Guidance Notes

Pricing Controls in respect of Open-Ended Collective Investment Schemes

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Guernsey Financial Services Commission

Contents

Glossary of Terms

In this Guidance Note:

Collective Investment Scheme means any arrangement such as is identified as described in paragraph 1 of Schedule 1 to the Law that is declared by the Commission to be Open-Ended Authorised or Registered;

de minimis provisions means as detailed in 5.2, - the threshold below which compensation will not normally be required to be paid to share/unitholders on a pricing error;

Law means the Protection of Investors (Bailiwick of Guernsey) Law, 2020;

Manager means:

(a) the designated administrator or

(b) where there is a principal manager and a designated administrator each such person or

(c) where there is more than one designated administrator each such person;

Rules means the Rules issued under the Law, from time to time, by the Commission in connection with Collective Investment Schemes as defined above; and

Trustee means:

- a person designated as such by the Commission for the purposes of the Law.
- a designated trustee in the case of a unit trust scheme
- a designated custodian in the case of an authorised or registered scheme other than a unit trust scheme

1: Introduction

1.1

This Guidance Note sets out the pricing controls and checks which Managers and Trustees should apply together with the standards of conduct expected when incorrect pricing issues relating to Collective Investment Schemes takes place and when the Commission considers compensation is required. The Commission would expect Managers and Trustees of Collective Investment Schemes to observe this guidance when complying with the Rules made under the Law. The Commission will take this Guidance Note into account when assessing a Manager or Trustee's compliance with the minimum criteria for licensing under the Law.

1.2

The Commission's general intention is to require Managers and Trustees to exercise due diligence over pricing and for Managers to compensate investors unless the error is of minimal significance. This Guidance Note gives a wide discretion to the Trustees of Collective Investment Schemes to determine in any particular case whether or not compensation is required. The Trustee has an oversight duty and must decide, in consultation with the Manager, and in accordance with that duty, how any such discretion should be exercised in any particular case. This Guidance Note is designed to ensure consistency across the industry but is not intended to be exhaustive.

1.3

This Guidance Note introduces a reasonable de minimis provision (which may be utilised at the sole discretion of the Trustees), but at the same time indicates to Managers and Trustees the need for tight controls over pricing routines to reduce the likelihood of incorrect pricing arising. It is intended to ensure that there is universally tight control over pricing throughout the industry to the benefit of investors generally whilst minimising the need for costly investigation into the consequences of very minor cases of incorrect pricing.

2. Guidance on Pricing Controls by Manager

The Commission expects that there is an appropriate demonstrable control environment in place if Managers are to rely on the de minimis provisions permitted by a Trustee.

If such controls are not in place, Managers may not take advantage of the de minimis provisions.

This section sets out the minimum checks which the Commission expects Managers to carry out.

2.1

Share prices and currency rates used should be up-to-date and from a reputable source. The reliability of the source of prices and rates should be kept under regular review and doubtful prices or rates questioned.

2.2

If a third party is used to carry out the pricing function the Manager still remains responsible for correct pricing and should ensure that the third party acknowledges the Manager's responsibilities in this respect. Should a Manager outsource any function, it is required to put in place and maintain demonstrable controls in order to oversee the outsource service provider.

2.3

Where the pricing function is outsourced the Manager must satisfy himself that the outsource service provider's system is robust and will produce accurate results. The Manager should review the outputs from the system at least annually and on any significant system change.

2.4

Unless the valuation and record keeping systems are integrated, the valuation output should be agreed with the Manager's records of the Collective Investment Scheme at each valuation point. In addition, the Manager's records, including debtors and creditors, should be agreed with the Trustee's record of stocks and both capital and income cash at least monthly, with reconciling items followed up promptly and debtors reviewed for recoverability.

2.5

Systems should be in place whereby securities deals are formally confirmed as quickly as possible to the Manager (or outsource service provider). All deals to which the Collective Investment Scheme is committed must be included in the valuation. A cut-off procedure should be in place to guard against omissions or duplications.

