

Memorandum to ESMA

AIFMD

National Private Placement & Guernsey's Fund Management Model



Guernsey Financial
Services Commission

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Glossary of Terms

AIFMD	Directive 2011/61/EU on Alternative Investment Fund Managers
AIFM	Alternative Investment Fund Manager
AIF	Alternative Investment Fund
Bailiwick	Bailiwick of Guernsey, which comprises the islands of Guernsey, Alderney and Sark
Commission	Guernsey Financial Services Commission
ESMA	European Securities and Markets Authority
EU	European Union
EU Competent Authority	any authority appointed in an EU Member State in accordance with Article 44 of AIFMD for the supervision of Managers, delegates, depositaries and, where applicable, Covered Funds.
FSC Law	The Financial Services Commission (Bailiwick of Guernsey) Law, 1987, as amended
Guernsey	Bailiwick of Guernsey
Member State	Member State of the European Union
NPPR	National Private Placement Regime
POI Law	The Protection of Investors (Bailiwick of Guernsey) Law, 1987, as amended

1. Regulatory Framework

Commission Functions

The Commission is the regulatory body for the finance sector in the Bailiwick. The Commission's primary objective is to regulate and supervise financial services in the Bailiwick, with integrity and efficiency, and in so doing help to uphold the international reputation of the Bailiwick as a finance centre. The Commission is the only financial services regulator within the Bailiwick.

The Commission is committed to international regulatory co-operation and is a signatory to the IOSCO MMoU and the IAIS MMoU. It also has numerous bilateral regulatory co-operative agreements in place; and, through ESMA, has in place MoUs covering AIFMD with 27 members of the EEA.

The Commission ensures the Bailiwick's regulatory framework and practice meets international standards and is a committed participant in discussions of international standards. It does so through membership of, or association with, the following international organisations:

- (i) The International Organisation of Securities Commissions ([IOSCO](#));
- (ii) The International Association of Insurance Supervisors ([IAIS](#)) and the Group of International Insurance Centre Supervisors ([GIICS](#));
- (iii) The Group of International Finance Centre Supervisors ([GIFCS](#));
- (iv) The Organisation for Economic Co-operation and Development ([OECD](#)) - through the UK's membership; and
- (v) The Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism ([MONEYVAL](#)).

Through its membership of the Group of International Finance Centre Supervisors, it works with:

- (i) The Basel Committee on Banking Supervision ([BIS](#));
- (ii) The Financial Action Task Force ([FATF](#)) on money laundering.

International Investment Flows into the EU & Role of Guernsey's Investment Fund Sector¹

The Guernsey funds sector is international, professional and concentrated in alternative investment asset classes.

Guernsey is used as a conduit to facilitate capital raise from investors in different countries and subsequently to facilitate the deployment of this capital into global assets: -

- (i) At least 66% of Guernsey funds deploy the majority of capital in regions that are different to where the majority of their investors are located. 34% invest in the same region but across different countries within that region (i.e. EU).
- (ii) Guernsey funds attract a global investor base with 86% of funds containing investors from at least 2 different regions. The majority of funds (77%) can be classified as truly global, attracting investors from all regions.

The Guernsey investment funds sector acts as a gateway for global capital into the EU: -

- (i) It provides a conduit for global investors to access European assets, our research demonstrates that of €130bn investment into EU (ex UK) assets through Guernsey funds, half originates from outside the EU.
- (ii) It provides a conduit for UK based professional investors to invest into assets in other EU Member States: 48% of €45bn of UK professional managed assets are invested into EU (ex UK) assets.
- (iii) Investment is predominantly in “real assets” (private equity, infrastructure and property). Collectively, these asset classes make up 92% of assets deployed into the EU.
- (iv) Private equity firms manage and grow companies valued at €100bn across Europe, supporting economic growth and supporting jobs in businesses ranging in size from SMEs up to multi-nationals.
- (v) Guernsey infrastructure funds (including a hub of renewable funds) assist with supporting key EU government objectives by facilitating the construction and management of €6.5bn of key infrastructure assets across Europe.

¹ Source: KPMG, Funds Research Project, States of Guernsey 2014, unpublished.

Investment Business Regulatory Overview

Investment business is regulated under the POI Law. The FSC Law transferred to the Commission the functions in relation to the authorisation and registration of open-ended collective investment funds and closed-ended collective investment funds, the making of rules in relation to such funds and the regulation of authorised and registered collective investment funds under the POI Law. It also transferred to the Commission the functions in relation to the licensing of persons to carry on controlled investment business under the POI Law, the making of rules in respect of such licensees and the regulation of controlled investment business under the POI Law.

