties concerned with the process of valuing the fund's property and those concerned with calculating the fund's NAV (where appropriate). If necessary, the fund's governing body can appoint a valuation committee to oversee the application of the valuation policy.

A public fund must have procedures in place to arrange for information about the valuation process to be provided to investors on request.

The fund's prospectus must contain the following:

- The person or persons who are responsible for undertaking valuations of the fund property, preparing NAVs and valuing the fund interests, the person or persons with oversight responsibility, and where the valuations will be undertaken.
- A description of any material conflicts of interest associated with the parties carrying out the valuation process, including whether the fund manager has any role in the valuation of the fund property.
- How frequently (in days), and at what time or times of day, the fund property and the fund interests will be valued, and a description of any circumstances in which the fund property and fund interests can be specifically valued.
- The basis on which the fund property will be valued, including the methodology and procedures for undertaking the valuation.
- An indication of the circumstances in which a valuation can be suspended.
- A statement that full details of the fund's valuation policies are contained in a written valuation policy, together with any other information concerning the valuation process that is available to investors on request and indicating how this information can be obtained.

Systems and controls

A public fund must:

- Establish and maintain such policies and procedures as are appropriate for the nature, size, complexity, structure and diversity of the fund and the fund property. The public fund must also ensure that these procedures are fully and clearly documented.
- Establish and maintain a policy for the issue and redemption of fund interests, and procedures to ensure that the policy is effectively implemented and fully and clearly documented, including provisions for:
 - the dealing days and times in the dealing day on which the fund will be available to receive requests for the issue and redemption of fund interests;
 - the procedures for effecting the issue and redemption of fund interests and the settlement of transactions;

- the steps required to be taken by an investor redeeming fund interests before he/she can receive the proceeds of redemption;
- the minimum number of fund interests which any one person can hold and the minimum number or value of fund interests which can be the subject of any one transaction of purchase or redemption;
- the circumstances in which the redemption of fund interests can be suspended; and
- when and where the most recent issue and redemption prices will be published and the investment exchanges (if any) on which fund interests are listed or dealt.
- Take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities between its governing body and functionaries, so that the business and affairs of the fund can be adequately controlled and monitored by the governing body.

Insider dealing and market abuse

Insider dealing. On summary conviction, the maximum sentence for insider dealing is a fine of US\$40,000 and/or imprisonment for a term of three years. On indictment, the maximum sentence is a fine of US\$100,000 and/or imprisonment for a term of five years. A person who has information as an insider (that is, the information is inside information, the person knows that it is inside information and has the information from an inside source) commits an offence if he/she either:

- Deals in price-affected securities that the information relates to where:
 - the dealing (that is, the acquisition or disposal) takes place on a securities market; or
 - the person dealing relies on a professional intermediary or is himself/herself acting as a professional intermediary.
- Encourages another person to deal in securities that are (whether or not that person knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing will take place on a securities market.
- Discloses the information to another person, other than in the proper performance of the functions of his employment, office or profession.

Inside information is defined as information which:

- Relates to one or more particular securities, or one or more particular issuers (and not to securities or issuers generally).
- Is specific or precise in nature.
- Has not been made public.
- Is likely to have a significant effect on the price of any securities if it were made public.

A person does not commit an offence by virtue of dealing in securities if he/she prove that either:

- He/she acted in good faith in the course of his/her:
 - business as a market maker; or
 - employment in the business of a market maker;

- The information which he/she had as an insider was market information and it was reasonable for an individual in his/her position to have acted as he/she did despite having that information as an insider at the time. This defence takes into account the content of the information, the circumstances in which the person first had the information and in what capacity, and the capacity in which he/she acted when the determination was made.
- He/she acted in compliance with the market rules applicable to the securities market concerned.
- He/she acted in connection with an acquisition or disposal which was under consideration or the subject of negotiation (or in the course of a series of such acquisitions or disposals) and with a view to facilitating the accomplishment of the acquisition or disposal (or series of acquisitions or disposals). The information which he/she had as an insider must be market information arising directly out of his/her involvement in the acquisition or disposal (or series of acquisitions or disposals).
- He/she did not at that time expect the dealing to result in a profit attributable to the fact that the information was price-sensitive information in relation to the securities.
- He/she reasonably believed at the time that the information had been, or will be, disclosed widely enough to ensure that none of those taking part in the dealing will be prejudiced by not having the information.
- He/she would have done what he/she did even if he/she had not had the information.

Misleading statements and market manipulation. It is an offence for a person to do any of the following for the purpose of inducing another person to enter, offer to enter into or refrain from entering into an agreement or arrangement which constitutes investment business, or to exercise or refrain from exercising any rights conferred by an investment:

- Make a statement, promise or forecast which he/she knows is misleading, false or deceptive.
- Dishonestly conceal any material facts.
- Recklessly make (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive.
- Do any act or engage in any course of conduct if:
 - this act or course of conduct creates a false or misleading impression as to the market, price or value of an investment; or
 - this is for the purpose of creating the impression which induces another person to deal in the investment, refrain from doing so or exercise (or refrain from exercising) any rights in relation to that investment.

A person commits an offence in this regard only if either:

- The statement, promise or forecast is made in, or from, the BVI.
- The facts are concealed in, or from, the BVI.
- Any arrangement which is entered into is made in or from the BVI.

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A person does not commit an offence if either:

- The statement, promise or forecast was made in respect of a securities market and he/she proves that he or she acted in compliance with the market rules applicable to the securities market concerned.
- He/she undertook the act or engaged in the course of conduct in respect of a securities market and he or she proves that:
 - he/she reasonably believed that the act or conduct would not create an impression that was false or misleading; or
 - he/she acted in compliance with the market rules applicable to the securities market concerned.

On summary conviction, the maximum sentence is a fine of US\$40,000 and/or imprisonment for three years. On indictment, the maximum sentence is a fine of US\$100,000 and/or imprisonment for five years.

Transparency

Public funds. A public fund is required to disclose to the FSC any matter that may reasonably be expected to have a significant regulatory impact on the fund including:

- The suspension of valuation, dealing or redemptions.
- Any matter that could impact on the ability of the fund to continue to carry on business.
- Any incident of fraud or other criminal activity that is connected with, or may affect, the public fund's business and which is material to the safety, soundness or reputation of the fund.
- The appointment or resignation or removal of a director, authorised representative or auditor or any change in the address of the fund's place of business.
- Any change in the place or places where the fund's financial or other records are kept.
- If the fund is incorporated under the laws of a jurisdiction outside the BVI, any material change in the nature and scope of the fund's business.
- Any proposed amendment to its constitutional documents.
- Its intention to issue an offering document not previously provided to the FSC or its intention to amend any offering document previously provided to the FSC.

Where a public fund proposes to make any changes to the rights of investors which the investors are not required to approve, the fund must give each investor notice of the change (where practicable, prior to the change being made).

Private and professional funds. A private fund or a professional fund must provide written notice to the FSC of:

- The appointment, resignation or removal of a director, authorised representative or auditor, or any change in the address of the fund's place of business.
- Any material change in the nature and scope of the fund's business (if the fund is incorporated under the laws of a jurisdiction outside of the BVI).

- Any amendment to its constitutional documents, the issuance of any offering document not already provided to the FSC or the amendment of any document previously provided to the FSC.

Incubator funds. An incubator fund must submit a semi-annual return to the FSC detailing:

- The number of investors in the fund.
- The total investments in the fund.
- The aggregate subscriptions to the fund.
- The aggregate redemptions paid to investors.
- The net asset value of the fund.
- Any significant investor complaint received by the fund and how the complaint was dealt with.

An incubator fund must also file an annual return with the FSC to confirm that it is not in breach of the requirements of the Securities and Investment Business (Incubator and Approved Funds) Regulations 2015 and to provide any other information as the prescribed form requires.

Approved funds. An approved fund must file an annual return with the FSC:

- Confirming that it is not in breach of the requirements of the Securities and Investment Business (Incubator and Approved Funds) Regulations 2015.
- Setting out any significant investor complaint received by the fund and how the complaint was dealt with.
- Providing any other information as the prescribed form requires.
- Providing details as of 31 December of the preceding year about the:
 - number of investors in the fund;
 - total investments in the fund;
 - aggregate subscriptions to the fund;
 - aggregate redemptions paid to investors. and
 - net asset value of the fund.

Money laundering

The BVI has a strict anti-money laundering and anti-terrorist financing regime in place. The BVI government, the FSC and other statutory bodies liaise with regulators in other jurisdictions to ensure compliance with international standards of good practice. All hedge funds are subject to:

- Proceeds of Criminal Conduct Act 1997;
- Anti-money Laundering Regulations 2008 (as amended); and
- Anti-money Laundering and Terrorist Financing Code of Practice 2008 (as amended).

This legislation provides a BVI hedge fund with the option to outsource client verification requirements to its non-BVI based administrator if the administrator is based in a recognised jurisdiction.

Short selling

There are no markets for securities in the BVI. Therefore short selling activities are governed by the jurisdiction of the exchange where the securities are listed.

Marketing

4. Who can market hedge funds?

The person carrying on the promotion may need to be licensed under the Securities and Investment Business Act 2010 (SIBA) to promote the fund. For example, subject to limited exceptions (such as acting for a company within the same group, or providing business to a company for which you act as a director without receiving remuneration), a licence is required under SIBA to:

- Carry on business as an investment adviser (promotion of a mutual fund by a third party in or from within the BVI may, depending on the circumstances, amount to regulated investment business as set out in SIBA).
- Arrange transactions in mutual fund interests.

Onshore hedge funds

A fund incorporated or established in the BVI cannot be promoted in or from within the BVI unless the fund is registered as a mutual fund with the BVI Financial Services Commission.

Offshore hedge funds

A fund incorporated or established outside of the BVI cannot be promoted in or from within the BVI unless the fund is recognised as a foreign fund by the BVI Financial Services Commission.

5. To whom can hedge funds be marketed?

Onshore hedge funds

Public funds can be marketed to any member of the public both in and outside of the BVI (subject to foreign regulations). However, the offer must be made by way of a registered prospectus.

However, a private fund can either have a maximum of 50 investors or offer interests in the fund on a private basis only.

Offshore hedge funds

A recognised foreign fund is permitted to market its interests in the BVI in accordance with the authorisation and supervisory regime of its home jurisdiction.

Investment restrictions

6. Are there any restrictions on local investors investing in a hedge fund?

There are no restrictions on local investors investing in a fund if the hedge fund is approved by the Financial Services Commission under the Securities and Investment Business Act 2010 and the regulations for public offers are followed.

Assets portfolio

7. Who holds the portfolio of assets? What regulations are in place for its protection?

A private or professional fund must, subject to limited exceptions, at all times have a custodian appointed. A public fund is required to appoint a custodian in the BVI or a recognised jurisdiction. The custodian must be functionally independent from the investment manager and the administrator and meet the Financial Services Commission's fit and proper criteria.

According to guidance from the Financial Services Commission, an exemption from the custodian requirement will normally be available in the following circumstances:

- Funds who have appointed prime brokers that perform the same function.
- Feeder funds in master/feeder structures.
- Funds operating as fund of funds.
- Funds in the process of winding down.
- Funds that invest in esoteric assets.

Requirements

8. What are the key disclosure or filing requirements (if any) that must be completed by the hedge fund?

A private or a professional fund must file any offering document with the Financial Services Commission (FSC) within 14 days of the date of its issue to any investor. Amendments to the offering documents previously provided to the FSC must be notified to the FSC within 14 days.

All regulated funds must submit an annual return for statistical and reporting purposes setting out summary financial information as at 31 December.

9. What are the key requirements that apply to managers or operators of hedge funds?

Onshore hedge fund managers

A person carrying on business in or from within the BVI as an investment manager, adviser or administrator of a fund must hold a licence issued by the Financial Services Commission (FSC).

The person carrying on promotion of the fund may also need to be licensed under the Securities and Investment Business Act 2010 (SIBA) to promote the fund. For example, subject to limited exceptions (such as acting for a company within the same group, or providing business to a company for which you act as a director without receiving remuneration), a licence is required under SIBA to either:

- Carry on business as an investment adviser (promotion of a mutual fund by a third party in or from within the BVI may, depending on the circumstances, amount to regulated investment business as set out in SIBA).
- Arrange transactions in mutual fund interests.

ONLINE RESOURCES

BVI Financial Services CommissionW www.bvifsc.vg

Description. The BVI Financial Services Commission is the Territory's single financial services regulator. The BVI FSC website contains links to all relevant financial legislation, policy guidelines, guidance notes and statistics.

BVI Official GazetteW www.bvigazette.org

Description. The *Official Gazette* is the official publication of the Government of the Virgin Islands. It is printed by the Gazette Unit, a unit of the Cabinet Office. It is free to register and access legislation online that has been published since 2007.

Offshore hedge fund managers

Fund functionaries which are located outside of the BVI are not required to be regulated in the BVI if the FSC is satisfied (on application) that the functionary's jurisdiction of establishment and location has a system for the effective regulation of investment business, including funds.

A list of current recognised jurisdictions is published by way of a statutory instrument.

Legal fund vehicles and structures**10. What are the main legal vehicles used to set up a hedge fund and what are the key advantages and disadvantages of using these structures?**

BVI funds are established as either:

- Companies limited by shares (including as segregated portfolio companies) under the Business Companies Act, as amended (BCA).
- International limited partnerships under the Partnership Act 1996.
- Unit trusts governed by the laws of the BVI.

