The Guide for Non-Executive Directors
What you really need to know...
and the small print...
We would not have been able to complete this Guide without the support, encouragement, help and advice from the following experienced Chairmen and Non-Executive Directors to whom we are indebted and give our thanks:

Mark Abrahams
Dame Helen Alexander
Andrew Allner
Ian Barlow
Glyn Barker
Charles Berry
Julie Chakraverty
Pamela Chesters
Colin Day
Michael Derbyshire
Justin Dowley
Ian Durant
Iain Ferguson
Anita Frew
David Garman
Chris Geoghegan
Tracey Graham
John Grant

Miriam Greenwood OBE
Charles Gregson
David Grigson
Anthony Habgood
Tony Hales CBE
Michael Harper
Ken Harvey CBE
John Hawkins
Debbie Hewitt MBE
Ishbel Macpherson
Steve Marshall
Roger Matthews
Alan McWalter
Anne Minto OBE
Vanda Murray OBE
John Nicholas
Jonathan Nicholls
Sir John Parker

Jamie Pike
Dr Raj Rajagopalan
Dr. Martin Read CBE
Nigel Rich CBE
Dr Gill Rider CBE
David Roberts
Philip Rogerson
Bill Shannon
David Shearer
John Sheldrick
Tim Stevenson OBE
Nick Thomlinson
Leslie Van de Walle
Paul Walker
Mike Welton
Phil White CBE
Peter Williams
Paul Withers
The role of the Non-Executive Director can appear to those sitting outside of Boards to be shrouded in secrecy. What is a Non-Executive Director? What do they do? And why be a Non-Executive Director?

Jointly in our roles advising the Boards of a range of organisations, and the Directors who sit on them, we are often asked what information a new Non-Executive Director should be aware of. Through combining our experience and perspective in providing Board advice, we have attempted to provide a Guide that answers both the ‘obvious’ questions to ask and issues to be aware of, together with the detail and summary of the working mechanics of the Board and the key legislation Non-Executive Directors need to understand.

In compiling this Guide, we have drawn upon the experience and expertise of a number of Non-Executive Directors and Chairmen, understanding what has made them successful, the lessons learnt and what they look for before joining a Board. The Guide enables the reader to quickly appreciate the key issues (See ‘Part 1 - What you really need to know...’), and delve into the detail (See ‘Part 2 - The small print...’), to further appreciate and understand the context of pertinent issues.

We hope you enjoy reading the Guide and find the insights and information of value.
Contents

Part 1: What you really need to know . . .

Chapter 1 - Why be a Non-Executive Director? 6
Chapter 2 - Key attributes organisations seek 8
Chapter 3 - Top issues to understand before accepting appointments 9
Chapter 4 - What makes a successful Non-Executive Director? 11
Chapter 5 - And finally... 12

Part 2: The small print...

Chapter 6 - What is a director? 14
Chapter 7 - Board composition 15
Chapter 8 - Board effectiveness 18
Chapter 9 - Appointment terms and fees 20
Chapter 10 - UK Corporate Governance Code 23
Chapter 11 - Roles and responsibilities (duties and liabilities) 26
Chapter 12 - Listing Rules, Disclosure and Transparency Rules and the Takeover Code 34
Chapter 13 - About Norman Broadbent and Eversheds 37

Appendix: Useful links 38
Part 1:
What you really need to know . . .
“All the risk, none of the reward”, said one high profile individual when being approached for a role as Non-Executive Director of a major company. Indeed, why risk tarnishing a so-far impeccable business career by being on the Board of a company where you share all the responsibility, yet have limited information and insight into the running of the business? However, the lure of being a Non-Executive Director remains attractive to many and, despite the perceived risks, a considerable number of successful executives take on Non-Executive roles, some going on to build portfolio careers where they sit on the Boards of a broad range of businesses and organisations.

The reasons often stated for taking on a Non-Executive Director role are varied and change throughout an individual’s career. For many current Executive Directors, it is to gain new perspectives and insights, learning about another sector and understanding a different organisation’s approach to threats and opportunities. Others state that being a Non-Executive Director helps them to understand their own Board better and enables them to appreciate their perspective to decision making. Indeed, many up-and-coming Executives are often encouraged by their Boards to seek out Non-Executive Director opportunities where they will gain valuable insights and enhance their boardroom skills, developing themselves to be better equipped executives in their current company.

