

Industry Presentations – 23 November 2012

Investment Business Division Presentation

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Introduction

Thank you Carl and good afternoon everybody.

My 10 year old son asked me this morning why I was looking so smart for a Friday. When I explained I was giving a presentation at St James, quick as a flash he responded “Oh Mum yes I know that’s where you stand up and say Blah blah blah and the audience fall asleep.” I would like to know how he got hold of last year’s feedback forms but I will endeavour to ensure I keep you awake this year.

A few weeks ago I was sat in the departures lounge of Heathrow terminal 5 awaiting a flight to Luxembourg where I was due to spend an interesting couple of days attending a meeting of collective investment scheme supervisors imaginatively entitled “the enlarged contact group” (it was a contact group and its membership grew so it became the enlarged contact group – you can see my point on imagination). Anyway, as I was sat waiting for my flight I switched off from reading the latest updates on AIFMD and MIFID and tuned into the conversation the gentleman sat opposite me was having on his mobile phone. This man was quite clearly in the “widget” making business, in this case valves. He was explaining at length and in some detail to the person at the other end of the line how valve type 4.6 would be a better fit than the 6.8 valves.

There were a few things I learnt from this conversation:

- 1) More information than I will probably ever need to know about valves
- 2) I felt it proved that a profession does exist, despite what people might say to me, that is potentially more tedious than regulation and;
- 3) Be careful what you say at airports as you never know who might be listening.

That said I suppose what attracted me to the gentleman’s conversation in the first place was his obvious enthusiasm for the topic. Rather like widget man, the team at the Commission, particularly in the Investment Business Division are enthusiastic about what we do; not because we are power hungry megalomaniacs but because we care. I know that all sounds very fluffy so let me expand.

The legislation that we work under in the Investment Business Division does what is says on the tin “The Protection of Investors (Bailiwick of Guernsey) Law, 1987.” Take that and consider for a moment the field in which you are all involved for a living; essentially it is based on trust.

Your clients and indeed many of us in this room at a personal level, undertake a real act of trust when hard earned money is handed over to professionals like you, to the asset managers, investment managers, fund managers, stock brokers and all the support service providers like administrators and custodians. When they do so, clients are entrusting to those professionals their future, the means by which they may live out their retirement, the means of paying for health care if needed and even their children’s future.

That is why the Commission focuses so carefully on the integrity and skill of the professionals looking to operate in or from within this jurisdiction and I will cover integrity and skill in more detail a little later.

As well as the impact on investors, we are of course very aware of the importance of the Finance Industry to Guernsey itself, as was clearly outlined by Dr Andy Sloan in his presentation this morning. Myself, Carl and Louise, are all either locally born and bred or married to those that were. We live in Guernsey and between our respective families we have 5 school age children. We are not simply in Guernsey for a few years as a stop gap before retiring (none of us are that old – despite appearances) nor is working for the Commission a stepping stone in our careers. Between us we have served 40 years at the Commission (that makes it sound like a prison sentence).

I wanted to start on this point, not because we are hoping ITV will commission a new series entitled “Island Regulator” but just to give you the context of how we think and how we approach our work.

Moving to main thrust of my presentation as Carl said I will be covering this afternoon our divisional objectives for 2012, what they were and the progress made in achieving them; followed by trends and themes we have seen from our activities over the past year.

Divisional Objectives

Financial services regulation is not about regulating the production of widgets; there is nothing standard about your clients or the services that you provide. The problems you encounter are wide ranging and the solutions you seek are different in type and measure. Therefore when I realised that I was due to speak to you about the divisional objectives for the past year my heart sank a little as I knew there was a reasonable chance given the reactive nature of our work to all the differing aspects of your work, not to mention the international perspective as described by Carl, that the IBD divisional objectives may not have been met.

We had set ourselves four Key Objectives for 2012. As part of the Commission’s commitment to being more transparent with industry each division published its objectives in the 2011 Annual Report. For the purposes of the slide I have paraphrased them however,

if you wish to check they can be found in full on page 29 of the Commission's Annual Report which is available to download from the Commission's website.