2.6

Where prices are obtained otherwise than from the main pricing source (e.g. unquoted, suspended or illiquid stocks) the Manager should maintain a record of the source and basis for the value placed on the stock. These should be frequently reviewed to ensure that the basis for pricing continues to remain valid.

2.7

A system should be in place to ensure that investment and borrowing powers are not breached and that, if breaches occur, they are identified and rectified promptly.

2.8

A system should be in place to ensure that dividends are accounted for as soon as stocks are quoted ex-dividend unless (as with some stock) it is more prudent to account for them on receipt. Unless a longer interval is more appropriate for reasons of materiality, fixed interest dividends and interest should be accrued at each valuation point. Similar considerations apply to the expenses of the Collective Investment Scheme.

2.9

The full tax position should be reviewed regularly, including any assumptions made about the recoverability of overseas taxes deducted at source and about applicable tax rates. Adjustments for substantive changes (e.g. to tax profile or likely tax charges) should be made when they occur.

2.10

In the case of dual-priced Collective Investment Schemes, a justification for the figures included for dealing expenses and commissions included in the price should be reviewed at least quarterly for each market. In addition adjustments should be made when substantive changes in a market's costs occur (e.g. changes in the rate of stamp duty).

2.11

Managers should set a limit for certain key elements of a valuation such that any movement beyond that limit is investigated and the investigation and evidence of the outcome should be evidenced by the signature of a suitably senior member of staff. Such key elements include: share/unit price; stock prices; exchange rates; income accruals and expenses, and tax.

If a price has remained unchanged for a fixed period it should be investigated to ensure that movement in the price has not been overlooked.

2.12

Cash should be reconciled at the bank account regularly. Outstanding items should be followed up promptly and a full reconciliation sent to the Trustee at least monthly.

2.13

Controls should be in place to ensure the correct number of shares/units in issue is recorded at each valuation point. This should be reconciled with the share/unit holder register at least monthly.

2.14

A copy of the valuation should be sent to the investment adviser/investment manager following each valuation date. He should check that the correct securities are recorded and advise the Manager immediately of any discrepancies.

3: Guidance on Pricing Checks by Trustee

3.1

The Trustee has a duty under the Rules to ensure that the Manager's pricing operation is properly controlled. This section provides details of the types of checks a Trustee should carry out to be satisfied that the Manager adopts systems and controls which are appropriate to ensure that prices of shares/units are calculated in accordance with this section and to ensure that the likelihood of incorrect prices will be minimised. These checks also apply where a Manager has outsourced all or some of its pricing functions to one or more third parties.

3.2

The Trustee should thoroughly review the Manager's systems and controls to confirm that they are satisfactory. The Trustee's review should include an analysis of the controls in place to determine the extent to which reliance can be placed on them.

3.3

A review should be performed when the Trustee is appointed and thereafter as it feels appropriate given its knowledge of the robustness and the stability of the systems and controls and their operation; and taking into account the nature, scope and complexity of the Collective Investment Scheme's strategy and the organisation of the Manager.

3.4

A review should be carried out more frequently where a Trustee knows or suspects that a Manager's systems and controls are weak or are otherwise unsatisfactory.

3.5

Additionally, a Trustee should from time to time review other aspects of the valuation of the scheme property of each Collective Investment Scheme for which it is responsible, verifying, on a sample basis, if necessary, the assets, liabilities, accruals, shares/units in issue, securities prices (and in particular the prices of OTC derivatives, unapproved securities and the basis for the valuation of unquoted securities) and any other relevant matters.

3.6

Where the Manager is not obtaining prices from the main pricing source as set out in 2.6 above the Trustee should periodically enquire that the Manager (and in the case of a company structure the Collective Investment Scheme's board or in the case of a partnership structure the general partner) can demonstrate that it has reviewed the continued suitability of the pricing source or methodology.

3.7

A Trustee should ensure that any issues, which are identified in any such review, are properly followed up and resolved.

3.8

Where pricing, or any other function in respect of the valuation is outsourced the same principles apply. It is accepted that the Trustee may decide to extend its visits to the outsource service providers of the Manager, in order to satisfy itself that operations are adequately controlled.