The vast majority of BVI hedge funds are established as companies under the BCA. The BCA is widely regarded as cutting edge corporate legislation and provides a modern and flexible regime suitable for use for hedge fund vehicles.

Companies limited by shares

Advantages The advantages of setting up a hedge fund as a company limited by shares are as follows:

- No corporation tax is imposed on companies incorporated in the BVI.
- There is flexibility as to how a BVI company is managed, and bespoke provisions can be incorporated into the BVI company's constitutional documents.
- Separate legal personality which allows the company to hold all of the fund's assets in its own name.

- There is no concept of authorised share capital in the BVI. As a result, there is no specified maximum number of shares that the company can issue.
- The liability of shareholders is limited to the unpaid amount (if any) in relation to their shares.

International limited partnerships

A new Partnership Act is expected to be published shortly and it is expected to significantly update the law applicable to partnerships incorporated in the BVI.

Advantages Setting up a hedge fund as an international limited partnership

are as follows:

- International limited partnerships offer a tax transparent "pass-through" structure.
- Offers flexibility in relation to capital raising, allocation of distributions and carry structure.
- Limited partners are only liable for their uncalled capital unless they take part in the management of the partnership.

Disadvantages The disadvantages of setting up a hedge fund as an international limited partnership are as follows:

- An international limited partnership does not have a separate legal personality and therefore the fund assets must be held by the general partner for the partnership.
- The general partner is liable for all of the debts and obligations of the partnership to the extent that the assets of the partnership are insufficient to discharge these.

Unit trusts

Unit trusts are rarely employed in the BVI and specific legal advice should be obtained in this regard.

Tax treatment**11. What is the tax treatment for hedge funds?****Funds**

A fund registered under the Securities and Investment Business Act 2010 is exempt from all provisions of the Income Tax Act. It will not be liable to BVI payroll tax unless it has employees in the BVI. Customary fees paid to directors are generally outside the scope of the payroll tax.

Resident investors

The following are exempt from income tax (*Income Tax Act*):

- All dividends and amounts that a fund formed as a BVI company pays to investors (including redemption proceeds).
- Capital gains realised by investors in relation to fund interests of a fund formed as a BVI company.

There are no estate, inheritance, succession or gift taxes payable in the BVI in relation to shares in a fund. Technically, income tax may apply to income and capital gains arising from interests in funds. However, as the income tax rate is currently zero, and not expected to change, this is academic.

Non-resident investors

The following are exempt from payment of income tax (*Income Tax Act*):

- All dividends and amounts paid by a fund to non-resident investors (including redemption proceeds).
- Capital gains realised by non-resident investors from fund interests.

There are no estate, inheritance, succession or gift taxes payable in the BVI in relation to shares in funds.

Restrictions

12. Can participants redeem their interest? Are there any restrictions on the right of participants to transfer their interests to third parties?

Redemption of interest

Open-ended funds can agree any restrictions on the issue and redemption of interests with their investors at the time they subscribe for such interests. In addition, the Public Funds Code 2010 (PF Code) requires a public fund to adopt policies and procedures for the issue and redemption of fund interests. The policies must be appropriate for the nature, size, complexity, structure and diversity of the fund and the fund property. They must also meet prescribed minimum criteria set out in the PF Code including the timing of dealing and redemption of fund interests. The introduction of additional restrictions in respect of an investor's existing interest can only be achieved in accordance with the consent mechanisms contained in the fund's constitutional documents.

Transfer to third parties

There are no statutory restrictions on the ability of investors in open-ended funds to transfer their interests to third parties, although the constitutional documents of the fund will normally contain restrictions.

Private placement

13. Are private placements of hedge funds permitted under national private placement rules in your jurisdiction?

Private placements are not a feature of the BVI hedge funds market and the majority of funds include specific provisions in their constitutional documents and offering documents preventing placements in the BVI. Specific legal advice should be obtained in this regard.

14. What are the requirements for making a private placement of hedge funds?

See *Question 13*.

Reform

15. What (if any) proposals are there for the reform of hedge fund regulation?

A new Partnership Act is expected to be published shortly and it is expected to significantly update the law applicable to partnerships incorporated in the BVI. There are no further proposals for the reform of hedge fund regulation at present.

Contributor Profiles



Clinton Hempel

Carey Olsen

T +1 284 394 4030

F +1 284 494 4155

E clinton.hempel@careyolsen.com

W www.careyolsen.com

Professional qualifications. South African Attorney, 1996; England and Wales, Solicitor, 1997; British Virgin Islands, Solicitor, 1999

Areas of practice. Investment funds and private equity; joint ventures and finance regulation.

Recent transactions

- Advising on the launch of two multi-billion US dollar hedge funds.
- Advising a US pension fund manager on investment in a BVI private equity fund.
- Advising a sovereign fund on investment in a BVI company operating in various Latin American countries in the telecommunications sector.

Languages. English

Professional associations/memberships. Member of the British Virgin Islands Bar Association.

Publications. *Private equity in British Virgin Islands: market and regulatory overview Private Equity Global Guide 2015/16 (co-author).*

Hedge funds in Cayman Islands: regulatory overview

Jarrod Farley
Carey Olsen

global.practicallaw.com/W-007-5747

HEDGE FUNDS

Market overview

1. What is the structure of the hedge funds market? What have been the main trends over the last year?

The regulatory regime in the Mutual Funds Law (MF Law) distinguishes between open-ended funds (which are mostly hedge funds) and closed-ended funds (which are generally not hedge funds).

Open-ended hedge funds will either be regulated by the Cayman Islands Monetary Authority (CIMA) as:

- **Licensed Funds.** These are funds licensed under section 4(1)(a) of the MF Law.
- **Administered Funds.** These are funds licensed under section 4(1)(b) of the MF Law (Administered Funds), that is, funds for which a CIMA-licensed mutual fund administrator provides the principal office and has delegated regulatory responsibilities.
- **Registered Funds.** These are funds registered under section 4(3) of the MF Law by virtue of being listed on an approved stock exchange.

Alternatively, open-ended hedge funds can be Unregulated MFs and therefore not subject to regulation by CIMA.

Unregulated MFs are funds exempted from registration with CIMA under section 4(4) of the MF Law due to having 15 or fewer investors, a majority of whom can appoint and remove the operator of the fund (the directors, general partner or trustee, as applicable).

As at 31 December 2016, the total number of Regulated Funds was 10,586 (down from 10,940 a year earlier). The vast majority of these (96%) are Registered Funds (10,113, down from 10,459 a year earlier). Approximately 94% (about 9,950) of these Regulated Funds require an investment of at least US\$100,000.

These figures reveal the predominance of the non-retail, institutional market. To register as a Registered Fund (rather than obtain a licence as a Licensed Fund or register as an Administered Fund), a fund must satisfy one of the following criteria:

- Require a minimum initial investment of at least US\$100,000.
- Have its interests listed on an approved stock exchange.
- Be a "master fund" (see below) that satisfies one of the two conditions above.

Based on the figures above, Registered Funds listed on an approved stock exchange generally still require an investment of at least US\$100,000 and are therefore listed for reasons other than the ability to admit retail investors.

The slight decrease in the number of Regulated Funds reflects a mature and relatively stable market.

A master fund must register with CIMA under the MF Law if it is an open-ended Cayman Islands vehicle trading in investments that has one or more "regulated feeder funds" (that is, a fund that is itself a Regulated Fund, and conducts more than 51% of its investing through the master fund).

Master funds will generally qualify for registration as Registered Funds under section 4(3) of the MF Law and require the:

- Filing of a Form MF4.
- Payment of the annual fee (US\$3,048.78) and application fee (US\$365.85).

Master funds cannot rely on the Unregulated MF exemption in section 4(4) of the MF Law.

Regulatory framework and bodies

2. What are the key statutes and regulations that govern hedge funds in your jurisdiction? Which regulatory bodies regulate hedge funds?

Regulatory framework

Open-ended hedge funds are regulated by the Mutual Funds Law (MF Law) (see Question 1).

Regulatory bodies

The regulatory body is the Cayman Islands Monetary Authority (CIMA) (see Question 1).

3. How are hedge funds regulated (if at all) to ensure compliance with general international standards of good practice?

The offering document of a Regulated Fund must:

- Describe the equity interests being offered in all material respects.

- Contain the information necessary to enable a prospective investor to make an informed decision whether or not to subscribe for or purchase the interests (the Cayman Islands Monetary Authority (CIMA) prescribes some information that must be included in the offering documents of Licensed Funds, and will generally expect to see such information in the offering documents of all Regulated Funds).

All Regulated Funds must have their financial statements audited annually by an approved local auditor. The audited statements must be submitted to CIMA, together with a Fund Annual Return, within six months of the fund's financial year end.

CIMA has issued guidance on corporate governance in December 2013 that is applicable to all Regulated Funds (CIMA's Governance SOG), and takes non-compliance into account when determining if the fund is being managed in a fit and proper manner. CIMA can impose significant sanctions on funds and their operators if it determines that a regulated fund is not being managed in a fit and proper manner or is otherwise in breach of the Mutual Funds Law (MF Law).

The Cayman Islands operates a strong anti-money laundering and anti-terrorist financing regime. The Cayman Islands government and CIMA actively engage with regulators in other jurisdictions to ensure compliance with international standards of good practice. All hedge funds are subject to the:

- Proceeds of Crime Law.
- Misuse of Drugs Law.
- Terrorism Law.

In addition, all Regulated Funds must comply with the detailed anti-money laundering compliance regime contained in the:

- Money Laundering Regulations (ML Regulations).
- Guidance Notes on the ML Regulations issued by CIMA (ML Guidance).

Risk

CIMA's rule from 28 April 2008 on segregated of assets for Licensed Funds (except those subject to the Retail Japan Regulations, which contain specific requirements) requires Licensed Funds to keep their portfolio assets segregated from the assets of any service providers. CIMA's Governance SOG requires the governing body of any Regulated Fund to ensure suitable oversight of risk management. CIMA's statement of guidance on outsourcing by regulated entities also requires Regulated Funds to thoroughly assess the risks attached to the outsourcing of any material functions or activities.

Valuation and pricing

CIMA's rule from 28 April 2008 on calculation of asset values for Licensed Funds (except those subject to the Retail Japan Regulations, which contain specific requirements) governs the disclosure of valuation policies, valuation methods, independence and frequency of valuations. Values must generally be based on market prices established in the prior 30 days. However, if such market prices are not available, consistently applied pricing models must be used.

Systems and controls

CIMA's Governance SOG sets out CIMA's expectations for the governing bodies of Regulated Funds on general matters of governance. These include the ongoing monitoring of compliance by the investment manager with the fund's investment strategy and any investment restrictions.

Insider dealing and market abuse

The Securities Investment Business Law (SIB Law) contains the offences of:

- Creating a false or misleading market.
- Insider dealing, in relation to trading in securities listed on the Cayman Islands Stock Exchange.

Transparency

The MF Law imposes general disclosure obligations on the offering documents of Regulated Funds (*see Question 1*). For Licensed Funds (except those subject to the Retail Japan Regulations, which contain specific requirements), this is supplemented by CIMA's rule from 28 April 2008 on the contents of offering documents. Regulated Funds must file an updated offering document with CIMA within 21 days of becoming aware of any material change to the details contained in its offering document on file with CIMA.

Money laundering

All Cayman hedge funds are subject to the ML Laws and all Regulated Funds are subject to the ML Regulations and ML Guidance. Unregulated MFs are also likely to be subject to the ML Regulations and ML Guidance if they carrying on any of the types of business specified in Schedule 2 of the ML Regulations (for example, trading in money market instruments, foreign exchange, exchange and interest rate instruments, index instruments, transferable securities or commodity futures).

Short selling

There are no specific rules governing short selling.

Marketing

4. Who can market hedge funds?

The Securities Investment Business Law (SIB Law) provides for the licensing and control of persons carrying on "securities investment business" in or from within the Cayman Islands by the Cayman Islands Monetary Authority (CIMA). Securities investment business includes dealing in, arranging deals in and advising on securities. Accordingly, the marketing of interests in funds will generally constitute securities investment business.

With limited exceptions for public authorities and so on, the SIB Law applies to:

- Any entity formed or registered in the Cayman Islands carrying on securities investment business.
- Any person that establishes a place of business in the Cayman Islands from which securities investment business is carried out.

Any of the foregoing will require a licence under the SIB Law to carry on securities investment business, unless the entity or person:

- Qualifies as an "excluded person".
- Files the relevant annual declaration and fee (US\$6,097.56) with CIMA before commencing securities investment business (and by 31 January each year thereafter).

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An entity or person will qualify as an excluded person if it only carries on securities investment business with:

- Group companies (that is, other companies within the same group of companies).
- Sophisticated persons, meaning persons who:
 - are regulated by CIMA;
 - are regulated by a recognised overseas regulatory authority;
 - have securities listed on a recognised security exchange; or
 - have the knowledge and experience and are capable of evaluating the merits of a proposed transaction with a value of at least US\$100,000.
- High net worth persons, meaning individuals with a net worth of at least US\$1 million or any person with total assets of at least US\$5 million.
- Entities in which the investors are all sophisticated or high net worth persons.
- Persons regulated in relation to securities investment business by a recognised overseas regulatory authority.

