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Guernsey Financial Services Commission

Consultation Paper on Proposals to Develop a Guernsey Green Fund

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Responding to the Consultation Paper

Responses to this Consultation Paper are sought by Friday 1st June 2018.

We welcome and strongly encourage respondents to provide feedback or comment on any section and question.

You can send your responses to us using the online submission tool, Citizen Space, accessible on our website at: https://consultationhub.gfsc.gg/

Or in writing to:

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FOREWORD

Climate change represents an urgent and potentially irreversible threat to human societies and the environment. It is recognised as a common concern for governments around the world and, as such, there is a global agenda to reduce the harm being done to our planet. In accordance with international climate obligations, sufficient financial resources are required in order to implement policies, strategies and regulations to contribute to the meaningful mitigation of climate change.

Green investments mobilise capital into low-carbon projects, infrastructure and research that can reduce the effects of climate change and make the necessary transition into a green future. The proposals set out in this consultation paper provide a framework upon which green investments can be encouraged and facilitated in the Bailiwick of Guernsey. We wish to assure investors that their investments are contributing to initiatives that have a positive environmental impact on the planet and in so doing inspire confidence that their investments are well regulated. The island has a sterling reputation as a funds centre and has the ability to attract individuals and institutions who want to put their money into fund vehicles that pursue green objectives.

Comments and suggestions on this paper from any party who has an interest in the green investment space will be highly valued.

Emma Bailey

Director, Investment Supervision and Policy Division

Guernsey Financial Services Commission

1. Executive Summary

1.1 What is the Purpose of the Guernsey Green Fund?

The Commission seeks to regulate and supervise financial services in the Bailiwick of Guernsey with integrity, proportionality and professional excellence, and in so doing help to uphold the international reputation of the Bailiwick of Guernsey as a finance centre.

Consistent with the Commission's objectives, the proposals in this paper are designed to help ensure that Guernsey is an innovative place in which to do business by creating a structure that caters for the development of informed green investments.

The purpose of this consultation paper is to lay out the Commission's proposed new Guernsey Green Fund Rules ("GGF Rules") to be opted into by green funds so that they may acquire the designation of a Guernsey Green Fund ("GGF").

Global investments are shifting their focus onto the environment. Scientific research reveals that high levels of greenhouse gases in the atmosphere are increasing the earth's temperature causing irreversible damage. The 2015 United Nations Climate Change Conference in Paris ("COP21") secured the co-operation of over 190 countries to prevent the planet warming by two degrees that is leading to jurisdictions around the world developing appropriate mechanisms to build a green future. Transitioning into a greener future is estimated to require $1 trillion of investments per year. Thus, it is important for financial centres such as Guernsey to adapt to the increasing demand for green investments.

Guernsey is a jurisdiction able to take advantage of what this movement has to offer. By creating the GGF Rules, we can assure investors that their investments are being used for environmental purposes that are established and monitored against a reliable set of standards. Guernsey has the benefit of already being a secure and experienced jurisdiction in which to hold investments and has the wealth of knowledge and expertise necessary to build a green fund platform on top of existing versatile structures. Securing capital for environmental purposes is a strong indication that Guernsey is an innovative and forward-thinking place in which to do business and demonstrates that we are mindful of international climate obligations. For these reasons, the Commission is introducing a new description of a Guernsey Green Fund. Any authorised or registered fund that applies for and meets the criteria required by the GGF Rules will be designated as a GGF.

This Consultation Paper is a working document and does not prejudge any final decision to be made by the Commission. Comments and feedback from all parties who are interested in green investments will be welcomed.

1.2 Objectives of the Guernsey Green Fund

The objective of the GGF is to provide a platform upon which investments into various green initiatives can be made. The GGF will enhance investor access to the green investment space by providing a trusted and transparent product that contributes to the internationally agreed objectives of COP21 and provides certainty, consistency and simplicity for investors.

Investors in a GGF will be able to rely on the GGF designation, provided through compliance with the GGF Rules, to represent a scheme that meets strict eligibility criteria of green investing and will have the objective of a net positive outcome on the planet's environment.

