

Investment funds in Guernsey: regulatory overview

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RETAIL FUNDS

1. What is the structure of the retail funds market? What have been the main trends over the last year?

Open-ended retail funds

A significant number of open-ended funds are established in Guernsey and the island continues to attract non-Guernsey open-ended funds due to its ability to provide high quality administration, management and custody services. Such vehicles are often designed to be promoted to institutional or professional investors, rather than retail investors, but they can also be used as retail funds. The funds regime in Guernsey is highly flexible and most types of funds can be used in a number of different markets, including the retail markets.

As at end of September 2014, the Guernsey Financial Services Commission (GFSC) announced that the total net asset value of funds under management and administration for Guernsey domiciled open-ended funds was GB£41.7 billion. Non-Guernsey funds that are administered or managed in Guernsey provided a total net asset value of GB£83.4 billion.

Closed-ended retail funds

The funds sector (and in particular the closed-ended fund sector) is one of the main pillars of the finance industry in Guernsey, with 140 new investment funds established in Guernsey during the 12 months to the end of September 2014. The majority of funds established in Guernsey are designed to be promoted to institutional or professional investors, rather than retail investors. However, Guernsey has a significant number of listed funds, whose shares can be acquired by the public on the secondary market. Guernsey is currently the global leader for non-UK London Stock Exchange listings, and also has funds listed on many other exchanges such as the CISE, Euronext, ISE, ASX and TSX.

In the past year, the Guernsey closed-ended funds sector has experienced increases in aggregate asset value as well as significant new launches and sizeable fund-raising by established funds. One growing trend has been a move away from remunerating managers through performance fees. The key asset sectors in the past year have been debt, infrastructure and a return of property investment. The Guernsey closed-ended funds sector is valued at GB£135.8 as at end of September 2014.

AIFM Directive

Guernsey is a "third-country" non-EU jurisdiction under the Directive 2011/61/EU on alternative investment fund managers (AIFM Directive), which provides Guernsey based managers and funds with a number of potential advantages.

There has been a strong trend towards establishing funds with a Guernsey based AIFM (whether this is the fund itself or a separate Guernsey based manager) so that the fund and the manager are

free from the requirements and costs associated with the AIFM Directive, but can make use of national private placement regimes if they wish to market the fund in specific EEA jurisdictions. As a result, Guernsey is particularly attractive for promoters based in the EU or for promoters in the US and Asia who may otherwise be discouraged by the complexities of raising capital in the EU.

A significant proportion of Guernsey funds fall outside the scope of the AIFM Directive, and it is expected that promoters will continue to use Guernsey as a base for such products, taking advantage of the non-EU status.

Regulatory framework and bodies

2. What are the key statutes, regulations and rules that govern retail funds? Which regulatory bodies regulate retail funds?

Open-ended retail funds

Regulatory framework. The types of open-ended funds are as follows:

- **Authorised funds.** Funds that are authorised by the Guernsey Financial Services Commission (GFSC) and subject to permanent and continuing supervision by the GFSC. These funds fall into three classes:
 - **Class A.** These are true retail funds that are equivalent to Undertakings for Collective Investment in Transferable Securities (UCITS) in the EU. The rules applicable to Class A funds are the Collective Investment Schemes (Class A) Rules 2002 (Class A Rules) (although these are due to be replaced by the Authorised Collective Investment Schemes (Class A) Rules 2008 at a date which has not yet been specified). These rules are prescriptive as to the form and content of the fund documents, and place limits on the investment and borrowing powers of the fund. Class A funds benefit from an investor compensation scheme under the Collective Investment Schemes (Compensation of Investors) Rules 1988. Class A funds can be:
 - registered for sale in numerous countries; and
 - promoted or distributed to the public in the UK in the same way as UK-authorised funds (subject to complying with certain notification requirements).
 - **Class B.** These can be structured as retail products marketed to the public, or established as strictly private or institutional funds. The rules applicable to Class B funds are the Collective Investment Schemes (Class B) Rules 2013 (Class B Rules). These rules are less prescriptive than for Class A funds, and allow Class B funds greater latitude in their investment and borrowing powers, provided that there is full disclosure in the fund documents.

- **Class Q.** These are not retail funds as they can only be beneficially owned by qualifying professional investors (essentially, government bodies or high net worth individuals or entities). The rules applicable to Class Q funds are the Collective Investment Schemes (Qualifying Professional Investor Funds) (Class Q) Rules 1998 (Class Q Rules).
- **Registered funds.** These are funds that are registered with the GFSC and are regulated, but not authorised, by the GFSC. The rules applicable to registered open-ended funds are the Registered Collective Investment Scheme Rules 2015. The fund documents must contain the disclosures required by the Prospectus Rules 2008. These rules are not prescriptive concerning the features of the fund (for instance, in relation to investment powers) but require full disclosure of all material matters and ongoing notification of specific events. There are no restrictions on who can invest in a registered fund, but they cannot currently be marketed directly to the public in Guernsey. They are unlikely to be used as retail funds.

