

GUIDANCE NOTE FOR NON-BANK LICENCEHOLDERS

*(Licenceholders which do not hold a Class 1 deposit taking
licence)*

Corporate Governance

September 2010



Financial Supervision Commission Barrantee Oaseirys

Contents

	Page
Introduction	2
Considerations	4
1. Licenceholders with simple corporate structure	5
1.1 Scope	
1.2 Corporate Governance objectives	
1.3 General guidance	
2. More complex licenceholders	7
2.1 Scope	
2.2 Corporate Governance objectives	
2.3 General guidance	
3. Subsidiaries, branches and unincorporated licenceholders	11
3.1 Scope	
3.2 Local subsidiaries of international groups	
3.3 Application to branches	
3.4 Application to unincorporated licenceholders	
Appendix 1 – Useful website links	13

Executive summary

This document provides guidance on corporate governance for all of the Financial Supervision Commission's licenceholders other than those which are deposit takers (Class 1). In this document, these are referred to as "non-bank" licenceholders. A related document provides guidance to Class 1 licenceholders.

CORPORATE GOVERNANCE GUIDANCE NOTE FOR NON-BANK LICENCEHOLDERS

INTRODUCTION

This is the first time that the Financial Supervision Commission has published a guidance document on corporate governance for its non-bank licenceholders. This guidance is addressed to all non-bank licenceholders other than professional officers.

This guidance is designed to apply as widely as possible. It is not prescriptive. This guidance brings together themes from three existing sources:

- Companies legislation and particularly the Companies Acts 1931;
- The Financial Services Rule Book;
- The Commission's existing [guidance note on the responsibilities and duties of directors under the laws of the Isle of Man](#), which is addressed to all Isle of Man companies.

Most non-bank licenceholders are either independent businesses or part of relatively small groups. Those licenceholders which are not banks, but are part of groups which are stock exchange listed, might also consider whether there any aspects of the “Guidance Note for Deposit Takers” which they might usefully apply.

Most documents on corporate governance are driven primarily by objectives for the governance of large organisations. This reflects the history of reports on the subject, which have originated in the needs of public companies and particularly companies which are listed on stock exchanges. The emphasis has traditionally been on communication between the board and shareholders, aligning the interests of the directors with those of the shareholders, and the role of chairmen and non-executive directors.

The UK has had a series of reports on corporate governance. This reflects the size of its quoted companies and the importance of good governance amongst listed companies in maintaining London’s role as a focus of international listings of public companies. Notable examples are the reports by Cadbury (1993), Greenbury (1995), Hampel (1998) and Higgs (2003). Links to these reports, together with the Combined Code on Corporate Governance, can be found in Appendix 1. They would particularly merit consideration by larger licenceholders. However, the disadvantage of this traditional approach is that the focus on quoted companies means that it has limited relevance to the circumstances of small and medium-sized enterprises. The “comply or explain” approach leaves them to work out which aspects apply to their circumstances.

This document starts with guidance for the simplest corporate structure, and then describes the additional steps which licenceholders may adopt as their business expands and develops. By doing so we aim to achieve:

- Clarity and ease of use for small businesses;
- Positive selection by larger businesses of aspects which are relevant to their circumstances.

We would also expect CSP licenceholders to have regard to corporate governance principles in conducting the business of client companies. Standards of corporate governance in a licenceholder or its client entities may be relevant to the Commission's assessment of the competence of the directors and other responsible officers.

For larger licenceholders interested in researching corporate governance further, we would recommend the report [Corporate Governance Guidance and Principles for Unlisted Companies in Europe](#) published in March 2010 by the European Confederation of Directors' Associations "ECODA". ECODA is a pan-European body to which the Institute of Directors is affiliated. The report concentrates on how good corporate governance can contribute to the success of small and medium enterprises.

CONSIDERATIONS

Stated objectives for the corporate governance process

The document addresses five objectives of corporate governance:

- i. Compliance with statutory obligations (which includes regulatory requirements). Every licenceholder must comply with the statutory obligations which apply to the business;
- ii. Management of risk. Each licenceholder must have an appropriate mechanism to identify and address the risks that are relevant to its business;
- iii. Aligning the interests of shareholders and directors. Where there is a separation of ownership and management, the board should be able to identify and respond to shareholders' interests;
- iv. Management and control systems. Proper control by directors where they delegate;
- v. Balancing of power and responsibility within the board.

Objective (iii) is particularly relevant where there are shareholders who are not involved in management. Objective (iv) is relevant where the business is large enough for the directors to delegate significant responsibilities to other managers. Objective (v) is particularly relevant where an organisation has a dominant shareholder who is also chairman or chief executive.

