CONSULTATION PAPER ON PROPOSALS FOR AMENDMENTS TO THE PROTECTION OF INVESTORS LAW, THE FINANCIAL SERVICES COMMISSION LAW AND THE INSIDER DEALING LAW

INTRODUCTION

1. The following legislative recommendations are made in order to enhance the development of the finance sector, to increase investor protection, to assist Guernsey's finance sector to be seen as fair, efficient and transparent and to reduce systemic risk. The recommendations include the proposals requiring primary legislation made by the finance industry and policy working group established in 2005 by the Commerce and Employment Department and the Guernsey Financial Services Commission to consider the investment industry in the Bailiwick and the conditions required for its continued prosperity – the recommendations below have modified some of the legislative approaches suggested by the working group but achieve the same objectives. Other recommendations of the working group can be met by changing policies or rules made under the Protection of Investors Law. The Commission is seeking comments from interested parties on the proposals in this consultation paper.

PROPOSALS ARISING FROM SUGGESTIONS BY THE WORKING GROUP ESTABLISHED TO CONSIDER THE INVESTMENT SECTOR AND ITS CONTINUED PROSPERITY

2. With regard to Guernsey collective investment funds, the Protection of Investors (Bailiwick of Guernsey) Law, 1987 ("the POI Law") currently applies only to open-ended funds, i.e. collective investment schemes where investors have an entitlement to redeem their shares. All open-ended funds established in Guernsey or any foreign open-ended fund with a manager, administrator and custodian/trustee in Guernsey must be authorised by the Commission and are subject to ongoing regulation. Regulation includes compliance with rules issued by the Commission.

   Guernsey closed-end funds are not authorised and regulated under the POI Law. Instead, closed-end funds require consent from the Commission (acting on behalf of the Policy Council) under the Control of Borrowing Ordinances for the raising of capital by the issue of shares, units or interests in limited partnerships.

   In order to enhance the development of the finance sector by increasing its ability to compete internationally and to simplify regulation, it is recommended that:

   - the provisions of the Control of Borrowing Ordinances relating to the raising of capital, except those relating to the formation of Guernsey and Alderney companies, should be repealed;

   - the POI Law should be amended so as to apply similar provisions to both open-ended and closed-end funds;

   - funds would be divided into two categories – regulated funds and registered funds. Regulated funds would be subject to rules and ongoing supervision by the Commission. Registered funds would simply be notified to the Commission. They would not be regulated but, in order to protect the reputation of the Bailiwick, they would still be required under the law to appoint a local administrator and to make an initial and annual

filing with the Commission so that it can maintain a register of funds and conduct on-site inspections of how the administrators carry out their duties. Registered funds could not be offered directly to the public in Guernsey.

The existing ability under the POI Law to make rules in respect of regulated open-ended funds would continue but the law should also be extended so that rules can be made by the Commission in connection with regulated closed-end funds and notification rules for registered closed–end funds. The Commission would consult with the investment sector before making any rules in respect of closed-end funds.

3. The Control of Borrowing legislation requires consent to be obtained from the Commission (acting on behalf of the Policy Council) before a prospectus or other offering document is circulated in the Bailiwick This legislation does not contain criteria for considering a consent or any appeal provisions if consent is refused. This approach is no longer appropriate. The elements of the Control of Borrowing legislation which require consent before a prospectus or other offering document is circulated should be repealed. In their place an enabling provision should be introduced in the POI Law so that the Commission may make regulations governing the circulation of offering documents seeking to raise capital by the issue of securities, whether or not the offering documentation is issued directly to the public. The regulations would include minimum criteria for disclosure in the offering documentation, a requirement to file the documentation and an appropriate fee with the Commission, together with the provision to the Commission of a certificate from a local advocate confirming that the requirements of the regulations have been satisfied. There would also need to be offences for breaches of the regulations and appropriate penalties.

