



Guernsey Financial
Services Commission

Industry Presentations – 23 November 2012

Investment Business Division Presentation

Carl Rosumek, Director

Introduction

Good afternoon ladies and gentlemen and welcome to the Investment Business Division's annual industry update. For those of you who don't know us, I am Carl Rosumek, the Director of Investment Business and joining me for this session are my Deputy Directors, Emma Bailey and Louise Bougourd.

Before we make a start on the session please can I deal with the relevant housekeeping points:

- Please can you ensure that you turn off your mobile phones/Blackberries and other electronic gadgets;
- I hope that you have all signed in order to obtain relevant CPD.
- If for any reason we do have to evacuate the building, the fire exits are at the front and back of the hall as pointed out. If you notice a fire please activate a break glass panel (located next to the emergency exits) which will activate an alarm which is audible in this hall.
- The slides and presentations will be published on the Commission's website from Monday 26 November.
- Finally, there are feedback forms and we would be grateful if you would complete them and return them to a member of staff before you leave today.

During our session today I will begin by providing some comments on the international perspective, especially the ongoing saga that is the Alternative Investment Fund Managers Directive (AIFMD) together with its slightly younger brother, the Markets in Financial Instruments Directive (MiFID). I will then move onto look at some of the Commission wide developments that have occurred in the last year, including those resulting from the Commission's Independent Evaluation Review that was mentioned this morning.

Emma will then bring things into a more divisional focus by considering the objectives that were published earlier this year in the Commission's Annual Report before finishing off with various trends and themes seen during our regulatory work over the past twelve months.

Finally, there will be an opportunity for questions at the end of the presentations.

International Issues

Alternative Investment Fund Managers Directive

Whilst it might be tempting for the non-fund sector representatives in the room to lose concentration at this stage, the argument being that AIFMD does not apply to me or my firm, I would suggest that you do listen as a number of issues arising from the work undertaken to date on AIFMD and to be undertaken are likely to have to be considered when we focus on MiFID.

I do not wish to comment in detail on the history of the AIFMD, the various turns it has taken and the detailed work already conducted not just by the Commission, but by the States of Guernsey and the Guernsey Investment Funds Association (GIFA). Instead I want to focus on where we are now and look into the future in terms of what is likely to happen and what we as a jurisdiction need to do.

The Directive was adopted in its final form in November 2010 and it must be implemented by Member States by 22 July 2013. Work commenced on the Level II Rule making provisions during 2011 with the European Securities and Markets Authority (ESMA) providing technical advice during that process.

It had been expected that the final Level II Rules would be published during the middle of 2012, albeit that was changed to September 2012, and that quickly became October. Recently the timing that has been mentioned is December 2012, although there is no certainty that this will be achieved and “early next year” has also been mooted, albeit that at the time of writing this speech 21 November has also been mentioned for publication. Unfortunately the deadline of 22 July 2013 I mentioned a minute ago is laid down by the European legislative provisions so is, at this time, set in the proverbial concrete. Whilst there is speculation that some form of amending directive may be adopted in order to push back the 22 July 2013 deadline there is currently no confirmation whether that is a viable option or indeed whether it will be taken up. So where does that leave Guernsey?

As mentioned earlier the Commission, States of Guernsey and GIFA have been monitoring the situation and considering the regulatory regime that would be required in Guernsey once AIFMD is fully effective. The Commission had previously indicated that it was looking at the implementation of two regulatory regimes for investment funds established and regulated in Guernsey. Whilst a number of fund promoters have a direct interest in the AIFMD due to the structure of their funds including EU participants or the funds being marketed into the EU there are other promoters who have no such interest as their products do not in effect touch Europe. Adopting a single regulatory regime that solely focuses on the European issues risks adversely impacting this non-EU directed business. Many, if not most, of you will have seen the Guernsey Finance News Release of 6 November 2012 confirming that proposition, ie dual regimes. In effect, and as outlined in that News Release, the issue will become a commercial decision for promoters, does the fund need to fall within the scope of AIFMD or can it remain outside?

As you are all aware, the current legal position in the Bailiwick is that any investment fund established in this jurisdiction must be regulated by the Commission, therefore we do not have a concept of unregulated funds. The legislation, predominantly the Protection of Investors Law, provides the regulatory foundation that is required and changes to that

foundation are not envisaged for AIFMD purposes. What we have to do is focus on the rules and regulations made under the law and against which compliance is assessed.

