



## **THE ROLE AND DUTIES OF DIRECTORS - A DISCUSSION PAPER**

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- 1.1 Insurance offices as investors are increasingly being approached by companies and their advisors with requests to indicate what in their view would be the reasonable expectation of shareholders in such matters as the provisions governing the appointment and removal of Directors, the duties of Non-Executive Directors, Directors' service contracts and emoluments, their borrowing powers, etc. ...
- 1.2 The Companies Act imposes certain fundamental obligations in respect of disclosure and emoluments, service contracts etc. Beyond this and any obligations imposed as listed companies by the Listing Agreement of the International Stock Exchange, however there is a rich variety of practice in the composition of Boards of Directors of UK companies and in the approach to remuneration of Directors, which reflects the widely different circumstances which pertain to companies across the whole spectrum of size and category. Whilst acknowledging the need to adapt such practice to suit the circumstances of any particular case, insurance companies as investors are of the view that the consideration and discussion of the best practices are of the view that the consideration and discussion of the best practices expected of Directors in those areas would enable the institutional shareholders to give a more coherent and consistent response when their views and votes are solicited by companies.
- 1.3 Such a summary of best practice clearly cannot be exhaustive but it is hoped that companies will accept it both in the spirit and in the letter.
- 1.4 It is recognised that Directors must, and in almost all cases do, act at all times in the best interests of the company and the reader is referred in this context to Section 317, Companies Act 1985 and to Section 5, Chapter 2 of the Listing Agreement.

### **2 APPOINTMENT AND REMOVAL OF DIRECTORS**

- 2.1 A Director must be elected by the Company in General Meeting unless provision is made otherwise. The Directors may appoint additional Directors if the Articles so provide but such an appointment terminates automatically at the next Annual General Meeting and any change in the directorate must be notified to the International Stock Exchange immediately. The reader is referred to Sections 282, 291, 294 and 303 of the Companies Act 1985.

2.2 It is suggested that, as a matter of good practice, these further provisions should be observed:-

- (a) The Articles should provide for a maximum as well as a minimum number of Directors. One third of the Directors should be subject to retirement by rotation each year. They can stand for re-election if they so choose.
- (b) The combination of the roles of Chairman and Chief Executive can give rise to conflicts and a concentration of power. The role of Chairman and Chief Executive should not therefore be combined unless there is an independent Committee of the Board which has delegated to it the authority to review the performance of the individual concerned if that is necessary.
- (c) Where companies feel that they must provide for divisional or assistant Directors or some other category whose title includes the word Director, it must be clearly provided that such Directors do not have any statutory authority or ability to act on behalf of the company in the capacity of a Director.
- (d) The Articles should provide that a Director may be dismissed from his office by written resolution of all his co-Directors. (Or at very least a majority of 75% of his co-Directors).
- (e) The Articles should provide that a Director may be dismissed from office by his fellow Directors for failure to attend a specified number of meetings of the Board "or Board Meetings held in a specific period".
- (f) Brief biographical details of each Director should be set out in the Annual Report. In particular, the Annual Report should disclose the age of any Director aged 70 or over.

### **3 NON-EXECUTIVE DIRECTORS**

3.1 Insurance offices strongly support the presence of independent Directors on Boards of companies. There has been a growing awareness of the value of Audit Committees and the importance of Non-Executive Directors has become evident, particularly in matters concerning remuneration of the senior management and in circumstances where there is potential for conflict of interest such as management buy-outs. They have a primary function to comment on corporate strategy where they can bring an objectivity and independence of view borne by their outside experience. While it is recognised that in some instances professional advisers bring their own particular expertise to this role, the value of the independent Non-Executive Director is the independence, personality and experience which he or she can contribute to the deliberations of the Board. It is suggested that, as a matter of good practice, these provisions should be observed:

- (a) The Non-Executive Directors should be sufficient in number and calibre for their views to carry significant weight on the Board. This is particularly necessary if the roles of Chairman and Chief Executive are combined.

- (b) Non-Executive Directors should be independent, eg they should not, under normal circumstances, be offered participation in share option schemes, neither should they be entitled to any compensation on loss of office since such arrangements might impair their impartiality. It is recognised that professional advisers such as merchant bankers and solicitors may well fulfil a specialist role but they should not be regarded as a substitute for the independent Non-Executive Director.
- (c) Non-Executive Directors should hold other Directorships in the same industry only with the approval of the Board.
- (d) While all Directors have a duty to monitor the performance of a company, the Non-Executive Directors should acknowledge a duty to monitor the performance of the executive Directors, and to report to the shareholders if they are not satisfied after reasonable efforts have been made by them to remedy the causes of their dissatisfaction.