4. The POI Law should include the ability for the Commission to make regulations which would amend the investment activities which, if carried on in or from within the Bailiwick, require a licence. These activities are promotion, subscription, registration, dealing, management, administration, advising and custody in relation to investments and operating an investment exchange. The Commission proposes to request the relevant political committees to approve the extension of the existing exemptions under the POI Law so that professional firms promoting investment products to licensed firms (but not the public) do not require a licence under the law. This should increase the number of products available for sale by Guernsey's investment community and, therefore, the choice to investors.

5. The Control of Borrowing legislation requires consent to be obtained from the Commission (acting on behalf of the Policy Council) for the registration of any shares of any company if the transaction consists of or includes the raising or borrowing of money outside the Bailiwick or if it consists of exchanging or substituting new shares for redeemable shares. In light of the long-standing requirement to obtain a licence under the POI Law to conduct the activity of registration in respect of the wide ranging investments defined in the law, the requirement to seek consent under the Control of Borrowing legislation is no longer necessary and should be repealed.

PROPOSALS TO IMPROVE INVESTOR PROTECTION; TO ENHANCE THE FAIRNESS, EFFICIENCY AND TRANSPARENCY OF GUERNSEY'S FINANCE SECTOR; AND TO REDUCE SYSTEMIC RISK

6. The POI Law should be amended to include the objectives for investment regulators established by the International Organization of Securities Commissions ("IOSCO"), which is the world's most important forum for investment regulatory agencies and which sets standards for investment regulators. The objectives are:

   - the protection of investors;
   - ensuring markets are fair, efficient and transparent;
   - reducing systemic risk.

7. One of the existing powers in the POI Law should be activated by introducing an Ordinance which would allow the Commission to approach the court to wind up a licensee or for the appointment of an administrator under the Protection of Investors Law where this is necessary to minimise damage and loss to investors or to contain systemic risks. In order to assist with these objectives, the Commission should also have specific powers to:

   - ensure assets are properly managed by for example requiring a licensee to appoint a person to take possession or control of assets held by the licensee or by a third party on behalf of a licensee or to otherwise minimise the risk to investors and counterparties, and systemic risk;
   - restrict activities by a licensee with a view to minimising damage and loss to investors;
   - require a licensee to take specific actions such as moving client accounts to another firm;
   - make public relevant information concerning a licensee's failure.

8. The POI Law does not contain the same detailed minimum criteria for licensing that are contained in the other regulatory laws administered by the Commission. Instead, the law requires the Commission to consider:

   - the general nature and specific attributes of the controlled investment business to which the application relates;
   - whether or not the applicant is a fit and proper person to carry on that business;
   - the manner in which it is proposed to organise the carrying on of the controlled investment business to which the application relates, the number of persons who will be responsible for carrying on each aspect of that business and the relationship between those persons;

- what, if any, economic benefit the Bailiwick is likely to derive from the carrying on of that business; and

- any other factors which the Commission thinks it appropriate to consider.

The requirements set out above should be rephrased on the basis of similar minimum criteria for licensing contained in the other regulatory laws. In summary, these criteria include a requirement for the business of a licensee to be carried on with integrity and skill; a requirement for the directors, controllers and managers to be fit and proper; a requirement for a licensee to be directed by at least two individuals of appropriate standing and experience; a requirement for locally incorporated licensees to have an appropriate board of directors; and a requirement for business to be conducted in a prudent manner. As with the other regulatory laws, the minimum criteria for licensing in the Protection of Investors Law should be capable of amendment by regulations made by a political committee.

9. There is one significant departure which should be made from the minimum criteria for licensing in the POI Law and in each of the other regulatory laws. Each of the laws contains a requirement for the Commission to consider the economic benefit to the Bailiwick of an applicant for a licence. These criteria also apply once a person has been licensed. It is not proposed to include this criterion in the POI Law. The Commission also wishes to promote the removal of the criterion from the other regulatory laws and will consult with industry at a later date on this and other modifications to reflect current thinking. The reason for this is that whilst financial regulators such as the Commission should consider the solvency of applicants and licensees in order to protect customers it is unusual for them to consider economic benefit to the jurisdiction. Economic benefit does not fall within the usual regulatory considerations such as the protection of investors.

