Is the funds industry the future of Jersey?

Jersey Funds Association Presentation

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What we'll cover

- Context: where is the finance industry right now?
- Current status of funds industry in Jersey
- AIFMD/BEPS and the McKinsey Funds Review - particular challenges and opportunities for Jersey
- SWOT analysis of Jersey's funds industry
- The constant change agenda
- The convergence of traditional work types
- Conclusions
- Questions

Where is Jersey's Finance Industry Right Now? (1)

- Finance industry activity contributes 40.2% of Jersey's gross value added (GVA) by industry
- Employs around c.25% of Jersey's workforce – c.13k people
- Four main pillars:
  - Banking
  - Private Wealth
  - Funds
  - Capital Markets
- Approximately 4k people employed in each of banking, private wealth and the remainder (funds/cap markets)

Where is Jersey's Finance Industry Right Now? (2)

BANKING

• majority of Jersey banks 'up-stream' to their parents' operations, more often than not, in London, NY, Paris, Frankfurt etc. where it is put to work

• post-crisis decline in deposits: £150.4bn in June 2012, £137.3bn in March 2015

• historically low interest rates and "de-risking" activity a challenge **BUT**

• a **diversified industry**: multi-discipline groups (eg DB, BNP); large UK clearers (Barclays, HSBC, RBS); core retail/commercial banking (eg Santander/Lloyds);global private banks (RBC; Citibank); specialist providers (State Street, Abu Dhabi Commercial Bank), **so** Jersey's banking model:

– does not rely exclusively on wholesale funding;
– attracts capital from around the globe;
– enjoys valuable and safe "up-streaming" model for international banking

Were is Jersey's Finance Industry Right Now? (3)

PRIVATE WEALTH

• leading international jurisdiction for Private Wealth: 187 licensed trust company businesses and c1,200 members of STEP (largest STEP branch in the world)

• centre of innovation: 31 years' experience of (much copied) Trusts (Jersey) Law 1984 and now 270 foundations too

• world-class **expertise**, including global banks, the Big 4 accounting firms, and multinational law firms

Rationales: tax neutrality but also: preservation of family wealth; protecting young family members from extreme wealth; platform for philanthropy; concerns about political instability

Challenge: balancing the above with international transparency agenda (FATCA/CRS)

Trends: moving from simple trusts for UK families/'drop-off' point for UK Res Non-Doms to high value/complex structures for international families; hosting private trust companies and family offices

Where is Jersey's Finance Industry Right Now? (3)

CAPITAL MARKETS

- flexibility of Jersey companies law
- access to CISE (eg for listed Eurobonds)
- Jersey co's used for FSTE and AIM listings (highest number of FTSE 100 companies registered outside the UK)
- challenges:
  - EU measures making market access to Jersey securitisation vehicles harder post-crisis
  - potential permanent establishment / transfer pricing implications under OECD BEPS initiative – sound rationale for using Jersey?
  - Eurobond exemption under UK media microscope...

Current status of Jersey funds industry (1)

Latest statistics:

- Fund assets under administration in Jersey in Q3 2014: £205bn
- Fund assets under administration in Jersey in Q4 2014: £229bn - highest level since Dec 2008
- Fallen back to £218.8bn during Q3 2015, but still steady growth:
- Total number of regulated Jersey CIFs increased from 1,298 to 1,311 in Q3 2015
- Stats don't show extent of bouyant "very private fund" activity and underlying deal activity (eg property holding JPUTs and PE holdco's and bidco's)
- As at 31 Dec 2014, value of hedge fund business grew by 46% year-on-year; real estate business grew by 32% to its highest ever level; private equity maintained a steady increase of 5%
- Evidence of net inward manager migration and substance building (eg hedge fund and private equity managers building "substance" offices)
- AIFMD does not, at present, appear to be threatening Jersey's funds industry

Current status of Jersey funds industry (2)

Fund types:

- Real estate and private equity predominate (largely closed ended)
- Hedge funds/platforms (corporate/PCC – open ended)
- Hedge fund servicing (eg Cayman funds managed or administered from Jersey)
- Expansion into infrastructure, secondaries, credit, debt, mezzanine and other developing alternative asset classes
- Real estate / private equity structuring used for infrastructure, shipping, mining etc; strategies
- Private equity structuring used for secondaries, credit, debt and mezzanine funds

Current status of Jersey funds industry (3)

Capturing changes in global capital flows:

- **Real estate**
  - ***historically*** UK pension fund / institutional investor monies invested through Jersey into UK commercial property;
  - ***now*** more evidence of Asian (institutional), Middle Eastern (SWF, family office) and U.S. (institutional) money flowing through Jersey structures into (booming) UK commercial and (sometimes distressed) European property market
  - ***chief global competitors*** are Luxembourg in the European property fund sphere (also has double tax treaty benefits for global property transactions) and Cayman/Delaware in the U.S. market

Current status of Jersey funds industry (4)

Capturing changes in global funds flows:

- **Private equity**:
  - ***historically*** Jersey PE funds with largely European investors investing in the European LBO/MBO space
  - ***now*** a wider range of global investors (including U.S. pension funds, Middle Eastern SWFs) and a wider geographical range of investment targets (eg Africa, LatAm) and asset types (infrastructure, mining, shipping)
  - ***drivers?*** PE houses using Jersey are growing, becoming more global/sophisticated and moving into new areas of investment
  - ***chief global competitor*** remains Cayman (in U.S. and Asian markets)
  - widespread ***use of investment holding companies with double taxation treaty benefits*** beneath Jersey fund (eg LuxCos for European investments; Mauritius for African investments) – ***Note***: possible impact of BEPS?

