COMMERCE AND EMPLOYMENT
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**By Online Submission Only**

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Dear Colleagues

**Consultation Response: Implementing Measures of the AIFMD in relation to supervision and third countries**

**EXECUTIVE SUMMARY**

The States of Guernsey welcomes the consultation and the opportunity to comment on the technical aspects of the level 2 implementing provisions for the third country elements of the Alternative Investment Fund Managers Directive,

- Our overall view is that the basis of any assessment of a third country regulatory regime must be focused on outcomes, and not on form. By way of example the issue of whether a third country entity can act as a depository should depend on whether that entity is subject to effective prudential oversight by an independent regulator in accordance with international standards, rather than on whether a third country regime is equivalent to UCITS, Mifid etc.
- While we have responded to specific points below, we would welcome greater clarity and detail on the process of equivalence assessments of legislation. This greater clarity and detail will also help to ensure that ESMA's consultation remains within the framework of the Directive and is aligned with the objectives of the Directive.
- Co-operation agreements should be limited to information exchange to permit EU competent authorities to carry out their duties, and should not extend to requiring third country competent authorities to enforce EU law which may not be applicable in their own jurisdiction. Additional clarity on the intention of ESMA would be helpful in furthering the debate.

- Greater detail is required on the requirements for third country competent authorities. We have responded below on that point, and we also support the response on those points made by the Guernsey Financial Services Commission.

**INTRODUCTION AND BACKGROUND**

The Commerce & Employment Department of the States of Guernsey is responsible for creating a dynamic and diversified economy, which includes responsibility for the financial services industry on the Island. The Channel Island of Guernsey is a major international domicile for alternative investment fund management, administration, and custody.

Some key points on Guernsey's investment industry are as follows:

- As at 30 June 2011 there were €316 billion of total assets under Administration, comprised of open-ended, closed ended, private equity, infrastructure, real estates, fund of funds and a small but growing hedge fund sector,
- Approximately 50% of closed ended funds and 30% of open ended funds are directly invested into EU Member States providing medium and long term investment into the EU,
- All investment funds in Guernsey are regulated by Guernsey's independent financial services regulator, the Guernsey Financial Services Commission ("GFSC"); there are no unregulated funds in Guernsey. The GFSC has in place memoranda of understanding with several EU member state regulators and is a signatory to the IOSCO MMoU,
- Guernsey has recently been assessed by the International Monetary Fund as having a very high level of compliance with FATF, IOSCO, IAIS and BASEL regulatory standards,
- Guernsey has signed 27 TIEAS of which 11 are with EU member States, and Guernsey was an original member of the OECD "white-list" of jurisdictions which have implemented the international standard on tax transparency and information exchange,
- Approximately 2000 people work in the investment funds sector providing a full range of services to investors around the world. A total of approximately 7000 people work in financial services in Guernsey which represents about 20% of the total workforce.

For more information please visit: www.gfsc.gg where further detail can be found on the regulatory regime as well as statistics and data on the investment funds sector.

**DELEGATION**

**Question 1: do you agree with the above proposal? If not please give reasons.**

The consultation paper does not provide sufficient detail on the way in which ESMA intends to proceed with respect to "equivalence assessments of legislation" to permit a complete and detailed response. Accordingly without further detail it is not possible to agree or disagree with the proposals.

The request for advice from the European Commission explained that the delegation provisions are intend to create a secure framework for the delegation of specific functions and that level 2 was to further specify the conditions for delegation and sub-delegation.

As a general rule Article 20 permits delegation provided that the AIFM can justify the delegation, the delegate has sufficient resources to perform the delegated functions and is of good repute. Subject to the existence of co-operation agreements discussed below, those general rules permit delegation under the level 1 framework. Where delegation includes portfolio and/or risk management then that function may only be delegated to undertakings which are "authorised or registered" for the purpose of asset management.

The consultation paper focuses on "equivalence assessments" for the delegation of risk and/or portfolio management. However article 20 is not solely concerned with delegation of risk and/or portfolio management. It is only where delegation involves portfolio and/or risk management that delegation must be to an undertaking which is "authorised or registered" for that purpose. Apart from that specific issue the Directive does not appear to envisage that "equivalence assessments" will be necessary for the delegation of other functions, such as administration, and the only prerequisite is the existence of appropriate co-operation agreements.

