

The future of international fund domiciliation 2021

IFI Global Research



Jersey Finance

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The Briefing Report

Foreword

When we supported the research undertaken by IFI Global at the end of 2019, a picture emerged of a fund domiciliation landscape which was becoming more competitive and more complicated than ever, with global regulatory initiatives looking to challenge traditional fund structuring models.

The study concluded that investors and managers want stability and continuity when it comes to fund domiciliation, a jurisdiction respected by investors, with good infrastructure, local expertise and well-established regulations.

As a leading funds jurisdiction that prides itself on its political and economic stability, the specialist expertise of its workforce and quality of its regulation, these findings provided further reassurance of our own strategy and service offering.

But there is no ignoring how much has happened since that research was undertaken. The rise of ESG, a Brexit agreement, BEPS and the demands for yet more substance, continue to influence fund domiciliation decisions, and all this alongside a business environment operating in an unprecedented pandemic.

So we welcomed the opportunity to once again collaborate with IFI Global on a further round of research, twelve months on, to find out how the events and trends of 2020 have impacted on the decision-making process, and what they mean for the funds community and especially for International Finance Centres (IFCs).

Joe Moynihan,
Chief Executive Officer, Jersey Finance

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Introduction

By Elliot Refson, Head of Funds, Jersey Finance

This latest IFI Global survey has been undertaken at a time when the international asset management industry is responding to a range of significant developments, including the backdrop of a pandemic and yet further regulatory pressures.

At the top of the agenda has been the continued rise in sustainable finance, already worth around £30 trillion globally, and now regarded as critical to the future structure of the funds industry. As a forward-thinking jurisdiction, Jersey wants to be at the forefront of sustainable finance best practice and we are in collaboration with our regulator to ensure we meet that objective, as part of a new sustainable finance strategy.

Meanwhile, the industry begins to experience the implications of a Brexit agreement which many commentators were surprised to find did not include financial services, with the EU and UK failing to agree on financial equivalence. First impressions on the implications of the Brexit deal are highlighted in the findings. From our perspective, outside the EU, Jersey already has third country status, with agreements in place, making our platform for EU bound alternative fund distribution ideal to support the market.



Introduction

There are other factors in 2020 that have had a bearing on responses to the survey. The threat posed by the EU in blacklisting certain IFCs, the demand for even greater substance within fund jurisdictions and the impact of new regulation, are likely to influence future domiciliation decisions.

As a constant behind these concerns has been the pandemic, which has acted as a catalyst for change in how we work and embrace technology, and the survey considers whether it has impacted on fund domiciliation patterns to date.

In Jersey we can look back on 2020 as another year of growth for our alternatives industry. Our assets under management broke the \$500 billion for the first time, and we recorded a sustained rise in the number of funds and managers using Jersey to access the EU. Jersey has also noted record inflows from the US and the survey includes a perspective from the US and views on fund domiciliation there.

This study, which Jersey Finance has been pleased to support, focuses on the issues that matter and has obtained the opinions of those at the cutting edge of the alternatives industry. While it was anticipated that managers and investors would still be drawn towards stability and certainty, the results provide a fascinating insight into their thinking at a time of unprecedented change.

