

CAYMAN ISLANDS MONETARY AUTHORITY

PRIVATE SECTOR CONSULTATION



STATEMENT OF GUIDANCE – SUCCESSION PLANNING

A. Introduction

1. Section 34(1) of the Monetary Authority Law (2018 Revision) (as amended) (“MAL”) states that –

After private sector consultation and consultation with the Minister charged with responsibility for Financial Services, 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 (“the Authority” or “CIMA”) seeks consultation and comment from the private sector associations concerning the following:
 - a. Statement of Guidance (SOG) on Succession Planning for all Licensees.

4. The SOG is attached as Appendix 1.

B. Background

5. Succession planning is loosely defined as the development of new generation of leadership for the eventual replacement of the old generation of leadership¹. According to *Investopedia* (www.investopedia.com), by definition, succession planning is "a strategy for passing each key leadership role within a company to someone else in such a way that the company continues to operate after the incumbent leader is no longer in control". Succession planning ensures that a business is able to run seamlessly and without pause or disruption to its clients in the event that any of the business' key employees become incapacitated or are subject to an event that will cause absence for a significant period of time or permanently (e.g. critical illness, family emergencies, bankruptcy, convictions, death). The replacement persons must either already possess the attributes necessary to be able to take over the job responsibilities immediately, or they are trained in advance to do so.
6. The Authority continues to see a steady number of applications for various licences whereby the applicant is owned by sole or dual shareholders, who are also directors of the Licensee, with management responsibilities for the running and operation of the company. In some instances, the sole or dual shareholders are also the only employees of the company. If the sole shareholder or one of the dual shareholders becomes incapacitated or suffers an event that will cause absence for a significant period of time or permanently, without an adequate succession plan in place, the company may encounter difficulties in continuing to serve its clients and fulfil its legal and regulatory obligations.
7. From a regulatory standpoint, succession planning should not only encompass the seamless transfer or replacement of key leadership, but also ownership, particularly when the licensee is owned by sole or dual shareholders. The Authority has no clear guidance in place with regards to succession planning from an ownership and management perspective. The essential cause for concern with regards to Licensees having an adequate succession plan is that the enactment of the succession plan - and in particular, an emergency succession plan - does not put the licensee in contravention of any applicable laws by the automatic transfer, disposal or dealing of those shares upon the incapacitation or significant/permanent absence of a current shareholder, which requires the Authority's prior approval. In the case where the sole shareholder of a licensee is also a director of the licensee, and if the licensee has only met the minimum statutory requirement of two directors, should that individual suddenly become incapacitated or suffer an event that will cause absence for a significant period of time or permanently, the licensee would also be in breach of the minimum statutory requirement of having two directors.

C. Purpose of Proposed SOG on Succession Planning

8. Currently, the Authority relies on clauses in the various regulatory measures regarding succession planning, such as the relevant measures on Corporate Governance and the *SOG on Business Continuity*. There is also a provision in the licensing policies that in summary state that the Authority may require an applicant to have more than two directors depending on the size, complexity and risks of the proposed business. In addition, applicants for a license who are

¹ See "Corporate Governance Success Stories"; <https://openknowledge.worldbank.org/handle/10986/24790>

owned by two shareholders or less must provide details of their succession plan, at application. Despite these clauses, the Authority notes that often the succession plans submitted by Licensees are not comprehensive. Moreover, the Authority receives many queries from Licensees and applicants for a license about the elements that should be covered in the succession plan.

9. The SOG was developed taking into account the international standards and practices currently seen by the Authority. It refrains from being too prescriptive and instead aims to capture some fundamental considerations regarding succession planning. In general, the SOG will provide:
 - a. recommendations aimed at the continuation of the business;
 - b. considerations for sole shareholders to take into account such as
 - i. share transfers elements of succession planning in emergency situations and for the longer term;
 - ii. the potential need for increased complement of directors.
 - c. the Authority’s expectations with respect to persons proposed in the succession plan;
 - d. general guidance on the content of the succession plan;
 - e. expectations on the abilities of the directors and persons in controlled functions; and
 - f. recommendations for a communications plan.
10. The proposed SOG aims to satisfy the Authority’s regulatory functions as stipulated in section 6(3)(a) of the Monetary Authority Law. This section states that

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

(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

11. A review of six jurisdictions was conducted to investigate the legislation and regulatory measures relating to succession planning in Australia, the Bahamas, Canada, Guernsey, and Ireland. The companies laws in many of the jurisdictions allow one director. However, some regulatory laws build on this by requiring more directors based on the sector. None of the regulators in the jurisdictions seems to have issued regulatory measures specific to succession planning, instead, as in the case of the Authority, the requirements for a succession plan are set out in various regulatory measures. Table 1 summarizes the findings.

