

Industry Seminar – 16 November 2016

Investment Supervision and Policy Division Presentation

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Good morning everyone and welcome to the Investment Supervision and Policy Division presentation.

I am joined on stage by Louise Bougourd who I am pleased to say despite a hectic travel schedule this year is on island today and will be presenting to you later. You may have noticed that Mark Le Page is conspicuous by his absence and following a bit of a trend if you were here for the Fiduciary presentation earlier Mark is currently on paternity leave and will be joining us in virtual form shortly.

We hope that you find the next 50 minutes informative, for some reason which I now cannot fathom I requested an extra 10 minutes for this year's presentation, it seemed a good idea at the time but anyway it will mean that there will be plenty of time for questions and answers at the end of our presentation.

You may have heard from William yesterday that the theme for this year's Industry Presentation is the Interaction of Business Culture with regulation in the present decade.

Slide: Presentation Overview

Applying this theme to our own presentation we wish to spend some time drawing out three main areas that have been occupying our time over the past year:

- Under Conflicts of Interest – I will share with you extracts from the discussions we have had with licensees and boards of funds over conflicts of interest, including how to recognise, declare, and manage them and ensure compliance with the regulations.
- Under Culture and Financial Statements – Mark will speak on the supervisory issues leading us to introduce the late accounts and modified audit opinion policy.
- Under Culture and the Global Perspective – Louise will describe the approaches from her international colleagues towards culture and how we must have an eye to these influences on our own methods.

We will wrap up by covering a number of key messages, a five minute whistle –stop tour of key takeaways from today and if you don't listen to anything else please do listen to those five minutes.

And very finally – to end on a positive note – we will view Mark Le Page the sequel, in which Mark will talk about the manager led product launched earlier this year and we will formally launch the jurisdiction’s new product the Private Investment Fund.

Slides: Conflicts of Interest

To kick off – Conflicts of interest – it is a very common phrase in many spheres but particularly in the financial services industry. Paragraphs if not pages, in prospectuses, scheme particulars and the like are dedicated to the disclosure and handling of conflicts of interest. The Commission’s website returns 60 references from a search on conflicts of interest and indeed in the Commission’s rules over the investment sector there are explicit sections on conflicts of interest across all the Licensee, and Fund rules and the Code on Corporate Governance also includes a section on Conflicts under the section entitled Business Conduct and Ethics.

Probably the most significant reference is in The Licensees (Conduct of Business) Rules 2014, which an entire principle, principle 3, exists on Conflicts of interest. I won’t read it out to you but would highlight the references throughout to customers and the fair treatment of customers.

3. Conflicts of Interest *A licensee should either avoid any conflict of interest arising or, where a conflict arises, should ensure fair treatment to all its customers by disclosure, internal rules of confidentiality, declining to act, or otherwise. A licensee should not unfairly place its interests above those of its customers and, where a properly informed customer would reasonably expect that the firm would place his interests above its own, the firm should live up to that expectation.*

Furthermore whilst most of us accept that conflicts exist and need to be managed I do think the first line of Principle 3 is worth focusing on “A licensee should either **avoid** any conflict...” whilst admirable and the ideal avoidance is not always possible.

I am confident that to the vast majority of you the concept of conflicts of interest will not be anything new and indeed it is not rocket science. That being the case the first step of identifying a conflict should be straight forward. But sometimes it is not as easy as one might think.

I said I would share with extracts from discussions we have had over the past year, and please as you have heard from my colleagues in other divisions yesterday and earlier today the examples of poorer behaviour are thankfully few in number however, their presence is concerning and therefore worth sharing.

Rather surprisingly we have had to point out to some members of Boards that they do have conflicts in the first place. I have also been surprised when we’ve asked for a copy of them by the standard of the conflicts of interest policies in place, often being too generic and missing the mark. A policy should be a valuable tool in helping one identify conflicts of interest but also assist with steps 2 & 3 of declaring and managing conflicts that I will move to next. The requirement for a policy on conflicts of interest is at Rule 11 of the Conduct of Business Rules and whilst not wishing to repeat all of that section of the Rules to you here today it is suffice to say the policy must identify, the circumstances which constitute or may give rise to a conflict of

interest entailing a material risk of damage to the interests of one or more clients. The Code of Corporate Governance has the requirement for the Boards of collective investment schemes to establish, implement and maintain an effective conflicts of interest policy which sets out the standards of expected behaviour including amongst matters, the treatment of any non-compliance with the policy. It is worth remembering the Code of Corporate Governance applies to funds as well as licensees and we do routinely review conflicts of interest policies as part of our engagement tasks under PRISM and risk based supervision.