The designated administrator or manager (if a POI licensee) will declare on application that the scheme will meet certain portfolio requirements and the prospectus will be required to contain disclosures to that effect. There will be a continuing obligation to confirm that the GGF meets set criteria chosen from a pre-decided list and the Commission will have in place robust procedures to take action if a GGF does not or no longer meets the required investment criteria. A GGF will have a continuing obligation to provide investors and the Commission with clear and comparable information about the composition of the portfolio and how it meets its green objectives.

The product will allow Guernsey to be at the forefront of the initiative to mitigate the risks associated with climate change and promote engagement in climate change issues.

1.3 The Development of this Paper

Many governments and financial institutions around the world are pursuing the aim of protecting the environment. In light of growing climate change obligations, there are plenty of opportunities to channel finance into green initiatives in order to fuel the transition into a global low-carbon economy.

The green bond market has picked up pace over the past few years, exemplified in the growing number of global stock exchanges which have specific segments dedicated to listing bonds which finance environmental projects. As an example, at the end of 2017 the London Stock Exchange reported a 57% growth of its listed green bonds in one year, with USD 20.2 billion equivalent raised.[1]

In light of the growing green bond market international standards, including the Green Bond Principles and the Climate Bonds Standard, have been developed to align an understanding of what constitutes a green bond, the certain governance procedures that should be in place around a green bond and the disclosures that should be made to participants.

Despite the aforementioned, green funds are at an embryonic stage. Investors remain hesitant to invest in funds which may not ring true to their green label or do not want to sacrifice a good return for the sake of the environment. The GGF Rules use standards developed by international financial institutions with the appropriate scientific background to ensure that the various assets held in a GGF are green within the true meaning of the word. Furthermore, in accordance with these standards, the Commission will require that the appropriate disclosures are made to investors and the Commission to ensure that the fund is being governed appropriately.

The development of the GGF Rules was facilitated though various working strategy groups involving industry and government participation and the Commission is grateful for all the feedback and continued support received from external parties.

[1]London Stock Exchange Group 'A stellar month for green bonds in November' 05/12/2017 (see https://www.lseg.com/markets-products-and-services/our-markets/london-stock-exchange/fixed-income-markets/green-bonds/stellar-month-green-bonds-november)

2. The Guernsey Green Fund

2.1 The Framework

Any type of fund can apply to be a GGF whether registered or authorised, open-ended or closed-ended. The GGF Rules have been structured in this way in order to encourage all types of funds to apply for a GGF designation if they fall within the green bracket and to provide flexibility around the types of GGFs that may exist. In accordance with section 2, schedule 3 of the Protection of Investors Law, the name of the scheme must not be undesirable or misleading. Therefore, any fund that is not a GGF or is not in the process of applying for a GGF designation will not be permitted to use language that corresponds to that of a GGF.

In order to show that a fund has been awarded the designation of a GGF, there must be information in the fund's prospectus to this effect so that investors are made explicitly aware that the fund carries the GGF designation. The Commission will designate GGFs on its website and is also in the process of investigating the use of a badge that, upon successful application, is provided to a GGF to be used on its various marketing and information materials so that it may clearly display its GGF designation and compliance with the GGF Rules. This badge will be subject to intellectual property interests belonging to the Commission.

The different parts of the GGF are designed to allow the applicant to select the parts that are most relevant to them. Below is a flow chart that depicts the three elements of the GGF.

1. Set up the fund starting with one of the existing products

Class A/B/Q/ Registered/Authorised/ Closed Ended/ PIF/Rules

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2. Comply with the opt-in GGF Rules that set out the description of fund known as a GGF.

The GGF Rules comprise:

1. **Application** requirements
2. **Disclosure and reporting** requirements, and
3. Compliance with the **green criteria** that the Commission has chosen.

↓

3. Choose from two options regarding how the fund is certified so that the Commission is assured the fund is run in accordance with the GGF Rules.

Level 1

A **third party certification** that the prospectus of the fund meets the abovementioned green criteria.

Level 2

A **self-certification** from the designated administrator or manager that the fund meets the abovementioned green criteria.

Optional

Funds can voluntarily commit to adopting **ESG Principles.**

Additionally, an applicant can voluntarily commit the fund to Environmental, Social and Governance ("ESG") Principles. For ease of reference, the proposed GGF Rules that govern the above process are appended to this Paper.