A couple of months ago following discussions between Jarrod Cowley-Grimmond, the Director of Finance Sector Development at the States of Guernsey Commerce and Employment Department, Neale Jehan in his role as Chairman of GIFA's Technical Committee and myself it was agreed that a working group would be established to begin work on drafting the necessary rules. That group consists of members of the Investment Business Division together with industry participants who have expressed an interest to be actively involved in this work. Due to the expected volume of work that is required it would not have been possible for the Commission to resource it alone and I am extremely grateful to those industry participants who have stepped forward, especially Neale Jehan for co-ordinating participation to date.

Whilst there is still uncertainty as to the final version of the Level II Rules it is felt that there are sufficient areas within that framework that are unlikely to change to which we can turn our attention and begin work. In that respect the first meeting of the working group has been arranged for next week.

In addition to the rules forming the regulatory framework we have also been liaising with ESMA in respect of the Commission's application to sign up to the relevant co-operation agreements that will be a requirement for Third Countries seeking to conduct business with the EU within the scope of the AIFMD. This is an important aspect of the overall regime and the relationship between the Commission and the European regulatory authorities is something that is likely to need to be considered in relation to other EU Directives that have some element of Third Country focus. The Commission remains optimistic that it will be able to sign the relevant agreements. One issue to highlight today is that under the requirements of the agreements an EU regulatory authority may wish to conduct its own visit to Guernsey based licensees. This is something that the Commission already has experience of, especially in the Banking and Investment Business sectors. The Commission would obviously expect the relevant authority to contact us in advance of such a visit and we would normally wish to have a member of Commission staff accompany the visiting regulator to all or part of their licensee visit. Whether in terms of the future in relation to the AIFMD or the here and now I would remind licensees that they themselves should inform the Commission about any proposed visits as we are not always contacted by the relevant authority.

Markets in Financial Instruments Directive

This directive has also been on our radar for a while now, albeit that it has not received the same level of attention as the AIFMD.

Scholars of the proposals previously released will recall that provisions were included to introduce rules regarding the establishment of branches within the EU by third country firms who provide, or are seeking to provide, investment services to clients other than eligible counterparties. That definition goes beyond the servicing of just retail clients. The branch would not be able to be authorised until the Commission has made a determination about whether the home jurisdiction of the third country firm provides equivalence to the requirements set out in MiFID and the Capital Adequacy Directive. Whilst it appears to be accepted that some form of European harmonisation is required the proposals as set out, depending upon assessments of equivalence and reciprocity of recognition would mean that few countries are likely to pass.

In July of this year the House of Lords European Union Committee published a report “MiFID II: getting it Right for the City and EU Financial Services Industry”. That Committee concluded that: “the MiFID II proposals have been rushed, and risk creating confusion rather than providing clarity in terms of the regulatory framework for investment. It is important to get the proposals right than to get them passed quickly”.

In terms of Third Country issues the Committee commented that:

“Whilst we recognise the legitimate desire to introduce greater harmonisation across the EU in relation to third country access, the Commission’s proposals are deeply flawed. There is a risk that, if introduced, such provisions could lock third country firms out of the EU markets, which, taking into account the risk of regulatory retaliation, would have an extremely damaging effect on European financial markets, and in particular the City of London..... Given the vital strategic importance of the UK financial sector, not only for the domestic economy but also the EU as a whole, and also given its international character, we urge the Government to work to ensure that any provision on third country access will not have a detrimental effect on the UK financial market or on the EU financial sector as a whole. We support the Government’s view that lengthy transitional periods for existing firms would be essential”.

Since the summer of 2012 there have been a number of compromise texts issued by the EU presidency, the latest being earlier this month.

In the past two weeks I have spoken with representatives of the Guernsey Investment Managers and Stockbrokers Association to consider the approach that Guernsey needs to adopt. We agreed that at this stage it requires a detailed watching brief so that the substantive issues are given due consideration and that appropriate work can be undertaken, including dialogue between the Guernsey Financial Services Commission, the States of Guernsey and relevant EU agencies and bodies. In effect, we are looking at a similar approach to that taken on AIFMD.

One overarching comment that I would make, not just relating to the AIFMD or MiFID, but to European Directives generally is to remind you all that the United Kingdom falls within the scope of those Directives and that their implementation and/or development may have a direct impact on licensees doing relevant business in the UK context. It is easy to focus all of the attention onto Continental Europe and forget that the UK should be seen in the same light.

