Guernsey Financial Services Commission

Spring Green Consultation Paper

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Results updated 6 Jul 2021

Amendments to the Finance Sector Code of Corporate Governance (Results updated 10 Jun 2021)

Background

On the 11th March 2021 the Commission published a Consultation Paper on its proposed addition to the Finance Sector Code of Corporate Governance ("the Code"), to take specific account of climate change considerations. The consultation period ran for eight weeks until 5th May 2021.

To recap, the proposal was to insert the following sentence into the Code as Principle 5.2.1 and Principle A:18 of Appendix 3:

The Board should consider the impact of climate change on the firm's business strategy and risk profile and, where appropriate in the judgement of the board, make timely climate change related disclosures.

General overall feedback and comments

Who responded?

Fourteen replies were received: mainly from licensees.

What was the general message in the feedback?

One respondent took no position on the recommendation whilst including some observations. Ten were in favour. Three against. Of the latter, one argued that climate change was already implicit within the current Code. Another thought that climate change should be the concern of the government rather than the Commission, whilst another preferred the use of ESG.

Among the fourteen respondents, several included reservations over disclosure. However, these reservations varied significantly. One respondent thought the disclosure requirement was insufficiently prescriptive; another that it was overly prescriptive. One that disclosure was already covered within the current Code. Another that the inclusion of climate change disclosure made sense but was premature

What is the Commission going to do next?

Picking up on the above, it is a fair argument that climate change is already implicitly covered by the current Code. However, in the Commission's experience, few boards currently act on this. It seems reasonable therefore to be specific.

On mandate, the emerging consensus is that climate change is a legitimate area of concern for central banks and financial regulators. Apart from the arguments around financial stability, climate change is of direct relevance to the business and risk profile of many licensees.

In terms of nomenclature, there are several definitions in wide circulation apart from climate change. Each has their advocates and the popularity of each varies according to circumstance. However, the Commission identified climate change as its preferred nomenclature some time ago and intends to stick to it. Moving the goalposts mid-game makes scoring difficult.

The Commission agrees that the inclusion of disclosure is forward-looking and that clear global guidelines have yet to emerge. However, in time such guidelines are likely to fall into place and licensees need to be ready for this. The Commission, in any case, has left the judgment call on disclosure firmly in the hands of the board. Overall, the Commission considers that the phrasing around disclosure remains appropriate.

Following the Consultation, the Commission has decided to re-issue the Code with the proposed amendments in place. A copy of the revised Code can be found below and on the Commission's website.

Licensees will be expected to comply with the amendment for financial years starting from 1st October 2021.

Specific Feedback

The replies also included some specific questions. These were (*with Commission responses in italics*):

1. Does the Commission expect companies to use sophisticated price adjustment tools and models for climate change?

> *No; unless there is specific business argument as in the case for example of catastrophe reinsurance where models are already used for weather.*

2. The Code applies to boards of GFSC authorised and registered collective investment schemes that are formed as companies. Therefore, it appears that the additional climate change clause would apply to these entities as well as licensees, is that the Commission's intention?

> *Yes.*

3. Must disclosures be made in the financial statements of the entity?

> *Standards will evolve over time in this regard but at present the Commission considers that it is for each board to decide its approach. For example, as one respondent pointed out, in practice many relevant disclosures for the funds industry are likely to be made on the investment managers/promoters' website.*

Amendments to the Guernsey Green Fund Rules (Results updated 6 July 2021)

Feedback Statement on the Spring Green Consultation Paper Proposals to amend the Guernsey Green Fund Rules

We asked

We asked for feedback on proposals to make two relatively minor modifications to the Guernsey Green Fund Rules ("the GGF Rules") made under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (the "PoI Law"). It was proposed:

- in the case of the required Designated Administrator's monitoring of closed ended funds against the notified green criteria and investment criteria that the minimum frequency be extended from a monthly to a quarterly basis; and
- to allow the requirement for disclosure of green status to be met through the use of a recognised stock exchange market announcement.

You said

Nine respondents to the broader consultation paper offered no comment, seven respondents were supportive of the proposals and two responses suggested further relaxation of the rules.

Below is a summary of the feedback received, which is immediately followed by the Commissions response.

<u>Comments on the proposed amendments to the GGF Rules</u>

One respondent suggested that the review period for closed ended funds remained still too frequent and overly onerous and that the minimum period could be further lengthened or replaced by a form of reporting by exception.

Commission response

The GGF Rules place reliance on the licensed Designated Administrator to monitor against the relevant criteria, and then to take steps to ensure contraventions are rectified and appropriate notifications made where necessary. This function is critical to the integrity of the regime and maintaining investors' confidence in the Guernsey Green Fund designation. The Commission therefore takes the view that frequent monitoring is an essential part of the regime and that the amendment proposed in the CP remains appropriate.

Another respondent, while supportive of the proposals, suggested that these proposals might be expanded more broadly to permit unlisted closed-ended scheme to meet disclosure requirements via website disclosure.

Commission response

The proposal in respect of disclosure in the CP originated from the findings of the Commission's recent thematic review but no specific issue in respect of unlisted funds was identified. More generally the Commission is not minded to replace prospectus disclosure requirements with website disclosure.

We did

The Commission has adopted the Consultation Paper proposals in the Guernsey Green Fund (Amendment) Rules, 2021 made on 6 July 2021.

Next Steps

The revised GGF Rules will come into operation on 6 July 2021.

Files:

- Finance Sector Code of Corporate Governance, 337.2 KB (PDF document)

Links:

- Guernsey Green Fund (Amendment) Rules, 2021

Overview

The Spring Green Consultation Paper proposes 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 consultation paper, Finance Sector Code of Corporate Governance, Funds Growth Omnibus Discussion Paper and Thematic Review 2020-2021 of the Guernsey Green Fund Regime can all be accessed from the links below.

What happens next

This Consultation will be open for a period of 8 weeks, with a closing date for responses of 5 May 2021.

Following the consultation period, the Commission will collate and consider responses provided and feedback will be issued.

Related

- Finance Sector Code of Corporate Governance
- Discussion Paper - Funds Growth Omnibus
- Thematic Review 2020-2021 of the Guernsey Green Fund Regime
- Spring Green CP Corp Gov & GGF

Audiences

FINANCE SECTOR

CODE OF CORPORATE GOVERNANCE

Amended February 2016

CONTENTS

INTRODUCTION

What is the GFSC Finance Sector Code of Corporate Governance?

The economic and financial crisis, which came to a head in 2008-2009, triggered widespread reappraisal locally and internationally of the effectiveness of systems of governance. The purpose of the GFSC Finance Sector Code of Corporate Governance ("the Code") is to provide both Boards of locally regulated financial services businesses and individual directors with a framework for sound systems of company governance and, help them discharge their duties efficiently and effectively. **Ultimately, corporate governance is about the behaviour of Boards and their directors.**

The Code provides a set of Principles and Guidance, but is not intended to be prescriptive; rather it is a formal expression of the components of good corporate practice, against which shareholders and Boards, as well as the Commission, can better assess the degree of governance exercised over companies in Guernsey's finance sector. Each business's approach to corporate governance should reflect its legal and operating structure, as well as the nature, scale and complexity of the business. It is not suggested that 'one size fits all'. The GFSC recognises that the differing nature, scale and complexity of businesses will lead to different approaches to meeting the Code. Non-compliance with the Principles does not automatically make a company subject to the Code liable to any sanction or proceedings. Indeed, the nature, scale and complexity of a business might mean in some cases that a company cannot meet some or all of a Principle. For example, collective investment schemes do not usually have their own business continuity plans. The GFSC will take into account the way in which and the extent to which companies have adopted the Principles in their policies, procedures, controls and practices.

The Code does not in any way reduce or otherwise change the obligations or enforceability of any enactment or other document. The Code is not intended in any way to codify or amend existing laws or to confer rights which conflict with or add to rights arising at law. In the event of any incompatibility with existing law, the guidance contained in this Code will be disapplied and law will prevail to the extent of any incompatibilities.

Corporate governance will continue to evolve internationally and therefore the Code will be continuously reviewed and updated. In addition, interpretation of the Code will also evolve as it will need to take account of expectations of changing developments in corporate governance. The Code is a living document.

Who is covered by the Code?

The Code provides a framework which applies to all companies which hold a licence from the GFSC under the regulatory laws or which are registered or authorised as collective investment schemes ("funds")[*] under (a) below. The regulatory laws are:

(a) the Protection of Investors (Bailiwick of Guernsey) Law, 1987;

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[*] The Code does not apply to any underlying SPVs or investment holding companies of funds.

(b) the Banking Supervision (Bailiwick of Guernsey) Law, 1994;

(c) the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000;

(d) the Insurance Business (Bailiwick of Guernsey) Law, 2002 (please note that only Appendix 3 of the Code applies to persons licensed under this law ("Licensed Insurers"));

(e) the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002.

The Code does not cover entities licensed under the above Laws which are Guernsey branches of foreign domiciled companies or which are partnerships.

Companies which report against the UK Corporate Governance Code or the Association of Investment Companies Code of Corporate Governance are deemed to meet this Code.

How does the Code work?

The Code is a guidance document and is structured around a set of **8 Principles** and additional **Guidance** on how to meet the Principles[1]:

- **Level one** – represents **Principles** of good corporate governance and sets out expected standards for Boards. The Principles are included in bold type in blue boxes. The application of the Principles will be dependent on the nature, scale and complexity of the entities. For example, certain Principles may not be fully appropriate for some investment sector entities, and some further guidance is provided in these instances in Appendix 1 to the Code.

- **Level two** – provides **Guidance** (and some statements) on how to meet the Principles. The GFSC recognises that, due to the differing nature, scale and complexity of companies, there may be other ways by which the Principles can be met.

Companies should prepare a self assessment in order to assist the Board in its consideration of the Code. The extent of the self assessment will need to reflect the nature, scale and complexity of the licensee. The Code should be considered periodically at a Board meeting and the discussion minuted.

When did the Code become effective?

The GFSC issued the Code in final form on 30 September 2011, it was amended on 18 February 2016 by the addition of Appendix 3.

[1] Please note that Appendix 3 which relates only to Licensed Insurers contains only principles of good corporate governance and does not contain guidance which relates to those principles.

The Code came into effect on 1 January 2012. Companies need to be in a position to discuss their governance practices with the GFSC. The GFSC will require an assurance statement from companies confirming that the directors have considered the effectiveness of their corporate governance practices and are satisfied with their degree of compliance with the Principles set out in the Code, or the alternative codes accepted by the GFSC, in the context of the nature, scale and complexity of the business. The GFSC will liaise with the finance sector on when and how the assurance statements should be provided.

The GFSC's document "Guidance on Corporate Governance in the Finance Sector", which was issued in December 2004, was withdrawn with effect from 1 January 2012.

Code of Corporate Governance

PRINCIPLE 1. THE BOARD

Companies should be headed by an effective Board of directors ("the Board") which is responsible for governance.

1.1 ***Governance structure***
The Board should have a clear governance structure which reflects the demands and complexities of the company's business environment, strategy, company values, standards, risk appetite, internal controls and key policies.

1.2 ***Central role of the Chairman***
The role of the Chairman is central to the effective leadership and corporate governance of the company. A Chairman should be elected for each meeting of the Board where there is no standing Chairman.

1.3 ***Balance and composition of the Board***
The Board should collectively comprise an appropriate balance of skills, knowledge and competence, taking into account its members' relevant experience, such that the Board as a whole is able to discharge its duties and responsibilities effectively and that no individual or group of individuals can or does unduly dominate the Board's decision making.

Taking into account the size, nature and complexity of the company, the Board may include one or more non-executive directors, including independent non-executive directors where appropriate, in order for there to be a suitable balance of skills.

1.4 ***Committees of the Board***
The Board may, but is not obliged to, establish committees to analyse and review specific issues or to carry out functions, and provide advice and recommendations to the Board on them. While the Board may delegate powers and authority to committees, the Board will retain ultimate responsibility for the actions of committees, with such committees being under an obligation to report back to the Board.

1.5 ***Delegation to management***
The Board should ensure that a clear and sufficient senior management structure is in place and should determine the powers and duties entrusted to management to enable them to perform their duties effectively. Such delegation does not absolve the Board from overall responsibility for the sound governance of the company.

