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UCITS III

# Guernsey Retail Funds

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Guernsey has a well established collective investment fund industry which has been operating for four decades and sells a variety of investment products, including investment funds targeted at retail clients. Liberalisation of rules in the EU for retail funds following the introduction of UCITS III has led Guernsey to amend its regulatory regime for open-ended authorised funds in order to ensure the continued competitiveness of Guernsey retail funds.

## Regulation of Funds

Funds are regulated by the Guernsey Financial Services Commission (GFSC) under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (POI Law).

The POI Law characterises funds into two categories for regulatory purposes: authorised funds and registered funds.

Authorised funds are regulated and subject to continuing supervision by the GFSC. Authorised closed-ended funds are regulated under The Authorised Closed-Ended Investment Scheme Rules 2008. Authorised open-ended funds are classified as A, B, or Q funds and are subject to the Class A, B or Q rules respectively.

Registered funds are subject to light-touch regulation by the GFSC.

## Class A Funds

Authorised open-ended Class A Funds (Class A Funds) are designed to conform to the EU's Undertakings for Collective Investment in Transferable Securities (UCITS) regulations. UCITS allows a collective investment scheme which is approved in one EU territory to be sold throughout the rest of the EU without further authorisation. By conforming to the UCITS rules, as adopted in the UK, Guernsey Class A Fund Rules are able to be designated in the UK by HM Treasury (on the advice of the FSA). Designation allows for sale of interests in funds subject to these rules to retail investors in the EU.

## Revised Class A Regime

On 28th February 2008 the FSA made certain changes to the UK Collective Schemes sourcebook as a result of the liberalisation of rules under UCITS III. To ensure that the Guernsey regulatory regime remains consistent with the UK's, the GFSC has issued the Authorised Investment Schemes (Class A) Rules, 2008 (New Rules). The New Rules took effect from 24th November 2008. They are currently awaiting confirmation of designation by HM Treasury.

## Changes to Rules

The New Rules represent a significant redrafting of The Collective Investment Schemes (Class A) Rules 2002 (Current Rules). Key changes include:

## 1 Investment and Borrowing Powers

1.1 Perhaps the most significant changes under the New Rules relate to investment and borrowing powers. The most important of these is in respect of derivatives. The Current Rules require one or more of the following to be achieved when using derivatives:

- 1.1.1 the reduction of risk;
- 1.1.2 the reduction of cost; and/or
- 1.1.3 the generation of additional capital or income for the authorised fund with no, or with an acceptably low level of, risk.

1.2 The above restriction has put Guernsey Class A funds at a significant disadvantage to other UCITS III regimes across the region. The New Rules change the requirement in 1.1.3 above to read "the generation of additional capital or income for the fund with a risk level which is consistent with the risk portfolio of the fund". This provides a major shift in the ability of Class A funds to take advantage of derivatives transactions.

1.3 The New Rules also clarify that funds which invest in immovables (e.g. property) and gold will not be considered UCITS III compliant and accordingly such investments are generally prohibited. There are exceptions under which immovables and gold may be invested in. However if these exceptions are used then the fund in question will be deemed non-UCITS III compliant and will lose its cross-border passporting advantages.

1.4 Further changes and clarifications of note include:

- 1.4.1 the position regarding investment by a fund in Section 270 Designated Funds (i.e. a Class A fund or its equivalent) or UCITS III compliant funds. There are no limits on such investments;
- 1.4.2 investment in a non-UCITS III compliant open-ended fund is not permitted; and
- 1.4.3 the potential for investment in warrants has been extended and is now unlimited, in comparison to the 5% limit in most circumstances under the Current Rules.

## 2 Requirements of principal documents

2.1 Schedule I to the New Rules sets out the required contents of a fund's principal documents. Additional information required to be set out under the New Rules includes:

- 2.1.1 a statement of the object of the fund, in particular the types of investments and assets in which it may invest; and
- 2.1.2 a statement as to the individual bodies in which over 35% in value of the fund may be invested in government and public securities.

### 3 Prospectus contents

- 3.1 Schedule 2 to the New Rules details the information required to be disclosed regarding a fund in its prospectus. Under these requirements a prospectus must now include, amongst other things, the following:
- 3.1.1 where derivatives transactions may be used by the fund, a prominent statement as to whether these transactions are for the purposes of hedging or meeting the investment objectives or both and the possible outcome on their use on the risk profile of the fund;
  - 3.1.2 information concerning the profile of the typical investor for whom the fund is designed;
  - 3.1.3 for funds which invest a substantial proportion of their assets in other funds, a statement of the maximum level of management fees that may be charged to the fund and the funds in which they invest;
  - 3.1.4 the names of the directors of the manager and the main business activities of each where these are of significance to the fund's business; and
  - 3.1.5 for funds which are prepared for the purpose of marketing in an EEA State details as to:
    - 3.1.5.1 payments in that EEA State of amounts distributable to unitholders resident in that EEA State; and
    - 3.1.5.2 how notices will be published in that EEA State regarding the availability for inspection of reports, the declaration of distributions, the calling of meetings and the termination of the fund.

### 4 Changes to funds - new procedures

- 4.1 Under the New Rules changes to funds are characterised as 'fundamental', 'significant' or 'notifiable', with different procedures to be followed for each type change.
- 4.2 'Fundamental' changes to a fund are those changes that either relate to its purpose or nature, may materially prejudice a unitholder, alter its risk profile or introduce a new type of payment out of the fund property. These changes require prior approval by a meeting of unitholders, together with prior approval of the GFSC.

- 4.3 'Significant' changes are those which either affect a unitholder's ability to exercise their rights, would reasonably be expected to cause a unitholder to reconsider participation in the fund or result in any increased payments out of fund property to managers or directors. These changes require prior written notice to unitholders. Such notice must provide unitholders a reasonable period of time (not less than 60 days) to consider the proposed change. Notice of the proposed change must also be given to the GFSC, though it is not necessary to await approval prior to proceeding.
- 4.4 'Notifiable' changes are changes other than fundamental or significant changes which have a reasonable likelihood of affecting the operation of the fund. This includes 'a significant political event which impacts on the fund or its operation'. Notifiable changes must be notified to unitholders by either sending an immediate notification, publication on a website or included in the subsequent long report to unitholders; the method used will depend on the severity of the change. Notice must also be given to the GFSC, though it is not necessary to await approval prior to proceeding.

### Summary

The New Rules add much needed investment flexibility, particularly in relation to derivatives. There are further, more detailed content requirements for principal documents and disclosure requirements for prospectuses, but each of these should not lead to significant amendments to the current drafting approach to such funds. Finally, a new regime for approval and notification of changes to funds has been introduced. These changes will bring the Guernsey Class A funds into alignment with UCTIS III structures across Europe to ensure the retail market accessed via Guernsey remains competitive.

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