Current status of Jersey funds industry (5)

Scope for Regulatory Arbitrage:

- Jersey offers a "full spectrum" of fund regulatory regimes – flexible but complex!
- A regulatory distinction is made depending on number of offeree investors:
  - up to 15 (Very Private Funds);
  - up to 50 (Private Placement Funds or COBO-only Funds)
  - 50+ (Expert, Eligible Investor, Listed, Unclassified, Recognized funds)
- A distinction is also made between funds marketed into or managed in the EU under AIFMD and those with no EU marketing or management under AIFMD
- Unregulated funds still available for non-EU investor structures
- Clients appear to be welcoming scope for regulatory arbitrage

Current status of Jersey funds industry (6)

Current AIFMD position:

Given no EU passport access (yet) under AIFMD, what are Jersey managers/clients doing to market into the EU?

- some **avoiding Europe** completely – too difficult/uncertain; or
- relying on "**reverse solicitation**"; and/or
- relying on the (AIFMD Art 42) national private placement regimes (**NPPRs**) available in EU Member States - marketing to “easier” States (e.g. UK, Netherlands, Ireland, Lux, Nordics)

Very often there are **non-EU investors** (e.g. from U.S., Canada, Middle East and Asia) too, hence desire to avoid higher AIFMD compliance costs of using EU AIFM for passporting

As time passes, will be increasing discomfort with reliance on reverse solicitation

Current status of Jersey funds industry (7)

AIFMD - NPPRs Are Working!

- JFSC statistics show that, as at 31 December 2015, **230 Jersey AIFs and 104 Jersey AIFMs were actively marketing to professional investors in the EEA using NPPRs**
- Very little evidence of Jersey AIFM migration to onshore EU – one or two institutional, continental EU (ie German or French) asset management groups, building on existing onshore infrastructure to benefit from AIFMD passporting alongside their UCITs–compliant products
- **BUT** more evidence of such groups maintaining Jersey (NPPR/RS) products alongside onshore (AIFMD/UCITs) products, to maximize global market access and cost effectiveness
- Evidence of some larger houses moving entire investment teams to Jersey if AIFMD-compliance in onshore EU is strategically problematic (eg leverage restrictions)
- Evidence of new teams launching AIFs in Jersey (e.g. private equity, debt, real estate, shipping, mining, renewable energy), using Jersey AIFMs that are cheaper to run than onshore AIFMD-compliant ones

Current status of Jersey funds industry (8)

AIFMD – EU Passporting a Future Possibility?

- option of EU passport marketing by Jersey AIFM not yet a possibility, even if AIFM is fully-AIFMD-compliant
- initial hopes Jersey's passport access would be confirmed by ESMA and EU Commission by end of 2015 in line with AIFMD's published timing, but not the case
- ESMA'S July 2015 assessment confirmed **only Jersey (and Guernsey) as technically ready to enjoy the passport** BUT only after ESMA has positively assessed more 3rd countries: next opinion due in June 2016
- so, might be positive news from ESMA and the EU Commission in 2016…
- **even so,** actual passporting by any Jersey AIFMs is unlikely before 2017 or even 2018, in our view

Current status of Jersey funds industry (9)

Fund Regulation in Jersey is Complicated!

- different categories/variations of funds
- vehicle types vary (company; cell company; unit trust, limited partnership)
- multiple service providers (manager, administrator, trustee, custodian registrar etc;)
- may be Jersey or non-Jersey (non-domiciled) funds serviced in Jersey
- types of investor vary (ie retail or professional – variable categories locally and internationally)
- location of investors varies
- publicly or privately offered?
- varied asset types and some funds open and some closed ended
- licensing and outsourcing policies are complex
- over-lapping of funds and service provider JFSC Codes requirements
- international standards (EU/ESMA, IOSCO etc.) are ever-changing
- regulated or unregulated?

Current status of Jersey funds industry (10)

Fund Simplification Project – On-going...

- McKinsey review of finance industry – key recommendation to simplify Jersey's fund regulatory regime
- Government and JFSC have embraced that recommendation
- Work underway to propose a simplified regime / stream-lined set of products and approach to authorisation and supervision
- Difficult to do against back-drop of ESMA AIFMD review and MONEYVAL review
- JFSC focussed on information gathering; reliance on exemptions and supervision in previously under-supervised areas
- Good progress made on a new “very private fund” guide
- Watch this space…..

Current status of Jersey funds industry (11)

BEPS – opportunity or threat?

