

# Financial Supervision Commission

## Companies Registry

P O Box 345

Finch Hill House

Bucks Road

Douglas

Isle of Man

IM99 2QS

Telephone: +44 (0)1624 689389

Facsimile: +44 (0)1624 689397

Email: [companies@fsc.gov.im](mailto:companies@fsc.gov.im)

P O Box 58

Finch Hill House

Bucks Road

Douglas

Isle of Man

IM99 1DT

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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

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 licence holders in understanding and meeting regulatory requirements, the Commission has produced Handbooks for:

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

All of which are available free of charge on the Commissions web site ([www.fsc.gov.im](http://www.fsc.gov.im)). Each of the above handbooks provides an up to date explanation of the FSC's regulatory requirements.

This practice note on the responsibilities and duties of directors under the laws of the Isle of Man 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 following guidance is indicative of the responsibilities and duties of directors, 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.
- 1.1 These guidance notes are published by the Financial Supervision Commission ("the Commission") in order to assist current and future company directors 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

- 1.2 **WHO IS A DIRECTOR? HOW A DIRECTOR IS APPOINTED TO OFFICE AND HOW HE CEASES TO BE A DIRECTOR**
- 1.2.1 Companies incorporated under the Companies Acts 1931-1993 of the Isle of Man ("the Companies Acts") must have at least two individual directors. Corporate directors are not permitted.
- 1.2.2 A director as defined by the Companies Act 1931 includes "any person occupying the position of director by whatever name called" (section 341), and acts of directors are valid "notwithstanding any defect that may afterwards be discovered in his appointment or qualification." (section 142). Therefore, even though it is an offence not to comply with the formalities of registration of a director's appointment, an individual 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.
- 1.2.3 Although the term "shadow director" is not used in the Companies Acts, anyone upon whose instructions the director(s) act, will, in the eyes of the law, be considered to be performing the functions of a 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.
- 1.2.4 The law in applying the standards to be observed by directors in discharging their duties applies no distinction between executive and non-executive directors. 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.
- 1.2.5 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.
- 1.2.6 When a new director is appointed, resigns or ceases to be a director (by removal, disqualification or death), a form 9N must be completed, and filed with the Companies Registry within one month of the date of the appointment, resignation or cessation. 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 form 9N within one calendar month of the date of such change.

- 1.2.7 The rules governing the appointment and retirement of directors are contained in the Companies Acts and the articles of association 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.
- 1.2.8 There are statutory provisions for removal from office and for disqualification of directors. The articles of association may also provide for the removal of a director from office, however the statutory power and procedures for the removal overrides the articles of association and any service agreement that may be in place.
- 1.2.9 A person cannot be appointed as a director or continue in office if he is:
- an undischarged bankrupt (section 141 Companies Act 1931); or
  - someone who is currently disqualified by a court from acting as a company director (section 26 Companies Act 1992; section 31 Companies Act 1982).

The company's articles of association may include conditions or exclusions, which would lead to the disqualification of a director, for example:

- if he is, or may be, suffering from mental disorder and either (i) he is admitted to hospital in pursuance of an application for admission for treatment or (ii) an order is made by a court having jurisdiction in matters concerning his mental disorder; or
- if he is directly or indirectly interested in any contract with the company or participates in the profits of any contract with the company; or
- if he fails to attend board meetings, without reasonable excuse, for a specified period of time.

### 1.3 DUTIES OF DIRECTORS

- 1.3.1 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. They should take appropriate professional advice where necessary.
- 1.3.2 Directors are subject to certain minimum standards of care, skill and diligence in discharging their duties.
- 1.3.3 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.
- 1.3.3.1 Loyalty - A director must act in good faith in what he considers to be the interests of the company.