- The first key objective was to implement the Class B Rules during the first half of 2012 having undertaken a public consultation process and provided detailed feedback as part of that process.

Well there's no getting away from it, quite clearly we did not achieve that deadline. However, a working party was established and a consultation was run from which feedback was provided. I am reliably informed, but I will let Carl answer any questions on this subject you may have later, that the penultimate step, as a matter of good governance, was for the rules to undergo a legal review. This review has been completed. Once Carl has completed his last review the final step will be for the Commissioners to approve the rules in the near future. Given the delay I would like to reassure you that once the rules are finally issued we will ensure there is at least a 4 month implementation lead in time before the rules will become effective.

- The next objective was to conduct self-assessments against the IOSCO Principles of Securities Regulation and consider the action required, including the extent and nature of any changes to legislation or underlying rules and regulations.

This I am pleased to say has been completed and we found we were largely in compliance. We have identified some areas requiring changes to the law, for example one of the main ones being the requirement for supervision of any credit rating agency seeking to establish itself in the jurisdiction.

Given the example of supervision of a credit rating agency the relevance of a self-assessment against IOSCO principles may not be immediately apparent to all but we have to be able to demonstrate compliance to a level that is acceptable for us to remain as a signatory to the IOSCO Multilateral Memorandum of Understanding, which in turn means we will be able sign MoUs with, for example, the European Securities and Markets Authority (ESMA) in relation to Alternative Investment Fund Managers Directive (AIFMD).

- Indeed this international engagement formed our next objective. We undertook to continue to engage with European authorities, including ESMA, the UK FSA (and its successor body) and other European national regulatory authorities in respect of AIFMD to consider the nature of any changes required in Guernsey's regulatory framework, including the access of Guernsey investment funds for marketing to EU – resident investors.

Together with the other Crown Dependencies we have been in discussion with ESMA over the signing of a MoU. This would be a MoU with all the regulatory authorities of the EU member states as signatories avoiding the need for us to negotiate individual MoUs with each member state. We have completed a questionnaire for ESMA and commented on a draft MoU but the process is currently on hold as we and ESMA await the issue of the final regulations by the European Commission.

In its widest context, international engagement also covers the cooperation between jurisdictions and the sharing of information for example on trading undertaken by Guernsey entities on exchanges including the London Stock Exchange. Where information is sought via the Commission from our licensees, generally the asset managers, we endeavour to ensure the information being requested is relevant and is being sought via the appropriate gateways.

- The fourth key objective was to continue to prioritise on-site visits undertaken by the Division on a risk-based approach and increasing the focus on risk based supervision more generally.

Our visit schedule for 2012 was determined on this basis. During the year we have undertaken 11 visits to a range of entities but all scheduled with a mind to that premise of what is the risk? It is worth mentioning that those 11 visits were physical visits to licensees which also covered administered licensees and funds.

The risk based approach allowed us to undertake the visits we needed to but the awareness of the risk allows us to maintain flexibility. Our visit schedule for 2013 will be determined on the same basis. As for any other objectives for 2013 we do not have a crystal ball but as Carl has said we already know AIFMD & MIFID will no longer be sitting on the horizon but instead charging full steam into view.

But back to 2012 and we did achieve 3 of our 4 key objectives. However, the deadline on the Class B Rules did slip so what was it that prevented us from completing the rules on time? This leads me to the second part of my presentation; Trends and Themes since we met last year. Here I would like to touch on a few areas, in addition to the international pressures that Carl outlined, which demonstrate how we have been kept busy.

Trends and Themes since 2011.

- Fast Track Applications

The fast track application process works well. It is popular with Industry – as the statistics show. For the year to date 46 licences have been issued of which 30 were submitted via the fast track route. As for open ended funds 8 from a total of 12 were Registered funds or QIFS and of 59 closed ended funds 52 used the fast track regime. The process generally works particularly well for existing promoters within the jurisdiction and for promoters well established in other jurisdictions. The process can be more challenging for administrators submitting applications for new promoters and start up entities. All of the designated managers in the audience will have received a letter from Carl earlier this month outlining our recent experience with fast track applications which led to us amending the warranties associated with the fast track application process.