10. The Investment Business Division of the Commission, which administers the POI Law, has carried out a number of investigations under the law. The most significant of these is the investigation into the promotion of split capital investment trusts. The cost of this investigation was and still is significant both in terms of staff time and money and it highlights the importance of amending the POI Law to include provisions equivalent to those in the other regulatory laws concerning investigations by inspectors. At present, if the Commission considers it desirable to do so in the interests of the customer of a licensee or for the protection or enhancement of the reputation of the Bailiwick, it has the power to investigate or appoint persons to investigate and report to it on matters of concern. As with the other regulatory laws, the costs, fees and expenses of an investigation should be met by the relevant licensee(s) under the POI Law rather than indirectly by the fees payable to the Commission by licensees as a whole.

Cooperation – General

11. (a) The POI Law permits the Commission to obtain information, books and papers relevant to investment activity or the investigation of a suspected offence from:

- any person who is, or who has at any time been, directly or indirectly employed (whether or not under a contract of service) by a licensee; and

- any person who has, or who has at any time had, any direct or indirect proprietary, financial or other interest in or connection with the licensee.

The Commission may also require such persons to answer questions. A person who does not comply with these requirements without reasonable excuse would commit an offence.

(b) In order to satisfy international expectations of the ability of investment regulators to meet the objectives in paragraph 6 outlined above, the provisions in paragraph (a) above should be extended so that the Commission will also have the ability to obtain information, documentation, answers to questions and statements from any person – not only regulated persons – in Guernsey, who may have information or documentation relevant to an enquiry or investigation by the Commission in carrying out its functions under the POI Law. The Commission is required by the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 ("the FSC Law") to keep all such material it receives confidential. Any non-public material held by the Commission may only be disclosed to third parties under specified legal gateways. It is an offence subject to prison sentences for such material to be disclosed by staff of the Commission in breach of these gateways. The Commission imposes a condition on transfers of non-public information disclosed under the gateways – the recipient of the material is advised that the information is confidential and that it may not further disseminate the information to other bodies without the prior written consent of the Commission.

IOSCO MMoU

(c) In May 2002, IOSCO issued a Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU). In the context of increasing international activity in securities and derivatives markets, the MMoU is particularly concerned with cooperation and the exchange of information by investment regulators. IOSCO has been looking at problems of cross-border cooperation for a number of years and its MMoU is a clear benchmark for international cooperation.

(d) IOSCO has already entered into a dialogue with a number of its members which are not yet able to provide the co-operation envisaged in the MMoU. Unless this process of dialogue initiated with members is resolved to IOSCO's satisfaction, it is clear that IOSCO will consider such members to no longer meet its membership criteria and that they will be invited to withdraw their membership. It is possible that the withdrawal of membership will be made public by IOSCO. This approach by IOSCO

has arisen because securities regulators in some of the larger financial markets have had difficulties in obtaining information from their counterparts in other jurisdictions. In a world where businesses can establish operations almost anywhere and where investors based all over the world can instantaneously buy and sell shares in companies quoted or dealt on almost any stock market, the ability of regulators to provide information across national borders to each other on request is seen not just as important but as crucial to global financial stability.

(e) The UK Financial Services Authority, the Jersey Financial Services Commission and the Isle of Man Financial Supervision Commission are already signatories to the MMoU. Thirty-four investment regulatory bodies are signatories and a significant number of others have applied to become signatories. The Commission made an application to become a signatory to the MMoU in 2003. There is a comprehensive programme of vetting each application by IOSCO. As a result of this process, it has become apparent that Guernsey's legislative framework will need to be modified if the Commission is to be successful in its application and to be able to honour the commitments entered into by being accepted as a signatory to the MMoU. The particular areas of legislation which require attention are those relating to market manipulation and insider dealing, and to obtaining and exchanging information for the purposes of foreign investigations.