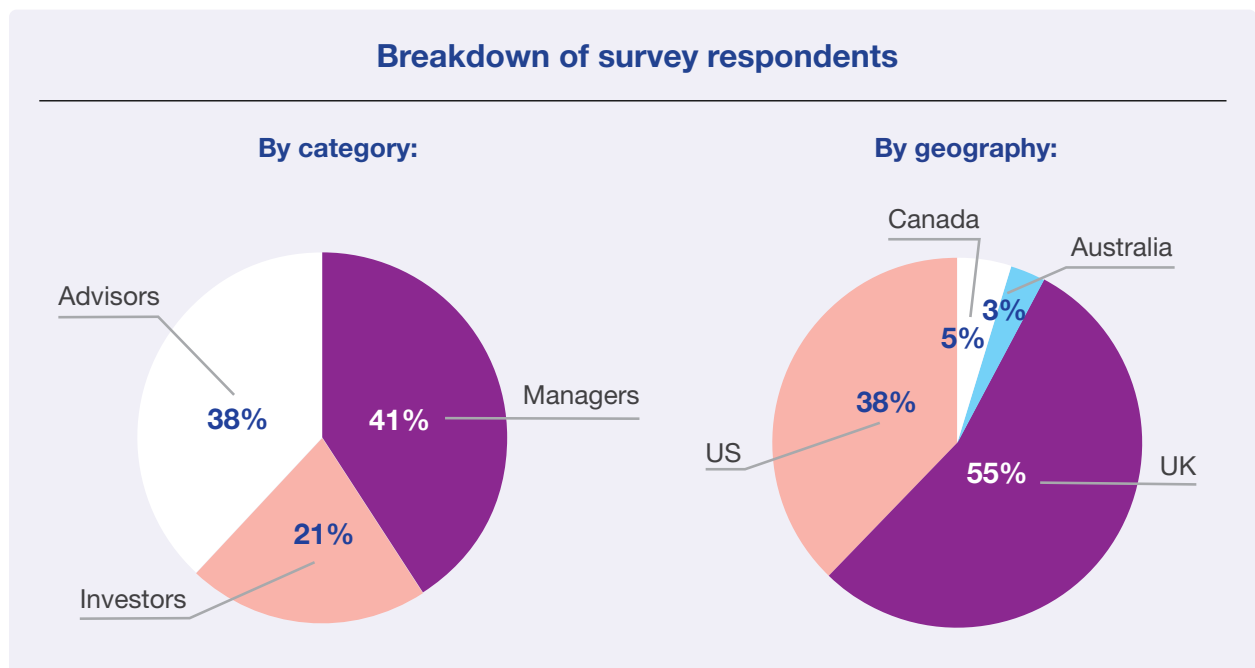


Interview breakdown

From October 2020 until February 2021, IFI Global's research department interviewed leading investors, managers, lawyers and other industry advisors to get their views for this research study.

Managers with overall assets of \$2.14 trillion, and dedicated alternative assets of \$91.5

billion, were surveyed along with investors in Australia, Canada, the UK and the US. Many advisors to fund managers, mainly lawyers, were also interviewed. IFI Global would like to thank all those who gave up their time to contribute to this study



The main conclusions

- Investors want to allocate to funds that are domiciled in well-known jurisdictions that have a good reputation, legal and regulatory framework, solid infrastructure and considerable expertise. The more funds that a jurisdiction has in the asset class that the investor is looking to allocate to, the better. Investors do not like surprises when it comes to fund domiciliation.
- There are differences in what many UK and US managers would consider to be their priorities in domicile selection. This has a lot to do with investors. Most UK managers interviewed say that they have European investors who need funds to be domiciled in jurisdictions that meet a certain regulatory threshold. Whilst there are exceptions, most US managers and their advisors appear to be less influenced by their investors in the same way.
- The vast majority of US managers and advisors surveyed say that what matters most to them in their domicile selection,

aside from familiarity, are cost considerations and local regulatory requirements. As more substance and regulatory requirements are imposed upon what were traditionally viewed as low-cost jurisdictions, some US managers have begun to look for alternatives.

‘the phony war is over, the real one has begun’

- The consequences for future fund domiciliation patterns of the UK’s departure from the EU are only just beginning. As one interviewee put it, ‘the phony war is over, the real one has begun’. Many UK based interviewees are pessimistic about where EU-UK relations are heading, especially in financial services. The largest managers made their Brexit transition plans a long time ago and are therefore largely unaffected by any fallout between Brussels and London. But medium-sized managers and smaller ones are potentially more vulnerable.



