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Practice Note

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GUIDANCE NOTE ON THE RESPONSIBILITIES AND DUTIES OF DIRECTORS UNDER THE LAWS OF THE ISLE OF MAN

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The FSC aims to provide a framework of regulation and supervision within which licensed institutions can compete and develop their businesses. Whilst maintaining high international standards, such a framework must ensure soundness and stability if it is to provide a firm basis for the confidence of depositors and investors.

To assist existing and potential new licenceholders in understanding and meeting regulatory requirements, the Commission has produced Handbooks for:

- Banks
- Investment Businesses
- Collective Investment Schemes
- Fiduciaries
- Anti-Money Laundering
- Building Societies

Each of the above provides up to date searchable text explaining the FSC's regulatory requirements. Downloadable PDFs of the various legislation and regulations are also included.

This practice note on the responsibilities and duties of directors under the laws of the Isle of Man is extracted from Section 5 of the "Fiduciaries Handbook".

It is intended as a general guide only and must be read in conjunction with the relevant legislation. It should not be relied upon and should not be used as a substitute for legal advice.

Advice should be sought from a competent person if you are unsure what legal requirements and obligations are imposed on you in whichever capacity you are acting.

SECTION 1 - GUIDANCE NOTE ON THE RESPONSIBILITIES AND DUTIES OF DIRECTORS UNDER THE LAWS OF THE ISLE OF MAN

1. The Commission's Guidance Notes on the responsibilities and duties of directors under the laws of the Isle of Man are relevant to all directors of Isle of Man incorporated companies but in particular, the Commission is concerned to ensure that directors understand their responsibilities for the proper conduct and financial well-being of an Isle of Man licenceholder. Where the licenceholder is a corporate service provider providing directors for client companies, such directors are also expected to be aware of their duties and responsibilities.
- 1.1 The Commission's Guidance Notes are intended as a general guide only and must be read in conjunction with the relevant legislation. The guidance is general in scope, and is not in any particular order of relative importance. These notes are derived from the duties and responsibilities that already exist at law, but are not exhaustive and further guidance should be obtained from your legal adviser.
- 1.2 Where corporate directors are permitted, the actions of the directors and members of the corporate director will be relevant in assessing the standards of conduct of the corporate director. Furthermore, these actions will also be relevant in assessing the ongoing fitness and propriety of those directors and members themselves. (see 2.2 and 5.6 below).
- 1.3. These guidance notes are published by the Financial Supervision Commission ("the Commission") in order to assist current and future directors of Isle of Man incorporated companies to perform their duties responsibly and within the laws of the Isle of Man. Directors should ensure that principles of good corporate governance are followed.

INTRODUCTION

SECTION 2 - WHO IS A DIRECTOR? HOW A DIRECTOR IS APPOINTED TO OFFICE AND HOW HE CEASES TO BE A DIRECTOR

- 2.1 There are two distinct company forms in the Isle of Man. These are companies incorporated under the Companies Acts 1931-2004 of the Isle of Man ("1931 Act companies") and companies incorporated under the Companies Act 2006 ("2006 Act companies").
- 2.2 1931 Act companies must have at least two individual directors and corporate directors are not permitted. However, 2006 Act companies may have a single director and corporate directors are permitted, provided that the corporate director is the holder of a corporate service provider ("CSP") licence (which does not exclude acting as such) or is the subsidiary of such a CSP licenceholder. A corporate director of a 2006 Act company is a legal person whose actions are directed and determined by natural persons. The directors of the corporate director therefore have responsibilities to ensure that the corporate director fulfils its duties and responsibilities as set out in this guidance.
- 2.3 A director includes any person acting as a director by whatever name called, and acts of a director are valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification. (See sections 341 and 142 of Companies Act 1931 ("1931 Act") and sections 221 and 100 of Companies Act 2006 ("2006 Act")). Therefore, even though it is an offence not to comply with the formalities of a director's appointment, a person is recognised as a director by his functions and by the authority and power he in fact exercises. Acting as a director in this way makes you a "de facto" director in the eyes of the law.

