

Industry Seminar – 23 November 2017

Investment Supervision and Policy Division Presentation

Investment Facts, Flags and the Future

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Good Morning and welcome to the Investment Division's Section of the Commission's Industry Seminar. I am very pleased to have on stage with me Mark Le Page, who as may have heard has unfortunately been somewhat below par recently. Although on the road to recovery Mark is still not back to full speed so I will deliver the majority of our presentation, with Mark wrapping up towards the end and of course both of us being available for any questions.

Yesterday many of you will have heard William speak about "Why we are regulating, How we are regulating and How we are innovating", and today we will take the same themes and drill down into them focussing on the Investment Business Division and Investment Sector.

Slide: Presentation Overview

Using the headings, Facts, Flags and the Future during this presentation we will cover:

First an overview of the sector using the statistics and other data that we gather. We are often asked for statistics in addition to those that we publish on the website and as a result on a couple of previous occasions at the Industry seminar I have promised to provide you with a more in depth examination of statistics. Well, be careful what you wish for as today we will be covering statistics in some detail.

Second we will discuss our findings from the supervision of the sector derived from Triage events, Engagement tasks and Thematics. Some points we make under "Flags" may seem fairly mundane or even statements of the blooming obvious to many of you, in which case you can leave here satisfied that you are doing everything correctly, or perhaps you will leave with a mind to just checking the risk areas we discuss today within your own firms, more on that in a moment.

Finally we will look to the Future and to what you might expect from us in 2018. We will provide details on the thematic we have planned for Q4 2017 and into Q1 2018, as well as announcing a couple of self-assurance educational events that we are planning for 2018.

Slide: Key Message

What do I mean by self – assurance educational events? Well here is brief recap for those of you who may not have been present yesterday when William described how the Commission would be seeking to evolve the educational sessions provided to Industry to help you or those of your teams who attend - to derive maximum value from them. At such events from now onwards you should find that:-

- We will normally aim to state at the beginning of an educational session what outcomes, in terms of knowledge acquisition, should be achieved by those attending by the end of the session;
- All educational sessions will ask you to reflect on how you are doing in comparison with that which we have been talking about at the end of the session; and
- We will generally provide those attending with a themed self-assurance help sheet or questionnaire at the end of the session which the person attending will be able to take back to his or her office and discuss with colleagues. This is not expected to be too onerous and as a rule of thumb will be limited to between 3-5 questions. The questions will be open and thought provoking in order to drive the consideration of key risks by individuals when they get back to the office and firms will not be required to submit responses to the Commission.

You might ask what educational events? The types of events I am referring to have thus far been outreach on a subsector or association basis e.g. meetings with the Custodians, with the GSCCA, with GIMSA, and with GIFA and we did run a Townhall on MiFID II led by Andy Sloan. As I say we will provide details of our plans later.

So in the vein of the educational events my aim for this year's presentation is to share information in an as helpful and informative manner as possible.

Slide: The Team

And I thought it might be helpful to just show a slide of the Division's organogram. The advent of the online services portal and the centralisation of the Authorisations team may make it seem that you have less contact with the Division members or perhaps the interaction feels more automated than even say a phone call but as you will see a good number of the team will be very familiar to most of you although there has been a smattering of new joiners over the past year. You might also note that the structure of the division as shown here is not determined by the impact level of the firms. As we end 2017 and move into 2018 this will allow the team to be more flexible and will ensure a cross fertilization of the skills of the team. There are benefits to Industry in this approach too, as well as the obvious one of the whole team being knowledgeable and experienced across the board it provides the opportunity for a fresh perspective on a licensee which is positive for the licensee too, as it will naturally erase any unconscious bias and it

eliminates any chance, however, remote of an over habitual relationship developing between a licensee and a member of the Commission team. I should also point out that I do not have 3 PAs as may be misconstrued from this slide, I am not that special although I do have Tom Jones in my team but not that Tom Jones. Martin and Sue have a wide range of roles including processing the statistics and other online returns. Katie is my PA but I have only 1/3 of her time sharing her as I do with two other directors.

Slide: Assets Under Management Guernsey Schemes

Moving to the “Facts” and to the big picture. At the end of June 2017 the AUM for was £211bn, across a total of 810 funds. This slide show that over the last four quarters the AUM has risen and the number of funds has stayed pretty much static. Looking back a little further this has been the pattern for a good number of quarters, indeed for the last eight quarters the AUM has been on the increase. So whilst there has not been significant growth in the number of funds, the number has at least been holding steady.