1.6 ***Board meetings***
The Board should meet sufficiently often to ensure that it fully discharges its duties in an effective manner.

PRINCIPLE 2. DIRECTORS

Directors should take collective responsibility for directing and supervising the affairs of the business.

2.1 ***Directors' duties***
Directors have a duty to operate in accordance with all relevant legislation and should also operate within a structured framework of specified responsibilities suitable for the particular company.

2.2 ***Legislation and regulation***
Directors have a collective duty to be conversant with applicable legislation, regulation, policy, rules, instructions, guidance and codes of practice to an appropriate level to enable them to discharge their responsibilities.

2.3 ***Strategy***
Directors should take responsibility for company strategy and key policies.

2.4 ***Appointment, induction and re-appointment of directors***
Where appropriate, there should be a procedure for scrutinising nominations for the appointment of new directors to the Board and a suitable induction programme provided to new appointees. The Board should also satisfy itself that plans are in place for the orderly succession of its members.

2.5 ***Commitment***
Prospective directors should confirm to the Board that they have sufficient understanding and time available to discharge their duties effectively, taking into account the number and importance of their other commitments.

2.6 ***Provision of information and support for the Board***
The Board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties, facilitate decision making and allow for effective monitoring and control of company performance.

2.7 ***Performance evaluation***
The Board should regularly evaluate the performance of its members and the effectiveness of its actions.

2.8 ***Training and development***
All directors should regularly update and refresh their skills and knowledge.

PRINCIPLE 3. BUSINESS CONDUCT AND ETHICS

All directors should maintain good standards of business conduct, integrity and ethical behaviour and should operate with due care and diligence and at all times act honestly and openly.

3.1 ***Conflicts, policy and standards***

Boards should establish, implement and maintain an effective conflicts of interest policy which sets out standards of expected behaviour, including, amongst other matters, the treatment of any non-compliance with the policy.

3.2 ***Conflicts of interest***

Directors have a duty to avoid, manage or minimise conflicts of interest and should, wherever possible, arrange their personal and business affairs so as to avoid direct and indirect conflicts of interest. Any actual or potential conflicts of interest should be declared to the Board in accordance with legislation and dealt with in accordance with the company's memorandum and/or articles of incorporation or other constitutional documents, or by the other directors as they consider appropriate.

3.3 ***Self dealing***

Any transactions between the company and its Board members should take place at arms' length or be disclosed in detail at a Board meeting before the Board considers the transaction. Any conflicted directors should consider abstaining from participating in the decision.

3.4 ***Duty to the company***

Directors have a fiduciary duty to act in the best interests of the company.

PRINCIPLE 4. ACCOUNTABILITY

The Board should have formal and transparent arrangements in place for presenting a balanced and understandable assessment of the company's position and prospects and for considering how they apply financial reporting and internal control principles.

4.1 ***Strategic business management***

The Board is responsible for overseeing the company's objectives and business plans.

4.2 ***Group policies***

The Board of a company which is a member of a group should review any group policies and assess their relevance and applicability to the business and the legal and regulatory environment in which the company operates.

4.3 ***Financial reporting***

The Board is responsible for the integrity of the company's financial statements and any other formal information relating to its financial performance, as well as any other statutory information required.

4.4 ***Internal control systems***

The company should maintain a sound system of internal control to safeguard the company's assets and to manage risk, and the Board should regularly review such controls.

4.5 ***Audit and auditors***

The Board should establish formal and transparent arrangements for considering how they apply financial reporting principles and for maintaining an appropriate relationship with the company auditors.

4.6 ***Performance monitoring***

The Board should determine and ensure that relevant monitoring criteria of the company's performance are in place and should regularly evaluate their effectiveness.

4.7 ***Outsourced functions***

The Board retains responsibility and accountability for all material outsourced functions.

4.8 ***Annual business reviews***

The Board should, at least annually, undertake a review of the company's business activities and future prospects. Such reviews should be conducted to the extent appropriate to the current and proposed activities of the company.

PRINCIPLE 5. RISK MANAGEMENT

The Board should provide suitable oversight of risk management and maintain a sound system of risk measurement and control.

5.1 ***Responsibility for risk***

The Board should maintain overall responsibility for the risk management of the company and, where appropriate, should support and be supported by a senior executive of the company who has responsibility for assessing and managing risk.

5.2 ***Risk strategy and policy***

The Board should determine the company's risk appetite and tolerance and developing policies, procedures and controls for identifying, evaluating and managing all significant risks faced by the company.

5.3 ***Risk reviews***

The Board should undertake, at least annually, a review of the effectiveness of the company's risk management, and related policies, procedures and controls.

5.4 ***Contingency planning and testing***

Companies should have in place properly constructed business continuity and contingency plans to safeguard against disruption of their operations and services and to mitigate risk. The Board should review these plans at least annually.

PRINCIPLE 6. DISCLOSURE AND REPORTING

The Board should ensure the timely and balanced disclosure to shareholders and/or to regulators of all material matters concerning the company.

6.1 ***Statutory disclosure and regulatory reporting***

The Board has a duty to ensure that information is made available as required by applicable rules, regulations and codes and that all statutory and regulatory reporting deadlines are met.

PRINCIPLE 7. REMUNERATION

The Board should ensure remuneration arrangements are structured fairly and responsibly and that remuneration policies are consistent with effective risk management.

7.1 ***Remuneration policy***

Where appropriate, the Board should review and set company remuneration policies. Such policies should, wherever possible, have regard for company and individual performance, and should avoid creating incentives that encourage excessive risk taking.

7.2 ***Levels of remuneration***

Levels of remuneration should be sufficient to attract, retain and motivate individuals of the quality required to manage and run the company successfully. Additionally, remuneration of non-executive directors should reflect the time commitment and responsibilities of the role.

PRINCIPLE 8. SHAREHOLDER RELATIONS

The Board should ensure that satisfactory communication takes place with shareholders and is based on a mutual understanding of needs, objectives and concerns.

8.1 *Communication*

The company should have in place an appropriate communications strategy with shareholders and, where relevant, other third parties. The Board should ensure the provision to shareholders of adequate information on which they may base informed decisions.

8.2 *Rights of shareholders*

The Board should respect the rights of shareholders, and ensure that facilities are made available for them to exercise their rights.

APPENDIX 1

PRINCIPAL MANAGERS, CLOSED ENDED FUND MANAGERS AND FUNDS

The purpose of this appendix is to acknowledge how the nature, scale and complexity of principal managers, closed ended fund managers and collective investment schemes (funds) in the investment sector influence their ability to meet the Code. (These investment sector entities are collectively defined as "relevant entities" for the purpose of this appendix.)

Corporate governance for the relevant entities may be determined by the constitutional documents of the fund and/or disclosed to investors in the investment particulars.

Investors in funds whose shares may be readily redeemed, transferred or otherwise realised will present different corporate governance demands for a Board of a relevant entity to those whose shares are not readily realisable.

Companies whose shares are held by members of the public will present different challenges for Boards to those whose shares not held by members of the public.

The boards of relevant entities might be comprised entirely of non-executive directors, might not establish Board committees and might not have a permanent Chairman. They do not have senior management or senior executives of their own and delegate significant functions to third party service providers, namely fund administrators.

Principal managers, closed ended fund managers and funds are likely to only need a simple induction programme and plan for the orderly succession of their members.

As shareholders of funds are also the investors in the fund their interests will differ from shareholders of other licensees.

Shareholders of funds may appoint and remove directors. It is also often shareholders rather than the Board which evaluate the performance of the Board's directors and the effectiveness of the Board's actions.

In meeting the rules on dealing within the Licensees (Conduct of Business) Rules 2009, principal managers and closed ended fund managers will be deemed to meet sections 3.2 and 3.3 of the Code.

Relevant entities are unlikely to have their own internal controls – they may rely on their administrators in relation to internal controls. They may also rely on the business continuity and contingency planning of their administrators.

Principle 7 of the Code will normally apply to Boards of relevant entities only in relation to the remuneration of their directors.

APPENDIX 2

BANKS

With reference to section 3.4 of the Code, the board of a regulated banking subsidiary should retain and set its own corporate governance responsibilities, and should evaluate any group-level decisions or practices to ensure that they do not put the regulated subsidiary in breach of applicable legal or regulatory provisions or prudential rules. The board of the regulated banking subsidiary should also ensure that such decisions or practices are not detrimental to:

- the sound and prudent management of the subsidiary;
- the financial health of the subsidiary; or
- the legal interests of the subsidiary's stakeholders.

APPENDIX 3

LICENSED INSURERS

The following more specific principles, rather than the general principles contained in the Code, apply to Licensed Insurers for financial years commencing on or after 1 April 2016. The Commission recognises that there will be different approaches to meeting these principles depending upon the nature, scale and complexity of the business.

Principle A:1 - An insurer's Board is required to set and oversee the implementation of the insurer's business objectives and strategies for achieving those objectives, including its risk strategy and risk appetite, in line with the insurer's long term interests and viability.

Principle A:2 - An insurer's Board is required to:

- ensure that the roles and responsibilities allocated to the Board, Senior Management and Key Persons in Control Functions are clearly defined so as to promote an appropriate separation of the oversight function from the management responsibilities; and
- provide adequate oversight of the Senior Management.

Principle A:3 - An insurer's Board is required to have, on an on-going basis:

- an appropriate number and mix of individuals to ensure that there is an overall adequate level of knowledge, skills and expertise at the Board level commensurate with the governance structure and the nature, scale and complexity of the insurer's business;
- at least one independent non-executive director;
- appropriate internal governance practices and procedures to support the work of the Board in a manner that promotes the efficient, objective and independent judgment and decision making by the Board; and
- adequate powers and resources to be able to discharge its duties fully and effectively.

Principle A:4 - The individual members of an insurer's Board are required to:

- act in good faith, honestly and reasonably;
- exercise due care and diligence;
- act in the best interests of the insurer and policyholders, putting those interests of the insurer and policyholders ahead of his/her own interests;
- exercise independent judgment and objectivity in his/her decision making, taking due account of the interests of the insurer and policyholders; and
- not use his/her position to gain undue personal advantage or cause any detriment to the insurer.

Principle A:5 - The insurer's Board is required to:

- adopt and oversee the effective implementation of a remuneration policy, which does not induce excessive or inappropriate risk taking, is in line with the identified risk appetite and long term interests of the insurer, and has proper regard to the interests of its stakeholders; and

- ensure that such a remuneration policy, at a minimum, covers those individuals who are members of the Board, Senior Management, Key Persons in Control Functions and other employees whose actions may have a material impact on the risk exposure of the insurer.

Principle A:6 - The insurer's Board is required to ensure that there is a reliable financial reporting process, for both public (where applicable) and supervisory purposes, which is supported by clearly defined roles and responsibilities of the Board, Senior Management and the external auditor.

Principle A:7 - The insurer's Board is required to have systems and controls to ensure the promotion of appropriate, timely and effective communications with the Commission and relevant stakeholders on the governance of the insurer.

Principle A:8 - The insurer's Board is required to have policies and procedures to ensure that Senior Management:

- carries out the day-to-day operations of the insurer effectively and in accordance with the insurer's strategies, policies and procedures;
- promotes a culture of sound risk management, compliance and fair treatment of customers;
- provides the Board adequate and timely information to enable the Board to carry out its duties and functions including the monitoring and review of the performance and risk exposures of the insurer, and the performance of Senior Management; and
- provides to the relevant stakeholders and the Commission the information required to satisfy the legal and other obligations applicable to the insurer or Senior Management.

Principle A:9 - The insurer's Board is required to provide oversight in respect of the design and implementation of sound Risk management and internal control systems and functions.

Principle A:10 - The insurer is required to establish, and operate within, effective systems of risk management and internal controls.

Principle A:11 - The insurer is required to have effective Control Functions with the necessary authority, independence, and resources.

Principle A:12 - The insurer is required to have an effective risk management function capable of assisting the insurer to identify, assess, monitor, manage and report on its key risks in a timely way.

Principle A:13 - The insurer should have an effective compliance function capable of assisting the insurer to meet its legal and regulatory obligations and promote and sustain a corporate culture of compliance and integrity.