- 2.4 Although the actual term "shadow director" is not used in the 1931 Act or 2006 Act, both Acts contain provisions which refer to persons in accordance with whose directions or instructions the director(s) are accustomed to act - and this is the widely accepted definition of a shadow director. A "shadow director" must comply with the same standards as a properly appointed director. Directors should not allow a person who has not been formally appointed to act as a director, nor should they allow their discretion to be fettered by such a person. Equally, a person who has not been appointed as a director should not seek to direct or instruct the directors of a company.
- 2.5 The law relating to the standards to be observed by directors in discharging their duties applies no distinction between executive and non-executive directors. However, it is widely recognised that non-executive directors have a useful independent role to play to ensure that the company's activities are undertaken in compliance with the law and pursuant to principles of good corporate governance.
- 2.6 There is no such entity in law as a "nominee" director. Every director has exactly the same responsibility to the company as a whole and if he neglects that responsibility in the interests of or on the orders of his principal, he will be guilty of a breach of duty. Directors should not allow others to unduly influence them in such a way as to undermine the exercise in good faith of their powers in the manner in which they consider to be in the best interests of the company. Any attempted "string-pulling", whether by other directors, shareholders, beneficial owners or other third parties, should be firmly resisted by directors. The directors must make their own decisions, after receiving appropriate professional advice if necessary. They must not simply "rubber stamp" decisions made by others.
- 2.7 In addition to other statutory requirements for certain information about the company to be available on the public record, both 1931 Act and 2006 Act companies are required to file an annual return with the Companies Registry. This ensures that there is an annual up-date of the company's public record, including details of the company's directors. (See also 5.2.8 and 5.7.1 below.)
- 2.8 A 1931 Act company is required to file notice of any change in its directors with the Companies Registry. When a new director is appointed, resigns or ceases to be a director, a form 9N must be completed, and filed with the Companies Registry within one month of the date of the appointment, resignation or cessation (by removal, disqualification or death) taking effect. Failure to notify within the time frame will incur a late filing penalty. Also, any changes in personal details, such as change of name, address, nationality, and occupation, should be notified on the relevant form within one calendar month of the date of such change. A 2006 Act company is not required to file notice of any changes in its directors or of any change of directors' personal details but may elect to do so. If such an election is made, changes to the information filed must be notified to the Companies Registry within one month of the change (see section 204 of the 2006 Act). Whether an election is made or not, a 2006 Act company is required under section 85 of the 2006 Act to file an annual return which, as prescribed by regulations, records the details of serving directors and any changes since the date of the last return so that the directors' details at the date of the annual return will be available on the public record.
- 2.9 The rules governing the appointment and retirement of directors are contained in the 1931 Act and 2006 Act respectively and the constitutional documents of the company. For example, the articles of association may require a director to take shares in the company as a condition of his appointment, and may require all the directors or one third of the directors to retire and offer themselves for election or re-election at the company's annual general meeting.
- 2.10 Both the 1931 Act and the 2006 Act include statutory provisions for the removal of a director from office. (See section 141A of the 1931 Act and section 96 of the 2006 Act.) The

constitutional documents may also provide for the removal of a director from office. However, nothing in the constitutional documents or in any service agreement can prevent members of the company from using the statutory power in preference to the procedure set out in the constitutional documents, if they so wish.

- 2.11 Persons may be disqualified from acting as directors by statute. For example, section 141 of the 1931 Act prohibits an undischarged bankrupt from acting as a director of a 1931 Act company without the permission of the court which adjudged him a bankrupt.
- 2.12 In relation to 2006 Act companies, section 93 of the 2006 Act expressly sets out a list of persons who are not permitted by statute to act as a director of a 2006 Act company, including:
 - an individual who is under 18 years of age;
 - an undischarged bankrupt;
 - in the case of a corporate director, a body corporate which does not hold an appropriate Isle of Man CSP licence or which is not a subsidiary of such a body corporate.
- 2.13 In addition, the constitutional documents of the company may include provisions disqualifying or prohibiting certain persons from being eligible to act as a director of that particular company.
- 2.14 Persons may also be disqualified from acting as director of a 1931 Act company or a 2006 Act company by the court (see section 26 of the Isle of Man Companies Act 1992 and section 31 of the Isle of Man Companies Act 1982).

