



GLOBAL GUIDE 2018

HEDGE FUNDS**in the 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

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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 30 September 2017, there were just under 1,500 funds recognised or registered under SIBA. The majority of these are recognised as professional funds (1014), followed by private funds (346), public funds (48), approved funds (48) and incubator funds (34). 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 Securities and Investment Business (Incubator and Approved Funds) Regulations 2015 governs approved and incubator funds.

This regulatory regime distinguishes between the various fund types, as follows.

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.

Public, private and professional funds 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 can prove that:

- 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.

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 the:

- Proceeds of Criminal Conduct Act 1997 (as amended).
- Anti-money Laundering Regulations 2008 (as amended).
- 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 a person acts 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.

A private fund can either have a maximum of 50 investors or offer interests in the fund on a private basis only. Incubator and approved funds are limited to 20 investors.

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 Commission

W 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 Gazette

W 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).
- Limited partnerships under the new Limited Partnership Act 2017 (LP Act) (see below, *Limited partnerships*).
- 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.

Limited partnerships

The BVI's new LP Act was brought into force on 6 February 2018. The LP Act provides for the eventual re-registration of all existing international limited partnerships as limited partnerships under the LP Act, and any new BVI limited partnership will be formed and registered under the LP Act.

Advantages Setting up a hedge fund as a limited partnership will confer the following advantages:

- Limited partnerships offer a tax transparent "pass-through" structure.
- It is possible to elect for the limited partnership to have (or not have) separate legal personality.
- 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 a limited partnership are as follows:

- As a new and (as yet) judicially-untested structure, investors may not be familiar with the features of a limited partnership.
- To the extent that the limited partnership does not have a separate legal personality, the fund assets must be held by the general partner for the partnership, and the general partner will be liable for all 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?**

There are no proposals for the reform of hedge fund regulation at present.

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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 the Cayman Islands: regulatory overview

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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 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, other than those exempted from regulation under section 4(4) of the MF Law (Unregulated MFs) will be regulated by the Cayman Islands Monetary Authority (CIMA) as one of the following types of Regulated Funds:

- **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 satisfying the listing or minimum investment criteria referred to below.

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 2017, the total number of Regulated Funds was 10,559 (about the same as the 10,586 a year earlier). The vast majority of these (96%) are Registered Funds (10,147, up from 10,113 a year earlier), which cater to the institutional market, with a minimum required investment of at least US\$100,000 (unless listed on an approved stock exchange). The increase in the number of Registered Funds during 2017 reflects the success of CIMA regulated funds during 2016, when their total and net assets increased by US\$435 billion (to US\$6.142 trillion) and US\$17 billion (to US\$3.575 trillion), respectively and there was an increase of 67% in net income. This increase in Registered Funds is significant because, excluding master funds, which have only had to register since 2013, it is the first increase in the number of Registered Funds since 2008.

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

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 exemption in section 4(4) of the MF Law to qualify as Unregulated MFs.

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 (*see Question 1*).

Directors of corporate Regulated Funds are regulated by the Directors Registration and Licensing Law as supplemented by the Directors Registration and Licensing (Registration and Licensing) Regulations.

The Securities Investment Business Law provides that the Cayman Islands Monetary Authority (CIMA) is responsible for the licensing and control of persons carrying on "securities investment business" in or from within the Cayman Islands (*see Question 4*).

Regulatory bodies

CIMA is the regulatory body for open-ended hedge funds (see Question 1).

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

For the requirements to register each type of Regulated Fund with CIMA see Question 3 of *Retail investment funds in the Cayman Islands: regulatory overview*.

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 (and if a Regulated Fund comprises more than one sub-fund, it must submit a Fund Annual Return for each sub-fund).

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 following anti-money laundering laws (AML Laws):

- Proceeds of Crime Law.
- Misuse of Drugs Law.
- Terrorism Law.
- Proliferation Financing (Prohibition) Law.