I do not intend to repeat verbatim the contents of that letter however, GIFA has asked us to provide further clarification on a couple of points in the letter and I would like to take this opportunity to do so.

An individual's employment history for the previous 10 years is required as per the guidance note for completing the Forms PQ. We recognise that licensees may experience difficulties in attempting to verify the accuracy of information disclosed on Forms PQ regarding the employment history and professional qualifications. Licensees can however, adopt a risk based approach to this. A documented assessment as to why the licensee has not gone to the nth degree to verify these matters is sufficient. That said we would expect the contents of a CV which has been attached to a Form PQ to have been at least compared to the information in the Form PQ.

Licensees are apparently also concerned over verifying the completeness of Forms PQ. We appreciate that difficulties may be encountered over performing this task; again a risk based approach may be adopted but at the basic level a licensee should review the Form PQ to ensure all sections are fully completed.

Where you have issues on either of these areas or any other matters associated with a fast track application you are very welcome to refer them to us prior to submitting the application.

A small but growing number of cases gave rise to the need to issue the letter and indeed to implement our enforcement process. We have imposed conditions, with the agreement of the Boards of the Directors, on seven licensees that they pre-submit their written assessments and copies of documentation to support their assessment of fitness and properness of the parties to the application; and that the normal timeframes for considering fast track applications will only apply once the Commission is satisfied with the due diligence. The guidance note on the fast track application regime states that if the warranties provided are found to be defective, or misleading, in appropriate cases the Commission would consider excluding licensees from future participation in the regime.

These cases where conditions have been imposed have generally involved poor or insufficient due diligence however, more recently we have noticed a rising trend in applications being submitted in respect of fast track applications without all of the supporting documentation/information required. In a very recent example financial statements of the promoter and prospectuses of established funds were missing from the submission. These documents, key to demonstrating track record, solvency and integrity, had been sourced by the administrator but simply not submitted to us. All applications are reviewed upon receipt for completeness and the applications team contact licensees where information is missing. The Commission can only process a licence application within 10 business days if all of the required information/documentation has been submitted and consequently this has led to delays.

But as I said, for the majority of firms the process works and works well. We have raised these issues now so that they can be nipped in the bud and allow the process to continue to be successful in the future.

I have included in this section two supplementary points which I would like to discuss briefly.

- Non-Guernsey Schemes

You will have seen that we issued on 14 November 2012 the consultation on the revised application process for the non-Guernsey schemes. This is a move to help reduce the regulatory burden and ease the process for licensees applying to undertake activities for non-Guernsey schemes. The proposals for revised process include:

- 1) removal of the “traditional” approval and Qualifying Investor Fund options in relation to the applications process for open-ended non-Guernsey schemes;
- 2) The introduction of a two-day approval process for all applications by licensees seeking to undertake the restricted activities of administration and/or management in respect of open-ended non-Guernsey schemes.
- 3) This process requires certification warranties, to be made by the applying licensee, of a similar nature to the qualifying investor fund route and nearly identical to those required for the registered fund route;

The information required for a licensee to satisfy themselves in order to be able to sign the warranties does not have to be obtained by requesting the completion of a Form PQ from a relevant individual, nor are such Forms to be submitted to the Commission. This is another means by which we are aiming to ease the regulatory burden.

Our discussions with the custodians over the NGS application process in respect of custody based applications are ongoing.

- Forms PQ

Moving to Forms PQ in another context – Change of Controllers. Again as a means of reducing the regulatory burden we are considering removing the requirement for Forms PQ for the directors of any proposed controller and instead request names, addresses and dates of birth of the directors to enable the Commission to conduct high level due diligence. Of course Forms PQ will still be required for any individual with a controlling interest of 15% or more.

Following the strengthening of the Form PD at the beginning of this year we feel the Form 28A is now redundant in respect of proposed Directors. We are therefore considering requesting that a Form PD is completed in advance of the application

instead. Ultimately this means that there will be one less form to complete. Once we have completed our deliberation on these points we will advise you all.

