

Consultation on the Review of Collective Investment Schemes Legislation

Update of the regulatory framework for:

- Full International Schemes
- Specialist Funds
- Qualifying Funds
- Experienced Investor Funds
- Professional Investor Funds and
- Recognised Schemes

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Financial Supervision Commission Barrantee Oaseirys

CONTENTS

	Page No.	
Section 1	INTRODUCTION	1
Section 2	THE FULL INTERNATIONAL SCHEME REGIME	4
Section 3	KEY CHANGES TO THE SPECIALIST, QUALIFYING AND EXPERIENCED INVESTOR FUND REGIME	6
Section 4	APPROACH TO PROFESSIONAL INVESTOR FUNDS	8
Section 5	CHANGES TO OTHER LEGISLATION	9
	 REGULATIONS FOR PARTICULAR SCHEME TYPES	
Appendix A -	Draft Collective Investment Schemes (Full International Scheme) Regulations 2010	
Appendix B -	Draft Collective Investment Schemes (Specialist Fund) Regulations 2010	
Appendix C -	Draft Collective Investment Schemes (Qualifying Fund) Regulations 2010	
Appendix D -	Draft Collective Investment Schemes (Experienced Investor Fund) Regulations 2010	
	 ANCILLARY REGULATIONS	
Appendix E -	Draft Collective Investment Schemes (Register) Regulations 2010	
Appendix F -	Draft Collective Investment Schemes (Promotion of Schemes other than Authorised and Recognised Schemes) (Exemption) Regulations 2010	
Appendix G -	Draft Collective Investment Schemes (Recognised Schemes from Designated Countries and Territories) (Notification) Regulations 2010	
Appendix H -	Draft Collective Investment Schemes (Recognised Schemes) (Facilities in the Island) Regulations 2010.	
Appendix I -	Draft Collective Investment Schemes (Prospectus) (Exemption) Regulations 2010	
Appendix J -	Draft Collective Investment Schemes (Return of Allotment and Redemption) (Exemption) Order 2010	
Appendix K -	Draft Limited Partnerships (Collective Investment Schemes) Regulations 2010	
Appendix L -	Draft Limited Partnerships (Collective Investment Schemes) (Exemption) Regulations 2010	

Section I – INTRODUCTION

I.1 Background

The Collective Investment Schemes Act 2008 (“the Schemes Act”) empowers the Financial Supervision Commission (“the Commission”) to make regulations concerning collective investment schemes.

Prior to the Schemes Act, the regimes for collective investment schemes were organised under the Financial Supervision Act 1988. When the Schemes Act was enacted, these regimes were preserved under the new Act pending their review and reissue.

I.2 The Proposals

The Commission proposes that existing legislation for Full International Schemes and Specialist, Qualifying and Experienced Investor Funds is updated and reissued under the Schemes Act. In relation to the future of Professional Investor Funds, the Commission is seeking views on the options.

In undertaking the review the Commission has considered each regime against the regulatory objectives of:

- (a) securing an appropriate degree of protection for the customers of persons carrying on a regulated activity;
- (b) the reduction of financial crime; and
- (c) supporting the Island’s economy and its development as an international financial centre.

The Commission has concluded that the draft legislation is in line with these objectives.

In discharging its functions the Commission is required to have regard to –

- (a) the need for the regulatory, supervisory and registration regimes to be effective, responsive to commercial developments and proportionate to the benefits which are expected to result from the imposition of any regulatory burden;
- (b) the need to use its resources in the most efficient and economic way;
- (c) the desirability of implementing and applying recognised international standards;
- (d) the desirability of cooperating with governments, regulators and others outside the Island;
- (e) the need to safeguard the reputation of the Island;
- (f) the responsibilities of those who manage the affairs of permitted persons;
- (g) the international character of financial services and markets and the desirability of maintaining the competitive position of the Island; and
- (h) the desirability of facilitating the development of the financial services industry.

The Commission has concluded that the draft legislation is appropriate when judged against the matters that the Commission must consider in discharging its functions.

The draft legislation is included in this consultation as Appendices. In addition, the more significant changes are highlighted in the sections below. This should assist with your navigation of the consultation and give some background into the reasons for these changes.

You should note that definitions which are now set out in the Schemes Act are not required in the Regulations and as such have been omitted from the draft Regulations. Therefore, the Regulations should be read in conjunction with the definitions and requirements of the Schemes Act.