Key survey findings

- 69% of all interviewees believe that ESG considerations will play a growing, and perhaps even critical, role in their decision-making in all industry areas – including eventually in domiciliation. But no one interviewed has said that ESG factors have (yet) determined where they would domicile their funds.
- Investors and their advisors were generally more interested in the ESG sections of the survey than managers or their advisors. In answer to the question: ‘Do you anticipate that including ESG criteria in the selection of fund jurisdictions and service providers will become more important in future?’ The response was 100% yes from the investors interviewed. By contrast, 74% of managers and their advisors said yes to this question. Most of those who said no are US based.
- Most interviewees believe that jurisdictions should develop their own ESG regulatory standards – only those that are required to comply with the SFDR want a standardised international approach to ESG regulation. Outside the EU the idea of an all-encompassing regulatory approach to the regulation of ESG, like the SFDR, is not popular. One UK based interviewee thinks that the EU may have ‘shot itself in the foot’ with the SFDR.
- The survey identified a degree of dissatisfaction in the US with recent increases in fees that have come from Cayman. It is understood that these fee increases are generally the result of new extra regulations such as MLRO rules, which Cayman has had to introduce. However, the extra costs and substance requirements are ‘eroding Cayman’s competitive advantage’, as one US based survey respondent put it.
- The BVI is still popular in the US with those advising managers starting with \$5 million or less. And Bermuda is seen as making more of an effort to get back into the market.
- The majority of interviewees do not expect that an agreement on financial equivalence will be reached between the EU and UK, at least in the foreseeable future.
- Substance demands in the jurisdictions where funds are based is beginning to affect domiciliation and fund structuring decisions. 58% of the managers interviewed have funds domiciled in the EU. A number of them said that they are struggling to keep up with the substance requirements demanded by regulators in jurisdictions like Ireland.



Key survey findings

- A number of UK survey respondents are concerned that the deteriorating EU-UK relationship will affect their ability to access EU investors via private placement or reverse solicitation arrangements. This appeared to be less of a worry for those who were interviewed in the UK prior to the end of 2020. This matter seems to have grown in importance as 2021 has unfolded. Although guaranteed for three years after the granting of the AIFMD passport to third countries, UK managers fear that private placement arrangements will become more difficult in future and might even be closed down. The same applies to reverse solicitation.
- 37% of managers interviewed do not see any real opportunity for growth in EU markets. There is much more interest in the US and Asia-Pacific region. After the UK, Switzerland, which is also outside the EU, is the most important European market for many managers.
- Covid-19 has not impacted fund domiciliation patterns but, should the pandemic require continued travel restrictions beyond this year, it may very well affect the EU industry's peripatetic structure. Should that happen then it may well begin to have an effect upon domiciliation decisions.



Investors & fund domiciliation

This study found little to no variation in investors' views on fund domiciliation. They generally do not have favoured jurisdictions, but they are consistent in knowing what they want: proven infrastructure, local expertise and, above all, ones with a strong connection with the asset class of the fund in which they are investing.

No one interviewed in the investor category said that they have vetoed an allocation to a fund because of the jurisdiction where it is domiciled. But questions are often raised if it is out of the usual. And a point made by a number of allocators is that managers generally select jurisdictions that are well known to their investors, thereby avoiding possible diligence problems.

If a jurisdiction is not well known by the investor, a visit might be undertaken to do due diligence on it. Information is needed on the regulations, the service providers, the local independent fund directors and experience of those in the local fund industry. Investors also like to see that there are large numbers of other funds domiciled in the jurisdiction that are in the same category as the fund in which they are investing.

Managers surveyed say that they want to make the due diligence process for their prospective investors as simple and as straightforward as possible. They prefer to spend their time with them focusing on performance.



Several survey respondents from the UK said that European investors tend to be more focused on domiciliation issues, often for regulatory reasons, than those in the US.

ESG & fund domiciliation

All investors surveyed, as well as 61% of managers and advisors, say that ESG criteria will play a growing role in fund domiciliation decision-making in future (and in service provider selection too).

ESG business practices are expected to be widely adopted across the funds industry. Fund domiciliation is not going to be an exception. But no one interviewed said that they have separate and distinct criteria for considering the domiciliation of ESG funds.

39% of survey respondents do not believe that ESG will impact on fund domiciliation patterns. The overwhelming majority of those with this view are in the US.

Just 12% of all interviewees believe that it would be beneficial if there is an agreed international standard of regulation for ESG.

