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FSC Newsletter

The general duties and responsibilities of directors

Introduction

When considering applications from companies or firms to carry on licensable activities, the Commissioner has to form a view as to whether or not the firm's business is, or will be, controlled and managed in a satisfactory way. In the case of companies, this means that the Commissioner must consider the manner in which the directors of a company carry out their duties and responsibilities and how, as a board, they ensure that the company seeks to achieve its objectives effectively and efficiently. The same concerns apply when the business of an existing licensee is being monitored and supervised.

In making his assessment, the Commissioner takes into account the obligations and duties of directors as set out in legislation, case law and best practice guidelines. The Commissioner has, therefore, decided that it would be helpful to make available the following summary of his considerations of what constitutes best practice in this Newsletter which is not intended to be prescriptive, exhaustive or a fetter on the Commissioner's exercise of his discretion on a case by case basis. Clearly, this Newsletter setting out, as it does, the preferred regulatory position, is not intended as a substitute for obtaining professional advice where appropriate, and it should be noted that it is based upon material published prior to 1st February, 1998. The Commissioner considers that directors of licensees and managed companies should consider carefully the principles and practices set out below and relate them to the particular circumstances of the companies to which they have been appointed.

General

Corporate governance is the system by which companies are directed and controlled. Good corporate governance is a duty of directors and can be best achieved by appropriately experienced and qualified individuals applying informed and independent judgement flexibly and sensibly to the varying circumstances of individual companies.

The governance and control environment must set the culture and permeate every business activity and operational aspect of the company. It must demand a high level of control consciousness and expect every employee to contribute to its effectiveness. Internal controls should cover, inter alia,:

(a) compliance with applicable laws, regulations, administrative notices, and guidance issued,
(b) effective and efficient operations,
(c) appropriate financial management, and
(d) risk management, safeguarding of assets, including prevention and detection of fraud and other irregularities.

A director is not necessarily restricted to a person formally appointed to the office. A director is recognized by his functions and by the authority and power he exercises, and can be any person carrying out the functions and with the power, whatever he is called.

It is imperative that any important decisions, especially those involving large amounts of money, are considered very carefully by a director and that all potential liabilities are analysed and understood. A director must always remember that he may be held accountable for losses if he has not been as diligent as he should and that there is, therefore, no such thing as a "nominee" director when it comes to liability.

Any company of whatever size - if it wants to maintain an active control over its future and not merely react passively to events - should pay proper attention to formulating long-term strategy by submitting itself to the discipline of having a pre-determined programme of meetings with a previously prepared agenda requiring it to concentrate on major issues. In this way, the board will be in a position to fulfil its legal obligations properly, to prepare in advance for its discussions, and thereby make a conscious effort to concentrate on direction rather than on operational management.

It is common practice for smaller private companies where the equity may be owned by a single individual not to have any formal board system, but this is undesirable. The reason for this lies in the nature of the decisions directors should take. Based as they are on uncertain assumptions about the future, they require the exercise of a great deal of judgement and mental weighing and testing. No more efficient method has yet been discovered for carrying out this process than discussion by a well-informed small group of equals. Having a single director does not achieve that as his views are not capable of being challenged by one or more peers. Similarly, the board should preferably not allow itself to be under the influence of an individual or a small group of individuals who can dominate its decision taking.

Every director is entitled to have notice of a meeting. The proceedings of a meeting where all directors did not have proper notice could be void. The notice need not be in writing to be valid but the period of notice must be reasonable having regard to all the circumstances.

A director may ask for and must receive any information he reasonably requires in order to perform his functions. As the time available for board meetings is limited, he needs complete and accurate information and he needs it sufficiently in advance of the meeting to have time to study it. Reliance on information volunteered by management may not be enough and further enquiries may be necessary.

The Articles of Association of a company determine the procedure to be adopted for its internal management, including directors' meetings, the form of notice required at such meetings and the powers that they may exercise in the discharge of their functions as directors.

Duties of a Director

A director must exercise a reasonable degree of care, skill and diligence. The standard is that which could reasonably be expected from a person of his knowledge and experience.

A Director's duties are to be performed, inter alia, at periodical board meetings that he ought to attend.

A director cannot be mandated by the shareholders as this would mean that his independence of judgement would be restricted. He is an agent of the company who also casts his vote to decide in what manner his principal (i.e. the company) should act. If he does no more than exercise his functions as a director then a director is all he is - an officer of the company. Those who, in addition to being a member of the board, also hold an executive management position as part of the company's work-force are usually referred to as executive directors.

