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## Corporate governance, regulation and life post credit crunch in the Channel Islands

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### Introduction

One definition of 'corporate governance' is that it is *'the process of regulating and overseeing corporate conduct and balancing the interests of all internal stakeholders and other parties who can be affected by the corporation's conduct in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation.'* It has been shown that investors favour good and visible corporate governance as it provides confidence that a company is running well and evidence suggests that these companies or structures perform better.

Whilst the history of corporate governance goes back at least as far as the South Sea Bubble and is suggested as a motivation for the Bubble Act of 1720 by some commentators, it is inevitable that the most recent economic turbulence will lead to an increased focus on corporate governance, as demanded by investors, politicians and regulators. Simply because a jurisdiction is an offshore financial centre should not mean that the corporate governance is any less than that onshore. Indeed good corporate governance and enforcement of it is something that has been on the agenda of both Guernsey and Jersey for some considerable time and is an area in which they have sought to distinguish themselves from their competitors.

The Channel Islands recognise that good governance should be appropriate and proportionate and that it enables, rather than inhibits, business activity, but also has the benefit of reputation.

During the early part of this century we were reminded by Sir Howard Davis, the then Executive Chairman of the United Kingdom's Financial Services Authority that: *'the Crown Dependencies [of which Guernsey and Jersey form part] continually have to go the extra mile just to prove that they are upright, honest and godly. Of course it is not fair, but it is realistic.'*

### The 'Offshore' Jurisdiction

The unfairness of the above expectation has currently been aligned with the political scapegoating and attempts to deflect responsibility for the credit crisis. Unfortunately, the Channel Islands have been drawn into those political agendas. Nonetheless, Guernsey and Jersey are very much fit for their purpose as has been confirmed and continues to be confirmed by a variety of external reviews and reports. Both jurisdictions have promoted recent significant revisions of their corporate laws to provide a greater emphasis on governance. The emphasis on corporate governance is coupled with the regulation of activities in relation to investment business and for directors generally in both jurisdictions. Perhaps one day onshore jurisdictions may measure up to our higher standards.

The terms 'offshore' and 'onshore' whilst regularly used in both political and legal circles are redundant and do not identify the distinctions that well informed professionals should be making. Along with good governance, tax transparency in particular has been highlighted by the Organisation for Economic Co-operation and Development (the OECD) in its harmful tax practices project, which was launched more than ten years ago. Both Guernsey and Jersey have agreed to participate and enter into tax information exchange agreements with a wide variety of jurisdictions including the UK and the US. Post the April G20 summit in London, the OECD designated jurisdictions as 'black', 'grey' or 'white' – Guernsey and Jersey are on the white list. Momentum for entering into more of those agreements will be kept up into 2010 and beyond. It seems only fair though, that with greater transparency must come a level playing field requiring standards to be maintained by everyone and not just imposed upon the smaller jurisdictions. What is good for the goose must be good for the gander.

Frameworks encouraging good corporate governance can be found in three particular areas in the Channel Islands; regulatory, statutory and under the local listing authority rules, all of which are explained in greater detail below.

## Regulation

Directors are scrutinised at an early stage if they wish to become involved with a Guernsey regulated company. Prior clearance is required for any person to be appointed to the board of a Guernsey licensed company. If a director cannot show the Guernsey Financial Services Commission (the Commission) that he/she is 'fit and proper' then he/she will not be allowed to sit on the board of a Guernsey investment fund, or any licensed entity. In order to evidence their integrity each prospective director must complete a detailed personal questionnaire form (PQ Form) which, among other requirements, requires a director to provide their personal and business history in detail for at least the past ten years. Corporate directors are not permitted to sit as director on licensed entities.

Unlike onshore jurisdictions, there is a licensing regime in place in respect of those who act as directors in or from within Guernsey, this applies to those who are directors of Guernsey companies as well as residents of Guernsey who are directors of non-Guernsey companies. A code of practice has been issued under the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 for company directors (the Code) (there are also separate codes for corporate service providers and trust service providers) which states certain general principles that a director is expected to follow. These principles, *inter alia*, include:

- understanding and acting in accordance with their legal duties and the constitution of the company and seeking advice on those when necessary;
- ensuring that the board of directors has effective control of the company (this includes holding adequate board meetings);
- knowing who owns the company (except to the extent that its shares are traded on a stock exchange); and
- knowing the company's business and finances and have full and up to date information on them.

These principles are wide ranging and although they are not a statement of the law, the Commission will take a failure to comply with the Code into account in any decision they have to make and they would therefore affect whether the Commission continues to deem a director 'fit and proper'.

The Commission also provides a guidance note entitled 'Guidance on Corporate Governance in the Finance Sector in Guernsey' which applies to all regulated financial services businesses in the Bailiwick of Guernsey. As with the Code, failure to meet the basic standards provided for in the Guidance Notes will be taken into consideration by the Commission in determining whether licensees or individuals are 'fit and proper.' These basic standards, *inter alia*, include:

- the Board should establish internal control procedures that are, in the Board's opinion, necessary and sufficient for the purposes of managing operational risks and conducting the organisation's business having regard to its size, nature and complexity;

- the Board should ensure that collectively its members have sufficient expertise to understand and challenge the important issues in relation to the operation and control of the organisation; and
- the Board should regularly access and document whether its approach to corporate governance achieves its objectives and, consequently, whether the Board itself is fulfilling its own responsibilities. The Board should review the effectiveness of its overall approach to governance and make changes where that effectiveness needs to be enhanced.