#### **4 SERVICE CONTRACTS**

- 4.1 Copies of all Directors' service contracts must be made available in an accessible place for inspection by shareholders and may not be entered into for a period in excess of five years without the consent of the company in general meeting. The unexpired period of any service contract must be disclosed where a Director is being proposed for re-election.
- 4.2 The reader is referred to Section 5, Chapter 2 of the Yellow Book and Sections 292, 318 and 319 of the Companies Act 1985.
- 4.3 It is suggested that, as a matter of good practice, these further provisions should be observed:-
  - (a) Service contracts should be approved by a Remuneration Committee, with Non-Executive Directors forming the majority of its members. The composition of this Committee should be disclosed in the Annual Report.
  - (b) Any 'rolling' contract should run for a period of no more than 3 years.
  - (c) Service contracts should permit the executive Directors to engage in or have an interest in, any business similar to that carried on by any group company only with approval of the Board (though the ability to hold shares in listed companies carrying on such business is accepted).
  - (d) Service contracts should prohibit the Director from disclosing confidential information about the company, both during this employment and following its termination.

#### **5 EMOLUMENTS**

- 5.1 Disclosure is required in the Annual Report of Directors' emoluments and of any compensation payments in respect of loss of office made to Directors. The Companies Act and the International Stock Exchange

impose certain requirements governing such payments including the issue of shares and grant of loans, guarantees etc.

- 5.2 The reader is referred to Section 23, Sections 312 to 316, Sections 330 to 346 and Schedule 5, Companies Act 1985: and to Section 6, Chapter 1 and Section 1, Chapter 1 of the Yellow Book.
- 5.3 It is suggested that, as a matter of good practice, these further provisions should be observed:-
- (a) The emoluments of executive Directors (including the provisions governing performance-linked remuneration schemes and share option and share incentive schemes) should be determined by the Remuneration Committee.
  - (b) A limit should be placed on the Directors' fees under the Articles of Association. This may take the form of either a limit on aggregate fees or a limit on the fees of the highest-paid Director.
  - (c) Details of any performance-linked remuneration schemes and of any share option incentive schemes should be disclosed in the Annual Report.
  - (d) Details of any ex gratia payments or payments by way of compensation should be disclosed to shareholders in the Annual Report and Accounts.
  - (e) It is in general undesirable that details of any compensation payments or ex gratia payments should be subject to confidentiality agreements or similar arrangements.

## **6 DUTY TO EMPLOYEES**

- 6.1 Directors have a statutory duty to take account of the interests of the company's employees.
- 6.2 The reader is referred to Section 309, Companies Act 1985.

## **7 BORROWING POWERS**

- 7.1 There is no requirement either under the Statutes or under the Listing Agreement that the powers of Directors to borrow on behalf of a company should be limited.
- 7.2 It is suggested that, as a matter of good practice, the following provision should be observed:-
- (a) There should be a reasonable limit under the Articles of Association on the power of the Directors to borrow, which should relate to the borrowings of the group as a whole. It is desirable that the amount permitted under the Borrowing Powers Article should be stated in the Annual Report and Accounts.

## **8 DIRECTORS' DEALINGS IN SECURITIES**

- 8.1 The company must adopt rules governing dealings by Directors in the listed securities of the company, in terms no less exacting than those

contained in the Model Code for Securities Transactions by Directors of Listed Companies, set out in the Yellow Book. The penalties for dealing when in possession of unpublished price sensitive information are well known and the reader is referred to Sections 198 to 202, Section 235, Sections 323 to 329 and Schedules 7, 12 and 13 of the Companies Act 1985: to Section 5, Chapter 2 of the Yellow Book: and to the Company Securities (Insider Dealing) Act 1985.

- 8.2 Attention is drawn also to the restrictions under the Takeover Code and SAR's which impose certain restrictions on share dealings by Directors of a company which is involved in a takeover or a substantial acquisition. See Rules 4, 8 and 9 of the Takeover Code.

## **9 DIRECTORS OF COMPANIES IN DIFFICULTIES**

- 9.1 Sections 214 and 215 of the Insolvency Act 1986 impose obligations on a Director once he knows that the company is unlikely to avoid insolvent liquidation.

## **10 MANAGEMENT BUY-OUTS**

- 10.1 Considerable concern has been expressed in recent months at the inadequacy of information given to shareholders in management buy-out situations and the need for competent independent advice. The advent of a takeover or a management buy-out imposes similar obligations upon management to make all relevant information available and the Takeover Code imposes quite stringent obligations in bid situations. However, given the potential for conflicts of interest where the buy-out consortium comprises or includes management, the need for full disclosure and independent advice becomes more acute.

- 10.2 It is suggested that, as a matter of good practice the following provisions should be observed:-

- (a) All Directors should ensure that there is made available to shareholders such information as will enable them to assess the value of the company or other assets which it is proposed to sell: all information bearing on this point which is available to the proposed purchasers should be supplied to shareholders and, in any event, to the Non-Executive Directors.
- (b) Shareholders should be provided with independent advice and the independent advisers should have access to all information necessary to enable them to give a fully informed opinion as to the merits of the offer.

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