

Guernsey Financial Services Commission

**Consultation Paper on Proposals for Private Investment
Funds**

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Responses to this Consultation Paper are sought by 1 February 2021.

We welcome and encourage respondents to provide feedback or comment on any section and question. Feedback may be provided via the Consultation Hub section of the Commission's website (www.gfsc.gg).

Background

In July 2020 the Guernsey Financial Services Commission published a Fund Growth Omnibus Discussion Paper¹ (the “Discussion Paper”) seeking feedback on proposals in relation to the Private Investment Fund Rules 2016 (the “PIF Rules”)². The PIF Rules require that a Private Investment Fund (“PIF”) has within its structure a licensee responsible for management. When considering an application for the registration of a proposed PIF, the Commission relies on certain declarations made by the proposed licensed fund manager. The fund manager makes declarations in respect of:

- prospective investors’ ability to sustain losses;
- the maximum number of investors; and
- the completeness and accuracy of the application.

The Discussion Paper invited comments on three proposed alternative approaches to PIF registration which might be introduced in addition to the current approach. Each suggested approach would not place reliance on a licensed manager, thereby potentially removing the need to make a related Protection of Investors Law³ (PoI) licence application, along with the associated costs, in respect of each new PIF application.

¹ https://www.gfsc.gg/sites/default/files/20200707%20-%20Funds%20Growth%20Omnibus%20Discussion%20Paper_0.pdf

² The Discussion Paper made a number of different proposals in addition to those relating to the PIF Rules. Each of these proposals will be addressed in separate consultations, based on appropriate timetables, with a Consultation Paper on Proposals for Non-Guernsey Schemes due to be published in December 2020.

³ Protection of Investors (Bailiwick of Guernsey) Law, 1987

Consultation feedback and analysis

There was a healthy response to the Discussion Paper and the Commission would like to thank all those parties who provided comment. Although much constructive feedback was received other than broad agreement that an alternative option for PIF registration not involving an associated PoI licensed manager was desirable, there was little consensus as to an appropriate alternative.

Option A Placing reliance on a declaration made by fund directors

This proposal effectively suggested replacing the manager's declaration with a fund director declaration while at the same time extending PoI powers over the responsible fund directors.

Feedback received

Some respondents made the argument that fund directors may not be well placed to provide a declaration as to the investors' ability to absorb loss because they may not have a relationship with those investors, particularly in the case of non-executive directors.

There was also a lack of support for, and some objections to, the proposal to extend PoI powers over fund directors. Some responses suggested that the Commission's powers in respect of directors within the existing legal framework were sufficient for the Commission to place reliance on any declaration made. Others thought that these powers might be extended through rules amendment or that the Rules might be amended to limit the directors' responsibility to ensuring that there was a process in place to assess investor suitability.

Commission response

The Commission is sympathetic to the argument that in the case of many fund directors there may be no pre-existing relationship with investors and that such directors may simply not be in a position to make the necessary declarations. This of course would not be true of all directors but the question of the Commission's relationship with the declaring party must also be considered. Where this party is a PoI Licensee the Commission has a range of statutory powers which could be brought to bear in the uncommon event that vulnerable investors are put at risk as a result of a false declaration. The Commission is of the view that, even if there was an extension of powers under the Rules, that the same level of investor protection could not be assured.

Option B Placing reliance on a declaration made by an associated fiduciary licensee

This option suggested placing reliance on a local licensed fiduciary, instead of a fund manager, to make the investor-related declaration.

Feedback received

Generally this option was not well supported. First, the involvement of a licensed fiduciary in the origination of fund business was not regarded as a common circumstance and therefore this

proposal was regarded as likely to have limited impact if implemented. Second, a number of respondents raised the fundamental concern about the involvement of an entity licensed under the fiduciaries regime operating within an area governed by the PoI regime. It was suggested that such activity may stray into the scope of PoI licensable activity as the licensed fiduciary would be subject to obligations under this law.

Commission response

The Commission recognises both the cross-regime challenges represented by this particular proposal and also the relative lack of industry support and is not minded to pursue this option further.