However, the document is not exhaustive. It does not attempt to list every aspect of companies' legislation or anti money laundering legislation.

Application – ready applicability to a particular business

In preparing the document the Commission has taken into account the varying size and complexity of its licenceholders. This is considered particularly important for small businesses, as it is widely accepted that "Regulation is more of a burden on smaller rather than larger firms." (*Business Regulation Survey, Department of the Taoiseach, Dublin, March 2007*)

The Commission has set out first its guidance for the simplest corporate structures which it regulates.

Proportionality to the licenceholder's circumstances.

The Commission supports the comments expressed by the Insurance and Pensions Authority in its consultation document on corporate governance (30 November 2009) to the effect that application of corporate governance should be proportionate to the licenceholder's circumstances. However, where this document draws attention to a mandatory requirement, it is identified as such.

PART 1 LICENCEHOLDERS WITH A SIMPLE STRUCTURE

1.1 SCOPE

We start with the simplest structure; a business in which:

- The directors own the licenceholder outright (there are no outside shareholders) and
- The directors undertake all of the management functions (there are no other managers to whom they delegate).

In such businesses the board does not need to address communication with shareholders or the appropriate delegation of powers to managers.

1.2 CORPORATE GOVERNANCE OBJECTIVES

The relevant objectives of corporate governance are:

- i. Compliance with statutory obligations (which includes regulatory requirements). Every licenceholder must comply with the statutory obligations which apply to its business; and
- ii. Management of risk. Each licenceholder must have an appropriate mechanism to identify and address the risks that are relevant to its business.

The board should also consider material transactions. “In general terms it is for the directors to meet, discuss and if appropriate, approve the substance of any material transactions the company is entering into.” ([Guidance note on the responsibilities and duties of directors under the laws of the Isle of Man](#)).

1.3 GENERAL GUIDANCE FOR SMALL LICENCEHOLDERS

It is recommended that the board holds at least two to four meetings per annum, spread across the year. Each meeting should have a structured agenda and should be minuted.

The agenda should enable the board to adopt and review in an orderly fashion the policies necessary to meet the various statutory and regulatory requirements, updating these policies as appropriate.

The board should record its consideration of material transactions.

Table 1 - Requirements and guidance for small businesses*This table is not exhaustive – it relates only to Commission expectations*

Requirements	Guidance
Companies Acts	
Licenceholders must comply with the relevant legislation and with their own Articles of Association	Licenceholders should meet the standards set out in company law and consider the Guidance note on the responsibilities and duties of directors under the laws of the Isle of Man . They should note in particular that: <ul style="list-style-type: none"> • Directors' powers are not individual but collective; and • Minutes must be kept of the proceedings of board meetings.
Financial Services Rule Book	
8.4 Management controls	The board should take account of the scale of the business in determining which controls and procedures are relevant to the business. The board should adopt the controls and carry out the review which is required by 8.4(3) annually or more frequently.
8.6 Risk management	The board should adopt the policy and review it annually or more frequently.
8.7 Conflicts of interest policy 8.8 Conflicts of interest register	The board should adopt the policy and review the policy and the register annually or more frequently.
8.9 Business plan	The board should adopt the plan and review it annually or more frequently.
8.11 Business resumption and contingency arrangements <i>and</i> 8.12 Business continuity	The board should adopt the plans and review the plans and the outcome of business resumption testing, annually or more frequently.
8.13 Delegation of function, outsourcing or inward outsourcing	The board should approve the arrangements and review the operation of the arrangements, annually or more frequently.
6.53 Valuation of investments that are not marketable	If a policy is maintained, the board should adopt the policy and review it annually or more frequently. (The rule applies to services to collective investment schemes only).
AML/CFT	
Licenceholders must comply with the relevant AML/CFT legislation	The board should adopt the AML-CFT policies and procedures required by legislation and review the scope and implementation of these policies and procedures annually or more frequently.

PART 2

GUIDANCE FOR MORE COMPLEX LICENCEHOLDERS

2. SCOPE

Businesses usually grow organically. Similarly, there is no sudden step-change in this guidance. The themes raised here should be addressed by businesses as and when they arise and in a manner which is proportionate to the growth of the business.

As the business develops one or both of the following may apply:

- The business has shareholders who are not also directors, which could mean that the directors' interests are not necessarily aligned with those of shareholders and
- The directors in the business employ other managers, creating a need for delegation and control systems.

These factors may be present in what is otherwise still a very small business (for example, a licenceholder which is basically a two-person business might have an outside shareholder or employ a manager). In such cases, the licenceholder should address the particular governance point arising and otherwise follow the guidance in Part 1.

