Channel Islands
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THE CHANNEL ISLANDS AND THE EU

FINANCIAL SERVICES

SUMMARY

The Channel Islands ('the Islands') comprise the Bailiwicks of Guernsey and Jersey. They are British Crown Dependencies and as such are not part of the United Kingdom. Similarly, the Islands are not part of the EU and, although part of the Customs Union, are considered third countries for trade in financial and other services. Over the past 50 years both Islands have developed into important international financial centres.

This note provides a snapshot of the Islands' finance industry and its importance to the EU. It reviews the Islands' compliance with international standards, including their work on tax and tackling financial crime.

In summary, Guernsey and Jersey:

- Have combined banking deposits of around £209.5 billion (Q4 2017). Many banking operations are branches or subsidiaries of parent banks based in the EU;
- Together are the sixth largest European funds centre with institutional and retail funds under management and administration totalling over £561 billion;
- Are home to a regulated trust and corporate service provider sector serving an international client base of private client, corporate and institutional businesses;
- Host Europe's largest captive insurance industry;
- Have been assessed by the Financial Stability Board (FSB) as meeting the highest international financial regulatory standards[1];
- Have been independently assessed as having anti-money laundering (AML) and countering the financing of terrorism (CFT) regimes that are among the strongest in the world. They are also recognised as leading jurisdictions in preventing the misuse of companies and legal arrangements;
- Have statutory audit regimes that have been deemed of comparable standard to EU Member States and Jersey and Guernsey, competent, authorities and the EU Member States are able to transfer audit papers;
- Are part of the Sterling Zone and are part of the UK's payment and clearing system, and are also part of the Single Euro Payment Area (SEPA) cross-border bank payment schemes for transfers, debit card purchases and direct debits in Euros;
- Have data protection regimes based on EU law. Thanks to their 'adequacy' decisions, personal data may flow between EU Member States and the Islands;
- Have established a track record as reliable, active and cooperative partners with the EU and the international community on tax matters, meeting all international standards; and
- As existing "third countries", have a relationship with the EU in financial services which is not directly affected by Brexit.

[1] Detailed evidence provided by the International Monetary Fund (IMF), the World Bank and the International Organization of Security Commissions (IOSCO).

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Introduction

1. The Channel Islands comprise the Bailiwicks of Guernsey and Jersey. They are British Crown Dependencies. They are not part of the United Kingdom, but the UK has ultimate responsibility for their external affairs and defence. The Islands enjoy a high degree of autonomy, including their own fiscal and judicial systems, and receive no financial subsidy from the UK or the EU. As a consequence of Protocol 3 of the UK's Accession Treaty, the Islands are part of the EU Customs Union which provides for seamless trading in goods, but are outside the Single Market for services.

2. When the UK leaves the EU as a result of Brexit, Protocol 3 will no longer apply. However, the relationship and the cooperation between the Islands and the EU in areas outside Protocol 3, including financial services, are unaffected as the Islands status as third countries will remain unchanged. Further details on the Islands and Brexit are set out in a separate paper (link).

3. The OECD Convention was extended to Jersey and Guernsey in 1990 and they are part of the UK for the purposes of OECD membership. OECD Decisions and Recommendations apply to the Islands to the same extent as they do to the UK, unless the contrary is specifically stated.

The Channel Islands as international financial centres

4. The Guernsey and Jersey economies are largely services based. In particular over the past 50 years both Islands have developed into important international financial centres. In this global industry, the Islands meet international investors' needs through their access to a wide range of assets and markets, their tax neutrality, their exemplary regulatory environment and ease of doing business, due to their highly-skilled professional services sector. Thus, they are significant net providers of liquidity and investment funds to the EU economy, directly and indirectly.

5. The Channel Islands financial sector includes banking, fund management, fiduciary and specialist asset management expertise as well as insurance.

6. Financial services firms are major employers in the Islands, with around 21% of the workforce (around 20,000 persons) employed in the different sectors. The industry makes a substantial contribution to the two islands' GDP. It also makes a significant fiscal contribution through personal income tax, social security contributions, corporate tax and other taxes which, in turn, finances government and welfare services.