SECTION 3 - DUTIES OF DIRECTORS

- 3.1 Directors should understand the nature and extent of the duties, which they owe as directors. They should understand the nature of the role they perform. If they are in any doubt then they should take appropriate professional advice where necessary.
- 3.2 Directors are subject to certain minimum standards of care, skill and diligence in discharging their duties.
- 3.3 The law imposes duties on directors. If a person does not comply with his duties as a director he may be liable to civil and/or criminal proceedings and he may be disqualified from acting as a director. Set out below is a summary of the main duties of a director to his company. It is not an exhaustive and complete statement of a director's duties and the law is subject to change. If a person is unsure about his duties as a director in any particular set of circumstances he should seek advice.
 - 3.3.1 Loyalty - A director must act in good faith in what he considers to be the interests of the company.
 - 3.3.2 Obedience - A director must act in accordance with the company's constitution (contained in the memorandum and articles of association) and must exercise his powers only for the purposes allowed by law.
 - 3.3.3 Independence - A director must not agree to restrict his power to exercise an independent judgement. But if he considers in good faith that it is in the interests of the company for a transaction to be entered into and carried into effect, he may restrict his power to exercise an independent judgement by agreeing to act in a particular way to achieve this.
 - 3.3.4 No secret profits - A director must not use the company's property, information or opportunities for his own or anyone else's benefit unless he is allowed to by the

company's constitution or the use has been disclosed to the company in general meeting and the company has consented to it (although this may not be sufficient in some circumstances).

- 3.3.5 Conflict of Interest - Directors must not put themselves in a position where there is a conflict (actual or potential) between their personal interests and their duties to the company or between their duty to the company and a duty owed to another person. If there is a conflict between an interest or duty of a director and an interest of the company in any transaction, the director must account to the company for any benefit he receives from the transaction. This applies whether or not the company sets aside the transaction. But the director does not have to account for the benefit if he is allowed to have the conflicting interest or duty by the company's constitution (and he has complied strictly with the requirements and terms of the company's constitution in that regard) or the interest or duty has been fully and properly disclosed to and approved by the company in general meeting. The 2006 Act contains express statutory provisions which provide that (subject to any provision to the contrary in the company's constitutional documents) a director of a 2006 Act company may in certain circumstances have a conflicting interest with the company and still retain any benefit which he derives by reason of such interest provided that the director has disclosed his interest in accordance with, and strictly complied with, the requirements of sections 103 to 105 of the 2006 Act. Directors must also remember their duty to disclose any interest to the board of directors of the company (see section 148 of the 1931 Act and section 104 of the 2006 Act).
- 3.3.6 Care, skill and diligence - A director owes the company a duty to exercise the care, skill and diligence which would be exercised in the same circumstances by a reasonable person having both (a) the general knowledge, skill and experience that may reasonably be expected from a person carrying out the same functions as are carried out by that director in relation to the company, and (b) the actual knowledge, skill and experience which the director has.
- 3.3.7 Fairness - A director must act fairly as between different members.

SECTION 4 - POWERS OF DIRECTORS

- 4.1 The powers of directors are derived from law and their powers relating to the management of the company may be further defined in its constitutional documents. They must exercise their powers:
- 4.1.1 in what they honestly believe to be the best interests of the company; and
 - 4.1.2 for a proper purpose, being the purpose for which the power is intended.
- 4.2 Directors' powers are not individual but collective. However, a board (subject to the articles of association) may delegate certain powers to one or more of their number or, if its constitutional documents permit, to non-directors.
- 4.3 Usually the board of directors will take all management decisions, and only those matters required by statute or the company's constitutional documents to be decided by the shareholders or members will be left in their hands. The directors are not agents of the members, and cannot be instructed by the members in general meeting as to how they should exercise their powers. It is important therefore that directors are mindful of any attempt to influence either themselves or any other board member in such a way so as to undermine the exercise of their powers. The members have a statutory right to remove a director before the

expiration of his period of office (see section 141A of the 1931 Act and section 96 of the 2006 Act).

- 4.4 A director cannot delegate his overall responsibility. There can be no total abrogation of responsibility. Directors remain responsible for the exercise of powers they delegate. Where delegation is properly authorised there still must be a proper monitoring of the exercise of the delegated powers. Provided it is duly authorised the board of directors may delegate their powers to a third party. For example the board may pass a resolution agreeing to enter into a contract but may, by power of attorney authorise a third party to execute the contract. In all circumstances the board should keep the attorney's powers within restricted parameters and ensure that it does not relinquish control over the company's affairs.
- 4.5 A director may rely on information, given by an employee, expert, professional adviser or another director in relation to matters within their competence or responsibility, provided that the director acted in good faith, made proper enquiries and had no ground for suspicion.
- 4.6 In general terms it is for the directors to meet, discuss and if appropriate, approve the substance of any material transactions the company is entering into. To a certain extent the directors can rely on opinions provided by the company's advocates, accountants and other advisers but the decision of whether to enter into a transaction or not must be a decision for the directors.

