

Innovation Islands – how the Channel Islands are innovating in the funds arena

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If you look around the world at countries, regions or cities that have become leading venues for innovation in any field, there are themes that come up again and again.

Whether it's Silicon Valley, the City of London or Estonia, innovation centres emerge where there is:

- A highly-skilled and educated workforce;
- An environment which people will choose to live in;
- A pragmatic approach to regulation makes it easy to do business; and,
- Opportunity for investment.

The existence of those four pre-conditions is not solely down to government, regulators or industry (and in fact, you can argue that nature and geography play a role too) but a combination of the efforts of all three.

And so, the success of innovation in the Channel Islands depends on whether those preconditions are met.

Clearly, they are – the islands have a highly-skilled workforce, natural features and culture make them a desirable place to live, the attitude of government and regulators are business-friendly and there is ready access to capital for investment purposes.

The Channel Islands' funds sector is itself a product of the innovation that environment has created, born as the finance industries in the islands sought to diversify from banking and trust

sectors in the 2000s to establish a presence in the alternative investment funds market.

Jersey's Expert Fund regime, established in 2004, was followed by Exchange Traded funds, and then by the Private Placement regime by 2012.

The innovation continues – Guernsey has already adopted an innovative manager-led product scheme that reduces compliance duplication by focussing attention on managers and not underlying funds, which is itself based on Luxembourg's RAIF or Reserved Alternative Investment Fund (Jersey is set to consult on a similar scheme in the coming months).

That manager-led product could be another game-changer in reducing costs both at the fund formation stage and throughout the life of the fund, and at the same time it gels with the EU's shift in focus to regulating the managers of investments, not the investments themselves.

The underlying work of the funds sector can also have an innovation theme – just this year, work that our firm has been involved with includes the establishment of Medicxi Ventures, one of Europe's largest life sciences focused venture firms, as well as collaboration with our real estate structuring team to assist Paloma Capital LLP on a UK-focused real estate investment fund, and work in concert with our Luxembourg office on AEW Capital Management's new fund targeting retail and office assets in Asia.

But is there a tension in a regulated industry between innovation on the one hand, and necessary checks and balances on the other?

The answer to that is that the relationship between the two, in the Channel Islands at least, might be better described as a state of healthy equilibrium.

The willingness of regulators and governments to make regulatory and legislative amendments to enable innovation to take place, not to mention the constructive attitude in terms of employee licensing, is matched by clear endorsement from international bodies. Just this year we have seen pleasing reports from Moneyval into Jersey and Guernsey, and an indication from ESMA that there is "no significant obstacle" to the granting of an AIFMD passport to both islands – both developments indicate that the appetite for innovation in the islands is not at the cost of proper regulation and supervision.

The next big test for regulators comes in the form of virtual currencies – how will they apply the same checks and balances to currencies outside of the traditional banking framework, and in which transfer of value from one jurisdiction to another is almost instant. It's worthy of note that Jersey's response is worthy of note, creating a "regulatory sandbox" allowing experimentation and development of virtual currency applications without heavy regulation up to a £150,000 turnover threshold.

On a related note, Guernsey has recently launched a consultation directed at establishing a

bespoke regulatory structure for crowd-funding platforms and similar retail-focused alternative funders – recognition of an unquestionably growing area.

A final thought: innovation is not just increasingly important, it's increasingly rapid.

The term "Silicon Valley" was coined in the 1970s, decades before it became what it is today. In 1980, the population of Shenzhen in China was around 30,000, only slightly more than St Helier. Today, it's a technology and manufacturing hub with an estimated population of 11 million. And Estonia's embrace of a digital future only began with their "Tiger Leap" project in the 1990s – their digital sector today contributes an estimated 15% of GDP.

The changing factor is technology – and the key point is not just that it has accelerated the pace of change and innovation but that it continues to do so. The future for the Channel Islands may be closer than we think.

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Meet the Author



[Emily Haithwaite](#)

Group Partner, Ogier Legal L.P.

Jersey

E: emily.haithwaite@ogier.com

T: [+44 1534 514072](tel:+441534514072)

Key Contacts



Niamh Lalor

Partner

Jersey

E: niamh.lalor@ogier.com

T: [+44 1534 514210](tel:+441534514210)



Sophie Reguengo

Partner

Jersey

E: sophie.reguengo@ogier.com

T: [+44 1534 514122](tel:+441534514122)



Matt McManus

Managing Associate

Jersey

E: matt.mcmanus@ogier.com

T: [+44 1534 514434](tel:+441534514434)



Brooke Lewis

Associate

Jersey

E: brooke.lewis@ogier.com

T: [+44 1534 514074](tel:+441534514074)



Tim Clipstone

Partner

British Virgin Islands

Guernsey

E: tim.clipstone@ogier.com

T: [+44 1481 752265](tel:+441481752265)



Bryon Rees

Partner

Guernsey

E: bryon.rees@ogier.com

T: [+44 1481 752312](tel:+441481752312)



Michelle Watson Bunn

Managing Associate

Guernsey

E: michelle.watsonbunn@ogier.com

T: [+44 1481 752220](tel:+441481752220)



James Hewlett

Associate

Guernsey

E: james.hewlett@ogier.com

T: [+44 1481 752233](tel:+441481752233)

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