You will notice that the style and layout of the legislation has been modernised in line with the current legislative style for Isle of Man legislation. This will ensure that the regime is as clear and accessible as possible.

1.3 Other secondary legislation

This consultation also considers updates to ancillary legislation to take account of the new Schemes Act and recent changes to Company Law made through the Companies (Amendment) Act 2009.

1.4 Consultation

The purpose of consultation is to obtain views and gather evidence from which an informed decision on the content of proposed legislation can be made. A response to this consultation will be considered against all comments received and the regulatory objectives before any decisions are made.

A summary of the comments received with the Commission's response will be published on the Commission's website after all comments have been considered. Unless the response specifies otherwise, all comments will be published without specifying by whom they were submitted.

The Commission views open dialogue with Industry as an essential element in developing an optimal regulatory framework. The Commission therefore appreciates the time that respondents will spend in reading and commenting upon these proposals.

The closing date for comments is **18 December 2009**. It would be appreciated if comments could be received as soon as possible and no later than this date. Email responses would be appreciated where possible.

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Section 2 – THE FULL INTERNATIONAL SCHEME REGIME

Approach to the review of Full International Schemes

Important note - the areas highlighted below are intended to give a flavour of the changes proposed in the draft Regulations. They are not exhaustive and the Commission recommends that interested parties review the draft Regulations in full. The draft Collective Investment Scheme (Full International Scheme) Regulations 2010 are attached at Appendix A.

2.1 The existing regulatory regime for Full international schemes is spread over 3 sets of Regulations –

- the Financial Supervision (International Collective Investment Schemes) Regulations 1990
- the Financial Supervision (International Collective Investment Schemes) (Advertising and Scheme Particulars) Regulations 1995; and
- the Financial Supervision (Prescribed Countries and Territories) Regulations 1990.

These Regulations are somewhat aged and have been supplemented over the years with various pieces of guidance.

Therefore, a key rationale for the review of the regime was to aim for 1 clear set of user friendly, transparent, modern regulations which are fit for purpose.

2.2 The Schemes Act changed the regulatory structure for Full International Schemes, and in particular introduced requirements for –

- members of a scheme's governing body to satisfy the Commission that they are fit and proper;
- the proposed manager of a scheme to obtain the Commission's consent before being appointed; and
- an existing manager of a scheme to obtain the Commission's consent to continuing where the scheme has changed or to the manager being replaced.

In revising the regulatory structure it was important to reflect the new legislative framework and set out the consent process.

2.3 The new regime for specialist and qualifying funds – In 2007 revised regulatory structures were issued for other classes of international scheme. Updates to these regimes are also considered as part of this consultation. In reviewing the full international scheme framework we have considered the new draft regimes for specialist and qualifying funds and have tried to achieve a similar level of clarity and in particular the draft regulations –

- set out clear responsibilities for scheme functionaries including:-
 - the governing body;
 - the manager;
 - the fiduciary custodian / trustee;
 - the custodian; and
 - the asset manager;
- clarify the sales process and require improved investor declarations;

- set out clear notification requirements to be followed at the launch of the fund and on changes to the fund;
- set out mandatory disclosures;
- require annual compliance statements and quarterly statistical information;
- set out requirements for annual audited financial accounts and interim financial accounts;
- set out auditor responsibilities.

2.4 Relationship between the manager and fiduciary custodian or trustee

Under the draft Regulations there are specific requirements for the manager to implement procedures and for these to be monitored by the fiduciary custodian or trustee. This is seen as a key control in the regulatory framework.

2.5 Investment, borrowing and liquidity requirements

The Commission recognises that full international schemes may be retail focussed, but at the same time could adopt higher risk investment, borrowing and liquidity strategies and may be limited to particular categories of investors. The Commission is mindful of trying to achieve balance in its approach and as such proposes to introduce regulatory levels for investment, borrowing and liquidity, above which practitioners must notify the Commission of the rationale for adopting a more aggressive strategy. This flexibility is backed up by the requirement to introduce a risk management process to ensure that attendant risks are recognised and managed.

2.6 Constitutional and offering documents

During the review the mandatory contents of the constitutional and offering documents have been considered. In doing so the Commission has tried to ensure consistency between the 2 documents and identify where further mandatory information should be required. In doing so we have tried to achieve a balance between lengthy requirements and necessary information and risk warnings. The information requirements in similar schemes in Jersey, Guernsey and the UK have been considered.