Slide: Statistics – Closed Ended Schemes

Looking at just the closed ended schemes, the AUM has grown by £15bn over the year and the number of schemes has increased, albeit only by 12.

Slide: Statistics – Closed Ended Schemes (Analysis by Main Investment Style)

Turning to the main investment activities of those 658 closed ended funds. We are known and identify ourselves as a jurisdiction of Private Equity expertise and indeed as is obvious from this slide we have the best part of 400 private equity funds so the statistics back that up. But we do also have all these other types of funds as well. This is because administrators and service providers on the Island are able to transfer the skills required for Private Equity to other asset classes and indeed the majority do, even if only into infrastructure funds or venture capital funds which arguably are a subsector of the Private Equity sphere.

Another indication of the sector diversification is that in addition to the types of funds listed here we have over the course of the year considered a range of innovative asset classes or innovative uses of the existing products including; structuring a licensee as an ICC, contracts for differences and use of the MLP for the non – EU markets.

Just focussing on applications for a further moment over the year to date 43 funds were authorised or registered and of those 37 were registered with 10 being established as PIFs but what does that represent? Well the majority were from existing promoters with a couple coming from new promoters, with a range of investment strategies from PE, to Sustainable Assets to telecommunications. We continue to receive interest in the PIF and I recently accompanied Guernsey Finance on a road show to New York where the concept was well received by the PE houses and advisers with whom we met.

Slide: Statistics – Open Ended Schemes

Turning to the open ended schemes AUM has remained relatively static over the past four quarters as has the number of schemes.

The predominant investment style, not unexpectedly, is equities but again there is a wide range of other investment styles.

In a combination of the experience of the closed ended and open end schemes the Non Guernsey Schemes have seen an increase in AUM but a decrease (albeit stabilised over the past 3 quarters) in the number of funds.

Slide: Statistics – Open Ended Schemes (Analysis by Main Investment Style)

The main investment style is fund of hedge funds, and given the vast majority of the Non Guernsey Schemes are Cayman incorporated this makes sense, but other than that the investment styles are very similar to those of the Guernsey open ended schemes.

Slide: Statistics – Non-Guernsey Schemes

Drawing the Guernsey Funds and the Non Guernsey Schemes together shows a not insignificant increase in AUM over the year together with overall a stable number of funds.

The statistics for the end of September are still being finalised but early indications are that AUM and Funds have remained static over the third quarter.

Slide: Total Assets Under Management

In September we met with Barnaby Molloy of Guernsey Finance and Mike de Haaff of GIFA to discuss how the Commission, GIFA and Guernsey Finance can work closer together to provide Guernsey Finance with the relevant statistics to be able to promote Guernsey as a jurisdiction of choice for Funds business and for all three organisations to gain a closer measurement of Funds sector performance through statistical analysis. The information we currently publish is the £ value of AUM, split by type: CE, OE and non-GSY, together with the number of funds and the split of asset class (pretty much the information I have used to illustrate my points today).

In addition we provide Guernsey Finance with the AUM in £ split by Hedge funds, PE and Property funds and the number of Guernsey Funds, by the same split.

Slide: National Private Placement Regime

Guernsey Finance and GIFA have also requested the number of Managers using National Private Placement Regime to market into Europe; the number of Private Investment Funds and the

number of MLPs. Again there is nothing confidential or identifiable in this information and so we see no issue with its provision from us.

More tricky to satisfy is Guernsey Finance's request to provide the £ value of new Fund launches.

We are considering how we can best achieve this whilst ensuring we still maintain confidentiality. Understandably Guernsey Finance would also really like to have information about the geographic origin of the investors in Guernsey Funds. At present we do not gather this type of information other than in the context of the AIFMD marketing rules and the use of National Private Placement, which is illustrated by this slide. As our discussions with Guernsey Finance and GIFA progress it may be that we consult with Industry as to whether the Geographic origin of the investors and other statistics would be a worthwhile collating. Of course our primary purpose of collating the statistics is for regulatory purposes and in this world of increasing big data I can see the regulatory advantages for collating information around distribution channels.

Just back on NPPR we are commonly asked for these statistics as means of determining how successfully Guernsey funds are marketed in the EU & EEA. In truth I do not think we receiving the full picture here and as part of the consideration of the statistics with Guernsey Finance and GIFA we may reframe at what point we receive this information, perhaps moving to the point of application for the registration or authorisation of the funds as opposed to a notification at a later stage.