Option C Defining a “qualifying private investor”

This proposal provides for an alternative whereby investment in a PIF is restricted to only qualifying private investors, a category of investor which would be strictly defined in such a way so as to bar “retail” investment in the fund.

Feedback received

A diverse range of views were received on this proposal. Some respondents were in favour of the concept of offering an alternative PIF qualification route based on a defined investor type although there was no consistent view on qualification criteria. There were suggestions that the criteria used in the existing Qualifying Investor Fund⁴ (“QIF”) overlay, or similar criteria, may be appropriate. Another suggestion was that the UK/EU concepts of professional client may be used. There was also some support to add a minimum individual investment as an alternative qualifying criteria.

Of those supporting this approach there was generally little support for the addition of further elements to this proposed PIF qualification route which might enhance investor protection such as limitation on marketing or increased disclosure.

Another view expressed in response to option C was that, as it is a truly private structure, investment in a PIF should not be restricted to persons meeting prescriptive, regulator-defined criteria but should be individually set by each fund. This view also aligned with a view that some restriction on marketing was appropriate given that investors should have an existing relationship with the fund promoter.

Commission response

While it is to some extent a simplification, it is possible to place responses into three groups.

The first group is not in favour of option C at all and broadly concerned with limiting any perceived increase in complexity in the PIF regime. The Commission is sympathetic to this view and this specific concern may be addressed through clear messaging on the continuing availability of the current qualification route and also through building on existing frameworks such as the QIF in looking to offer alternative PIF routes.

⁴ https://www.gfsc.gg/sites/default/files/QIF%20Guidance%20Note_0.docx

The second group are broadly supportive of option C, using local or internationally recognised investor eligibility criteria but is not supportive of other accompanying measures. A key consideration for the Commission is to ensure that the bar is set sufficiently high to ensure investor protection objectives continue to be met.

The third group take the view that investor eligibility criteria should be set by the fund itself because such criteria reflect a private, “bespoke” arrangement which is not marketed with a view to attracting third party capital. The Commission observes that funds would be free to apply narrow investor eligibility restrictions within a broader regulatory eligible investor definition but also recognises that where a fund is not publicly offered and restricted only to a defined group, such as a family, that the level of required regulatory investor protections may be lower.

Alternatives Suggestions

As part of feedback received there were a number of other suggested possible amendments to the PIF regime which included: removal of the requirement for annual audit and relaxation of the requirement for the completion of Personal Questionnaires by applicants. The Commission is not minded to view such suggestions favourably as these are fundamental elements of our approach to protecting investors.

Another suggestion made was that we look to expand declaring parties beyond locally licensed fund managers to other Bailiwick financial institutions or entities regulated in other jurisdictions. The former raises the same concerns as discussed in relation to option B, as described above, while the latter may raise issues of cross-border enforceability.

Proposals

Given the breadth of views expressed in response to our Discussion Paper it is clear that while there is strong support for amendment to the existing PIF Rules to offer greater flexibility, there are divergent views on how this might be achieved. A number of common themes can, however, be identified from responses:

- The current framework does work well for certain providers and clients, and should continue to be available.
- An alternative to the current licensed fund manager-reliant regime is broadly supported.
- Keeping the PIF framework simple and easy to understand is important.
- The PIF is not viewed as an appropriate investment for retail investors and in seeking to expand the PIF framework appropriate levels of investor protection must be maintained.

The proposals below are offered with the above considerations very much in mind but it should be appreciated that striking the appropriate balance between these sometimes less than fully aligned objectives is challenging.

A draft version of amended PIF Rules is provided at Appendix 1.

Route 1 – PoI Licensed Manager

The option to register a PIF in exactly the same way as one does today will remain. There will be no change to the applicable rules⁵ at the time of application. This will be described as “Route 1”.

Route 2 – Qualifying Private Investor

Recognising the strong support for a PIF model without an attached PoI licensed manager and an alternative route to registration is proposed with the following elements:

- a) All investors must meet qualifying criteria consistent with the definition of qualifying investor under the QIF regime⁶.
- b) The number of offers of units for subscription, sale or exchange must not exceed 50.
- c) Written disclosure must be made to prospective investors providing at a minimum information on the regulatory status of the scheme, investor suitability and risk warning. A draft form of guidance on the form of the disclosure is provided at Appendix 4.