Onshore hedge funds

See above.

Offshore hedge funds

See above.

5. To whom can hedge funds be marketed?

The position is the same as for retail funds.

If incorporated as an exempted company or a limited liability company (LLC), a fund's securities cannot be offered to the public in the Cayman Islands unless listed on the Cayman Islands Stock Exchange.

Any other type of Regulated Fund or an Unregulated MF can market its interests to the public in the Cayman Islands through a person appropriately licensed under the Securities Investment Business Law (SIB Law).

Overseas open-ended funds that do not register with the Cayman Islands Monetary Authority (CIMA) as a Regulated Fund, can only market their interests to the public in the Cayman Islands through a person appropriately licensed under the SIB Law, and provided that either:

- The interests are listed on a stock exchange approved by CIMA.
- The fund is regulated in a category and by an overseas regulator approved by CIMA.

However, for this purpose, "public in the Cayman Islands" does not include the following categories of person (meaning an overseas fund will not be restricted in marketing to them from outside the Cayman Islands):

- Sophisticated persons (as defined in the SIB Law), meaning persons who:
 - are regulated by CIMA;
 - are regulated by a recognised overseas regulatory authority;
 - have securities listed on a recognised security exchange; or

- have the knowledge and experience and are capable of evaluating the merits of a proposed transaction with a value of at least US\$100,000.
- High net worth persons (as defined in the SIB Law) meaning individuals with a net worth of at least US\$1 million or any person with total assets of at least US\$5 million.
- Entities in which all the investors are sophisticated or high net worth persons.
- Exempted or ordinary non-resident Cayman Islands companies, LLCs, or any director or officer of the same acting in such capacity.
- Overseas companies registered as foreign companies in the Cayman Islands, or any director or officer of the same acting in such capacity.
- Any Cayman Islands LLC, exempted, ordinary non-resident or foreign company acting as general partner of a Cayman Islands exempted limited partnership, or any director or officer of the same acting in such capacity.
- The trustee of any Cayman Islands exempted trust.

Closed-ended funds can market their interests to the public in the Cayman Islands through a person appropriately licensed under the SIB Law.

Overseas closed-ended funds can freely market their interests to the public in the Cayman Islands provided they do so from outside the Cayman Islands, and not from a place of business in the Cayman Islands.

Onshore hedge funds

See above.

Offshore hedge funds

See above.

Investment restrictions

6. Are there any restrictions on local investors investing in a hedge fund?

The position is the same as for retail funds.

If incorporated as an exempted company or an LLC, a fund's securities cannot be offered to the public in the Cayman Islands unless listed on the Cayman Islands Stock Exchange.

Any other type of Regulated Fund or an Unregulated MF can market its interests to the public in the Cayman Islands through a person appropriately licensed under the Securities Investment Business Law (SIB Law).

Overseas open-ended funds that do not register with the Cayman Islands Monetary Authority (CIMA) as a Regulated Fund, can only market their interests to the public in the Cayman Islands through a person appropriately licensed under the SIB Law, and provided that either:

- The interests are listed on a stock exchange approved by CIMA.
- The fund is regulated in a category and by an overseas regulator approved by CIMA.

However, for this purpose, "public in the Cayman Islands" does not include the following categories of person (meaning an overseas fund will not be restricted in marketing to them from outside the Cayman Islands):

- Sophisticated persons (as defined in the SIB Law) (see Question 5).
- High net worth persons (as defined in the SIB Law) (see Question 5).
- Entities in which all the investors are sophisticated or high net worth persons.
- Exempted or ordinary non-resident Cayman Islands companies, LLCs or any director or officer of the same acting in such capacity.
- Overseas companies registered as foreign companies in the Cayman Islands, or any director or officer of the same acting in such capacity.
- Any Cayman Islands LLC, exempted, ordinary non-resident or foreign company acting as general partner of a Cayman Islands exempted limited partnership, or any director or officer of the same acting in such capacity.
- The trustee of any Cayman Islands exempted trust.

Closed-ended funds can market their interests to the public in the Cayman Islands through a person appropriately licensed under the SIB Law.

Overseas closed-ended funds can freely market their interests to the public in the Cayman Islands provided they do so from outside the Cayman Islands, and not from a place of business in the Cayman Islands.

Assets portfolio

7. Who holds the portfolio of assets? What regulations are in place for its protection?

The position is the same as for retail funds.

Open-ended retail funds

Licensed Funds to which the Retail Japan Regulations apply must appoint a custodian in an approved jurisdiction.

Apart from this exception, there are currently no rules requiring the appointment of a custodian or broker to hold a fund's portfolio assets.

Closed-ended retail funds

There are no restrictions applicable to closed-ended funds.

Requirements

8. What are the key disclosure or filing requirements (if any) that must be completed by the hedge fund?

For the filing requirements to register with the Cayman Islands Monetary Authority (CIMA) as a regulated fund, any proposed director of a corporate fund regulated by CIMA must register with CIMA (via CIMA's online registration portal) before he can be appointed.

For the filing requirements for Regulated Funds that are master funds, see Question 1.

For annual account filings requirements applicable to Regulated Funds, see Question 3.

Regulated Funds must also comply with the following ongoing requirements:

- If the fund is offering its interests to investors on an ongoing basis and becomes aware that something in its offering document is materially affected by any change, it must file an updated offering document with CIMA within 21 days (which can take the form of a supplement).
- Any additional director of a corporate fund must be registered with CIMA before he can be appointed.
- Annual fees must be paid to CIMA by 15 January each year.

9. What are the key requirements that apply to managers or operators of hedge funds?

The position is the same as for retail funds.

Open-ended retail funds

The following key requirements apply to managers and operators of open-ended funds:

- A corporate Regulated Fund or the corporate general partner of a limited partnership Regulated Fund must have at least two directors.
- All the directors of a corporate Regulated Fund must be registered with the Cayman Islands Monetary Authority (CIMA) under the Directors Licensing Law.
- The trustee of a Licensed Fund must be licensed under the Banks and Trust Company Law (BTC Law).
- Investment managers incorporated or registered in the Cayman Islands must generally be regulated under the Securities Investment Business Law (SIB Law).
- Any director, manager or officer of a fund regulated by CIMA must be a "fit and proper person", as determined by reference to this person's:
 - honesty, integrity and reputation;
 - competence and capability; and
 - financial soundness.

Closed-ended retail funds

Investment managers of closed-ended funds, if incorporated or registered in the Cayman Islands, will generally be carrying on securities investment business and require regulation under the SIB Law, unless the fund does not invest in "securities" (as defined in the SIB Law).

Onshore hedge fund managers

Managers established outside the Cayman Islands are generally not subject to any regulation in the Cayman Islands in relation to Cayman hedge funds.

ONLINE RESOURCES

Cayman Islands Monetary Authority (CIMA)

W www.cimoney.com.ky

Description. This is the CIMA website. It provides useful information and has a feature that allows users to search for regulated entities.

Offshore hedge fund managers

For regulation of managers incorporated or registered in the Cayman Islands, see *Open-ended retail funds* and *Closed-ended retail funds* above.

Legal fund vehicles and structures

10. What are the main legal vehicles used to set up a hedge fund and what are the key advantages and disadvantages of using these structures?

These are the same as for retail funds.

Legal vehicles. Funds can be formed as:

- **Companies.** The exempted company limited by shares is the most commonly used vehicle for regulated open-ended funds (accounting for 77% of Regulated Funds, based on the Cayman Islands Monetary Authority's (CIMA's) statistical digest for 2014). Most of these are standard exempted companies, but about 12% of such companies are segregated portfolio companies (in which separate portfolios can be created with assets and liabilities that are legally ring-fenced). LLCs were introduced in June 2016, but so far have mainly been used as the vehicle for general partners of limited partnership fund vehicles, not as the fund vehicles themselves.
- Exempted companies and their shares are widely understood and in addition to a body of Cayman Islands jurisprudence, the Cayman Islands courts can draw on a long tradition of relevant case law from England and the rest of the Commonwealth. A company has legal personality separate from its shareholders and can issue shares in different classes and series. A shareholder's liability for the company's debts is limited by statute to the amount unpaid on its shares (which in an investment fund will usually be issued fully paid).
- **Limited partnerships.** These are registered under the Exempted Limited Partnership Law 2014. Cayman Islands exempted limited partnerships are underpinned by English partnership law, but are modified by statute to make them more suitable for use as investment funds. For example, exempted limited partnerships, while not having separate legal personality, can sue and be sued in their own name.
- **Unit trusts.** These are governed by the Trusts Law. Unit trusts are underpinned by English trust law, but are modified by statute to make them more suitable for use as investment funds. For example, STAR trusts (Special Trusts - Alternative Regime) are not subject to any perpetuity period and can have purposes as their objects.

Advantages/disadvantages. The key advantages and disadvantages of the different types of vehicle are:

- **Flexibility.** Companies are generally governed by more rigid rules than those applicable to limited partnerships and unit trusts (for example, in relation to provisions regarding maintenance of capital, the method of changing their constitutional documents and so on).
- **Legal personality.** Companies have separate legal personality, while limited partnerships must operate through their general partner, and unit trusts through their trustee.
- **Additional vehicles.** Exempted limited partnerships require at least one general partner that is established or registered in the Cayman Islands and unit trusts require a trustee, who will usually insert a controlled subsidiary for liability protection.
- **Regulatory requirements.** A Licensed Fund that is a unit trust requires a trustee licensed under the Banks and Trust Company Law (BTC Law).
- **Overseas requirements.** The choice of vehicle will often depend on whether it can qualify for specific tax or regulatory treatment in an overseas jurisdiction (for example, unit trusts are generally used for the Japanese market and limited partnerships for the Israeli market).

Tax treatment

11. What is the tax treatment for hedge funds?

There is no Cayman Islands tax applicable to payments made to or from a Cayman Islands fund.

Funds

See above.

Resident investors

See above.

Non-resident investors

See above.

Restrictions

12. Can participants redeem their interest? Are there any restrictions on the right of participants to transfer their interests to third parties?

Redemption of interest

Funds can agree any restrictions on the issue and redemption of interests with their investors at the time they subscribe for such interests. The introduction of additional restrictions in respect of an investor's existing interests can only be achieved in accordance with the consent mechanisms contained in the fund's constitutional documents.

Transfer to third parties

There are no statutory restrictions on the ability of participants in funds to transfer or assign their interests to third parties. However, the constitutional documents of such funds usually contain restrictions, except where the interests are listed on a stock exchange.

Private placement

13. Are private placements of hedge funds permitted under national private placement rules in your jurisdiction?

There are no specific private placement rules in the Cayman Islands, but there are exceptions to the definition of "public in the Cayman Islands". This may exempt an offering to residents from regulation (see *Question 5*).

14. What are the requirements for making a private placement of hedge funds?

Essential requirements to qualify for the regime

See Questions 5 and 13.

Registrations/permits/licences

Not applicable.

Documents to be filed

Not applicable.

Regulatory timescales

Not applicable.

Registration/permit/licence fees

Initial fees. Not applicable.

Ongoing fees. Not applicable.

Content requirements for offering memorandum

Not applicable.

Restrictions on investments/leverage

Not applicable.

Requirements for local service providers

Not applicable.

Requirements for non-local service providers

Not applicable.

Requirements for directors

Not applicable.

Ongoing filing/consent requirements

Not applicable.

Other

Not applicable.

Reform

15. What (if any) proposals are there for the reform of hedge fund regulation?

Amendments to the Mutual Funds Law and the Securities Investment Business Law were approved in September 2015, and detailed regulations were approved in December 2016 to introduce an "opt in" regulatory framework for purposes of the EU's Alternative Investment Fund Managers Directive (AIFMD). Subject to obtaining European Securities and Markets Authority (ESMA) approval, this regulatory regime is designed to enable Cayman Islands investment funds and managers to market in the EU under the AIFMD passport system.

Contributor Profiles



Jarrod Farley, Partner

Carey Olsen

T +1 345 749 2004

F +44 1481 739081

E jarrod.farley@careyolsen.com

W www.careyolsen.com

Professional qualifications. England and Wales, Solicitor, 2000 (non-practising); Cayman Islands, Attorney-at-law, 2004

Areas of practice. Corporate and commercial; investment funds and private equity; mergers and acquisitions.

Non-professional qualifications. BA in Ancient and Modern History, Oxford University

Recent transactions

- Advising on the acquisition of a Cayman Islands captive insurance business.
- Advising a leading Canadian fund manager on the launch of a Can\$600 million alternative credit fund.
- Advising on an innovative investment fund structure to syndicate participation in an aircraft financing transaction.
- Advising a US private equity fund on the structuring of its acquisition vehicles in connection with the US\$130m acquisition of a UK online travel agency.
- Advising an Israeli fund manager on the launch of a US\$400m private equity fund.
- Advising on multiple fund financings secured against capital calls.
- Advising on multiple open-ended and closed-ended fund launches for existing and new manager clients.
- Advising leading Israeli and Chinese fund managers on the establishment of a jointly-managed venture capital fund to invest in Israeli and Israeli-related companies operating in China.