Regulatory bodies. The GFSC regulates all funds in Guernsey and its powers are derived from the Protection of Investors (Bailiwick of Guernsey) Law 1987, as amended (POI Law). The GFSC issues the rules and regulations regulating funds under powers derived from the POI Law.

Closed-ended retail funds

Regulatory framework. The types of closed-ended funds are as follows:

- **Authorised closed-ended funds.** These are funds that are authorised by the GFSC and are subject to its permanent and continuing supervision. The rules which apply to authorised closed-ended funds are the Authorised Closed-ended Investment Schemes Rules 2008. These rules are not prescriptive concerning the features of the fund (for example, in relation to investment powers) but require full disclosure of all material matters and ongoing notification of specific events.
- **Registered closed-ended funds.** See above, *Open-ended retail funds: Registered funds*.

Regulatory bodies. The GFSC rules governing closed-ended funds are issued under powers derived from the POI Law.

AIFM Directive

Guernsey is a "third-country" non-EU jurisdiction under the EU Directive 2011/61/EU on alternative investment fund managers (AIFM Directive) and has established a dual regime which provides a flexible regulatory framework and allows fund managers to comply with the AIFM Directive without being required to do so when compliance is not absolutely necessary.

The first part of the dual regime ensures that Guernsey funds can be marketed in the EEA using national private placement regimes, with the GFSC acting as a local regulator that co-operates with the relevant EEA securities regulator. Such funds can also be marketed to non-EU investors without being concerned with compliance with the AIFM Directive.

The second part of the dual regime allows managers and depositaries, before the introduction of the pan-European passport, to opt in to a regime which is fully compliant with the AIFM Directive, if this is required.

3. Do retail funds themselves have to be authorised or licensed?

Open-ended retail funds

Open-ended funds must be either authorised or registered (see *Question 2, Open-ended retail funds*), but do not require licensing. Special rules apply to foreign funds (see *below, Foreign funds*).

Authorised funds. There are two separate procedures that apply for authorisation of an authorised open-ended fund:

- **Traditional three-stage application process.** This procedure applies to Class A, Class B and Class Q funds. It involves the following stages:
 - **Preliminary (new promoter's introductory checklist).** Before starting the three-stage application process, it is necessary to identify the promoter of the fund (the person ultimately responsible for the success of the fund, usually the investment manager). If the promoter is not previously known to the Guernsey Financial Services Commission (GFSC), the promoter should review the checklist and provide the information outlined in that form. The GFSC requires a demonstrable track record in the establishment and/or management of investment funds. The GFSC will then indicate whether or not it will consider a formal application from the promoter. New promoters should allow up to three months for this process;
 - **Stage one (outline authorisation).** A Form GFA is submitted setting out:
 - basic details of the proposed fund;
 - the fund's objectives;
 - the parties involved;
 - the fees to be charged; and
 - any unusual features.

The designated manager (a locally based administrator) and the designated custodian must sign this form. A prospectus is not required at this stage. If the parties meet the GFSC's selection criteria and the proposals are acceptable, the GFSC then issues an outline authorisation. Applicants should allow between six to eight weeks from the submission of the stage one application to the formal authorisation (assuming that no issues arise);
 - **Stage two (interim authorisation).** The following are submitted:
 - a nearly final draft of the fund's prospectus (or equivalent document);
 - the investor's application form; and
 - the appropriate form for the proposed class of the fund (forms APA, APB and APQ respectively).

These forms act as a checklist and ensure that the required disclosures are included in the fund documents. Derogations can be sought in respect of the Class B and Class Q rules, but no derogations are allowed from the Class A rules. The GFSC aims to issue the interim authorisation within ten working days of the receipt of the application;
 - **Stage three (formal authorisation).** This is granted when all issues have been resolved and all conditions have been satisfied, including the GFSC receiving:
 - a certified copy of the prospectus;
 - certified copies of all final constitutive documents and key agreements (for example, articles of incorporation, management agreement, custodian agreement, and so on).

- **Fast track application (Qualifying Investor Funds) (QIFs).** A fast track application process is also available, under which the proposed designated manager of the fund carries out the assessment that the GFSC otherwise carries out at stage three of the traditional process (see *above*). The designated manager submits the QIF application (Form QIF) once all:

- due diligence on both the parties and the fund structure is complete; and
- fund documents are in final (or near final) form.