2.2 CORPORATE GOVERNANCE OBJECTIVES

Licenceholders must comply with statutory obligations and should also address the guidance set out in Part 1. In addition they should address corporate governance objectives (iii) (iv) and (v) as issues arise:

- iii. Aligning the interests of shareholders and directors. Where there is a separation of ownership and management, the board should be able to identify and respond to shareholders' interests;
- iv. Management and control systems. Proper control by directors where they delegate; and
- v. Balancing of power and responsibility within the board.

- iii. Shareholder communication and aligning the interests of shareholders and directors

"Good corporate governance should contribute to better company performance by helping a board discharge its duties in the best interests of shareholders." Combined Code June 2008.

Licenceholders should have an appropriate mechanism for reporting progress to shareholders who are not directors.

As the organisation grows in scale and complexity the board should

- Consider creating an appropriate system of checks and balances within the board, including splitting the roles of chairman and chief executive and recruiting independent non-executive directors;

- Consider whether the board should take steps to measure its own effectiveness;
- Aim to align remuneration policies with the long term interests of the business;
- Consider the formation of board committees (for example for audit, remuneration and risk) with documented delegated powers, a mechanism for reporting to the board and, if considered appropriate, for reporting to the shareholders.

iv. Proper control by directors where they delegate

Licenceholders in which the directors delegate operational responsibilities to other managers should address the greater complexity of the management of the business. The board should:

- Segregate functions where practical;
- Minimize any matters that it is delegating and establish a mechanism to receive reports of actions under delegated powers;

As the organisation grows in scale and complexity the board should

- Encourage high standards of professional conduct by setting appropriate standards and having policies to address any illegal, unethical or questionable behaviour by members of the board or staff;
- Enhance the controls under rule 8.4 to reflect the greater complexity of the business;
- Make arrangements for direct access to the board for the MLRO and the compliance officer under rule 8.19;
- Receive regular reports from the compliance officer;
- Segregate functions where practical so as to create a system of checks and balances for governance purposes;
- Establish a structured mechanism for each business area to report progress to the board and for the company secretary or another person to communicate board decisions to the management;
- Establish a whistleblower regime, including appropriate action to protect the whistleblower from any negative repercussions arising from reporting in good faith their concerns. The confidentiality of any reports should be respected;
- Consider (where relevant) the formation of an investment committee with documented delegated powers and a mechanism for reporting to the board.

v. Balancing of power and responsibility within the board.

"... No one individual should have unfettered powers of decision." (Combined Code, June 2008)

Many businesses are started by one or two people with entrepreneurial flair and drive. At some point in the development of the business, those founders will need to devolve power.

Larger licenceholders in which a major shareholder is also a director should consider the appointment of one or more non-executive directors to provide an independent view and willingness to challenge decisions.

The presence of a director who is both a major shareholder and chairman or chief executive may lead to situations in which decisions are taken by that individual with inadequate involvement of the board as a unit, or in which the board meets but does not function effectively. The controller's views may be insufficiently challenged by salaried directors. This presents a risk of arbitrary or poor quality decision-making.

Self-assessment by the board.

Directors should understand the licenceholder's business, the regulatory environment, their oversight role, the licenceholder's risk profile and the potential for conflicts of interest to occur.

It is good practice for all directors to receive or to have received training on their legal duties and regulatory responsibilities prior to or shortly after being appointed to the board and be reminded of these on a periodic basis. This includes their responsibilities under the Proceeds of Crime Money Laundering Code 2010. The licenceholder should agree and regularly review a personalised approach to training and development with each director.

It is recommended that there is an induction programme for independent non-executive directors and that they are able to challenge and test proposals on strategy, risk matters and can draw on any information they feel is relevant to understand the business.

It is good practice for all directors and senior officials to maintain appropriate levels of continuing professional development (CPD). This assists them in keeping up to date with current developments and best practice.

The board should periodically evaluate the performance of its members and of the effectiveness of the actions of the board and its committees, identify any inadequacies and follow up any actions arising from such an exercise.

2.3 GENERAL GUIDANCE FOR LARGER LICENCEHOLDERS

It is recommended that the board meets not less than quarterly, and more frequently where this is appropriate to the organisation.

Board meetings should have a structured agenda which, together with the supporting papers, should be circulated some days in advance of the meeting. Each meeting should be minuted.

The agenda should enable the board to adopt and review in an orderly fashion the policies necessary to meet the various statutory and

regulatory requirements, updating these policies as appropriate.

The board should record its consideration of significant issues and decisions made relating to ongoing operations and material transactions.

