Out of the shadows

Robin Fuller, chairman of the marketing committee of the Guernsey Investment Fund Association, looks at new opportunities for the Guernsey funds sector and highlights fintech as one likely to be significant

Winston Churchill's quote of 'Never let a good crisis go to waste' has been very appropriate as we struggle to restore stability and prosperity to our banking and financial services industries.

Politicians and economists have bemoaned the lack of credit following the banking crisis, the impact this is having on households and industry, and how it is acting as a serious brake on economic activity.

However, as the supply of bank credit ebbs, human ingenuity searches for alternatives and so we have seen the phenomenal growth in 'shadow banking'.

Shadow banking has emerged as a generic term for many quite different alternative forms of financing. The funds industry is increasingly serving as a direct conduit between institutions and investors holding cash, and property investors requiring development finance or the refinancing of existing loans. Commercial property loans, office developments and social housing development financing are just some of the opportunities being offered to investors.

Alongside property debt investment, Guernsey's funds industry has seen growth in various types of debt fund – bank loan book refinancing, factoring and trade financing to name but a few. Guernsey continues to be the domicile of choice outside of the UK for closed-ended London Stock Exchange-listed funds, and Guernsey's open-ended B scheme environment offers all the flexibility required for open-ended funds investing in debt.

Just as funds are an important part of the new loans landscape, helping to fill the gap left by the banks reducing their loan books, so crowdfunding and P2P lending are developing to meet the demand from households and businesses for loans, and also for equity investment into smaller companies and start-ups. Crowdfunding has its origins in charitable giving and community funding and as such is unregulated. However as the funding model develops from one in which individuals make charitable donations or sponsor someone or an organisation for either no return or in return for a service, to one in which investors make equity investment into start-up and smaller companies so the business model migrates from the unregulated to the regulated financial services industry.

The crowdfunding model encompasses three quite distinct activities – origination, the sourcing of debt from borrowers, platform, the web-based transaction platform matching borrowers with lenders, and funding, the provision of capital by lenders.

The making of loans, running trading platforms and the administration of making investments is not regulated activity in Guernsey. This means crowdfunding models which provide no investment advice or which make no offers via investment promotions or a prospectus or an investment scheme (I am not going to attempt to define a fund here) are not conducting a regulated activity and fall within the Guernsey definition of a non-regulated financial services business. The Registration of Non-Regulated Financial Services Businesses (Bailiwick of Guernsey) Law, 2008 requires businesses to register with the Guernsey Financial Services Commission, but has no effect on the conduct of business, except for the carrying out of AML/CFT measures.

However, while the crowdfunding platform is a relatively simple business model and is registered but unregulated, P2P lending increasingly incorporates regulated business as it includes investment in equities or some sort of securities offering.

Guernsey's existing funds regime can be used for P2P business. While lending itself is unregulated, investors are increasingly buying shares in a closed-ended investment company or in securities issued by a CEIC.

The CEIC can be listed on an exchange, as can any debt instruments issued by either a CEIC or an open-ended investment company. Guernsey is the most popular domicile for London-listed CEIC's outside of the UK, and the Channel Island Securities Exchange is a very popular and recognised exchange on which to list debt instruments.

P2P business is providing capital to SME's, infrastructure companies and businesses seeking longer-term funding. Lenders are most frequently institutions, pension funds and wealth managers. Offering illiquid loans through a CEIC with a market listing brings the benefits of adherence to market listing requirements, secondary market liquidity and corporate governance. OEICs and CEICs authorised in Guernsey can lend direct to borrowers under Guernsey's existing regulations. The choice of Guernsey as a domicile also enables fintech entrepreneurs to use the tried and tested PCC and ICC fund structure – structures that have proved very popular with Guernsey's hedge fund and insurance company managers.

So with a mobile industry such as fintech, why use Guernsey as a domicile for the business or the investment securities being offered?

Fintech is a new, fast-developing industry with all the potential risks and rewards that tech businesses can bring. Investors will want the comfort of not adding jurisdiction, legal and operational risk into the mix.

Guernsey continues to offer a stable environment to alternative investment fund managers, fiduciary and insurance managers. It has the legal, regulatory and administrative expertise and resource to offer fintech entrepreneurs a domicile from which to grow and prosper.