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

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

- Hedge funds are also subject to regulations made under the Tax Information Authority Law, which implement the US Foreign Account Tax Compliance Act (FATCA) and the Organisation for Economic Co-operation and Development's (OECD's) Common Reporting Standard (CRS). With some limited exceptions, hedge funds are required to register with and report annually to the Tax Information Authority on any reportable accounts of investors under FATCA and CRS.

Risk

CIMA's rule from 28 April 2008 on segregation of assets for Licensed Funds (except those subject to the Retail Mutual Funds (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 Mutual Funds (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. CIMA's Statement of Guidance on Outsourcing by Regulated Entities goes further and sets out the criteria that must be considered by a Regulated Fund when outsourcing any functions (even to affiliates), the controls to be incorporated into a written outsourcing agreement, and the requirements for ongoing monitoring of the service provider's performance of those functions.

Insider dealing and market abuse

The Securities Investment Business 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 Mutual Funds (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 AML Laws, AML Regulations and AML Guidance. Unregulated MFs are also likely to be subject to the AML Regulations and AML Guidance if they carrying on any of the types of business specified in Schedule 2 of the AML 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?****Onshore 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).

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.

Offshore hedge funds

See above, *Onshore funds*.

5. To whom can hedge funds be marketed?**Onshore hedge funds**

The position for hedge funds is the same as for retail funds (see *Question 5 of Retail investment funds in the Cayman Islands: regulatory overview*). Outside the Cayman Islands, any local limitations on the marketing of hedge fund securities will apply.

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) (see *Question 4*).
- High net worth persons (as defined in the SIB Law) (see *Question 4*).
- 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.

Offshore hedge funds

See above, *Onshore hedge funds*.

Investment restrictions

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

See *Question 5*.

Assets portfolio

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

The position for hedge funds is the same as for retail funds (see *Question 7 of Retail investment funds in the Cayman Islands: regulatory overview*).

Licensed Funds to which the Retail Mutual Funds (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.

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 (see *Question 3 of Retail investment funds in the Cayman Islands: regulatory overview*). For the filing requirements for Regulated Funds that are master funds, see *Question 1*.

Any proposed director of a corporate fund regulated by CIMA must register with CIMA under the Directors Registration and Licensing Law (via CIMA's online registration portal) before he can be appointed.

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 for hedge funds is the same as for retail funds (see *Question 6 of Retail investment funds in the Cayman Islands: regulatory overview*).

The following key requirements apply to managers and operators of hedge 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 Registration and Licensing Law.
- The trustee of a Licensed Fund must be licensed under the Banks and Trust Companies Law.
- Investment managers incorporated or registered in the Cayman Islands must generally be regulated or registered as excluded persons under the Securities Investment Business Law (see *Question 4*).
- 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.

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.

Offshore hedge fund managers

See above, *Onshore hedge funds*.

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 (historically accounting for around 75% of Regulated Funds). Most of these are standard exempted companies, but around 10% 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.

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.

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. 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 Companies 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.

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 hedge 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 deemed non-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 Question 5 and Question 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 EU Directive 2011/61/EU on alternative investment fund managers (AIFM Directive)). 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 AIFM Directive passport system.

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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 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\$130 million acquisition of a UK online travel agency.
- Advising an Israeli fund manager on the launch of a US\$400 million 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.

Hedge funds in Guernsey: regulatory overview

Tom Carey and Matt Brehaut
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global.practicallaw.com/W-014-0437

HEDGE FUNDS

Market overview

1. 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, Pershing Square and Credit Suisse. The net asset value of hedge funds and funds of hedge funds currently stands at approximately GB£35 billion.

Alternative investments are at the core of Guernsey's funds industry, in particular private equity, venture capital and funds of hedge funds. Private equity and venture capital funds account for almost two-thirds of the closed-ended funds in Guernsey, by number and value, with a current net asset value of over GB£200 billion.

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 position is virtually the same as that for open-ended retail funds.