Where roles which are important to meeting regulatory requirements, such as compliance officer, MLRO or company secretary are held by non-directors, there should be clear arrangements for the post-holders to report on their respective responsibilities. The post-holders should have direct access to the board.

Licenceholders should encourage regular attendance of all directors at board meetings and monitor levels of attendance. Directors should aim to attend board meetings in person wherever possible.

PART 3

SUBSIDIARIES, BRANCHES AND UNINCORPORATED LICENCEHOLDERS

3.1 SCOPE

This section addresses the application the corporate governance principles set out in Part 1 and Part 2 to licenceholders which are either locally incorporated but are part of a larger group and are subject to group reporting obligations, or are not locally incorporated:

- Local subsidiaries of international financial services groups;
- Branches of overseas incorporated companies;
- Managed licenceholders; and
- Unincorporated licenceholders.

3.2 LOCAL SUBSIDIARIES OF INTERNATIONAL GROUPS

It is acknowledged that some institutions will operate to group policies and procedures. This guidance is not intended to create additional requirements but rather to set out some of the expectations in the Isle of Man.

Licenceholders which are local subsidiaries of international financial services groups should have a clear understanding of group policies and the extent of their autonomy.

Larger groups might have a group internal audit department. The function might otherwise be outsourced to a third party for example a firm of accountants. Irrespective of the form of the internal audit function the board of directors should review the arrangements at least annually to ensure that they are appropriate for the size and nature of its operations. For internal audit to be effective it should have direct access to the board.

The Commission believes the relationship between internal audit, external audit and itself are very important. Each can assist the other in discharging their respective duties and responsibilities. It is the normal practice for the internal audit and external audit to liaise at least on an annual basis. The Commission always welcomes the opportunity to meet with internal audit when it visits the Island.

Where appropriate the Commission will rely on work undertaken by the internal audit function and might request internal audit to undertake particular tasks and report to it.

3.3 APPLICATION TO BRANCHES

It is acknowledged that some institutions will operate to group policies and procedures and this particularly applies to branch entities. This guidance is

not intended to create any additional requirements but rather to set out some of the expectations in the Isle of Man.

If the Isle of Man operation is a branch, then there should be documented delegated authority from the head office that provides senior management with the authority to operate and a framework in which this works.

Having established the extent of their local management responsibilities, licenceholders should:

- Address the standards and guidance in Part 1; using its arrangements with the parent to determine which of the functions are carried out by the local senior management and which are referred to the head office;
- Address the guidance in Part 2 on “shareholder communication and aligning the interests of shareholders and directors” in ensuring that there is proper communication between the local senior management and head office;
- Branches in which the local senior managers delegate operational responsibilities to other managers should address the guidance in Part 2 on proper control by directors where they delegate (substituting local senior management for the directors).

Larger groups might have a group internal audit department. The function might otherwise be outsourced to a third party for example a firm of accountants.

The Commission believes the relationship between internal audit, external audit and itself are very important. Each can assist the other in discharging their respective duties and responsibilities. It is the normal practice for the internal audit and external audit to liaise at least on an annual basis. The Commission always welcomes the opportunity to meet with internal audit when it visits the Island.

3.4 APPLICATION TO MANAGED LICENCEHOLDERS

The Commission has published guidance on the corporate governance of managed licenceholders in its [General Licensing Policy](#).

3.5 APPLICATION TO UNINCORPORATED LICENCEHOLDERS

It is recommended that partnerships apply the guidance, substituting the partners’ meeting for the board.

It is recommended that sole traders should address principle (iv) (management and control systems) where they delegate and should consider whether it is appropriate to involve their senior staff in consideration of the matters set out in Table 1.

Useful Website Links – further reading

Standard-setting and professional bodies

ACCA: Association of Chartered Certified Accountants www.acca.co.uk

FSA: Financial Services Authority www.fsa.gov.uk

FRC: Financial Reporting Council www.frc.org.uk

Combined Code - Derived from the Cadbury and Greenbury Reports

ICSA: Institute of Chartered Secretaries and Administrators www.icsa.org.uk

ICAEW: Institute of Chartered Accountants in England and Wales www.icaew.com

IoD: Institute of Directors www.iod.com

OECD: Organisation for Economic Co-operation & Development www.oecd.org

Reports on Corporate Governance

European Confederation of Directors' Associations www.ecoda.org

The European Corporate Governance Institute has available on its site an [Index of Codes page](#) which includes the main reports on corporate governance published worldwide (listed by country). The UK list includes amongst other entries:

- Cadbury (1993 – financial aspects of corporate governance)
- Greenbury (1995 - remuneration)
- Hampel (1998 – review of the Cadbury code)
- Higgs (2003 – effectiveness of NEDs)