

CONSULTATIVE PAPER

COMPANY LAW REFORM IN THE ISLE OF MAN

7th May 2004

SECTION 1

INTRODUCTION

On 17th February 2004, the Treasury Minister announced in his Budget speech that he proposed to launch a full-scale reform of company law in the Isle of Man.

In the course of his speech, he commented that: -

“I am.....conscious of the views expressed from a number of quarters of the need for a thorough review of the Island’s company law to enhance our competitiveness whilst maintaining our hard won reputation as a high quality, well regulated jurisdiction.

I accept the need for this to be addressed without delay and to this end I propose taking direct responsibility for the review. I have established a high level Steering Group consisting of the Attorney General, Chief Executive of the Financial Supervision Commission and the Chief Financial Officer, to assist me in this task.

There is a significant commercial advantage to be gained from a speedy and meaningful development of strategies to address these specific and time-sensitive issues.....

I believe that it is vital that we maximise every opportunity to promote and develop the Island’s business environment in the forthcoming years and I further believe that this is an appropriate means by which we can achieve this objective”.

This Consultative Paper is issued by the Steering Group referred to in the Budget Speech (“*the Steering Group*”) with a view to seeking the views of interested parties as to the Steering Group’s detailed remit.

In particular, the Steering Group seeks the views of consultees as to the scope of the proposed Company Law review. A series of options relating to the scope of the review are set out in Section 3 and the Steering Group is inviting comment from all interested parties prior to the finalisation of its terms of reference.

As the Minister indicated in his speech, the issue of company law reform needs to be addressed without delay and it would therefore be appreciated if comments on any of the issues raised in this paper or on any related matter could be submitted on or before 30 June 2004 to: -

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SECTION 2

THE CASE FOR REFORM

Isle of Man company law is currently contained in the Companies Acts 1931 – 1993 and the Companies, etc. (Amendment) Act 2003 (together “*the Companies Acts*”). The Companies Acts are largely based on UK legislation, with the exception of the Companies Act 1986, which was based on law then in place in New Zealand.

In common with those of most English law based jurisdictions, the Companies Acts are intended to facilitate the incorporation of vehicles primarily intended as trading entities, operated by managers (the directors), on behalf of the owners (the shareholders or members), to whom the managers report and are accountable. Whilst the separate legal personality accorded to an Isle of Man company by the Companies Acts has many advantages for commercial, tax planning and other purposes, it is questionable whether the “trading company model” established by the Companies Act 1931 and developed by subsequent legislation is the most suitable vehicle for use in the modern financial services context or whether other models should be considered, or perhaps devised.

As is evidenced by the sheer number of companies' statutes in the Isle of Man, company law is a dynamic area of law and reform has been high on the Government's agenda for some years. Companies Acts were passed in 1982, 1986, 1992 and 2004, largely in response to external pressure from the legal and accountancy professions (driven by their clients) to reform various aspects of the law.

During the 1990s, in keeping with the climate of that time, company law reform initiatives concentrated upon the regulatory, rather than the commercial, aspects of company law:

- ?? In 1991, the Corrin Report recommended enhanced investigation powers in relation to Isle of Man companies (later dropped from the Bill which ultimately became the Companies Act 1992 due to commercial pressure);
- ?? In 1992 the Council of Ministers reported on “*Certain Aspects of Company and Trust Law*”, giving rise to a Working Party on Companies Supervision convened in March 1998 and which reported in July 1998 (“*the Working Party*”).

The remit of the Working Party related to accountability of Isle of Man companies, enforcement of Isle of Man company law and the regulatory consequences of the use of corporate vehicles. Not surprisingly, the main thrust of its report related to enhanced regulation of Isle of Man companies, the strengthening of the powers of the Companies Registry and the supervision of Isle of Man companies and those who operated them.

The transfer of functions of the Companies Registry to the Financial Supervision Commission in 2000 and the introduction of the regulation of Corporate Service Providers (“CSPs”) later that year have addressed, in part, the recommendations of the Working Party. Arguably, the regulation of those who incorporate and administer Isle of Man companies, the encouragement of a culture of good corporate governance and better enforcement of legal compliance with company law in Companies Registry, has done much to enhance the reputation of the Island as a well-regulated jurisdiction. Regulation of CSPs has resulted in a raising of the standards within the CSP industry on the Island and a notable increase in the quality of business carried on by such providers. This, coupled with taxation changes in response to international pressure, has resulted in a substantial reduction in the number of “registered office only” companies linked to the Isle of Man by incorporation and a “brass plate” registered office but otherwise uncontrolled here, thus giving rise to substantial reputational risk.

In the context of the prevailing climate in 2004, it can be strongly argued that corporate law reform should have a different emphasis. The regulatory concerns which gave rise to the Corrin Report and the Working Party may no longer be seen as a driving force. Instead, in the light of a marked reduction in the number of companies currently registered in the Isle of Man, the driving force should perhaps be the promotion and development of the Island's business environment, as stated in the Minister's speech.