The second step in handling conflicts of interest is declaring any conflicts. At the start of any board meeting conflicts of interest should be discussed, with periodic reminders being presented. Who monitors those conflicts? Traditionally the role for a Company Secretary, not a requirement of Guernsey company law admittedly, but arguably perhaps good practice to have one? At the very least if one is prone to forgetting one's own conflicts it may be an idea to have someone on the board or in attendance at the meeting to remind you. I have seen over the past year the very positive actions by some NEDS and others parties, in reminding Board members of their conflicts of interest to the point of making what I would imagine the other directors consider to be a complete nuisance of themselves and requiring the conflicted directors to physically remove themselves from meetings. And of course most importantly of all conflicts should be declared to your clients through the appropriate means.

Assuming the conflict has been identified and declared, the third step is to manage the conflict of interest. If the Licensee's policy on Conflicts of interest is sufficiently robust managing the conflicts should not be a problem however, where we have seen problems arise is where for example the Licensee is an investment adviser/manager to a fund which for an array of reasons is experiencing difficulties. On a day to day basis the conflicts are managed well but when that norm shifts into more difficult territory, causing perhaps decisions to be needed to be taken at greater speed than usual, the controls around conflicts may slip. Of course we all know that it is at these very times that the controls need to be robust.

Slide: Arm's Length Transaction

It is also at these times that other controls come into force for example arm's length transactions. Again in name it sounds straightforward. The requirement to undertake transactions at arm's length is in the rules for each type of Guernsey fund and requires that the arrangements between the relevant person and the collective investment scheme are at least as favourable to the scheme as would be any comparable arrangement effected on normal commercial terms negotiated at arm's length between the relevant person and an independent party. Whilst supposedly well understood as a concept in times of stress a Board's judgements on how to conduct themselves may become diluted and transactions may be considered that would not have otherwise been undertaken, e.g. the sale of assets to a related party. Clearly however well intended these transactions may be they cannot be allowed to take place without being demonstrably at arm's length. We have seen examples of fund in managed wind down where such transactions have been proposed to be undertaken not demonstrably at arm's length. I would like to pause here on conflicts for a moment and mention area of concern during a managed **wind down**. In

managed wind down situation directors must be aware of the considerable risks, that is whilst a managed wind down may well seem to be the most cost effective approach, directors must be certain that the Company has not become insolvent placing their own position in jeopardy.

Slide: Wearing too many hats!

Back to conflicts, the conflict of interests I have described thus far have been the expected ones involving Board members however, there are a number of others that we see crop up from time to time. Conflicts of roles or wearing too many hats...for example can a client relationship manager really be an effective MLRO and/or compliance officer? And I had already written that sentence before seeing the Financial Crime Division's blockbuster this morning. If you missed it, it is well worth a watch when it is available on our website. Or should the highest fee earner really be on the remuneration committee? And as well as at the individual level there are the different overlapping interests and relationships of the entities involved in providing financial services to clients. I saw an excellent example recently of the way conflicts that arise in these situations should be managed. The compliance officer to an administrator met with us on an issue involving their client. That same compliance officer had been instructed by their client, an investment manager to also deliver a letter to the Commission on their behalf. As the meeting was focussed on the role of the administrator that compliance officer did not bring the letter with them to the meeting. Instead they completed the meeting, at the end advised us of the letter and upon return to their office arranged for the letter to be delivered to us separately. Some of you might feel that was overkill but all it took as a little aforethought and it was exactly the right thing to do. It ensured that during the conversations we knew who were talking to and about what. Of course many of you do have multiple roles and we are not necessarily saying you shouldn't this is just a reminder to know what hat you have on when and not to forget the interests of the ultimate client the investor.

As I said earlier none of this is rocket science or new to you conflicts should be identified, declared and managed or see it, state it and manage it.

We will now run the VT to listen to Mark talking about Culture and Financial Statements and the new policy.