The consultation paper also refers to Box 67 of ESMA's draft technical advice by which it is inferred that "equivalence assessments of legislation" will be against a number of EU directives (Mifid, UCITs etc.).

This leads to two problems:

- Firstly does the reference to box 67 apply only for the delegation of portfolio and/or risk management or does it cover delegation more broadly? If it is intended that it covers delegation more broadly then that appears to go beyond what is envisaged by the directive.
- Secondly if the reference to box 67 is intended to only cover portfolio and/or risk management then that assumes that that the legal and regulatory architecture of a third country will be largely similar to that within the EU. Legal and regulatory systems vary widely and may not be drawn along the same lines as that within the EU. This may create significant difficulties in carrying out "equivalence assessments".

The concept of "equivalence assessments" is not defined in consultation paper. The Directive implicitly recognises that third countries may not have legislation and regulation drawn along the same lines as in the EU and envisages an outcome based assessment to ensure that the third country has in place effective regulation and supervision which is (see for example article 21(3)(b)).

The assessment of third country regimes should be based on the outcome of the third country regulatory regime. For example where there is delegation of portfolio and/or risk management to a third country entity then that should be permissible where the third country entity is regulated and subject to supervisory oversight that meets internationally accepted standards and not on the basis of whether or not that jurisdiction has in place equivalent regulation to a specific EU directive.

There should also be much greater clarity on the manner in which "equivalence assessments" will be carried out. As far as possible any such assessments should:

- Be carried out at quickly, objectively and in a transparent manner,
- Wherever possible reliance should be placed on assessments carried out by international bodies such as the IMF under its Financial Stability Assessment Program ("FSAP") which

specifically assesses compliance with international standards such as the IOSCO core-principles. Relying on the FSAP where possible will minimise duplication and be more cost effective from the perspective of third countries and the European Commission itself. The European Commission could then independently verify the conclusions of the FSAP.

ESMA should also ensure that equivalence assessments are conducted at the earliest possible opportunity and well before the commencements of the third country passporting regime. To fail to have such assessments carried out at an early stage is likely to result in considerable uncertainty and potentially market disruption. There may be advantages in testing the process with a third country once the criteria are finalised. It may be that trialling the process with a third country which has substantial experience in regulating alternatives, and has established relationships with the competent authorities of Member States, may ensure that future assessments may be carried more efficiently.

**Question 2: In particular do you support the suggestion to use as a basis for the co-operation arrangements to be signed at EU level the IOSCO Multilateral Memorandum of Understanding and the IOSCO Technical Committee Principles for Supervisory Co-Operation?**

Yes with the following qualifications:

- While a central ESMA administered MMoU has some advantages its existence should not prohibit bi-lateral MoU between third country supervisors and the supervisors of Member States, provided that those bilateral arrangements do not go beyond the IOSCO standards. Bi-lateral arrangements could remain in force up until such time as the third country becomes a signatory to an ESMA MMoU which would then supplant those bi-lateral arrangements. That would ensure market certainty in the interim.
- Paragraph 4(e) of Box 1 is uncertain as it is not clear what is meant the obligation "to ensure that enforcement actions can be performed in cases of breach of regulations". If that is intended to suggest that a third country competent authority will take action to enforce EU law within its own jurisdiction then that is legally uncertain and may be impossible to achieve. It also goes beyond what is contained in the Directive. The comments below under question 5 are also relevant.

**DEPOSITORY**

**Question 3: Do you agree with the above proposals? If not, please give reasons.**

Some of the comments in response to Question 1 are applicable here. The ESMA consultation paper does not contain sufficient detail on the process or standards to be used in assessing third country regimes. In the circumstances that uncertainty makes it difficult to either agree or disagree with the proposals.

Article 21(6)(b) requires third country depositories to be subject to effective prudential regulation and supervision "which have the same effect as Union law". However in the ESMA consultation it is proposed that the third countries regime for depositories ought to be "equivalent" to EU law with respect to credit institutions or investment firms. This presupposes that third country legal and regulatory regimes will be drawn along the same lines as that which exists in the EU. There may be circumstances in a third country where an entity which provides depository services is not licensed

as a "credit institution" or an "investment manager" but may be licensed under different regulatory laws, but still subject to supervision and prudential regulation. For example in some jurisdictions custody services may be provided by a fund administrator or a professional trustee. Provided that those operations are subject to supervision and prudential requirements that satisfy the directive it should not be necessary that they be licensed as a credit institution or investment manager.