Moving away from funds for a few moments, we have not for some time now issued the statistics for the asset managers/stockbrokers. This was a result of a rebasing exercise that we conducted during the move to the online submissions. As part of the discussions with Guernsey Finance we are considering reinstating the publication of the figures. To give you a flavour of the statistics for this part of the sector as at the end of Quarter 2 2017, Gross Assets under Regulated Activity stood at £51 billion and the turnover of stockbroking activities was £6.2 billion. These statistics are based on information from a population of 35 licensees each of which has as its primary business asset management or investment management for private clients, or stock broking.

Slide: Triage – Trigger Based Supervision

So moving to Flags. One of the main means by which we identify the need to look more closely at a firm is through Triage or Trigger Based Supervision. Triage as the name suggests is a first response to events or triggers.

Slide: Trigger Types

There are a number of different trigger types. Listed here in alphabetical order you can see are examples derived from a range of different sources, at the top left we have Emphasis of matters

in Accounts (more on accounts generally later), at the top right we have Data Security matters possibly sourced from the returns submitted to us regarding breaches, and further down on the right you will see (or you may not) Mis-selling identified to us by way of complaints we receive. Having mentioned breaches I would just as an aside like to remind everybody that a breach is a breach and should be treated as such and should be recorded on an appropriate breaches register. Whilst the regulatory response to breaches may differ (and therefore some may then be referred to as “technical”) they are all breaches. This is one of those statement of the blooming obvious I referred to at the outset but I only raise it as a result of conversations we have had with licensees which indicate there may still be confusion on the matter in industry.

Slide: Triage Types – previous 12 months

During the last 12 months the following trigger types were the most prevalent; with Conduct Issues, Breaches of Rules and Corporate Governance featuring most frequently. Our actions as a result of these triggers differ depending on the particular circumstances of each case however; many of you will be aware that for late accounts and accounts with qualifications or other audit modifications we have introduced a specific policy.

Slide: Policy on Late Accounts

The policy was introduced last year and as we have previously commented publically it takes effect from the point at which the submission of the accounts has passed where upon we issue notice of the intention to impose conditions. The relevant Designated Manager, together with the Board of the Fund is given 28 days to submit the accounts or provide representations as to why the accounts are late but conditions should not be imposed. If during the 28 days the accounts are submitted with, very importantly, a clean audit report then it is highly likely that the conditions will not be applied.

The number of times conditions have been imposed is, I am sure, far lower than most of you might imagine and following the end of June 2017 submission date, being the point through the year with the highest volume of accounts submitted we issued notice of conditions to 11 funds. It is pleasing to note that of those 11 funds 8 submitted their accounts with clean audit reports within the 28 day notice period meaning imposition of the conditions was not necessary. Of the remaining 3, one had changed its year end; one had not yet launched; and the other requested a modification in respect of two underlying sub funds which are in wind down, resulting again in no imposition of conditions.

It is of course important remember that where accounts are late the penalties will apply regardless of whether conditions are imposed. In addition the Commission cannot allow a situation where Companies Law is breached.

Slide: Engagements and Full Risk Assessments

During the year we completed 11 full risk assessments, 10 engagements and a number of custom engagements. The full risk assessments predominately but also the engagements resulted in around 65 Risk Mitigation Programme Actions being issued. What did we find that might be helpful to share with all of you, well unsurprisingly like the Triage Types Governance continued to be one of the risk areas where we see most need for improvement or where we need to impose RMP actions. Examples included: requiring firms to formalise their assessment of risks facing the entity in the jurisdiction and ensure oversight of outsourcing was reported to the Board. Both of these, taken from more than one firm I hasten to add, are symptomatic of a general over reliance on Group functions and giving insufficient attention to the interests of the local firm as a legal entity.

During the engagements we cover a range of topics including GDPR which are not necessarily directly correlated to a requirement of a rule but if not adequately addressed by a firm could result in potentially damaging outcomes.

Where we have seen examples of good practice, and we have seen them, they have mainly derived from, and this sounds like another statement of the obvious, they have mainly derived from a good understanding of the firm's clients.