“Being a Non-Executive Director meant different things to me at different times. My first Non-Executive role was during my mid-40s when I was a CEO and I was interested in acquiring a different experience and to position myself in a different place. I found this experience to be highly valuable when running my own show, recognising different ways and approaches and I learnt how to balance views and not be dogmatic.”

For others who have recently stepped down from full time Executive roles, the shift of focus tends to be on giving something back, imparting experience to younger management teams and adding value to a company. It is also a means for some to maintain their interest in business; to gain new experience and perspectives. Being a Non-Executive Director can also provide an element of identity, in addition to maintaining intellectual activity and involvement.

The relative flexibility of being a Non-Executive Director can also present an attractive alternative to a busy executive career, enabling experienced executives to create a more balanced lifestyle to suit their personal needs and desires. Often they have created enough wealth to be comfortable with and seek an alternative to the highly pressurised, all-consuming nature that executive careers can often be in today’s 24/7 global economy.

Being a Non-Executive Director can be tremendously rewarding and experienced Non-Executive Directors often comment that being associated with success and feeling that they have made a difference are key motivators for them. They enjoy seeing a company progress and evolve and know that they have played a part in this success, perhaps by steering a proposal through the Board and witnessing its successful delivery.

“When you see a company thrive, being able to point to things that you know you contributed to, but the Executives own, is hugely rewarding”.

However, being a Non-Executive Director requires considerable influencing skills and not all advice will fall on fertile ground. Those who were former CEOs especially, comment that not being in charge and getting their own way can be tremendously frustrating at first, and can take some adapting to. Non-Executive Directors also mention that they can occasionally feel like an outsider, never really feeling part of the team, and that they miss the daily interaction and cut and thrust of business.

“It can be disheartening when the Executives take all the credit and believe only in their own success”.

Others cite frustrations including late Board papers, the “ever-increasing” corporate governance and the feeling that you are “sometimes only there to tick boxes”. The Chairman is responsible for setting the tone of the Board and frustrations mount when there is a weak Chairman who does not encourage debate, is disorganised and focuses on the “wrong” things rather than tackling the key issues facing the company.

“Being a Non-Executive Director gives the intellectual challenge of problem solving at the highest levels and the ability to make a difference as a team”.

Chapter 1 - Why be a Non-Executive Director?
When it does go wrong, it can go spectacularly wrong. When a company is in crisis, the time you will need to commit to sort out the problems can increase dramatically. And with increased media attention on Board governance, once - “invisible” Non-Executive Directors are often put in the spotlight and can be vilified for “being asleep on the job”, “lacking attention to detail”, and “being the puppets of an all-powerful CEO”. It is often flattering to be approached and asked to join a Board. For some however, it can be a time-consuming role for little reward and, for an unlucky few, successful reputations have been tarnished.

“The real measure of a Non-Executive comes during a crisis when tough decisions need to be made”.

Whatever your reasons for taking on your first Non-Executive Director role, the opportunity can be fulfilling, stimulating and fun.

“You need to be conscious that as a Non-Executive, your reputation is your currency in the market”.

Chapter 2 - Key attributes organisations seek

The generic attributes organisations typically seek from their Non-Executive Directors are outlined below:

- a reflective and thoughtful approach combined with an ability to offer considered advice based on sound judgement;
- an individual of integrity, likely to be respected in their sector and peer group, demonstrating stature and gravitas;
- the ability to listen and to pick up on what is important;
- an ability to probe incisively, to challenge effectively and constructively, and to offer support and guidance where appropriate;
- an ability to build a successful working rapport with others around the Board;
- well-developed communication skills, an ability to articulate complex ideas clearly, listen to others attentively and influence effectively;
- an independence of mind, yet an ability to accept collective responsibility following full discussion and debate; and
- an ability to demonstrate an understanding and respect of the Executive / Non-Executive boundaries.