4: Regulatory Position

4.1

A Manager must be able to demonstrate that he has complied with the minimum control requirements set out in this Guidance Note. Evidence of persistent/repetitive incorrect pricing, or incorrect pricing consistently in the Manager's favour, is likely to make this more difficult to demonstrate. Compensation may be required where the Manager would otherwise derive material benefit from the use of incorrect prices.

4.2

Should the Trustee feel that the Manager's pricing controls do not meet what the Trustee determines as adequate, the Trustee will notify such to the Manager. Should the Trustee consider there to be a material issue in this regard, the Trustee will notify the Commission accordingly.

4.3

It is at the discretion of the Trustee as to whether the Manager can rely, or continue to rely, upon de minimis provisions. In such circumstances where the Trustee has determined the Manager may not rely on the de minimis provisions, the Trustee will notify the Commission and Manager accordingly.

4.4

It is the Commission's expectation that the Trustee assessments, described in Section 3 of this Guidance Note, be documented in writing and kept under regular review. The Commission will review these assessments as part of its impact and risk based on-site regime.

5: Guidance on Incorrect Pricing

5.1

All instances of incorrect pricing amounting to 0.1% or more of the price of a share or a unit must be recorded, reported to the Trustee and action taken to avoid repetition as soon as they are discovered. Details of the action taken should also be reported to the Trustee. All instances of incorrect pricing amounting to 0.5% or more of the price of a share or unit must be reported by the Trustee to the Commission. The appendix to this Guidance Note sets out the relevant information that should be disclosed when making a report to the Commission. The paragraphs below cover action to be taken as regards compensation for incorrect pricing.

5.2 *Prices found to be incorrect by less than 0.5%*

Provided that the Manager can demonstrate compliance with the relevant provisions of 2.1 to 2.14 above, where a dealing, creation or cancellation price of any share/unit is found to be incorrect by less than 0.5% of the price of that share/unit, compensation to share/unit holders or to or from the Collective Investment Scheme will not normally be required, unless the Trustee decides otherwise.

5.3 *Prices found to be incorrect by 0.5% or more*

5.3.1 Where the dealing price of any share/unit is found to be incorrect by 0.5% or more of the price of that share/unit, compensation to share/unit holders will be required unless, exceptionally, the Trustee considers that compensation is inappropriate. If so, the Trustee must report the matter to the Commission together with his recommendation and justification.

5.3.2 Where a creation or cancellation has taken place at a price which is incorrect by 0.5% or more of the price of a share/unit, the Trustee will normally require the transaction to be corrected and money paid into or out of the Collective Investment Scheme.

5.3.3 Where the factor leading to an incorrect price continues (or has continued) in existence over a period of time, compensation will normally be required only on days where the price is incorrect by 0.5% or more of the price of a share/unit.

5.3.4 Where there is more than one factor at any one time which causes an incorrect price to be calculated, compensation will normally be required whenever, and so long as, the combined effect on any one day is 0.5% or more of the price of a share/unit.

5.4 *Generally*

5.4.1 In all cases where compensation is otherwise required, amounts due to reimburse share/unit holders for individual sums under £30 (or currency equivalent at the rate taken at the valuation point) will not normally need to be paid, although Managers are free to pay such smaller amounts, or to make such smaller amounts up to a higher figure (e.g. £30).

5.4.2 The chart below is intended to show each of the different circumstances where incorrect pricing can occur and the effect of this Guidance Note on each. The succeeding paragraphs set out the procedure in each circumstance. Notwithstanding the paragraphs below, the Trustee may agree to a payment from the Collective Investment Scheme following an instance of incorrect pricing, if he deems it appropriate.

(N.B. the word "normally" used throughout this section denotes "unless the Trustee directs otherwise").

