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

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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]

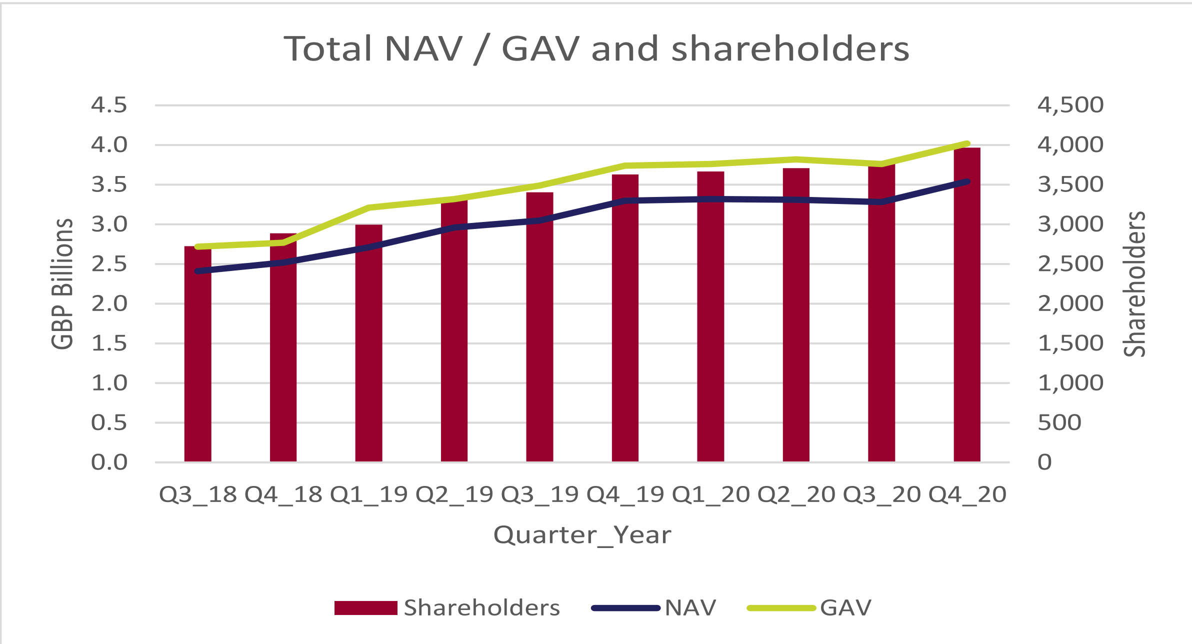
Analysis

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.

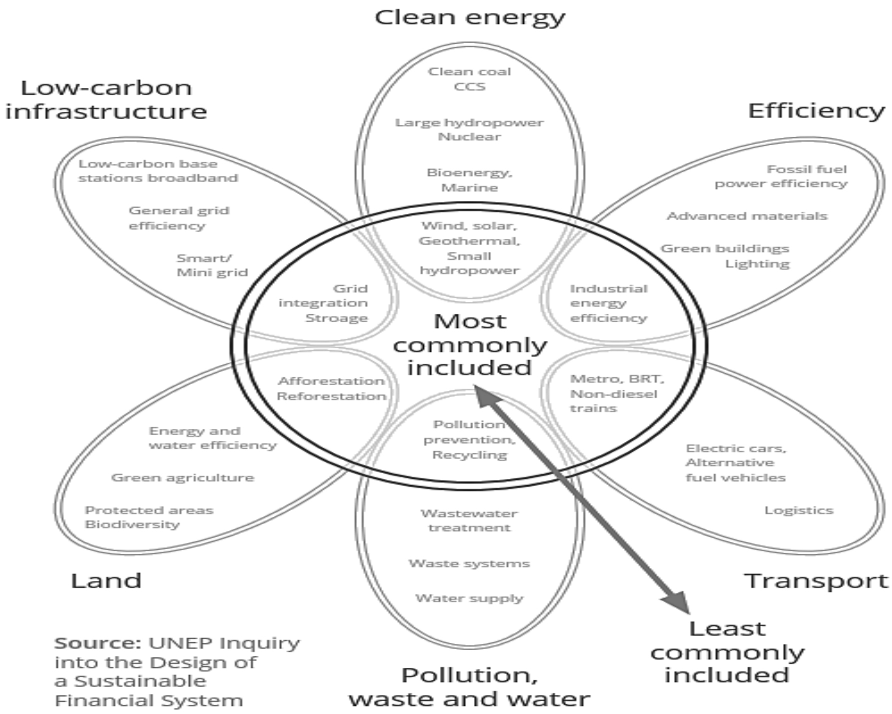
All of the accredited funds are closed-ended structures, reflecting the long-term nature of the underlying investments. One of the fundamental characteristics of green investment is that decision-making needs to focus on long-term outcomes and not just the short-term goal of returns for stakeholders. 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.



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[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.

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[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]

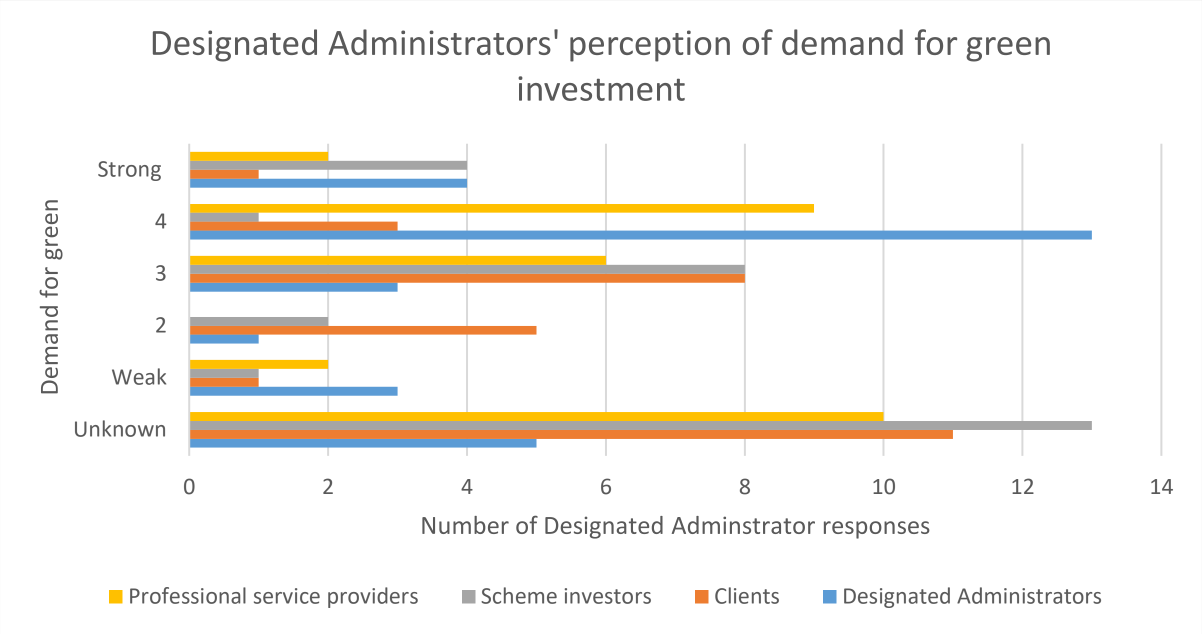
Economy Mark. The underlying methodology of the Green Economy Mark is the Green Revenues taxonomy developed by FTSE Russell as part of the FTSE Environmental Markets Classification System. The Green Economy Mark accreditation is free and no additional third party verification is required. The LSE applies 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.