Authorised funds. These funds are authorised and regulated, and subject to ongoing supervision, by the Guernsey Financial Services Commission (GFSC). The funds are classified as follows:

- **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 (which are "true" retail funds that are equivalent to Undertakings for Collective Investment in Transferable Securities in the EU), 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 funds are registered with and regulated by the GFSC. The ongoing supervision is performed by the designated administrator (a local entity authorised by the GFSC, carrying out such supervision on its behalf, also referred to as the designated manager). Registered funds include:

- **RCIS funds.** Commonly referred to as "registered funds" (as they were the only type of registered fund until the introduction of private investment funds (*see below*), the rules applicable to such registered open-ended funds are the Registered Collective Investment Schemes 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 an RCIS fund, but they are not typically used as retail funds.
- **Private investment funds.** In 2016 the GFSC introduced a new class of registered fund, the Private Investment Fund (PIF), governed by the Private Investment Fund Rules 2016 (PIF Rules). The PIF regime is intended for funds with a small number of investors where there exists a close relationship between the manager of the PIF and the investors. In recognition of this close relationship, the PIF rules do not require an offering document. The PIF must contain 50 or fewer investors and can add no more than 30 investors per year after the first year. The manager of the PIF is responsible for giving certain undertakings to the GFSC on the ability of investors to suffer losses. Other than this, the PIF rules are not prescriptive concerning the features of the fund (for instance, in relation to investment powers) but require ongoing notification of specific events. There are no restrictions on who can invest in an RCIS fund, but they are not typically used as retail funds.

Class A funds are not suitable for use as hedge funds, but the other types of fund are all suitable.

The GFSC can also grant certain derogations to 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, who is not required to offer physical segregation of fund assets from its own (so long as the fund prospectus makes clear the risks of such arrangement).

- 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

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.

AIFM Directive

Guernsey is a "third-country" non-EU jurisdiction under the Directive 2011/61/EU on alternative investment fund managers (AIFM Directive) and has established a dual regime which provides a flexible regulatory framework which 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. These are now thoroughly tried and tested routes to market which typically require only partial adherence to the provisions of the AIFM Directive which can result in lower running costs and consequently higher investor returns.

The second part of the dual regime allows managers and depositaries, in connection with 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 twice assessed Guernsey and concluded that no obstacles exist to the extension of a "third country" passport to Guernsey, giving the island an "unqualified and positive assessment". However, due primarily to the UK's vote to leave the EU, it is currently uncertain when the passport regime will be introduced for third countries and so there continues to be a strong trend towards establishing funds with a Guernsey based alternative investment fund manager so that the fund and the manager are free from the full requirements (and associated costs) of 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.

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

Risk

The applicable fund rules (other than the Private Investment Fund Rules 2016 (PIF Rules) which do not require a prospectus) 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 rules (other than the PIF rules, which do not require a prospectus) require disclosure of 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 Licensees (Conduct of Business) Rules 2016 (COB Rules) and the Licensees (Capital Adequacy) Rules 2010 (Capital Adequacy Rules). These 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 and the requirement under the Prospectus Rules (applicable to RCIS funds) to disclose in the prospectus significant beneficial ownership interests (meaning 5% or more of the voting rights) in the offeror at the date of the prospectus.

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.
- **Open-ended RCIS funds and PIFs: 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 provide its accounts to shareholders at its annual general meeting.

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 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**4. Who can market hedge funds?****Guernsey hedge funds**

A Guernsey authorised or registered fund can be marketed in Guernsey:

- By a Guernsey entity which is licensed by the Guernsey Financial Services Commission (GFSC) under the Protection of Investors (Bailiwick of Guernsey) Law 1987, as amended (POI Law) (using a POI licence)
- By persons who are not Guernsey bodies or persons ordinarily resident in Guernsey (Non-Guernsey Persons) whose main place of business is in one of the countries or territories specifically designated by the GFSC as affording "adequate protection" to investors. In this case, the promotion must only be made:
 - to persons holding a licence under a designated list of Guernsey regulatory laws;
 - in the manner in which the person making the promotion would be permitted to market the relevant fund in their home country;
 - following written notice to the GFSC of the date from which the marketing will be carried on.
- On a reverse solicitation basis without the need for a POI licence or notification.

