Codes of Practice for Certified Funds

The funds industry in Jersey is anticipating the launch of new codes of practice for certified funds (the "Codes"), to be implemented from 31 March 2012.

The purpose of the Codes is to "establish sound principles and provide practical guidance" in respect of the conduct of business by, and operation of, certain categories of Jersey funds.

The background to the Codes is the desire for Certified Funds to achieve, so far as possible, "fully implemented" ratings under the IOSCO Methodology as well as for Jersey to be in a position to act quickly in response to requirements of the AIFM Directive, which impacts Jersey funds.

Certain parts of the Codes will replace conditions formerly imposed on a fund through its Certificate so do not, in reality, introduce new requirements to those already operating in relation to Certified Funds.

Elsewhere, new requirements have been introduced. The expectation is that compliance with the Codes will form part of the contractual arrangements with service providers to Certified Funds.

FUNDS TO WHICH THE CODES WILL APPLY

All Certified Funds will be required to comply with the Codes. The Codes will not apply to:

- Private placement funds, investment syndicates and 'club' arrangements, which are approved under the Control of Borrowing (Jersey) Law 1947, as amended;
- Non-Jersey domiciled funds;
- Unregulated funds within the meaning of Article 1 of the Collective Investment Funds (Unregulated Funds) (Jersey) Order 2008, as amended;
- Recognised funds within the meaning of Article 1 of the Law.

RESPONSIBILITY FOR COMPLIANCE WITH THE CODES

It will be the responsibility of every Certified Fund, through its governing body, to comply with the Codes. Whilst the fund will be able to appoint another person (for example, the manager or administrator of the fund) to implement any necessary actions to comply with the Codes, ultimate responsibility will remain with the fund and its governing body.

EXISTING FUNDS/ GRANDFATHERING

Once issued, the Codes will have immediate effect. Whilst there will be no formal "grandfathering" for existing funds, allowance will be made for the implementation of the detail of the Codes, provided that the fundamental principles set out below are complied with and active steps are being taken by funds to secure compliance with the detailed underlying requirements. Departures from the principles will be permitted by the Jersey Financial Services Commission (the "JFSC") in exceptional circumstances (for example, where strict adherence would produce an "anomalous result"), although funds operating in accordance with pre-existing derogations will not be deemed to be in breach of the Codes.

"Jersey's regulatory framework will be enhanced, offering further protection to investors in Jersey funds."

EMILY HAITHWAITE *PARTNER, BEDELL*

THE PRINCIPLES

In summary, the following eight principles for the conduct of business by Certified Funds are set out in the Codes:

Principle 1

A Certified Fund must conduct its business with integrity. In particular, a fund must not act or contract so as to avoid any regulatory responsibilities imposed on it under the Codes.

Principle 2

A Certified Fund must act in the best interests of unitholders. Noting that this principle does not affect the priority of any legal rights owed to any other person (e.g. creditors of the fund), it involves the fund acting with due skill, care and diligence, avoiding or disclosing conflicts of interest with service providers, maintaining proper records of actions and decisions, transacting business in an expeditious manner, giving notice to unitholders of changes which affect their rights and ensuring that all unitholders are treated fairly (without prejudice to any preferred rights conferred on certain persons or classes pursuant to the fund's constitution or any discount to fees charged to unitholders upon their investment in the fund). There are additional requirements in relation to hedge funds.

Principle 3

A Certified Fund must organise and control its affairs effectively for the proper performance of its business activities and be able to demonstrate the existence of adequate risk management systems. In summary, this principle deals with:

Principle 3a

Corporate governance, including span of control, the exercise of independence of judgement by a fund's principal persons (e.g. directors) and compliance/anti-money laundering officer(s), the apportionment of responsibilities and accountability, the adoption of clear risk management procedures and, if appropriate, the establishment of a risk management committee;

Principle 3b

Internal systems and controls to ensure compliance with the fund's constitutive documents, Certificate, applicable legislation, guidance of the Codes, and to ensure that adequate business recovery arrangements exist, that the systems are effective to guard the fund against financial crime and that all decisions and transactions are properly authorised. The fund must have proper procedures to ensure that its principal persons and other employees are demonstrably fit and proper for their roles;

Principle 3c

Continuing Professional Development ("CPD"), including the maintenance of CPD records for principal persons and compliance/anti-money laundering officers. The Codes provide that, as a general guide, at least 25 hours per year should be spent on CPD;

Principle 3d

The compliance officer, money laundering reporting officer ("MLRO") and money laundering compliance officer ("MLCO"): the Codes set out the requirement for and responsibilities of the compliance officer of the fund, the MLRO and MLCO roles being covered by the Money Laundering (Jersey) Order 2008. The appointment of such officers is subject to the approval of the JFSC. In the case of unit trusts and limited partnerships, it is the obligation of the compliance officer, MLRO and MLCO of the trustee(s) or general partner(s) to fulfill the equivalent roles in relation to the fund;

Principle 3e

Complaints - the fund must have an effective complaints handling system and procedure and must notify the JFSC of the complaint in certain circumstances;

Principle 3f

Record keeping, including the maintenance of a policy and procedures manual, up-to-date records of transactions, internal organisation and risk management systems and procedures to safeguard the fund's assets. Unless otherwise required by legislation or the fund's constitutive documents, it is expected that records will be kept for a period of ten years;

Principle 3g

Financial statements - the Codes provide for the submission of audited financial statements (within seven months of the fund's financial year-end) and any interim report (upon publication) and accounts of the fund to the JFSC, the appointment and prior approval of an auditor for the fund and for prescribed auditing and accounting standards;

Principle 3h

Valuations, to be prepared in a regular and timely manner in accordance with the fund's constitution and any applicable conditions or requirements.

