# Funds Europe: 2018 Jersey Roundtable

**Earlier this month, our very own Simon King, joined an expert roundtable hosted by leading publication, Funds Europe, to discuss the key developments facing the Island's funds industry. Here's what they had to say.**

**Funds Europe – *How are global fragmentation, protectionism and geopolitics impacting global fund structuring, and what is driving growth within alternatives?***

**Peggy Gielen, Jersey Finance –** There is still strong support for globalisation – it was one of the key themes that emerged from the World Economic Forum in Davos.

These views are in line with Jersey's outlook on global trade. Our island is ideally placed to facilitate cross-border transactions by working with key stakeholders across the globe. In the current climate, it is fair to say that it has not been an easy ride, but the island has weathered the storms well and one of the reports we've worked on with KPMG recently shows that our investor base is still very global.

The five biggest sources of capital committed into Jersey alternative investment funds (AIFs) are the UK, the US, Canada, Ireland and Luxembourg. After Brexit, it is expected that almost three-quarters of capital in Jersey AIFs will come from non-EU sources, demonstrating the global nature of our funds industry even further.

**Simon King, Aztec Group –** My headline response from an international perspective would be, "What protectionism?" There's generally been more talk than action. The AIFMD [the Alternative Investment Fund Managers Directive] has certainly benefited Luxembourg, but the directive has not stopped EU managers structuring their funds in non-EU jurisdictions. Our industry is still very global, very interconnected. If we look at the types of funds, the investor base, and where the advisers and the sub-advisers are based, it's all very international and not specific to one area in particular. Certainly, in Jersey, Europe remains one of our largest markets.

I would add that our industry is far more mature than it was pre-recession. The investor base understands what they want to a far greater degree and they are being driven to the higher returns that may be gained by investing in alternatives, rather than say listed stocks, which in turn drives asset-allocation committees to further increase investment into our sector. The market is also far more aware of what the investors desire, in terms of greater transparency – particularly the institutional investors – and have responded positively, thus making alternatives more mainstream.

**Simon Page, Hawksford –** I agree with that but you have to factor in global uncertainty, which is not what any GP [general partner, as in a private equity fund] wants. One of the key concerns is about policy change driven by the discontent of the general public and what that might lead to. That's still to play out and will be an active concern for a number of GPs.

**Tim Morgan, Mourant Ozannes –** The question is, how does your average GP or manager benefit from these uncertainties? The heart of alternative fund management is finding areas of underexploited benefit for the investors. There are some very large managers who have genuinely global funds, but there is a lot of fragmentation further down the value chain where smaller funds are spending their time finding niches. That can be an upside of the uncertainty which is happening at the moment.

**Mark Hucker, VG –** I agree that there are opportunities, but I'm less sanguine about protectionism, mostly because, whichever way you look at what the EU is doing, there isn't talk of open access to European markets and there is talk about the end of the national private placement regime (NPPR). If you look further into the future there's even more worrying developments. There could be a Brexit where, for example, those were specifically left out of an agreement, and that could make life difficult for the island. Protectionism is a real risk at this moment, especially with the EU.

**Niamh Lalor, Ogier –** I share those concerns. The AIFMD seemed like a very protectionist piece of legislation when it was introduced. AIFMD II and threats about what's going to happen to the concept of reverse solicitation and premarketing is some way down the line, but it's worrying. There are headwinds.

I agree that globalisation is a trend but there are places like India where there are huge opportunities – for venture capital, for instance – but there isn't a developed IPO [initial public offering] market yet. You can go in, spot opportunities, exploit them, but are you able to capitalise on that? It will be some time before all of these global barriers are gone.

**Mike Byrne, PwC –** As managers are looking to structure their long-term funds there's a certain amount of uncertainty which they can manage, but their structuring can be achieved through Jersey, and that's where we offer stability in an uncertain world. We've got a tried and tested jurisdiction which, when you're planning a ten-year view, works nicely. We see that in one of the largest funds ever raised in Jersey, the Vision Fund [established by SoftBank].

**Funds Europe – *What strategies are EU, UK and other fund managers taking as regards Brexit, and are there opportunities for Jersey? More broadly, how are the AIFMD and the national private placement regime (NPPR) developing?***

**Gielen –** Brexit is one of those examples where Jersey offers stability. We are not impacted by Brexit. We are neither part of the EU nor the UK, but work well with both, so Jersey is an ideal place for managers at the moment. In terms of market access, research issued by the European Commission on cross-border distribution of collective investment funds found that only 3% of AIFs are registered for sale in more than three EU member states. That's a powerful statistic, and it shows that NPPR is a viable route into Europe.