Foreign hedge funds

Non-Guernsey funds can be marketed in Guernsey (without the need for the fund to be authorised by or registered with the GFSC):

- By POI licensees and Non-Guernsey Persons, where the scheme is authorised under the law of a country or territory specifically designated by the GFSC as affording "adequate protection" to investors and the marketing is conducted in a manner that would be permitted in that designated country or territory and (in the case of a Non-Guernsey Person) following notification to the GFSC and payment of a fee. This exemption covers certain categories of funds that are authorised in the UK, Jersey, the Isle of Man and the Republic of Ireland as well as EU alternative investment funds.
- By Non-Guernsey Persons whose main place of business is one of the countries or territories specifically designated by the GFSC as affording "adequate protection" to investors. In this case, the promotion must only be made:
 - to persons holding a licence under a designated list of Guernsey regulatory laws;
 - in the manner in which the person making the promotion would be permitted to market the relevant fund in their home country;
 - following written notice to the GFSC of the date from which the marketing will be carried on.
- On a reverse solicitation basis without the need for a POI licence or notification.

5. To whom can hedge funds be marketed?**Guernsey hedge funds**

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, Regulatory framework*).
- Funds authorised using the fast-track QIF application process. These funds can only be marketed to qualified investors (applicable to Class B funds and Class Q funds only).
- Registered funds. There are no restrictions.

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 funds. There are no restrictions.

Foreign hedge funds

Certain funds authorised in the UK, Jersey, the Isle of Man or the Republic of Ireland, as well as EU alternative investment funds, can be promoted in Guernsey without being authorised or registered in Guernsey (*see Question 4, Foreign funds*). Guernsey regulations permit these funds to be marketed in the same manner in which such funds can be marketed in the designated country or territory in which they are authorised.

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

See *Question 5*.

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

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 COB Rules and Capital Adequacy Rules.

Institutional or expert investor hedge funds can be permitted to appoint a foreign prime broker rather than a local custodian or trustee, who is not required to offer physical segregation of fund assets from its own, so long as the fund prospectus makes clear the risks of such arrangement. 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.

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.

Requirements

8. 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 Guernsey Financial Services Commission:

- 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.

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

There are two key roles in a Guernsey fund.

Promoter. The term promoter is not specifically defined but is generally considered to be 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 both:

- Equivalent to the new proposal;
- Financially successful.

The following are also taken into consideration:

- Whether the promoter is authorised or licensed by another regulatory body.
- The promoter's ownership, financial resources and reputation.
- The experience of the principals behind the promoter.

In the case of qualifying investor funds 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 were 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).** These 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.
- **Licensees (Capital Adequacy) Rules 2010 (CA Rules).** These 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.

Foreign fund managers. It is common for a foreign manager to perform the investment management role, and a local designated manager to perform the administration role. The considerations set out above in respect of the promoter will be applied to the foreign manager.

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?

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*). The most commonly used for hedge funds are the:

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 GuernseyW 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.

- **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.

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 participate in the conduct or management of the partnership's business. The law provides certain "safe harbours" (investor actions that do not constitute management (*The Limited Partnerships (Guernsey) Law, 1995, as amended*)), including acting as a director or shareholder 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) as part of the authorisation/registration process);

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

Funds are eligible for tax exempt status (for Guernsey tax purposes), on payment of an annual fee of GB£1,200. 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.

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

Participants of open-ended hedge funds can redeem their interests under the terms specified by that fund. No minimum frequency of liquidity is specified by Guernsey regulations for a fund to be classified as open-ended. 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. 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 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. 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.

Private placement

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

There are no private placement exemptions as such for the marketing of hedge funds in Guernsey (*see Question 5*).

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

Not applicable (*see Question 4*).

Reform

15. What (if any) proposals are there for the reform of hedge 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, 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.

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Areas of practice. Corporate; commercial; investment funds.

Recent transactions

- Advised Permira on the launch of Permira VI, Permira Credit Solutions III, Permira Credit Solutions Managed Account, Permira Growth Opportunities and Permira Sigma V funds.
- Advised Earth Capital Partners on the launch of the Nobel Sustainability Fund.