Banking

7. The combined level of banking deposits across the Islands is around £209.5 billion (Q4 2017). These deposits are drawn into the UK and the rest of Europe largely from the rest of the world and the Islands' marketing efforts are directed at increasing this flow from the Far East, Gulf and other wealth creating countries outside of Europe.

8. There are 23 licensed banks in Guernsey and 28 regulated banks in Jersey. Many banking operations are branches or subsidiaries of parent banks based in the EU, including HSBC and BNP Paribas. Both jurisdictions have their own deposit compensation schemes.

9. The Islands are part of the Sterling Zone and are part of the UK's payment and clearing system. Since May 2016 Jersey and Guernsey have been included in the geographic scope of the Single Euro Payment Area (SEPA) cross-border bank payment schemes for transfers, debit card purchases and direct debits in Euros. Both Islands have voluntarily transposed the relevant parts of the EU Payment Services Directive (PSD and PSD II) into domestic legislation to enable payments in Euros between Channel Islands banks and SEPA Member banks.

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Funds

10. Guernsey and Jersey are leading funds domiciles with more than 50 years' experience in the formation, administration and cross-border distribution of investment funds. At the end of Q4 2017 the overall value of institutional and retail funds under management and administration in the CI was over £561 bn. This compares favourably to leading EU domiciles. Capital is raised mainly from investors located in geographical Europe and North America who are attracted by the wide range of fund and investment vehicles on offer in the Islands and their strong regulatory frameworks.

11. A wide variety of funds are structured through the Channel Islands across a range of asset classes, including alternatives such as private equity, venture capital, real estate, infrastructure, debt, hedge funds and fund of funds. Both islands have a deep pool of dedicated fund specialists. Although the majority of Channel Islands funds invest into the UK, UK private equity funds accounted for 29% of European investments and 56% of funds raised in 2016 [2].

12. Although the nature of capital flows means that it is very difficult to put an accurate figure on the flow of investment to the EU, the following studies provide a snapshot of the industry in the islands. A 2016 Capital Economics study estimated that Jersey is a conduit for €188bn of foreign investment into the EU27, equivalent to 4% of total net international investment[3]. That investment supports around 88,000 EU27 jobs, in addition to those created solely in the UK (currently estimated at 250,000 British jobs). KPMG's 2015 study of Guernsey's fund management industry identified that, of the £220 billion of Guernsey funds under management and administration, around £105 billion, is invested into assets in Europe and that over half of this originated from outside of the EU. The KPMG study also identified that the Guernsey acted as a conduit for £51.4 billion of inward investment into Europe in addition to £24.6 billion of inward investment into the UK. Guernsey also facilitated access to £26.5 billion of global assets for UK investors.

13. European investors contribute approximately half of Channel Islands investment into European assets. KPMG's 2015 study of Guernsey's fund management industry identified that European investment companies earn £800mn of fees per annum from managing assets in Guernsey funds sourced from non-European investors. Recent research by KPMG, 'Analysis of the Jersey Alternative Funds Sector Investor Base', shows that capital committed into Jersey Alternative Investment Funds (AIFs) comes from the UK (33.9%), US (18%), Ireland, Luxembourg and Canada. These are generally institutional investors: pension funds, insurance companies and family-offices. Additional Channel Islands investment into Europe comes from non-European investors. Channel Islands funds markets also facilitate European investors in obtaining exposure to global alternative assets.

14. In research by Europe Economics, 'Jersey for Institutional Investors: A Clear Choice' (November, 2017), pension funds account for 79% of institutional assets under administration, with nearly half (£18 billion) originating from the EU excluding the UK, around £5 billion from UK based investors and a third (£12 billion) from the rest of the world excluding the US. In Guernsey, administration is increasingly being carried out locally for non-Guernsey schemes, making Guernsey a location of choice for fund managers from around the world in a wide range of asset classes.