A director must act in good faith in the interests of his company and must not misuse his powers or the opportunities of his position, misapply the company's assets, or disclose its secrets. He stands in a fiduciary relationship to his company and must show the highest loyalty to it. He must use his discretion but whatever decisions he takes must be within the company's objects, be in the interests of the company and not be to support any other purpose or for personal motive. Acting honestly and with intelligence, a director will have performed his duty if he reasonably believes that the transaction he is about to approve is for the benefit of the company, but even that will not be enough if the transaction is outside the scope of the company's objects.

A director's duties relate to the company as a whole. However, by the very nature of voting procedures at company meetings, individual shareholders or minorities may need protection. Further, the director's duty to his company may not be fulfilled if he is acting in the interests of one section of the shareholders only or if he is not balancing short term interests and long term interests of the shareholders.

A director may operate only according to the rules contained in the Articles and within the powers of the company contained in the Memorandum. Accordingly, a director taking office will need to familiarize himself with the objects (the Memorandum) and rules (the Articles) of the company. He must bear in mind particularly the danger of acting ultra vires.

A director must not abuse his position of trust. This rule covers such potential conflicts of interest as secret profits, directors' contracts, insider dealing and confidentiality. The basic rule is that being in a fiduciary position towards his company, a director is not permitted to profit from his office except with the knowledge and lawful consent of the company. However, his connection with a business from which he may profit ought to be made known to his fellow board members.

A director must keep in regular touch with the company's finances and its assets and cash position. He should ensure that the company's property is not misappropriated or misapplied. The definition of property is a wide one including not only tangible assets but such items as cash at bank, trade secrets and know-how.

Non-executive directors

The overriding consideration is that Non-executive Directors must participate to the full in the board's deliberations. As they will inevitably be less well informed about the company's business than their executive colleagues, their effectiveness turns, to a considerable extent, on the quality of information supplied to them. Their legal duty to act bona fide in the interests of the company as a whole is identical with that of their executive colleagues. However, within this framework, their independence has further contributions to make. These include:

a) Bringing an independent judgement to bear on issues of strategy, performance, resources (including key appointments), and standards of conduct.

b) Widening the horizons within which the board determines strategy by bringing into board discussions any background of special skill, knowledge and experience which is relevant to strategy and which the board might otherwise lack.

c) Challenging the accepted wisdom of the executive directors and causing issues to be fully and carefully examined.

d) Taking a special role for monitoring executive director's management performance and results.

e) Ensuring that the board has adequate systems to safeguard the interests of the company where these may conflict with the personal interests of individual directors.

f) Exercising a duty to the company in such areas as board appointments and remuneration, and ensuring the presentation of adequate financial information to shareholders.

It is also important to highlight that the responsibility and liability of non-executive directors is identical to that of their executive equivalent.

The Board

The board as a whole should:

- Be the directing will and mind of the company. It should have a balance of appropriately skilled, experienced and qualified individuals who can apply informed and independent judgement to the governance of the company. It should ensure the Company is effectively directed and managed, and its business is conducted in a sound and prudent manner with integrity, due care and professional skills appropriate to the nature and scale of its activities. The board should meet regularly and ensure that evidence exists of attendance at meetings of directors. It should have a formal schedule of matters specifically reserved to it for decision to ensure that the direction, and the full and effective control of the company, is firmly in its hands.

- Be knowledgeable about the affairs of the company with an on-going awareness of the company's activities, identify the risks and vulnerabilities to which the company is exposed and ensure they are properly managed.

- Determine the businesses in which the company should engage and those which it should avoid, and the extent and priority of the company's investments in relation to the opportunities and threats ahead, having regard to the resources available.

- Ensure that the company has adequate long-term objectives and strategies, expressed not merely in financial terms, and approve these from time to time. The board should also ensure that the company reviews its business plans in the wider context of the current and likely local, national and international environment.

- Approve the budgets presented by the management and ensure that they are compatible with short-term and long-term objectives.

- Approve specific major investments and policy proposals. To that end, the board should ensure it is provided with all necessary information supporting proposals by management for new projects seeking authority to commit funds to new investments. If such proposals are not complete and clear it is a fair assumption that the project itself may not have been properly evaluated.

- Ensure that reliable financial information and proper and accessible accounting records are maintained such that a reference to them at any time will reveal a reasonably accurate picture of the company's financial position. Also, ensure that the company's information systems are adequate to monitor financial and executive management performance.

- Ensure that it is provided with all information needed in order to make sound decisions and to review policy and strategy. It should have adequate information about underlying assumptions highlighting areas of sensitivity that may effect the company's business or results.

- Ensure that all directors when they are first appointed to the board receive induction into the responsibilities of a director. Directors should also receive further training from time to time, particularly on relevant new laws and regulations and changing commercial risks.

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