2.7 Jurisdictions in which a fiduciary custodian or trustee can be located and regulated

Under the existing legislation a fiduciary custodian or trustee can be regulated on the Isle of Man or located and regulated in the UK, Guernsey or Jersey. Under the draft Regulations the list of prescribed territories is extended to include Ireland and Luxembourg. The Commission would be interested to hear respondents views on these and other jurisdictions and their suitability jurisdictions for the location of fiduciary custodians and trustees.

Section 3 – KEY CHANGES TO THE SPECIALIST FUND, QUALIFYING FUND AND EXPERIENCED INVESTOR FUND REGIMES

3.1 In reviewing the regulatory structures for specialist, qualifying and experienced investor funds for reissue under the Schemes Act the Commission has considered how these structures have operated in practice since 2007 and has updated the draft Regulations to take account of issues encountered.

3.2 Significant changes made to the previous exemption orders:-

3.2.1 Update of offering documents and governing body responsibility statements

In some circumstances (particularly for limited partnerships) a scheme may have a limited number of closings. In this circumstance, offering documents are updated at the time of each offering, as required. However, once a scheme has closed there are no further offerings to investors, and the offering document effectively becomes redundant.

The Commission is of the view that it is important that an offering document is up to date whenever a scheme is open to investment. However, where a scheme is not open to investment, providing investors, and the Commission, are aware of material changes, the offering document is of less importance. The Regulations have been updated to reflect this policy and the governing body responsibilities and responsibility statement have also been updated.

3.2.2 Standards for preparing financial statements

The current regime does not identify US GAAP as a standard to which financial statements may be prepared. Many schemes will have investors who prefer to use US GAAP. Allowing the use of US GAAP is in line with changes introduced via the Companies (Amendment) Act 2009 and a recent request from the auditors with regards to scheme valuations.

This policy has been incorporated in the draft Regulations by making reference to the appropriate companies' acts provisions.

3.2.3 Investor certifications

The current investor certification requires that all investors (including discretionary managers and life companies) agree to five statements including;

“I/we personally accept all the risks associated with this investment and particularly that my/our investment in the [name of fund] involves risks that could result in a loss of a significant proportion or all of the sum invested.”

However, where an institution is making the certification but is not beneficially entitled to the investment, or where the value is linked to a life assurance particular policy, this wording is not appropriate.

To address this, the Part 1 and Part 2 certifications have been revised.

These changes have been discussed with the Fund Management Association and are already available to schemes that consent to having a modification applied to them by the Commission.

3.2.4 Acceptable jurisdictions for scheme custodians

The current requirement that custodians of qualifying and experienced investor funds must be located in a jurisdiction acceptable to the Commission was found to place unnecessary delays upon schemes when appointing custodians. The Commission believes that it is the responsibility of the schemes' governing body, in conjunction with the manager, to ensure that a custodian is suitable to act and is regulated for that function in an appropriate jurisdiction. This has been reflected in the draft Regulations.

3.2.5 Extent of custody

The Commission notes that in some instances a schemes' appointed custodian will control the shares in a company, such as a special purpose vehicle, but does not have custody of the underlying assets in that entity. The Commission believes that in these circumstances the extent of the custodian's control of the underlying assets should be disclosed in the offering document and has included a disclosure requirement to this effect in the Regulations.

3.2.6 Minimum investment criteria for specialist funds

A fund's sponsor and associated persons will typically invest a nominal amount to establish the structure. To this end an exemption from the US\$100,000 minimum investment value has been introduced solely for this seed capital amount.

3.2.7 Regulated financial advisers

In October 2008 a standard modification was made available in relation to the experienced investor and qualifying fund regimes. This allowed certain schemes to opt to make all sales through regulated financial advisers and not appoint a regulated promoter. This modification and its attendant conditions have been incorporated into the new Regulations.

To reflect the differing responsibilities between regulated promoter regime and the regulated financial adviser regime, the regulations make it clear where responsibilities for oversight of promotional and marketing materials lies for each regime.

3.2.8 Housekeeping changes

Housekeeping changes are included to ensure that legislative references to the Financial Supervision Act 1988 now refer to the appropriate sections in the Financial Services Act 2008 and the Schemes Act.