Principle A:14 - The insurer is required to have, or to have access to, an effective actuarial function capable of evaluating and providing advice to the insurer regarding, at a minimum, technical provisions, premium and pricing activities, and compliance with related statutory and regulatory requirements. (This principle is not applicable to category 5 insurers.)

Principle A:15 - The insurer is required to have, or to have access to, an appropriate and effective internal audit function capable of providing the Board with independent assurance in respect of the insurer's governance, including its risk management and internal controls.

Principle A:16 - The insurer is required to retain at least the same degree of oversight of, and accountability for, any outsourced material activity or function (such as a control function) as applies to non-outsourced activities or functions.

Principle A:17 - The Board should carry out an annual review of the effectiveness of its corporate governance and internal controls.

Discussion Paper

Funds Growth Omnibus

Issued 7 July 2020

Guernsey Financial
Services Commission

Contents

Discussion Paper

Responses to this Discussion Paper are sought by 2 September 2020.

We welcome and strongly encourage respondents to provide feedback or comment on any section and question. Feedback may be provided via the Consultation Hub section of the Commission's website (www.gfsc.gg).

Introduction

The Commission seeks to regulate and supervise financial services in the Bailiwick of Guernsey, with integrity, proportionality and professional excellence, and in so doing help to uphold the international reputation of the Bailiwick of Guernsey as a finance centre.

The purpose of this Discussion Paper is to seek feedback from all interested parties on potential changes to the regulatory framework under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (the "PoI Law").

Consistent with the Commission's objectives, the proposals in this Discussion Paper aim to ensure that the Guernsey funds framework remains fit for purpose including: broadening the options available for certain categories of fund formation; introducing efficiencies in the current framework and seeking to clarify current areas of uncertainty. These changes will ensure that investors and the reputation of the Bailiwick continue to be protected while also helping to create opportunities for further growth.

Responses to this Discussion Paper will be considered by the Commission with a view to making more detailed policy proposals in the form of a Consultation Paper to be issued later in the year.

This Discussion Paper is a working document and does not prejudge any final decision to be made by the Commission.

Private Investment Fund

The Manager Requirement

The Private Investment Fund Rules 2016 (the "PIF Rules") require that a Private Investment Fund ("PIF") has within its structure a licensee responsible for management[1]. When considering an application for the registration of a proposed PIF, the Commission relies on certain declarations made by the proposed licensed fund manager. The fund manager makes declarations in respect of:

- prospective investors' ability to sustain losses;
- the maximum number of investors; and
- the completeness and accuracy of the application.

There have been calls from some industry participants for the Commission to consider the necessity of the requirement to appoint a PoI Law-licensed manager to a PIF. The costs associated with the appointment of a locally licensed manager are viewed by some in industry as a disincentive for new PIF formations.

The philosophy behind the PIF is that the manager through its relationship with the promoter, will have a close relationship with the investors giving them the necessary knowledge and familiarity with them to be in a position to make the required declarations. The licensed status of the manager provides the Commission with comfort and assurance as to the reliability and accuracy of any declaration made and, ultimately, the Commission would have recourse to enforcement powers in the unlikely circumstances where a declaration is false, misleading or recklessly made. In this way, the Commission seeks to ensure the protection of investors by ensuring only those able to sustain any potential losses invest in a PIF.

If alternative approaches to PIF registration were to be introduced, with the requirement for a licensed manager removed, the question must be asked as to how the Commission could continue to ensure that only appropriate investors have access to a PIF. Three possible solutions have been identified: placing reliance on a declaration made by fund directors; placing reliance on a declaration made by an associated fiduciary licensee; or more strictly prescribing the nature of investors permitted to invest in a PIF by defining a qualifying private investor.

Option A Placing reliance on a declaration made by fund directors

If certain PoI Law provisions applicable to licensees and funds were to be extended to PIF directors then the Commission may be in a position to rely on declarations made by such directors as an alternative option to placing reliance on declarations made by the fund manager. The requirement for a local, PoI-licensed manager may fall away in such a scenario. The requirement that a PoI licensee administrator is appointed would remain. The administrator would be required to confirm that it has performed sufficient due diligence to be satisfied that the directors of the PIF are fit and proper. Such a change in the legal framework would require the making of Ordinance by the States.

[1] PIF Rule 2.05

Option B Placing reliance on a declaration made by an associated fiduciary licensee

In the case of certain PIF structures, investment may be limited to a group of investors who may have a client relationship with a local licensed fiduciary. In such circumstances the licensed fiduciary may have sufficient knowledge of the investors to be in a position to make the appropriate declaration to the Commission.

Option C Defining a "qualifying private investor"

An alternative to the current declaration may be the use of a more quantitative approach. Under such an approach, access to investment in the PIF would be limited to certain types of entity or investors would be required to meet certain qualifying criteria. There are examples of this approach within the current Guernsey funds framework such as the Class Q Authorised Scheme and the Qualifying Investor Fund process. Under such an approach the licensed administrator would confirm that there were effective procedures in place to ensure restriction of the scheme to qualifying private investors. This approach could be combined with the following additional elements:

- Restriction of marketing to 50 investors;
- A prescribed minimum investment amount;
- Investor disclosure in the form of a short form prospectus or minimum investor suitability disclosure.

Key considerations

In considering and developing alternative approaches to the PIF, the Commission must be mindful of a number of factors. First and foremost, there must be no weakening of the existing framework for the protection of investors. The PIF is unsuitable for retail, unsophisticated or vulnerable persons and the above options would continue to appropriately restrict investor access.

It is important than any changes do not create potential gaps in our jurisdiction's framework for countering financial crime and terrorist financing. All the options above would ensure that the PIF, like all Guernsey funds, would continue to be required to appoint a fund administrator acting as the nominated firm responsible for investor due diligence, with therefore no weakening of controls.

Another consideration is the need to ensure that the current funds framework continues to be fit for purpose. In considering changes it is important to avoid negative impacts on the current framework and funds created under it, or the introduction of additional levels of complexity. Simple, universally understood rules are both beneficial to industry participants and their clients, and lead to positive regulatory outcomes. It is therefore proposed that in implementing any of the potential changes described above that these would be described as an alternative route to qualification as a PIF and that the original existing PIF qualification would be retained. There is no intention to create an entirely new class of fund.

Question 1

Option A - are director declarations an appropriate and viable alternative option to declarations made by a PoI-licensed fund manager?

Question 2

Option B - is a declaration by an associated licensed fiduciary an appropriate and viable alternative option to declarations made by a PoI-licensed fund manager?

Question 3

Option C - is restriction of PIF investment to a defined category of "qualifying private investor" an appropriate and viable alternative option to declarations made by a PoI-licensed fund manager?

Question 4

Do you have a view on the appropriate criteria which would distinguish a "qualifying private investor"?

Question 5

Would introduction of additional investor protection requirements such as restriction of marketing, minimum individual investment or increased disclosure negatively impact the viability of a new proposed PIF approach?

Question 6

Of options A, B and C described above, if any, which would you most strongly support?

Question 7

Do you have any views on any further alternative approaches to the current PIF model?

Basis of declaration

The Commission's PIF guidance currently in issue is not prescriptive as to how the declaring party should satisfy itself as to the ability of investors to sustain loss. The guidance does, however, offer examples of how the declaration may be satisfied and also clearly cautions against any failures in the process leading to the signing of such declaration. It is proposed that, where a declaration is relied upon as a part of the application process, an explicit requirement be placed on the declaring party to retain evidence of its assessment process in making the declaration and to make this available to the Commission upon request.

Question 8

Do you have any comments on the proposed introduction of an explicit requirement on the declaring party to retain evidence of its assessment process in making the declaration?

New promoters

The PIF regime provides a streamlined application process whereby application for fund registration and licensing of the fund manager is made via a single form. The fund administrator is required to confirm that it has performed sufficient due diligence to be satisfied that the promoter of the PIF is fit and proper but there is no requirement to complete and submit to the Commission a New Promoter's Introductory Checklist, as is required for other fund category application. It is not proposed to change the streamlined application process but the absence of the Introductory Checklist does not diminish the obligation on the declaring administrator to ensure that sufficient due diligence is conducted on the promoter. The Commission relies on the investor-related declarations made by the promoter, which are in turn supported by the promoter due diligence of the administrator. It is proposed that additional guidance be published, clarifying the Commission's expectations in respect of due diligence to be performed by the administrator.

Question 9

Do you have any comments on the proposed issuance of additional guidance to clarify the Commission's expectations in respect of due diligence to be performed by the administrator?

Additional classes, sub-funds and cells

Existing Commission guidance states that a new declaration, in respect of investors' ability to sustain loss, must be made to the Commission if new cells, sub-funds or share classes are added to an existing registered PIF. It is proposed, therefore, that the framework is amended to clarify the rules and process for this type of declaration and create a standardised declaration form for additional classes, sub-funds and cells.

Question 10

Do you have any comments on the proposed standardisation of the form and process for declaration at the point of formation of additional PIF classes, sub-funds and cells?

Exemption from Licensing for General Partners of Funds Structured as Limited Partnerships

Typically a Guernsey-based general partner ("GP") of a collective investment scheme authorised or registered under the PoI Law would hold an investment licence under this Law.

Certain fund structures may be formed where an entity separate to the GP (the "Management Company") may assume the primary management role for the fund. Such an entity may be appointed through the terms of the limited partnership agreement. The Commission understands that such a structure may be regarded as more efficient from the perspective of the fund sponsor because a single manager could act in respect of a number of funds within its stable. Duplication of governance, administration, licensing and compliance costs could be avoided. Representations have been made to the Commission that where such an appointment has been made the residual responsibilities of the fund GP should not be regarded as controlled investment business requiring a licence.

The Commission is of the view, however, that in all circumstances the GP to a fund, provided that it acts by way of business, is carrying on controlled investment business as defined under the PoI Law and would be prohibited from carrying on business without a licence.

The Commission is, nevertheless, supportive of proposals enabling innovative and efficient structures, provided that there is no diminution in investor protection. The Commission believes that investors would be protected, provided the Management Company is licensed under the PoI Law and shares common ownership with the fund GP.

The Commission is of the view, and is supported in this view by some leading players in industry, that the treatment of GPs in this type of fund structure could be clarified and regularised through the creation of a new category of exempt person under section 29 of the PoI Law. The States of Deliberation has the power to exempt persons from licensing by the making of Ordinance.

Question 11

Do you support the making of Ordinance to exempt the GP of a limited partnership authorised or registered fund where a Management Company has been appointed to exercise managerial function in relation to the a partnership and its underlying assets?

Question 12

Do you agree that such exemption should only be available where such Management Company is licensed under the PoI Law and shares common ownership with the fund GP? If not, what alternative restrictions on this possible exemption category do you believe would be appropriate?

Non-Guernsey Schemes

The Licensees (Conduct of Business and Notification) (Non- Guernsey Schemes) Rules 1994 (the "NGS Rules") require PoI licensees intending to carry out the restricted activities of management, administration or custody in connection with a Non-Guernsey Scheme ("NGS")[2] to give prior written notice to the Commission and receive approval before commencing these restricted activities. Approval must be sought in respect of each individual NGS. This requirement applies only to PoI licensees in respect of restricted activities for open-ended NGS which are not exempt by virtue of establishment in a Designated Country or Territory[3].

The observation can be made, and has been made by representatives of the Guernsey funds industry, that the current NGS Rules are both inconsistent and duplicative.

The role of the Commission in approving individual fund client take on is inconsistent with the jurisdiction's other supervisory regimes.

The NGS is subject to the regulatory regime in its domicile jurisdiction and the argument could be made that the NGS Rules introduce a second form of indirect quasi-fund regulation. The NGS Rules also impose certain conduct of business rules. These rules are however largely duplicative of provisions made under the Licensees (Conduct of Business) Rules 2016 (the CoB Rules") which all PoI Licensees are required to meet.

It is therefore proposed that the NGS Rules are amended to remove the requirement for prior Commission approval in respect of the commencement of restricted activities in respect of a NGS. The requirement to provide notification under the NGS Rules would be retained for open-ended funds. It is further proposed to amend the NGS Rules to remove any duplication with the CoB Rules.

Question 13

Do you agree that the Non Guernsey Scheme Rules should be amended to remove the requirement for prior Commission approval in respect of the commencement of restricted activities in respect of a NGS?

