Guernsey Financial Services Commission

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Investment, Fiduciary and Pension Division

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Slide: Overview

Welcome to the Investment Fiduciary and Pension Division update. I'm Gillian Browning and I will be talking you through a number of slides covering:

- the health of these important sectors,
- our recent Guernsey Green Fund Thematic Review,
- sharing with you hot topics that are raising our supervisory eyebrows,
- an overview of our current policy work,
- And share some insights into our aspirations for the year ahead.

Slide 3: Sectoral Health Check – Investment

Roughly a year ago we started collecting monthly data from our most significant licensees to understand the impact COVID 19 was having on their businesses.

This data has been submitted from our most significant licensees on a best efforts basis. In terms of representation they

employ over 50% of the workforce in these sectors
represent over 70% of investment turnover
and over 60% of the AUM within the investment sector

We had previously collected annual turnover data – as illustrated by the dotted lines on the chart.

This graph illustrates that investment licensee turnover for 2020 is on track to be at least on par, if not ahead of previous years – despite all the challenges COVID 19 has thrown at us.

We intend to maintain this return for the next while, albeit moving its frequency to quarterly rather than monthly.

The data collected here also helps us to understand more about the composition of fees for our key licensees, which can be an indicator of business model vulnerability. For example, the dip in April reflects the initial COVID 19 impact on NAV based income, and the September spike correlates to crystallisation of performance fees.

Slide 4: Sectoral Health Check – Investment

Moving from licensee income, to fund NAV.

Guernsey Funds are a key part of the Bailiwick's financial ecosystem. As a reminder as at the end of 2020 the NAV of Guernsey Funds stood at £245.5bn – an increase of 7.8% year on year.

This chart breaks down all those Guernsey funds and depicts them by the year they were first authorised or registered. This gives us insights into our future fund population if we work on the basis of crude replacement rates.

The chart in front of us illustrates, via the dots, the healthy number of funds authorised or registered in the last few years. We would expect there to be a lag between fund authorisation and NAV growth – although possibly would have expected to see the NAV of funds launched in 2017 to be higher by now.

The chart also illustrates – via the blue bars - our dominance in CE funds, particularly over the past decade.

Over the past couple of years we have formed an Investment Data Working Group – which has representatives on from GIFA, Guernsey Finance and the States of Guernsey. We have seen real benefits from working together analysing the data the Commission collects for maximum mutual benefit and I'd like to thank the members of that group for their time. One observation, of possible wider interest, that came out of our recent meeting was the potential trend in increased fund term extensions – CE funds running for longer than originally anticipated due to potentially market conditions, or investor demands.

Slide 5: Sectoral Health Check – Investment

The first pie chart on the slide reflects the NAV of Guernsey Funds by Currency. It is fairly static year on year, but I share with you as it illustrates how vulnerable the Guernsey Fund NAV is to FX movement. Future increases or drops in NAV may not reflect performance or inwards investment, but rather reflect currency movements.

The second chart, again fairly static year on year, illustrates our continued specialism in the Private Equity Space.

Slide 6: Sectoral Health Check – Investment

In addition to administration of Guernsey funds, the Bailiwick also administers a large number of vehicles that fall outside the definition of a Collective Investment Scheme (a Guernsey Fund) but are still Investment Structures.

We are progressing with gathering more data on the volume and value of these structures, however looking at the number of General Partnership Fiduciary discretionary exemptions we grant each year is one proxy to illustrate the size and maturity of this market.

As can be seen from the attached chart the number of General Partnership Discretionary Exemptions has grown over time, and has consistently been over 80 per year for the past five years. This chart represents numbers of exemptions, not values, however some could reflect material investment structures.

As an aside, we estimate roughly ¼ of these GP exemptions relate to carry interest and co-investment vehicles – which the forthcoming Ancillary Vehicle Consultation Paper proposes becoming an automatic fiduciary exemption, and a notifiable investment activity.

What am I saying? The Investment sector in Guernsey is resilient and material, not just in the Collective Investment Scheme space but also in the wider Investment structure landscape – and we are currently making policy proposals and changes to support this market further.

Slide 7: Sectoral Health Check – Fiduciary

We have also been collecting monthly COVID 19 impact data from our most significant fiduciary licensees. The data on this chart represents licensees that represent over 60% of all Fiduciary turnover and over 70% of the AUM within the fiduciary sector.

Because this is the first year, we have collected this data we are still learning about the cyclical nature of fiduciary income. For example, will we see a dip in income every holiday season due to its reliance on time spent income? How much of the April dip was due to licensees moving to working from home?

I will share further data on fiduciary licensee turnover in a minute based on our annual returns, but wanted to comment here that composition of fee income is different to that of the Investment sector, but that said we have not observed any financial stability issues with any of our Investment or Fiduciary licensees over the past year.