3.3 The draft Regulations

The following draft Regulations are contained in the Appendices to this document –

- Collective Investment Schemes (Specialist Fund) Regulations 2010 (Appendix B);
- Collective Investment Schemes (Qualifying Fund) Regulations 2010 (Appendix C);
- Collective Investment Schemes (Experienced Investor Fund) Regulations 2010 (Appendix D).

Section 4 – APPROACH TO PROFESSIONAL INVESTOR FUNDS

The Commission is currently considering the regime for professional investor funds. At the date of this consultation there are only five professional investor funds in existence and the professional investor product has in effect been replaced by the specialist fund.

The options for professional investor funds are as follows:

1. revise the regulatory structure and issue new professional investor fund regulations which are equivalent to the specialist fund regulations and require all existing schemes to make required changes to come into compliance;
2. require all existing professional investor funds to transition into the specialist fund regime;
3. leave the existing professional investor fund regime in place but close the structure to new funds.

The Commission would welcome any views on the above options.

Section 5 – CHANGES TO OTHER LEGISLATION

- 5.1 The legislation detailed in this section is being reissued by the Commission to fully reflect the Schemes Act and the regimes there under and to bring it into a modern form. Except where explicitly highlighted below, the effect of the legislation is to maintain the status quo position which is set out in brief for each item.
- 5.2 **Appendix E - The Collective Investment Schemes (Register) Regulations 2010** - These Regulations set out the matters to be included in the public registers of schemes maintained by the Financial Supervision Commission.
- 5.3 **Appendix F - The Collective Investment Schemes (Promotion of Schemes other than Authorised and Recognised Schemes) (Exemption) Regulations 2010** - These regulations have the effect of permitting the promotion of schemes which are not authorised or recognised schemes subject to certain conditions being met.
- 5.4 **Appendix G - The Collective Investment Schemes (Recognised Schemes from Designated Countries and Territories) (Notification) Regulations 2010** - These Regulations specify the information and documents which must be provided by the manager of a collective investment scheme from a designated country or territory, when giving written notice to the Commission, that he wishes it to be a recognised scheme in the Island. Under these Regulations the Commission has a period of two months to notify the manager of a recognised scheme from a designated country or territory that the scheme will not be recognised.
- 5.5 **Appendix H – The Collective Investment Schemes (Recognised Schemes) (Facilities in the Island) Regulations 2010** - These Regulations require the governing bodies of schemes recognised under Schedule 4 paragraphs 1 and 2 to the Collective Investment Schemes Act 2008 to maintain specified facilities at an address in the Island, or in the United Kingdom.
- 5.6 **Appendix I - The Collective Investment Schemes (Prospectus) (Exemption) Regulations 2010** - These Regulations exempt schemes (other than exempt schemes) from the following provisions of the Companies Act 1931:
- Section 38C of the Act which makes a person criminally liable for knowingly authorising the issue of a prospectus that contains false or misleading information.
 - Section 38DA of the Act which permits the Commission to direct a company to amend a statement in a prospectus that is false or misleading, and to place this direction on the public record.

The basis for the exemption is that such schemes are subject to equivalent provisions under the Collective Investment Schemes Act 2008.

These Regulations do not wholly replicate the previous Regulations because the Companies (Amendment) Act 2009 removed the specific matters to be contained in a company's prospectus and replaced it with a requirement to disclose material information.

This change has removed the need to distinguish between a Prospectus and Offering Document and with it, the need for an exemption to the filing of such a document.

- 5.7 Appendix J - The Collective Investment Schemes (Return of Allotment and Redemption) (Exemption) Order 2010** - This Order exempts authorised and international collective investment schemes that are companies incorporated under the Companies Act 1931 from the requirement to file returns of allotment and redemption of shares with the Registrar of Companies.
- 5.8 Appendix K - The Limited Partnerships (Collective Investment Schemes) Regulations 2010** - These Regulations permit collective investment schemes that are constituted as limited partnerships to have more than 20 members.
- 5.9 Appendix L- The Limited Partnerships (Collective Investment Schemes) (Exemption) Regulations 2010** - The Regulations exempt a limited partnership that is classed as an international scheme from the requirement to disclose details of the limited partners on the public file held at the Companies Registry. The exemption is subject to the condition that the partnership maintains certain information relating to the limited partners, and the terms of the scheme, at its principal place of business in the Isle of Man.