Guernsey Green Fund

The Guernsey Green Fund Rules 2018 (the "GGF Rules") establish a framework under which a fund registered or authorised under the PoI-Law may be designated as a Guernsey Green Fund ("GGF").

The objective of the GGF framework is to provide a platform upon which investments into various green initiatives can be made. The GGF designation enhances investor access to the

[2] A NGS is defined as a collective investment scheme which is neither incorporated nor established under the law of any part of the Bailiwick of Guernsey nor authorised under the PoI Law

[3] Designated Countries and Territories are Jersey, Isle of Man, the United Kingdom and the Republic of Ireland

green investment space by providing a trusted and transparent product that contributes to the internationally agreed objectives of mitigating environmental damage and climate change.

The GGF Rules provide that the Commission may designate a fund as a GGF provided that certain green criteria are met. Schedule 2 to the GGF Rules provides a list of the green criteria that are endorsed by the Commission. At present the Commission endorses only one standard, the Common Principles for Climate Mitigation Finance Tracking[4], but has indicated the intention to add to the list of green criteria standards in Schedule 2 where it considers it appropriate to do so.

In the period since the development of the GGF Rules, internationally a plethora of privately and publicly sponsored green investment standards have been published of varying quality and nature. In this crowded environment it is important that the Commission in adopting additional alternative green criteria ensures that only credible and internationally recognised standards are considered.

The European Union has published and agreed a general framework proposal for a Taxonomy for Sustainable Finance (the "Taxonomy")[5] and the European Commission is to finalise a fully developed Taxonomy, addressing the objectives of climate change mitigation and adaptation, before the end of 2020, for implementation before the end of 2021. The Taxonomy is a classification system for sustainable activities and is designed to sit under a regulatory reporting framework and to be used by EU financial market participants and financial products, such as Alternative Investment Funds.

The Taxonomy promises to be widely adopted through its use in EU regulation and therefore will represent a credible and well-understood international standard. The Commission proposes that, once finalised, the Taxonomy should be considered for adoption within Schedule 2. Adoption would therefore likely take place during 2021. It is considered that through careful and considered expansion of green criteria the GGF will continue to be a relevant, transparent and broadly recognised product providing investors with assurance that their investments make a positive environmental impact.

For the avoidance of doubt, application for GGF designation will continue to be at the discretion of fund sponsors and management and there is no proposal at this time to introduce mandatory green investment, reporting or disclosure requirements.

Question 14

Do you agree that the EU Sustainable Finance Taxonomy should be considered by the Commission for endorsement under the GGF Rules?

[4] Developed by the joint climate finance group of Multilateral Development Banks and the International Development Finance Club

[5] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf

Green Verifier

At present the verification or certification of Green Financial Products rely on voluntary codes of conduct or membership of industry bodies. Globally we do not understand there to be a regime backed by Financial Services Regulation. The International Organisation of Securities Commissions published a report in April 2020 that identified concerns by both regulators and market participants, amongst others, relating to greenwashing. Recent research by Guernsey Finance among Family Offices has also shown that "*Trust in green products is key to unlocking the demand for green and sustainable investment and providing the confidence to invest. The need for transparent verification or certification of green investment products has been highlighted*".

The Commission is seeking views on a proposal to introduce a new restricted activity to the POI Law of "Verification of *Green Transactions*". This activity would enable new multi-disciplinary licensees to operate with compliance and financial experts working alongside environmental scientists.

Licensees would, as now, have to meet the Minimum Criteria for Licensing, be fit and proper with the necessary integrity, skill and appropriate policies, procedures and controls. The Licensee would crucially have a *Chief Scientific Officer*; a Member/Fellow of a recognised Scientific Organisation. In order for the Commission to assess all aspects of scientific governance it would appoint appropriate Officers to advise it. In all other respects the Commission would approach licensing and regulating in the same way as for other licensees.

It is proposed that the scope of the green verification restricted activity would be broad including not only the verification of Guernsey Green Funds under Route 1 but also verification of instruments offered elsewhere, such as Bonds, Securities and other financial products. It is proposed that the provision of a declaration under Route 2 of the GGF Rules would not be within scope of the green verification restricted activity.

The new Licensees would create a "one-stop service" for verification of Green Transactions which should provide a more effective and efficient mechanism for the market. It is considered that the introduction of a verification regime, if undertaken carefully, will provide an important tool in the fostering of confidence in financial products intended to support the fight to address the significant issues of Climate Change. It would also see Guernsey develop further as a centre of *Green Finance*.

Question 15

Do you agree with the introduction of a new restricted activity of "verifying *Green Transactions*"?

Question 16

What financial products should, and should not be considered *Green Transactions*?

Guernsey Financial Services Commission

Review of the Guernsey Green Fund Regime

Thematic Review 2020-2021

Executive summary

During Q4 2020 and Q1 2021, the Commission undertook a Thematic review in order to gain a solid understanding of our existing Guernsey Green Fund population and assess how they comply with the Guernsey Green Fund Rules, 2018. The Commission's other objectives in undertaking the Thematic review were:

- To assess both the Route 1 and Route 2 notification processes;
- To investigate how the Designated Administrators fulfil their ongoing monitoring requirements;
- To educate licensees as to the Commission's expectations in this area;
- To gain information on the investment portfolios of the current Guernsey Green Funds;
- Ascertain if any future amendments to the regime would be beneficial.

What did the Commission find?

The current Guernsey Green Funds have an energy and agriculture focus

Three of the Guernsey Green Funds fall under Section 1.1 of the Common Principles for Climate Mitigation Finance Tracking – Renewable Energy; electricity generation. The remaining four funds all fall under Agriculture, forestry and land-use with a combination of agriculture, afforestation, reforestation, biosphere conservation and livestock. Further details are provided in Key Finding 1.

Green investment knowledge and expertise is not widespread in industry

Guernsey is a strong supporter of green initiatives and a variety of specialist firms are located within the Bailiwick but within the finance industry expertise is clustered in small pockets. Several of the larger international groups contain centres of excellence in green, which can be called on to assist locally. Environmental risk is perhaps the fastest growing risk area in finance, consequently as green finance becomes better-established local firms will have to ensure that staff are appropriately trained. Key Finding 2 provides further detail.

Variation in the level of assessment carried out in relation to certification requirements

The Commission noted that the level of assessment carried out for both Route 1 and Route 2 certification varied depending on the perceived complexity of the underlying asset type, the potential investors and the party carrying out the verification review. Key Finding 3 provides further detail on these variations.

Designated Administrators approached their ongoing oversight obligations in a variety of ways

The Thematic review once again highlighted the diverse nature of funds and approaches to regulatory compliance within the Bailiwick. The level of ongoing oversight demonstrated by some of the Designated Administrators during the review did not, in all cases, meet the expectations of the Commission. In these instances the Commission is imposing risk mitigation programmes on the firms. Key Finding 3.

The objective of mitigating environmental damage resulting in a net positive outcome for the environment can be verified and measured in a number of ways

The individual investment focus of each of the Guernsey Green Funds necessitates a bespoke approach to establishing the net positive outcome of investment. The Thematic review established that in some cases additional oversight of the impact assessment process carried out by the investment managers is required in order to demonstrate compliance with the Guernsey Green Fund Rules, 2018 and consequently the Commission will be imposing risk mitigation programmes on the relevant firms. Key Finding 3.

The Guernsey Green Fund accreditation provides investors with independent validation

The Board of Directors for all of the seven Guernsey Green Funds explained that one of the benefits of obtaining the accreditation was the ability to provide investors with an independent validation of the fund's investment strategy and knowledge that their investment will result in a net positive outcome for the environment. Key Finding 4.

The appetite for green investment within the Bailiwick is in its nascent stage

The surveyed Designated Administrators provided feedback on the appetite for green products held by their own business, their clients, underlying scheme investors and their professional service providers. The survey results are presented in detail under Key Finding 5.

The current Guernsey Green Funds regime is mostly viewed as appropriate

The thematic respondents acknowledged that the requirements of the Guernsey Green Fund Rules, 2018 are appropriate and not unnecessarily onerous, demonstrating the ongoing credibility and integrity of the regime. Two possible amendments to the regime are being considered;

- monthly monitoring of the investment and green criteria was viewed as too onerous for closed ended funds, quarterly being more appropriate.

- a modification to the prospectus disclosure requirements to permit certain disclosures to be made via a recognised stock exchange announcement. Key Finding 6 expands on these themes.

What should licensees do as a result of this?

Licensees should:

- ✓ *Continue to document how ongoing oversight obligations are fulfilled to ensure that a good audit trail can be demonstrated;*
- ✓ *Ensure that all the appropriate reporting and monitoring requirements are set in place to enable their oversight requirements to be fulfilled;*
- ✓ *Consider whether staff have access to training and knowledge which will assist in delivering their role in the Guernsey Green Fund regime;*
- ✓ *Remain confident that the Commission is committed to the Guernsey Green Fund regime and continue to consider if any of the schemes administered should seek to attain accreditation;*
- ✓ *Consider environmental risks to their business on an on-going basis.*

What is the Commission not saying?

The Commission is not saying that:

- *There is a preference for either Route 1 or Route 2 certification, both options will be maintained;*
- *The net positive outcome for the planet must be measured using any specific methodology;*
- *The Designated Administrator should be preparing or recalculating the net positive outcome outputs. The assessments carried out by the manager or third parties should be provided to, and scrutinised by, the Designated Administrators.*

The Commission would like to thank all the participants in the thematic review, and in particular, those who were visited for the file reviews and discussions regarding their approach to the Guernsey Green Fund regime.

Gillian Browning
Director of Investment Fiduciary and Pension Division
March 2021

Contents

Approach

The Thematic Review consisted of three core elements:

1. An initial information gathering stage. A brief general questionnaire on the appetite for green investment was sent to all Designated Administrators. This was followed up by targeted information gathering requests to the Designated Administrators of seven Guernsey Green Funds. Finally, a questionnaire was sent to the fund / general partner boards of the current accredited funds.

2. Onsite visits were carried out to six Designated Administrators of Guernsey Green Funds to meet with stakeholders and conduct reviews. One of the funds is in wind down so an onsite visit was not carried out with its Designated Administrator.

3. Meetings with other stakeholders involved in the green finance sector in Guernsey.

The Thematic team carried out a desk-based review of the information provided in response to the initial requests and used this to inform the discussions and file reviews whilst onsite at the Designated Administrators.

Background

Thematic reviews are used by the Commission as a tool to gather information on specific aspects of the Bailiwick financial services sector. The reviews also provide a means by which the Commission can share observations with industry on both good and poor practices and to engage with a wide selection of licensees within a relatively short period of time. **The Commission carried out the thematic in order to gain a solid understanding of the existing green fund population and their compliance with the GGF Rules, to assess if any greenwashing was taking place and to ascertain if changes to the current regime would be beneficial.**

Climate change and environmental issues

The speech given by Mark Carney, the then Governor of the Bank of England, at Lloyd's of London on 29 September 2015 is now viewed as a pivotal moment in raising awareness about the potential impact of climate change. Mr Carney termed this potential impact as the 'tragedy on the horizon' citing that 'the catastrophic impacts of climate change will be felt beyond the traditional horizons of most actors – imposing a cost on future generations that the current generation has no direct incentive to fix'.[1] This key speech raised awareness in the financial services sector and was a call to arms for industry to take action, it utilised scientific evidence to illustrate that climate change will threaten financial resilience and longer term prosperity, with the window of opportunity to act shrinking quickly.

Three key characteristics of the current financial system can contribute to environmental problems, rather than offer solutions:

- A bias towards short-termism in decision making;
- A narrow focus on profit and shareholders; and
- A failure to address 'externalities'.

[1] Bank of England. Breaking the tragedy on the horizon – climate change and financial stability – speech by Mark Carney. [ONLINE] Available at: https://www.bankofengland.co.uk/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability [Accessed 17 September 2020].

The G20 estimates that the global transition to a low-carbon economy will require approximately $6 trillion per year for the near future. For the Bailiwick's financial services sector, this is not only a commercial opportunity but also fulfils a valuable social purpose by giving the opportunity to demonstrate our commitment to participating in the transition to a low-carbon, more sustainable world.

