Guernsey Financial Services Commission

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Presentation to Fund Service Providers

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Introduction

Good afternoon ladies and gentlemen and welcome to the Investment Business Division's industry update. For those of you who don't know me I am Carl Rosumek, the Director of Investment Business and joining me for this presentation is one of my Deputy Directors, Emma Bailey, together with Assistant Director, Mark Le Page

During our session today I will begin by providing some comments on the international perspective and background in which we find ourselves operating before Mark talks to us about on-site visits to licensees and provides us with an update as to the status of ongoing rules and policy reviews covering Class B and Non-Guernsey schemes. Last but not least Emma will talk to us about the Extranet project that has recently been established by the Commission as well as providing some reminders about late filings.

There will be an opportunity for questions, both at the end of my session as well as at the end of the overall presentation.

IOSCO (The International Organisation of Securities Commissions)

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.

The IOSCO Objectives and Principles of Securities Regulation set out a broad general framework for the regulation of securities, including the regulation of (i) securities markets, (ii) the intermediaries that operate in those markets, (iii) the issuers of securities, and (iv) the sale of interests in, and the management and operation of, collective investment schemes.

The objectives of that framework are:

(1) To protect investors.
(2) To ensure fair, efficient, and transparent markets.
(3) To reduce systemic risk.

The IOSCO Principles and underlying Methodology have a key role in promoting a sound global financial regulatory system. They are used by the World Bank/International

Monetary Fund ("IMF") when undertaking Financial Sector Assessment Programs evaluations and by countries doing self assessments. The Bailiwick of Guernsey has itself been subject to scrutiny by the IMF on its compliance with IOSCO principles. The IOSCO methodology provides guidance to assessors and assessed countries on how to assess the level of implementation of the IOSCO principles in a certain country.

At its 2010 Annual Meeting IOSCO published its revised Principles of Securities Regulation to incorporate eight new principles (taking the total to 38), based on the lessons learned from the financial crisis and subsequent changes in the regulatory environment.

The added Principles include requirements:-

1. to monitor, mitigate and manage systemic risks (Principle 6);

2. to review the perimeter of regulation regularly (Principle 7);

3. to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed (Principle 7);

4. that auditors should be subject to adequate levels of oversight (Principle 19);

5. that auditors should be independent of the issuing entity they audit (Principle 20);

6. that credit rating agencies should be subject to adequate levels of oversight (Principle 22);

7. that other entities that offer investors analytical or evaluative services should be subject to oversight (Principle 23);

8. that regulation should ensure that hedge funds and/or hedge fund managers and advisors are subject to appropriate oversight (Principle 28).

Some of the existing Principles have been combined or sub-divided and some others have been subject to variations of drafting. Much of the drift of these developments is already encompassed in the language of Guernsey's Protection of Investors Legislation and the Rules made under it which apply to all Guernsey licensed and regulated investment businesses. It may well be, however, that as IOSCO develops its detailed methodology for assessing adherence to the Objectives and Principles of Securities Regulation, which is currently being finalised after consultation some further development both of the Protection of Investors Law, and rules made under it, will be required. Based on the draft version of the methodology seen by the Commission it is likely that most of the required changes will be focussed at the rules and regulations level with some minor changes to the Protection of Investors Law.

European Union

AIFMD (Alternative Investment Fund Managers Directive)

As many of you are no doubt aware, the EU Alternative Investment Fund Managers Directive has been a particular focus of activity for a couple of years, since work

commenced in the EU on drafting the Directive. You will know that the Directive was adopted in final form in November 2010 and preserves existing arrangements for third country access to European markets, along with the possibility of a Community-wide "passport" at a later stage. While some reassurance has been gained from this outcome, it is clear that continuing efforts will be required to maintain contact with decision making bodies in Europe to ensure that the quality and effectiveness of Guernsey's regulatory system is properly understood.

ESMA (European Securities and Markets Authority) issued its draft technical advice to the European Commission on possible implementing measures of the AIFMD in relation to supervision and third countries for consultation on 23 August. The consultation paper covers the issues of Delegation, Depositaries and Supervision, the last issue covering co-operation and exchange of information between EU and third country competent authorities as well as considering the Member State of Reference for the authorisation of non-EU AIFMs. The deadline for responses was 23 September (the Commission submitted a response within deadline and it can be seen on ESMA's website) and an open hearing was held in Paris on 26 September to consider the issues arising from the consultation.

The proposed co-operation arrangements between EU and third country competent authorities centre on the IOSCO Multilateral Memorandum of Understanding ("IOSCO MMoU"), together with the IOSCO Technical Committee Principles for Supervisory Co-operation. The Commission is a signatory to the IOSCO MMoU and also complies with the stated principles for ongoing supervisory co-operation. Proposed arrangements will also be subject to specific input from ESMA which will ensure consistency between jurisdictions. In principle, these proposals are considered reasonable, albeit the legal position of such arrangements, where they run contrary to domestic legislation, needs to be considered. The delegation and depositary sections provide indications as to how equivalence will be considered between regulatory regimes in the EU and third countries. However, there is still significant uncertainty as to whether equivalence will be considered in terms of whether a third country's regime exactly mirrors the requirements of relevant EU directives or whether an "outcomes" approach is going to be acceptable.

The open hearing effectively concentrated on two issues, being the issue of "equivalence" and the scope of regulatory co-operation envisaged by the draft ESMA advice.

In respect of "equivalence", the reaction of the vast majority of attendees was that ESMA had gone further than the Directive (Level 1) had required. It was pointed out that the Directive, unlike UCITs and MIFID, did not actually use the word "equivalence" in terms of assessing a third country's regulatory regime or approach to regulating specific issues, rather the phrase "same effect" had been inserted. The question of regulatory co-operation also threw up various questions relating to the clarity of ESMA's expectations. Whilst there was general agreement that the basis for agreements should be IOSCO's MMoU and Technical Committee principles the use of certain wording in the Consultation Paper caused uncertainty as to how far away ESMA wanted to move from these internationally understood provisions.

