

CAYMAN ISLANDS MONETARY AUTHORITY
PRIVATE SECTOR CONSULTATION



DRAFT STATEMENT OF GUIDANCE – CORPORATE GOVERNANCE

A. Introduction

1. Section 34(1)(a) of the Monetary Authority Law (2013 Revision) (as amended) (“MAL”) states that –

After private sector consultation and consultation with the Financial Secretary, the Authority may –

- (a) *issue or amend rules or statements of principle or guidance concerning the conduct of licensees and their officers and employees, and any other persons to whom and to the extent that the regulatory laws may apply;*
2. Requirements specific to the private sector consultation are outlined in section 4(1) of the MAL as follows:

When this Law requires private sector consultation in relation to a proposed measure –

- (a) *the Authority shall give to each private sector association a draft of the proposed measure, together with –*
 - i. an explanation of the purpose of the proposed measure;*
 - ii. an explanation of the Authority’s reasons for believing that the proposed measure is compatible with the Authority’s functions and duties under section 6;*
 - iii. an explanation of the extent to which a corresponding measure has been adopted in a country or territory outside the Islands;*
 - iv. an estimate of any significant costs of the proposed measure, together with an analysis of the benefits that will arise if the proposed measure is adopted; and*
 - v. notice that representations about the proposed measure may be made to the Authority within a period specified in the notice (not being less than thirty days or such shorter period as may be permitted by subsection (3));and*
 - (b) *before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector associations, and shall give a written response, which shall be copied to all the private sector associations.*

3. The Cayman Islands Monetary Authority (“Authority” or “CIMA”) seeks consultation and comment from the private sector associations concerning the following:
 - a) Draft Statement of Guidance (SOG) on Corporate Governance for all regulated entities (excluding regulated mutual funds and licensed insurers).

B. Background

4. The importance of corporate governance standards was highlighted during the 2008 financial crisis. International bodies and standard-setters have issued updated international standards for corporate governance, with regulators subsequently revising their corporate governance guidance requirements. Some developments include:
 - a) The Basel Committee for Banking Supervision (BCBS) updated the Core Principles for Banking Supervision (BCP) in September 2012. In this revision as a result of the corporate governance deficiencies identified in the 2008 crisis, the Basel Committee issued a Core Principle for corporate governance, BCP 14. In addition, in October 2010 the BCBS issued the “Guidelines – Corporate Governance Principles for Banks” which sets out best practices with regards to the qualifications and composition of the board, risk management, requirement for key independent functions, and responsibilities of the board. A revision to these guidelines is scheduled for release later this year.¹
 - b) The International Association of Insurance Supervisors (IAIS) presented an issues paper on corporate governance in 2009 and updated the Insurance Core Principles (ICP) in October 2011. The Authority is in the process of putting forward a regulatory measure to address corporate governance for insurers but it will not capture insurance intermediaries, namely brokers and insurance managers. This SOG is applicable to those licensees.
 - c) The OECD issued 3 reports in 2008 to develop a set of improvements on several priority areas from the OECD “Principles of Corporate Governance”, 2004. In addition a series of thematic peer reviews on the Principles were conducted such as review on board practices in 2009, board member nomination and election in 2011, and risk management and corporate governance in 2012. Additionally, a revised version of the Principles is scheduled for release in September 2015.
 - d) The new Standard on the Regulation of Trust and Corporate Service Providers (SRTC), adopted in October 2014 for members of the Group of International Financial Centre Supervisors (GIFCS) sets out the international standards for trust and corporate service providers (TCSPs). The SRTC are an evolution of the Best Practice Statement of 2002. One standard addresses corporate governance.
5. The Authority conducted self-assessments against the new or updated international standards and identified gaps in the area of corporate governance.

¹ See <http://www.bis.org/publ/bcbs294.htm>

In addition, shortcomings by regulated entities in sound corporate governance practices have been identified during onsite and offsite inspections.