In 2013 the Bailiwick created an AIFMD focused regime for those AIFMs and AIFs which market into the EU. There are two aspects to the Bailiwick's AIFMD focused regime, the first being The AIFMD (Marketing) Rules, 2013, which ensure that Guernsey AIFMs established in Bailiwick who wish to market into the EU meet the requirements of Articles 42 and 43 of AIFMD. These Rules also introduced notification requirements to the Commission which assist the Commission in co-operating effectively with EU Competent Authorities. These Rules became effective on 22 July 2013.

The second part of the Bailiwick's AIFMD focused regime is an equivalent AIFMD opt-in regime for Guernsey AIFMs and Depositaries, which is predominantly based on the Level 1 Directive. The AIFMD Rules, 2013, governing this opt-in regime became effective from 2 January 2014. The Commission anticipates that the Bailiwick's proactive approach to AIFMD will assist ESMA with its advice on the application of the passport to third-country AIFMs and AIFs in accordance with the rules set out in Article 35 and Articles 37 to 41 of the AIFMD.

The legislation underpinning the Bailiwick's regulatory regime can be found at <http://www.guernseylegalresources.gg/article/6325/Home>.

2. ESMA Request

At the meeting held on 8 October 2014 ESMA requested that the Commission provide notes to ESMA regarding: -

- (i) its experience to date on the NPPR and specific approaches adopted by EU Member States, and
- (ii) a description and explanation of how the fund management model operates in the Bailiwick of Guernsey.

Subsequent to this meeting, the Commission has noted that ESMA has issued a “Call for Evidence” and, in particular, has requested comments from Non-EU supervisors to comment on any general or specific difficulties which EU AIFMs and UCITS Management companies may encounter in establishing themselves or marketing or managing AIFs or UCITS in the non-EU countries. The Commission has also provided comments on this aspect below.

3. NPPR Experiences

The Commission notes that Article 42 of AIFMD permits Member States to impose stricter rules on Non-EU AIFMs; however, this provision has presented significant difficulties to EU AIFMs managing and marketing non-EU AIFs and non-EU AIFMs marketing non-EU AIFs into the EU. The following observations are based on notification of marketing by Guernsey AIFMs and generic feedback provided to the Commission by the Bailiwick's investment fund industry.

Marketing by Guernsey AIFMs

The Commission has been advised that Guernsey AIFMs have successfully used the NPPR in 16 of the 27 Member States that Guernsey signed bilateral co-operation agreements with in July 2013. However, Guernsey AIFs have mainly been marketed into 5-6 Member States predominantly located in Northern Europe. This is principally because these Member States have decided to impose only the minimum AIFMD NPPR requirements (that is, disclosure to investors, regular reporting to EU Competent Authorities, the preparation of an annual report and certain asset stripping and notification requirements).

Nil implementation of NPPR

Although the Commission signed bilateral co-operation agreements with 27 EU Competent Authorities in the European Economic Area, it is disappointing to note that several Member States have failed to fully implement AIFMD or decided not to implement a NPPR in their jurisdiction. This has put non-EU jurisdictions such as the Bailiwick at a significant disadvantage. We believe it also is serving to act as a barrier in attracting international investment into the EU.

Depositary-Lite

The Commission is aware that some Member States have imposed a "depositary-lite" requirement. This in effect means that the non-EU AIFM must appoint one or more entities to carry out the following functions in respect of the AIF being marketed: (i) custody of assets; (ii) cash monitoring; and (iii) general oversight. The appointment of one or more entities to carry out depositary functions is not a problem in itself, it is the fact that this requirement has not been imposed consistently across the EU, and therefore, has created uncertainty.

Reporting

Non-EU AIFMs are required to file an Annex IV report on a regular basis to the regulator of each EU Member State in which its AIF is being marketed. The Annex IV report is in the format specified by ESMA and appears to be consistently applied in EU Member States; however, it would be preferential if Non-EU AIFMs only had to report to one EU Competent Authority.

Definition of Marketing

The definition of marketing has also been interpreted and implemented differently across EU Member States. The Commission is aware that a Member State has taken the view that marketing takes place when a person makes AIF units or shares available for purchase by a potential investor; this implies that preliminary marketing material may not constitute marketing in that Member State. However, other Member States appear to have taken a far broader interpretation of that term. The differing interpretations have caused difficulties for non-EU AIFMs who are conducting pre-marketing because this not always clear if this activity is captured by a Member State's NPPR.