- Intervention

Over the last year we have, through our regulatory due diligence and via intelligence received, intervened in applications and dissuaded parties from entering our jurisdiction. The issues here have been identified solely through the regulatory checks we have undertaken. The local licensees involved in the applications would not have been able to identify this information for themselves. Intervention takes time and a great deal of effort, as we have to be sure we have considered matters correctly and allowed relevant parties the right to respond as appropriate. However, we think it is worth it, because as any good bouncer will tell you it is easier to turn away people at the door than having to turf them out when they've overstayed their welcome.

Intervention is one of the reasons we stress the importance of the standard of the application. If the applications reach us in good order it means we can be left to do the work we actually should be doing.

- Funds with problems

We have been and continue to see the fallout from the financial crisis including funds with problems or should I say funds facing challenges. Funds are experiencing performance difficulties leading to the implementation of a whole range of measures from redemption gates, to restructuring and unfortunately to situations where proceedings for winding up both compulsorily and voluntarily have been necessary. In addition we have also seen instances of entities being placed into administration. These issues are not unexpected and are not necessarily of regulatory concern.

We have seen some excellent examples of how to manage these types of challenges. The most effective have involved active participation by all the relevant parties, the board of the fund, the administrator, the investment manager and any custodian. That is not to say that the discussions between these parties are always easy, far from it, but it is clear that each has understood the responsibilities expected of them. By the time they meet with us any issues have been ironed out, although there may still be questions they wish to raise with us. These matters take up time but they take up even more time where the parties are not communicating effectively.

- Investor communication

Probably the most vital area for communication is that with your investors or clients. Usually our contact with investors or clients arises out of complaints received – you will not be surprised to hear that we very rarely receive calls from investors commending licensees. I have spoken directly to investors and very often even though they have received bad news about the performance of their investment, what

they value highly is to receive information, and to do so without having to chase for it, or obtain it via the regulator. Where adviser or intermediary relationships are involved we encourage the Boards of funds or any licensee to try to ensure that the information is actually reaching the investors themselves.

Communication with investors impacts on the asset managers as well the fund managers and administrators. We receive complaints from clients of the asset managers as well as the fund sector, but in addition the asset managers may also be in the position of being the client invested in some of the funds facing challenges that I referred to earlier.

- Applications received.

We are often asked if we are busy, generally this is by advocates who measure our level of activity by how many applications we are receiving. Usually when I'm asked my response of yes we are busy is a reflection of the matters I have just described to you rather than due to applications. But is fair to say that applications have continued to flow into the Commission over the period since the crisis. The slide shows the number of applications received for the year to date (or last Friday to be exact). On a personal level I am respectful of an industry that despite difficult circumstances has been able to bring the levels of new business to the jurisdiction that we have seen.

We also undertake a range of other activities, probably all the things you might expect us to do including for example, training our staff to ensure they are well informed. Attending relevant conferences often forms part of that training. Earlier in the year Carl was invited to attend the Guernsey Fund Forum in London, unfortunately he was unable to attend and so I went in his stead. One of the panel sessions was entitled "Regulation Never Dies". Naturally I was listening intently to this panel. However, I did nearly fall off my chair when I heard one of the panellists say "after all regulators are only human" and even more surprisingly no one contradicted him. I have to say it was heartening to hear as we are so often referred to as "the Commission" by all parties including ourselves and it is easy to forget that the Commission is simply a collection of individuals attempting to do a job to the best of their abilities.

When I left industry to join the Commission I was understandably quite apprehensive about crossing over to the "dark side". So I asked my then Managing Director, who will remain nameless as he is still very active in the Industry albeit as a NED now, I asked him to be sure to let me know if working for the Commission ever changed me. He said what I took at the time to be a kind compliment, "it would never change you Emma". With hindsight, ten years' worth, it has occurred to me that perhaps he was trying to imply there was no hope for me and the Commission was always the best place for me.

Thank you for your attention this afternoon.

There is now an opportunity for you to ask the three of us any questions you may have. There are a couple of my colleagues dotted around the room with roaming microphones so if you have a question please could you make yourself known to them.