The Intergovernmental Panel on Climate Change ("IPCC") estimates that approximately 2.5% of global gross domestic product annually needs to be invested in the energy system between 2016 and 2035 to meet the goal of reduction in global temperatures of 1.5 degrees Celsius above pre-industrial levels.[2] *The IPCC report delivered at COP 24 to the United Nations Framework Convention on Climate Change in December 2018, states that inter alia, if global warming of 2 degrees Celsius takes place by 2100 there would be an associated global sea level rise of up to circa 1 metre, a cause for concern for all island dwellers.*

The Guernsey Green Fund regime is an attempt to harness the potential of the financial services market to help combat climate change. There are a number of EU, UK and global initiatives already in place, for example, the Financial Stability Board's Taskforce on Climate-related Financial Disclosures ("TCFD"), the European Commission's Sustainable Finance Action Plan and the UK Government's Green Finance Strategy.

Climate-related financial disclosures will be one of the key drivers ensuring that capital is channelled into areas that achieve positive environmental outcomes. The TCFD recently published its third annual status report noting that support for the disclosure regime had reached 1,500 organisations globally, including over 1,340 companies with a market capitalisation of $12.6 trillion and financial institutions responsible for assets of over $150 trillion.[3]

This feedback paper is being published alongside the Commission's Spring Green CP which brings forward proposals for Board to consider green disclosure as international green disclosure standards evolve.

By the introduction of the GGF Rules in July 2018, the Commission aimed to create a regime in which investors can be assured that their investments have a positive environmental impact on the planet monitored against internationally recognised criteria. Guernsey is uniquely placed to be a world leader in this area; it is a member of the UN's Finance Centres for Sustainability network and has more than 50 years' of experience in financial services provision. The Commission is also a member of the Network for Greening the Financial System, a network of central banks and regulators who share best practices and contribute to the development of environment and climate risk management in the finance sector.

The Financial Conduct Authority issued a discussion paper on Climate Change and Green Finance in October 2018 with the feedback being published in October 2019.[4] One theme of the feedback paper is the difficulty in identifying genuinely green investments. The lack of common metrics and standards coupled with few disclosure requirements results in confusion and frustration for potential investors when making investment choices. By investing in a 'badged' or accredited Guernsey Green Fund investors can be confident that the scheme documentation meets the notified green criteria and that the fund is monitored against both these and the investment criteria.

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[2] International Panel on Climate Change. 2018. *Global Warming of 1.5 degrees.* [ONLINE] Available at: https://www.ipcc.ch/sr15/ [Accessed 18 September 2020].

[3] Task Force on Climate-related Financial Disclosures. *2020 Status Report.* [ONLINE] Available at: https://www.fsb.org/2020/10/2020-status-report-task-force-on-climate-related-financial-disclosures/ [Accessed 11 November 2020].

[4] Financial Conduct Authority 2019. *Climate Change and Green Finance: summary of responses and next steps* [ONLINE] Available at: https://www.fca.org.uk/publication/feedback/fs19-6.pdf [Accessed 18 September 2020].

"The purpose of certification is to provide certainty to investors that the Guernsey Green Fund is invested in accordance with the recognised green standards". [5]

The Common Principles for Climate Mitigation Finance Tracking [6] is the only standard currently included in the GGF Rules, additional detail is provided at Appendix 1.

Bailiwick fast track application regimes rely on the assessments and reviews carried out by the licensees signing the declarations on the application forms. The Commission expects Guernsey licensed administrators to carry out sufficient due diligence to confirm that a Guernsey Green Fund application, including the information submitted in support of the application is complete and accurate and that the prospectus meets the requirements of the GGF Rules.

There is also an ongoing requirement within the GGF Rules for the Designated Administrator to ensure that a fund is monitored against the notified green criteria and the investment criteria on a monthly basis. Annual confirmation of this compliance must be provided to the Commission within six months of the fund's accounting year-end and provided to investors on an annual basis.

Greenwashing

The recent growth in green investment activity has resulted in a corresponding rise in greenwashing – making false, misleading or unsubstantiated claims about the positive environmental impact of a product, service or activity. The Bailiwick has a hard-earned reputation as a high quality, well-regulated jurisdiction so the Commission wanted to gain reassurance that the green funds it authorises could not be seen as undertaking greenwashing. The drive to prevent greenwashing has led to an acceleration in a number of policy and regulatory measures designed to promote green and sustainable finance, particularly in emerging and developing countries.

According to the UN Environment Inquiry into the Design of a Sustainable Financial System, by the end of June 2016, there were 217 policy and regulatory measures supporting green finance, by 2017 this had risen to over 300 measures.[7] *A point echoed by Kevin Stiroh (co-chair of the Task Force on Climate-related Financial Risks and member of the Basel Committee on Banking Supervision) at the IIF Annual Membership Meeting on 14 October 2020. The Task Force carried out a stocktake of members' existing regulatory and supervisory initiatives on climate related financial risk, noting 'there is a multitude of initiatives under way among a wide range of international forums, central banks, academics and private stakeholders to study climate related financial risks and co-ordination at a global level would be beneficial.'* [8]

This lack of clarity regarding standards and measures highlights one of the advantages of a credible green fund regime.

Greenwashing is a real risk to the long-term viability of green finance not only within the Bailiwick but also on a wider scale. If investors lack confidence in the credibility of green funds there will not be sufficient appetite to invest and the required shift in capital towards green projects and products will not facilitate the transition to a more sustainable, low-carbon world at a fast enough pace to reduce climate change and environmental damage. A review into greenwashing published by New Money in

[5] Guernsey Financial Services Commission website. [ONLINE] Available at: https://www.gfsc.gg/industry-sectors/investment/guernsey-green-fund [Accessed 18 September 2020].
[6] International Development Finance Club. *Common Principles for Climate Mitigation Finance Tracking*. [ONLINE] Available at: https://www.worldbank.org/content/dam/Worldbank/document/Climate/common-principles-for-climate-mitigation-finance-tracking.pdf. [Accessed 18 September 2020].
[7] UN Environment Inquiry 2018. *Making Waves: Aligning the Financial System with Sustainable Development*. [ONLINE] Available at http://unepinquiry.org/wp-content/uploads/2018/04/Making_Waves_Summary_English.pdf [Accessed 15 October 2020]
[8] The Basle Committee's Initiatives on Climate-Related Financial Risks, speech by Kevin Stiroh Executive Vice President. [ONLINE] Available at https://www.newyorkfed.org/newsevents/speeches/2020/sti201014 [Accessed 16 October 2020]

March 2020 indicated that data from Morningstar suggested that of the 2,405 ‘sustainable’ funds in Europe, just 160 or 6.7% explicitly state, by prospectus, that they either screen out or reduce exposure to fossil fuels beyond coal.[9]

International activities to promote green investment

IOSCO established the Sustainable Finance Network (“SFN”) in October 2018 to facilitate discussions on sustainability issues, disclosure requirements, investor behaviour and the update of industry-led sustainability initiatives. Guernsey joined the SFN in February 2019 and contributes to collaborative work on common regulatory and supervisory issues relating to sustainable finance. The SFN carried out a survey of market participants in Q4 2019 in order to understand market sentiment towards regulators in relation to sustainable finance.[10]

Survey participants had a clear expectation that regulators have a pivotal role to play in promoting transparency of information and preventing greenwashing. Market participants see the differing international disclosure standards and lack of credible comparable data as severe impediments to the development of sustainable finance. The key findings of the SFN work can be summarised as;

1. There are multiple and diverse frameworks and standards;
2. There exists a lack of common definitions of activities;
3. There are investor protection challenges such as greenwashing that need to be overcome.

The establishment of the GGF regime is an attempt by the Commission to provide both investors and market participants with an assurance that the accredited structures are credible products that contribute to the internationally agreed objectives of mitigating environmental damage and climate change.

[9] The New Money Guide to Greenwashing 2020. [ONLINE] Available at https://www.new-money.co.uk/wp-content/uploads/2020/03/Guide-to-Greenwashing-FINAL-digital2449.pdf [Accessed 15 October 2020]
[10] Sustainable Finance and the Role of Securities Regulators and IOSCO Final Report April 2020. [ONLINE] Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf [Accessed 20 October 2020]

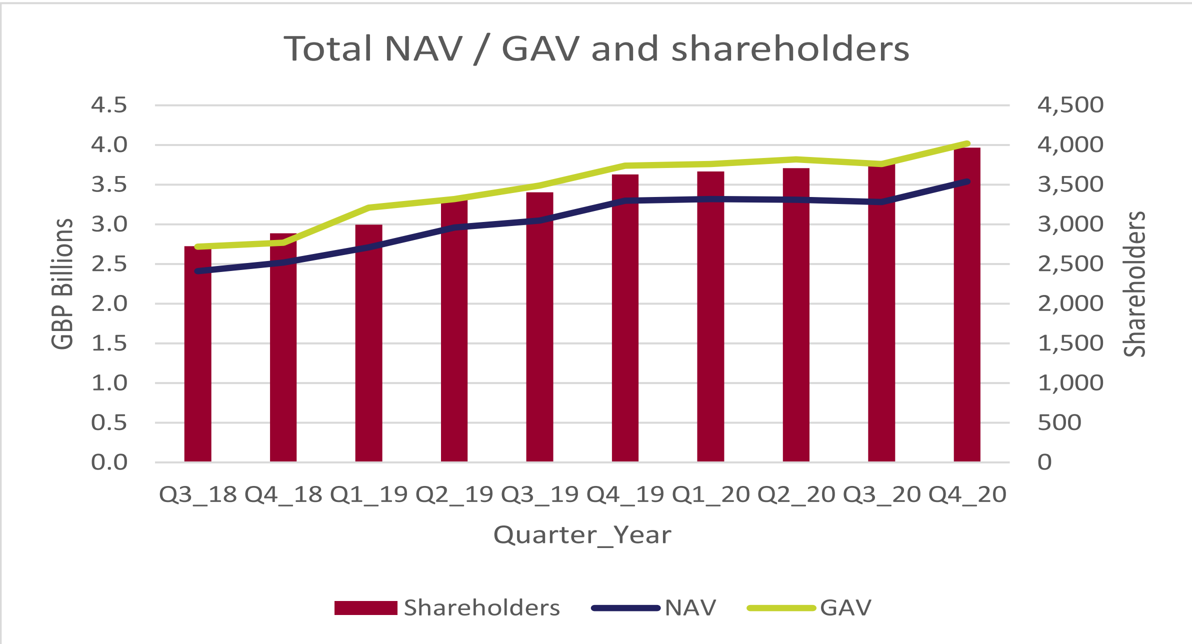
Analysis

Key Findings: 1. Composition of the population of Guernsey Green Funds

The first Guernsey Green Fund received its accreditation in October 2018, three months after the launch of the regime. A second accreditation was issued in December 2018, followed by three during 2019 and two in 2020. Only two of the funds requested accreditation at launch, the majority of the accreditations being issued to existing funds already holding regulatory approvals. At the end of Q4 2020 the Guernsey Green Funds reviewed in the thematic held a total gross asset value of c.£4 billion.