There are currently just over 30,000 companies on the Register in the Isle of Man. This number has been declining steadily over recent years (partly as a result of the strike-off of abandoned companies), but it is of concern that the number of companies incorporated in 2003 was less than half of the number incorporated in 1998. Furthermore, only some 50% of companies administered in the Isle of Man by licensed CSPs are Isle of Man companies.

The Isle of Man company is not, therefore, as popular a choice of vehicle for the clients of financial service providers as the Island's government and service providers would wish it to be. As a result, the Island's economy is not receiving the benefit of the incorporation fees, filing fees, service-related fees and taxation generated by the incorporation and administration of Isle of Man companies in the Isle of Man.

Reasons cited by CSPs for the use of companies incorporated in other jurisdictions, such as the BVI, include cost of set-up and operations; less cumbersome administration requirements (no Annual General Meeting requirements, for example); fewer public filing requirements; uncertainty over the future of the Isle of Man non-resident and exempt companies; the prohibition on corporate directors; and client preference.

Another perceived difficulty in the use of Isle of Man companies is the complexity of the Island's company law. The piecemeal reforms and lack of consolidation make it difficult to use and therefore unattractive to those unfamiliar with its requirements. Added to this, the law looks old fashioned and lacks the simplicity and consistency essential for a modern system and forward-looking system.

In addition, the archaic state of the Island's corporate insolvency law is perceived by some as a disincentive to commercial enterprise and may give rise to reputational issues and a perception that creditors are not adequately protected. Much of the practice is based on rules of court which as well as being ancient, are not readily available; procedures are cumbersome and expensive and the practical difficulties of dissolving companies are disproportionate to any benefit to the creditors (if any) of, for example, a privately held investment vehicle. Conversely, the expectations of creditors of commercial vehicles are often not met. The Working Party pinpointed this as a significant area for urgent reform.

On 3rd October 2001, the Financial Supervision Commission held a meeting at which views were sought on the scope and structure of a proposed review of Isle of Man company law in order to address some of the issues referred to above. Attendees at that meeting included representatives of all the relevant private and public sector organisations. A questionnaire was issued to attendees but the clear impression gained from the responses was that the exercise was, at that stage, premature and that the outcome of the UK company law review, then in progress, should be awaited.

Industry views expressed recently upon which the Minister based his comments appear to indicate that there has been a change in the attitude of both industry and government to company law reform and it appears that there is now a clear appetite for a full-scale company law review. In addition, the UK company law reform is now well underway and may provide some guidance, as originally suggested by some parties, to the 2001 consultation process. Furthermore, many jurisdictions have, in the past five years, reviewed their company law and made substantial changes. It may therefore be possible to draw upon the best of the reforms made in other jurisdictions, or at least to learn from them in formulating our own reform strategy.

The Minister sees it as important that the review of company law and the introduction of the zero rate tax regime for Isle of Man companies should be established as a “corporate package” where the taxation treatment of the reformed corporate vehicle would be integral to other legal and cost structure changes, thus developing an attractive “product” for the future. The proposed zero tax regime for companies therefore presents a superb opportunity to re-kindle interest in the use of Isle of Man companies and this opportunity should not be missed.

On the basis that the time is now ripe for a reform, views are sought on the scope of that reform. The options set out in the following part of the consultation paper are not exhaustive and the Steering Group is open to further suggestion as to the ambit of the review and will consider these fully before commencing work.

SECTION 3

THE SCOPE OF THE PROPOSED REVIEW

If it is generally accepted that there should be a review of company law, the scope and ambit of that review should be carefully defined before work commences. The following section sets out a number of ways in which the project might be approached ranging from a straightforward consolidation of the existing Companies Acts to a full-scale rewrite based on a new model. A number of possible approaches within this range have also been identified but these are suggestions only and are not exhaustive. The Steering Group will welcome further suggestions from participants in the consultative process.

Option A

PURE CONSOLIDATION OF EXISTING COMPANY AND INSOLVENCY LAW

This option would be cheap and relatively quick and easy to carry out.

It would result in more modern-looking and user-friendly company law as all the legal requirements relating to companies would be in one easily navigated place and would therefore be easier to use. This would assist practitioners and potential users of Isle of Man companies in the short term.

However, there would be no fundamental change to corporate or insolvency law and therefore the difficulties perceived in relation to the cumbersome, expensive and old fashioned nature of the present system would not be addressed, resulting in there being unlikely to be any significant economic gain.

Option B

CONSOLIDATION OF EXISTING COMPANY AND INSOLVENCY LAW WITH MINOR AMENDMENTS

This option would also be cheap and relatively quick and easy to carry out.