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Recent transactions

- Advised Earth Capital Partners on the launch of the Nobel Sustainability Fund.
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- Advised Nexus Investment Partners LLP on the launch of its maiden private equity fund.

Hedge funds in Jersey: regulatory overview

Robert Milner, James Mulholland, Daniel O'Connor and Christopher Griffin
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 Jersey Financial Services Commission (Commission) has also recently published a new private funds guide (PFG) which enables private funds (PFs) to benefit from a light touch fast-track regulatory process. Under the PFG, up to 50 offers can be made to investors who qualify as "professional" investors and/or subscribe for interests with a value of at least GB£250,000 in PFs, and the PF (and frequently its service providers) is entirely unregulated, other than the need to obtain consent under the Control of Borrowing (Jersey) Order 1958 (COBO) upon the establishment of the fund vehicle.

(Prior to the PFG being published, 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 are benefitting from the PF regime's fast-track authorisation (within 48 hours) and its low initial and ongoing costs.)

The PF regime's speed, flexibility and low cost has proved popular with a wide range of funds, from small funds established by first time managers to multi-billion dollar/euro funds with a limited number of sovereign/institutional investors.

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).
- Code 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 Code 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 Code 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.

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HEDGE FUNDS

- **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.

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.

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.

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).

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£395.

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*.

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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 on the establishment of the US\$100 billion SoftBank Vision Fund LP and its subsequent conversion from a very private structure to a Jersey Expert Fund.
- Advising EIJ Investments on the migration to Jersey and subsequent initial public offering of EIJ Investment's shares on the Specialist Fund Segment of the London Stock Exchange.
- Advising Bluecrest on their migration to Jersey.
- Advising Systematica on their establishment in Jersey.



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

Recent transactions

- Advising ARC Fiduciary Limited on the launch of Jersey's first Initial Coin Offering (ICO) CoinShares Fund I.
- Advising FSN Capital on launch of SEK9.62 billion fund.
- Carey Olsen advised Blackstone/GSO Loan Financing in respect of the listing of shares of the fund on the Channel Islands Securities Exchange 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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Areas of practice. Investment funds (including structuring and formation of investment funds and offshore funds).

Recent transactions

- Advising Nordic Capital on the private equity firm's 2008 vintage fund, Nordic Capital Fund VII, to a new Jersey vehicle, Nordic Capital CVI. Including the structuring of the transaction, Fund VII investor communication and elections and advisory committee approval and on the establishment of Nordic Capital CVI as a new Jersey expert fund.
- Advising Nordic Capital in relation to the launch of their flagship private equity buyout fund, Nordic Capital Fund VIII, structured as a Jersey expert fund comprising multiple Jersey vehicles, whose geographic scope the Nordic region, the German speaking countries and selected global healthcare investments with a diversified portfolio and a special focus on and expertise in healthcare investments and on the establishment of Nordic Capital Fund IX.
- Advising on the US\$100 billion SoftBank Vision Fund LP conversion from a very private structure to a Jersey Expert Fund.



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Areas of practice. Investment funds with particular expertise in private equity and hedge funds and the legal and regulatory aspects of fund launches and other bespoke investment structures. Leads the firm's digital assets practice.

Recent transactions

- Advising ARC Fiduciary Limited on the launch of Jersey's first Initial Coin Offering (ICO) CoinShares Fund I.
- Advising Global Advisors (Jersey) Limited on the first ever crypto-denominated fund.
- Advising on the successful launch of first time fund AVI Frontier Fund I. The fund will invest into a series of South-East Asian companies listing on the Vietnamese Stock Exchange and allows investors to handpick which companies they want to invest in.
- Carey Olsen's funds team obtained JFSC regulatory approval for a Jersey eligible investor fund, Quinbrook Low Carbon Power Fund, raising US\$100 million at first close and a further US\$10 million at second close.

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ANNE ROACHE, INFORMATION MANAGER,
WEIL GOTSHAL & MANGES



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