In addition to these attributes, organisations will typically require specific skills and experience. These skills may be pertinent to the specific requirements of that Non-Executive Director role and the committees that the Non-Executive Director is expected to contribute to (such as Audit, Remuneration or Risk). The requirement may also include familiarity with the sector that the organisation operates in (such as financial services, life sciences or utilities) or revolve around the dynamics associated with product life cycle, business-to-business or business-to-consumer experience. Or it could be experience of operating in or developing business in specific geographies, developing digital product platforms, mergers and acquisitions experience, marketing and brand management expertise etc. Indeed the list of requirements can be endless.

“A team doesn’t play with five centre-forwards”.

Equally, ignorance of Board matters and areas of discussion at the Board table will hold you back. You will need to demonstrate a certain degree of financial awareness, be comfortable analysing the P&L and discussing balance sheet issues etc. For listed companies, you will also need to understand how the City and advisor community work and how companies use them, as well as understanding what and when you can say anything without infringing applicable legislation and regulation. Part 2 of this Guide provides a summary of the key legislation and regulation of which all directors should be aware, and by which they should abide.

“Ignorance of finance is no defence”.

The most effective Boards are those that bring together a diversity of experience, background and skills to serve the business as it competes now, and to position it as it faces the future. Non-Executive Directors need to be able to rely on a broad base of experience rather than restrict their input to a relatively narrow area of expertise.

“Non-Executive Directors need to have seen and done a lot. They need to have previously dealt with big issues and challenges and made the tough decisions”.

“A Non-Executive Director needs good radar to fly at 30,000ft; to know when to go down to 3,000ft and when to come back up again.”
A Non-Executive Director should be on the Board of an organisation to add value, to challenge the Executive Directors on the strategy and direction of the business and ensure that the investment of the shareholders and broader stakeholders is being managed responsibly.

Before taking on a Non-Executive role, it may be useful to understand what specific skills and experience you have and how you are perceived by others.

“You need to be clear what your criteria are for joining a company and how it plays to your strengths and interests. Be very clear about what you will learn and take away from the company and, as importantly, the added-value that you will give”.

Similarly:

“Be clear what your point of difference is. If all the Non-Executives bring similar background and experience, your ability to influence is much harder”.

In the same vein, a degree of familiarity with the sector in which the company operates in and an affinity and empathy for the product is regarded by many as essential, especially for those taking on their first Non-Executive Director role. Enthusiasm for the company, an interest and a degree of knowledge of the sector is important, as individuals will be better able to translate their experience and perspectives. It is important to balance your interest in taking on a Non-Executive role with ensuring that the role is the right one for you.

“Don’t get flattered. I ended up accepting a role as a Non-Executive Director and joined a Board of a company operating in an industry that I knew nothing about and subsequently didn’t enjoy”.

However, the more familiar you are with the sector, the greater the potential for conflict of interest and, where significant, such conflicts will present an insurmountable barrier to appointment. Obvious conflicts of interest include companies working in the same sector or providing a similar service; but equally conflicts can arise when company strategies collide and a strategic acquisition by one of your companies can create a conflict with another.

The importance of due diligence

Probably the most important task you need to complete prior to joining any Board is to undertake extensive due diligence. You need to ensure that you gain a comprehensive understanding of the business and the culture that pervades, its financial performance and funding, its strategy, and the experience, standing and reputation of the Executives and Chairman. Due diligence can take many forms, including speaking to the auditors, brokers and other advisers to the company.

“I did withdraw from one opportunity the day before the appointment because I could not match the profit record with the management accounts cash flow. My timing was terrible and I felt I had let the Chairman down but the company was in administration within six months - so right decision, if awkward at the time. I have always started with cash flow since”.

Some individuals enjoy the hands-on nature that a company in turnaround can present, and indeed their experience in corporate transformation or refinancing can be of huge benefit to a company facing significant issues. However, knowing that you are joining a company in turnaround is very different to discovering that you have unwittingly joined a sinking ship and the breakdown in trust and openness that is implied.

Use your own contacts and networks, including headhunters and advisers, to sound out the opportunity, to gain their perspective on the company, the board and its reputation. Speak informally to your contacts within their customer base or their suppliers to gain a wider picture and even to their competitors to develop a comprehensive picture on the company.