Overall Summary

As Article 42 of AIFMD permits Member States to impose stricter rules on Non-EU AIFMs, NPPR only operates effectively in 5-6 Member States, which are predominantly located in Northern Europe. This is principally because these Member States have decided to impose only the minimum AIFMD NPPR requirements. Non-EU AIFMs are unable to access a large proportion of the EU market because some Member States have: 1) not implemented AIFMD; 2) not created a NPPR regime and 3) over complicated the NPPR registration process.

We believe these issues serve to act as barriers in attracting international investment into the EU to the detriment of the EU economy's access to the international capital and investor base – an outcome contrary to the EU's growth agenda.

Accordingly, in order to create a level playing field, and improve the EU's efficient and effective access to international capital, the Bailiwick is trusting that ESMA will be in a position to recommend that the passporting provisions be extended to third-country AIFMs and AIFs, in particular, those located in the Bailiwick.

4. Guernsey's Fund Management Model

AIFM Licensing Requirements

Any person carrying on the restricted activities of promotion, subscription, registration, dealing, management, administration, advising or custody in connection with controlled investment business or operating an investment exchange requires a licence from the Commission. Persons effectively conducting the business of an AIFM in or from within Guernsey must therefore be licensed under the POI Law.

The Commission shall not grant an application for a licence under the POI Law unless satisfied that the criteria specified in Schedule 4 to that law are fulfilled. Schedule 4 to the POI Law sets out the Minimum Criteria for Licensing and its provisions must be fulfilled in relation to the applicant for a licence and in relation to any person who is or is to be a director, controller, manager or partner of the applicant. A licensee, and any person who is or is to be a director, controller, manager or partner of the licensee, must continue to meet the Minimum Criteria for Licensing following the issue to it of a licence.

The Minimum Criteria for Licensing cover the following areas:

Fit and Proper Persons

The applicant or licensee is a fit and proper person to hold a licence and every person who is, or is to be, a director, controller, partner or manager of the applicant or licensee, is a fit and proper person to hold that position. In determining whether a person is a fit and proper person to hold a licence or a particular position the Commission has to give regard to various issues in respect of probity, competence, experience and soundness of judgement for fulfilling the responsibilities of that licence or as the case may be that position.

Integrity and Skill

The business of the applicant or licensee will be carried on with prudence and integrity and professional skill appropriate to the nature and scale of the activities undertaken and in accordance with the POI Law and applicable rules, regulations and other relevant enactments.

Business to be directed by at least two individuals

At least two individuals of appropriate standing and experience and who are sufficiently independent of each other are required to direct the business. This is referred to colloquially as “4 eyes.”

Composition of the Board of Directors

In the case of a company the board of directors shall include such number of executive and non-executive directors as the Commission considers appropriate having regards to the circumstances of the company and the nature and scale of its operations.

Business to be conducted in a prudent manner

The applicant or licensee must conduct its business in a prudent manner maintaining an appropriate capital base and insurance cover. The actual requirements regarding capital adequacy and insurance cover are set out in underlying rules made under the POI Law and which apply to all licensees under that legislation.

Information required by the Commission

The Commission may reasonably require any information for the purpose of assessing compliance with the Minimum Criteria for Licensing.

Conduct of Business and Capital Adequacy Rules

Underpinning the POI Law are rules relating to the conduct of business and capital adequacy, which apply to all licensees under the POI Law. In addition, Guernsey AIFMs and Depositaries which are conducting AIFMD related business with the EU also have the ability to opt-in to comply with The AIFMD Rules, 2013, which are predominantly based on the Level 1 Directive.

Overall Summary

The Commission considers that for many years the aforementioned Minimum Criteria for Licensing has ensured that Guernsey AIFMs’ do not fulfil the attributes of a “letter box entity”; however, this has been reinforced with the introduction of The AIFMD Rules, 2013.