Form QIF includes warranties from the designated manager to the GFSC concerning the suitability of the fund and the parties involved. The GFSC then undertakes to issue the formal authorisation of the fund within three working days of the receipt of a complete application.

The disadvantage to this fast track process is that investment in the fund must be restricted to qualified investors, which are defined as professional investors, experienced investors or knowledgeable employees.

Registered funds. The process for applying for the registration of a registered open-ended fund is the same as for the QIF application (see above), except that the applicable form is Form REG. The time period of three working days also applies. The type of investor who can invest in the fund is not restricted (although these funds cannot be marketed directly to the public in Guernsey).

Foreign funds. Certain categories of funds that are authorised in the UK, Jersey, Isle of Man or Republic of Ireland can be promoted in Guernsey on completion of a Form EX and the payment of a fee, but without being authorised or registered in Guernsey (*Investor Protection (The Designated Countries and Territories) Regulations 1989* and *Investor Protection (The Designated Countries and Territories) (Republic of Ireland) Regulations 1992*).

A Guernsey licensee providing management, administration or custody services to open-ended foreign funds must comply with the Licensees (Conduct of Business and Notification) (Non-Guernsey Schemes) Rules 1994.

Under these rules, the licensee must notify, and obtain the approval of, the GFSC before providing these services. This approval will usually only be granted if the fund would broadly meet the criteria for authorisation as an authorised fund in Guernsey (if this authorisation was necessary).

Closed-ended retail funds

Closed-ended funds must be either authorised or registered (see Question 2, *Closed-ended retail funds*) but do not need to be licensed.

Authorised funds. There are two separate processes for applying for authorisation of an authorised closed-ended fund:

- **Traditional three-stage application process.** This process is the same as for authorised open-ended funds (see above, *Open-ended retail funds*), except as follows:
 - **Stage one (outline authorisation).** As there is no requirement for closed-ended funds to appoint a custodian or trustee, there is no requirement for the custodian or trustee to sign the Form GFA;
 - **Stage two (interim authorisation).** The A, B and Q Classes do not apply to closed-ended funds, and so there is only one type of application form (Form APC). Derogations from the Authorised Closed-ended Investment Schemes Rules 2008 can be sought if either:
 - compliance with a particular rule is not appropriate in the circumstances;
 - compliance would require a fund to alter its proposed operations or practices.
- The GFSC must be satisfied that investors will not be adversely affected before granting derogations.

- **Fast track application (QIFs).** The fast track application process is available for authorised closed-ended funds and is the same as for authorised open-ended funds (see above, *Open-ended retail funds*).

Registered funds. The process for applying for the registration of a registered closed-ended fund is the same as for a registered open-ended fund (see above, *Open-ended retail funds*).

Foreign funds. Closed-ended funds that are constituted outside Guernsey must be authorised or registered in Guernsey if the functions of administration and custody of the fund are carried out within Guernsey. This does not apply if only the administration of the fund is carried out in Guernsey.

Marketing

4. Who can market retail funds?

Open-ended retail funds

Any person marketing a fund, receiving subscriptions or registering investors in (or from within) Guernsey must be licensed by the Guernsey Financial Services Commission (GFSC) (*POI Law*). An exemption applies to nationals of the UK, Jersey, Isle of Man or the Republic of Ireland who would be permitted to market the relevant fund in their home country.

Closed-ended retail funds

See above, *Open-ended retail funds*.

Foreign funds

Certain categories of funds that are authorised in the UK, Jersey, Isle of Man or Republic of Ireland can be promoted in Guernsey without being authorised or registered in Guernsey on both completion of a Form EX and payment of a fee (*The Investor Protection (Designated Countries and Territories) Regulations 1989* and *The Investor Protection (Designated Countries and Territories) (Republic of Ireland) Regulations 1992*).

5. To whom can retail funds be marketed?

Open-ended retail funds

The following restrictions apply:

- **Class A funds.** There are no restrictions.
- **Class B funds.** There are no restrictions.
- **Class Q funds.** These non-retail funds can only be marketed to qualifying professional investors (see Question 2, *Open-ended retail funds*).
- **Funds authorised using the fast-track QIF application process.** These funds can only be marketed to qualified investors (see Question 3, *Open-ended retail funds*).
- **Registered open-ended funds.** There are no restrictions on the type of investor, but these funds cannot currently be marketed directly to the public in Guernsey. These funds can be offered to regulated entities in Guernsey, or to the public in Guernsey by entities licensed by the Guernsey Financial Services Commission (GFSC).