Table 1: Jurisdiction Comparison

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| Australia | As per the <i>Corporations Act 2001</i> , proprietary companies limited by shares in Australia may have one shareholder. There is no guidance document that addresses succession planning as a separate consideration. Instead, the elements of effective succession planning are present in a number of regulatory guides ² ; for instance, Licensees |
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² The Regulatory Guidance 105: Licensing: Organisational competence, highlights the obligations on Licensees to ensure that persons who manage the financial services business possess the competence, knowledge, and skills to do so, initially and on an ongoing basis. The Regulatory Guidance documents are applicable to ASIC and APRA Licensees.

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| | <p>are expected to have at least two persons to manage the day to day activities of the financial services business³, the exception being a small advisory business, one person can be a responsible manager. The Australian Institute of Company Directors highlights guidance on succession planning⁴ and points to the appointment of a deputy chair for the board, acting appointments should the CEO depart suddenly, and a few questions businesses should consider when considering family members in the succession plan.</p> |
| <p>The Bahamas</p> | <p>The <i>Companies Law of The Bahamas</i> stipulates that a company shall have at least two directors (public companies must have at least three directors). However, section 43 of <i>The Investment Funds Regulations, 2003</i> gives the Securities Commission of The Bahamas the right to prescribe the minimum number of directors required by an investment fund administrator. <i>The Banks and Trust Companies (Licence Application) Regulations</i> mandate that only a minimum of five individuals may apply as a group for a licence to operate a bank or trust company⁵ though an exemption can be granted to waive the minimum number of shareholders for some types of bank and for trust Licensees. <i>The Insurance (General) Regulations 2010</i> stipulates that a company shall have a minimum of five directors with further stipulations on residency requirements, connections to the insurance company and any subsidiaries, and person who are disqualified from being directors of a company such as an individual under the age of eighteen and a person of unsound mind.</p> <p>Two of the regulators generally address the requirements for succession planning in the corporate governance requirements and guidelines. The Central Bank of the Bahamas requires that the licensee's board of directors develop and regularly update a management succession plan⁶ but does not provide further details in this regard. The Insurance Commission of the Bahamas "<i>Guidance Note on Independent Directors</i>" notes that there must be adequate succession plans in place to mitigate the effects of losing independent directors.</p> |
| <p>Canada</p> | <p>The Office of the Superintendent of Financial Institutions ("OSFI") <i>Corporate Governance Guideline</i> states that the board of a federally regulated financial institution (i.e. licensee) should approve succession plans with respect to the Board, the senior management team, and any heads of oversight functions. OSFI requires that persons be fit and proper and in instances where there are exceptional circumstances, where timely appointment of senior management and director positions is deemed necessary for the purpose of the Licensees operational requirements, OSFI requires that Licensees make contact immediately to notify of the circumstances. <i>The Canada Business Corporations Act, 1985</i>, allows</p> |

³ Regulatory Guidance 105: Licensing: Organisational competence, section 43 - 45

⁴ "Director Tools: Board Composition-Succession Planning, 2016

⁵ Section 1(2) of the Banks and Trust Companies (Licence Application) Regulations, 2002

⁶ Guidelines for the Corporate Governance of Banks and Trust Companies licensed to do business within and from within The Bahamas, May 2013, section 5.2 (f)

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| | for a corporation to have one director. The exception is that a distributing corporation ⁷ , which must have minimum of three directors, two of which must not be officers or employees of the corporation or its affiliates. |
| Guernsey | <i>The Companies (Guernsey) Law, 2008</i> states that a company can have one member ⁸ and must have at least one director. However, the regulatory laws dictate the number of individuals who may conduct the relevant financial services business. For instance, Full Fiduciary Licensees are required to have at least two individuals who are sufficiently independent of each other ⁹ ; the same requirement exists for banks and other deposit-taking business under the <i>Banking Supervision (Bailiwick of Guernsey) Law, 1994</i> ¹⁰ and those applying to become insurers ¹¹ . Some of the application forms require potential Licensees to submit a summary of the succession plan, such as the Full fiduciary licence application form, but do not provide guidance on what the plan should consider. |
| Ireland | In Ireland, limited companies are allowed to have one director ¹² . A company should also have a secretary who may be one of the directors and where a company has only one director, that person may not also hold the office of secretary. The Central Bank of Ireland has not currently issued a regulatory measure specific to succession planning. Instead, any requirements for succession planning are captured in guidance on corporate governance, specifically the appointments of persons in controlled functions, the requirement note only for there to be a succession plan in place. However, where a director, manager or other person required to receive pre-approval for a controlled function, the licensee must ensure each person is compliant with the Central Bank’s fit and proper standards. |

E. Significant Costs and Benefits

12. The extent of the costs associated with issuing the proposed measure will be dependent upon the existing practices of Licensees and their observance of the current stipulations for succession planning in the various regulatory measures.