As well as pre-mandated engagements as a result of PRISM we also undertake custom engagements. These may be as a result of a request from the firm for example to meet with the group compliance officer whilst on a visit to the Island. We are happy to do this as far as resources (and notice) allow as we recognise that those firms who are a part of a wider CI, European or even Global group often have a policy of updating the Regulator in each jurisdiction in which they operate. It also affords us with an opportunity to get an insight into a firm with whom we might otherwise only have little interaction. Custom engagements may also come about as a result of other information that reaches us. For example we may decide to meet with the Board of a firm following a number of complaints, or where we are aware a significant piece of business has been lost or indeed won, or that key staff have recently left the firm. Custom engagements can take various forms for example a singular or a series of meetings onsite or at the Commission's offices or even a request for specific documentation which we will examine at the Commission's offices before deciding whether or not to meet with or visit the firm. Another example of a Custom engagement is an exit interview with the CEO or equivalent upon them leaving a firm for whatever reason: resignation, retirement.

Slide: Thematic Reviews

Governance matters continued to come to the fore in the thematic work we undertook over the year. At last year's presentation we had commenced the thematic on Governance, Risk and Compliance Frameworks of Fund Managers & Fund Administrators which we conducted jointly with the Financial Crime Division. The feedback from the thematic was issued last week and

whilst I encourage you all to take the time to review the findings (both ISPD's and those contained in a separate report from our colleagues in Financial Crime) I appreciate you may not have had the opportunity to do so as yet and therefore it is worth just running through certain key aspects with you now.

Slide: Thematic – Objective

As you can see there, the objective of the thematic was to understand how fund managers and fund administrators had structured their governance, risk and compliance frameworks to mitigate governance and compliance risk in relation to collective investment schemes. This was chosen because a key theme to emerge from supervision has been a weakness in the application of effective compliance monitoring arrangements.

Slide: Thematic – Process

The thematic followed the Commission's standard approach of a questionnaire, this time sent to 34 investment licensees, predominately rated low impact and following the analysis of the responses a number of licensees were identified for an onsite visit. Finally as I mentioned earlier the thematic has culminated in the production of a report from each Division. The thematic focussed on low impact firms because as you are aware by now thematic reviews are one of the main means by which we interact with low impact firms however; the findings are relevant for all firms.

Slide: Thematic – Findings

What were the findings from the Thematic? In both reports we have identified case studies, areas for improvement and points of note from each of the areas covered being: Oversight by the Board, and Take on Arrangements & Ongoing Review; the latter of which included Scheme take-on arrangements, Frequency of Review of a Scheme's Performance, Method and Challenge of Valuations, Oversight of Key Risk Indicators and Conflicts of Interest. I am going to highlight a couple of case studies and areas for improvement from the Investment Division's report and will leave you to follow up on the rest and those from the Financial Crime report in your own time.

Amongst the case studies, we saw one fund manager intending to conduct thematic reviews to assess the risks and identify trends across its funds to be provided to Board demonstrating suitable oversight. Whereas one licensee's compliance reports required improvement as it did not provide sufficient detail for the Board's review with regard to the compliance monitoring tests. Without appropriate information the Board cannot take the necessary steps to address the issues identified.

In another case study we have explained how one licensee under the topic of method and challenge of valuations considered each investment individually and requested support for

unlisted or inactively traded valuations. Further, in appropriate circumstances it reviewed discounted cash flows and queried assumptions, particularly where a price had changed significantly. This licensee had often challenged the rationale behind an increase in price of an unlisted investment, resulting in a valuation adjustment. We recognise that these specific controls may not apply in every circumstance but are a good example of additional controls employed by an administrator.

At the other end of the scale we consider improvement was required where one firm noted that there had been no reason to challenge the valuations provided by connected parties in the last 12 months as valuations had been discussed and accepted by the Boards of the schemes (or their general partners) which had a majority of independent non-executive directors. This does not suggest an appropriate level of assurance through evidence gathering or testing.

As to points of note we have included a number ranging from the Commission's expectation of tolerance testing to the key events we wish to be kept informed of.

We hope you will find the findings of the thematic helpful and thank you to all of those licensees that participated.

As well as the ISPD and Financial Crime Division's thematic – there was of course the Commission's 2017 Thematic Review of "Investment and Long Term Insurance Sales Practice" undertaken by the Conduct Unit which also impacted firms licensed under the Protection of Investors Law. I am aware that many of you will be staying on for the next session from the Conduct Unit so do not wish to steal Rose Stevens' thunder here however; the topic was chosen to help consider the effectiveness of two factors designed to have a positive influence on industry behaviour in relation to advice being given to retail clients. Firstly, the Commission's 2014 thematic report on this subject identified key areas requiring attention across the sector.

