



Association of Investment Companies
Wednesday 25th September 2013

Good afternoon. I would like to spend a few minutes updating you on a couple of external issues which the Commission is focusing on – issues which I think are pertinent to your overall agenda of “building the relationships for future growth”.

As you are no doubt aware changing international initiatives and expectations are a fact of life for the financial services sector, especially the Regulator. The pace of change has increased significantly in the last five years as politicians and regulators have responded to the global economic crisis. We cannot ignore what is happening outside the Bailiwick. To do so could be damaging for the jurisdiction in light of the fact that the majority of our financial services activity is outwards facing. The challenge that we face is to assess the issue and consider the response that we should make. In this case the “we” is not just the Commission but the financial services industry on the island together with the States of Guernsey.

In this respect, the European Union has been particularly active since the global economic crisis and I do not think that it will surprise you that I am going to say a few words about the Alternative Investment Fund Managers Directive (AIFMD) which came about as a direct result of the crisis.

AIFMD

The Directive, which came into force just over two months ago, seeks to regulate the alternative investment fund sector, including hedge funds, private equity funds and real estate funds. Many have asked why it is significant for Guernsey when we are not part of the EU? Well, the Directive’s provisions specifically cover the marketing of funds established outside the EU into the EU, therefore relevant Guernsey investment funds are caught. In fact, due to the Directive’s legal definitions all Guernsey funds marketed into the EU fall within its scope, hence its significance to us. Remember also, that it is not just Continental Europe that has to be considered, but the UK as well which, in itself, is a significant market for Guernsey investment funds. Doing nothing or ignoring this particular Directive has therefore never been a realistic option as this approach would have seen a massive reduction in Guernsey’s fund sector as a direct result of the inability to market funds into the EU.

The Commission has worked closely with both the Commerce and Employment Department and the Technical Committee of the Guernsey Investment Funds Association since the Directive was first announced in 2009. An early consideration was the approach that the Bailiwick should take in terms of the Directive – recognising its potential impact, but also acknowledging that there are many funds marketed outside the EU, for example to Southern Africa, Asia and America. The general consensus, between the Commission, Commerce & Employment and GIFA, was that a dual regime would be the best solution so that firms seeking to do business with EU markets would be able to demonstrate appropriate equivalence with those requirements whilst non EU focused business could continue to operate under existing rules and regulations. Thus promoters of Guernsey funds would be

given the regulatory foundation upon which they could establish their funds recognising the target market of potential investors.

Initially, The AIFMD (Marketing) Rules, 2013 will help to ensure that Guernsey funds and Guernsey fund managers established in the Bailiwick, who wish to market into the EU, meet the relevant Directive requirements. These Rules introduce minimal notification requirements to the Commission (that is us, rather than the European Commission) by Guernsey fund managers and Guernsey funds in respect of marketing into the EU. These rules will also allow the Commission to better understand the extent of EU focussed marketing and to co-operate effectively with the relevant EU securities regulators.

Regulatory Co-operation on AIFMD

In order for Guernsey funds to be able to market into the EU from July 2013 the Commission had to enter into regulatory co-operation agreements with its EU counterparts. The European Securities and Markets Authority (ESMA) played a key role in negotiating the proposed co-operation arrangements. For those of you who don't know, ESMA is an independent EU authority whose mission is to enhance investor protection and promote stable and well-functioning financial markets in the EU. Many in the EU would like it to become the pan European investment and market regulator but, at present, it only has direct authority over credit rating agencies.

We commenced discussions with ESMA two years ago to offer our input to the process of considering regulatory co-operation agreements and we understand that we were part of a preliminary group of non-EU regulators contacted by ESMA for our comments on their initial proposals. In addition, senior members of the Investment Supervision and Policy Division have been in regular contact with both the UK's Financial Conduct Authority, as well as other key EU securities regulators in order to update them in terms of Guernsey's approach to the Directive as well as to better understand any issues that might arise in relation to the proposed co-operation arrangements. This ongoing dialogue has been extremely useful in understanding the EU's direction of travel as well as being able to explain and clarify Guernsey's approach, not just to the Directive but in terms of funds' regulation.

Whilst ESMA played a key role in negotiating the proposed agreements, the actual arrangements are bilateral Memoranda of Understanding between the Commission and individual Member States as it is for national securities regulators to supervise the relevant firms. Following a detailed application process that took over a year to complete we announced on 12th July that we had signed 27 bilateral co-operation agreements *and that I was considering investing in an automatic signature machine*. Had these agreements not been reached it would have been markedly more difficult for Guernsey investment funds to raise money from investors in these European countries, adversely affecting Guernsey's investment businesses.

The future - a possible passport and more work

Looking to the future, this not the end of the story as far as AIFMD is concerned.

At present, Guernsey funds looking to market into the EU have to consider the national regimes existing in the Member State in which marketing is to occur. This in itself is a frustration, not just for the Commission but for relevant managers as this means that there are no common standards or processes that currently apply across all Member States. The

Directive anticipates that this will change as in 2015 ESMA has to report on the functioning of the current EU marketing passport available for EU firms and funds as well as other aspects of the Directive in order that the European Commission can consider extending those passporting arrangements to Third Countries such as Guernsey.