6. The Weaving Macro Fixed Income Fund Limited (In Liquidation) vs Stefan Peterson and Hans Ekstrom case in August 2011 intensified the spotlight on the Cayman Islands' corporate governance framework. The Grand Court of the Cayman Islands imposed a US\$111 million restitution order as the fund's loss caused by willful neglect or default of both directors.²
7. The existing Statement of Guidance (SOG) on Corporate Governance was issued in 2003. In January 2014, the Authority issued a new Corporate Governance SOG for regulated mutual funds. That SOG incorporated the upgraded international standards on corporate governance. The Authority is also in the process of putting forward a separate regulatory measure to address corporate governance for insurers. The Authority is now seeking to update the SOG on Corporate Governance for the other sectors regulated by the Authority.

C. Purpose of Proposed SOG on Corporate Governance

8. In 2013, in a survey on corporate governance conducted by Ernst & Young and commissioned by the Authority, industry indicated a preference for general guidance on corporate governance over a sector-specific measure. Therefore, the goal is to modernize the SOG Corporate Governance and bring it in line with international standards and best practices.
9. The SOG refrains from being too prescriptive on the corporate governance culture while capturing the fundamentals of the relationship between the licensee and its stakeholders.
10. The key principles of the proposed SOG are:
 - a) expanding on the duties and responsibilities of the Board and the appropriate actions and oversight needed for carrying out these functions'
 - b) expansion on the knowledge and competence of directors;
 - c) elaborating on the duties of individual directors and their responsibility to act in a way that takes into account the best interest of the company;
 - d) guidance on management of conflicts of interest;
 - e) recommendations on appropriate recordkeeping from a corporate governance perspective including meeting agendas and minutes; guidance on delegation of duties;
 - f) recommendations on disclosure to the Authority; and
 - g) expansion on the elements of risk appetite and strategic risk management.

11. The proposed SOG aims to satisfy the Authority's regulatory functions as stipulated in section 6 (3) (a) of the Monetary Authority Law.

12. Section 6(3) the MAL states:

In performing its regulatory functions and its co-operative functions, the Authority shall, in addition to complying with the requirements of subsection (2):

² This decision was overturned by the Cayman Islands Court of Appeal in February 2015. The Court disagreed with the finding of the directors breach of duty as "willful neglect or default". However, the appeal did not alter the standards of corporate governance expected of directors articulated by in the first instance. In January 2015, the UK Serious Fraud Office handed down a judgment of 13 years imprisonment to the founder of the fund Mr. Magnus Peterson for defrauding investors.

(a) *endeavour to promote and enhance market confidence, consumer protection and the reputation of the Islands as a financial centre;*

D. Implementation in Other Jurisdictions

13. The BVI Financial Services Commission, the Bermuda Monetary Authority, the Securities Commission of the Bahamas, the Central Bank of Ireland, the Guernsey Financial Services Commission, the Jersey Financial Services Commission, and the Isle of Man Financial Supervision Commission have all updated their corporate governance codes. With the exception of BVI and Ireland, these updates occurred over the last 3-4 years. Table 1 presents a summary of findings.