Investment funds in Guernsey: regulatory overview

Tom Carey and Tony Lane
Carey Olsen

global.practicallaw.com/7-504-1153

RETAIL FUNDS

1. What is the structure of the retail funds market? What have been the main trends over the last year?

Open-ended retail funds

A significant number of open-ended funds are established in Guernsey and the island continues to attract non-Guernsey open-ended funds due to its ability to provide high quality administration, management and custody services. Such vehicles are often designed to be promoted to institutional or professional investors, rather than retail investors, but they can also be used as retail funds. The funds regime in Guernsey is highly flexible and most types of funds can be used in a number of different markets, including the retail markets.

As at end of September 2015, the Guernsey Financial Services Commission (GFSC) announced that the total net asset value of funds under management and administration for Guernsey domiciled open-ended funds was GB£39.4 billion. Non-Guernsey open-ended funds that are administered or managed in Guernsey provided a total net asset value of GB£47 billion.

Closed-ended retail funds

The funds sector (and in particular the closed-ended fund sector) is one of the main pillars of the finance industry in Guernsey, with the net asset value of all funds under management or administration in Guernsey being GB£224.8 billion at the end of September 2015. The majority of funds established in Guernsey are designed to be promoted to institutional or professional investors, rather than retail investors. However, Guernsey has a significant number of listed funds, whose shares can be acquired by the public on the secondary market. Guernsey continues to be the global leader for non-UK London Stock Exchange listings, with 129 Guernsey entities listed on the Main Market, AIM or the SFM as at the end of December 2015. Guernsey funds are also listed on many other exchanges such as the CISE, Euronext, ISE, ASX and TSX.

In the past year, the Guernsey closed-ended funds sector has experienced increases in aggregate asset value as well as significant new launches and sizeable fund-raising by established funds. There is a continued move away from remunerating managers through performance fees. Debt funds have remained popular for new fund launches in the past year as investors seek yield during this period of low interest rates. Other dominant themes have been infrastructure and real estate. The Guernsey closed-ended funds sector is valued at GB£138.4 billion as at end of September 2015.

AIFM Directive

Guernsey is a "third-country" non-EU jurisdiction under the Directive 2011/61/EU on alternative investment fund managers (AIFM Directive), which provides Guernsey based managers and funds with a number of potential advantages.

There has been a strong trend towards establishing funds with a Guernsey based AIFM (whether this is the fund itself or a separate Guernsey based manager) so that the fund and the manager are free from the requirements and costs associated with the AIFM Directive, but can make use of national private placement regimes if they wish to market the fund in specific EEA jurisdictions. As a result, Guernsey is particularly attractive for promoters based in the EU or for promoters in the US and Asia who may otherwise be discouraged by the complexities of raising capital in the EU.

A significant proportion of Guernsey funds fall outside the scope of the AIFM Directive, and it is expected that promoters will continue to use Guernsey as a base for such products, taking advantage of the non-EU status.

Regulatory framework and bodies

2. What are the key statutes, regulations and rules that govern retail funds? Which regulatory bodies regulate retail funds?

Open-ended retail funds

Regulatory framework. The types of open-ended funds are as follows:

- **Authorised funds.** Funds that are authorised by the Guernsey Financial Services Commission (GFSC) and subject to permanent and continuing supervision by the GFSC. These funds fall into three classes:
 - **Class A.** These are true retail funds that are equivalent to Undertakings for Collective Investment in Transferable Securities (UCITS) in the EU. The rules applicable to Class A funds are the Collective Investment Schemes (Class A) Rules 2002 (Class A Rules) (although these are due to be replaced by the Authorised Collective Investment Schemes (Class A) Rules 2008 at a date which has not yet been specified). These rules are prescriptive as to the form and content of the fund documents, and place limits on the investment and borrowing powers of the fund. Class A funds benefit from an investor compensation scheme under the Collective Investment Schemes (Compensation of Investors) Rules 1988. Class A funds can be registered for sale in numerous countries and promoted or distributed to the public in the UK in the same way as UK-authorised funds (subject to complying with certain notification requirements).

- **Class B.** These can be structured as retail products marketed to the public, or established as strictly private or institutional funds. The rules applicable to Class B funds are the Collective Investment Schemes (Class B) Rules 2013 (Class B Rules). These rules are less prescriptive than for Class A funds, and allow Class B funds greater latitude in their investment and borrowing powers, provided that there is full disclosure in the fund documents.
- **Class Q.** These are not retail funds as they can only be beneficially owned by qualifying professional investors (essentially, government bodies or high net worth individuals or entities). The rules applicable to Class Q funds are the Collective Investment Schemes (Qualifying Professional Investor Funds) (Class Q) Rules 1998 (Class Q Rules).
- **Registered funds.** These are funds that are registered with the GFSC and are regulated, but not authorised, by the GFSC. The rules applicable to registered open-ended funds are the Registered Collective Investment Scheme Rules 2015. The fund documents must contain the disclosures required by the Prospectus Rules 2008. These rules are not prescriptive concerning the features of the fund (for instance, in relation to investment powers) but require full disclosure of all material matters and ongoing notification of specific events. There are no restrictions on who can invest in a registered fund. They are unlikely to be used as retail funds.

Regulatory bodies. The GFSC regulates all funds in Guernsey and its powers are derived from the Protection of Investors (Bailiwick of Guernsey) Law 1987, as amended (POI Law). The GFSC issues the rules and regulations regulating funds under powers derived from the POI Law.

Closed-ended retail funds

Regulatory framework. The types of closed-ended funds are as follows:

- **Authorised closed-ended funds.** These are funds that are authorised by the GFSC and are subject to its permanent and continuing supervision. The rules which apply to authorised closed-ended funds are the Authorised Closed-ended Investment Schemes Rules 2008. These rules are not prescriptive concerning the features of the fund (for example, in relation to investment powers) but require full disclosure of all material matters and ongoing notification of specific events.
- **Registered closed-ended funds.** See above, *Open-ended retail funds: Registered funds*.

Regulatory bodies. The GFSC rules governing closed-ended funds are issued under powers derived from the POI Law.

AIFM Directive

Guernsey is a "third-country" non-EU jurisdiction under the EU Directive 2011/61/EU on alternative investment fund managers (AIFM Directive) and has established a dual regime which provides a flexible regulatory framework and allows fund managers to comply with the AIFM Directive without being required to do so when compliance is not absolutely necessary.

The first part of the dual regime ensures that Guernsey funds can be marketed in the EEA using national private placement regimes, with the GFSC acting as a local regulator that co-operates with the relevant EEA securities regulator. Such funds can also be marketed to non-EU investors without being concerned with compliance with the AIFM Directive.

The second part of the dual regime allows managers and depositaries, before the introduction of the pan-European passport, to opt in to a regime which is fully compliant with the AIFM Directive, if this is required.

The European Securities and Markets Authority (ESMA) has assessed Guernsey and concluded that no obstacles exist to the extension of a "third country" passport to Guernsey. However, at present it is uncertain when the passport regime will be introduced for third countries and so Guernsey funds with non-EU AIFMs continue to make use of national private placement regimes in the EU.

3. Do retail funds themselves have to be authorised or licensed?

Open-ended retail funds

Open-ended funds must be either authorised or registered (see *Question 2, Open-ended retail funds*), but do not require licensing. Special rules apply to foreign funds (see *below, Foreign funds*).

Authorised funds. There are two separate procedures that apply for authorisation of an authorised open-ended fund:

- **Traditional three-stage application process.** This procedure applies to Class A, Class B and Class Q funds. It involves the following stages:
 - **Preliminary (new promoter's introductory checklist).** Before starting the three-stage application process, it is necessary to identify the promoter of the fund (the person ultimately responsible for the success of the fund, usually the investment manager). If the promoter is not previously known to the Guernsey Financial Services Commission (GFSC), the promoter should review the checklist and provide the information outlined in that form. The GFSC requires a demonstrable track record in the establishment and/or management of investment funds. The GFSC will then indicate whether or not it will consider a formal application from the promoter. New promoters should allow up to three months for this process;
 - **Stage one (outline authorisation).** A Form GFA is submitted setting out the basic details of the proposed fund; the fund's objectives; the parties involved; the fees to be charged and any unusual features.

The designated manager (a locally based administrator) and the designated custodian must sign this form. A prospectus is not required at this stage. If the parties meet the GFSC's selection criteria and the proposals are acceptable, the GFSC then issues an outline authorisation. Applicants should allow between six to eight weeks from the submission of the stage one application to the formal authorisation (assuming that no issues arise);
 - **Stage two (interim authorisation).** The following are submitted a nearly final draft of the fund's prospectus (or equivalent document); the investor's application form and the appropriate form for the proposed class of the fund (forms APA, APB and APQ respectively);

These forms act as a checklist and ensure that the required disclosures are included in the fund documents. Derogations can be sought in respect of the Class B and Class Q rules, but no derogations are allowed from the Class A rules. The GFSC aims to issue the interim authorisation within ten working days of the receipt of the application;

- Stage three (formal authorisation). This is granted when all issues have been resolved and all conditions have been satisfied, including the GFSC receiving a certified copy of the prospectus and certified copies of all final constitutive documents and key agreements (for example, articles of incorporation, management agreement, custodian agreement, and so on).
- **Fast track application (Qualifying Investor Funds) (QIFs).** A fast track application process is also available, under which the proposed designated manager of the fund carries out the assessment that the GFSC otherwise carries out at stage three of the traditional process (*see above*). The designated manager submits the QIF application (Form QIF) once all:
 - due diligence on both the parties and the fund structure is complete; and
 - fund documents are in final (or near final) form.

Form QIF includes warranties from the designated manager to the GFSC concerning the suitability of the fund and the parties involved. The GFSC then undertakes to issue the formal authorisation of the fund within three working days of the receipt of a complete application.

The disadvantage to this fast track process is that investment in the fund must be restricted to qualified investors, which are defined as professional investors, experienced investors or knowledgeable employees.

Registered funds. The process for applying for the registration of a registered open-ended fund is the same as for the QIF application (*see above*), except that the applicable form is Form REG. The time period of three working days also applies. The type of investor who can invest in the fund is not restricted.

Foreign funds. Certain categories of funds that are authorised in the UK, Jersey, Isle of Man or Republic of Ireland can be promoted in Guernsey on completion of a Form EX and the payment of a fee, but without being authorised or registered in Guernsey (*The Investor Protection (Designated Countries and Territories) Regulations 1989 and The Investor Protection (Designated Countries and Territories) (Republic of Ireland) Regulations 1992*).

In addition, an EU AIFs (within the meaning of the AIFM Directive) may be promoted in Guernsey on completion of a Form EX and the payment of a fee, but without being authorised or registered in Guernsey (*The Investor Protection (Designated Countries and Territories) (Amendment) (AIFMD) Regulations 2015*).

A Guernsey licensee providing management, administration or custody services to open-ended foreign funds must comply with the Licensees (Conduct of Business and Notification) (Non-Guernsey Schemes) Rules 1994.

Under these rules, the licensee must notify, and obtain the approval of, the GFSC before providing these services. This approval will usually only be granted if the fund would broadly meet the criteria for authorisation as an authorised fund in Guernsey (if this authorisation was necessary).

Closed-ended retail funds

Closed-ended funds must be either authorised or registered (*see Question 2, Closed-ended retail funds*) but do not need to be licensed.

Authorised funds. There are two separate processes for applying for authorisation of an authorised closed-ended fund:

- **Traditional three-stage application process.** This process is the same as for authorised open-ended funds (*see above, Open-ended retail funds*), except as follows:
 - **Stage one (outline authorisation).** As there is no requirement for closed-ended funds to appoint a custodian or trustee, there is no requirement for the custodian or trustee to sign the Form GFA;
 - **Stage two (interim authorisation).** The A, B and Q Classes do not apply to closed-ended funds, and so there is only one type of application form (Form APC). Derogations from the Authorised Closed-ended Investment Schemes Rules 2008 can be sought if either compliance with a particular rule is not appropriate in the circumstances or compliance would require a fund to alter its proposed operations or practices.
- The GFSC must be satisfied that investors will not be adversely affected before granting derogations. **Fast track application (QIFs).** The fast track application process is available for authorised closed-ended funds and is the same as for authorised open-ended funds (*see above, Open-ended retail funds*).

Registered funds. The process for applying for the registration of a registered closed-ended fund is the same as for a registered open-ended fund (*see above, Open-ended retail funds*).

Foreign funds. Closed-ended funds that are constituted outside Guernsey must be authorised or registered in Guernsey if the functions of administration and custody of the fund are carried out within Guernsey. This does not apply if only the administration of the fund is carried out in Guernsey.

Marketing

4. Who can market retail funds?

Open-ended retail funds

Any person marketing a fund, receiving subscriptions or registering investors in (or from within) Guernsey must be licensed by the Guernsey Financial Services Commission (GFSC) (*POI Law*). An exemption applies to nationals of the UK, Jersey, Isle of Man or the Republic of Ireland who would be permitted to market the relevant fund in their home country. In addition, investment products, including foreign funds, can be marketed in Guernsey without a licence provided that the promotion is only directed at persons or entities who are licensed by the GFSC.

Closed-ended retail funds

See above, *Open-ended retail funds*.

Foreign funds

See above, *Open-ended retail funds*.

In addition, certain categories of funds that are authorised in the UK, Jersey, Isle of Man or Republic of Ireland or which are EU AIFs within the meaning of the AIFM Directive can be promoted in Guernsey without being authorised or registered in Guernsey, and without the promoter being licensed in Guernsey, on both completion of a Form EX and payment of a fee (*The Investor Protection (Designated Countries and Territories) Regulations 1989, The Investor Protection (Designated Countries and Territories) (Republic of Ireland) Regulations 1992 and The Investor Protection (Designated Countries and Territories) (Amendment) (AIFMD) Regulations 2015*).