And secondly, the implementation in January 2015, of the Guernsey Financial Advice Standards introduced the requirement for firms to authorise qualified and competent individuals to provide advice to retail clients. With firms being able to charge commission, the requirement for disclosure was enhanced to facilitate a clear and informed decision by clients to whom this advice is given. The Commission also streamlined the conduct of business rules and related codes for the investment and insurance intermediary sectors.

As is the purpose of thematics, this thematic review has allowed engagement with firms which do not form part of the Commission's structured engagement plans. This thematic review has again highlighted the diversity of the investment and insurance intermediary sectors in Guernsey and provided assurance that industry has, on the whole, responded well to the Commission's messaging. I will leave it to Rose to cover the rest of the findings and cover the feedback however; for anyone unable to attend the Conduct Unit's presentation it will of course be available for you to view at your leisure on our website in due course. In any event many of you may have attended one or other of the separate workshops recently hosted by the Conduct Unit

for Financial Advisers and Compliance Officers focussing on the observations and conclusions of this thematic.

Slide: Thematic Reviews

Last year at this event we showed you this slide identifying potential thematics for the future and we have now completed 2. Today I can reveal that we will be undertaking none of those listed there but will be in fact undertaking a thematic on the transparency of Management Fees. The thing about themes is that new ones are always emerging and we need to react accordingly and like other regulators we are concerned about the transparency of management fees. Since 2016 we have been tracking this issue both in the retail and institutional space. We have also read the final report of the FCA's Asset Management Market Study noting the comments about single pricing and other matters raised and in monitoring MiFID II, we are mindful of its support for the unbundling of fees.

We have identified a range of subject matters that we wish to explore as part of the thematic split by retail and institutional funds:

1. In funds targeted more towards retail investors we intend looking at:
 - a. The precise constitution of the fee;
 - b. To what extent this constitution is fully disclosed to investors; and
 - c. The amount of trail commissions paid and the number of distribution channels to which they are paid.
2. In more institutional investor funds, particularly private equity and infrastructure we will consider:
 - a. The transparency of carried interest calculations, including the controversy over subscription line financing;
 - b. How they are accrued; and
 - c. How they are treated in the financial statements – at present we are aware that there is no clear view within the accountancy profession as to whether they are debt, equity or derivative.

The focus on retail funds will help to inform the consideration of a review of marketing rules, and specifically whether we should introduce a requirement for Key Investor Information Documents or KIIDS. The next step is for us to finalise the questionnaire we are currently drafting and we anticipate issuing it prior to the year end.

Self-Assurance Events for 2018

As I referred to earlier we will be running regulatory self-assurance events including one on online submissions. We felt that this would be useful as we have seen a number of instances where forms are not being completed correctly. For example with the Forms 142 and 143, being the forms that accompany the submission of investment licensee and fund audited financial statements, from a sample of 300 fund account submissions (Form 143) 100 had an emphasis of matter or qualification and 61 of those failed to disclose on the form that the accompanying financial statements had a qualified opinion and/or emphasis of matter.

Equally we recognise that some Forms would benefit from further explanation or guidance from us for example, it is inevitable with capital adequacy derogation requests we will request further information or indeed in many examples the derogation is not actually required. The opportunity to discuss this would be advantageous to both sides.

We also intend to run an event around the outcomes of the next thematic and there will be another update townhall on MiFID II.

I will now hand over to Mark to wrap up and I am sure you will forgive him for remaining seated while he talks to you. Mark ...

Slide: What else to expect in 2018...

So what else to expect in 2018.... Whilst there is always a certain amount of crystal ball gazing in looking ahead there are a couple of knowns that will appear:

First we will be publishing the revised Registered Fund Rules and Prospectus Rules following the consultation held earlier this year.

We will also be looking to consult on new client asset and money rules.

Speaking of consultations we are aware from feedback particularly from GIMSA that a pithy summary at the start of consultations would be welcomed by industry and we will endeavour to incorporate that in to future consultations.

As particular markets continue to experience difficulties certain funds will fall under our radar, debt funds and property funds, including open ended real property funds, come to mind.

And finally we will of course, although only referred to briefly here today, be keeping a watch on the international policy front for example MiFID II, where we feel the challenges it presents to others may well bring opportunities for stockbrokers and asset managers in Guernsey. It is always good to finish on an optimistic point – thank for listening.

We are now happy to take any questions.