Slide 8: Sectoral Health Check – Fiduciary

As in previous years, the Fiduciary Annual Return provides us with a rich data set upon which we analyse trends. All data is as at 30 June for a particular year.

Overall the fiduciary industry remains stable, but we have been observing a steady trend of consolidation/amalgamation of licenses and this is something we expect to continue.

There is often a delay between consolidation and surrender of a fiduciary license as businesses are tidied up and clients transferred between entities. Our data is based on 142 full fiduciary licensees in 2020, compared with148 in 2019.

This chart illustrates the continued growth in licensees that identify as being part of an International Financial Group – for example PE owned fiduciaries. Number of licensees are plotted along the bottom, and the chart illustrates the value of the assets they are acting as trustee or corporate service provider for.

Across all ownership types there is a trend of continued growth in the sector with Assets under Fiduciary Regulated Activities having grown overall by 6.8% since 30 June 2019. These assets are Roughly divided between Trust and Corporate related activities,

Other metrics that may be of interest:

The annual data highlights that the Fiduciary sector still employs over 10% of the total Guernsey workforce (3,849 last year).

On average each full time equivalent member of staff employed has 13.5 appointments (2019 – 13.9) and generates £170,000 of income (2019 - £162,000) [NB this is average across all fiduciary licensees based on reported figures within the annual returns].

Slide 9: Sectoral Health Check – Fiduciary

Building on the previous slide, these two charts illustrate in pictorial form the evolution of the Fiduciary sector over time.

On the left, we clearly see the decrease in number of appointments (as Trustee or Director) and increase in the value of assets being managed by Fiduciary licensees. I've commented on this before, but it's a reflection of the jurisdiction move to fewer, higher value and more complex structures.

On the right, over a 16 year period, is the same data on number of appointments, but compared with licensee turnover. The total annualised fiduciary income for 2019/2020 was £354.2m – effectively flat from the same period last year.

Breaking down turnover further, 31% of total fiduciary turnover originates from the UK. 11% from Guernsey and 6.6% from South Africa – very similar figures to last year.

The same top ten locations account for 78% of all new business, including 31.2% from the UK, 17.5% from Guernsey and 8.2% from South Africa.

Slide 10: Sectoral Health Check – Pension

Since introduced pension scheme regulation in 2017 we have been monitoring its growth via quarterly returns. It is clearly a much smaller sector than either the Fiduciary or Investment sectors – but it is growing.

Firstly the red line shows the total value of assets has increased from c£8bln in Oct 2017 rising steadily to c£11.8bln as at Jan 2021

The grey line reflects membership numbers growing from c93,000 to 118,000 over the same period
There was a slight fall from c122,000 members in April 2020 to 118,000 in Jan 2021 which was largely as a result of a couple of schemes being cancelled later in 2020 – each scheme having in excess of a thousand members.

We know from the first set of annual return data that the majority of scheme assets are relatively concentrated into Investment products, which includes funds, structured products, ETF's, collective investment schemes.

Slide 11: Sectoral Health Check – Pension

Finally, what types of Pension schemes do we administer in the Bailiwick?

We service two distinct types of schemes. Personal and occupational. As seen from the first pie the majority of schemes by number are personal, but the majority of assets are in occupational schemes.

The second pie illustrates, of the current population of 118,000 members, many fall within the larger occupational type schemes. In fact, there are 41 schemes with over 500 members and 25 of these have more than 1000 members.

At the smaller end (as illustrated by the blue sections of the chart), there are fewer members but a larger number of schemes– in fact 81% of all schemes have just 1 or 2 members (eg local RATs). Whilst large in terms of number of schemes, these only account for 12% of total scheme assets

The vast majority of Guernsey regulated pension schemes are Defined Contribution.

The annual pension data also shone a light on fees and charges.

Our analysis, perhaps unsurprisingly, identified that personal schemes where members had a smaller pension were more likely to be charged a higher fee as a percentage of pot.

Whilst this could be due to fee structures, where e.g. a flat rate is charged and the amount is very small in relative terms, the fact remains that members with less funds are more likely to be charged a multiple of the fees of members with higher value pensions.

Overall Licensee annual revenue was less than 1% of scheme assets in 78% of schemes
Total scheme expenses less than 1% of scheme assets in 56% of schemes

However, there were some significant outliers in terms of charges, and we are seeing schemes where fees are materially eroding the value of the funds and the pension may not be in the members best interest.