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THE PRINCIPLES CONTINUED...

Principle 4

A Certified Fund must be transparent in its business arrangements with unitholders. The fund must make it clear on its stationery and advertising material that it is regulated by the JFSC and must be transparent with unitholders about all fees, charges and other remunerations or expenses which are charged to the fund.

Principle 5

A Certified Fund must maintain and be able to demonstrate the existence of both adequate financial resources and adequate insurance. The Codes do not prescribe what is adequate in these circumstances but it is expected that the fund's governing body will assess these matters carefully.

Principle 6

A Certified Fund must deal with the JFSC and other authorities in Jersey in an open and cooperative manner. This principle has wide effect. In addition to providing information regarding the fund (such as, changes of beneficial ownership, a change of name and prior notification of winding up), the JFSC expects to be notified of "significant events" affecting non-regulated activities and other members of the corporate group to which the fund belongs of which the fund becomes aware. Other new requirements include that the JFSC should be notified of a failure to launch a fund within 90 days of the granting of a Certificate or of the date specified in the fund's offering document, an error in the pricing of units greater than 0.5%, an inability to calculate net asset value, a suspension of the fund on any stock exchange on which it is listed and any matter which is likely to cause material harm to the interests of unitholders.

Principle 7

A Certified Fund must not make statements that are misleading, false or deceptive. This principle applies to advertisements issued by the fund or one of its service providers. The fund should ensure that any facts stated in advertisements will continue to be true for as long as the advertisement is made, any statements of opinion held by any person are reasonably believed to be honestly held by that person and any comparisons with other funds are fair.

Principle 8

A Certified Fund must at all times comply with and be operated in accordance with any applicable guide. The Codes acknowledge existing requirements relating to particular categories of funds. Accordingly:

Principle 8a

OCIFs must adhere to the terms of the OCIF Guide;

Principle 8b

Jersey Expert Funds must be operated in accordance with the Jersey Expert Fund Guide;

Principle 8c

Jersey Listed Funds must be operated in accordance with the Jersey Listed Fund Guide;

Principle 8d

Other funds aimed at sophisticated investors and closed-ended funds - the OCIF Guide continues to be a benchmark for the expected level of disclosure for such funds. As such, the prior consent of the JFSC is required to material changes to such funds, including changes to service providers and constitutive documents.

CONSEQUENCES OF BREACHING THE CODES

Failure by a Certified Fund to comply with the Codes will represent grounds for the JFSC to take enforcement action and to use its regulatory powers which, in serious cases, could result in the winding up of the Certified Fund and revocation of its Certificate. Whilst failure to follow the Codes will not of itself render any person liable to proceedings, or invalidate any transaction, the Codes will be admissible in evidence if it appears to a court to be relevant to any question arising in court proceedings, and can be taken into account in determining any such question.

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CONCLUSIONS

It is anticipated that the Codes will mean that compliant ratings for Certified Funds for the purposes of the IOSCO Methodology can be achieved, and will be a useful building block in constructing an AIFM-equivalent fund regime in Jersey. The Codes will 'fill the gap' that currently exists in that Jersey fund services providers are subject to detailed codes of practice requiring minimum standards as to the conduct of their business, but funds themselves are not. In this way, Jersey's regulatory framework will be enhanced, offering further protection to investors in Jersey funds.

In practice, much of the work in ensuring compliance with the Codes will fall on the Jersey service providers to funds. The new Codes are based on, and thus have a high degree of consistency with, the existing regulatory requirements for fund service providers, which should facilitate implementation. However, there are a number of areas of difference. Jersey funds, their service providers and advisers will all need to ensure that they meet, or are working towards, the requirements of the Codes when introduced on 31 March.

[1] "Certified Funds" means all unclassified collective investment funds, within the meaning of Article 3 of the Collective Investment Funds (Jersey) Law 1988, as amended (the "Law"), issued with a Certificate.

[2] "IOSCO Methodology" means the IOSCO Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Security Regulation as at October 2008.

[3] "Certificate" refers to a certificate issued by the JFSC under Article 8B of the Law.

[4] The "governing body" of the Certified Fund is, in the case of a company, its board of directors, in the case of a limited partnership, its general partner(s) and in the case of a unit trust, its trustee(s).

[5] "OCIF Guide" means the guide to the establishment of open-ended unclassified collective investment funds offered to the general public issued by the JFSC.