Thanks Louise.

Slide: Key Messages – 2016-2017

For the remainder of 2016 and into 2017 the Division will remain focussed or start to focus on the following issues:

As you will see Risk Based Supervision remains at the core of what we do. Our primary objective remains the same, to execute high quality risk based prudential, financial crime and conduct regulation – via a series of Full Risk Assessments and Engagement visits and a Thematic – therefore you can effectively expect more of the same.

Taking the supporting tasks in no particular order:

We will cover the fund strategy later so I will speak to that here except to say it is clearly of importance;

Online submissions; We have very nearly reached the point where all the notifications from licensees and funds are now online. The last of the main stable of forms to go live is the Licensee's annual compliance return and thank you to those who have been helping to pilot this form. The licensees Conduct of Business rules will change as a result. Schedule 1 to the CoB rules will be amended from the including the Compliance Return to referring to the Online Compliance Return this will be issued for a short consultation in December. Online submissions also covers PQs and in response to a recent question in a meeting, I thought it was worth reiterating you are required to include all of your directorships in the online PQ submission.

The IOSCO EMMoU or Enhanced Multilateral Memorandum of Understanding to give it its full name will be a significant piece of policy work and it will be important in order to ensure that Guernsey maintains its position as a credible and cooperative financial services jurisdiction.

Alongside the IOSCO EMMoU will continue to run our other main international policy matters being AIFMD and MIFID II.

We will continue to work with our colleagues in the Authorisations Unit to ensure that the authorisations process is a robust gatekeeper and we will continue to work on more domestically driven policy like the Code of Market conduct and consultation on this will be issued very shortly.

Clearly this list is not exhaustive but gives a flavour of the matters that will occupy us in addition we continue to meet with industry members individually and in their interest groups on a wide range of matters and we value that open dialogue with you.

Slide: Potential Thematic Reviews

As you may be aware a key part of PRISM is an annual thematic review per sector. So far in Investment we have undertaken two thematics. The first covered Custody where there is a derogation in place to allow for the use of Prime Brokers rather than a local custodian. The findings of that thematic were published on our website earlier this year.

More recently as many of you will know we have undertaken a joint thematic with the Financial Crime Division. Thank you to those licensees who have participated and we are in the course of reviewing your responses and will be accompanying our colleagues in Financial Crime on a number of onsite visits identified from the review of the data. You may wish to take note of the smaller circles which provide the potential themes for next year. The thematics may not always follow the same format but they always improve our understanding of risks in a certain area and facilitate identification and understanding of emerging risks.

Slide: project Timelines

This next slide shows that it will be another busy year with a number of projects as already described to you but with that core of risk based supervision running through our work.

So the key message we would like you to take away from today is: we need to work together – we are reliant on a strong finance sector and consider that the jurisdiction benefits from a robust and credible regulator.

You will by now, if you weren't already, be aware of who Mark, Louise and I however, we thought it may also be useful to share with you the rest of the Investment team and divisional structure. I would like to take this opportunity to thank each member of the team for their incredible support and commitment through what has been another busy and challenging year.

Slide: And to end...The Private Investment Fund – the Launch

So to return to Mark Le Page part II. Before we formally launch the PIF Mark will start out by commenting on the Manager Led Product....

Thanks Mark and so the launch of the Private Investment Fund.

I am really pleased to announce the launch of this product and will just quickly run through a few of its key features which we feel make it as flexible as possible whilst still retaining the essence of what it is Private Investment Fund.

- Up to 50 natural or legal persons.
- Warranties allowing us to turnaround the applications in 1 business day.
- No rules to be applied to the manager.
- No requirement for scheme particulars

Thank you to everyone who either contributed to the development of the product or participated in the consultation. I am pleased to say that through the consultation period there has already been interest in the use of the fund and we can see that the attractions could be across all sectors not just the fund sector.

Our news release with the relevant application form and the rules should be on our website by the end of the day.

This Private Investment Fund will help complete the suite of Guernsey funds which we feel is and will continue to be SIMPLE, FLEXIBLE, COMPREHENSIVE.

Thank you for your attendance and your attention this today we now have a little time remaining for any questions first Louise and I will cross over to the table to answer them.

To allow you time to warm up here is one we prepared earlier. AIFMD passport update.....