Market Manipulation

(f) The POI Law already contains provisions which make market manipulation a criminal offence. This law, together with the FSC Law and the Criminal Justice (Fraud Investigation) (Bailiwick of Guernsey) Law, 1991 ("the CJ(FI) Law"), allow respectively the Commission and HM Procureur to help foreign law enforcement agencies and regulatory bodies requesting assistance with their enquiries concerning market manipulation in most circumstances. The FSC and POI Laws contain specific provisions which allow the Commission to obtain information or documents from regulated institutions in connection with those institutions or their clients, and to conduct interviews with executives of regulated institutions, on behalf of another investment regulator. The CJ(FI) Law allows HM Procureur by way of a "production order" to provide a foreign criminal law enforcement or regulatory body with information or documents in connection with market manipulation where the subject of the enquiry may have been involved with the commission of a criminal offence that amounts to serious or complex fraud – cross border enquiries in connection with potential market manipulation will usually potentially involve serious or complex fraud.

(g) The provision of information in connection with the potential commission of a criminal offence of market manipulation to a foreign regulatory body by HM Procureur under the CJ(FI) Law is not ideal. There may be cases where assistance is requested in respect of potential market manipulation in which it does not appear to HM Procureur, when the request is made, to involve serious or complex fraud. At that stage, no fraud may be

disclosed, simply because there is insufficient evidence, but which, however, may be suspected. As a result, it is possible that HM Procureur may not be able to co-operate with, and provide information or documents, to a body requesting assistance. Accordingly, provisions should be incorporated in the POI Law so that HM Procureur may:

(i) appoint inspectors to investigate whether market manipulation has occurred;

(ii) apply to the Bailiff to grant warrants authorising an officer of police and any other person named in the warrant to enter and search premises; and

(iii) obtain and transmit material to foreign authorities, including regulatory bodies, for the purposes of investigating or prosecuting potential offences of market manipulation, in terms similar to the relevant provisions of the CJ(FI) Law.

(h) Where a foreign regulator is making enquiries about a potential violation of some regulatory or administrative legislation relating to market manipulation – but in which no criminal prosecution, as that term is understood in Guernsey, is contemplated because, for example, the offence will be dealt with by way of civil process, not the jurisdiction's criminal prosecuting authority – and where the subject of the enquiry is not a regulated person or business in Guernsey or the client of a regulated business here – there is no legal mechanism which allows either HM Procureur or the Commission to obtain information, documents, or statements, or to interview the person concerned. The absence of this legal mechanism is a key weakness in Guernsey's ability to meet the requirements of the MMoU and satisfy expectations of Guernsey's ability to protect investors, safeguard the proper operation of markets and reduce systemic risk. Importantly, the absence of this legal mechanism prevents the Guernsey authorities from being able to consider on their own behalf enquiries made by a foreign regulator – a foreign regulator requesting information held by a Guernsey person in connection with potential market manipulation means that the Guernsey authorities should have an interest in considering whether an offence may have been committed under our own legislation. The Commission should therefore be provided with the ability under the POI Law to deal directly with unregulated, as well as regulated, persons in Guernsey directly in connection with potential market manipulation, including its own enquiries and where a foreign regulatory body is making enquiries about a potential breach of its jurisdiction's non-criminal market manipulation provisions, and asks the Commission for assistance. The Commission should have the power to investigate, obtain statements and conduct interviews, and when appropriate be able to take copies of information and documents for disclosure to the foreign regulator. Such powers are essential if the MMoU is to be satisfied, and again should be appropriately enforceable.

(i) Where an enquiry involves assistance to a foreign regulator, each request for assistance would be subject to the same considerations as currently apply to requests for copies of information or documents by, or the conduct of interviews on behalf of, foreign regulatory bodies, under the FSC Law. The Commission would therefore take into account:

(i) whether, in the country or territory of the requesting authority, corresponding assistance would be given to the Commission;

(ii) whether the case concerns the breach of a law or other requirement which has no close parallel in the Bailiwick or involves the assertion of a jurisdiction not recognised by the Bailiwick;

(iii) the seriousness of the case and its importance to persons in the Bailiwick;

(iv) whether the disclosure of information to or cooperation with the requesting authority would, in the Commission's view, lead to disproportionate injury, loss or damage to the persons subject to the exercise of the powers in question; and

(v) whether it is otherwise appropriate in the public interest to give the assistance sought.