In future, we will have to see how the Brexit agreement pans out, and that will influence the AIFMD review, but a key political concern will be the impact of Brexit negotiations on UK, EU and international investors. Their needs should be at the heart of negotiations and, seen from that perspective, it is in nobody's interest to limit market access.

**King –** We were discussing the private placement regime in-house recently. Most of our clients market to just a few EU countries, generally five or six countries at the most. They don't need a passport. They don't need the burden of full compliance and the cost that goes with it. Doing it in Jersey, the private placement way is cheaper and more efficient and now a well-trodden path.

**Page –** You've only got to look at the ageing demographic and pension fund liabilities. Alternatives have outperformed even through the financial crisis, so these institutional investors, the pension funds, have to look at where the best returns are going to be for the future.

**Byrne –** When it comes to distribution, there's a misunderstanding about the comparison of retail products and alternative products. Many Jersey-domiciled real estate or private equity funds are distributed through reverse solicitation or through reinvestment of one group of investors into the next fund. It's a very different way of coming to market than for a retail fund.

AIFMD aimed to apply the principles of retail distribution to alternatives but it has proven to be unnecessary because you are not protecting investors from a kind of spot sale or doorstep approach. These funds are distributed with a much longer due diligence process, better governance and so on.

**Morgan –** I agree. The AIFMD was a rather lazy attempt to apply what had worked for Ucits to alternatives, with concepts based on investor protection, retail distribution and anonymised investors coming into a pooled fund. In its first five years of operation, AIFMD hasn't worked in that way. Where there is European domestic fundraising, it tends to be on a country-by-country basis. The idea of cross-border passporting has almost not been used at all, and when it's come to high-quality, top-performing alternatives, they have tended to be based on a pre-AIFMD model, which has used NPPRs.

There'll be an interesting battle, no doubt, as the EU continues to promote its own models as the global standard, but it seems very unlikely they'll manage to do that without the UK in the EU, and off the back of a very successful five years of NPPR, which many wouldn't have predicted at the beginning of AIFMD in 2013.

**Lalor –** The longer time goes on, the more we can say that private placement is tried and tested. Many of us sat around this table five years ago when AIFMD was coming in, and what we couldn't then say to investors was, "This will work because I've done it for my last manager." Now, we have evidence.

With NPPR, managers can select those three or five jurisdictions where they know they're going to raise the money, get to market a lot quicker, not have a depositary, and not have all of the costs and the disclosure required by AIFMD.

**Hucker –** But there are risks around Brexit. I don't like to be the prophet of doom, but I am concerned when we say, "People will always want to trade with London." Yes, it makes absolutely no sense to stop trading with London, but that doesn't mean it won't happen. Getting all of the EU economies in line is not going to be easy.

A commentator on Brexit recently said the easy bit has already been done. It's easy to say they want free movement of people, to say we don't want to split Ireland and so on, but as soon as you get to the tricky issues, where some people have vested interests, it will be much harder to reach an agreement. Brexit is an opportunity but there is a risk that it all goes badly.

**Byrne –** The key point here is that Europe mustn't create inappropriate barriers. It is not in the interests of the EU to build a fortress around Europe that means European investors' pension funds cannot access the best investment products in the world. Turning off NPPR could lead to some very poor consequences.

**Morgan –** What's curious is that NPPR was already the pivot for Jersey's interactions with Europe marketing, but as a result of Brexit, it will now become the pivot for London's. The existing third-country issue was a matter for Jersey, Singapore, Japan, Canada and so on – because these countries were signed off by Esma [the European Securities and Markets Authority] in both 2015 and 2016. Now, as a result of Brexit, this process will also need to involve the UK, which will become a third country, and which means it will become a bigger issue than it was from the EU's perspective.

**Byrne –** Let's remember the facts. If you look at the statistics for 2017, we were 17% up on the number of AIFMs [alternative investment fund managers] marketing into Europe and 15% up on the number of funds, so 149 AIFMs at December 31, 2017 and 291 funds. NPPR is working. There was some noise in Europe that 2018 would see the turn-off of NPPR, but that was a misunderstanding of an earlier proposal that Germany had put forward. It's not in anyone's interests to turn off NPPR.