COMPENSATION CHART

LOSES GAINS	COLLECTIVE INVESTMENT SCHEME	MANAGER	INCOMING SHARE/ UNITHOLDERS	OUTGOING SHARE/ UNITHOLDERS
COLLECTIVE INVESTMENT SCHEME		A		
MANAGER	B		D	F
INCOMING SHARE/UNIT HOLDERS		C		
OUTGOING SHARE/UNIT HOLDERS		E		

5.5 *Dealing between Collective Investment Scheme and Manager whether or not shares/units are issued or repurchased from share/unit holders*

A. Collective Investment Scheme gains vis-a-vis the Manager.
(Creation at too high or cancellation at too low a price).

INCORRECT PRICE BY LESS THAN 0.5% - normally no action.

INCORRECT PRICE BY 0.5% OR MORE – Trustee will normally compensate the Manager from the Collective Investment Scheme.

B. Collective Investment Scheme loses vis-a-vis the Manager. (Creation at too low or cancellation at too high a price).

INCORRECT PRICE BY LESS THAN 0.5% - normally no action.

INCORRECT PRICE BY 0.5% OR MORE – Trustee will normally direct the Manager to compensate the Collective Investment Scheme.

5.6 *Dealing between share/unit holders and the Manager whether or not shares/units are created or cancelled*

C. Incoming share/unit holders gain vis-a-vis the Manager.
(New share/unit holders buy shares/units at too low a price).

INCORRECT PRICE BY LESS THAN 0.5% - no action.

INCORRECT PRICE BY 0.5% OR MORE – see paragraph 5.7.

D. Incoming share/unit holders lose vis-a-vis the Manager.
(New share/unit holders buy shares/units at too high a price).

INCORRECT PRICE BY LESS THAN 0.5% - normally no action

INCORRECT PRICE BY 0.5% OR MORE– the Manager will normally compensate incoming share/unit holders.

E. Outgoing share/unit holders gain vis-a-vis the Manager. (Outgoing share/unit holders sell at too high a price).

INCORRECT PRICE BY LESS THAN 0.5% - no action.

INCORRECT PRICE BY 0.5% OR MORE – see paragraph 5.7.

F. Outgoing share/unit holders lose vis-à-vis the Manager. (Outgoing share/unit holders sell at too low a price).

INCORRECT PRICE BY LESS THAN 0.5% - normally no action.

INCORRECT PRICE BY 0.5% OR MORE – the Manager will normally compensate outgoing share/unit holders

5.7 *Share/Unitholders who gain vis-a-vis the Manager*

It may not be practical or even, in some cases, legally permissible for the Manager to seek to recover money from share/unit holders where they have benefitted from an incorrect price. In such cases the Manager will usually wish to consider his legal position, as well as the commercial implications, in deciding whether to seek to make such recovery.

Appendix

Relevant information that should be disclosed by the Trustee when making a report to the Commission in connection with an incorrect pricing. It is expected that Managers will provide any such information required by the Trustee, in a timely manner, in order that the relevant information may be disclosed to the Commission

1. The name of the Collective Investment Scheme and, if applicable, the name of the class of the scheme affected by the incorrect pricing.

2. The date(s) the incorrect pricing occurred (it may extend over several valuation days/points).

3. The date the incorrect pricing was detected and by whom (for example, the Manager, the Trustee or another party).

4. The date the incorrect pricing was corrected.

5. The cause of the incorrect pricing (detailed information to be provided, rather than a brief comment such as “human error”).

6. The extent of the incorrect pricing, expressed as a percentage of the net asset value of the scheme/class (as appropriate) on each valuation day affected.

7. Whether the scheme was over or undervalued as a result of the incorrect pricing.

8. The number of subscribing investors and redeeming investors that were affected by the incorrect pricing.

9. The number of investors that were compensated (if any) and the value of such compensation.

10. Details as to how the scheme was compensated (if at all) and the value of such compensation.

11. Details of any other compensation paid (for example, to the Manager/Investment Adviser for loss of income).

12. The detailed action that has been taken by the Manager and Trustee to prevent recurrence.

13. An explanation relating to any delay in the notification of the incorrect pricing by the Manager to the Trustee or by the Trustee to the Commission.

14. The Trustee’s conclusions in respect of the incorrect pricing, including an indication as to whether additional checking is required (refer to section 3.2 of the Guidance Note).