Further specific corporate governance principles are imposed upon directors of Guernsey insurance companies under the Insurance Business (Guernsey) Law 2002. It is also the case that the Guernsey Financial Services Commission are currently reviewing the guidance on governance with a view to drafting specific principles for each business sector.

The benefits of a small jurisdiction are evidenced by the ability of the Commission (as well as the Registrar of Companies or Channel Islands Stock Exchange) to understand the Island's business and its licensees well and in greater depth than often their onshore counterparts may be able to achieve. Communication channels are well established and issues can be easily identified and dealt with quickly.

### **The Companies Law (Guernsey) 2008**

The Companies (Guernsey) Law, 2008 (the Companies Law) replaced the previous law in July 2008 and with it brought enhanced corporate governance applicable to all Guernsey companies. The Companies Law was expanded from around 124 to 545 sections and 5 schedules. A theme of governance underpinned the company law review. The following points should be noted:

#### **Disclosure of Beneficial Ownership**

Eleven sections are now dedicated to ensuring that a company is able to identify the beneficial owners of the company. This led to the introduction of the position of a "resident agent" (a requirement for every company with various exceptions including listed and investment companies) and the responsibility of maintaining a record of beneficial ownership is delegated to that agent.

#### **Register of Disqualification Orders**

The Registrar, who is now in charge of the Register of Companies, is also obliged to keep a Register of Disqualification Orders in relation to directors, secretaries and other officers, which can be viewed by the public in working hours. Although this concept is not new, it now also refers to disqualification orders made both within and outside the Bailiwick of Guernsey.

#### **Unfair Prejudice**

Members of a company still have enhanced protection by the inclusion of unfair prejudice provisions. A member of a company is still able to apply to the court under the statutory provisions for the court to make an order for relief in respect of a matter where the affairs of the company are being or have been conducted in a manner which is unfairly prejudicial to the interest of members or where an actual or proposed act or omission of the company is or would be so prejudicial.

#### **Auditor's Powers**

Auditors, when appointed, also still have responsibility for examination of a Company's accounting records. In particular, an auditor has increased rights of access including general right to information and it is an offence to provide an auditor with misleading, false or deceptive information about a company. Furthermore, in order to remove an auditor, an ordinary resolution and special notice are required and the auditor is entitled to be heard at a general meeting which concerns him as auditor.

## **Codification of Directors Duties**

Whilst provision is included for the possibility of codification of director's duties, Guernsey still applies the same common law in relation to director's duties which pervade corporate law in many commonwealth countries.

## **CISX Listing Rules and Model Code for Directors**

The listing of funds on a securities exchange is often used to address concerns as to independent ongoing compliance oversight and particularly facilitates information flow from fund managers to directors and investors. A company with securities listed on the Channel Islands Stock Exchange (CISX) is required to comply with the CISX Listing Rules, which includes the Model Code for Securities Transactions by Directors of Listed Companies (the Model Code). The rules and code are very much principle based rather than prescriptive.

The CISX rules provide that the management of an investment fund must satisfy the CISX that its directors, together with any appointed investment manager, have sufficient and satisfactory experience in the management of investments of the type in which the investment fund proposes to invest. In addition, the board of directors or equivalent body of the investment fund must be able to demonstrate its ability to act independently of any appointed investment manager of the investment fund and furthermore, where an investment fund is a company, other than an open ended fund, there must be a minimum of three directors of which two must be sufficiently independent of any appointed investment manager, any appointed investment adviser and/or their affiliated companies.

## **Service Provider Excellence**

The primary responsibility for the implementation, monitoring and effectiveness of any corporate governance regime lies with the board of directors. From an offshore perspective, a company's licensed service providers form part of the architecture to enable that governance is realised. Service providers in the Channel Islands have a reputation for excellence (often with expertise in specialist alternative areas such as private equity, property, hedge as well as more traditional asset classes).

## **Taxation**

Aside from regulatory requirements and investors demands, good corporate governance needs to be taken with great seriousness in relation to offshore structures: the possible ramifications from a taxation perspective if there is a failure to ensure that the mind and management or the place of effective management of the structure remains offshore may be crucial to the success of the structure. In times of economic hardship, revenue authorities will seek to increase the amount of tax taken and will target offshore structures. Those structures that are unable to demonstrate strong corporate governance may come in for particular scrutiny. Directors of an offshore company need to meet frequently to discuss important decisions affecting the company, and most importantly, such meetings must be conducted offshore. The Channel Islands offer an ideal location for such purposes. It may be significantly easier to prove (or argue if the question arises) that a company is resident in a specific jurisdiction than broadly arguing it was not, for example, specifically resident in the UK.

## **Economic Stability**

Both Guernsey and Jersey have no government borrowings and very low levels of unemployment, certainly compared with other jurisdictions. In February 2009 Standard and Poor's Rating Services assigned "AAA" long-term and "A+1" short term Sovereign credit ratings to Guernsey, placing it in the top 25 of more than 120 rated jurisdictions in the world. It is easy to see why other jurisdictions may look with envy at the Channel Islands' economic position.

## **Conclusion**

It is important for investors and the sustainability of financial markets generally that good governance is addressed and is not only done but visibly seen to be dealt with and demonstrated. Fund managers have their part to play in fulfilling these duties and part of that responsibility is the selection of jurisdictions with effective regimes of corporate governance for the establishment and continuing operation of their investment structures.