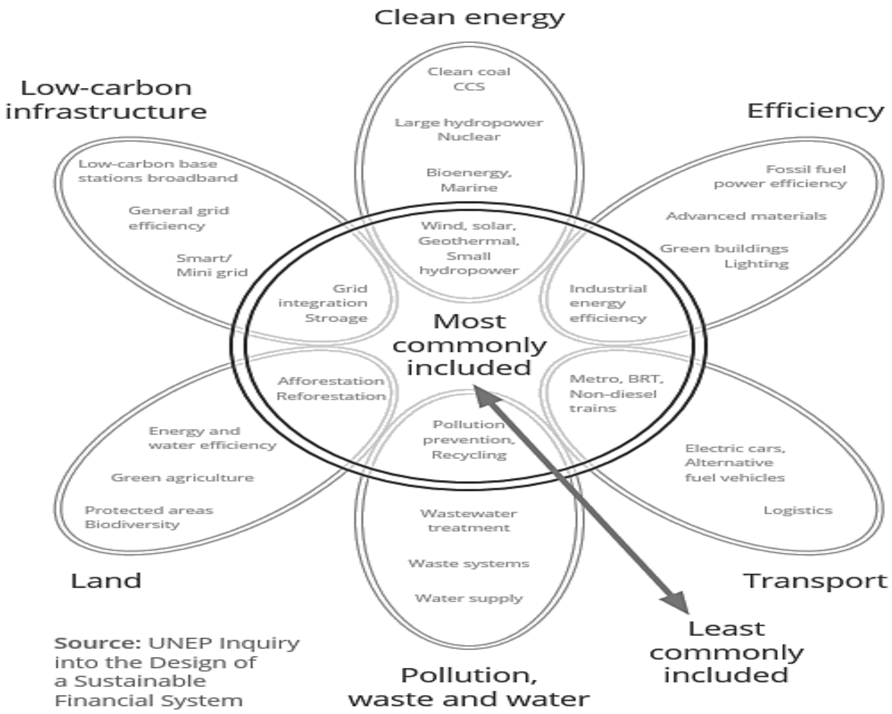
All of the accredited funds are closed-ended structures, reflecting the long-term nature of the underlying investments. One of the fundamental characteristics of green investment is that decision-making needs to focus on long-term outcomes and not just the short-term goal of returns for stakeholders. The current financial system is dominated by a short-term bias but the increasing awareness of green issues is starting to shift this approach in investing.

The following graph illustrates the growth in asset values and shareholder numbers in the current population of green funds from the launch of the regime in July 2018 to date.



GAV – gross asset value. All assets including cash and bank balances plus any prepayment accounts due. In effect, this represents the asset side of a fund's balance sheet.
NAV – net asset value. Gross asset value less all liabilities, including bank overdrafts, borrowings, creditors and accruals.

The current green fund population has an investment focus on renewable energy and agriculture. As can be seen from the diagram below this focus largely reflects the investment strategy of green funds as a whole and is not unique to the Bailiwick.



[11]

[11] Chartered Banker Principles and Practice of Green Finance 2019

Key Findings: 2. Green expertise within the Bailiwick (and beyond)

Professional 'green' qualifications are proliferating and cover a wide range of industries from construction to energy production. Within finance, short courses and qualifications are both available. The Chartered Institute of Securities & Investment and the Chartered Banker Institute have partnered to deliver the Green and Sustainable Finance Certificate. Launched in 2018, it is the first global benchmark qualification for the green finance sector.

The Bailiwick is developing 'green' expertise and experience. The International Stock Exchange launched a green segment, TISE Green, in November 2018 that is open to all types of listed investments that are verified as green. TISE Green promotes investments that make a positive impact on the environment. Approval to list on TISE Green requires an issuer to provide an appropriate third party verification, and, unlike the GGF regime, TISE is not prescriptive about the qualifying criteria that the listing is verified against. The Commission and TISE do not impose additional fees for their respective green accreditation or listing.

The Thematic team met with additional private sector organisations during the review, one of these firms has been established in the Bailiwick with the objective of seeking to measure the environmental and social impact of organisations and also investment portfolios. A network of experts has been developed to provide services such as carbon footprint assessment, benchmarking against the UN Sustainable Development Goals and accreditations for organisations. The resulting service offering meets ISO 14064 standards.

A green infrastructure or 'eco-system' of firms is developing within the Bailiwick. These firms are bringing together expertise and knowledge, which can be utilised within the Bailiwick and beyond, giving Guernsey the opportunity to be a leader in both green and wider sustainability matters. One forum for this pooling of knowledge is the Guernsey Green Finance Committee which is attended by We are Guernsey, States of Guernsey, Designated Administrators, Bankers and Insurance providers amongst other representatives. Meetings take place on a monthly basis and have had numerous guest attendees including an official from the United Nations. The committee is a knowledge sharing and educational exercise.

When the Commission launched the GGF regime, the expectation was that the actual calculation of the environmental impact of the investments would not be part of the Designated Administrator's contracted responsibilities and therefore a high level of detailed technical knowledge would not be necessary. Monitoring that the assessment and calculation is taking place does however fall within the remit of the Designated Administrators, as required by Section 6 of the GGF Rules and therefore there is an expectation that the output of this assessment and calculation is reviewed to a level that satisfies the Designated Administrator as to their responsibilities.

Overall, the Thematic team observed a growing 'eco-system' of expertise and knowledge on the island. However, this expertise sat predominantly outside of Designated Administrators with little demonstrable appetite being identified to offer training to staff to upskill their Green Finance knowledge. The Commission does not expect staff at Designated Administrators to be experts in all asset types administered. It is, though, important that staff have a basic understanding of green investments to ensure that they can fulfil their responsibility to monitor a green fund against the notified green criteria and investment criteria. Further feedback on this subject is covered under Key Finding 3. Environmental risk is one of the emerging risks facing financial services businesses as a whole so it is crucial that Bailiwick firms have the skills and knowledge to understand the risks and incorporate the mitigations into business models and operations.

GOOD PRACTICE

There is increasing evidence of Bailiwick businesses taking green and ESG risk factors into consideration when planning their business strategies. During Full Risk Assessments undertaken in 2019 and 2020 supervisors regularly raised questions regarding appetite and approach to green and ESG. From the responses received, it is more likely that initiatives are group led, where expertise and knowledge can be shared with all group companies. Continuing growth in this awareness will permit Bailiwick firms to ensure environmental risks are managed.

GOOD PRACTICE

It is encouraging to see that a number of Designated Administrators are members of the Guernsey Green Finance Committee that promotes knowledge sharing and upskilling within the Bailiwick. Additionally, some licensees have 'Green Champions' within their offices in Guernsey offering training and support to colleagues.

AREA FOR IMPROVEMENT

As yet, not all of the Bailiwick Designated Administrators providing services to green funds have in-house 'green' specialists. Whilst comprehensive knowledge of all asset types held by regulated funds is not expected by the Commission for all levels of staff, we would encourage Bailiwick Designated Administrators and other service providers to ensure that staff have access to appropriate training and qualifications in this area. When presented with clients who want a green product, service providers will need to 'talk their language' and understand their requirements. An appreciation of this growing risk area will be necessary to ensure the Bailiwick remains a key player in green finance provision.

Key Findings: 3. Compliance with the Guernsey Green Fund Rules

Application stage

Bailiwick fast track application regimes rely on the assessments and reviews carried out by the licensees signing the declarations on the application forms. The Commission expects Guernsey licensed Designated Administrators to carry out sufficient due diligence to be able to confirm that the Guernsey Green Fund application, including the information submitted in support of the application is complete and accurate and that the prospectus meets the requirements of the GGF Rules. No application or ongoing fees are charged for green accreditation.

At the initial accreditation stage, Route 1 notification requires that a certificate from a suitable independent third party be provided to evidence that the prospectus meets the notified green criteria. Details of the third party's name, address and expertise must be provided along with a confirmation that no conflict of interest exists between the third party and the governing body of the scheme. The Commission is not prescriptive in relation to the third party utilised to provide the certification, however the Designated Administrator signing the declarations on the Route 1 notification has to confirm that the third party is independent and has adequate expertise. Route 1 is favoured by some fund promoters as it provides the increased credibility of being subject to external verification by an independent party, which is perceived as attractive to investors.

It is the Commission's expectation that the Designated Administrator make a documented assessment of the Route 1 selected third party to evidence that the declarations it makes are valid. Our thematic review found that where assessments were documented they were limited in scope. Three of the Designated Administrators have utilised Route 1 and typically used professional services firms as their independent third party. The third party firms utilised international standards such as ISRS 4400[12] and ISAE 3000[13] for their assurance reviews.

The main difference between Route 1 and Route 2 is that the Designated Administrators carry out the actual review for Route 2 rather than utilising the services of a third party provider. The additional level of independent verification provided by Route 1 is seen as beneficial by some promoters, particularly when the fund holds a variety of green investments rather than just being single focus (such as solar power).

AREA FOR IMPROVEMENT

Consideration of the skills, experience and independence of the Route 1 third party provider must be documented by the Designated Administrator in order to ensure that compliance with the application form declarations can be demonstrated. The lack of documented assessment did not mean that the consideration had not taken place, but without evidence, compliance with the GGF Rules is not demonstrated.

At application stage confirmation of the green criteria to be applied to the fund is provided, ongoing monitoring against this criteria is required by Section 6 of the GGF Rules. It is possible that the green criteria will change over the lifetime of a fund, for example, a land-use focussed fund may be permitted to invest in both agriculture and reforestation but only one asset type was invested into and notified at application stage. Under Section 9 of the GGF Rules, notification must be made to the Commission of any changes in green criteria.

[12] International Standard on Related Services 4400 "Engagements to Perform Agreed-Upon Procedures Regarding Financial Information".
[13] International Standard on Assurance Engagements (ISAE) 3000, Assurance Engagements other than Audits or Reviews of Historical Financial Information, issued by the International Auditing and Assurance Standards Board.

AREA FOR IMPROVEMENT

If a green fund makes investments into categories of green criteria other than those stated at application stage a notification must be made to the Commission by the Designated Administrator and any internal monitoring schedule should be updated to reflect the additional criteria.

Ongoing compliance

Section 6(1) of the GGF Rules states that *"The Designated Administrator shall ensure that the Guernsey Green Fund is monitored against the notified green criteria and the investment criteria on a monthly basis..."*

The Thematic team was advised via the survey that all but one of the Designated Administrators are ensuring that their accredited fund is administered in accordance with the scheme particulars by way of reviewing reports from the investment manager to fulfil their monthly oversight requirement. The remaining Designated Administrator confirmed that no specific monthly monitoring took place and this omission was recorded as a breach of the GGF Rules on their breaches register and corrected immediately.

The GGF Rules are designed to overlay both the registered and authorised fund regimes, which cover open-ended and closed-ended funds. The Authorised Closed-ended Investment Schemes Rules 2008 and the Registered Collective Investment Schemes Rules 2018 both require a Designated Administrator to administer a fund in accordance with the principal documents, the rules themselves, the most recently published information particulars and the directions of the board or general partner. The two sets of rules are not prescriptive in relation to monthly monitoring and whilst onsite it was suggested to the Thematic team that quarterly or half-yearly monitoring would be more appropriate due to the closed-ended structure of the funds currently accredited. It is proposed that the GGF Rules be amended to include an option for less frequent monitoring requirements for closed-ended funds where investments often change more slowly than in open ended funds with daily trading.

It is worth noting that at the time of drafting the GGF Rules consideration was made for any open-ended funds seeking the accreditation, hence the requirement for monthly oversight.

The GGF Rules require ongoing monitoring of compliance with the GGF criteria via scrutiny of information typically provided by the investment manager. The thematic review found that Designated Administrators were unable to evidence this scrutiny in half of the instances assessed. If a Designated Administrator does not see any documentation/reports or perform any assurance themselves their oversight (of compliance with GGF criteria) cannot be effective. All Guernsey domiciled funds must appoint a Designated Administrator, this includes Guernsey Green Funds. A Designated Administrator is responsible for ensuring that a fund is managed and administered in accordance with the applicable regulatory regime. For the GGF Regime Section 3(1) of the GGF Rules sets out that the Designated Administrator shall take reasonable steps to ensure that *"the property of a Guernsey Green Fund shall be invested with the aim of spreading risk and with the ultimate objective of mitigating environmental damage resulting in a net positive outcome for the environment."*

It is the Commission's expectation that the Designated Administrator has access to all relevant information in order to be able to fulfil the requirements of both Section 3 and Section 6 of the GGF Rules, the oversight of the running of a fund is a key responsibility for a Designated Administrator.
It is disappointing that the oversight is not being adequately performed as in most instances the actual assessment is being carried out by the investment manager and the requirement could be easily satisfied by scrutiny of these managers' reviews which evidence that the underlying investments are complying with the Guernsey Green Fund Rules. When discussions were held onsite, the Thematic team noted

that in some cases there is a lack of understanding of the reporting provided by the investment managers leading to a lack of challenge and internal assessment.

It is apparent that monitoring of environmental impact occurs at the investment manager level. The quality and quantity of environmental impact reporting received by the Designated Administrators varies, as does the level of scrutiny applied to the information received. Some firms review this output whereas others do not consider it within their remit. Only one of the investment managers appoints an independent third party to specifically carry out an environmental impact assessment every three years, the other managers rely on their own internal monitoring. The success, or otherwise, of any fund is largely related to the calibre of the investment manager. All of the green fund investment managers are signatories to the UN PRI ("United Nations Principles for Responsible Investment") and at least one has received an A+ (highest possible) PRI network rating for the last five years.