Closed-ended retail funds

The following restrictions apply:

- **Authorised closed-ended funds:** there are no restrictions.
- **Funds authorised using the fast-track QIF application process:** qualified investors only.
- **Registered closed-ended funds:** there are no restrictions on the type of investor, but these funds cannot be marketed directly to the public in Guernsey. These funds can be offered to regulated entities in Guernsey, or to the public in Guernsey by entities licensed by the GFSC.

Foreign funds

Certain funds authorised in the UK, Jersey, Isle of Man or Republic of Ireland can be promoted in Guernsey without being authorised or registered in Guernsey (see *Question 4, Foreign funds*). Guernsey regulations do not restrict the persons to whom such funds can be marketed.

Managers and operators

6. What are the key requirements that apply to managers or operators of retail funds?

Open-ended retail funds

There are two key roles in a Guernsey fund:

- **Promoter.** The term promoter is not specifically defined but is generally considered as the party ultimately responsible for the fund's success. It is usually, but not always, the investment manager. The identity, standing and track record of the fund's promoter are of vital importance to the Guernsey Financial Services Commission (GFSC) when determining whether (or not) to authorise a fund. The GFSC's selection policy requires applicants to be able to demonstrate a favourable track record in an established jurisdiction, involving a business which is:
 - equivalent to the new proposal; and
 - financially successful.

The following are also taken into consideration:

- whether the promoter is authorised or licensed by another regulatory body is a positive indicator (although the GFSC will make its own assessment);
- the promoter's:
 - ownership;
 - financial resources; and
 - reputation;
- the experience of the principals behind the promoter.

In the case of QIFs and registered funds, the proposed designated manager of the fund carries out the assessment. However, it involves the same considerations and the same criteria as if the GFSC was conducting the review.

- **Designated manager/designated administrator.** All funds authorised or registered in Guernsey must appoint a local designated manager (also referred to as the designated administrator) which must be licensed by the GFSC. Guernsey has a well-developed fund administration industry, and a local firm usually carries out the functions of the designated manager. However, these functions can be outsourced to a third party (whether local or foreign). In those cases, the local designated manager remains primarily responsible to the GFSC, and must comply with the GFSC's guidance on outsourcing when considering and monitoring those appointments. Designated managers must comply with:

- The Licensees (Conduct of Business) Rules 2014 (COB Rules);
- The Licensees (Capital Adequacy) Rules 2010 (CA Rules).

The COB Rules include provisions dealing with the following:

- compliance arrangements, including monitoring and employee training;
- record keeping;
- categorising clients;

- suitability of transactions for clients and disclosure of information to clients;
- timely execution and best execution;
- dealing with client assets;
- the timing and content of contract notes relating to transactions;
- conflicts of interest;
- events to be notified to the GFSC.

The CA Rules specify the level of financial resources, liquidity and insurance that a licensee must maintain, as determined by reference to their business type, historical turnover and risk profile.

It is common for a foreign manager to perform the investment management role, and a local designated manager to perform the administration role.

Foreign funds. A Guernsey licensee providing management, administration or custody services to open-ended foreign funds must comply with the Licensees (Conduct of Business and Notification) (Non-Guernsey Schemes) Rules 1994 (see *Question 3, Open-ended retail funds*).

Closed-ended retail funds

See above, *Open-ended retail funds*.

Assets portfolio

7. Who holds the portfolio of assets? What regulations are in place for its protection?

Open-ended retail funds

All open-ended funds authorised or registered in Guernsey must appoint a local designated custodian or trustee, who must be licensed by the Guernsey Financial Services Commission (GFSC). Irrespective of the type of fund, the custodian or trustee must be:

- Independent of the designated manager and investment manager.
- Where the fund is a company, independent of the company and its directors.

Designated custodians/trustees must comply with the Licensees (Conduct of Business) Rules 2014 and the Licensees (Capital Adequacy) Rules 2010.

Closed-ended retail funds

Closed-ended funds are not required to appoint a designated custodian or trustee. However, the GFSC must be satisfied that the assets of the fund are adequately safeguarded. This can involve the appointment of a local custodian or trustee (or a foreign custodian or trustee), or it can involve some other form of safeguarding arrangement. The designated manager can provide safekeeping facilities.

Legal fund vehicles

8. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures?

Open-ended retail funds

Legal vehicles. The vehicles most often used for open-ended retail funds are corporate vehicles or unit trusts. Limited partnerships and limited liability partnerships (LLPs) are unlikely to be used for

retail funds (see Question 25, *Legal vehicles: Limited partnership and Limited liability partnership (LLP)*).