**Question 4: Do you have an alternative proposal on the equivalence criteria to be used instead of those suggested in point (b) above?**

There is insufficient detail contained in the proposals to properly develop detailed alternative proposals. However, one possible alternative is that instead of requiring equivalence with specific EU directives with respect to credit institutions and investment managers the approach be more aligned to the Commission's request for advice as follows:

- The third country entity should be subject to independent oversight consistent with international standards (for example IOSCO, Basel, etc),
- The third country entity should be subject to ongoing supervision and regulation which is effectively enforced,
- The third country depository should be subject to capital requirements which are broadly the same as those required in the EU for a credit institution or investment manager regardless of whether the custodian would otherwise meet the definition of a credit institution of investment manager,
- The third country entity should be able to meet the conditions laid down in article 21 either through regulation or other enforceable means,

As far as possible when conducting any assessment reliance should be placed on compliance with relevant international standards as assessed by international bodies, for example the International Monetary Fund through its FSAP program.

**SUPERVISION**

**Question 5: Do you agree with the above proposals? If not please give reasons**

Paragraph 2 of Box 3 provides:

> "The third country competent authority should assist the EU competent authorities where it is necessary to enforce EU legislation and national implementing legislation breached by the entity established in the third country"

It is unclear what is meant by this paragraph as it is open to multiple interpretations. If this means that the third country competent authority shall provide evidence and information to an EU competent authority so that the EU competent authority can enforce its own laws then that should be expressly stated. Of course each third country competent authority will operate within a distinct legal framework and can only exchange information within the scope of that framework. The implementing provisions should recognise that potential limitation.

An alternative interpretation is that this paragraph will require that third country competent authorities should take action in their own jurisdiction to enforce EU Law on behalf of EU competent authorities. Third country competent authorities can only enforce the legal and regulatory framework which exists in their own jurisdiction. If this is the intended outcome then arguably that goes beyond the terms of the directive which require co-operation agreements to ensure solely that there is "effective exchange of information" to enable EU competent authorities to carry out their responsibilities.

Paragraph 7 of the explanatory text does not appear to be consistent with article 52 of the Directive. Article 52 permits the transfer of data to a third country competent authority where the third country meets the requirements of articles 25 and 26 of Directive 95/46/EC ("the Data Protection Directive"). Under the Data Protection Directive the European Commission may take a decision that a particular third country provides an adequate level of protection consistent with EU Law. Paragraph 7 appears to require a third country competent authority to independently confirm to an EU competent authority that it has the ability to meet the requirements of the Data Protection Directive. This is unnecessary where the European Commission has already taken a decision concerning that particular third country except where a third country has not been recognised as equivalent under the Data Protection Directive. Therefore implementing provisions with respect to article 52 of the Directive are not necessary. For example Guernsey has been recognised by the European Commission as being equivalent with the Data Protection Directive and that recognition ought to be sufficient to meet the obligations of article 52.

**Question 6: In particular do you support the suggestion to use as a basis for the co-operation arrangements to be signed at EU level the IOSCO Multilateral Memorandum of Understanding of May 2002 and the IOSCO Technical Committee Principles for Supervisory Co-operation?**

Yes, subject to the proviso outline above with respect to the scope of co-operation agreements and the "enforcement" of EU Law by third countries.

**MARKETING BY NON-EU AIFM PRIOR TO PASSPORT**

**Question 7: Do you agree with the above proposals? If not, please give reasons.**

Yes, subject to comments above on the scope and content of co-operation agreements. There should also be further consultation on the relevant implementing provisions relating to the third country passport well before the commencement of the relevant provisions of the Directive.

**CO-OPERATION BETWEEN EU COMPETENT AUTHORITIES**

**Question 8: Do you agree with the above proposal? If not, please give reasons.**

No comment.

**MEMBER STATE OF REFERENCE**

**Question 9: Do you have any suggestions on possible further criteria to identify the Member State of Reference?**

No comment.

**Question 10: Do you think that any implementing measures are necessary in the context of Member State of Reference given the relatively comprehensive framework in the AIFMD itself?**

No comment.

**Question 11: Do you agree with the proposed time period for competent authorities identified as potential authorities of reference to contact each other and ESMA?**

No Comment

Yours sincerely,

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