These provisions prevent the inappropriate disclosure of information or documentation. As is the case currently with non-public material it provides to foreign regulatory bodies, the Commission intends to impose a condition with regard to confidential information disclosed by the Commission under a legal gateway in respect of market manipulation as outlined above so that the recipient of the information is advised that the information is confidential and that it may not further disseminate the information to other bodies without the prior written consent of the Commission.

(j) During 2004 the Commission issued a public statement on the procedures and implications of interviews it (or inspectors appointed by the Commission) held on behalf of foreign regulators. This statement, which is a requirement of the FSC Law, protects individuals who are to be interviewed by providing a framework for providing notice of interviews and the interviews themselves. This statement would also apply to individuals in Guernsey who are not employed by regulated institutions.

(k) It should be an offence for an unregulated person without reasonable excuse to fail to comply with a request by the Commission for an interview or statement or to fail to provide information or documents. The maximum penalty should be a fine at level 5 on the uniform scale (£10,000) and 12 months' imprisonment. It would also be an offence for unregulated persons to provide false or materially misleading statements, information or documents or to remove from the Bailiwick, destroy, conceal or fraudulently alter any information or documents to avoid detection of an offence. The penalty should be a maximum fine of level 5

on the uniform scale on conviction in the Magistrate's Court and a maximum of 2 years in prison if convicted on indictment in the Royal Court.

(l) In light of the proposed development of powers for the Commission to conduct enquiries involving unregulated persons, the Commission should be required by law to maintain records in readily accessible form on its enquiries into potential market manipulation – and all other requests for information made by the Commission to third parties in Guernsey under the POI Law – for a minimum of 5 years after its investigation into a potential case have been completed. Such records should be exempt from the Bailiwick's data protection regime.

Insider Dealing

(m) The offence of insider dealing is contained in the Company Securities (Insider Dealing) (Bailiwick of Guernsey) Law, 1996, as amended ("the CS(ID) Law"). Under this law, HM Procureur is able to obtain material from any person in Guernsey, and transmit that material to a prosecuting or regulatory authority in another jurisdiction, if he is satisfied that it is likely to be of relevance to criminal proceedings or an investigation in respect of a contravention or suspected contravention of the law relating to insider dealing in the foreign jurisdiction: i.e. non-criminal proceedings.

(n) The POI Law gives the Commission power to obtain information and documents from regulated institutions, but not unregulated firms or individuals, in connection with investment business. Routinely, the request for information made by the Commission would cover:-

(i) the account for which the transaction(s) was executed;

(ii) the name, nationality and address of the beneficial owner of that account;

(iii) the person who instructed the Guernsey licensed firm to execute this transaction; and

(iv) any other information that the Guernsey licensed firm may have which would explain the rationale for the transaction(s).

Where information has been requested from the Commission about a licensee or its customers by another regulatory body, the Commission formally advises the licensee that the information may be shared with a specific overseas regulatory body which has equivalent confidentiality provisions to those in the FSC Law and that the overseas body may use such information in related legal proceedings. On the basis of this advice, where the enquiry relates to a potential criminal offence of insider dealing, the licensee may decide that it would prefer to be served with notice under the CS(ID) Law, as that law deals specifically with such offences.

(o) In order to satisfy the MMoU and to enable foreign regulatory and prosecuting authorities to easily understand Guernsey legislation, the Commission considers that the POI Law should be amended to specifically refer to insider dealing and the obtaining and disclosure by the Commission of information (by conducting interviews, taking statements and taking copies of information and documents as necessary) where the potential insider dealing offence which is being investigated by a foreign regulatory authority is a potential violation of administrative or regulatory legislation. This would explicitly provide the Commission with locus under the POI Law for potential non-criminal violations, with HM Procureur clearly remaining responsible for potential criminal offences and responding to requests from foreign criminal prosecutors.