Guernsey Funds Overview

The Bailiwick has a wide variety of fund structures, both open-ended and closed-ended, which cover assets classes such as private equity, property, hedge funds as well as more traditional assets such as equity, bond and money markets. The net asset value of total funds under management and administration for the quarter ended 30 June 2014 stood at £261.3 billion. In recent years, the Bailiwick has been considered as a centre of excellence for private equity funds and promoters of private equity funds in Guernsey include: -

Aberdeen

Apax

Apollo

Alchemy

BC Partners

Better Capital

Cinven

Coller Capital

EQT

Mid Europa

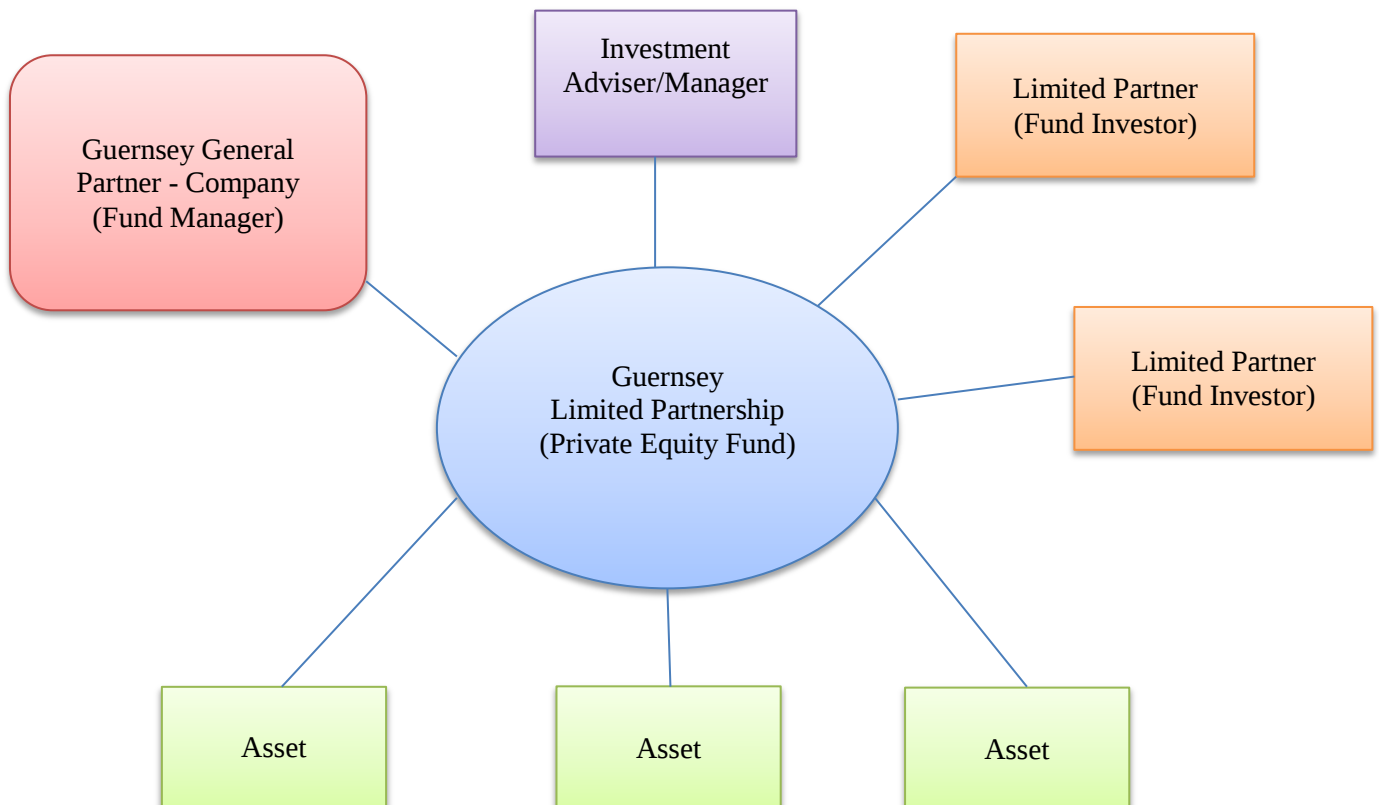
Permira

Partners Group

Terra Firma

The Bailiwick's administrative heritage is being increasingly complemented by the growth of investment management services, for example, promoters such as, Apax, Partners Group and Terra Firma, have set up fully staffed management and administration companies in the Bailiwick.

Typical Guernsey Private Equity Structure



Notes

- The Guernsey Limited Partnership is authorised or registered as a collective investment scheme under the POI Law;
- The Guernsey General Partner is licensed under the POI Law;
- The Investment Adviser/Manager is licensed under the POI Law if it is holding itself as operating in or from within the Bailiwick, however, generally the Investment Adviser/Manager is located outside of the Bailiwick. For example, many of the Investment Advisers/Managers of Guernsey collective investment schemes will be located in London as this tends to be where the asset management expertise lies.
- Dependent on the structuring of the investment advisory/management agreements the AIFM will be either the General Partner or the Investment Adviser/Manager.