Some Designated Administrators view the annual audit process as verification of the green credentials of a fund, however environmental impact is not considered as part of the standard annual audit. A review of the submitted annual accounts indicated that if details of environmental impact are included it is usually in the Chairman's statement or the investment report.

The nature of some of the assets held by Bailiwick green funds, for example solar and wind energy farms, does mean that the positive environmental impact can be verified via carbon saving calculations. It is the Commission's expectation that the Designated Administrators have sight of and assess these calculations as far as can be reasonably expected. The LSE listed green funds additional disclosure and reporting requirements result in specific inclusions in the annual reports relating to environmental impact, which can be used by the Designated Administrators in their assessments.

AREA FOR IMPROVEMENT

The Commission expects the Designated Administrator to ensure that the manager provides key performance indicator and service level standard information on underlying investments regularly. The Designated Administrator must be able to understand and challenge what the reporting details, a lack of understanding of green assets will hamper this oversight process. The Commission is not prescriptive on how a Designated Administrator fulfils its oversight and monitoring responsibilities but a documented record must be maintained in order to be able to demonstrate compliance with the GGF Rules. It is unsatisfactory to merely state that a fund invests in green assets and is therefore 'green' without providing a rationale or evidence for this conclusion.

The nature of the underlying assets in the current Guernsey Green Funds means, in the vast majority of cases, there is a clear demonstrable positive impact on the environment. This environmental impact is being monitored by the investment managers but the reporting is not being fully integrated into the oversight processes utilised by all of the Designated Administrators. Where there is uncertainty regarding a few less 'clearly green' assets held within a fund the Commission will undertake further risk mitigation work with the relevant Designated Administrators to ensure that the requirements of the GGF Rules are met.

Case study

Two of the green funds invest into reforestation schemes, the Designated Administrators connected to these funds take comfort in the fact that the funds have utilised planting schemes designed to Forestry Stewardship Council standards for approval by the Forestry Commission with the objective of securing government-planting grants such as The Woodland Carbon Fund. The high standards and rigorous assessments required to qualify for grants provide comfort on the environmental benefits of these funds.

AREA FOR IMPROVEMENT

Section 3(1) of the GGF Rules sets out that the fund shall be invested with the aim of spreading risk and with the ultimate objective of mitigating environmental damage resulting in a net positive outcome for the environment. All Designated Administrators should ensure that appropriate reporting is provided from the manager. The Commission expects Designated Administrators to have sufficient understanding to talk through the reporting and be able to challenge the contents if required.

GOOD PRACTICE

At the initial acquisition and development stage of a portfolio asset there may be a negative environmental impact as the asset is constructed. This needs to be taken into account when the net positive outcome for the environment is assessed. For instance, one investment manager calculated that the initial negative impact on the environment was 'repaid' within 8 months of operation of the asset. The asset type in question has an estimated productive life of 25 – 30 years, clearly illustrating the net positive outcome for the environment.

Case study

As part of the development plan for a renewable energy park, an ecological assessment and a landscape plan were both commissioned by the investment manager. In order to manage the environmental impact of the energy park an Ecological Mitigation and Environmental Plan was developed with the aim of achieving net gains in biodiversity wherever possible. Planning permission conditions were imposed on a variety of environmental elements including hedgerows, trees, grass areas, wild flower coverage and grazing requirements. Additionally bird, owl, bat, hedgehog and dormice boxes were required, limits were set on the use of fertilisers and the impact on the local community assessed.

All of these environmental benefits are in addition to the CO2 savings from the generation of solar electricity.

The investment recommendation process, where applicable, was reviewed by the Thematic team. Varying degrees of scrutiny were undertaken by the Designated Administrators. In most instances, the process filtered through from the investment team and the Fund Board to the Designated Administrators whereby in some instances a checklist was completed to consider the investment against the investment restrictions and the notified green criteria. However, there was an identified instance whereby a Designated Administrator was unable to provide support for its consideration of the investment.

Although consideration is given to new investment recommendations by the fund boards, there may be no record of verification against the notified green criteria. Designated Administrators should add this extra check when reviewing recommendations against investment restrictions to document that the GGF Rule requirements are being met.

It would appear from reviewing minutes that the green accreditation is sometimes not at the forefront of the investment managers' and boards' minds once it has been achieved. The Commission, would therefore, expect to see the Designated Administrator making appropriate checks to ensure a fund is fully compliant with the GGF Rules at every stage of its life cycle.

Section 3(2) of the Rules requires that the GGF *'shall comprise a minimum of 75% of assets by value that meet the notified green criteria set out in Schedule 2 of these Rules. The remaining 25% by value of the property must not lessen or reduce the Guernsey Green Fund's overall objective of mitigating environmental damage'*.

The pre-visit survey sent to the seven Designated Administrators asked how clear it was that assets met the notified green criteria, all seven responded with 'very clear'. The green fund population (with the exception of one) invest 100% of their assets (excluding cash) in green criteria investments.

The Commission has no appetite for greenwashing within the Bailiwick and will continue to check that the accredited funds within the GGF Regime comply with the requirements. The Commission will take action when required to do so to remove a designation. The Commission has the ability to remove an accreditation if a GGF remains invested for more than 3 months in breach of the notified green criteria or the investment criteria. Additionally the Commission may remove the accreditation at any time after a GGF ceases to meet the notified criteria if it is in the best interests of investors, the public or the reputation of the Bailiwick as a finance centre.

Key Findings: 4. Benefits of accreditation

Green investing no longer means compromising on return in order to make a positive difference to the planet. Both Green and ESG investment demand is increasing, as is competition for investors' funds. Third party research firms such as Morningstar, Bloomberg and Thomson Reuters offer an independent view on both green and sustainable investments. Morningstar has developed a Sustainability Rating for funds to help investors understand how the companies in their portfolios are managing their ESG risks relative to their peers. Morningstar analysis published on 15 June 2020 showed that;

"Average returns and success rates for sustainable funds suggest that there is no performance trade-off associated with sustainable funds. In fact, a majority of sustainable funds have outperformed their traditional peers in multiple time horizons".[14]

The use of accreditation or badging of green funds provides assurance to investors on the integrity and credibility of a product. The green fund logo can be used in marketing material and is seen as beneficial for raising the profile of the funds holding the accreditation even when they are not in an active fund raising stage. The Commission is reassured Bailiwick accredited funds are taking seriously and positively contributing to such an important risk area. When correctly complied with, the GGF Regime results in reduced risk for investors of being exposed to greenwashing.

Feedback received on the benefits of utilising the accreditation included;

"The accreditation demonstrates to current and potential investors that the fund fulfils the Guernsey Green Fund certification criteria and this resonates with investors"

The independent validation of an accredited fund's investment strategy and ongoing operational practices is seen as an important differentiator for the Guernsey Green Funds as most investment managers and funds rely on self-review. Route 1 and Route 2 accreditations are viewed as valid for providing independence as it is not the investment manager carrying out the assessment. One fund board noted that their choice of notification route was largely governed by the skills and experience of the incumbent Designated Administrator of their fund.

Current green fund boards confirmed support for future applications under the regime, noting that the accreditation helps significantly from a marketing perspective. Inclusion of the information in press releases is noted as beneficial for both the individual fund promoters and the Bailiwick's reputation as a green centre of excellence.

As previously noted all the current green funds are closed-ended structures, three of which are listed on a recognised stock exchange. The accreditations have not all been obtained at fund launch stage when promotion to potential investors is taking place. The value of the accreditation is viewed by these investment managers as a sign of commitment to green objectives and proof of validation and credibility of their funds.

There are competing green 'badges' available to funds, for example the LSE Green Economy Mark recognises listed companies which derive 50% or more of their revenues from environmental solutions. This accreditation, introduced in Q4 2019, highlights companies and investment funds listed on all segments of the LSE's Main Market and Alternative Investment Market that are contributing to the global green economy. As at 12 October 2020, there were 47 Green Economy Mark issuers on the Main Market and 40 on the Alternative Investment Market, accounting for a combined market capitalisation of over £67 billion. The three Guernsey green funds listed on the LSE also hold the Green

[14] Morningstar analysis shows green investments outperforming traditional funds 15 June 2020. [ONLINE] Available at https://ieefa.org/morningstar-analysis-shows-green-investments-outperforming-traditional-funds/ [Accessed 22 October 2020]

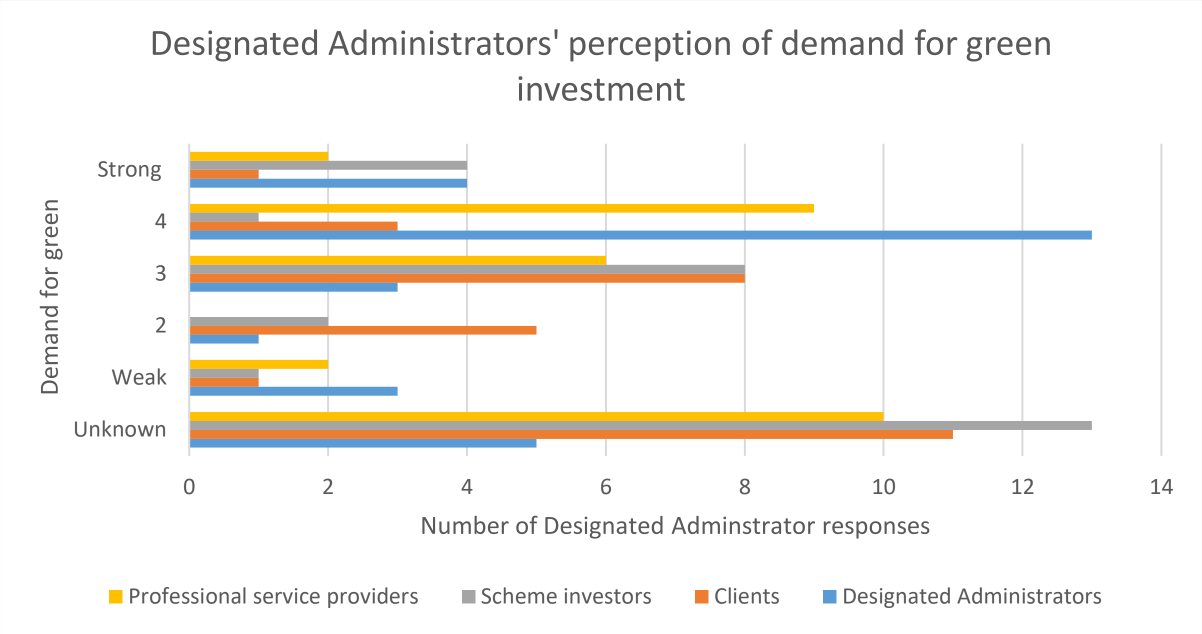
Economy Mark. The underlying methodology of the Green Economy Mark is the Green Revenues taxonomy developed by FTSE Russell as part of the FTSE Environmental Markets Classification System. The Green Economy Mark accreditation is free and no additional third party verification is required. The LSE applies the taxonomy and data from the FTSE Environmental Markets Classification System and FTSE Environmental Technology Index Series to establish which listings are eligible to be awarded the Mark.[15]

[15] London Stock Exchange Green Economy Mark 8 October 2019. [ONLINE] Available at https://docs.londonstockexchange.com/sites/default/files/documents/lseg_green_economy_mark_factsheet.pdf [Accessed 22 October 2020]

Key Findings: 5. Awareness and demand for green investments

As part of the Thematic review short questionnaires were sent to twenty nine Designated Administrators to ascertain green appetite from the administrators themselves, their clients, underlying fund investors and professional service providers, the overall headline from the responses is that administrators are largely unaware of the green appetite of the parties they engage with. This is in contrast to most of the Designated Administrators themselves stating that they have a medium - strong green appetite. It was disappointing to note that five responses stated 'unknown' – indicating that a minority of Designated Administrators have yet to form an opinion on their client's demand for green finance.