5. To whom can retail funds be marketed?

Open-ended retail funds

The following restrictions apply:

- **Class A funds.** There are no restrictions.
- **Class B funds.** There are no restrictions.
- **Class Q funds.** These non-retail funds can only be marketed to qualifying professional investors (*see Question 2, Open-ended retail funds*).
- **Funds authorised using the fast-track QIF application process.** These funds can only be marketed to qualified investors (*see Question 3, Open-ended retail funds*).
- **Registered open-ended funds.** There are no restrictions on the type of investor. These funds can be offered to regulated entities in Guernsey, or to the public in Guernsey by entities licensed by the Guernsey Financial Services Commission (GFSC).

Closed-ended retail funds

The following restrictions apply:

- Authorised closed-ended funds: there are no restrictions.
- Funds authorised using the fast-track QIF application process: qualified investors only.
- Registered closed-ended funds: there are no restrictions on the type of investor, but these funds cannot be marketed directly to the public in Guernsey. These funds can be offered to regulated entities in Guernsey, or to the public in Guernsey by entities licensed by the GFSC.

Foreign funds

Certain funds authorised in the UK, Jersey, Isle of Man or Republic of Ireland can be promoted in Guernsey without being authorised or registered in Guernsey (*see Question 4, Foreign funds*). Guernsey regulations do not restrict the persons to whom such funds can be marketed.

Managers and operators

6. What are the key requirements that apply to managers or operators of retail funds?

Open-ended retail funds

There are two key roles in a Guernsey fund:

- **Promoter.** The term promoter is not specifically defined but is generally considered as the party ultimately responsible for the fund's success. It is usually, but not always, the investment manager. The identity, standing and track record of the fund's promoter are of vital importance to the Guernsey Financial Services Commission (GFSC) when determining whether (or not) to authorise a fund. The GFSC's selection policy requires applicants to be able to demonstrate a favourable track record in an established jurisdiction, involving a business which is:
 - equivalent to the new proposal; and
 - financially successful.

The following are also taken into consideration:

- whether the promoter is authorised or licensed by another regulatory body is a positive indicator (although the GFSC will make its own assessment);
- the promoter's ownership, financial resources and reputation;
- the experience of the principals behind the promoter.

In the case of QIFs and registered funds, the proposed designated manager of the fund carries out the assessment. However, it involves the same considerations and the same criteria as if the GFSC was conducting the review.

- **Designated manager/designated administrator.** All funds authorised or registered in Guernsey must appoint a local designated manager (also referred to as the designated administrator) which must be licensed by the GFSC. Guernsey has a well-developed fund administration industry, and a local firm usually carries out the functions of the designated manager. However, these functions can be outsourced to a third party (whether local or foreign). In those cases, the local designated manager remains primarily responsible to the GFSC, and must comply with the GFSC's guidance on outsourcing when considering and monitoring those appointments. Designated managers must comply with:
 - The Licensees (Conduct of Business) Rules 2014 (COB Rules);
 - The Licensees (Capital Adequacy) Rules 2010 (CA Rules).

The COB Rules include provisions dealing with the following:

- compliance arrangements, including monitoring and employee training;
- record keeping;
- categorising clients;
- suitability of transactions for clients and disclosure of information to clients;
- timely execution and best execution;
- dealing with client assets;
- the timing and content of contract notes relating to transactions;
- conflicts of interest;
- events to be notified to the GFSC.

The CA Rules specify the level of financial resources, liquidity and insurance that a licensee must maintain, as determined by reference to their business type, historical turnover and risk profile.

It is common for a foreign manager to perform the investment management role, and a local designated manager to perform the administration role.

Foreign funds. A Guernsey licensee providing management, administration or custody services to open-ended foreign funds must comply with the Licensees (Conduct of Business and Notification) (Non-Guernsey Schemes) Rules 1994 (*see Question 3, Open-ended retail funds*).

Closed-ended retail funds

See above, *Open-ended retail funds*.

Assets portfolio

7. Who holds the portfolio of assets? What regulations are in place for its protection?

Open-ended retail funds

All open-ended funds authorised or registered in Guernsey must appoint a local designated custodian or trustee, who must be licensed by the Guernsey Financial Services Commission (GFSC). Irrespective of the type of fund, the custodian or trustee must be:

- Independent of the designated manager and investment manager.
- Where the fund is a company, independent of the company and its directors.

Designated custodians/trustees must comply with the Licensees (Conduct of Business) Rules 2014 and the Licensees (Capital Adequacy) Rules 2010.

Closed-ended retail funds

Closed-ended funds are not required to appoint a designated custodian or trustee. However, the GFSC must be satisfied that the assets of the fund are adequately safeguarded. This can involve the appointment of a local custodian or trustee (or a foreign custodian or trustee), or it can involve some other form of safeguarding arrangement. The designated manager can provide safekeeping facilities.

Legal fund vehicles

8. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures?

Open-ended retail funds

Legal vehicles. The vehicles most often used for open-ended retail funds are corporate vehicles or unit trusts. Limited partnerships and limited liability partnerships (LLPs) are unlikely to be used for retail funds (see Question 25, *Legal vehicles: Limited partnership and limited liability partnership (LLP)*).

Corporate vehicles. Guernsey company law allows for a number of different forms of company (*The Companies (Guernsey) Law 2008, as amended*). The following types can be used for retail funds:

- **Non-cellular company.** This is a traditional company with limited liability and issuing shares of one or more classes.
- **Protected cell company (PCC).** The PCC takes the form of one company that can form any number of cells, with the assets and liabilities of each cell segregated from the other cells. Shares issued by the PCC are attributed to a cell, so that a shareholder's rights relate only to that cell.
- **Incorporated cell company (ICC).** The same rules apply as for a PCC (see above), except each cell has its own legal personality.

The non-cellular company structure is most frequently used for open-ended retail funds; PCCs and ICCs are more commonly used for hedge funds (see Question 25, *Legal vehicles: Corporate vehicle*).

Unit trust. A unit trust is not a legal person in its own right. It is a trust arrangement, under which a trustee holds the assets on trust for the benefit of unitholders, according to the terms of a trust instrument. Investors hold units in the trust, with each unit representing an undivided fractional interest in the trust property. The Trusts (Guernsey) Law 2007 regulates unit trusts.

Compared to companies, unit trusts have greater flexibility in regulating their own affairs as they see fit, within the confines of the applicable fund rules. Unit trusts are familiar to UK investors in the authorised retail funds market. However, most investors are typically more familiar with corporate entities, and there is a greater body of established learning and practice in relation to the operation and management of companies.

Guernsey company law permits the use of open-ended companies in all circumstances and this therefore removes one of the original advantages of using unit trusts.

Advantages. Unit trusts offer greater flexibility as regards internal governance.

Disadvantages. Investors (particularly non-UK investors) may be more comfortable with corporate structures than they would be with unit trusts.

Closed-ended retail funds

Legal vehicles. The vehicles always used for closed-ended retail funds are corporate vehicles (see above, *Open-ended retail funds: Corporate vehicles*). Private equity funds are typically structured as closed-ended limited partnerships but such vehicles are not appropriate for retail funds.

Advantages. Only corporate vehicles are used, and so the advantages are not relevant.

Disadvantages. Only corporate vehicles are used, and so the disadvantages are not relevant.

Investment and borrowing restrictions

9. What are the investment and borrowing restrictions on retail funds?

Open-ended retail funds

Guernsey law only sets out restrictions on investment and borrowing powers for Class A authorised open-ended funds. The Class A Rules contain restrictions that apply to all Class A funds, such as:

- Requirements designed to ensure efficient portfolio management.
- Rules regulating the use of stocklending.
- Restrictions on the circumstances in which the fund can hold cash.
- A requirement that borrowing is on a temporary basis and does not exceed 10% of the value of the fund's property.

In addition, the Class A Rules include specific restrictions which apply to each of the following categories of Class A fund:

- Securities funds.
- Money market funds.
- Futures and options funds.
- Geared futures and options funds.
- Property funds.
- Warrant funds.
- Feeder funds.
- Funds of funds.
- Umbrella funds.

The investment restrictions vary, depending on the type of fund and the nature of the investment. All other forms of open-ended retail fund must disclose the investment and borrowing limits that apply, but no specific restrictions are prescribed.

Closed-ended retail funds

All forms of closed-ended fund must disclose the investment and borrowing limits that apply, but no specific restrictions are prescribed.

10. Can the manager or operator place any restrictions on the issue and redemption of interests in retail funds?

Open-ended retail funds

For Class A funds, the issue or redemption of interests can only be suspended by the manager if the custodian or trustee considers that "due to exceptional circumstances there is good and sufficient reason to do so, having regard to the interests of holders" (*Rule 13.01, Class A Rules*). The fund documents can specify a minimum number, or value, of interests that can be redeemed, and can specify a minimum holding. If a redemption request does not comply with those minimums, the request can be refused.

For all other types of fund, managers are free to impose restrictions on the issue and redemption of interests, but the circumstances in which these arise must be clearly disclosed in the fund documents. New restrictions for redemptions cannot generally be imposed (and existing restrictions cannot be increased) without giving existing holders an opportunity to exit on the old terms.

Closed-ended retail funds

The manager or operator can impose restrictions on the issue of shares. Holders of interests in closed-ended retail funds have no right of redemption in any event.

11. Are there any restrictions on the rights of participants in retail funds to transfer or assign their interests to third parties?

Open-ended retail funds

Restrictions on the transfer of interests would normally be imposed for both open-ended and closed-ended funds to ensure that interests are not transferred to any investor whose circumstances would cause the fund to breach any securities laws or to suffer any adverse tax consequences, or if the transfer would result in any investor holding less than the specified minimum holding for the fund.

Units or shares in Class A funds and Class B funds must be freely transferrable. For all other types of fund, restrictions can be imposed. Interests in Class Q funds and QIFs cannot be transferred to persons who are not eligible to invest in such funds (*see Question 5, Open-ended retail funds*). The manager, the fund and its directors must take all reasonable steps to ensure that interests in Class Q funds are not owned by ineligible investors. The designated manager of a QIF must be satisfied that effective procedures are in place to ensure that interests in the QIF are not owned by ineligible investors.

Closed-ended retail funds

Restrictions can be imposed. Interests in QIFs cannot be transferred to persons who are not eligible to invest in a QIF. The designated manager of a QIF must be satisfied that effective procedures are in place to ensure that interests in the QIF are not owned by ineligible investors.

Reporting requirements

12. What are the general periodic reporting requirements for retail funds?

Open-ended retail funds

Investors. The managers of open-ended funds must prepare the following periodic reports:

- **Class A fund: annual and half-yearly reports.** The annual reports must contain audited accounts and a report by the custodian or trustee. The annual reports must be published within four months of the year end, and half-yearly reports must be published within two months of the end of the half-year period.
- **Class B fund: annual reports.** The reports must contain audited accounts and a report by the custodian or trustee. The annual reports must be published within six months of the year end, and if interim reports are prepared, they must be on a basis consistent with the annual reports.
- **Registered open-ended fund: no periodic reporting requirements.** However, the annual report that must be given to the Guernsey Financial Services Commission (GFSC) is usually also given to investors. Every Guernsey company is legally required to lay its accounts before its shareholders at its annual general meeting.

Regulators. The reporting requirements depend on the type of fund:

- **Class A fund.** The manager must provide to the GFSC:
 - reports issued to investors;
 - either an annual notification of any changes to the information contained in the application form, or a confirmation that there are no changes.
- **Class B fund.** The manager must provide to the GFSC:
 - reports issued to investors;
 - either an annual notification of any changes to the information contained in the application form, or a confirmation that there are no changes.
- **Registered open-ended fund.** The manager must provide to the GFSC:
 - either an annual notification of any changes to the information contained in the application form, or a confirmation that there are no changes;

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- audited annual report and accounts within six months of the year end;
- a quarterly statistical return;
- annual notification of any material amendments to the fund's principal documents or agreements.

Closed-ended retail funds

Investors. The same rules apply as for registered open-ended funds (see above, *Open-ended retail funds: Investors*).

Regulators. The same rules apply as for registered open-ended funds (see above, *Open-ended retail funds: Regulators*).

Tax treatment

13. What is the tax treatment for retail funds?

Open-ended retail funds

Funds. Funds are eligible for tax exempt status (for Guernsey tax purposes), on payment of an annual fee of GB£1200. Funds with exempt status are not regarded as being tax resident in Guernsey.

Resident investors. The fund must provide the Guernsey director of income tax with details of distributions made to investors resident in Guernsey, or who carry out business in Guernsey through a permanent establishment. In all other respects, the tax treatment is the same as for non-resident investors (see below).

Non-resident investors. The fund does not deduct income tax from any dividends, distributions or interest payable by the fund to investors. There are no death duties, capital inheritance, capital gains, gifts, sales or turnover taxes levied in Guernsey in connection with the acquisition, holding or disposal of interests in funds. No Guernsey stamp duty or stamp duty reserve tax is payable on the issue, transfer, conversion or redemption of interests in funds.

Closed-ended retail funds

- **Funds.** See above, *Open-ended retail funds*.
- **Resident investors.** See above, *Open-ended retail funds*.
- **Non-resident investors.** See above, *Open-ended retail funds*.