15. The Islands have strong links with capital markets across the globe and are home to companies that have been the subject of significant listings on worldwide stock exchanges. Channel Islands companies are listed on global stock exchanges - from the LSE to the NASDAQ - and there are more Channel Islands FTSE 100 companies registered outside the UK than any other jurisdiction.

[2] https://www.thecityuk.com/assets/2017/Reports-PDF/Key-facts-about-the-UK-as-an-International-financial-centre-2017.pdf

[3] Jersey is also estimated to be a conduit for almost £500 billion of foreign investment into the UK, equivalent to 5% of the total stock of foreign owned assets. (Link to study)

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16. The Alternative Investment Funds Directive (AIFMD) established an EU-wide authorisation system for hedge fund and private equity fund managers that actively market funds to professional investors, along with a 'passport' to facilitate cross-border marketing. Guernsey and Jersey are among the first jurisdictions whose regulators concluded ESMA negotiated MoUs, which has enabled Channel Islands financial services firms to maintain market access through the national private placement regimes (NPPR). This has proved to be an effective route to access the UK, Germany, the Netherlands, Ireland, and Luxembourg. In July 2015 and again in July 2016 Jersey and Guernsey, with Switzerland, Canada and Japan, received positive assessments by ESMA regarding their suitability for passporting. The decision, which is currently delayed, will be taken by the European Commission.

17. For their part, the Channel Islands have enacted legislation providing reciprocal market access. For example Guernsey investor protection law unilaterally extends market access in Guernsey to EU firms from those EU Member States that have implemented AIFMD. Jersey has created an authorisation regime which enables Jersey AIFMs and depositories to opt-in to a regime which mirrors EU AIFMD requirements.

18. The European Commission has initiated work on a comprehensive review of the AIFMD. Consultants have been engaged to undertake a background report. Industry has been invited to provide feedback. A legislative proposal is expected later this year.

19. The European Commission has published proposals to review the EU prudential regime for investment firms which would change the provisions under MiFID II governing the way third country firms provide services to EU professional clients and eligible counterparties.

Trust and Company Service Provision

20. The Islands are leading international fiduciary centres, hosting a wide range of services which are governed by modern trust and company law. Guernsey was the first to introduce protected cell companies in 1997 and both continue to innovate in this area.

21. Both Islands have regulated Trust and Company Service Providers (TCSPs) since 2000. TCSPs are required to hold and keep up to date beneficial ownership information for all companies administered by them. That information is then available to the financial regulator and law enforcement authorities and can be provided to competent authorities in other jurisdictions using gateways provided for in the legislation, as well as under the Islands' tax agreements. TCSPs are subject to routine, ongoing onsite and offsite supervision for all aspects of their activities.

22. Jersey has had a central register of beneficial ownership information since 1989. Those forming Jersey companies also know that the ultimate beneficial owner must be identified by the TCSP. Since 2008 companies in Guernsey have been required to appoint a resident agent to obtain and verify information on their beneficial owners. Since summer 2017, resident agents for all types of legal persons are required to provide beneficial ownership information to the Guernsey registrar which is held on a central register. Both Islands provide foreign authorities with timely, adequate, accurate and current information on beneficial ownership.

23. Both islands company registers actively participate in European Business Register (EBR), the European network of national business registers and information providers from 25 European countries.

Financial Regulation and Supervision

24. The Channel Islands have a robust and internationally respected system of financial regulation and share a strong interest in a sustainable, stable regulatory environment both locally and in their key export markets. The Financial Stability Board (FSB) which monitors and makes recommendations about the global financial

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system, has placed Guernsey and Jersey in Group 1, which consists of jurisdictions 'demonstrating sufficiently strong adherence to the relevant international standards'.

25. The Islands' independent regulators – the Jersey Financial Services Commission (JFSC) and the Guernsey Financial Services Commission (GFSC) - enjoy excellent regulatory cooperation with their EU counterparts, including the European Supervisory Authorities. The regulators also enjoy a respected profile in international standards bodies, both the GFSC and JFSC are active members of several IOSCO policy committees. On that basis, they work with European Institutions directly or in collaboration with EU counterparts to ensure effective supervision of cross border firms' activities. In this regard, the Islands benefit from several 'equivalence' determinations through individual European Commission Decisions.