SECTION 5 - KNOWLEDGE OF THE LEGAL FRAMEWORK

- 5.1 A director must operate within the legal framework of the laws of the Isle of Man (or be reasonably able to rely on someone who possesses the relevant knowledge), to ensure that the company's operations comply with all relevant laws. In addition to the laws of the Isle of Man, directors must also have sufficient knowledge (or be reasonably able to rely on someone who does) of the laws of any other jurisdictions within which their companies may operate and ensure that such operations comply with those laws.
- 5.2 In addition to complying with relevant laws, a director should ensure that he has knowledge of the memorandum and articles of association of the company. The memorandum gives the basic information about the company (name, registered office, type of company etc) and the articles of association deal with the internal conduct of the company's affairs. However, a 2006 Act company does have more flexibility than a 1931 Act company as to what information can be included in its memorandum of association.
- 5.3 A 1931 Act company incorporated after 1st June 1988 or to which Part I of the Isle of Man Companies Act 1986 applies may adopt all or any part of the statutory standard model articles of association made under section 7 of the Companies Act 1986 and contained in the Companies (Memorandum and Articles of Association) Regulations 1988. (Table A is the model for a company limited by shares.) A 1931 Act company may, however, tailor its own articles, within the powers and limitations of the relevant statutory requirements, to meet its particular needs.
- 5.4 A 2006 Act company limited by shares or limited by guarantee may adopt all or any part of the relevant statutory model articles of association made under section 5 of the 2006 Act and contained in the Companies (Model Articles) Regulations 2006. A 2006 Act company may also tailor its own articles, within the powers and limitations of the relevant statutory requirements, to meet its particular needs.
- 5.5 It should be noted that the 1931 Act and 2006 Act only permit companies to do certain specified acts if their constitutional documents also authorise it. For example, a 1931 Act company may reduce its capital only if authorised to do so by its articles of association (and subject to the sanction of the court) (section 56 of the 1931 Act) and the directors of a 2006 Act company can

only remove a fellow director if this is expressly permitted by its constitutional documents (section 96(4) of the 2006 Act).

- 5.6 The 2006 Act allows flexibility concerning the internal management of the company and many sections of the 2006 Act allow the company's constitutional documents to provide otherwise than is required by or stated in the 2006 Act. For example,
- the rights attaching to a share in the company are set out in section 27(1) of the 2006 Act but the company's constitutional documents may negate, modify or add to such rights
 - section 68(2) of the 2006 Act enables a members' meeting to be held at short notice if a member or members holding at least 90%, or such smaller percentage as may be specified in its articles, of the voting rights have waived notice of the meeting;
 - section 106(1) of the 2006 Act provides that the directors of a 2006 Act company may meet at such times and in such manner and places within or outside the Isle of Man as they may determine to be necessary or desirable and can regulate their proceedings as they see fit, subject to any contrary provision in the company's constitutional documents.
- 5.7 The company's constitutional documents have no effect to the extent that they contravene or are inconsistent with the Act. Although not expressly specified in the 1931 Act, for the avoidance of doubt this is stated in the 2006 Act (see section 7(2)).

SECTION 6 - LIABILITIES - CRIMINAL AND CIVIL

- 6.1 Many provisions in the 1931 Act impose specific duties on a company's officers (particularly directors) in connection with the conduct of the company's business. In many instances, the 1931 Act provides that a failure to perform such duties constitutes a criminal offence.
- 6.2 Generally the 2006 Act imposes duties on the company itself but section 223 provides that if an offence committed by the company is proved to have been committed with the consent or connivance of or to be attributable to neglect on the part of a director, manager or other officer of the company or its registered agent, or a person who was purporting to act in any such capacity, that person as well as the company is guilty of the offence and is liable to be proceeded against and punished accordingly.
- 6.3 Where a director acts in breach of his fiduciary duty, he may be liable to indemnify the company for any loss it has suffered as a result, and to account to the company for any profit made. In some cases the members, with full knowledge, can ratify the actions of the directors. Such ratification cannot obviously be guaranteed and, in any event, may not be sufficient in some circumstances.
- 6.4 A director must always remember that he may be held accountable for losses if he has not complied with his statutory and fiduciary duties or failed to exercise the requisite duty of care, diligence and skill and that there is no such entity as a "nominee" director when it comes to liability.
- 6.5 Directors should also be aware of potential liability on a "constructive trust" basis if they are engaged or assist in wrongful conduct. A constructive trust is imposed where a person receives assets and, although there is no formal recognition by him that anyone else has any interest in them, it would be inequitable to deny such an interest.