OECD's Base Erosion and Profit Shifting initiative

Two key areas of potential impact on Jersey funds:

1. will non-CIV (eg Jersey alternative) funds continue to be able to enjoy "treaty benefits" (eg through use of Lux HoldCo's with DTA advantages) to achieve tax neutral investing? Still unclear. If not, greater analysis needed of ability of fund investors to derive treaty benefits themselves;
2. focus on permanent establishment and transfer pricing with a view to taxing economic activity where it takes place:
   - (i) may require and drive more asset management "substance" to Jersey if Jersey tax rates are to apply to management activities/fees;
   - (ii) may make it hard for some activities to be hosted here (eg UK property development under UK's "diverted profit tax" initiative)

SWOT analysis of Jersey Funds Industry (1)

Strengths

- Mature, professional and varied fund service providers
- Relative speed to market (flexible fund regimes)
- AIFMD positioning
- Avoidance of worst excesses of EU over-legislation
- Tax neutrality not dependent on DTAs/tax rulings/contrived arrangements
- Relative substance/fiduciary capability
- Quality of JFL promotional output
- Positive international assessments (ESMA, Moneyval?)
- Quick to implement regulatory/legal change
- Sustainable transparency model (central, but non-public, registers)

SWOT analysis of Jersey Funds Industry (2)

Weaknesses

- “Tax haven” label hard to shift – may impact some investors’ sentiment and creates “black-listing” risk to market access
- Being outside the EU/OECD full membership restricts access to some markets
- Recruitment and connectivity constraints in a small Island
- Risk of AML over-kill (relative to competitors) in light of rigorous preparations for Moneyval assessment
- Lack of DTA network may hamper activity in some new markets (eg Africa)
- Relative lack of marketing budget and capability versus, say, Lux (ALFI)

SWOT analysis of Jersey Funds Industry (3)

Opportunities

- Build credentials as a genuine asset management substance jurisdiction in post-BEPS/AIFMD world
- Maximum AIFMD optionality – no impact for non-EU structures; private placement into EU in partial compliance; EU passporting in full compliance
- Continue to capitalise on regulatory flexibility – eg appeal of the very private fund regime as club, JV and co-investment structures thrive
- Capture funds regulation simplification and process enhancements through completion of post-McKinsey funds review
- Stream-line AML processes and procedures post-Moneyval and incubate I.T. solutions to improve information gathering and sharing
- Manage FATCA, CRS and BEPS complexities through smart use of I.T. solutions (“Fin Tech”)

SWOT analysis of Jersey Funds Industry (4)

Threats

- Potential loss of certain business types (eg UK commercial property **development** structures) through BEPS/DPT initiatives
- New “onshore” fund products (Lux RAIFs; UK PAIFs/LPs)
- Small risk of failure to obtain AIFMD passport (ie EU politics) or swift removal of NPPRs of some Member States (eg Germany)
- Arbitrary “black-listings” (eg German insurers/pension funds only able to invest in OECD Member countries) denying market access
- Lack of local understanding and support for finance industry (threats to 0/10 taxation model)
- Under-investment in JFL, local education and training etc.
- Excessively conservative risk appetite closing off new markets (eg application of JFSC AML and/or sound business policies in practice)

Recognising The Constant Change Agenda

Change and uncertainty becoming “constants”

- When is a fund, a “fund”? Growing use of club, JV and co-investment structures (eg for SWFs, family offices) as opposed to “classic” blind pool fund activity
- Changing global capital flows: exposure to new markets and asset classes
- BEPS requirements for greater substance and alternative structures for holding fund assets
- AIFMD requirement for greater substance for passporting AIFMs
- Impact on local recruitment policy (eg increased need for local portfolio and risk management and compliance skills)
- Keeping pace with continued AML policy tightening
- Keeping pace with international transparency agenda (FATCA, CRS, BEPS)
- Keeping pace with international/EU regulatory agenda where it impacts Jersey directly (eg MiFID II)

The Theme of Convergence

- Inter-action of **banking and funds** industries – local banks maintaining deposits for Jersey funds and providing financing facilities
- Inter-action of **private wealth and funds** industries – increased family office activity; influx of asset managers to Jersey; club, JV and co-investment structures; requirement for carried interest and other asset management fee mechanisms to be administered
- Inter-action of **capital markets and funds** – through listing activity
- Lines between the traditional four pillars being blurred
- Requirement to build robust (and expensive) AML, FATCA, CRS etc, compliant platforms may drive Jersey service providers to maximise usage of and leverage from that platform by undertaking mixed business types

Conclusions

- Jersey's short to medium future (at least) has to involve a robust and healthy finance industry
- Continued diversification across the "four pillars" of the industry is essential
- Convergence within the "four pillars" of the industry is inevitable and creates opportunity
- Many of our fundamentals remain strong and are sustainable
- Our challenges can be addressed by a resilient and flexible response to inevitable and continuing global change
- The funds (or "investment structures"?) industry is likely to continue to play a key, and possibly growing, role, but for it to be playing the only role would be worrying...

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