**Funds Europe –** ***What is driving decisions as to choosing jurisdictions for asset servicing? Are any asset classes particularly buoyant in Jersey, and why?***

**Gielen –** A pool of expertise drives managers to Jersey. We've got 13,000 highly skilled people working in our finance industry. All our fund service providers have a deep knowledge and understanding of the asset classes they service. The asset classes that are doing particularly well are alternatives, specifically private equity, real estate and hedge funds.

**King –** What's driving demand? Returns, expertise, stability and cost, perhaps in that order. I'd make an observation as well – the variety of funds has changed. We talked earlier about the amount of cash in the market. We're also seeing promoters who have one strategy and then branch out to another strategy using their existing skill base. You might have a debt fund promoter who will also develop another product, perhaps a fund that invests into small or mid-cap, or one of the larger players who will branch out into, say, infrastructure. It's about having lots of different offerings available and satisfying the increased demand.

**Lalor –** It used to be that you either set your fund up in Jersey or Cayman or potentially Luxembourg. To my mind, it feels more nuanced now, particularly for big managers. You see a lot of the use of feeders, parallels, even sometimes for North American funds with our new JPF [Jersey Private Fund] regime. There's more clarity around carry – we're seeing a lot of carried interest vehicles being set up here for non-Jersey funds. Some managers may have a master fund here with either a feeder or parallel, and co-invest elsewhere. That won't work for the smaller managers because the costs will be too high, but if you've got the same administrator in the three or four jurisdictions where the fund is structured, there can be economies of scale.

**Page –** Our investors don't have a preference as to where the managers choose to incorporate their funds. They're different investors across multiple jurisdictions, they don't have a specific preference as long as they have the usual characteristics of limited liability for the investors and tax transparency, which is where our sweet spot is.

**Hucker –** There's a strong element of "if it ain't broke, don't fix it". If you've used a jurisdiction and you know it and you trust it and you've found good partners, why would you go somewhere else unless there's an overwhelming case to do it?

**Morgan –** Jersey has a very wide base of skills. Its ecosystem is widely drawn. Historically, as a jurisdiction, it serviced open-ended products. We'd all agree in the room that the core business for Jersey right now is around private equity and other illiquid alternatives. What's interesting is looking at how momentum can play out: if private equity is doing well, it's likely that investors will be drawn to private equity-like structures and investments, whether that's private debt or real estate or infrastructure. At the same time, there will be an appetite to develop these products further and as this happens, Jersey's wide experience, whether in closed-ended, listed or open-ended structures, will be able to cater for this well.

**Funds Europe – *How important are transparency and tax neutrality in fund structuring? How has Jersey responded to the OECD's base erosion and profit shifting (BEPS) project?***

**Morgan –** BEPS has been an interesting project, and although it wasn't originally aimed at asset management as an industry, inevitably asset management has been affected. From a fund structuring point of view, transparency is going to remain key. There have been attempts by certain other jurisdictions to position themselves as being somehow BEPS-compliant, but for purposes of structuring funds, the strongest position you could possibly have is to be transparent and to have internationally measured and signed-off standards that are aligned with what the OECD are trying to achieve.

**Gielen –** Tax neutrality is vital for a successful funds jurisdiction and, surprisingly, is still difficult to achieve in an onshore cross-border investment context. BEPS has an impact on funds and their managers but, put simply, Jersey is not a jurisdiction that is targeted by BEPS because we do not allow letterbox arrangements. There's a regulatory requirement to demonstrate substance, and thanks to Jersey's clear and simple tax-neutral system, we are not reliant on complex tax rulings or double-taxation agreement (DTA) networks.

**Byrne –** Almost all funds in Jersey are set up as limited partnerships, and limited partnerships are by their nature tax transparent. That means Jersey doesn't shelter tax and doesn't gather tax. The vehicle is transparent in that the investor pays tax in their home jurisdiction at the tax rate which is applicable to them. So, Jersey is not a target of BEPS in that way.

If we compare Jersey with other jurisdictions where there are corporate vehicles used, and corporate vehicles used specifically to access tax treaties, we are in a different starting point. When we think about substance and compare with other jurisdictions, we see an industry of 13,000 people where the GPs have real substance, they meet and there is proper governance. That doesn't compare with what happens in other jurisdictions where the meetings don't really happen.