Table 2: Estimated Costs and Benefits of Proposed Measure

| | Costs | Benefits |
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| Authority | 1. Conduct consultation with industry and re-submit measure | 1. Enhance and support regulatory processes, in particular on-site |

⁷ The exception is a “Distributing Corporation”, defined as a corporation that is a reporting issuer (of securities) or is not a reporting issuer but has filed a document in relation to the public distribution of shares, or has securities listed for trading on a stock exchange, or is a distributing corporation that is involved in or results from a statutory procedure such as an amalgamation or reorganization.

⁸ Section 120

⁹ The Regulation of Fiduciaries, Administration Businesses and Company Directors, etc (Bailiwick of Guernsey) Law, 2000, Schedule 1

¹⁰ Schedule 3, section 4

¹¹ The Insurance Business (Bailiwick of Guernsey) Law, 2002, Schedule 7, section 4

¹² Section 128 of Companies Act, 2014

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| | <p>for internal approvals.</p> <ol style="list-style-type: none"> 2. Gazette and publication of new measure (initial one time cost). 3. Amend internal supervisory manuals and procedures (initial one time cost). 4. Initial one-time training on the new SOG with all staff from the five regulatory Divisions. 5. Ongoing cost of reviewing the succession plan before and during the licensing process. | <p>inspections.</p> <ol style="list-style-type: none"> 2. Enhance the Authority's risk based approach to supervision by aligning supervision efforts with Licensees succession planning strategies. 3. Decrease compliance and enforcement costs for the Authority as a result of increased adoption by Licensees of sound risk management processes. 4. Enhance the Authority's reputation locally and internationally as the early adopters in the recommendation and guidance for adequate succession planning. 5. Increase efficiencies during the licencing process as a result of minimal explanations/clarifications from affected Licensees. |
| Cayman | <ol style="list-style-type: none"> 1. Contraction of industry and Government revenue should some Licensees leave the jurisdiction as a result of the SOG (though this is unlikely to occur as a result of the SOG) | <ol style="list-style-type: none"> 1. More transparency and protection for prospective and current investors and clients of Licensees by mitigating against the likelihood that clients will suffer as a result of incapacitation or an event leading to the long term or permanent absence of key persons in the licensee. 2. Assist in strengthening the rationale for ratings of future assessments of some of the international standard setters. 3. Enhance the jurisdiction's reputation from a consumer protection standpoint. 4. Improvement of the jurisdiction's ranking on international consumer protection surveys. |
| Licensees | <ol style="list-style-type: none"> 1. Initial cost of amending current practices and policies. 2. Direct costs of engaging experts prepare any legal documents for succession planning as identified as a result of the SOG. 3. Costs of general resources needed to identify necessary | <ol style="list-style-type: none"> 1. Overall impact to licensees may be minimal due to the small numbers of licensees that have sole shareholders or have a small complement of persons in control functions. 2. Increase certainty for on-site inspections due to more clarity on the expectations of the Authority. |

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| | <p>enhancements to succession planning.</p> <p>4. Costs of hiring new staff or training existing staff to meet the needs of the succession plan.</p> <p>5. The human resources cost of preparing persons identified in the succession plan to ensure they are deemed fit and proper by the Authority should the incapacitation or event leading to long term or permanent absence of existing persons occur.</p> <p>6. Overall costs of ongoing efforts to increase compliance with the SOG.</p> | <p>3. Better risk management practices and reduced risks related to the lack of succession planning.</p> <p>4. Improved guidance to Licensees on elements to consider for succession planning therefore increases the likelihood that Licensees will gain more knowledge of local succession legislation and the potential impact on the business.</p> <p>5. Increased assurance of effective succession planning to the Authority when applying for a licence.</p> <p>6. Improved consumer protection for existing and prospective clients/customers particularly for sole shareholder and smaller licenced entities. Potential increase in revenues as investors/clients concerns become alleviated as a result of the SOG.</p> |
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F. Comments and Consultation

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

- SOG on Succession Planning for all Licensees.

14. The Authority must receive representations by **Monday, 29 October, 2018**.

15. Comments and representations must be addressed to

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16. 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.