Corporate vehicles. Guernsey company law allows for a number of different forms of company (*The Companies (Guernsey) Law 2008, as amended*). The following types can be used for retail funds:

- **Non-cellular company.** This is a traditional company with limited liability and issuing shares of one or more classes.
- **Protected cell company (PCC).** The PCC takes the form of one company that can form any number of cells, with the assets and liabilities of each cell segregated from the other cells. Shares issued by the PCC are attributed to a cell, so that a shareholder's rights relate only to that cell.
- **Incorporated cell company (ICC).** The same rules apply as for a PCC (see above), except each cell has its own legal personality.

The non-cellular company structure is most frequently used for open-ended retail funds; PCCs and ICCs are more commonly used for hedge funds (see Question 25, *Legal vehicles: Corporate vehicle*).

Unit trust. A unit trust is not a legal person in its own right. It is a trust arrangement, under which a trustee holds the assets on trust for the benefit of unitholders, according to the terms of a trust instrument. Investors hold units in the trust, with each unit representing an undivided fractional interest in the trust property. The Trusts (Guernsey) Law 2007 regulates unit trusts.

Compared to companies, unit trusts have greater flexibility in regulating their own affairs as they see fit, within the confines of the applicable fund rules. Unit trusts are familiar to UK investors in the authorised retail funds market. However, most investors are typically more familiar with corporate entities, and there is a greater body of established learning and practice in relation to the operation and management of companies.

Guernsey company law permits the use of open-ended companies in all circumstances and this therefore removes one of the original advantages of using unit trusts.

Advantages. Unit trusts offer greater flexibility as regards internal governance.

Disadvantages. Investors (particularly non-UK investors) may be more comfortable with corporate structures than they would be with unit trusts.

Closed-ended retail funds

Legal vehicles. The vehicles always used for closed-ended retail funds are corporate vehicles (see above, *Open-ended retail funds: Corporate vehicles*). Private equity funds are typically structured as closed-ended limited partnerships but such vehicles are not appropriate for retail funds.

Advantages. Only corporate vehicles are used, and so the advantages are not relevant.

Disadvantages. Only corporate vehicles are used, and so the disadvantages are not relevant.

Investment and borrowing restrictions

9. What are the investment and borrowing restrictions on retail funds?

Open-ended retail funds

Guernsey law only sets out restrictions on investment and borrowing powers for Class A authorised open-ended funds. The Class A Rules contain restrictions that apply to all Class A funds, such as:

- Requirements designed to ensure efficient portfolio management.
- Rules regulating the use of stocklending.
- Restrictions on the circumstances in which the fund can hold cash.
- A requirement that borrowing is on a temporary basis and does not exceed 10% of the value of the fund's property.

In addition, the Class A Rules include specific restrictions which apply to each of the following categories of Class A fund:

- Securities funds.
- Money market funds.
- Futures and options funds.
- Geared futures and options funds.
- Property funds.
- Warrant funds.
- Feeder funds.
- Funds of funds.
- Umbrella funds.

The investment restrictions vary, depending on the type of fund and the nature of the investment. All other forms of open-ended retail fund must disclose the investment and borrowing limits that apply, but no specific restrictions are prescribed.

Closed-ended retail funds

All forms of closed-ended fund must disclose the investment and borrowing limits that apply, but no specific restrictions are prescribed.

10. Can the manager or operator place any restrictions on the issue and redemption of interests in retail funds?

Open-ended retail funds

For Class A funds, the issue or redemption of interests can only be suspended by the manager if the custodian or trustee considers that "due to exceptional circumstances there is good and sufficient reason to do so, having regard to the interests of holders" (*Rule 13.01, Class A Rules*). The fund documents can specify a minimum number, or value, of interests that can be redeemed, and can specify a minimum holding. If a redemption request does not comply with those minimums, the request can be refused.

For all other types of fund, managers are free to impose restrictions on the issue and redemption of interests, but the circumstances in which these arise must be clearly disclosed in the fund documents. New restrictions for redemptions cannot generally be imposed (and existing restrictions cannot be increased) without giving existing holders an opportunity to exit on the old terms.

Closed-ended retail funds

The manager or operator can impose restrictions on the issue of shares. Holders of interests in closed-ended retail funds have no right of redemption in any event.

11. Are there any restrictions on the rights of participants in retail funds to transfer or assign their interests to third parties?

Open-ended retail funds

Restrictions on the transfer of interests would normally be imposed for both open-ended and closed-ended funds to ensure that interests are not transferred to any investor whose circumstances would cause the fund to breach any securities laws or to suffer any adverse tax consequences, or if the transfer would result in any investor holding less than the specified minimum holding for the fund.

Units or shares in Class A funds and Class B funds must be freely transferrable. For all other types of fund, restrictions can be imposed. Interests in Class Q funds and QIFs cannot be transferred to persons who are not eligible to invest in such funds (see *Question 5, Open-ended retail funds*). The manager, the fund and its directors must take all reasonable steps to ensure that interests in Class Q funds are not owned by ineligible investors. The designated manager of a QIF must be satisfied that effective procedures are in place to ensure that interests in the QIF are not owned by ineligible investors.