**Hucker –** Jersey has marketed itself historically and traditionally as a full service offering that's allowed managers to gear up here. We have the talent pool and the expertise for the managers to tap into all of that, so it plays to the point around substance. King – It's a mature industry. We've been around longer than a lot of other jurisdictions, so we've got an increasing number of experienced professionals available to add substance, and that's only going to increase as the years progress.

**Lalor –** We're having conversations with Scandinavian fund managers exactly along these lines. The approach we've traditionally taken as an industry is all around corporate governance, asking: "How long did you have the board papers? Where did you make the decision? How many queries did you raise afterwards?" It's all been about corporate governance and as a jurisdiction, we've grown with that, and the "letterbox entity" concerns all fed into that.

The other approach to substance is physical addresses, boots on the ground, where does your compliance officer live. It's going to be interesting to see how those two approaches play out, but certainly the message we got from Scandinavia was that either BEPS drives you onshore, so you set up your fund in Stockholm, or you stick with jurisdictions such as the Channel Islands.

**Page –** It's a balance, isn't it. You put the advantages of tax neutrality versus those reputational concerns, especially when policy is being driven by the popular view at the moment. That's the challenge for many managers. However, Jersey offers familiarity for investors and a clear understanding of the regulatory and tax treatment of vehicles structured in Jersey in their home jurisdictions.

**Funds Europe –** ***Is financial technology (fintech) poised to have a significant impact on the fund management and fund administration industries?***

**Gielen –** Fintech offers enormous opportunities, especially in relation to operational efficiencies. The challenge is scalability, especially in certain fund asset classes such as private equity that are highly bespoke. Fintech solutions will therefore need to build in some flexibility to make them work in a funds servicing surrounding. But it's very exciting, both in terms of creating cost efficiencies and as an asset to invest in.

**King –** The world is digitising. How we as the industry embrace that and use it ourselves will be an interesting factor, not only on the operational efficiency side of things, but also in terms of cyber security. Given the size of this island and the relative tightness of the community here, we could do something within cyber security to differentiate ourselves. I'm seeing some good work and some joined-up thinking among various companies here, which we could use as a selling point. That could be part of our messaging.

**Page –** Looking at the horizon, fintech will become almost an asset class in itself, and LPs [limited partners] will be looking for GPs with specific exposure to that asset class. In my role, probably the largest client I have is solely focused on fintech.

Some of the investments they're making are cutting edge. It plays to the point about what we'll be doing in the future if AI or machine learning can replace certain roles formerly done by people. That's going to be the difficulty – how we make that transition.

Blockchain technology carries the potential to disrupt many industries, in particular financial services. We're moving closer to reality in terms of what blockchain can do for the future of how we operate as administrators, lawyers and so on. Jersey, as a jurisdiction, will need to structure itself accordingly in order to move forward, something which is already well underway.

**Byrne –** Jersey has a long history of being an early adopter of technology. We were early to move to dedicated bespoke systems – that's the eFronts and Investrans of this world. Now we're leading the way in the evolution from email to investor portals, moving to new forms of reporting, looking at how fintech is embedded in fund management firms and how they communicate with investors, how they source investors, how they monitor investments.

Jersey has invested in technology partly in response to the constraints of being an island economy. This project is entirely aligned with the objectives of the island vis-à-vis our population.

**Hucker –** There's a challenge for us in terms of re-educating and training our staff to use new technology, and that becomes a bigger island challenge in the education system.

But there's another point here. If we look at what our funds are investing in – and we referred to the Vision Fund earlier – this is game-changing disruptive technology that's being invested in via Jersey. That's going to change the way we live our lives and that's huge.

**Morgan –** A multiplier effect has certainly been present in Jersey historically because of the cluster effect of being a specialised economy, and the proximity of service providers and their directors to the activities of industry-leading investors, which brings experience of dealing with digital assets. The next step is to bring the regulator and the government alongside as well. The JFSC [Jersey Financial Services Commission] have been, as a regulator, very encouraging around digital technologies such as cryptocurrencies, blockchain and others. We're still at an early stage but Jersey is building on a model of being proactive with new initiatives that we've seen to be successful in the past.

Lalor – Investors are getting more sophisticated and they expect more in return. Rather than reducing headcount, technology allows you to do things more efficiently. At my firm, headcount has grown enormously over the last year, and it's because we are servicing bigger clients. But there is a scale issue, which means there are some people who cannot access this technology or don't keep up quickly enough, and they will lose out.

If you'd like to read more from the Funds Europe Jersey 2018 Report, please click here.