Quasi-retail funds

14. Is there a market for quasi-retail funds in your jurisdiction?

The majority of funds established in Guernsey are designed to be promoted to institutional or professional investors, rather than retail investors. However, Guernsey has a significant number of listed funds, whose shares can be acquired by the public on the secondary market.

Reform

15. What proposals (if any) are there for the reform of retail fund regulation?

The Guernsey Financial Services Commission (GFSC) has conducted a consultation on a major revision of the regulatory laws, including the Protection of Investors (Bailiwick of Guernsey) Law 1987, as amended (POI Law). It is anticipated that the change will result in a rationalisation and consolidation of laws, rather than result in substantial changes in the nature of regulation applicable to funds.

The Class Q Rules are due to be revised (following the recent revision of the Class B Rules), although wholesale changes are not expected.

The Limited Partnerships (Guernsey) Law 1995, as amended, is due to be revised and updated to enable further flexibility in the use of limited partnerships.

HEDGE FUNDS

16. What is the structure of the hedge funds market? What have been the main trends over the last year?

Guernsey is a long established jurisdiction for the establishment of hedge funds and funds of hedge funds, and such funds form a significant part of the island's fund industry. Established promoters of hedge funds in Guernsey include Dexion, BBBSA, Man, FRM, Fauchier and Credit Suisse. The net asset value of hedge funds and funds of hedge funds currently stands at approximately GB£27 billion.

Alternative investments are at the core of Guernsey's funds industry, in particular private equity and funds of hedge funds. Private equity funds account for more than half of the closed-ended funds in Guernsey, by number and value, with a current net asset value of over GB£85 billion.

Regulatory framework and bodies

17. What are the key statutes and regulations that govern hedge funds in your jurisdiction? Which regulatory bodies regulate hedge funds?

Regulatory framework

The position is virtually the same as that for open-ended retail funds (see *Question 2, Open-ended retail funds*). Class A funds are not suitable for use as hedge funds, but the other types of fund are all suitable.

The Guernsey Financial Services Commission (GFSC) can also grant certain derogations to different types of hedge funds (which are not available to other types of fund), as follows:

- Institutional or expert investor hedge funds can be permitted to appoint a foreign prime broker rather than a local custodian or trustee.
- Retail or less sophisticated investor hedge funds can be permitted to appoint a foreign prime broker to take control of the fund's property, but will normally be expected to appoint a local custodian or trustee to oversee the prime broker.
- Hedge funds can be permitted to accept subscription monies or effect redemptions on the basis of estimated valuations.
- Hedge funds can be permitted to apply client money in certain circumstances, in which other funds would be required to segregate such money in a client account.

Regulatory bodies

See above, *Regulatory framework*.

ONLINE RESOURCES

Guernsey Financial Services Commission (GFSC)

W www.gfsc.gg

Description. The official website of the GFSC. This website contains relevant legislation, rules, guidance and application forms. The website also provides access to the public register of regulated entities.

Royal Court of Guernsey

W www.guernseylegalresources.gg

Description. An official website maintained by the Royal Court of Guernsey and containing copies of legislation, both in its official original form and in unofficial consolidated form.

18. How are hedge funds regulated (if at all) to ensure compliance with general international standards of good practice?

Risk

The applicable fund rules require clear disclosure of all material risks to the fund and investors, in order to enable the investor to make an informed judgment as to whether or not to invest.

Valuation and pricing

The applicable fund rules do not prescribe a method of valuation or pricing. However, fund documentation must disclose the methods and bases to be used.

Systems and controls

All Guernsey funds must be administered by a local licensee, which must comply with the COB. These rules also apply to custodians and trustees in relation to the provision of custody services.

Insider dealing and market abuse

Insider trading is prohibited (*The Companies Securities (Insider Dealing) (Bailiwick of Guernsey) Law 1996*). The POI Law prohibits market abuse.

Transparency

There are no transparency requirements requiring reporting to investors or the disclosure of significant holdings, aside from periodic reporting requirements (see Question 12, *Open-ended retail funds*).

Money laundering

Funds and their Guernsey service providers must comply with the various laws and regulations concerning the prevention of both money laundering and terrorist financing. The local designated manager of the fund must ensure compliance with these laws. The Guernsey Financial Services Commission (GFSC) endorses the international standards of the Financial Action Task Force (FATF) in relation to combating money laundering and the financing of terrorism.

Short selling

There are no applicable regulations.

Marketing

19. Who can market hedge funds?

See Question 4, *Open-ended retail funds*.

20. To whom can hedge funds be marketed?

See Question 5, *Open-ended retail funds*.

Investment restrictions

21. Are there any restrictions on local investors investing in a hedge fund?

There are no restrictions on local investors investing in a hedge fund.

Assets portfolio

22. Who holds the portfolio of assets? What regulations are in place for its protection?

See Question 7, *Open-ended retail funds*.

Requirements

23. What are the key disclosure or filing requirements (if any) that must be completed by the hedge fund?

The fund must file copies of the following with the GFSC:

- All constitutional and offering documents.
- The principal agreements relating to the fund, for example, the:
 - administration agreement;
 - custodian agreement; and
 - investment management agreement.

Side letters which are personal to a particular investor do not need to be filed.

24. What are the key requirements that apply to managers or operators of hedge funds?

See Question 6, *Open-ended retail funds*.

Legal fund vehicles and structures

25. What are the main legal vehicles used to set up a hedge fund and what are the key advantages and disadvantages of using these structures?

Legal vehicles

The vehicles most often used for hedge funds are corporate vehicles, although it is also possible to use limited partnerships:

- **Corporate vehicle.** Guernsey company law allows for a number of different forms of company (*The Companies (Guernsey) Law, 2008, as amended*). PCCs and ICCs are commonly used for hedge funds (see *Question 8, Open-ended retail funds*) and are particularly useful for managers wishing to establish a number of sub-funds that share many similar features. In this way, the cells can each have different investment objectives, invest in different asset classes, or be hedged against different currencies. The statutory basis for the segregation between cells provides comfort to investors that each cell is properly ring-fenced.
- **Limited partnership.** Funds established as Guernsey limited partnerships have the following features:
 - a specific general partner company is usually incorporated. It manages the affairs of the limited partnership and has unlimited liability in respect of those affairs. It must be licensed or receive an exemption from licence if incorporated or operating in Guernsey;
 - each of the investors is a limited partner, holding a partnership interest, with no liability beyond its investment commitment, provided that it does not do anything that would constitute conduct or management of the partnership's business. The law provides that certain investor actions do not constitute management (*The Limited Partnerships (Guernsey) Law, 1995, as amended*), including acting as a director or shareholders of a corporate general partner; being an employee of the limited partnership or of a general partner and consulting with and advising the general partner;
 - a partnership is typically treated as tax transparent in many jurisdictions (that is, tax is levied at the level of the individual investor rather than the partnership itself);
 - there are no restrictions on returning capital to limited partners, provided that the limited partnership is solvent. If the partnership becomes insolvent within six months of the payment, the return of capital can be clawed back within one year of the payment;
 - the limited partnership agreement remains a private document (but must be provided to the Guernsey Financial Services Commission (GFSC));
 - limited partnerships can elect to have a separate legal personality and to be a body corporate. However, this does not affect its transparency for tax purposes.
- **Limited liability partnership (LLP).** LLPs were introduced in Guernsey in 2014. LLPs are rarely used as fund vehicles but may be used as part of the wider structure for funds that are established as limited partnerships. LLPs have the following features:
 - an LLP is an incorporated legal entity;
 - members have limited liability for the liabilities of the LLP;
 - an LLP is typically treated as tax transparent in many jurisdictions (that is, tax is levied at the level of the individual investor rather than the LLP itself).

The most important difference between the corporate and partnership structures (whether limited partnerships or LLPs) is the partnership's tax transparency. Whether this is an advantage or a disadvantage depends on the position of the prospective investors. With corporate funds it is usual for investors to subscribe for the full amount of their commitment at the outset, whereas with a limited partnership structure the investors' commitments are often drawn down in stages as and when required.

Advantages. The advantages of each legal vehicle in relation to each proposed structure will depend on what the parties wish to achieve when establishing the fund. For example, a corporate vehicle has greater certainty as to its rules of governance as many rights of shareholders are enshrined in law or are considered to be standard practice. Limited partnerships are more flexible in terms of their governance and the rights of partners depend, to a greater extent, on the terms of the individual agreements. This may be an advantage or disadvantage depending on the view of the promoter and the investors.

Disadvantages. The disadvantages of each legal vehicle in relation to each proposed structure will depend on what the parties wish to achieve when establishing the fund.

Tax treatment

26. What is the tax treatment for hedge funds?

Funds

See *Question 13, Open-ended retail funds*.

Resident investors

See *Question 13, Open-ended retail funds*.

Non-resident investors

See *Question 13, Open-ended retail funds*.

Restrictions

27. Can participants redeem their interest? Are there any restrictions on the right of participants to transfer their interests to third parties?

Redemption of interest

Participants of open-ended hedge funds can redeem their interests under the terms specified by that fund. Interests in closed-ended funds are not redeemable at the option of the participant.

Transfer to third parties

It is common to include restrictions to prevent persons acquiring interests if that acquisition would bring the fund within the scope of US Employee Retirement Income Security Act 1974 (*Pub. L. 93-406, 88 Stat. 829*) (ERISA) legislation. This is generally undesirable as the ERISA legislation can impose strict fiduciary standards on the management of the fund assets.

The rules concerning restrictions on participants' rights to transfer their interests are the same as for retail funds (see *Question 11, Open-ended retail funds*).

Reform

28. What (if any) proposals are there for the reform of hedge fund regulation?

See *Question 15*.

Contributor Profiles



Tom Carey

Carey Olsen

T +44 1481 741 559

F +44 1481 711 052

E tom.carey@careyolsen.com

W careyolsen.com

Professional qualifications. England and Wales, Solicitor, 2000; admitted as an advocate of the Royal Court of Guernsey, 2007

Areas of practice. Corporate; commercial; investment funds.

Recent transactions

- Advised Alchemy Partners on the launch of Alchemy Special Opportunities Fund III.
- Advised Ashmore on the launch of an Emerging Market Distressed Debt Fund and a Russian Debt Fund.
- Advised Permira on the launch of Permira V and Permira Credit Solutions II.
- Advised Roundshield on the launch of Roundshield Fund I.



Tony Lane

Carey Olsen

T +44 1481 732 086

F +44 1481 711 052

E tony.lane@careyolsen.com

W careyolsen.com

Professional qualifications. England and Wales, Solicitor, 1998; admitted as an advocate of the Royal Court of Guernsey, 2010

Areas of practice. M&A; investment funds; public equity transactions.

Recent transactions

- Advising Apex Global Alpha on its establishment (including its acquisition of an existing private investment structure), IPO and listing on the Main Market of the LSE.
- Advising Fair Oaks Income Fund on its establishment (including an underlying limited partnership master fund), IPO and listing on the Specialist Fund Market of the LSE.
- Advising Better Capital PCC, a closed-ended private equity fund listed on the LSE, in relation to its conversion to a PCC, the launch of its second fund and subsequent transactions.
- Advising The Glanmore Property Fund on an ongoing basis in relation to all regulatory matters, a reorganisation and a scheme of arrangement.

Hedge funds in Jersey: regulatory overview

Robert Milner, James Mulholland and Daniel O'Connor
Carey Olsen

global.practicallaw.com/W-007-6729

HEDGE FUNDS

Market overview

1. What is the structure of the hedge funds market? What have been the main trends over the last year?

Jersey is dominated by its finance industry, which employs over 13,000 people and contributes a significant portion of Jersey's income. In recent years the finance industry has increasingly focused on the institutional market and sophisticated investors.

In particular, alternative asset classes and hedge funds have provided growth to the overall funds sector in Jersey. An increasing number of fund managers have relocated to or established a presence in Jersey, and the tax and regulatory authorities have been sympathetic to these new businesses. Jersey is now the sixth largest centre for hedge fund managers.

The unregulated funds regime is aimed specifically at the hedge and alternative asset funds sectors (*see Question 2*).

The Financial Services Commission has also recently published a new private funds guide (PFG), which enables up to 50 offers to be made to investors who qualify as 'professional' investors and/or subscribe for interests with a value of at least GB£250,000 in private funds (PFs) with minimal regulation. Before it published the PFG, the Commission was applying a similar proportionate and light-touch approach to very private structures (which permitted up to 15 offers). This resulted in a large number of very private structures being established, as they were seen as ideal for club investments, funds of one and co-investments in particular. Now, because of the wider scope and the ability to make offers to up to 50 potential investors, many more funds will benefit from an even quicker fast-track (within 48 hours) authorisation. For this authorisation can be obtained by obtaining a simple consent under the Control of Borrowing (Jersey) Order (COBO) and can potentially reduce initial and ongoing costs.

The PFG regime is expected to be particularly attractive to European fund managers and promoters.

Jersey has introduced a new, light-touch regime that enables, without further regulation, Jersey-regulated hedge fund managers to service qualifying segregated managed accounts by employing strategies that replicate (or are comprised of material elements from) hedge-fund strategies used by their Jersey funds, while continuing to benefit from Jersey's 0% corporate tax rate. Additionally, a new policy has been introduced to enable LLPs to act as fund managers. Both of these initiatives are designed to appeal to hedge fund managers.