ESMA has to provide its advice to the European Commission by mid November this year and have so far encouraged firms, industry associations and regulators to contribute to the various consultation processes. It will be interesting to see what the final advice issued by ESMA is.

The GFSC is not complacent about the challenges that it faces in respect of the possible changes that might be required in order to achieve "equivalence" should the passport proposals proceed, however, it considers that the Bailiwick's regulatory regime has a firm foundation from which to proceed and to meet revised international expectations.

MiFID (Markets in Financial Instruments Directive)

This may not be of as much relevance to the investment fund sector as to the non-Fund sector but I hope that the following comments provide additional background to the current EU approach.

MiFID came into effect on 1 November 2007, replacing the Investment Services Directive. The aim of MiFID is to set out basic high-level provisions governing the organisational and conduct of business requirements that should apply to investment businesses. It also harmonises certain conditions governing the operation of regulated markets. The directive improves the "passport" for investment firms by drawing a clearer line between the respective responsibilities of home and host states and generally clarifying some of the jurisdictional uncertainties that arose under the ISD.

One of the terms of reference set by the Working Party considering amendments to the old FNCC Rules, applicable to all Guernsey investment licensees, was to ensure that the revised Conduct of Business Rules did not present difficulties to firms that had to comply with MiFID provisions through, for example, parent and/or group policies. Accordingly, reference is made to MiFID within the Conduct of Business Rules for the explicit determination of client classification.

In December 2010 a consultation paper was issued in respect of possible changes to MiFID. In the words of the European Commission this effectively resulted from market developments and experience from the financial crisis that demonstrated to the EC that the key principles of MiFID (a regulatory framework centred on shares and regulated markets) needed updating.

The Consultation Paper includes a section on Access of Third Country firms to EU Markets. Access of third country firms to EU markets is not currently harmonised under the MiFID but is left to the discretion of Member States, subject to their general obligations under EU Law and relevant international obligations and provided that national provisions do not result in treatment more favourable than that given to European firms. The CP contains possible options under a revised directive. In practice, this might mean that third country firms would have to be subject to a regulatory regime which covers specified requirements, including the members of the management body, membership of an authorised or recognised investor-compensation scheme (or join the EU scheme), capital requirements and organisational requirements. We will have to see whether the directive requires "equivalence" of regimes.

The draft directive is due out in the next few days, at which time we will be able to review and consider the proposals contained therein.

Will the revised directive have any impact for Guernsey firms? This depends on your business model and whether you have any relevant contact with the EU, especially in terms

of EU clients falling within the scope of the directive. In this respect do not forget that the UK falls within the EU. Developments relating to MiFID are something we will be keeping an eye on and we will have to ensure that our approach is relevant to the firms within this jurisdiction who may be impacted.

Regulatory Co-Operation

The Financial Services Commission and Protection of Investors Laws set out the legal gateways that enable the Commission to co-operate with foreign regulatory authorities, in addition to undertaking investigations in support of those regulatory authorities.

There is much talk about MoUs in the context of international co-operation and I thought it would be useful to put that type of document into context. It is important to note that the Commission can co-operate without a MoU in place because of the legal provisions referred to just now.

A memorandum of understanding is a statement of intent to consult, co-operate and exchange information in connection with the supervision and oversight of entities, normally operating or undertaking regulated activities in the jurisdictions concerned. It does not create any legally binding obligations, confer any rights or supersede domestic legislation. We cannot ignore the provisions of the national legislation referred to above. When the Commission receives a request for assistance or regulatory co-operation it will consider the request in the light of the Guernsey legislative provisions to ensure that the requested assistance/co-operation can be provided. It is therefore necessary for the requesting authority to provide full information and background to us in order that we may fully consider each approach.

Therefore it is not possible to respond to "fishing expeditions" or matters that fall outside the Commission's remit.

Requests covering issues that do not fall within the Commission's remit, for example criminal matters such as alleged fraud, will be referred back to the requesting authority suggesting they be directed to the Law Officers.

Statutory notices issued to licensees will make reference to the involvement of other regulators in connection with the enquiries so that the licensee is aware. Responses from licensees will be assessed by the Commission to ensure that they not only respond to the enquiry but also that they do not go outside the parameters of such enquiry. Therefore we are not simply acting as a form of post box service, passing on requests and responses. Our review may highlight issues of regulatory concern to us, especially if a potential breach of Guernsey legislation is suspected.

Finally, I just want to touch on the issue of visits to Guernsey licensees by other regulators. This is something that we already see but in light of the possible requirements being considered by ESMA in the context of relevant EU Directives it is possible that such visits may become more frequent. The Investment Business Division's standard line is that, in principle, we do not object to these visits but would expect the regulator concerned to contact the Commission in advance to notify us of the visit and the issues to be covered. We would normally wish to have a member of our staff accompany the visiting regulator to all or part of their visit, especially any closing meeting. It is also a good idea for licensees to

inform us as well about these visits, in advance, as occasionally we do not get informed by the foreign regulator.

Conclusion

Taking all of the above issues together you can see that international regulatory initiatives are going to continue to take up a large amount of Commission time over the next few years as we consider their possible impact on Guernsey's investment business regulatory regime. The impact of the Global financial crisis has led to changes in the international landscape and it is expected that this will continue, especially as issues such as consistent regulatory standards, addressing concerns of systemic risk and ongoing regulatory co-operation form the basis of international regulatory initiatives.

Thank you for your attention, I would now like to hand over to Mark who will bring you up to date with various regulatory developments.