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The reasons behind the success of the Guernsey investment funds sector

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Guernsey's financial services regulator, the GFSC, recently reported the fifth consecutive quarter of growth in the island's investment funds industry, with the 12 months up to the end of 2016 seeing a 12.5% increase in the net asset value of all funds under management and administration.

That growth meant that at the end of the year, funds worth £255.9bn ($330.4bn) were being managed and/or administered in Guernsey, as the industry continues to thrive. Moreover, these figures only account for funds which are classified by the GFSC as "collective investment schemes" – there are other vehicles domiciled in Guernsey which are AIFs for the purposes of AIFMD but do not fall within the CIS category.

The rise in NAV covers closed-ended and open-ended funds – and there is an increasing amount of work being done by Guernsey managers and administrators for funds that are not based in the island, an endorsement of the City of London-levels of expertise, innovation and responsiveness that Guernsey professionals offer.

There are a variety of factors driving the success of the sector.

One of the key factors, although its impact is limited to the last 12 months, is the UK's decision to leave the European Union. While "Brexit" continues to raise more questions than answers, the European Securities and Markets Authority (Esma) has made clear in its Opinion of 31 May 2017 that it is working on the assumption that the UK will become a "third-country" after it withdraws from the EU. That means that UK AIFs will no longer be permitted to market funds to EU investors by relying on the EU-wide marketing passport.

Although relocating to another third-country such as Guernsey may sound counterintuitive, there are compelling reasons for doing so:

- In relation to financial services, Guernsey's third-country status in relation to the EU is clear and established;

- Guernsey meets the conditions set out in the AIFMD for an EU manager marketing third-country funds in the EU under National Private Placement Regimes (NPPR) and a third country manager marketing funds in the EU under NPPR, and has been operating successfully within NPPR since 2013;

- Cooperation agreements for risk oversight have been entered into with 25 of the 27 EU Member States;

- Guernsey is one of only five third-countries which have been positively assessed by Esma for the purposes of extending the AIFMD marketing passport;

- Being located in Guernsey means managers can market their funds outside the EU without being subject to any EU regulation.

While Esma's positive assessment of the Guernsey regulatory regime is now almost a year old, there is no clear timeframe for when the AIFMD passport system, which is currently only available to EU entities, will be extended to third countries, such as Guernsey, and ultimately, the UK. However, the existing NPPR rules – under which non-EU AIFMs and AIFs must comply with each EU country’s national regime when they market funds in that country – will be in force until at least 2018.

In addition, the recent launch of the manager-led product (MLP) and private investment fund (PIF) demonstrate that the island's legislature and regulator are not standing still where new opportunities arise. The MLP and PIF are two examples of the way that the investment funds space is changing in terms of innovation and regulation – and that pace of change is itself changing the role of lawyers in the investment funds industry in particular.

Both developments may help streamline the set-up of investment fund vehicles, while also keeping costs down and adopting a risk-based approach to investor protection and regulation.

The PIF regime, introduced in November 2016, requires a licensed manager in respect of the entire fund structure – it is not permitted to have separate advisers in respect of individual cells.

There is no limit on the number of investors to whom a PIF may be marketed, however a PIF should contain no more than 50 legal or natural persons holding an ultimate economic interest in the PIF, save where the investment is made by an investment manager acting as agent for a wider group of stakeholders.

The MLP takes a different approach, focusing the regulatory effort on the manager, and not the underlying investment funds and related vehicles, so investors and promoters will benefit from (i) the removal of regulatory duplication, (ii) a more efficient path to market and (iii) reduced administration fees in respect of those vehicles no longer subject to various rules.

The new classification has been made possible by the Commission's risk-based approach to regulation. Regulatory oversight remains through an appropriately regulated investment manager within the structure – in much the same way as the successful Luxembourg Reserved Alternative Investment Fund.

Alongside the international element created by Brexit and the willingness of the legislature and regulator to act swiftly on opportunities for innovation there is a third, straightforward factor – a lower cost base.

Over the last few years, there has been a noticeable price squeeze from clients and underlying investors who are trying to reduce fees to increase yield.

That pressure on fees is a significant one for lawyers, who are dealing with an increasing level of regulation and compliance-driven activity that demands time and effort – put simply, clients are demanding more, for less.

The compliance burden that falls on investment managers can be high – they are seeking not just the establishment of a vehicle, but also business advice, structuring advice and commentary on what's happening in the market, not just in the UK but also in the Channel Islands and Luxembourg, and increasingly frequently, the US and Caribbean jurisdictions.

This again feels counterintuitive, but it is a boost for the Guernsey offering.

For those structures that can be set-up offshore in Guernsey, costs may well be lower, simply because operational costs may not be as high as they are in the City of London. Additional service providers, such as depositaries, are required in the UK in order to comply with AIFMD and the overheads are naturally higher.

It is partly that lower cost base, and partly the proven track record of the professionals within the Guernsey funds sector, that is driving work to the island.

Guernsey remains the investors' choice for non-UK entities listed on the London Stock Exchange, and there is a demonstrable, consistent rise in work being carried out here, even where the funds are not domiciled in Guernsey.

That is a clear endorsement that shows managers and investors have confidence in the service quality and expertise on the island.

All of these factors combine to build a persuasive case for Guernsey – the certainty that it offers in contrast to the uncertainty created by Brexit, the sustainability of the NPPR marketing route and the favourable indications towards a full AIFMD passport, the willingness to innovate and to take a risk-based approach to regulation, the lower cost base, and the endorsement provided by the industry looking to Guernsey professionals to do non-Guernsey work.

Whatever the case that Guernsey is presenting, the statistics from the GFSC show that offshore jurisdictions like Guernsey should always be considered for any new fund and for those existing vehicles looking to relocate.

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