It would result in a more user-friendly corpus of company and insolvency law, would remove anomalies and could address other difficulties, depending on the extent of the amendments agreed. Thus, it might enhance the benefits of Option A at relatively little extra cost.

Arguably, however, many of the minor anomalies which might be addressed in such a consolidation with amendments have been removed by the recent Companies, etc. (Amendment) Act 2003. It should also be noted that, when considering the contents of the Companies, etc. (Amendment) Act 2003, the Commission took the view that any fundamental “root and branch” reform of company law should be left out of the Amendment Act which was intended to deal with minor and urgent matters only and carried over to a proposed more fundamental review of company law reform to be carried out in the future.

Option B would have the same disadvantage as Option A in that it does not support major or fundamental change nor, thus, the strategic imperative referred to by the Minister.

Option C

SEPARATE COMPANY AND CORPORATE INSOLVENCY LAW AND CONSOLIDATE EACH SEPARATELY (WITH OR WITHOUT MINOR AMENDMENTS)

It may be appropriate to consider separating corporate insolvency law from company law and dealing with corporate insolvency law in a package of insolvency legislation governing both personal and corporate insolvency.

Such an option would present an opportunity to consolidate the two sets of legislation separately and to carry forward reforms to each independently of the other. The advantages of consolidation discussed under Options A and B apply equally here.

Whilst there may be substantial merit in separating corporate law and corporate insolvency law, the shape of the corporate product and the rules for dealing with insolvency are unavoidably linked and it might therefore be argued that to take forward a reform of corporate law without at the same time considering the consequences in relation to the insolvency of any reformed corporate product, could result in a flawed corporate product. However, views are sought.

Option D

RETAIN THE EXISTING CORPORATE AND CORPORATE INSOLVENCY FRAMEWORKS (WITH OR WITHOUT SEPARATING THEM) AND REDUCE THE STATUTORY FILING REQUIREMENTS AND THE NUMBER OF COMPANIES ACTS OFFENCES

This option would have the advantage of being an apparent “quick commercial fix”.

One of the criticisms of the existing corporate product is that it is too cumbersome and expensive to use in the context of a modern financial services centre. Many jurisdictions have fewer reporting requirements in terms of annual returns, changes of director, changes of shareholder, etc. All of these generate not only Companies Registry fees (in some cases) but also time costs in relation to the provision of services for dealing with these filing requirements by CSPs.

However, a reduction in reporting requirements may result in a perceived reduction in transparency. Coupled with a regulated CSP sector, such a reduction in transparency may be less significant than it might have been prior to the licensing of the corporate sector but it is nonetheless a factor which should be considered as, from an international perspective, any reduction in transparency may be seen as undesirable.

The existence of a large number of criminal offences which are, in practice, never prosecuted, means that the enforcement regime under the current Companies Acts lacks credibility and, more importantly, teeth. It was clear from the Working Party report that enforcement was a key issue. Although the emphasis may have changed as outlined in Section 2 above, it is still essential for a reputable well-regulated financial services centre to have a credible enforcement regime for its company law. A review of the existing offences and penalties should therefore be considered as part of the review.

Option E

RETAIN THE EXISTING CORPORATE LAW FRAMEWORK (WITH OR WITHOUT CONSOLIDATING THE LEGISLATION) AND CREATE IN ADDITION A NEW “INTERNATIONAL COMPANY”

This option has the advantage of retaining certainty where certainty is commercially important but at the same time providing a cheaper, more saleable, more flexible, vehicle where, for example, a privately owned holding company is all that is required without the protections and controls necessary in a less closely held vehicle.

Such a solution has attractions in that the new vehicle could be developed relatively quickly, drawing upon the existing framework and the experience of other jurisdictions, as has been done with the recent PCC legislation.

However, in an international environment where “ring fencing” is perhaps considered undesirable, the development of an “IBC type” vehicle may be seen as a retrograde step, making the type of distinction between local, commercial business and “offshore business” more likely to be attacked by “onshore” jurisdictions seeking to maximise their tax revenues or by organisations seeking to ensure that world economies are not destabilised by low tax jurisdictions. In addition, this type of vehicle may be a poor fit with a tax regime which seeks to make the same zero rate of tax applicable to all companies whether locally owned and operated or not. In the context of developing a modern company law capable of taking the Isle of Man into future prosperity, this Option would need careful consideration.

Option F

CARRY OUT A MAJOR ROOT AND BRANCH REFORM OF BOTH COMPANY AND INSOLVENCY LAW AS TWO PARALLEL PROJECTS

This option is by far the most time-consuming and comprehensive and would require the greatest resources. However, as the Chairman of the Working Party stated in his report in July 1998:-

“An inadequately resourced or supported initiative could do more harm than good.”