Those in this category have fund distribution in the EU and so have had to comply with the SFDR. One of these called the SFDR the ‘gold standard’ of ESG regulation. He believes something similar should, and will be adopted by regulators from outside the EU. A UK based lawyer suggested that she thought that the SFDR might be adopted around the world in a similar fashion to the take up of UCITS funds outside the EU. ‘The EU is the most powerful trade block in the world and so has a lot power to set compliance standards’, she said.

However, the majority of survey respondents, including all of those in the US, believe regulations should be tailored to local

‘The EU is the most powerful trade block in the world and so has a lot power to set compliance standards’

- UK based lawyer

conditions. One interviewee thinks that the EU may have gone too far with the SFDR, unless it is adopted in Anglo-Saxon countries, where most fund management organisations are headquartered. ‘Having different regulatory approaches in different countries and fund jurisdictions will give investors more options’, said a US based advisor.

‘Having different regulatory approaches in different countries and fund jurisdictions will give investors more options’

- US based advisor

UK interviewees were sometimes not sure what to make of the country’s decision to diverge from the SFDR. Several were not aware of it when they were surveyed. A small majority welcomed the news that they will not have to comply with the SFDR’s complicated reporting requirements, unless they are distributing funds in the EU. It is anticipated that the TCFD (Task Force on Climate-related Financial Disclosures) the ESG rulebook being adopted in the UK, will be much less onerous.

Brexit & fund domiciliation

Interviews with UK based respondents suggest that, paradoxically, Brexit will have the most impact upon those managers that are not heavily committed to EU markets, rather than those with large numbers of investors, and strong distribution, in continental Europe.

The larger managers interviewed say that they have either added substance to what were often already well-established operations of their own in jurisdictions like Ireland and Luxembourg, or they have joined management companies there that cater for third party funds. Either way, Brexit has not had an impact upon their fund domiciliation decisions.

That was different from the smaller managers surveyed (71% of UK managers surveyed have an overall AUM of less than \$500 million). Smaller managers are often not as committed to EU markets as larger ones. A few have little to no interest in the EU at all. However, the majority of the smaller manager groups surveyed do want to continue to have access EU investors. Boutique UK based alternative managers would like to continue to rely upon private placement or reverse solicitation for their access to European investors. Many of them are concerned that this will become more difficult in future.

Managers with a substantial investor base in the EU made their post Brexit plans a long time ago, however many boutique alternative managers have not made definitive plans. Responses to this survey suggest that smaller managers' views of distribution in the EU are essentially opportunistic; it is only worth doing if regulations do not make it too onerous along with evidence that there are real prospects

of finding investors for their funds. 'We have adopted a wait and see attitude' said one with of these with investors in other parts of the world.

Other boutique alternative managers interviewed for this study also say that they will wait to see what happens in this post Brexit period before deciding whether they will commit to developing investor contacts in the EU. Europe, outside Switzerland, is often not a priority.

All UK interviewees are concerned that the EU will make changes to distribution and portfolio manager delegation rules in this post Brexit period.

One UK lawyer said the following: 'The passport for distribution in the EU does not provide free, unfettered access. Each country has its own specific requirements and costs.'

For AIFs, available data suggests that only about 3% of AIFs are registered for sale in more than three Member States

And another said: 'Only 37% of UCITS are registered for sale to more than three Member States. For AIFs, available data suggests that only about 3% of AIFs are registered for sale in more than three Member States. Industry feedback indicates that regulatory barriers represent a significant disincentive to cross-border distribution.'

Substance & fund domiciliation

36% of managers surveyed have funds domiciled in Ireland (and 14% have funds domiciled in Luxembourg). Much of the fieldwork for this research was done just after the Central Bank of Ireland published its review of CP86 last autumn. Substance requirements within the EU were therefore high up on the agenda of several interviewees.

One large UK manager said: ‘the CBI does not take into account, when it makes demands for additional staffing requirements at Irish fund management companies, that finding qualified personnel to fill these positions is extremely difficult, especially during a pandemic’.

Another interviewee said that there was ‘a supply and demand mismatch’ in Ireland which, in his opinion, is worse than in Luxembourg. He added that salaries for well-qualified people in risk and other specialist areas have been skyrocketing. He fears that there is a danger that Ireland could become uncompetitive if present trends continue.