Subject to the above, the PIF Rules as currently in place would apply.

At the time of application the PoI licensed fund administrator would be required to provide confirmations equivalent to those currently provided by a fund administrator in respect of any QIF application. A draft wording for the declaration is provided at Appendix 3.

⁵ The structure of the draft rules in Appendix 1 has been amended to reflect modern drafting standards, the addition of new application routes and in anticipation of revision to the PoI Law.

⁶ It should be noted that there is a proposed enhancement to the criterion for an individual investor who makes an initial investment of not less than US\$100,000 or equivalent, requiring that the amount invested represents no more than 25% of the individual’s investable assets.

Route 3 - Family relationship

Taking into account the view from a section of Discussion Paper respondents that the PIF should be a truly private structure it is proposed that a third route to registration as a PIF should be offered. This would firmly place the PIF as a private wealth structure, as opposed to a private wealth product. Using this route there would be a family relationship between investors and no capital raising from investors outside this relationship.

It is proposed that the following restrictions would apply:

- a) A family relationship must apply between all of the investors
- b) No capital may be raised by the fund from investors outside the family relationship

There would be no requirement to appoint a PoI licensed fund manager.

At the time of application the PoI licensed fund administrator would be required to provide confirmation that effective procedures are in place to ensure restriction to only eligible family-related investors. A draft wording for the declaration is provided at Appendix 5.

Changes to existing PIFs

All currently registered PIFs would continue to be registered under the proposed regime as they will meet the requirements under Route 1. If a currently registered PIF seeks to change the basis of its registration, to use either the new Route 2 or 3, then this will be treated as a new PIF application with a corresponding application fee being payable. Similarly if an existing PIF seeks to change registration to the RCIS Rules (“de-PIFing”) then it is proposed that a new application must be made which will incorporate a relevant form and fee.

Q1: Do you have any comments on the proposed Route 2 PIF qualification route?

Q2: Do you have any comments on the proposed Route 3 PIF qualification route?

Q3: What additional steps might be taken to ensure the PIF application process remains efficient?

Other PIF proposals

Basis of declaration

The Discussion Paper proposed that where an investor declaration is relied upon as a part of a licensed fund manager's assessment of investors' ability to sustain loss then an explicit requirement be placed on the manager to retain evidence of this assessment and to make this available to the Commission upon request. This proposal was broadly supported and it is proposed that an additional manager declaration be included in the application form for what would become a Route 1 application. Draft wording is provided in Appendix 2.

New promoters

The Discussion Paper proposed issuance of additional guidance to clarify the Commission's expectations in respect of due diligence to be performed by the administrator in respect of its declaration as to the fitness and propriety of the fund promoter. Respondents were broadly in favour of additional guidance but some cautioned that such guidance should be clear, concise and not introduce overly prescriptive requirements. Taking these comments into account it is proposed that guidance be issued, consistent with the long standing guidance applicable under the RICS regime. The proposed guidance on PIF promoter due diligence is provided at Appendix 6⁷.

Additional classes, sub-funds and cells

The Discussion Paper proposed the creation of a standardised declaration form for additional classes, sub-funds and cells. This was broadly welcomed by respondents and such a form will be made available.

Q4: Do you have any comments on the proposed addition to the manager declaration under Route 1?

Q5: Do you have any comments on the proposed promoter due diligence guidance?

⁷ The proposed guidance uses wording broadly consistent with guidance currently applicable to other fund types. The Commission in the future intends to review the content of promoter due diligence guidance across the board to ensure that this is current and appropriately consistent.

Q6: Please provide any further comments you may wish to share with respect to the proposed revised PIF Rules and Guidance?