Delegation of Management

Rule 2.1.3 of The Licensees (Conduct of Business) Rules 2009 states that the Board of a licensee must retain responsibility for the outsourcing of any of its functions. The Commission has issued a

Guidance Note on the Outsourcing of Functions by entities licensed under the POI Law. Compliance with this Guidance Note is considered under the Minimum Criteria for Licensing as referred to above. The Guidance Note has been conformed to IOSCO's "Principles on Outsourcing of Financial Services for Market Intermediaries".

Licensees must communicate with the Commission in respect of any proposals to outsource functions, or any changes to existing arrangements. The guidance applies to any entity licensed under the POI Law where functions are outsourced to either entities within the same group or third parties, both within or outside the Bailiwick.

The Commission has a legitimate regulatory responsibility under the POI Law in respect of the conduct of a licensee's controlled investment business. In addition, Principle 10 of The Licensees (Conduct of Business) Rules 2009 requires that "A licensee should deal with the Commission in an open and co-operative manner and keep the regulator promptly informed of anything concerning the firm which might reasonably be expected to be disclosed to it." Consequently, the Commission must be advised at an early stage of any proposals to outsource.

Responsibility cannot be outsourced and the licensee at all times remains responsible and accountable to the Commission, as its regulator, for compliance with the POI Law and the rules and regulations made thereunder. The outsourcing arrangement must not impair the Commission's ability to exercise its statutory responsibilities. Outsourcing arrangements utilised by licensees under the POI Law are considered as part of the Commission's ongoing regulation and supervision of the licensee concerned.

In addition, Guernsey AIFMs which are conducting AIFMD related business with the EU also have the ability to opt-in to comply with The AIFMD Rules, 2013. Article 20 of AIFMD is enshrined in Rule 10.1. As part of the Commission's AIFM equivalent regime, the Commission takes into account guidance issued by ESMA, and therefore will endorse any future guidance issued by ESMA regarding delegation structures as part of this regime. Should the passporting provisions in AIFMD be extended to Guernsey AIFMs, the Commission would expect Guernsey AIFMs to opt-in to comply with The AIFMD Rules, 2013.

5. Call for Evidence

EU AIFMs and UCITS Management Companies managing AIFs established in the Bailiwick

There is no requirement for a Guernsey AIF to have a Guernsey AIFM. Consequently there is no restriction on EU AIFMs and UCITS Management Companies establishing AIFs in the Bailiwick. However, the Commission does insist that Promoters and/or Investment Managers, irrespective of their location, (including their directors, controllers and senior managers) must be fit and proper. This can be defined as being a requirement for integrity (or honesty), competence (or track record) and solvency.

EU AIFMs and UCITS Management Companies marketing AIFs or UCITS in the Bailiwick

General Promotional Requirements

Under the POI Law, promotion of collective investments schemes (including AIFs) is a restricted activity, which requires a licence. The POI Law defines promotion as:-

- a) advertising;
- b) issuing a prospectus, application form or proposal form; and
- c) circulating or making available promotional material.

However, promotion of collective investments schemes (including AIFs) will not be regarded as an activity requiring a licence under the POI Law provided that the promoters have taken and can demonstrate that they have taken steps to ensure that any such promotion will be directed only to those firms supervised by the Commission. In these circumstances promotional material must make it clear that it is not for distribution to private investors, and invitations to promotional seminars must not be directed to private investors.

Licence Exemptions

Under Section 29(1) of the POI Law, the Investor Protection (Designated Countries And Territories) Regulations 1989 and the Investor Protection (Designated Countries And Territories) (Republic Of Ireland) Regulations 1992 ("the Regulations"), Designated Territory status has been granted to:

- The United Kingdom
- Jersey

- The Isle of Man
- The Republic of Ireland

An applicant carrying on business in relation to collective investment schemes with a main place of business in any of the above does not require a licence under the POI Law to promote certain collective investment schemes (UCITS equivalent) in the Bailiwick, but must give prior notice to the Commission.

The Regulations were drafted on the basis of reciprocity; therefore, the Commission will extend the Regulations to all Member States, should the passport be extended to Guernsey AIFMs and AIFs.

6. Conclusion

The Commission trusts that the above information will assist ESMA with its advice on the application of the passport to third-country AIFMs and AIFs in accordance with the rules set out in Article 35 and Articles 37 to 41 of the AIFMD. Should you wish to hear further from the Commission regarding its AIFMD equivalent regime, please contact Emma Bailey, Louise Bougourd or Nick Herquin.