ESMA is expected to consider the experiences gained from the operation of the Directive, including regulatory co-operation between EU authorities and third country regulators such as ourselves. ESMA will also consider issues relating to the “equivalence” of regulatory regimes. This last point explains the work that has been undertaken to implement specific rules for Guernsey firms looking to market into Europe in the future. Drafting of detailed rules which would cover EU focused business has been undertaken by a joint Commission/Industry Working Group and these rules were issued for consultation earlier this month. The rules will be available to firms who wish to “opt-in” as a result of their European focussed business. Firms who are not marketing funds into Europe and who do not fall within the scope of the directive can continue to be regulated under the existing regulatory framework. I would encourage all interested parties to consider the proposed rules and provide feedback to the Investment Supervision and Policy Division. I am sure that Carl Rosumek and his team would appreciate suggestions as to how these rules might be further improved.

Over the next couple of years it will be important for the Commission to continue its dialogue with its supervisory counterparts within the EU and at ESMA, so building on the relationships already established, in order to understand the direction of travel regarding the possible passport as well as sharing technical experience gained since implementation. Not least, we need to demonstrate that we continue to be a credible independent regulator in whom other regulators can have confidence.

MIFID II

AIFMD is not the only EU directive requiring significant attention from Commission staff.

The Markets in Financial Instruments Directive (MIFID) has been in existence since late 2007 and some of you will know that its aim is to set out basic high level provisions governing the organisational and conduct of business requirements that should apply to investment businesses. It also harmonises certain conditions governing the operation of regulated markets.

It is probably true to say that - so far - this Directive has had only a limited impact on Bailiwick investment business, although that is likely to change as a result of proposals currently under consideration relating to MIFID II. When the Commission amended its conduct of business rules applying to licensees under the Protection of Investors Law three years ago it took account of comments from firms that it would be useful to make reference to MIFID in relation to the explicit determination of client classification. This inclusion was specifically made in order that the rules did not present difficulties for firms that had to comply with MIFID provisions through, for example, parent and/or group policies.

In December 2010 the European Commission issued a consultation paper in respect of possible changes to MIFID. In the words of the European Commission this effectively resulted from market developments and experience from the financial crisis that demonstrated to it that the key principles of MIFID (being a regulatory framework centred on shares and

regulated markets) needed updating. Following what appears to be the standard European Commission process of negotiating, drafting, negotiating again and re-drafting proposals the latest versions of the proposed directive and regulation were issued three months ago and it appears as though these proposals will now be taken through the European legislative process.

The MIFID II proposals mirror AIFMD in terms of their requirements regarding third countries in relation to regulatory co-operation and tax information exchange together with the third country not being considered as non-cooperative for anti-money laundering purposes. We would expect that the work we have already undertaken in relation to AIFMD will greatly assist Guernsey with regard to these areas. The most important of the current proposals affects firms outside the EU (Third Countries) intending to provide investment services to retail clients in the EU as they will be required to establish a branch operation in a Member State and be subject to certain provisions of the directive. The Commission's Director of Investment Supervision and Policy and his team recently met with staff from Commerce & Employment and industry to discuss the Directive. A further meeting is planned for the first week of October with Government and representatives of a small number of firms to consider the current proposals released by the EU. Based on the initial meeting and consideration of the wide scope of investment services defined under the Directive it is likely that its impact may go beyond what would be considered as traditional investment licensees and the dialogue between Regulator, Industry and Government is going to be critical in informing firms as to the possible implications for their business models in the future.

Global

Whilst the two directives outlined above are of significant importance to the Bailiwick's investment sector the Commission, through its Investment Supervision and Policy Division, attempts to stay abreast of other initiatives and issues that are under consideration in the various global forums. The Commission's status as a member of the International Organisation of Securities Commissions allows us to be informed as to the issues and themes under consideration by the international standards policy setters in terms of investment business. Issues such as the nature, levels and scope of regulatory protection necessary for professional as opposed to retail investors, and the evolution of new innovative products and services to augment and in some cases replace traditional financial services are likely to be two that will require consideration into the future.

As I said at the start of this speech we cannot ignore what is happening internationally. As a small jurisdiction we are not large enough to have great influence in making international regulatory policy. We have to take on board the international agenda and attempt to distil those issues in terms of local regulatory requirements.

In conclusion, I would hope from this brief presentation that you can see that the Commission has played, and continues to play, its part in safeguarding Guernsey's investment sector. Not only has the Commission liaised closely with both Government and local industry in terms of Guernsey's response to this ongoing challenge, but that it has also been able to demonstrate to its European counterparts that it is a credible independent regulator understanding the international imperative of cross-border supervision. For our part we plan to continue to work with both Guernsey investment businesses and external regulatory authorities to help ensure that Guernsey continues to have, and to be recognised as having, a healthy and well regulated investment sector.