Regulatory framework and bodies

2. What are the key statutes and regulations that govern hedge funds in your jurisdiction? Which regulatory bodies regulate hedge funds?

Regulatory framework

The following categories are generally used for hedge funds:

- Unregulated eligible investor funds.
- Expert funds, Jersey eligible investor funds (JEIFs) and listed funds.
- PFs.
- Other private and public funds.

The AIFM Directive overlay is applicable to hedge funds in the same way as retail funds if funds or managers are subject to it.

Unregulated funds. The UF Order enables the establishment of eligible investor funds, which are exempt from the CIF Law. These allow hedge funds to be established in Jersey without any:

- Jersey service providers.
- Regulatory approval under Jersey's funds legislation.

Eligible investor funds can be open- or closed-ended and are restricted to sophisticated investors (including those investing US\$1 million). They must be one of a:

Jersey company.

Jersey limited partnership (which must have at least one Jersey company as general partner).

Unit trust (which must have at least one Jersey company as a trustee or manager).

A regulated Jersey administrator must supply the registered office to that company. SPV general partners and trustees are exempt from the requirement to be regulated under the FSJ Law.

Expert funds, JEIFs and listed funds. The same laws and regulations for retail funds apply. The three-day approval process applies to each of these categories. The short time to approval and the fair balance of regulatory oversight have proved successful selling points of the Jersey expert fund as an ideal fund structure for most promoters.

PFs. The Commission has recently established a new private funds regime, whereby PFs can benefit from a 'light touch' fast-track regulatory process under the PFG and up to 50 offers can be made to investors who qualify as professional investors or subscribe for interests with a value of at least GB£250,000. The fund (and frequently its service providers) is entirely unregulated, other than the need to obtain consent under COBO on the establishment of the fund vehicle.

Other private and public funds. The same laws and regulations apply as for retail funds. Generally, the higher the minimum investment level and the more sophisticated the investors to whom the fund can be offered, the more flexible the Commission will be as to the scheme proposed (and in these cases the requirements of the OCIF Guide will generally not apply). These categories of fund are generally not used for hedge funds due to the speed and flexibility of the other options, and are not considered further in this chapter.

Regulatory framework. The following legislation applies:

- The Collective Investment Funds (Jersey) Law 1988, as amended (CIF Law), which regulates public funds and recognised funds.
- COBO, which regulates PFs and controls, among others, the creation and issue of:
 - shares;
 - securities;
 - units in a unit trust scheme; and
 - limited partnership interests.
- The Collective Investment Funds (Certified Funds - Prospectuses) (Jersey) Order 2012 (CFPO), which regulates the contents of prospectuses for certified funds.
- The Financial Services (Jersey) Law 1998 (FSJ Law), which regulates fund service providers operating or incorporated in Jersey.
- Alternative Investment Funds (Jersey) Regulations 2012, which overlays the AIFM Directive requirements where applicable.

The following legislation applies to recognised funds:

- The Collective Investment Funds (Recognized Funds) (Rules) (Jersey) Order 2003 (RF Order).
- The Collective Investment Funds (Recognized Funds) (Permit Conditions for Functionaries) (Jersey) Order 1988 (RF Functionary Permit Order).
- The Collective Investment Funds (Recognized Funds) (Compensation for Investors) (Jersey) Regulations 1988.
- The Collective Investment Funds (Recognized Funds) (Actions for Damages) (Jersey) Regulations 2008.

The legislation that applies to unregulated eligible investor funds is the Collective Investment Funds (Unregulated Funds) (Jersey) Order 2008 (UF Order), which exempts them from regulation under the CIF Law if specified conditions are satisfied. Jersey's internationally compliant regime to assist in the detection and prevention of money-laundering and terrorism still applies to these funds (*see Question 3*).

Regulatory bodies

The Commission authorises and supervises regulated investment funds as the principal regulatory authority in Jersey. In addition to its statutory regulation of the financial services sector, the Commission also publishes guidelines and codes of practice for the different industry sectors. These guidelines and codes of practice are produced after consultation with the relevant industry sectors.

Guidelines and codes of practice. The Commission has published the following codes and guidelines which are often as important as the primary legislation:

- Guide to open-ended unclassified collective investment funds offered to the general public (OCIF Guide). This is also applied (by analogy) to CCIFs.
- Promoters of Public and Private Collective Investment Funds (Promoter Policy).
- Licensing Policy in respect of those activities that require registration under the FSJ Law (Licensing Policy).
- Codes of Practice for Fund Services Business (FSJ Codes of Practice).
- Establishing a Collective Investment Fund Operation in Jersey.
- Securities Issues under the Control of Borrowing Legislation.
- The Codes of Practice for Certified Funds (including Expert Fund, JEIF and Listed Fund guides), which applies to funds domiciled and regulated in Jersey holding a certificate under the CIF Law (that is, Expert Funds, JEIFs, Listed Funds, OCIFs and CCIFs).
- The Codes of Practice for Alternative Investment Funds and AIF Services Business (AIF Codes), which apply where funds and/or fund service providers are required to comply with provisions of the AIFM Directive.
- The PFG.

The Commission also issues letters to industry participants from time to time covering fund and manager related issues as a way of highlighting to practitioners and fund professionals the Commission's approach on a particular policy area.

3. How are hedge funds regulated (if at all) to ensure compliance with general international standards of good practice?

Risk

The following apply to the various categories of fund used:

Unregulated eligible investor funds. There are no regulations. A form of investor risk warning is prescribed.

Expert funds, Jersey eligible investor funds (JEIFs) and listed funds. The Jersey administrator, manager or trustee must monitor compliance by the investment manager with the investment restrictions and borrowing limits of the fund. A form of investor risk warning is prescribed.

PFs. Investors must receive and accept a specified form of investment warning.

Valuation and pricing

There are no regulations for valuation and pricing.

Systems and controls

The following apply:

- **Unregulated eligible investor funds.** There are no regulations. No regulated or Jersey service providers are required, other than a Jersey registered office provider (to the fund company, general partner or trustee).
- **Expert funds, JEIFs and listed funds.** All service providers that are regulated in Jersey under the FSJ Law must comply with the FSJ Codes of Practice, which require the:
 - implementation of appropriate corporate governance systems;
 - implementation of internal systems and controls; and
 - demonstration of the existence of adequate risk management systems.
- In the case of SPV managers for expert funds or JEIFs which are supported by a regulated administrator, an expedited approach can be adopted. Codes of Practice for Certified Funds have been adopted (*see Question 15*).
- **PFs.** A Jersey regulated administrator must be appointed to ensure that the necessary criteria and applicable AML legislation are complied with and to carry out due diligence on the promoter.

Insider dealing and market abuse

Insider dealing and market manipulation are regulated under the FSJ Law to comply with international standards. Offences in relation to misleading statements and practices exist under the CIF Law and FSJ Law.

Transparency

See above, *Systems and controls*.

Money laundering

Funds and their Jersey service providers must comply with the following legislation, which applies international standards:

- Proceeds of Crime (Jersey) Law 1999, as amended.
- Money Laundering (Jersey) Order 2008, as amended.
- Terrorism (Jersey) Law 2002, as amended.
- Proceeds of Crime (Supervisory Bodies) (Jersey) Law 2008.
- Drug Trafficking Offences (Jersey) Law 1988, as amended.
- Criminal Justice (International Co-operation) (Jersey) Law 2001, as amended.

They must also comply with any related legislation, and the Commission's Handbook for the prevention and detection of money laundering and the financing of terrorism.

Short selling

There are no regulations restricting short selling.

Marketing

4. Who can market hedge funds?

Jersey law does not prescribe who can market hedge funds. However, a distributor of hedge funds which carries on business (or is incorporated) in Jersey must be registered with the Commission under the FSJ Law.

5. To whom can hedge funds be marketed?

Onshore hedge funds

- **Unregulated eligible investor funds.** These are restricted to 11 categories of "eligible investor", which include:
 - Those investing at least US\$1 million; and
 - Other sophisticated and high net-worth categories.

Listed funds. There are no restrictions.

Expert funds. These can only be marketed to "expert investors". There are ten categories, including:

- Those investing or committing a minimum of US\$100,000 or currency equivalent.
- Other sophisticated and high net-worth categories.

Jersey eligible investor funds (JEIFs). There are 11 categories of "eligible investor", including:

- Those investing or committing a minimum of US\$1 million or currency equivalent.
- Those whose ordinary business or professional activity includes dealing in, managing, underwriting or giving advice on investments (or an employee, director, consultant or shareholder of such a person).
- Individuals with property of a total market value of not less than US\$10 million or currency equivalent.

PFs. PFs under the PFG may only be marketed to up to 50 investors who qualify as professional investors and/or subscribe for interests with a value of at least GB£250,000.

Investment restrictions

6. Are there any restrictions on local investors investing in a hedge fund?

There are no restrictions other than those set out in *Question 4*.

Assets portfolio

7. Who holds the portfolio of assets? What regulations are in place for its protection?

Unregulated eligible investor funds

There are no restrictions.

Listed funds, expert funds and Jersey eligible investor funds (JEIFs)

A listed fund (which is a hedge fund) must appoint a prime broker that either:

- Has a credit rating of A1/P1 or long-term equivalent.
- Is otherwise approved by the Commission.

An open-ended expert fund must appoint either a regulated Jersey custodian/trustee or prime broker. A closed-ended expert fund does not require a custodian/trustee, provided it has adequate safe custody arrangements (including, if applicable, prime brokerage arrangements). The position is the same for JEIFs.

PFs

There are no restrictions.

Requirements

8. What are the key disclosure or filing requirements (if any) that must be completed by the hedge fund?

Investors

Where the OCIF Guide applies:

- At least two reports must be published and distributed to holders in relation to each financial year, with the annual statements audited. Holders must be notified of any changes to the offering or constitutive documents (unless there is no prejudice to the holders' interests).
- The latest selling and redemption prices and NAV must be available to all holders.

For recognised funds, the annual and half-yearly audited financial statements and portfolio statements and reports prescribed by the RF Order must be made available to investors and sent out within:

- Four months of the relevant period's end in the case of an annual report.
- Two months of the period's end in the case of a semi-annual report.

See below for the specific requirements relating to each fund type.

Regulators

Copies of the same reports distributed to the holders must be filed with the Commission (*see above, Investors*).

Where the fund is an AIF which has not appointed a sub-threshold manager, the disclosure and transparency requirements set out in the AIF Codes will also apply.

Unregulated eligible investor funds

Notice of the establishment of an eligible investor fund must be filed and a form of investment warning is prescribed. An unregulated fund which is a company must send annual audited financial statements to investors and file them with the Commission.

Expert funds, listed funds and JEIFs

The requirements for offering documents are the same as for retail funds (except that JEIFs are exempt from the content requirements set out in the CFPO). They must:

Contain all material information in relation to the fund.

Otherwise comply with the disclosure requirements in the relevant guide.

Each offering document must be filed within 14 days of publication. Material changes to the fund must have received Commission consent if they do not comply with the EF Guide, JEIF Guide or LF Guide. If they do comply, they merely need to be notified to the Commission. The fund must file annual audited financial statements and any interim reports with the Commission when these are published. A fund which is a company must file and send to investors annual audited financial statements.

PFs

There are no specific disclosure requirements (except for PFs set out in the AIF Codes, where the PF is an AIF that has not appointed a sub-threshold manager).

9. What are the key requirements that apply to managers or operators of hedge funds?

Unregulated eligible investor funds

There are no requirements. Service providers must be registered under the FSJ Law and regulated by the Commission (unless an exemption applies) if carrying on business in (or incorporated in) Jersey, in the same way as public retail funds. Once a service provider is regulated, there is no requirement to obtain any further consent to act in the same capacity for other public funds (including non-Jersey funds)

Expert funds, Jersey eligible investor funds (JEIFs) and listed funds

There is no requirement for the investment manager or adviser to be Jersey based. For an expert fund, the investment manager or adviser (and/or the distributor, if different) must satisfy certain requirements set out in the EF Guide. Similarly, the investment manager or adviser (and/or the distributor, if different) of a listed fund must satisfy certain requirements set out in the LF Guide. This also applies to JEIFs under the JEIF Guide. The distributor of the expert fund or JEIF (if different from the investment manager/adviser) must also satisfy these requirements if it is not the investment manager/adviser or one of its associates. A distributor is either:

- The driving force behind the fund (that is, if the distributor were to withdraw from the proposal, the fund would not go ahead).
- The entity responsible (either directly or through its agents) for putting the majority of investors into the fund.

Expert funds and JEIFs must appoint an administrator or a manager with at least two Jersey resident directors with appropriate experience, together with staff and a physical presence in Jersey.

In relation to the establishment of SPVs (such as general partner or investment management companies) investment managers or advisers in Jersey, a tailored regime applies such as general partner or investment management companies. These applications are dealt with together in the fund application.

Expert funds, JEIFs and listed funds must appoint an administrator or a manager that has at least two Jersey resident directors with appropriate experience, together with staff and a physical presence in Jersey.

In relation to expert funds, the Commission does not need to review the structure, documentation or the promoter. Instead the fund administrator certifies to the Commission that the fund complies with the Expert Fund (EF) Guide. The Commission aims to issue its approval within three working days of the submission of a completed application. The EF Guide is flexible. However, where any unusual derogations are sought from its terms, it is usual to seek these in advance while the documents are being prepared to avoid potential delay in the approval process.