“I always try to speak to the previous Non-Executive Directors if possible. History has a habit of repeating itself.”

Chapter 3 - Top issues to understand before accepting appointments
As well as understanding the financial position of the company, the quality and balance of the Board is vital. Take time to understand the individuals concerned, their reputation, track record and the culture that prevails. Is it an open and transparent culture? Is the CEO open to being influenced? Is there an effective and constructive relationship between the CEO and Chairman? Do you understand their principles, priorities, ambitions and egos? Essentially, do you trust the key individuals concerned and is it a team you want to play for?

“The Chairman is the key differentiator to an effective Board. The way that they chair and set the agenda defines the tone and inclusiveness”.

Chapter 7 of this Guide provide more detail regarding the various individuals comprised within the Board and their respective roles, including the roles of Chairman and CEO.

Due diligence checklist

Whilst not comprehensive, due diligence can include gaining information on the company, its financial position, strategy, principal risks and shareholder profile. As importantly, you need to do your own research on the key individuals concerned, their reputation, the quality of the Board and the culture that prevails. Due diligence is gained from a variety of sources including:

- annual reports
- company announcements
- company website
- analyst and rating agency reports
- company advisers including auditors, brokers, lawyers and headhunters
- press coverage
- contacts you may have with the organisations competitors, suppliers or customers
- previous directors of the company
- shareholders

And when you join...
The induction programme

As a new Non-Executive Director, you should take time to understand from the Chairman and the Company Secretary what the induction programme contains to enable you to get up to speed quickly with the key issues facing the company. An effective induction programme will take up considerable time during your first year as you visit the operational sites and meet and spend time with the Executive Directors and key management to understand the company better. Working with the Chairman to tailor your induction programme for your needs can be helpful. If functional specialists are crucial to the success of a company, make sure you make time to meet them to understand their key issues. For instance, if the company has a complicated debt structure, meet the Treasurer, Head of Tax, etc.

“Is the Board size effective? Too large and I will be one voice amongst many, too small and the demands on me will be greater”.

You will need to have read the previous Board minutes, understand the key projects and priorities that the Board are considering and the nature and personalities of your fellow Board colleagues. If you are new to the listed company environment, you may need additional support to understand the dynamics and interactions of the various advisers in and around the Board. If you are less experienced in financial management, spend more time with the CFO to understand the key issues to enable you to contribute rather than feel as if you are staring into a void. Many of the larger audit firms run training programmes and seminars on a range of issues pertinent to Non-Executive Directors.

You also need to ensure that you understand the Board committees, risk management policies and procedures and that you are covered by the company’s Directors and Officers (D&O) liability insurance. The Company Secretary will often be at hand to provide you with all the information you require and the Chairman is often actively involved in ensuring that you, as a new Non-Executive Director, are able to understand the business and their issues quickly to enable you to contribute effectively.

“Do not rush into your first role. This role will define you and your early non-executive success may be defined by the opinion of that first Chairman.”
Chapter 4 - What makes a successful Non-Executive Director?

What to do...

“Think carefully when choosing your first Non-Executive Director position - it plays a crucial role in shaping your future portfolio”.

Realising your ambition to be a Non-Executive Director is often a great achievement in itself. However, ensuring that you are successful in transitioning effectively to the role is often easier said than done. Based on the wide-ranging experience and advice provided by the experienced Non-Executive Directors and Chairmen who have contributed to this Guide, we highlight some of the attributes that successful Non-Executive Directors tend to demonstrate:

- a degree of self-knowledge - they know who they are and how they are perceived by others
- team spirit, with a low ego and a desire to make others successful, rather than themselves
- strong and effective relationship management skills

“Being a Non-Executive Director is a unique role. You come together a few times a year with people from different backgrounds, agendas and styles and need to be able to fit in quickly and contribute effectively”.

- ease and comfort in handling ambiguity
- self-confident style, yet ability to demonstrate humility
- willingness to take the tough decisions
- lack of embarrassment about asking the simple questions
- an enthusiasm, for and an interest in, the business
- patience and an ability to “seed and water” an idea

“It’s all about emotional intelligence – the ability to listen, challenge constructively and build trust with your fellow directors quickly”.