APPENDIX 1

PROPOSED AMENDED PRIVATE INVESTMENT FUND RULES AND GUIDANCE,
20XX [*SEE SEPARATE DOCUMENT*]

APPENDIX 2

ADDITIONAL DECLARATION BY THE PROPOSED MANAGER UNDER PROPOSED ROUTE 1

In making the above declarations on the ability of investors to sustain loss, where we have relied, or will rely, upon a declaration from an investor or prospective investor, we undertake to document our assessment of such investor declaration and make evidence of this assessment available to the Commission upon request.

APPENDIX 3

DECLARATION BY THE PROPOSED DESIGNATED ADMINISTRATOR UNDER PROPOSED ROUTE 2

I confirm that we, as proposed designated administrator of the scheme, have performed sufficient due diligence to be satisfied that the promoter of, and the associated parties to, the scheme are fit and proper and that in this respect consideration has been given to all of the issues set out in the Guidance on PIF Promoter Due Diligence dated [XXXXXX].

I confirm that we, the proposed designated administrator of the scheme, have effective procedures in place to ensure restriction of the scheme to qualifying private investors.

We certify that the private investment fund will contain no more than 50 legal or natural persons holding an ultimate economic interest in the private investment fund.

I confirm that we, the proposed designated administrator of the scheme, are content that prior to subscription all investors will receive a disclosure statement in the format as prescribed in the relevant Commission guidance.

I confirm that the information supplied is complete and correct to the best of my knowledge and belief at the time of submission and that there are no other facts material to the application of which the Commission should be aware.

I am aware it is an offence, under The Protection of Investors (Bailiwick of Guernsey) Law, 1987, as amended in respect of which the Commission exercises its functions, to knowingly or recklessly provide the Commission with information, which is false or misleading in a material manner.

APPENDIX 4

PROPOSED GUIDANCE ON INVESTOR DISCLOSURE STATEMENT UNDER PROPOSED ROUTE 2

General guidance

The disclosure statement should state all material information (including risk disclosures) that an investor would reasonably require to enable such investor to make an informed judgement about the merits and risks of investing in the PIF.

Specific statements

The disclosure statement should include the following statements (or words of equivalent effect):-

“The scheme is a registered closed-[open-] ended investment scheme registered pursuant to the Protection of Investors (Bailiwick of Guernsey) Law, 1987, as amended and the Private Investment Fund Rules 2021 issued by the Guernsey Financial Services Commission (the “Commission”). The Commission, in granting registration, has relied upon specific warranties provided by X], the Company’s Designated Administrator.”

“The Commission takes no responsibility for the financial soundness of the [Scheme] or for the correctness of any of the statements made or opinions expressed with regard to it.”

“The scheme has been established in Guernsey as a Private Investment Fund. It is only suitable for those who fall within the definition of a Qualifying Private Investor as defined in the Private Investment Fund Rules 2021. Regulatory requirements which might provide a higher degree of protection appropriate for retail investors are not applied to this scheme. This scheme is not suitable for retail investors.”

Acknowledgement of receipt of the disclosure statement

The Designated Administrator should receive written acknowledgment from prospective PIF investors that they have received and understood the disclosure statement.

APPENDIX 5

DECLARATION BY THE PROPOSED DESIGNATED ADMINISTRATOR UNDER PROPOSED ROUTE 3

- I confirm that we, as proposed designated administrator of the scheme, have performed sufficient due diligence to be satisfied that the promoter of, and the associated parties to, the scheme are fit and proper and that in this respect consideration has been given to all of the issues set out in the Guidance on PIF Promoter Due Diligence dated [XXXXXX].
- I confirm that we, the proposed designated administrator of the scheme, have effective procedures in place to ensure that investment in the scheme is restricted to only eligible family-related investors.
- I confirm that the information supplied is complete and correct to the best of my knowledge and belief at the time of submission and that there are no other facts material to the application of which the Commission should be aware.
- I am aware it is an offence, under The Protection of Investors (Bailiwick of Guernsey) Law, 1987, as amended in respect of which the Commission exercises its functions, to knowingly or recklessly provide the Commission with information, which is false or misleading in a material manner.