Closed-ended retail funds

Restrictions can be imposed. Interests in QIFs cannot be transferred to persons who are not eligible to invest in a QIF. The designated manager of a QIF must be satisfied that effective procedures are in place to ensure that interests in the QIF are not owned by ineligible investors.

Reporting requirements

12. What are the general periodic reporting requirements for retail funds?

Open-ended retail funds

Investors. The managers of open-ended funds must prepare the following periodic reports:

- **Class A fund: annual and half-yearly reports.** The annual reports must contain audited accounts and a report by the custodian or trustee. The annual reports must be published within four months of the year end, and half-yearly reports must be published within two months of the end of the half-year period.
- **Class B fund: annual reports.** The reports must contain audited accounts and a report by the custodian or trustee. The annual reports must be published within six months of the year end, and if interim reports are prepared, they must be on a basis consistent with the annual reports.
- **Registered open-ended fund: no periodic reporting requirements.** However, the annual report that must be given to the Guernsey Financial Services Commission (GFSC) is usually also given to investors. Every Guernsey company is legally required to lay its accounts before its shareholders at its annual general meeting.

Regulators. The reporting requirements depend on the type of fund:

- **Class A fund.** The manager must provide to the GFSC:
 - reports issued to investors;
 - either an annual notification of any changes to the information contained in the application form, or a confirmation that there are no changes.

- **Class B fund.** The manager must provide to the GFSC:
 - reports issued to investors;
 - either an annual notification of any changes to the information contained in the application form, or a confirmation that there are no changes.
- **Registered open-ended fund.** The manager must provide to the GFSC:
 - either an annual notification of any changes to the information contained in the application form, or a confirmation that there are no changes;
 - audited annual report and accounts within six months of the year end;
 - a quarterly statistical return;
 - annual notification of any material amendments to the fund's principal documents or agreements.

Closed-ended retail funds

Investors. The same rules apply as for registered open-ended funds (see above, *Open-ended retail funds: Investors*).

Regulators. The same rules apply as for registered open-ended funds (see above, *Open-ended retail funds: Regulators*).

Tax treatment

13. What is the tax treatment for retail funds?

Open-ended retail funds

Funds. Funds are eligible for tax exempt status (for Guernsey tax purposes), on payment of an annual fee of GB£600. Funds with exempt status are not regarded as being tax resident in Guernsey.

Resident investors. The fund must provide the Guernsey director of income tax with details of distributions made to investors resident in Guernsey, or who carry out business in Guernsey through a permanent establishment. In all other respects, the tax treatment is the same as for non-resident investors (see below).

Non-resident investors. The fund does not deduct income tax from any dividends, distributions or interest payable by the fund to investors. There are no death duties, capital inheritance, capital gains, gifts, sales or turnover taxes levied in Guernsey in connection with the acquisition, holding or disposal of interests in funds. No Guernsey stamp duty or stamp duty reserve tax is payable on the issue, transfer, conversion or redemption of interests in funds.

Closed-ended retail funds

- **Funds.** See above, *Open-ended retail funds*.
- **Resident investors.** See above, *Open-ended retail funds*.
- **Non-resident investors.** See above, *Open-ended retail funds*.

Quasi-retail funds

14. Is there a market for quasi-retail funds in your jurisdiction?

The majority of funds established in Guernsey are designed to be promoted to institutional or professional investors, rather than retail investors. However, Guernsey has a significant number of listed funds, whose shares can be acquired by the public on the secondary market.

Reform

15. What proposals (if any) are there for the reform of retail fund regulation?

The Class Q Rules are due to be revised (following the recent revision of the Class B Rules), although wholesale changes are not expected.

The Limited Partnerships (Guernsey) Law 1995, as amended, is due to be revised and updated to enable further flexibility in the use of limited partnerships. The Companies (Guernsey) Law 2008 introduced a modern and streamlined company law regime, and certain minor changes and improvements are expected during 2015 as a result of initial feedback from industry and legal professionals.

HEDGE FUNDS

16. What is the structure of the hedge funds market? What have been the main trends over the last year?

Guernsey is a long established jurisdiction for the establishment of hedge funds and funds of hedge funds, and such funds form a significant part of the island's fund industry. Established promoters of hedge funds in Guernsey include Dexion, BBBSA, Man, FRM, Fauchier and Credit Suisse. The net asset value of hedge funds and funds of hedge funds currently stands at approximately GB£27 billion.