- 6.6 Directors should also be aware of the various statutory provisions which impose personal liability on directors guilty of wrongdoing. For example section 259 of the 1931 Act (which also applies to 2006 Act companies by virtue of section 182 of the 2006 Act) contains detailed provisions in relation to the personal responsibility of directors for fraudulent trading. If a director enables a company to carry on business and incur debts when to the knowledge of the director there is no reasonable prospect of the debts being paid, the director could suffer personal liability in such circumstances. Section 260 of the 1931 Act (which also applies to 2006 Act companies by virtue of section 182 of the 2006 Act) gives the court wide powers to make an order requiring a director to repay or restore any money which he has misapplied or retained or become liable or accountable for to the company or to contribute to the company's assets an appropriate sum by way of compensation. In addition, section 51 of the 2006 Act imposes a statutory personal liability on directors of a 2006 Act company where a 'distribution' has been made by the company to the members and the company did not, immediately after the distribution, satisfy the solvency test.
- 6.7 There are also provisions which enable the court to make orders disqualifying individuals from acting as directors (section 31 of the Companies Act 1982; section 26 of the Companies Act 1992).

SECTION 7 - ADMINISTRATION AND ACCOUNTS

- 7.1 The directors are responsible for the company's administration, including maintenance of proper accounting records, minutes of meetings, statutory books and filing of information at the Companies Registry. It is usual for these duties to be delegated - to the Secretary of a 1931 Act company or to the Registered Agent of a 2006 Act company - but this does not relieve the directors of the ultimate responsibility.
- 7.2 It is the duty of the directors under the Companies Acts:
- to ensure that proper accounting records are kept by the company;
 - to prepare and approve annual accounts which comply with the Companies Acts;
 - to ensure that the company sends a copy of the accounts to parties entitled to receive them; and
 - to lay the accounts and reports before the shareholders in general meeting.
- 7.3 Under the 2006 Act, the obligation to maintain accounting records falls on the company and the Registered Agent is required to hold such records. However, the responsibility for accounting records lies with the directors as they are responsible for the management of the company (see section 91(1) of the 2006 Act). The 2006 Act does not require a 2006 Act company to prepare financial statements or have them audited (but the company's constitutional documents may so provide) and there is no statutory requirement in the 2006 Act to lay accounts before the members in general meeting or send them copies, but members may on request access the accounting records of a 2006 Act company (see section 82 of the 2006 Act).

SECTION 8 - BOARD MEETINGS

- 8.1 As already mentioned, the powers of directors are not individual but collective. The directors should therefore exercise their powers by holding board meetings at which collective decisions are taken. The articles of association may stipulate when and how board meetings shall be held, and the quorum requirements. A meeting cannot proceed to business unless a quorum is present. Any member of the board is entitled to call a meeting of directors and every director is entitled to receive notice of a meeting.
- 8.2 Minutes must be kept of the proceedings of board meetings. Once agreed and signed by the chairman of the meeting they are evidence, though not conclusive evidence, of the proceedings

to which they relate. In respect of 1931 Act companies, where minutes have been made in accordance with the relevant statutory provisions then, until the contrary is proved, the meeting shall be deemed to have been duly held and convened, and all proceedings shall be deemed to have taken place, and all appointments of directors, managers, or liquidators shall be deemed to be valid (see section 119 of the 1931 Act). A written resolution, may replace a meeting of the board (section 109(3) of the 2006 Act and in respect of a 1931 Act company, section 118A to 118C of the 1931 Act and its articles).

SECTION 9 - GOOD CORPORATE GOVERNANCE

Corporate governance relates to ownership and control and the roles of owners, directors, company secretary (1931 Act companies), registered agent (2006 Act companies), managers and shareholders and the way the business of the company is run. The board of directors are but one component. Good corporate governance can best be achieved by appropriately experienced and qualified individuals applying informed and independent judgements. Directors have an important role in ensuring good corporate governance.