The results are presented in the following graph:



There is commitment and engagement with green within the Bailiwick but further development and awareness is still needed. Changes such as the Paris climate agreement being re-instated in the US will continue to highlight the global need to tackle environmental risks.

An observation was made that it can take up to two years for a fund to launch. It was proposed that due to the infancy of the GGF regime, there might be more accreditations being sought in the near future. One of the Designated Administrators advised that there were two potential accreditations in their new business pipeline. However, conversely, they are also aware of existing funds that are deterred from seeking accreditation due to the perceived associated costs of doing so. The reality is that no regulatory application or ongoing costs are included in the GGF regime and the actual costs of Route 1 certification are minor in comparison to the size of most funds.

Future developments

- **Possible development of an ESG regime to supplement the existing green regime**

During the thematic, a recurring theme was ESG, many of the participants voicing opinions that ESG is now more of a focus than just the narrow area of green.

Whilst on-site, feedback was sought from the Designated Administrators on whether an ESG regime or overlay product would be beneficial for industry. All agreed that ESG is a growing sector with one remarking that in fact it is on the *'forefront of shareholders' minds'*. A number of them noted, however, that it would be difficult to achieve an ESG accreditation because it would be problematic to quantify ESG impact and there would likely be disparity in methods of measurement. It was commented that the regulator could act as an unnecessary barrier if it prescribed ESG accreditation, arguably it would be a step to over-regulation without associated benefits.

- **The interpretation of the ultimate objective of mitigating environmental damage resulting in a net positive outcome for the environment**

The Commission is not prescriptive on the details of how this ultimate objective may be achieved. For some of the current funds this is a relatively straightforward process, for example the annual report for one of the LSE listed funds noted that the renewable energy generated powered 185,000 UK homes for one year thereby avoiding 307,500 tonnes of carbon dioxide emissions. Another similarly listed green fund detailed 800,000 tonnes of carbon emissions avoided.

For some funds, the method by which this objective is achieved is less clear, the Commission considers that the following is required; a demonstrable approach in the underlying assets to mitigate environmental damage and that the fund (or parties to the fund) monitors that approach on an ongoing basis with a clear exit strategy for any assets that do not meet the criteria.

Where demonstrating positive environmental impact is complex the requirement for Designated Administrators to receive appropriate reporting is key.

- **Proposed modifications to the GGF Rules**

Section 6(1) of the GGF Rules requires the Designated Administrator to ensure that the scheme is monitored against the notified green criteria and the investment criteria on a monthly basis. Following a review of the types of assets and structures of the funds already accredited, it has been suggested that this rule could be perceived as unnecessarily onerous for some closed ended funds. We plan to amend the relevant section of the GGF Rules to include an option of less regular monitoring (for example quarterly).

Section 8 of the GGF Rules require an accredited fund to include certain disclosures in its prospectus regarding its green status. A modification has been granted to the listed green funds to include a market announcement on the LSE as a method for making these disclosures. In order to prevent the need to issue this modification for other listed funds we propose to amend the mechanism by which the announcements can be made to include recognised stock exchange market announcements.

A Spring Green Consultation Paper to include the two proposed amendments to the GGF Rules is published alongside this thematic report. The Commission continues to monitor for developments in the EU Sustainable Finance Taxonomy and UK Taxonomy.

Glossary of Terms

COP 24	24th Conference of Parties
Commission	The Guernsey Financial Services Commission
Green fund	Guernsey Green Fund
IPCC	Intergovernmental Panel on Climate Change
Prospectus, as defined in the GGF Rules	Means written particulars of a Guernsey Green Fund prepared revised and published in accordance with these Rules and any other rules applicable to the Scheme.
GGF Regime	The Guernsey Green Fund Regime
GGF Rules	The Guernsey Green Fund Rules, 2018
TISE	The International Stock Exchange
TCFD	Taskforce on Climate-related Financial Disclosures
Thematic review	Review of the Guernsey Green Fund Regime
Thematic team	Alison Gavey, Jane Maclure and Angus Morgan
UN PRI	United Nations Principles for Responsible Investment

Appendix 1

- The Common Principles for Climate Mitigation Finance Tracking

These principles were developed in 2015 by the International Development Finance Club in conjunction with a group of multilateral development banks such as the African Development Bank, Asian Development Bank and the European Investment Bank. There are nine green criteria listed in these principles and it is the decision of the governing body of a Guernsey Green Fund to select the criteria that are most relevant to the fund;

1. Renewable Energy
2. Lower-carbon and efficient energy generation
3. Energy efficiency
4. Agriculture, forestry and land-use
5. Non-energy greenhouse gas reductions
6. Waste and wastewater
7. Transport
8. Low-carbon technologies
9. Cross-cutting issues

The only notified green criteria utilised to date are category 1 Renewable Energy and category 4 Agriculture, forestry and land-use.

SPRING GREEN CONSULTATION PAPER

MARCH 2021

Part 1 – Board Consideration of Climate-related Risk

In 2011, the Commission published its Finance Sector Code of Corporate Governance (the 'Code'); with subsequent amendments[1]. This Consultation Paper proposes that the Code take specific account of climate change considerations.

Even if limited by current mitigation efforts, climate change will materially alter the world we live in over the coming years. For that reason, licensees need to consider their business strategy and risks in relation to climate change. As a financial services regulator, the Commission is obliged to ensure that licensees consider key risks especially when they extend beyond the immediate time horizon. International regulatory understanding of climate change risk is evolving fast. Licensees should maturely consider this risk, adapt to it in an orderly fashion and continue to keep abreast of standards and market expectations as they develop, not least with regard to disclosure.

The Commission is not planning to set out specific rules or guidance at this time. There is already much in the public domain to help firms in this respect. Emerging requirements and guidance set out by international bodies such as the Task Force on Climate-related Financial Disclosures and the proposed partner body to the International Accounting Standards Board[2] may be relevant for many firms. What works for one sector or licensee, may not work for another. What licensees cannot do is to ignore climate change; even if, in the event, a licensee concludes that any adjustment to its business strategy and risk profile should be limited.

Directors have a general duty to promote the success of the company and act with due care. The board sets company strategy and risk appetite. Board-level commitment is vital in order to gain assurance that work on climate-related strategy and risks has sufficient standing in the organisation. Amending the Code encourages appropriate consideration of climate change risks; whilst allowing firms to prepare for probable new international standards on climate change disclosure in a balanced fashion.

The Commission is aware that other jurisdictions are already starting to mandate climate change actions and prescriptive climate change non-financial reporting. The Commission is pleased to see the evolution in the currently less than mature reporting standards but considers it premature to mandate what disclosures are necessary until more general international agreement on what standards should apply to what types of financial services firm is reached. That said, it encourages firms to consider and act upon as appropriate international developments in this fast moving area.

The Code is concise. Accordingly, the Commission proposes to add the following requirement:

<u>Climate-Change</u>

The Board should consider the impact of climate change on the firm's business strategy and risk profile and, where appropriate in the judgement of the board, make timely climate change related disclosures.

This clause becomes 5.2 (1) in the Risk section of the Code. For insurers, it becomes Principle: 18. The placement of the clause is such that it will not require boards to renumber extant clauses.

We would propose that the obligation on boards to comply with the new clause should apply for financial years starting from 1st October 2021.

Q1: Do you have any comments on the proposed amendment to the Corporate Governance Code?

[1] The current version of the Code is dated February 2016 and can be found at this link.

[2] Consultation Paper on Sustainability Reporting (ifrs.org)

Part 2 – Guernsey Green Fund Rules

Thematic Review Findings

During Q4 2020 and Q1 2021, the Commission undertook a thematic review of the Guernsey Green Fund Regime in order to gain an enhanced understanding of our existing Guernsey Green Fund ("GGF") population and assess how they comply with the Guernsey Green Fund Rules, 2018 ("GGF Rules"). Full details of this review and its findings are provided in a separate report published at the same time as this paper[3]. The review identified two areas where relatively minor modification to the GGF Rules may be made to better reflect established closed ended fund management practises whilst maintaining the integrity of the regime. The first area related to Section 6(1) of the GGF Rules which requires the Designated Administrator of a GGF to ensure that the scheme is monitored against the notified green criteria and the investment criteria on a monthly basis. Following a review of the types of assets and structures of the GGFs already accredited, it has been suggested that this rule could be perceived as unnecessarily onerous for some closed ended funds. It is therefore proposed to amend the relevant section of the GGF Rules to require monitoring to be performed at a minimum on a quarterly basis, in the case of closed ended funds. It is proposed that the monitoring requirement for open ended funds remain unchanged. The proposed amendment to the drafting of the rule is set out in Appendix 1.The second proposed modification to the GGF Rules is in respect of section 8 of the GGF Rules which requires an accredited fund to include certain disclosures in its prospectus regarding its green status. Certain fund-specific modifications to these disclosure rules have previously been granted to listed green funds to permit the disclosure requirements to be met through the use of market announcements on the LSE. In order to facilitate future disclosures by listed funds it is proposed that an amendment be made to the GGF Rules to allow the disclosure requirement to be met through the use of a recognised stock exchange market announcement. The proposed amendment to the drafting of this rule is set out in Appendix 2. We hope that these deregulatory measures will enable more green funds to be raised more easily for investment into high quality green assets.

Q2: Do you have any comments on the proposed amendments to the GGF Rules?

Feedback on Green Aspects of Discussion Paper

In July 2020 the Guernsey Financial Services Commission published a Fund Growth Omnibus Discussion Paper[4] (the "Discussion Paper") seeking feedback on proposals in relation to adoption of the EU Taxonomy for Sustainable Finance as additional alternative green criteria under the GGF Regime and also proposals on the regulation of the activity of verification or certification of Green Financial Products.

Respondents were supportive of the proposal to add the EU Taxonomy for Sustainable Finance to the existing GGF Rules. At the time of writing the final form of the Taxonomy has yet to be agreed. The Commission also notes with interest the plans of the United Kingdom authorities to introduce their own

[3] Review of the Guernsey Green Fund Regime – Thematic Review 2020-2021 – https://www.gfsc.gg/sites/default/files/2021-03/2021%20GGF%20THEMATIC%20PUBLISHED%20REPORT.pdf

[4] https://www.gfsc.gg/sites/default/files/20200707%20-%20Funds%20Growth%20Omnibus%20Discussion%20Paper_0.pdf

Green Taxonomy and will monitor future developments with a view to ensuring that the GGF Regime continues to keep pace with emerging international standards.

The second Discussion Paper proposal to create a Green Verifier licence category under our Protection of Investors Regime was not supported by a majority of respondents. This proposal will not be pursued further.

Providing Feedback

Responses to this Consultation Paper are requested by 5 May 2021

Responses should be submitted through the Commission's Consultation Hub, which can be found at https://consultationhub.gfsc.gg/ .

Next Steps

This Consultation will be open for a period of 8 weeks, with a closing date for responses of 5 May 2021.

Following the consultation period, the Commission will collate and consider responses provided and feedback will be issued.

APPENDIX 1 – PROPOSED AMENDMENT TO SECTION 6 OF THE GGF RULES

It is proposed that the Current Rule text below is replaced by the Proposed Replacement Text below.

Current Rule

6. OVERSIGHT OF THE FUND
(1) The *designated administrator shall ensure that the Guernsey Green Fund is monitored against the notified green criteria and the investment criteria on a monthly basis and where the Scheme contravenes either:-*

....

Proposed Replacement Text:

6. OVERSIGHT OF THE FUND
(1) The designated administrator must ensure that the Guernsey Green Fund is monitored against the notified green criteria and the investment criteria. Where the Guernsey Green Fund is an open-ended investment scheme such monitoring must be performed, at a minimum, on a monthly basis and where the Guernsey Green Fund is a closed-ended investment scheme such monitoring must be performed, at a minimum, on a quarterly basis. Where the Guernsey Green Fund contravenes either the notified green criteria or the investment criteria the designated administrator:-

…

APPENDIX 2 – PROPOSED AMENDMENT TO SECTION 8 OF THE GGF RULES

It is proposed that the following text will be inserted following Rule 8(1)(g):

(2) Rules 8(1)(a) and 8(1)(d) do not apply to a Guernsey Green Fund which is listed on a recognised stock exchange and where commensurate disclosure has been made by way of a stock exchange announcement.