A wide ranging review would draw on the experiences of other jurisdictions and, if properly conducted with the correct professional support, could result in the creation of a “model” corporate product which would serve as a template for company law in jurisdictions world-wide.

It may be, for example, that a “one size fits all” corporate and insolvency law is no longer appropriate. The uses to which corporate vehicles are put are many and varied. It cannot therefore be assumed that the same rules will suit all purposes. This has been recognised in the UK where small and medium sized companies are treated differently from large ones, and, to some extent under the existing Isle of Man regimes, where there are different rules for public and private companies. However, it might be argued that this approach gives insufficient flexibility and that there needs to be a greater number of variations.

A new corporate product should perhaps be devised in such a form that it can be tailored to the type of business for which it is used. For example, different rules may be perceived to be required for the following types of vehicle:-

- ?? Public trading company;
- ?? Private trading company;
- ?? Open-ended investment company;
- ?? Privately held holding company where all the shareholders are also directors;
- ?? Joint venture vehicle;

- ?? Protected cell company;
- ?? Regulated entities, such as banks and investment companies;
- ?? Group holding companies;
- ?? Subsidiary companies.

All of these are companies and therefore arguably require core elements that allow them to have separate legal personality (if indeed separate legal personality is considered essential) on some rules governing the way they are operated and the responsibilities of the operators to the owners.

Ownership and finance may also require to be reconsidered – is the company limited by shares any longer appropriate? Where no par value shares are mooted as a means of ownership, might it not be more practical to abandon the idea of shares and consider the use of some other method of finance and evidence of ownership? These are just some of the issues that would require examination as part of a “root and branch” reform if the Minister’s vision of a new corporate product to take the Isle of Man forward into a successful future is to be realised.

In the context of insolvency law, it might be argued that, in an international financial centre, adequate provision for the “international” aspects of insolvency, such as the recognition of foreign liquidators and the provision of adequate resources for winding-up in the public interest companies which are not operating in accordance with the highest standards of corporate governance, are even more important than up to date Winding Up rules. Thus, the drivers for the reform of insolvency law might not only need to address the needs of a new corporate vehicle but also the need for better international recognition of our insolvency law. This might be developed in conjunction with the development of an office of Official Receiver and might recognise and address a need for the introduction of procedures more flexible than the current option of liquidation, such as administration or other rescue procedures currently unavailable for Isle of Man companies in the Isle of Man.

SECTION 4

CONSULTATION

The company law review project is sponsored by the Treasury Minister. The Steering Group's remit will be set following the consideration of the responses to this consultation.

The Steering Group would welcome any comments and suggestions in response to this document in formulating its remit and considering how best to progress the company law review. In so doing it would be particularly appreciated if respondents would consider addressing some or all of the following questions as part of their responses: -

- ?? Do you agree that it is necessary to reform Isle of Man company law?
- ?? Do you consider that it is necessary to reform Isle of Man insolvency law?
- ?? Would a consolidation of the existing legislation address the issues you currently face in relation to Isle of Man company and/of insolvency law?
- ?? Should the reform of company law or insolvency law have the higher priority?
- ?? Should corporate insolvency law continue to be treated as part of the company law framework?
- ?? Would it be more appropriate to reform corporate insolvency as part of a review of personal and corporate insolvency?
- ?? Do you consider that the filing requirements for Isle of Man companies should be reduced and if so, what do you consider the essential filing requirements that should be retained?
- ?? Do you agree that the enforcement regime for corporate law lacks teeth?
- ?? Would the issues you are facing in relation to the decline in the use of Isle of Man companies be addressed by the addition of an "international company" to the existing company law regime?
- ?? Is a "quick fix" more important than a slower, more sophisticated solution?
- ?? If you were to be involved in the design of a new corporate product, what essential features should that new product have?
- ?? How would you or your organisation be prepared to assist in the company law review?

Following the conclusion of this consultation, the Steering Group will finalise its remit and then consider the methodology for carrying the project through to completion. It is anticipated that if the more wide-ranging options are favoured, the project will be conducted in conjunction with industry and that substantial industry input may be required. It is also anticipated that some of the options may require substantial off-Island expertise, in particular in relation to making comparative assessments of other jurisdictions, should this be deemed to be appropriate.

Clearly the methodology will depend upon the remit. A pure consolidation of the existing legislation will require resources principally from the Attorney General's Chambers and very little else. On the other hand, a far-reaching reform of company and insolvency law will require substantial input from a number of parties and this will require to be managed. An indication from industry of the amount of time and resource they might be prepared to expend in relation to this project over the coming two years would be of immense value at this stage.

It is not anticipated that a formal working party will be set up but the Steering Group may appoint one or more Project Teams, co-ordinated by a project manager, to consider or research particular issues and that a number of informal consultative groups may meet on an *ad hoc* (possibly fairly concentrated) basis from time to time.