Table 1: Jurisdiction Comparison

<p>Bahamas</p>	<p>In December 2012, the Securities Commission of the Bahamas amended the corporate governance code applicable to registered or licensed entities. The “Guidelines for the Corporate Governance of Banks and Trust Companies” was amended in May 2013. These documents set out the roles and responsibilities of the board, the responsibilities of directors, board structure and composition, and the role and responsibilities of non-executive directors and the sub-committees.</p> <p>Additionally, it is expected that the board and management develop and implement prudent risk management policies and procedures and monitor their effectiveness and that the board is ultimately responsible for the effective corporate governance. The corporate governance guidelines for banks mentions that within 120 days of the end of each calendar year, the board must provide certification statement to the Central Bank that the licensee has complied with the contents of the guidelines and provide reasons for noncompliance in any areas.</p>
<p>Guernsey</p>	<p>The Guernsey Financial Services Commission revised its “Financial Sector Code of Corporate Governance” in September 2011. The non-compulsory code is an industry wide measure aimed at providing boards and individual directors of regulated financial services businesses with a framework for corporate governance. It states that each business’s approach to corporate governance should reflect the nature, scale and complexity of the business. Established as a set of eight principles, it provides guidance on how to meet the principles as well as additional material for some sectors.</p> <p>The code of corporate governance sets out the responsibilities of the board including the recommendation that companies should prepare self-assessments for the board to assess effectiveness. Board elections and nominations should follow a procedure and there must be suitable succession planning of members. Directors have a duty to operate in accordance with what is required under legislation and as part of their responsibilities to the licensee. The areas of delegation of responsibilities are covered wherein responsibilities delegated to senior management or subcommittees ultimately require board oversight with the onus remaining with the board; the same with risk management where the board should determine the licensee’s risk appetite and manage these risks.</p>

Jersey	<p>The Jersey Financial Services Commission revised the sector-specific Codes of Practice in July 2014³. Arranged as fundamental principles, each principle is supported by minimum requirements. For the most part, the principles are consistent across the sectors unless not deemed relevant due to the nature of the business. Specifically, the corporate governance principle details that risk management strategies must be approved at the board level with the board being made aware of any deviations from sound risk management practices. Responsibilities of the board and directors must be clear and the board is expected to establish and monitor the effectiveness of internal controls and have effective record keeping of board minutes.</p> <p>Additionally, the independence of key control functions personnel is expected as they report directly to the board. All of the codes indicate the licensee deal with the regulator in an open and cooperative manner. In the case of the code for funds services business, continuing professional development is a compulsory requirement for directors. To take corporate governance a step further, the banking code contains an appendix on corporate governance and risk management and refers licensees to papers by the Basel Committee on corporate governance best practices for banks.</p>
BVI	<p>In 2007, the BVI published a user guide for directors to provide general information on the responsibilities of directors as stated in the Business Companies Act. The BVI "Regulatory Code" of 2009 however, is a comprehensive and enforceable code applicable to all licensees of the Financial Services Commission. The first part of the code sets out the fundamental principles of business that apply to all licensees while the rest of the code focuses on principles of business applicable to specific sectors. The code sets out the expectations of directors and the responsibility of the board in general terms as well as specifically for each sector.</p>
Ireland	<p>The "Corporate Governance Code for Credit Institutions and Insurance Undertakings" was issued by the Central Bank & Financial Services Authority of Ireland in 2010. Corporate governance frameworks for the other regulated sectors are pending. The code sets out minimum core standards along with additional requirements for major institutions and informs that the Central Bank will monitor adherence to the code as well as institutions reporting deviations from the code within a specific timeframe. Board responsibilities are laid out in detail in the code such as the requirement that institutions review board membership at least once every three years and justify membership of anyone serving over nine years. The board is also required to conduct an annual assessment of its own performance and undertake to have an external evaluator perform an assessment every three years. It is expected that board members attend each</p>

³ The Jersey FSC measures are "Codes of Practice for Deposit-taking Business", Codes of Practice for Fund Services Business", "Codes of Practice for Investment Business", "Codes of Practice for Money Service Business", and "Codes of Practice for Trust Company Business".