2.2 Applying for a Guernsey Green Fund

Applying for a GGF will consist of three elements as detailed above.

Firstly, as previously stated, any fund, new or existing, can apply for GGF status. In accordance with section 6 of the GGF Rules, applicants will be required to submit the appropriate application forms to the Commission. In addition, the designated administrator of a fund seeking to use the description of a GGF must submit:

- A final version of the Prospectus,
- In the case of a Level 1 Scheme, a declaration in accordance with Part 1 Schedule 1 of the GGF Rules that the fund meets the Green Criteria,
- In the case of a Level 2 Scheme, a declaration in accordance with Part 2 Schedule 1 that the fund meets the Green Criteria,
- The requisite fee, and
- Such other information that the Commission may require.

Processing the application will vary according to the type of fund that has applied for GGF status. For new funds, the usual timeframes (as detailed on the GFSC website) will apply depending on whether the fund is applying through the authorised or fast track route and up to five days will be taken to process the GGF application. For existing funds, up to five days will be taken to process the GGF application. It is proposed that a £500 administration fee for all GGF applications will be inserted into The Financial Services Commission (Fees) Regulations, which will come into effect next year. Until the fee regulations are amended there will be no administration fee charged for the submission of a green fund notification. For the avoidance of doubt the application fees for authorisation or registration of the schemes will still apply.

The Commission will designate a fund to be a GGF if it is satisfied that:

- The fund's principal documents and prospectus appear to comply with the GGF Rules, and
- A declaration has been provided in accordance with Schedule 1 of the GGF Rules that the GGF meets the selected green criteria.

2.3 The Guernsey Green Fund Rules

Upon successful application, the fund must comply with the GGF Rules. A fund opts into compliance with the GGF Rules and thereon is a designated Guernsey Green Fund. The Rules provide details on:

- The scope of the Rules (section 2),
- The Investment Criteria (section 3),
- The application process (section 4),
- Details relating to designation (section 5),
- Obligations relating to oversight of the fund (section 6),
- Removal of designation (section 7),
- Prospectus disclosures (section 8), and
- Notifications and filings to be submitted to the Commission (section 9).

As referenced in the Investment Criteria, the Rules contain Schedule 2 which consists of the green criteria that the Commission has selected. In order to comply with the Rules, 75% of the assets in a

GGF must be held in accordance with the green criteria set out in the Schedule. The Commission is open to suggestions for other green criteria that could be adopted by the Rules.

Currently, there is only one green criteria provided which is The Common Principles for Climate Mitigation Finance Tracking that have been designed to increase transparency and credibility of climate mitigation finance reporting. The Principles have been developed by the Joint Climate Finance Group of Multilateral Development Banks (MDBs) and the International Development Finance Club (IDFC) and have been selected by the Commission due to their experience with the topic and their intention to share these principles with other institutions that are looking for common approaches to climate change mitigation.

Within the Principles, there are a number of categories that green investments must fall into and are listed as follows:

- Renewable energy
- Lower carbon and efficient energy generation
- Energy efficiency
- Agriculture, forestry and land-use
- Non-energy greenhouse gas reductions
- Waste and wastewater
- Transport
- Low-carbon technologies
- Cross-cutting issues
- Miscellaneous

Under each category exists a list of activities to give an indication into the types of assets that may be held in a GGF. Therefore, the Principles focus on the type of activity to be executed as opposed to the actual results. The Principles also contain a list of definitions and guidelines that provide detail around what constitutes climate change mitigation and how mitigation activities may be structured; please see Annex 1 for the Principles in full.

The Commission has selected these Principles as they provide a flexible framework for entities to adopt and provide a comprehensive understanding of what encompasses climate change mitigation. As the Principles are activity based, they do not measure the management of funds and therefore leave it to the respective parties to operate the funds as they see fit. At this stage, the Rules will set out the principles as they stand at the time of launch in order to maintain control and oversight. The Commission will continuously monitor the Principles and any other criteria that may apply. Any future updates will be subject to transitional provisions.