26. Additionally both Financial Services Commissions have signed Memoranda of Understanding (MoU) regarding mutual assistance in the supervision and oversight of Managers of alternative investment funds as well as cross-border delegates and depositaries with the European Securities and Markets Authority (ESMA) and many EU Member States.

27. Under the Statutory Audit Directive, the Guernsey and Jersey 'equivalence' decisions (2013) confirm that the 'public oversight, quality assurance, investigation and penalty systems of the islands are of a comparable standard to EU Member States'. In June 2016, the European Commission granted an adequacy decision which allows Jersey and Guernsey competent authorities and the EU Member States to transfer audit papers.

Tackling financial crime

28. The Channel Islands recognise the important role they have to play in tackling financial and economic crime, particularly as regards anti-money laundering (AML) and countering the financing of terrorism (CFT). The IMF has assessed Guernsey's and Jersey's compliance with AML/CFT standards, concluding that their legal systems and enforcement were among the strongest in the world. The Financial Action Task Force (2012) recommendations and the Jersey and Guernsey MONEYVAL Mutual Evaluation reports by the Council of Europe (published in 2016) have resulted in policy and legislative changes for fighting financial crime in the Channel Islands. The reports demonstrate the robustness of both Islands' legal framework for AML/CFT and the implementation of that framework (including in respect of customer due diligence and transparency of beneficial ownership).

29. Guernsey and Jersey have also been internationally recognised as leading jurisdictions in preventing the misuse of companies and legal arrangements. Following the G8 Summit in June 2013, the Islands provide accurate, adequate and timely information on the beneficial ownership of companies to competent authorities in other jurisdictions. The Islands comply with Financial Action Task Force (FATF) Recommendations 24 and 25 on transparency and beneficial ownership of legal persons and legal arrangements, which are also reflected in the EU 4th AML Directive. Jersey and Guernsey, together with all EU Member States, have committed to developing and implementing a new global standard for the automatic exchange of beneficial ownership information. This initiative was launched by the G5 countries in April 2016 following the Panama Papers scandal and is managed by the OECD and FATF under a mandate from the G20.

Assistance to developing countries

30. The Islands actively explore ways to help developing countries enhance their revenue raising capacity, working in collaboration with other international partners. Both Islands have put in place legislation designed to stop creditors, including so-called 'Vulture Funds', from pursuing inequitable payments from 'heavily indebted poor countries' (as defined by the IMF/World Bank) through the Guernsey and Jersey legal system. The Islands provide a safe and well-regulated business environment which facilitates African access to investment funds which the continent needs to fulfil its economic potential. For further information, a 2014 independent study by Capital Economics has examined Jersey's value to Africa.

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31. As founder members of the Camden Asset Recovery Inter-Agency Network (CARIN), the Islands help countries that have emerged from dictatorship to recover assets illegally hidden abroad. Channel Islands authorities have assisted in prosecutions affecting Brazil, Kenya, Indonesia, Nigeria, Norway, Denmark, South Africa and the United States, resulting in significant restraint of assets or their confiscation and repatriation. Notable examples include Guernsey's Garnet case, which prevented the transfer of EUR 36m related to Tommy Suharto of Indonesia, and was successfully defended under judicial review. Following investigation into corruption involving the military regime of General Abacha, Jersey identified and returned over US$160 million to the Nigerian Government. The Privy Council, the highest court in Jersey, recently rejected a legal challenge to a Jersey restraining order on a bank account linked to the General worth over US$300 million. These funds will remain frozen pending civil asset recovery.