	<p>board meeting and that a detailed agenda be made available. Additionally, directors should remain qualified, understand their role, and manage conflicts of interest.</p>
Bermuda	<p>In January 2014, the Bermuda Monetary Authority issued a "Corporate Governance Policy" for trust businesses, investment businesses, and investment funds which sets out nine principles and related guidance on corporate governance. To summarize, the principles call for directors to remain qualified and receive training as required to enable them to effectively carry out their functions; the size and composition of the board should reflect the scale and complexity of the institution; senior management are under the direction of the board and are to ensure the institution's activities are carried out in a manner approved by the board; the board's responsibility for risk oversight, approval of internal control frameworks, remuneration arrangements and reporting by internal and external stakeholders.</p>
Isle of Man	<p>The Financial Supervision Commission's "Guidance on the responsibilities and duties of directors", 2011; some components of the Financial Services Rule Book 2013; the "Guidance Note for Deposit Takers – Corporate Governance", March 2014; and the "Guidance Note for Non-Banks", September 2010 feature the key elements of corporate governance for regulated entities. The guidance note for non-banks, which is to be proportionally applied, firstly sets out general corporate governance for simple structures; secondly for more complex structures; and thirdly for subsidiaries, branches, and unincorporated licenceholders. The responsibilities of the board include the recommendation that the board meet a specified number of times per year, adopt risk management policies, manage conflicts of interest, and approve as well as review delegation arrangements. For more complex licenseholders, the corporate governance elements become broader and more in line with those in the guidance note for banks such as that the board consider self-assessments, enhanced risk management and internal control policies, establish board committees, and make arrangements for key control functions staff to report directly to the board. Additionally, directors are to understand their responsibilities and maintain continuing professional development.</p> <p>The directors' guidelines highlight the requirements for care in conflicts of interest, acting in good faith, independent judgment, impartiality, and diligence. The Financial Services Rule Book consists of information applicable to all sectors but contains specific requirements for each sector as needed. From a corporate governance standpoint, disqualification of directors require notification to the Commission by the licenceholder as soon as it becomes aware and that responsible officers must ensure good governance and compliance with regulatory requirements.</p>

E. Estimation of significant costs and benefits

14. The extent of any costs will be dependent upon the existing practices of licensees. For the purpose of this analysis, the costs are estimated for those firms that currently operate according to the existing SOG – Corporate Governance.

Table 2: Cost/Benefit Analysis

	Costs	Benefits
CIMA	<ol style="list-style-type: none"> 1. Issuance and publish in Gazette the amended SOG 2. Amendments to internal supervisory manuals, policies and procedures 3. Training for staff 	<ol style="list-style-type: none"> 1. Compliance with international standards issued by BCBS, IOSCO and GIFCS 2. Enhances corporate governance standards and there by reduces the possibility of corporate failures and financial crisis 3. Supports supervisory processes such as inspections/examinations 4. Decreases compliance costs and enforcement costs for CIMA.
Cayman Islands	None	<ol style="list-style-type: none"> 1. Minimises the risk of corporate failures and financial crisis and contributes to a strong and stable financial sector 2. Strong financial industry attracts new businesses 3. Compliance with international standards and strong corporate governance framework enhances the reputation of the Cayman Islands 4. Improved consumer protection due to the reduced possibility of financial failures and crisis.
Regulated Entities	<ol style="list-style-type: none"> 1. Regulated entities need to amend their corporate governance policies and procedures to accommodate the new components of the amended SOG 2. Costs with respect to 	<ol style="list-style-type: none"> 1. Promotes strong corporate governance framework and reduces the possibility of corporate failures 2. Streamlines corporate governance practices

	Costs	Benefits
	implementation of new elements of amended SOG such as self-assessment of board effectiveness, succession planning and Board committees.	<p>3. Provides clarity and enhanced guidance with respect to the development and implementation of corporate governance policies and procedures</p> <p>4. Enhances the efficiency of the board</p>

F. Comments and Consultation

15. The Authority seeks consultation through written comments and representations from the private sector associations concerning

- Draft SOG on Corporate Governance for all regulated entities (with the exception of regulated mutual funds).

16. The Authority must receive representations by 5:00PM, 14 September 2015.

17. Comments and representations must be addressed to

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Consultation@cimoney.com.ky with a copy to s.francis@cimoney.com.ky

18. The Authority shall have due regard to any representation made by the private sector associations and industry stakeholders. The Authority shall provide a written response collating the feedback received and the Authority's position on this feedback. This response shall be copied to all relevant private sector associations only.