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Funds development

Summary

1. The Commission proposes to create a streamlined fund approval regime for investment funds – both closed-end and open-ended - to be targeted at qualifying professional, experienced and knowledgeable employee investors. Funds approved under the new regime would be referred to as Qualifying Investor Funds. It is also for consideration whether any investment fund to be listed on a reputable stock exchange, where listing arrangements and continuing obligations to report to shareholders may provide satisfactory protections, should be eligible for a similar streamlined regime.

QUESTION 1 *Given that listed vehicles may be available to unsophisticated investors, should arrangements of the type set out below extend to any vehicle subject to satisfactory listing and continuing obligations?*

Existing arrangements

2. Under the existing regime, Commission staff assess applications for approval of Guernsey-domiciled funds, under either the Control of Borrowing (“COBO”) regime applicable to closed-end funds, or the rules made under the Protection of Investors Law (“POI”) concerning open-ended funds. Assessment is made against a set of parameters derived from the statutory duties imposed on the Commission through the GFSC Law and POI. Those statutory duties were set by the States of Guernsey with the intention of protecting investors and the reputation of the Bailiwick. The detailed parameters include fitness and propriety of promoters and related parties, organisational arrangements, and economic benefit to the Bailiwick.

New proposal

3. Under the new proposal, a service provider, (who would have to be the holder of a licence under POI), associated with an application for POI authorisation or COBO consent for the launch of a Qualifying Investor Fund, would have to certify to the Commission that they had performed sufficient due diligence to be satisfied, *inter alia*, that:
 - the promoter and associated parties were fit and proper;
 - effective procedures would be in place to ensure restriction of the fund in question to professional, experienced and knowledgeable employee investors; and
 - the economic rationale for the proposed fund and any attendant risks were clearly disclosed.
4. In each case it would be a requirement that the fund’s promoter and/or investment manager, if not domiciled in Guernsey, would be an institution regulated and in good standing, or, if conducting activities which did not require regulation, otherwise in good

standing. Good standing would imply that the institution itself, its directors and senior managers had not been the subject of material disciplinary action by a regulator or professional standard setting body, or subject to any conviction for fraud, dishonesty or related offences of a financial nature. Where applicants were aware of such issues in relation to an associated party, but were uncertain of their materiality, they would be able to consult Commission staff prior to submitting the application.

5. Provided the certification was complete in all respects, the Commission would not need to perform its own prior due diligence on the application. It would therefore be able to complete its application assessment and grant the necessary COBO consent or POI authorisation within three working days of an application being delivered to it.
6. Open-ended funds domiciled outside Guernsey may have some aspect of administration or custody undertaken by Guernsey POI licensed firms without seeking full Guernsey fund authorisation, provided approval has been obtained from the Commission under the Non-Guernsey Scheme Rules. It is intended that equivalent streamlining would be introduced to the process for non-Guernsey scheme approval where the fund in question was restricted to similar classes of qualifying investor
7. The Commission would continue to discharge its regulatory role under the new regime. The requirements of the IOSCO Objectives and Principles of Securities Regulation would be met in particular through enhancing the ongoing monitoring of those local POI licensees providing the certification referred to in paragraphs 3 and 5 above. IBF staff would include assessment of licensees' application due diligence as part of their post-facto monitoring of licensees. If the Commission were to find that warranties provided were defective, or misleading, the Commission would take action against the licensee, and appropriate cases would exclude that licensee from future participation in the self-certification programme.
8. This proposal does not affect the verification requirements as set out in the Guidance Notes on the Prevention of Money Laundering and Countering the Financing of Terrorism as these will continue to be an obligation of all local service providers.

Proposed Definitions

9. Only Qualified Investors would be permitted to invest in a Qualifying Investor Fund.

A Qualified Investor is deemed able:

1. to evaluate the risks and strategy of investing in a Qualifying Investor Fund; and
2. to bear the economic consequences of investment in the Qualifying Investor Fund including the possibility of any loss arising from the investment.

Qualified Investor means: a Professional Investor; an Experienced Investor; and/or a Knowledgeable Employee.