International Sanctions

32. The Channel Islands voluntarily adopt all EU sanctions and asset freezes, to ensure Islands-regulated institutions cannot be misused. The Islands have implemented all EU restrictive measures imposed since January 2011 and administer the measures robustly. Significant attention is paid during the grant of any licences or authorisations, and the Islands' competent authorities communicate proactively with their counterparts in the EU Member States. This close operational cooperation has led the European External Action Service to informally regard Jersey and Guernsey as 'likeminded jurisdictions' on sanctions-related issues.

Data protection

33. The protection of personal data as well as efficient and secure data flows between jurisdictions is vital for Island public bodies and industry. Guernsey and Jersey's privacy legislation is based on EU law. They are among a small group of third country jurisdictions that been assessed and granted 'adequacy' through individual Commission Decisions, which means personal data may flow between EU Member States and the Islands without the need for further safeguards. Following the adoption of the new EU General Data Protection Regulation (GDPR) in May 2016, the Islands have amended their legislation. These changes will apply from May 2018, the same timetable as the EU Member States.

Taxation

34. The Islands have a long-standing track record as reliable, active and cooperative partners of the EU and the international community on tax matters, meeting international standards.

35. They were early adopters of the Common Reporting Standard (CRS) for automatic exchange of information, they are committed to OECD actions for tackling Base Erosion and Profit Shifting (BEPS) and are members of the BEPS inclusive framework. The OECD's Global Forum on Transparency and Exchange of Information on Tax Matters (the Global Forum) has rated Jersey fully compliant with tax transparency and information exchange standards. Guernsey, which is currently rated largely compliant, is expected to be re-assessed in 2018. The Islands have voluntarily committed to the EU Code of Conduct on Business Taxation since 2003. On 5 December 2017, ECOFIN confirmed the Islands status as cooperative jurisdictions as part of the EU's review of third country jurisdictions. In common with 53 other jurisdictions of the 92 reviewed, Guernsey and Jersey's status as cooperative jurisdictions is subject to the implementation of political commitments made to address certain concerns identified by the EU as part of the listing process. Further details on tax cooperation between the Islands and the EU can be found in a separate paper (link).

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EU policy developments

The future of equivalence

36. The Commission is expected to approach equivalence differently in future, due to Brexit and the review of the ESAs founding legislation. Decisions will account for the impact they will have on EU financial stability, integrity of the financial markets and the level playing field. Decisions will continue to differ depending on the legislation and we expect greater on-going monitoring of third country regimes. This is likely to be a role for the ESAs and may include supervision over certain third country operators. Brexit could result in potential restrictions that may be imposed on EU firms delegating/outsourcing services to third country firms – either through legislation (e.g. the proposed changes to the investment firms regime) or ESA activity (e.g. ESMA's Opinion on delegation).

Capital Markets Union (CMU)

37. When the Capital Markets Union (CMU) was launched in September 2015, much emphasis was placed on opening up the EU to global capital flows. Commission Vice President Dombrovskis stated in April 2017 that there is no shortage of investment needs in Europe and that risk finance is scarce. The Islands have consistently provided input to the Commission, including a Ministerial letter to the Commissioner emphasising the value of open markets to the EU. The Islands have also submitted responses to individual consultations, most recently on FinTech.

38. The June CMU mid-term review has done little to improve third country access to the single market. The EU needs foreign investment but non-EU domiciled investment funds and managers are restricted from participating in UCITS, ELTIF and EuVECA. Additionally, the Regulation which creates a European framework for securitisation is too restrictive for third country market operators to be able to make an adequate contribution to EU efforts to revive this market segment.

39. The European Commission has published new proposals covering, inter alia, an action plan on sustainable finance with regulatory measures and an initiative on FinTech.

40. The Islands will continue to engage with the EU institutions on these developments as well as the specific sectoral topics covered in this paper. They will continue to provide evidence-based arguments to demonstrate the mutual benefits of more open financial markets, underpinned by high regulatory standards and close regulatory cooperation.

Useful links

Channel Islands Brussels Office

The States of Guernsey | The States of Jersey

Guernsey Financial Services Commission | Jersey Financial Services Commission

Guernsey Finance | Jersey Finance

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