On a related point I would remind you that the States of Guernsey Commerce and Employment has commenced a consultation on the retail distribution review which runs until 2 January 2013.

IOSCO (International Organisation of Securities Commissions)

I will finish this part of the presentation with a few words in respect of IOSCO.

IOSCO is recognised as the international standard setter for securities markets. Its membership regulates more than 95% of the world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies. IOSCO members

are drawn from, and regulate, over 100 jurisdictions and its membership continues to grow. The Commission is an ordinary member of IOSCO.

During the past couple of years IOSCO has been reviewing its strategic direction, including the role played by member organisations. As part of that review, earlier this year the Commission was accepted as a member of the IOSCO Committee on Enforcement and the Exchange of Information (in IOSCO speak, Committee 4). This committee focuses on the co-operation that securities regulators can provide to international counterparts in the context of their statutory functions, both of a routine nature but especially in cases of possible infringements of relevant legal provisions, for example possible market abuse or insider dealing cases.

The recent economic and financial crisis exposed weaknesses in cooperation and information exchange between supervisors and there is a tangible move by the G20 countries and the standard setters for supervisory authorities to improve the standards in practice in these areas. It is difficult to conceive of any supervisory authority arguing against the importance of cooperation and information exchange as a prerequisite for effective supervision, particularly in the context of financial groups. Nevertheless, there is a desire by the supervisory community to seek to ensure that confidential information disclosed from one supervisory authority to another remains confidential. The concept of confidentiality is also embodied in the international supervisory standards. Supervisory authorities, including the Commission, will not disclose confidential information to their counterparts unless they are comfortable that the confidentiality of such information is maintained.

As I have outlined in previous industry briefings the Commission takes its responsibilities seriously when it comes to international co-operation, my earlier comments on the AIFMD indicate how serious an issue this is in terms of maintaining the relevant status with the relevant European authorities. The Commission's participation in IOSCO Committee 4 will allow it to actively participate in discussions relating to these important issues as well as contributing to the formulation of future international policy.

Commission Developments

The following issues were covered to some degree or other in this morning's presentations, however I am aware that not all of you attended those sessions so thought it would be useful to comment on them now.

Independent Evaluation Review

As a result of the implementation of Ernst & Young LLP's Independent Evaluation Review ("IER") of the Guernsey Financial Services Commission two regulatory/supervisory functions have been centralised to improve efficiency and consistency. An Authorisations Unit and an Anti-Money Laundering Division have been established. Previously these functions were undertaken separately by and within each of the various divisions.

Authorisations Unit

Owners, directors and senior management of regulated firms are required to meet fit and proper criteria. Though the processing of approximately 1,700 personal questionnaires and approximately 1,600 personal declarations each year updating relevant individual's circumstances the Commission is able to make, or update, its assessment of those individuals

against the criteria. The Authorisations Unit will be responsible for the processing of those forms and as a result the following benefits will be achieved:

- There is a single point of contact and response for Forms PQ and PD;
- There is a common and consistent approach for dealing with Forms PQ and PD;
- Forms PQ and PD will be immediately recorded and dealt with sequentially, removing the peaks and troughs previously seen as divisional level;
- There will be a common approach to due diligence;
- Enhanced IT provides real time status of the submissions.

During the course of 2013 the Authorisations Unit will also come to assume further functions in the processing of authorisations.

AML Division

The establishment of the AML Division will achieve the following benefits:

- Better co-ordination of on-site visits to minimise inconvenience to licensees. Co-ordinated regulatory division onsite visits will occur concurrently;
- An AML/CFT Questionnaire has been implemented for completion by licensees prior to an on-site visit. This will provide the AML Division with a greater understanding of the business prior to commencing the visit and will increase efficiency and optimise the time spent during visits;
- The application of standardised AML and CFT processes will provide an efficient, effective and consistent approach;
- Centralising the AML functions across all areas will provide a focused centre of expertise;
- The AML Division will enable the Commission to apply a Commission-wide risk-based approach to anti-money laundering and financial crime surveillance, which is consistent with the revised international standards published by the Financial Action Task Force.

Data Management Unit

The third aspect of the IER related to the centralisation of data management into one unit. Work has commenced on the implementation of that unit, including consideration of the processes and procedures for which the unit will be responsible. As with the two functions referred to above efficiency, effectiveness and consistent delivery are key focuses for the team involved in that work.