- 1.3.3.2 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.
- 1.3.3.3 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.
- 1.3.3.4 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.
- 1.3.3.5 Conflict of Interest - If there is a conflict between an interest or duty of a director and an interest of the company in any transaction, he 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 he does not have to account for the benefit if he is allowed to have the interest or duty by the company's constitution or the interest or duty has been disclosed to and approved by the company in general meeting.
- 1.3.3.6 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 knowledge and experience that may reasonably be expected of a person in the same position as the director, and (b) the knowledge and experience which the director has.
- 1.3.3.7 Fairness - A director must act fairly as between different members.

#### 1.4 **POWERS OF DIRECTORS**

- 1.4.1 The powers of directors are derived from law and their powers relating to the management of the company may be further defined in its articles of association. They must exercise their powers:
  - 1.4.1.1 In what they honestly believe to be the best interests of the company; and
  - 1.4.1.2 For a proper purpose, being the purpose for which the power is intended.
- 1.4.2 Directors' powers are not individual but collective. However a board (subject to the articles of association) may delegate powers to one or more of their number (or if its articles of association permit to non-directors), but any such delegation of their powers must be authorised by the Board. Individual directors do not have the authority to commit the company unless authorised by the board. An individual director who acts without the board having delegated the requisite authority can be liable for breach of duty to the company.
- 1.4.3 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. If the members are dissatisfied with a director's acts, they may have the power (subject to the company's articles of association) not to re-elect a director at the company's annual general meeting. The members have a statutory right to remove a director before the expiration of his period of office (section 141 of the Companies Act 1931).

- 1.4.4 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.
- 1.4.5 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.
- 1.4.6 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 commercial decision of whether to enter into a transaction or not must be a decision for the directors.

## 1.5 **KNOWLEDGE OF THE LEGAL FRAMEWORK**

- 1.5.1 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.
- 1.5.2 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 deals with what the company can do. The articles of association deal with the internal conduct of the company's affairs. A company 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).
- 1.5.3 It should be noted that frequently the Companies Acts only permit companies to do certain specified acts if their articles of association also authorise it. For example, a company may reduce its capital only if authorised to do so by its articles of association (section 56 Companies Act 1931). If the Companies Acts details a specific procedure to be followed, notwithstanding anything in the company's articles of association, then the statutory procedure must be followed notwithstanding anything to the contrary in the articles of association.

## **1.6 LIABILITIES - CRIMINAL AND CIVIL**

- 1.6.1 Many provisions in the Companies Acts impose specific duties on a company's officers (particularly directors) in connection with the conduct of the company's business. In many instances, a failure to perform the duties could result in criminal liability.
- 1.6.2 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 future confirmation cannot obviously be guaranteed and may not be sufficient in some circumstances.
- 1.6.3 A director must always remember that he may be held accountable for losses if he has not been as diligent as he should have been and that there is no such entity as a "nominee" director when it comes to liability.
- 1.6.4 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.
- 1.6.5 Directors should also be aware of the various provisions in the Companies Act which impose personal liability on directors guilty of wrongdoing. For example section 259 of the Companies Acts 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 Companies Act 1931 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.
- 1.6.6 There are also provisions in the Companies Acts, 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).

## **1.7 ADMINISTRATION AND ACCOUNTS**

- 1.7.1 The directors are responsible for the company's administration, including maintenance of proper accounting records, minutes of meetings, and filing of information at the Companies Registry. It is usual for these duties to be delegated, and the Secretary may handle much of the administration, but this does not relieve the directors of the ultimate responsibility.
- 1.7.2 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, unless all the members have passed a resolution relieving the directors from this requirement.

## **1.8 BOARD MEETINGS**

- 1.8.1 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.
- 1.8.2 Minutes must be kept of the proceedings of board meetings. Once agreed and signed by the Chairman they are evidence, though not conclusive evidence, of the proceedings to which they relate. 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 had thereat to have been duly had, and all appointments of directors, managers, or liquidators shall be deemed to be valid.

## 1.9 GOOD CORPORATE GOVERNANCE

Corporate governance relates to ownership and control and the roles of owners, directors, managers and shareholders. 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.