Similarly, in relation to JEIFs, the fund administrator certifies to the Commission that the JEIF complies with the relevant guide and aims to issue its approval within three working days of the submission of a completed application (assuming that no derogations are needed).

Recognised funds are structured to ensure investor protection that is at least equivalent to that afforded to investors in the UK. Recognised funds issued with a recognised fund certificate can apply to the UK Financial Conduct Authority (FCA) to market directly to the public in the UK and can also be marketed to the public (subject to any local requirements) in a number of other territories including Australia, Belgium, Hong Kong, The Netherlands and South Africa. Functionaries of recognised funds are regulated under the CIF Law.

PFs

There are no requirements other than the need for a Jersey-regulated administrator as "designated service provider" (except where the PF is an AIF, in which case its manager can require regulation as an "AIF services business"). An investment manager or adviser that carries on business (or is incorporated) in or from within Jersey may need to be regulated under the FSJ Law unless a relevant exemption is available or it only advises on real estate.

Legal fund vehicles and structures

10. What are the main legal vehicles used to set up a hedge fund and what are the key advantages and disadvantages of using these structures?

Funds in Jersey are typically established as:

Companies (single class, multi-class, umbrella or protected cell or incorporated cell).

Limited partnerships (including incorporated limited partnerships (ILPs) and separate limited partnerships (SLPs)).

Unit trusts.

Hedge funds usually prefer a corporate structure, except where another vehicle is used to achieve tax transparency from the perspective of one or more onshore jurisdictions (see *Question 10*).

A fund of any legal structure can be open-ended or closed-ended.

Recognised funds must be structured as companies or unit trusts.

Companies

Advantages. In recent years, the Companies (Jersey) Law 1991 has been modified to accommodate improvements for the funds industry (particularly companies with a fluctuating membership), such as:

- Introducing no par value companies (that is, companies the shares of which do not have a nominal value).
- Allowing companies to hold treasury shares.
- Simplifying the making of income and capital distributions, generally permitting them from any source, subject to the company's solvency.
- The use of corporate directors.
- The abolition of financial assistance restrictions.
- Permitting the merger of companies and the migration of companies to Jersey from other jurisdictions.

Investors' interests can be represented by shares (which can be traded uncertificated) or by depository receipts or certificates.

Cell companies are companies which can create cells separate from themselves, each of which can hold separate assets (and liabilities):

- **Protected cell companies (PCCs).** The PCC has a number of features, for example, a PCC cell can invest in another cell within the same PCC structure.
- **Incorporated cell companies (ICCs).** The ICC is very similar to a PCC except that individual cells have separate legal personality.

The ICC and the PCC have found favour as fund vehicles. Statute clearly provides for the segregated nature of the cellular structure, giving legal certainty. Over 400 protected cells and 250 incorporated cells have now been registered. PCCs and ICCs are particularly suited to repeat transactions, where:

A fund manager can seek to establish a number of funds.

The same infrastructure is used but with different investment objectives, investor profiles or fee structures.

Given their ring-fenced structure, PCCs and ICCs are particularly suitable as hedge fund vehicles.

Limited partnerships

Limited partnerships are established under the Limited Partnerships (Jersey) Law 1994 (LP Law).

Advantages. The liability of limited partners for the debts of the partnership cannot extend beyond their agreed capital contributions, provided their activity does not constitute management under the LP Law. The LP Law provides a safe harbour for certain activities that would otherwise constitute management and permits the limited partner a greater degree of involvement in the management of a limited partnership than some other jurisdictions.

Other advantages of a Jersey limited partnership include that:

- There is no upper limit on the number of limited partners.
- Confidentiality is preserved, as the only document to be publicly filed is a short declaration of limited partnership that does not disclose the:
 - identity of the limited partners;
 - business of the partnership; and
 - partnership contributions.

Both ILPs and SLPs (introduced in Jersey in 2011 by the Incorporated Limited Partnerships (Jersey) Law 2011 and the Separate Limited Partnerships (Jersey) Law 2011 respectively) have separate legal personalities (allowing each form of limited partnership, for example, to own assets, and sue and be sued in its own name). An ILP is also a body corporate (SLPs do not have this status). These entities provide greater flexibility for fund managers in structuring their fund's general partner and carried interest vehicle, particularly where the fund is an English limited partnership.

Unit trusts

A unit trust is not a separate legal entity but a trust arrangement under which the legal ownership of the scheme's assets is vested in a trustee who holds those assets on trust for the benefit of unitholders. A unit trust is constituted by an instrument of trust (in the case of an open-ended structure, the parties to the instrument are usually a manager and a trustee), which regulates:

The appointment and retirement of the trustee and manager.

Their respective duties.

The distribution or accumulation of trust income.

Investment powers.

Dealing.

Valuation.

The applicable trusts legislation in Jersey is the Trusts (Jersey) Law 1984.

Advantages. In addition to preserving confidentiality, and the relative flexibility of trusts, there can be significant tax advantages where a unit trust structure is used.

Tax treatment

11. What is the tax treatment for hedge funds?

Funds

A fund, whether established as a company, unit trust or limited partnership, is not generally subject to any local Jersey tax. In particular, there is no capital gains, capital transfer, wealth or inheritance tax payable in relation to the issue or realisation of investments in a Jersey investment fund (unless the fund invests in Jersey property or buildings). In addition, no corporation tax, profits tax or stamp duty is payable. Funds structured as unit trusts and limited partnerships are fully exempt from tax; fund companies are subject to a 0% rate but can become fully exempt.

Jersey resident administrators and custodians are generally liable to Jersey income tax at the rate of 10%. However, Jersey-administered entities, such as general partners and managers that provide services to a fund, are taxed at 0%.

Resident investors

Jersey-resident investors must pay tax at up to 20% on income received from a fund. There is no capital gains tax in Jersey (*see above, Funds*).

Non-resident investors

Non-resident investors are generally not subject to Jersey tax.

Restrictions

12. Can participants redeem their interest? Are there any restrictions on the right of participants to transfer their interests to third parties?

Redemption of interest

There are no statutory restrictions on participants redeeming their interests, but such restrictions can be imposed by fund terms.

All Jersey fund vehicles have great flexibility in distributing income and returning capital to investors (through redemption or distribution), subject to the solvency of the fund.

Transfer to third parties

The fund documents must make provision to prevent non-eligible investors acquiring interests in Jersey eligible investor funds (JEIFs) or eligible investor funds or non-expert investors acquiring interests in expert funds. No other statutory restrictions apply, but more can be imposed by fund terms.

Private placement

13. Are private placements of hedge funds permitted under national private placement rules in your jurisdiction?

Yes, private placements of hedge funds are permitted under national private placement rules. However, consent is needed from the Commission under COBO before circulating offers to invest in non-domiciled funds in Jersey. This is subject to certain exemptions for companies and unit trusts that apply if:

- A fund has no relevant connection with Jersey.
- Either there is no offer to the public, or the offer is valid in the UK or Guernsey and is circulated in a similar manner there. This requirement does not apply to the circulation of marketing materials that do not constitute an offer.

If physical marketing takes place in Jersey or investment advice is to be given, a distributor may need to be licensed under the FSJ Law (subject to available exemptions).

ONLINE RESOURCES

Jersey Financial Services Commission

W www.jerseyfsc.org

Description. This is the website for the Jersey Financial Services Commission. It contains the relevant guidance notes and application forms.

14. What are the requirements for making a private placement of hedge funds?

Essential requirements to qualify for the regime

There are no specific requirements, although the Commission will expect certain information to be contained in the offering document if a COBO consent is needed (*see below*).

Registrations/permits/licences

A COBO consent will be needed, subject to available exemptions for companies or unit trusts.

Documents to be filed

The fund's offering document and evidence of its establishment (for example, a certificate of incorporation).

Regulatory timescales

The Commission generally processes COBO consent applications in five to ten working days.

Registration/permit/licence fees

Initial fees. Currently GB£330.

Ongoing fees. Not applicable.

Content requirements for offering memorandum

The level of the Commission's review of the fund's prospectus depends largely on the type of target investor. Also, factors such as the minimum investment level are relevant to this analysis.

The Commission expects the following to be included in every prospectus, as a minimum:

- The names of the directors.
- A directors' responsibility statement for the contents of the prospectus.
- A statement that investors should consult their stockbroker, bank manager, solicitor, accountant or financial adviser if they have any doubt about the contents of the prospectus.

Restrictions on investments/leverage

None.

Requirements for local service providers

A local distributor may be needed depending on the proposed marketing activities and whether or not a relevant exemption applies.

Requirements for non-local service providers

None.

Requirements for directors

None.

Ongoing filing/consent requirements

None, subject to any conditions attaching to the COBO consent (for example, that the Commission's prior consent is obtained for changes to the offering document).

Reform

15. What (if any) proposals are there for the reform of hedge fund regulation?

See *Question 1*.

Contributor Profiles



Robert Milner

Carey Olsen
T +44 1534 822336
F +44 1534 887744
E robert.milner@careyolsen.com
W www.careyolsen.com

Professional qualifications. Advocate of the Royal Court of Jersey, 2003

Areas of practice. Innovative Jersey fund structures, with a particular focus on property and hedge funds.

Recent transactions

- Advising Gravis Capital Partners on the launch of a new fund and the restructuring of their existing Jersey-funds.
- Advising Ahli United Bank (UK) PLC on the restructuring of AUB Central London Office Fund.
- Advising Alpha Real Capital LLP on their restructuring of an existing Irish fund into a new Jersey vehicle.
- Advising Brevan Howard Capital Management LP on internal restructurings.
- Advising Morgan Stanley & Co International plc. on the establishment of a new Jersey expert fund and new sub-funds.
- Advised SG Hambros on the launch of new sub-funds for SGH Collectives PCC.
- Advising Bluecrest on their migration to Jersey.
- Advising Systematica on their established regulation in Jersey.
- Advising Altis Partners on a new fund launch.



Daniel O'Connor

Carey Olsen
T +44 1534 822249
F +44 1534 887744
E daniel.oconnor@careyolsen.com
W www.careyolsen.com

Professional qualifications. Australia, Solicitor, 1993; England and Wales, Solicitor, 2005; Advocate of the Royal Court of Jersey, 2006

Areas of practice. Investment funds (including structuring and formation of investment funds and offshore funds).

Recent transactions

- Acting for PW Real Assets LLP (formerly Perella Weinberg Real Estate UK LLP) in relation to their substantial Jersey-domiciled fund portfolio focused on real estate and real estate related opportunities in Europe Advising on the establishment of the Falko Regional Aircraft Opportunities Fund L.P, which raised US\$415 million in capital to fund the purchase and leasing of aircraft primarily based in developed markets across Europe, Australia and the US.
- Advising Nordic Capital in respect of their extensive £GB billion Jersey-domiciled private equity fund portfolio, including in relation to the launch of the firm's eighth fund, Nordic VIII, which closed with investor commitments of EUR3.5 billion.



James Mulholland

Carey Olsen
T +44 1534 822369
F +44 1534 887744
E james.mulholland@careyolsen.com
W www.careyolsen.com

Professional qualifications. England and Wales, Solicitor, 2001; Advocate of the Royal Court of Jersey, 2012

Areas of practice. International funds and corporate work with a particular emphasis on private equity.

Recent transactions

- Carey Olsen advised Blackstone/GSO Loan Financing Limited ("the fund") in respect of the listing of shares of the fund on the Channel Islands Securities Exchange Limited and continues to advise the fund in respect of its future growth opportunities. The fund is listed on the Specialist Funds Market of the London Stock Exchange and the Channel Islands Securities Exchange.
- Advising Kennedy Europe Real Estate Plc in relation to the successful close of its GB£300 million debt senior unsecured bond and GB£2 billion Euro Medium Term Note Programme, under which a further EUR300 million notes were issued.
- Advising Global Advisors on the launch of the world's first ever regulated Bitcoin investment Fund.
- Advising on the establishment of Kennedy Wilson Europe Real Estate plc and unprecedented capital raise of up to GB£1 billion through its initial public offering (IPO) on the LSE.
- Advised on the Jersey law aspects of one of last year's most competitive real estate acquisition and financing mandates: the GB£430 million purchase of three UK business parks in a joint venture between funds managed by Oaktree Capital Management, LP and Patrizia Immobilien AG.
- Advising Hastings Insurance Group on investment by Goldman Sachs private equity funds valuing the business at GB£700 million.
- Advised property company Kennedy Wilson Europe Real Estate plc (KWERE) on its acquisition of a corporate vehicle that owns the building which houses the Telegraph Media Group's London headquarters.

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THOMSON REUTERS

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VISIT: global.practicallaw.com

CALL: +44 (0) 20 7202 1220

EMAIL: info.practicallaw@thomsonreuters.com

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CAREY OLSEN

VISIT: careyolsen.com

BVI

CLINTON HEMPEL

CALL: +1 284 394 4030

EMAIL: Clinton.hempel@careyolsen.com

Cayman Islands

JARROD FARLEY

CALL: +1 345 749 2004

EMAIL: jarrod.farley@careyolsen.com

Guernsey

TOM CAREY

CALL: +44 1481 741 559

EMAIL: tom.carey@careyolsen.com

Jersey

ROB MILNER

CALL: +44 1534 822336

EMAIL: robert.milner@careyolsen.com

Carey Olsen

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