On the other hand, the largest UK headquartered manager interviewed for this study, with funds domiciled in Ireland, said that he was under the impression that the CBI was showing flexibility on staffing. The head of his Irish ManCo had recently completed a negotiation with the CBI on personnel. At the beginning of these discussions, the CBI wanted the Irish ManCo to have 12 full time people. But the regulator agreed to settle on nine (for a ManCo with approximately €5 billion in AUM in Ireland).



‘The CBI does not take into account, when it makes demands for additional staffing requirements at Irish fund management companies, that finding qualified personnel to fill these positions is extremely difficult, especially during a pandemic’ - *UK based manager*

The US & fund domiciliation

Previous domiciliation research studies undertaken by IFI Global have found a consistently strong and positive view of Cayman in the US. All US managers, lawyers and other advisors are very familiar with this Caribbean jurisdiction. This study, for the first time, identified a degree of disquiet with the direction that Cayman is going in at present.

The dissatisfaction is not widespread and the industry in Cayman is not considered to be at fault for the current problems arising there. The dissatisfaction comes from the extra costs and substance requirements that are being imposed on Cayman from outside entities, like the EU.

Extra regulations, like the new MLRO rules, mean that more costs are being passed on to the managers of funds that domiciled in Cayman and other jurisdictions. Some

interviewees said that this isn't a lot of extra work, but it is being used as an excuse to increase fees. This is seen as eroding Cayman's competitive advantage.

Cayman has traditionally been viewed in the US as a low-cost jurisdiction with a relatively light regulatory touch. Many US based interviewees no longer see Cayman in this way anymore. 'People are looking for alternatives to Cayman' said one US based advisor.

Partners interviewed from a number of the major New York law firms, who advise large numbers of US managers, said that relatively low-cost onshore jurisdictions - such as Delaware and Canada - are benefitting from the increasing regulatory burdens imposed on offshore jurisdictions like Cayman. A US based advisor said that the extra costs and substance



The US & fund domiciliation

requirements are eroding Cayman's competitive advantage over possible onshore competition. She said the cost difference of being in Cayman over Canada is no longer significant.

There is concern that if present trends continue much further, then the benefits for US managers of going offshore, and specifically into Caribbean jurisdictions, will be seriously eroded. However, the BVI is still popular in the US with those advising managers starting with \$5 million or less. Bermuda is seen as making more of an effort to get back into the market.

Also, 38% of all the interviews that were conducted for this study were done in the US. Only 41% of this sub sample expressed concern with the direction that Cayman is going in at present.

'Primary focus remains on identifying a jurisdiction that minimises regulatory burdens for manager/sponsor, and that will be attractive (or at least not a major deterrent) to an anticipated investor base'

- *New York fund lawyer*

One leading New York fund lawyer said the following: 'Primary focus remains on identifying a jurisdiction that minimises regulatory burdens for manager/sponsor, and that will be attractive (or at least not a major deterrent) to an anticipated investor base.'



The pandemic & fund domiciliation

No one surveyed said that the pandemic has had any impact upon fund domiciliation patterns. However, several interviewees believe that if it continues to be difficult to travel next year too, then this might begin to change.

There could be a potential problem in Luxembourg, in particular, if the pandemic is still restricting office access in 2022. That is because some of the people who are making governance decisions on behalf of Luxembourg funds live in France, Belgium and Germany. This could possibly have tax issues for Luxembourg domiciled funds.

The vast majority of interviews for this study were conducted after the vaccine rollout had commenced. So, respondents believe that



Covid-19 is a temporary problem that will not have structural implications for the funds business.

Glossary of terms

AIFMD – Alternative Investment Fund Managers Directive

CBI – Central Bank of Ireland

ESG – Environmental, Social & Governance

MLRO – Money Laundering Reporting Officer

SFDR – Sustainable Finance Disclosure Regulation

TCFD – Task Force on Climate-related Financial Disclosure

UCITS – Undertakings for Collective Investment in Transferable Securities



IFI Global

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