Slide 12: Overview

Slide 13: Green Thematic Review

As a reminder, the Guernsey Green Fund Rules were introduced in 2018 with the objective of creating a regime in which investors could be assured that their investments had a positive environmental impact on the planet and monitored against internationally recognised criteria. We believe this was the world's first regulated green investment vehicle – and supports something that has gone from a minority interest to a mainstream concern in only a few years.

As at the end of 2020, the Guernsey Green Fund NAV was around £4bn. All the accredited funds are closed ended structures reflecting the long-term nature of the underlying investments.

We felt it was important to undertake a thematic review of our existing Guernsey green fund population.

The thematic review was published in March 2021, and contains far more details than I will relay in the next few minutes, but in essence it sought to gain a fuller understanding of the Green funds, assess compliance with the Rules and gain reassurance that our green funds are not contributing in any way to green washing – something we have zero tolerance of.

Our key findings were encouraging, that Guernsey Green Funds do invest in projects which comply with the criteria for green investments set out by the multilateral development banks. However, there were lessons to be learnt, especially for the Designated Administrators of GGF's – some of which have received tailored feedback and accompanying risk mitigation programmes.

Slide 14: Green Thematic – key takeaways for Designated Administrators

The thematic review provides far more detail, and I hope you may have a chance to read it, however I wanted to draw out today 5 key takeaways for Designated Administrators.

Firstly, the GGF is based on Guernsey licensed administrators carrying out sufficient due diligence at application stage and fulfilling ongoing requirements that the fund is monitored against notified green criteria. In order to do this successfully the designated administrator must establish reporting and monitoring requirements, or else they are effectively operating blind.

Once reporting and monitoring is established, it needs documenting in order to ensure a good audit trail that evidences how ongoing oversight obligations are fulfilled.

Thirdly, the Commission's expectation is that the actual calculation of environment impact of the investments would not be part of the Designated Administrators contracted responsibilities – however the assessments would be carried out by the manager or a third party, and these should be provided to and scrutinised by the Designated Administrators. It was apparent during our review that monitoring of environmental impact did occur at investment manager level, however the quality and quantity of environmental impact reporting received by designated administrators varied, as did the scrutiny applied to the information received.

On the positive, the Commission remains committed to the GGF regime and encourages more schemes to consider seeking accreditation – something the Commission does not charge for.

Finally, Climate Risk is becoming one of the key risk areas which we all should be considering. We are encouraging all licensees to consider the impact climate change will have on their business strategies and discuss sustainability matters in an appropriate way with their clients. The thematic review hopefully helps complement this wider conversation.

Slide 15: Overview

Slide 16: Wat is raising our supervisory eyebrows? Investment and Fiduciary

Moving gear, what is raising our supervisory eyebrows at the moment?

Across both the Fiduciary and Investment sectors there are three particularly hot topics.

Firstly – the continued trend of mergers and acquisitions. They happen frequently, but frankly the times it goes well are far outweighed by the times there is pain after purchase. One of our observations is that a lot of effort is put into completing the deal, making the purchase – far less resources are initially put into integration or remediation. This is repeatedly a costly mistake to be wary of avoiding.

Outsourcing is another perennial trend. We see more mixed practice here. Some outsourced arrangements are entered into with thorough monitoring arrangements, assessment of resource needs and clarity regarding accountability. Some 'centres of excellence' bring genuine corporate and customer benefits; however, this is an area the Commission is closely interested in, and would remind all licensees that it is in our collective interest to remain a jurisdiction of substance.

I've spent a fair proportion of today sharing some annual data highlights. What never ceases to amaze me is the poor quality of submissions we receive from you. Its not an unreasonable leap to then question if data to the regulator is incorrect, what else is wrong? Recently we have issued a reminder about the importance of reporting accurately when there has been an emphasis of matter – to not tick 'no' when in fact there has been an emphasis of matter. The amount of Quality Control work undertaken by supervisors to clean data submitted up is also disappointing. Again we consider that It is in our collective interest that you only need to report data once – and that its accurate first time – with no surprise 0's added or numbers double counted.

Slide 17: What is raising our supervisory eyebrows? Investment

Focusing on the Investment sector specifically, we would draw out three key topics attracting our frowns at the moment.

Firstly, and this is also picked up in our annual report, we observe a wide variety of quality amongst fund directors. This manifests itself in some fund directors

- Failing to understand the rationale for a particular structure
- Failing to validate the nature of assets
- Failing to take accountability – it seems that if a problem arises in a fund it is always another parties responsibility

The second point relates to fund directors, but other service providers too – for example Administrators, Custodian, possibly even the auditors. We observe a failure to manage conflicts of interest, with Bailiwick individuals being unduly seduced by the pull of ongoing fees, over and above whether the long term running of a particular fund is actually in the best interests of investors.

