Industry Seminar – 20 October 2011

Corporate Governance Cross-Divisional Presentation

David Richings – Assistant Director, Insurance Division

Thank you Fiona.

Following on from how the Commission intends to monitor adherence to the Code, I will be covering how the Commission will enforce the new Corporate Governance Code.

To do this, we thought the easiest way would be to set out a case study which includes a number of potential corporate governance issues where the Commission would consider taking enforcement action. This case study is based on real examples that the four regulatory Divisions have come across in the past, although names have been changed to protect the guilty and some of the issues have been embellished somewhat! I should also add that all the issues raised in this case study did not occur in one licensee, if they had it is doubtful that they would still have a licence!

Firstly, I would just like to repeat something that is already stated in the introduction of the code. Non-compliance with a principle does not automatically make a licensee liable to any sanction or proceedings. The Commission will take into account the way in which and the extent to which licensees have adopted the principles in their policies, procedures, controls and practices. The Commission will also take into account the nature, scale and complexity of the business (it's those words again!).

Part of the minimum licensing criteria contained in the various regulatory laws and must be fulfilled on an ongoing basis, includes compliance with any applicable Codes and Guidance Notes. The Codes and Guidance issued by the Commission emphasise the importance which we place on the topics described in them. The Codes and Guidance Notes in and on themselves are not a means by which to impose sanctions (ie the Commission does not impose sanctions for breaches of individual sections of a Code) but it does allow the Commission to assess, within context the extent to which operations and activities, in this case in relation to the Board, contribute towards a licensee's compliance with the minimum licensing criteria.

As has been mentioned previously, a number of enforcement cases the Commission has dealt with can be traced back to an issue over governance of the licensee. The Commission will now consider the Code when looking at potential enforcement cases, in addition to any breaches of legislation, regulations, rules, codes etc.

Now, some background to our fictional licensee with just a few corporate governance issues. Fudge Assurance and Investments Limited ("FAIL") is an independent financial adviser licensed by the Commission under the insurance laws and protection of investors law. FAIL sells insurance and investment products in Guernsey and overseas. It has a large number of clients. FAIL has a board of directors consisting of Mr Pear – the managing director, Mr Orange – a non-executive director based in Timbuktu and Mr Lemon – a non-executive director based in Guernsey.

During an on-site visit to FAIL, it became apparent that there were a series of compliance failings which resulted in breaches of the Licensees Conduct of Business Rules. When questioned on these breaches, Mr Pear states that he is not aware of the breaches and in any case it's not his fault, compliance is the Compliance Officer's responsibility. Mr Lemon is also unaware of the compliance failings and states that it is Mr Pear's fault, as he is managing director. The Commission was unable to speak to Mr Orange as he was still in Timbuktu.

In this instance, it would appear that there is not just a compliance issue, the Board was unaware that there was any issue and when it was made aware started pointing fingers at others. The Commission in this case would now look at the governance of FAIL.

Principle 2 of the Code states, "Directors should take collective responsibility for directing and supervising the affairs of the business." The guidance under Principle 2 includes, directors having a duty to operate in accordance with relevant legislation and to be conversant with applicable legislation, regulation, policy, rules etc.

In the case of FAIL it would appear that no one has taken responsibility for ensuring the business is run in compliance with applicable legislation etc. The directors are all blaming each other rather than taking collective responsibility. This lack of responsibility by the Board has resulted in a number of compliance failings. The Commission would be looking to take enforcement action in relation to the Board, not just the compliance failings.

After a review of Board minutes during the visit, it is noted that the Board only meet once a year, although the business is very active. It is also noted that Mr Lemon has not attended any Board meetings in the last three years. In addition, whilst Mr Orange attends the one board meeting a year, the rest of the time he is in Timbuktu. This indicates that not only is the Board not taking collective responsibility for compliance but it is not effective.

Principle 1 of the Code states, "Companies should be headed by an effective Board of directors which is responsible for governance." The guidance under Principle 1 includes, the board should meet sufficiently often to ensure it fully discharges its duties in an effective manner. Principle 2 guidance also includes, directors having sufficient time and understanding to carry discharge their duties.

It would appear that the Board is not effective in this instance, the Board do not meet often, although the company is very active, one director appears never to be there and there have been a number of compliance failings which the Board appeared to be unaware of. This would add to the Commission's concerns over the governance of FAIL.

During the visit, a number of documents are reviewed. One document raises issues, a request to pay commissions due to FAIL to Mr Pear's personal account. The provider has asked for a letter signed by two directors, the second signature appears to be that of Mr Lemon, however when asked about this he says that he didn't sign it because he has nothing to do with FAIL and knows nothing about the company. This further adds to the Commission's concerns regarding the effectiveness of the governance of FAIL. In this instance the poor governance appears to have resulted in a potential fraud being perpetrated by Mr Pear. This would seem to indicate a problem with the balance of the board with Mr Pear having undue influence (Principle 1.3). Mr Lemon knows nothing and Mr Orange is in Timbuktu, so who is really running the business?

Any three of the examples I have just mentioned may lead the Commission to consider whether FAIL continues to meet the minimum criteria for licensing when taking into account the requirements of the Code and whether enforcement action should be taken. This could be in addition to any potential enforcement action in relation to the compliance failings or be an aggravating factor when considering enforcement action in relation to the compliance failings. In this case, FAIL appears to have lived up to its acronym!

I don’t intend to go through in detail the potential enforcement measures available to the Commission but potential enforcement action can range from license conditions to fines and public statements to revocation of a licence in the most serious of cases. Any enforcement action will be considered in line with the Commission’s enforcement policy.

In summary, the Commission will not be taking enforcement action purely in relation to a breach of a principle or guidance contained in the Code, however, it will consider the Code when governance issues arise and use the Code to assess whether a licensee continues to meet the minimum criteria for licensing.

I have not been through examples of many Principles, we would be here all day if I did, but I hope this gives you a flavour of how the Commission will enforce the Code where necessary. I will now hand you over to Audrey, who will be covering future developments.