Enforcement

Emma will comment later on the operational issues that the Division has encountered in the context of enforcement but at this time I wanted to highlight an issue covered by the Commission's Legal Counsel at this morning's presentations.

The Commission is proposing to publish a number of explanatory notes on the Commission's website at the beginning of 2013. The notes will relate to certain powers of the Commission which include powers of the Commission to impose sanctions or make application to the Royal Court. This follows on from comments made at last year's industry seminar and subsequently in relation to the Commission's undertaking to adopt a more transparent approach in relation to how it uses the various powers available to it.

The notes that will be published will describe some of the Commission's powers and its existing approach towards the use of those powers. The Commission has not developed notes in relation to all of the powers, but has instead focused upon those sanction powers about which it is most frequently asked questions about in relation to their scope and its approach when considering whether to use them. The notes reiterate the concepts documented in the Commission's Enforcement Policy posted on its website. Going forward, the Commission intends to publish further notes relating to the Commission's supervisory functions.

As I mentioned a few minutes ago, the publication of the notes is an attempt by the Commission to be more transparent in its approach to enforcement, the notes relate to the powers already in place, they do not go beyond those neither do they attempt to amend the Commission's existing Enforcement Policy or its approach to enforcement.

Anti-Money Laundering Handbook

As part of its continuing commitment to ensuring that supervisory standards are up to date and appropriate, the Commission is preparing revisions to its regulations and rules governing anti-money laundering (AML) standards for financial services businesses as well as prescribed businesses. These revisions largely arise from the Commission's findings during on-site visits and from comments made by industry. A number of the changes will be of particular benefit to industry.

The amendments will include:

- A more sophisticated approach for firms in risk profiling their customers. Approaches to risk by industry internationally and locally have developed considerably over the last few years. The Commission's rules will reflect this. The changes will be particularly beneficial for Guernsey firms which are part of financial groups as they will allow those firms' procedures to mesh more easily with group procedures; feedback from industry indicating that "one high all high" risk profiling methodology has been especially challenging for such firms.
- Revisions to the "likely to benefit" rules, so that, other than in high risk situations, there will be more flexibility for firms in the timing of verification of identity of beneficiaries of trusts falling within the rules.

- A new chapter providing guidance for firms in relation to bribery and corruption, which are of increasing international concern as crimes in their own right as well as motivations for money laundering. The new guidance will assist Guernsey – and Guernsey firms – to focus on this concern.

The revisions will be issued in the New Year and, where necessary, firms provided with a transitional period so that they can amend their policies, procedures and controls before the changes come into effect.

The Sentinel Programme

The Extranet project is now called Sentinel, as we have identified that it is more comprehensive than just online submissions – it is an operating platform for the future. A dedicated team under the direction of the Commission’s Chief Transformation Officer, Tim Loveridge, is tasked to deliver a comprehensive set of recommendations on the scope, route, benefits and recommended approach to the Commissioners in January.

The team have split the project into “5 pillars”:

- Extranet – this covers online submissions and licensee engagement. The Commission is exploring opportunities with other regulators, including Jersey.
- Operating platform – The Commission is looking at the best way to integrate Workflows, Document Management and build on our CRM investment.
- Risk Based Supervision methodology – discussions have commenced with other regulators who have already implemented a similar programme.
- Data structures – the creation and management of the data we need to feed the systems.
- Reporting methods – what are the industry standards that the Commission needs to embrace?

The intention is to take a modular, phased approach and buy-in proven technologies wherever possible. The programme will be underpinned by change management best practise, including looking at training needs and how we address those so that everyone can use the tools effectively. Through GIBA, a working party has been established with industry, which will meet monthly.

The implementation of the various aspects of the Sentinel Programme will enhance the Commission’s risk based supervisory approach, an approach that is increasingly used by financial services regulators across the globe and which is used to direct the regulatory effort. Under a risk based approach the most significant firms, those with an ability to have the greatest impact on financial stability, including the Bailiwick’s reputation, and the consumer, will receive a high level of supervision under structured engagement plans, leading to early interventions to mitigate potential risks. Firms which have the lowest potential adverse impact would be supervised reactively or through thematic assessments. That is the vision.

Ladies and gentlemen thank you for your attention this afternoon, I will now hand over to Emma.