Thirdly, and this is a topic we are likely to focus more on in the future, is making sure a Designated Administrator's role in the Investment Sector is clear. The way the POI Law is drafted responsibility for a particular issue can end up with the Administrator. We will look to work through specific regimes, as we did with the Guernsey Green Fund, to ensure regulatory clarity and to work to remediate with the sector when issues are found.

Slide 18: What is raising our supervisory eyebrows? Pension and Fiduciary

Turning to the Fiduciary and Pension Sectors, our eyebrows have been most regularly raised in the following three areas:

Firstly, complaints regarding pension transfers have materially increased over the past few years. Whilst there are important and legitimate reasons to decline a transfer request, including where significant risks to scheme members have been identified, we do not want to be known as the hotel California of pensions where members or schemes can come, but never leave. Unfortunately, we are working with a number of licensees who appear to be placing unreasonable barriers in the way of scheme members who request a transfer, and could be accused of prioritising their own ongoing revenue stream ahead of scheme members best interests.

Secondly is the age of topic of understanding and managing conflicts of interest. We have been surprised this year by some apparent fundamental miss understandings about what may or may not constitute a conflict of interest.

Finally, we are noticing from onsite visits some entities which have still not sought tax or professional advice, or adequately considered what they have received. To be clear this does not mean we expect you to get opinion after opinion on the same issue, however we do expect to see evidence of common-sense scrutiny from directors. We know failure to obtain and maintain up-to-date professional advice has led to legal action and/or disclosures to HMRC/tax authorities, both of which are a resource drain on our licensees.

Slide 19: Overview

Slide 20: IFPD Policy Overview 2021

In terms of policy development - We balance a trilemma – creating an enabling environment for good business growth, protecting investors/members/beneficiaries/clients and preventing financial crime.

With that trilemma in mind we have been making good progress in a number of policy areas as illustrated on the screen.

The top hexagons cover our new live rules - The Fiduciary and Pension Rules which commenced at the start of this year (after a transition period). These provide what we hope will be the firm foundations of regulation in these areas for many years to come.

The next two hexagons related to what I hope are imminent rule changes. I have pre-recorded this session on 31 March 2021 and we are hopeful that a number of additional policy changes are just on the horizon – possibly even pre-dating this presentation being viewed.

The first are changes to our PIF regime, the proposals made in our December 2020 consultation paper were widely welcomed by respondents and seek to create two new PIF registration routes – one based on funds restricted to professional and institutional investors, the second limited to a group of family investors – each of these two additional routes would not require a licensed Guernsey manager, but as for all other fund regimes will require administration by a locally licensed fund administrator.

The second change, would be following up on our proposal to abolish non Guernsey scheme rules, and instead collect additional data. Further communication on this is likely to follow in the next couple of months.

The third row of hexagons is a shameless plug for our current live consultation paper. At only 6 pages long, including a cover page and two pages of appendix, it hopefully isn't too off putting. Responses are sought by 5 May 2021 in respect of proposals to make an addition to the Finance Sector Code of Corporate Governance to take specific account of climate change considerations and two minor modifications to the Guernsey Green Fund Rules.

The final row relate to two imminent, and much trailed consultation papers. The first considers changes to the Fiduciary Rules necessitated by the Revision of Laws project – including introduction of Primary and Secondary licensees, but also proposing de regulation for Personal Fiduciary Licensees who may wish to advertise their services.

The second, as touched on earlier in this presentation, covers new automatic exemptions from the Fiduciaries Law, when they have been notified to the Commission under our Investment framework and meet restricted characteristics.

Slide 21: Overview

Slide 22: Window to the future

And finally, a look through the window in the rock in Sark towards the future.

We have been conscious for some time about the global tightening in the Professional indemnity insurance market. We commenced a thematic review towards the end of last year, are currently analysing responses and will share our findings over the summer.

COVID 19 has forced us all to adapt, especially when we were in lock down and working from home. One of our lessons from this period was the benefit of undertaking a more thematic supervisory approach – and thus in the future we intend to conduct more themed visits. Essentially, we will be undertaking fewer detailed onsite inspections, instead we will select one or two particular risk areas and analyse multiple licensees in this respect. We have found that outliers soon jump out and we focus more of our attention on these areas.

And last but not least, there has been some innovative and encouraging work going on behind the schemes in the SUPTECH space. Our hope is to keep in the pack of technological advances to free up supervisors to spend more time on the real material issues of regulatory concern and less time on processing bits of paper.

So in summary, If I was to ask you to take away two things from this talk, it would be that the Investment and Fiduciary sectors remain healthy and resilient in the Bailiwick; however yes of course there are areas for regulatory improvement and it is in our collective interest to understand what these areas are and to work on them together. Thank you for listening.