APPENDIX 6

DRAFT GUIDANCE ON PIF PROMOTER DUE DILIGENCE

1. The promoter and/or investment manager should be a skilled investment person or an institution regulated and in good standing, or, if conducting activities which do not require regulation, otherwise in good standing.
2. Good standing would imply that the promoter and/or investment manager itself, its directors, controllers and senior managers had not during the past 5 years been the subject of material disciplinary action by a regulator or professional body, or subject to any conviction for fraud, dishonesty or related offences of a financial nature.
3. The designated administrator must certify to the Commission that it has performed sufficient due diligence to be satisfied that the promoter and/or investment manager are fit and proper. In that regard, such service providers should take account of the issues referred to at 8(a), (b) and (c) below and should document their findings and conclusions accordingly. When assessing the fitness and propriety of a Promoter and/or Investment Manager the Fund Administrator should also be cognisant of its obligations to perform customer due diligence as required by Paragraph 4 of Schedule 3 to the Proceeds of Crime Law and Chapter 4 of the Handbook on Countering Financial Crime and Terrorist Financing.
4. For the avoidance of doubt, applications on behalf of newly formed promoters and/or investment managers will be considered. The Guernsey licensed service provider who is seeking the scheme's registration will need to consider the track record and experience of the controllers, directors and management of such entities taking into account their previous employment history. Such previous employment history should demonstrate that the individuals possess relevant experience in relation to managing or advising on investors' funds using similar investment strategies to those that will be adopted by the Private Investment Fund. The licensed service provider's consideration of these matters and conclusions arising should be documented.
5. Where applicants are aware of issues in relation to a promoter and/or investment manager (which term should be taken to include their controllers, directors and management) and associated parties, but are uncertain of their materiality or possible impact on the subject application, they should consult the Commission prior to submitting the formal application at the time they become aware of the issue.
6. The Commission will assess licensees' application due diligence as part of their post-facto monitoring of licensees. If the Commission were to find that declarations provided were defective, or misleading, the Commission could take action against the licensee and in appropriate cases could exclude that licensee from future participation in the fast track regime.
7. The Commission expects each licensee to ensure that its due diligence in respect of the promoter and/or investment manager and associated parties is updated on a regular basis. The Commission will not prescribe the means by which this requirement is to be achieved but as set out in 3 above licensees should take account of the issues at 8(a), (b) and (c) below and should document their findings and conclusions. Where licensees become aware of issues in relation to a promoter and/or investment manager (which term should be taken to include their controllers, directors and management) and

associated parties, but are uncertain of their materiality or possible impact on the subject Private Investment Fund, they should consult the Commission, prior to the submission of a formal application to the Commission, at the time they become aware of the issue.

8. Promoters and/or investment managers (including their directors, controllers and senior managers) must be fit and proper. This can be defined as being a requirement for integrity (or honesty), competence and solvency. Guernsey licensed service providers should ensure that the following issues are covered as part of their due diligence procedures in respect of new client relationships and that their findings and conclusions are documented.

- a. Integrity

Promoters and/or investment managers (which term should be taken to include their controllers, directors and management) should be of a good reputation and standing. Poor reputation would be considered to be a negative factor. The promoter and/or investment manager must carry on their business with prudence, professional skill and honesty. In the case of promoters and/or investment managers with a limited history, due to the fact that they are newly or recently established, the integrity of the controllers, directors and management should be assessed in the light of previous employment and experience.

- b. Solvency

Promoters and/or investment managers should be solvent. A firm regulated in another jurisdiction should also comply with the solvency, capital adequacy or financial resources requirement (as appropriate) laid down by the relevant regulatory body to which it is accountable.

Past performance in this respect should also be considered to ensure that relevant requirements have been consistently met in the past.

- c. Competence

The most obvious way to demonstrate competence is to have established a favourable track record, in a business similar to that to be conducted in the Bailiwick. The promoter and/or investment manager should be able to demonstrate an acceptable complaints history. In the case of promoters and/or investment managers with a limited history, due to the fact that they are newly or recently established, Guernsey licensed service providers may wish to consider whether the controllers, directors and management of such entities have been subject to significant complaints whilst employed by other firms. Promoters and/or investment managers should have staff of adequate skills, knowledge and experience to undertake and fulfil their duties efficiently and effectively.