The remaining 25% of investments in the fund must not be invested in a manner that would lessen the scheme's objective of mitigating climate change. The Commission has selected an exclusion policy that sets out a non-exhaustive lists of activities that are banned from use in the GGF and are listed as follows:

Sector	**Excluded areas**
Energy	Uranium mining for nuclear power;
	Any fossil fuel-based power generation including: gas, 'clean' coal and other coal.
Energy efficiency	Efficiency upgrades to greenhouse gas intensive power sources – e.g. cleaner coal technology;
	Energy savings in fossil fuel extraction activities – emission reduction requirements require a rapid phase-out of all fossil fuel usage. Anything that helps to extend the life of fossil fuel usage is excluded.

Waste	Landfill without gas capture;
	Waste incineration without energy capture.
Transport	Rail lines where fossil fuels account for more than >50% of freight.

The exclusion policy has been drawn from the Green Bonds Methodology of the Climate Bonds Initiative which specifically checks for any assets that fall outside the appetite for green bonds. It provides a clear indication on the types of activities that are considered inappropriate for green investments.

The Commission may update and add exclusion policies as it sees fit in order to remain abreast of changing environmental standards. Transitional provisions may also be added in the circumstance where a GGF holds an asset that falls within scope of an exclusion policy and no longer complies with the Rules. This will allow a GGF appropriate time to dispose of assets that are excluded. Such amendments would be subject to consultation.

The Commission is proposing that the investment criteria contained in the GGF Rules must where the fund is:

(i) A company be specified in its memorandum of association
(ii) A limited partnership be specified in the Limited Partnership Agreement
(iii) A trust be specified in the Trust Deed

This will ensure that the fund is complying with the investment criteria, importantly the green criteria, as set out in the GGF Rules and its working documents. This will provide investors with a level of certainty that the fund is invested in strict accordance with its investment objectives.

2.4 Certification of the Guernsey Green Fund

The fund will need to acquire certification of the fund in one of two ways and provide such a certification to the Commission upon application:

- Level 1: a declaration from the designated administrator or manager (if a POI licensee) that the fund meets the green criteria. A copy will be provided to the Commission in the form of a signed document from the designated administrator. In addition, the designated administrator will have to provide the Commission with a certificate from a suitable third party that the prospectus meets the green criteria. Details of the relevant third party must be provided to the Commission including the party’s name, address and experience.
- Level 2: a declaration from the designated administrator or manager (if a POI licensee) that the fund meets the green criteria. A copy will be provided to the Commission in the form of a signed document from the designated administrator.

The purpose of certification is to provide certainty to investors that the GGF is invested in accordance with regulated green standards. Level 2 will require additional work from the designated administrator to confirm that the fund is invested in the way that the prospectus prescribes. Level 1 will come at an increased cost and, therefore, will provide the fund with a well-established certification from a third party that the fund is invested in accordance with the prospectus and possibly other details relating to the environmental impacts of the fund. The designated administrator will be required to assess the experience and expertise of the third party certifier before accepting a certificate. Examples of parties who might be acceptable third party certifiers would be qualified audit firms or rating agencies.

2.5 The ESG Principles

A GGF can voluntarily commit to adopt Environmental, Social and Governance ("ESG") Principles. This will be done by declaring on application that the fund will consider the ESG Principles selected by the Commission and a disclosure in the prospectus to this effect.

The ESG Principles selected are the Principles of Responsible Investment ("the PRI"). The PRI are a voluntary and aspirational set of investment principles that offer a method of incorporating ESG issues into investment practice, and read as follows:

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4: We will promote acceptance and implementation of the principles within the investment industry.

Principle 5: We will work together to enhance our effectiveness in implementing the principles.

Principle 6: We will each report on activities and progress towards implementing the principles.

It will be the joint responsibility of the board of the fund (where applicable) and the investment manager to incorporate these principles into their investment analysis and decision-making processes. Additionally, these parties will have to confirm to the Commission on an annual basis that the fund continues to adopt the Principles, or if they decide to discontinue adoption of the principles, to make a declaration to that effect.

The Commission does not propose to monitor the implementation of the ESG Principles. Instead, it is the role of the Investment Manager (see s3.2) to implement the Principles in a way that is considered appropriate for the fund. If a fund ceases to adopt ESG Principles, unless declared as above, this will be a breach of the fund's prospectus and will need to be disclosed as such to the Commission. The declaration of the fund will be renewed to reflect this change.