A. A Professional Investor is:

1. a Government, local authority, public authority or supra-national body (in the Bailiwick or elsewhere) ; or

2. a person, partnership or other unincorporated association or body corporate, (whether incorporated, listed or regulated in an OECD country or otherwise) whose ordinary business or professional activity includes or it is reasonable to expect that it includes, acquiring, underwriting, managing, holding or disposing of investments whether as principal or agent, or the giving of advice on investments; or
3. an affiliate of the Qualifying Investor Fund or an associate of an affiliate of the Qualifying Investor Fund. *(The terms “affiliate” and “associate of an affiliate” are intended to refer to financial services businesses or financial services professionals associated, directly or indirectly, with the operation of the fund in question).*

B. An Experienced Investor is :

a person, partnership, or other unincorporated association or body corporate which has in any period of 12 months (whether on his own behalf or in the course of his employment by another person) so frequently entered into transactions of a particular type in connection with

1. open-ended collective investment schemes and/or
2. general securities and derivatives as defined in Schedule 1 of the POI Law. *(In summary, that definition includes equities, bonds, participations in closed-end investment vehicles, warrants, options, futures, contracts for differences and rights on any of those investments).*

being transactions of substantial size (or of substantial size in relation to his total wealth) entered into with or through the agency of reputable persons who carry on investment business, that he can reasonably be expected to understand the nature of, and the risks involved in, transactions of that description; or who provides a certificate from an appropriately qualified Investment Advisor confirming that the investor has obtained independent advice.

QUESTION 2 *Should Experienced Investors need to show that their experience had been gained in investment activity specifically relevant to the fund in question?*

C. A Knowledgeable Employee is:

1. a person who is an employee, director, general partner, consultant or shareholder of, or to an affiliate appointed by the Qualifying Investor Fund to advise, manage or administer the investment activities of the Qualifying Investor Fund, who is acquiring an investment in the Qualifying Investor Fund as part of his remuneration or an incentive arrangement or by way of co-investment, either directly or indirectly through a personal investment vehicle, such as a trust, for or substantially for, that person; or
2. any employee, director, partner or consultant to or of any person referred to at A.2 above;

QUESTION 3 *None of the proposed definitions of Qualifying Investor includes any minimum test by size, scale of operation, wealth or net worth. Should such minima be set, and if so, on what basis?*

QUESTION 4 *References to employees could include individuals who, although on the staff of a Qualifying Investor, were not in themselves sophisticated investors. Is this acceptable, or should a narrower definition be imposed?*

Limitation to Qualified Investors:

10. It is proposed that funds which are to be approved as Qualifying Investor Funds must have in place measures to ensure that they are only available to investors who fall within the above definitions. The Commission does not intend to be prescriptive about the means licensees will use to achieve that requirement.

11. On the basis of legal advice, the Commission understands that the following warranty and disclaimer would be sufficient to provide estoppel in the Guernsey courts of a claim by an investor that they were not a Qualifying Investor.

“I/we acknowledge that this [fund] has been established in Guernsey as a Qualifying Investor Fund and is suitable only for those investors who satisfy the definition of Qualifying Investor as published by the Guernsey Financial Services Commission as being either a Professional Investor or an Experienced Investor or Knowledgeable Employee.

I/we represent that I/we satisfy the definition of a Qualifying Investor. I/we represent that I/we will not acquire [Shares] [Units] [Partnership interests] in the [Fund] for the benefit of any person who is not a Qualifying Investor.

I/we acknowledge that requirements that may be deemed appropriate for the protection of retail or non-Qualified Investors do not apply to my/our investment in this [Fund].

I/we acknowledge that I/we have read and understood the [fund’s] [Scheme Particulars/Offering Memorandum/Information Memorandum] and am/are aware that it is intended that the [Fund] is only suitable for investors who understand the risks involved in acquiring such investment. I/we acknowledge that investing in this [fund] may involve special risks that could lead to a loss of all or a substantial portion of any investment that I/we make in this [Fund].”

12. The Commission recognises that such a warranty and disclaimer may not meet the requirements of all jurisdictions where Qualifying Investor Funds may be offered. Subject to the overriding requirement, set out in paragraphs 3 and 9 above, that there must be adequate arrangements to ensure that Qualifying Investor Funds are restricted to Qualifying Investors, the Commission does not propose to require a specific form of words to be used in every case. Licensees will also need to consider by what means they will ensure that Qualified Investors may only transfer their holdings to parties who would meet the Qualified Investor test.

Question 5 *Should the Commission prescribe the form of disclaimer and warranty which must be signed by Qualified Investors?*

Question 6 *Should the Commission prescribe any undertaking which a transferor might be required to give to ensure that his holding was being transferred to a Qualified Investor?*

13. The present proposal is based on changes to existing authorisation and consent policy and will be implemented, if approved, before the end of 2004.

Next Steps

These proposals have been developed in consultation with a working group representing various parts of the Guernsey investment sector. The Commission is now seeking comment on the proposals from investment firms and the public in Guernsey and elsewhere. A number of specific questions have been included in this consultation paper, highlighting areas where feedback would be particularly helpful; the Commission is, however, ready to receive comments on any aspect of the proposals.

The closing date for comments is **Friday 12 November 2004**. Comments should be sent to:-

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