Alternative investments are at the core of Guernsey's funds industry, in particular private equity and funds of hedge funds. Private equity funds account for more than half of the closed-ended funds in Guernsey, by number and value, with a current net asset value of over GB£80 billion.

Regulatory framework and bodies

17. What are the key statutes and regulations that govern hedge funds in your jurisdiction? Which regulatory bodies regulate hedge funds?

Regulatory framework

The position is virtually the same as that for open-ended retail funds (see Question 2, *Open-ended retail funds*). Class A funds are not suitable for use as hedge funds, but the other types of fund are all suitable.

The Guernsey Financial Services Commission (GFSC) can also grant certain derogations to different types of hedge funds (which are not available to other types of fund), as follows:

- Institutional or expert investor hedge funds can be permitted to appoint a foreign prime broker rather than a local custodian or trustee.
- Retail or less sophisticated investor hedge funds can be permitted to appoint a foreign prime broker to take control of the fund's property, but will normally be expected to appoint a local custodian or trustee to oversee the prime broker.
- Hedge funds can be permitted to accept subscription monies or effect redemptions on the basis of estimated valuations.
- Hedge funds can be permitted to apply client money in certain circumstances, in which other funds would be required to segregate such money in a client account.

Regulatory bodies

See above, *Regulatory framework*.

18. How are hedge funds regulated (if at all) to ensure compliance with general international standards of good practice?

Risk

The applicable fund rules require clear disclosure of all material risks to the fund and investors, in order to enable the investor to make an informed judgment as to whether or not to invest.

Valuation and pricing

The applicable fund rules do not prescribe a method of valuation or pricing. However, fund documentation must disclose the methods and bases to be used.

Systems and controls

All Guernsey funds must be administered by a local licensee, which must comply with the COB. These rules also apply to custodians and trustees in relation to the provision of custody services.

Insider dealing and market abuse

Insider trading is prohibited (*The Companies Securities (Insider Dealing) (Bailiwick of Guernsey) Law 1996*). The POI Law prohibits market abuse.

Transparency

There are no transparency requirements requiring reporting to investors or the disclosure of significant holdings, aside from periodic reporting requirements (see Question 12, *Open-ended retail funds*).

Money laundering

Funds and their Guernsey service providers must comply with the various laws and regulations concerning the prevention of both money laundering and terrorist financing. The local designated manager of the fund must ensure compliance with these laws. The Guernsey Financial Services Commission (GFSC) endorses the international standards of the Financial Action Task Force (FATF) in relation to combating money laundering and the financing of terrorism.

Short selling

There are no applicable regulations.

Marketing

19. Who can market hedge funds?

See Question 4, *Open-ended retail funds*.

20. To whom can hedge funds be marketed?

See Question 5, *Open-ended retail funds*.

Investment restrictions

21. Are there any restrictions on local investors investing in a hedge fund?

There are no restrictions on local investors investing in a hedge fund.

Assets portfolio

22. Who holds the portfolio of assets? What regulations are in place for its protection?

See *Question 7, Open-ended retail funds*.

Requirements

23. What are the key disclosure or filing requirements (if any) that must be completed by the hedge fund?

The fund must file copies of the following with the GFSC:

- All constitutional and offering documents.
- The principal agreements relating to the fund, for example, the:
 - administration agreement;
 - custodian agreement; and
 - investment management agreement.

Side letters which are personal to a particular investor do not need to be filed.

24. What are the key requirements that apply to managers or operators of hedge funds?

See *Question 6, Open-ended retail funds*.

Legal fund vehicles and structures

25. What are the main legal vehicles used to set up a hedge fund and what are the key advantages and disadvantages of using these structures?

Legal vehicles

The vehicles most often used for hedge funds are corporate vehicles, although it is also possible to use limited partnerships:

- **Corporate vehicle.** Guernsey company law allows for a number of different forms of company (*The Companies (Guernsey) Law, 2008, as amended*). PCCs and ICCs are commonly used for hedge funds (see *Question 8, Open-ended retail funds*) and are particularly useful for managers wishing to establish a number of sub-funds that share many similar features. In this way, the cells can each have different investment objectives, invest in different asset classes, or be hedged against different currencies. The statutory basis for the segregation between cells provides comfort to investors that each cell is properly ring-fenced.
- **Limited partnership.** Funds established as Guernsey limited partnerships have the following features:
 - a specific general partner company is usually incorporated. It manages the affairs of the limited partnership and has unlimited liability in respect of those affairs. It must be licensed or receive an exemption from licence if incorporated or operating in Guernsey;
 - each of the investors is a limited partner, holding a partnership interest, with no liability beyond its investment commitment, provided that it does not do anything that would constitute conduct or management of the partnership's business. The law provides that certain investor actions do not constitute management (*The Limited Partnerships (Guernsey) Law, 1995, as amended*), including:

- acting as a director or shareholder of a corporate general partner;
- being an employee of the limited partnership or of a general partner;
- consulting with and advising the general partner.
- a partnership is typically treated as tax transparent in many jurisdictions (that is, tax is levied at the level of the individual investor rather than the partnership itself);
- there are no restrictions on returning capital to limited partners, provided that the limited partnership is solvent. If the partnership becomes insolvent within six months of the payment, the return of capital can be clawed back within one year of the payment;
- the limited partnership agreement remains a private document (but must be provided to the Guernsey Financial Services Commission (GFSC));
- limited partnerships can elect to have a separate legal personality and to be a body corporate. However, this does not affect its transparency for tax purposes.
- **Limited liability partnership (LLP).** LLPs were introduced in Guernsey in 2014. LLPs are rarely used as fund vehicles but may be used as part of the wider structure for funds that are established as limited partnerships. LLPs have the following features:
 - an LLP is an incorporated legal entity;
 - members have limited liability for the liabilities of the LLP;
 - an LLP is typically treated as tax transparent in many jurisdictions (that is, tax is levied at the level of the individual investor rather than the LLP itself).

The most important difference between the corporate and partnership structures (whether limited partnerships or LLPs) is the partnership's tax transparency. Whether this is an advantage or a disadvantage depends on the position of the prospective investors. With corporate funds it is usual for investors to subscribe for the full amount of their commitment at the outset, whereas with a limited partnership structure the investors' commitments are often drawn down in stages as and when required.

Advantages. The advantages of each legal vehicle in relation to each proposed structure will depend on what the parties wish to achieve when establishing the fund. For example, a corporate vehicle has greater certainty as to its rules of governance as many rights of shareholders are enshrined in law or are considered to be standard practice. Limited partnerships are more flexible in terms of their governance and the rights of partners depend, to a greater extent, on the terms of the individual agreements. This may be an advantage or disadvantage depending on the view of the promoter and the investors.

Disadvantages. The disadvantages of each legal vehicle in relation to each proposed structure will depend on what the parties wish to achieve when establishing the fund.

Tax treatment

26. What is the tax treatment for hedge funds?

Funds

See *Question 13, Open-ended retail funds*.

Resident investors

See *Question 13, Open-ended retail funds*.

Non-resident investors

See *Question 13, Open-ended retail funds*.

Restrictions

27. Can participants redeem their interest? Are there any restrictions on the right of participants to transfer their interests to third parties?

Redemption of interest

Participants of open-ended hedge funds can redeem their interests under the terms specified by that fund. Interests in closed-ended funds are not redeemable at the option of the participant.

Transfer to third parties

It is common to include restrictions to prevent persons acquiring interests if that acquisition would bring the fund within the scope of US Employee Retirement Income Security Act 1974 (*Pub. L. 93-*

406, 88 Stat. 829) (ERISA) legislation. This is generally undesirable as the ERISA legislation can impose strict fiduciary standards on the management of the fund assets.

The rules concerning restrictions on participants' rights to transfer their interests are the same as for retail funds (see *Question 11, Open-ended retail funds*).

Reform

28. What (if any) proposals are there for the reform of hedge fund regulation?

See *Question 15*.

ONLINE RESOURCES

Guernsey Financial Services Commission (GFSC)

W www.gfsc.gg

Description. The official website of the GFSC. This website contains relevant legislation, rules, guidance and application forms. The website also provides access to the public register of regulated entities.

Royal Court of Guernsey

W www.guernseylegalresources.gg

Description. An official website maintained by the Royal Court of Guernsey and containing copies of legislation, both in its official original form and in unofficial consolidated form.

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Recent transactions

- Advised Alchemy Partners on the launch of Alchemy Special Opportunities Fund III.
- Advised Ashmore on the launch of an Emerging Market Distressed Debt Fund and a Russian Debt Fund.
- Advised Permira on the launch of Permira V and Permira Credit Solutions II.
- Advised Roundshield on the launch of Roundshield Fund I.



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Areas of practice. M&A; investment funds; public equity transactions.

Recent transactions

- Advising Fair Oaks Income Fund on its establishment (including an underlying limited partnership master fund), IPO and listing on the Specialist Fund Market of the LSE.
- Advising Better Capital PCC, a closed-ended private equity fund listed on the LSE, in relation to its conversion to a PCC, the launch of its second fund and subsequent transactions.
- Advising International Public Partnerships, a FTSE 250 closed-ended infrastructure fund, on its GB£200 million equity raising.
- Advising The Glanmore Property Fund in relation to the restatement of its debt facilities totalling GB£330 million and ongoing corporate and regulatory advice.