3. Using the Guernsey Green Fund

3.1 Duties of the Designated Administrator

The designated administrator has the shared responsibility to ensure that the GGF is invested in accordance with the investment criteria in the GGF Rules. Any breach should be notified to the relevant parties specified in the GGF Rules and the designated administrator should monitor the corrective measures required.

In addition, the designated administrator must ensure that the fund is monitored against the green criteria on a monthly basis and, where there is a contravention, take such steps as are necessary to remedy the position. If the position is not rectified within a month, the Commission must be notified and provided with proposals to rectify the breach. If the position does not change for two months, investors must also be informed of the breach. It is worth noting that for the first six months from the date on which persons are invited to become investors in the GGF or until the GGF is fully invested (whichever is sooner) the obligations relating to any contraventions do not apply.

Without prejudice to any other rules to which the GGF is subject to, the designated administrator shall submit to the Commission, within 6 months of the GGF's year-end, a notification providing details on how the fund is invested within the green criteria. Additionally, the designated administrator must take reasonable steps to ensure that the GGF makes the notifications set out in the GGF Rules.

3.2 Duties of the Investment Manager

There is no requirement in the GGF Rules to have a Guernsey domiciled manager however, for the purposes of the Rules, any requirements placed on the manager are only applicable to managers licensed under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (as amended).

The investment manager has the shared responsibility to ensure that the GGF is invested in accordance with the investment criteria in the GGF Rules. In the event of a breach, the investment manager should consider the most appropriate course of action taking into account the type of assets in the GGF, the type of investors and the disclosures in the prospectus.

If a GGF chooses to adopt the ESG Principles, it will be the responsibility of the investment manager to incorporate the Principles into the investment analysis and decision-making processes of the fund. This must be provided in the Prospectus of the GGF.

3.3 Interests of the Investors

The GGF is designed to be flexible for investors as well as to protect their interests. As is the case with any other Fund Rules, the prospectus must contain all material information that an investor would reasonably require in order to make informed investment decisions. It may be necessary to provide prospective investors with other documents that are material to the nature of the GGF.

In addition to the notification requirements in the GGF Rules, if a breach of the GGF Rules is not rectified within three months, the licensee who submitted the declaration of compliance with the green criteria shall:

- Provide a declaration of non-compliance to the Commission,
- Ensure that the fund ceases to use the designation of a GGF on all documents and other material,
- Notify all investors of the steps taken under this paragraph, and
- Place a copy of the declaration of non-compliance in a prominent position on its website.

The Commission reserves the right to remove the designation of a GGF where a GGF:

- remains in breach of the green criteria for a period in excess of three months, or
- at any stage ceases to meet the green criteria in order to protect:
    - the interests of investors,
    - the public, or
    - the reputation of the Bailiwick as a finance centre.

In addition to the above, if the fund had been promoted in accordance with ESG Principles, then it shall cease to so promote itself, unless otherwise agreed in advance with the Commission.

All green funds will be listed on the GFSC website for the information of prospective investors.

4. Consultation Questions

Question 1
Do you have any consultation feedback on the proposed GGF and the GGF Rules?

Question 2
Do you have any comments on the proposed framework of the GGF?

Question 3
Do you have any comments on the proposals relating to how a GGF designation is communicated to investors, as well as the creation of a GGF badge?

Question 4
Do you have any comments on the proposals relating to the application process of the GGF?

Question 5
Do you have any comments on the proposals relating to the Green Fund Rules and/or their application?

Question 6
Do you have any comments on the proposals relating to the Green Criteria in the Green Fund Rules?

Question 7
Do you have any comments on the proposals relating to the Exclusionary Policy in the Green Fund Rules?

Question 8
Do you have any comments on the proposals to incorporate the investment criteria in the memorandum of association, limited partnership agreement and trust deed of a scheme?

Question 9
Do you have any comments or suggestions on the proposals relating to Level 1 and Level 2 certification?

Question 10
Do you have any comments or suggestions on the proposals relating to the voluntary opt-in ESG Principles?

Question 11
Do you have any comments on the proposals relating to the responsibilities of the designated administrator of the GGF?

Question 12
Do you have any comments on the proposals relating to the responsibilities of the investment manager of a GGF?

Question 13
Do you have any further comment or suggestion on the topics raised in this Consultation Paper?