(p) As with market manipulation, where a foreign regulator is investigating a potential violation of the civil law of insider dealing in which the subject of the enquiry is not a regulated business in Guernsey or the client of a regulated business, there is no legal mechanism which allows either HM Procureur or the Commission to obtain information, documents or statements or to interview the person concerned. As with foreign market manipulation enquiries, it is important that the Guernsey authorities are able to consider whether the material requested by the foreign regulator means there has been a breach of local legislation. In light of the Commission's responsibilities under the POI Law and its track record in dealing with enquiries concerning potential insider dealing, the Commission should be provided with the statutory ability to contact unregulated, as well as regulated, persons in Guernsey directly, including its own enquiries and situations where a foreign regulatory body is making enquiries into a potential violation of the civil law of insider dealing provisions and asks the Commission for assistance. As with the position concerning market manipulation, the absence of such powers is a key weakness in Guernsey's legislative framework which must be dealt with if the Bailiwick is to satisfy expectations of Guernsey's ability to protect investors, safeguard the proper operation of markets and reduce systemic risk. The considerations and framework for providing assistance, including the protections offered to unregulated persons and the offences and penalties, would be identical to those outlined above in connection with enquiries concerning market manipulation.

Power to Cooperate Generally

(q) Cooperation between regulatory authorities is important in order to protect investors (and the public); to ensure markets are fair, efficient and transparent; to reduce systemic risk; and to protect Guernsey's reputation. Cooperation is regarded as a crucial component in the increasingly concerted global fight against financial crime. Those countries and territories which are not prepared to cooperate by taking the powers to obtain, and then obtaining and exchanging, information and documents will increasingly become marginalised and treated as non-cooperating jurisdictions, with all that that potentially entails in terms of sanctions. If the Bailiwick is to remain as a well regarded financial services jurisdiction it cannot ignore this tendency, and in reviews such as that of the IMF, to

be conducted in mid-2008, Guernsey's willingness to co-operate will be regarded as an important parameter in evaluating Guernsey in a comparative international context.

(r) As the foregoing makes clear, a distinction is drawn between obtaining and exchanging information in connection with criminal investigations – that is, where the requesting authority is a law enforcement agency such as the police, or an examining magistrate, and the information obtained will be utilised by the foreign prosecuting authority; and information obtained and exchanged for the purposes of proceedings which are not criminal in nature, such as investigations and proceedings conducted by regulatory or administrative authorities. In the case of criminal proceedings, HM Procureur is the competent and appropriate authority in Guernsey to act, and in non-criminal investigations and proceedings into alleged breach of financial services laws and regulations, the Commission is the competent and appropriate authority to act. However, the FSC Law does not contain a general power to co-operate with foreign regulatory and administrative authorities investigating matters which, whilst they might eventually lead to, or be in aid of, a criminal prosecution, at the time are only being conducted with a view to ascertain whether conduct has occurred which would be susceptible of non-criminal, i.e. regulatory sanction.

(s) In order to remedy this shortcoming, the Commission should be generally empowered to act in aid of investigations conducted abroad by regulatory bodies, whether or not an eventual criminal prosecution is intended or apprehended, and whether or not the foreign regulator at the time of the enquiry intends to proceed with regulatory or administrative sanctions, provided that the foreign regulator has reasonable cause to believe that some breach has occurred of its domestic regulatory framework and in respect of which an investigation has been launched. Accordingly, the Commission should be given power in such cases to serve a notice on any person requiring him to produce information, documents and statements, and to furnish explanations of the same, and, importantly, for the information, documents, statements and explanations so obtained to be transmissible to the foreign regulator for use in that regulator's investigations and be available for purposes of whatever regulatory sanctions or penalties that may ensue. Importantly, these powers should be subject to the same protections and offences and penalties specified in paragraphs (i) to (l) above.

Insider Dealing Law

(u) Finally, during the course of this document reference has been made to the CS(ID) Law. The States by Ordinance should have power to amend the CS (ID) Law, in the same way as the States have resolved (in July 2006) that they should have power by Ordinance to amend the FSC Law, and other regulatory laws relating to banking, fiduciaries, insurance and investment business.

CONSULTATION

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Comments should be made by the close of business on 15 January 2007. Copies of correspondence received by the Commission in respect of this consultation will be forwarded by the Commission to the Commerce and Employment Department.