- An interest in strategy, people and performance
- Intelligence, incisiveness and an ability to identify the key issues and priorities quickly
- Financial literacy and good analytical skills based on data and fact combined with an experienced “sense of smell”
- Independence of the Executive Directors and of the Chairman and being there on their own merits

“As a Non-Executive Director it is OK to ask for evidence”.

- ability to effectively balance the challenge and supportive nature of the role
- ability to think strategically

“Brains – strong analytical skills and the ability to understand complex issues...

Bravery – strong in questioning and perseverance if not happy with the response...

Balance – be pragmatic, the world is not a perfect place.”

...and what not to do...

However, like it or not, some individuals are less suited to the role of a Non-Executive Director. The habits and behaviour they tend to demonstrate that are less well received include:

- not being prepared for the Board meeting, neither having read the papers nor understood the issues
- lack of contribution to the debate – does the Non-Executive Director not understand the issue, is not engaged or just not interested in the company?
- a tendency to talk too much, hog the debate, pontificate or show little care for others’ opinion
- overreaction and jumping in too quickly

“Being in ‘receive’ as well as ‘transmit’ mode makes a more effective Non-Executive Director”.

- being too hesitant, nervous or cautious
- straying into the Executives’ territory, telling rather than influencing
- not appreciating the difference between opinion and fact
- sulking when they lose an argument

“It’s a job and those who do not approach it as such are the ones to watch out for”.

- frequently being distracted by mobiles or emails
- becoming identified with a singular agenda and not letting it go
- not commanding the respect of their peers

“A raised eyebrow or a distinct change of tone when a Non-Executive speaks is a warning sign that they have lost the respect of the Board”.

Chapter 4 - What makes a successful Non-Executive Director?
Chapter 5 - And finally...

The insight and advice of those who have contributed to this Guide have been invaluable. When asked what would be the most important piece of advice they would wish to impart to an individual taking on a new Non-Executive role, the following observations were made...

• be prepared for the unknown
• take time to build your relationships

“Trust your instincts – first impressions are usually spot on”.

• don’t think you need to make a contribution from day one – take time to understand the key issues and don’t jump to early conclusions
• don’t short-cut the due diligence – once you join, it can be hard to leave
• be really clear why you are doing this and why it is of benefit to you – what value do you bring and what experience will you gain? Make sure it’s a win-win

“Think about your Non-Executive role as a logical building block that builds on the experience you have and enables you to shape and influence your career as you wish”.

• get feedback from your Chairman after your first year and ask yourself if you are really adding value
• don’t be afraid to put your head above the parapet to ask the awkward question
• be absolutely certain you trust the Executives
• ensure you focus on the key issues

“Make sure the culture is right – it drives everything”.

• if going plural, recognise that you will lose your PA just when you need them to cover diary management, admin and travel arrangements
• initially focus on listening and understanding rather than contributing
• understand the character and relationships of the others on the Board – not their caricatures
• have humility and don’t take yourself too seriously
• make sure of your facts before speaking

“There will be a moment when you don’t agree with something. If it is about the way an action is being implemented – keep quiet and don’t teach the Executives to suck eggs. If it is about the decision to do something, speak out”.

• is it a company you are interested in and can be passionate about?
• be respectful of the company and go with the flow of the business

“I do not have a plural career. Rather I am a Multiplex Director with something happening on every screen. Hopefully, not all are showing horror movies….”

“It is a great privilege to be in someone else’s boardroom. A Non-Executive Director occupies a special place to influence rather than provide direction”.

“Make sure the culture is right – it drives everything”.

• if going plural, recognise that you will lose your PA just when you need them to cover diary management, admin and travel arrangements
• initially focus on listening and understanding rather than contributing
• understand the character and relationships of the others on the Board – not their caricatures
• have humility and don’t take yourself too seriously
• make sure of your facts before speaking

“There will be a moment when you don’t agree with something. If it is about the way an action is being implemented – keep quiet and don’t teach the Executives to suck eggs. If it is about the decision to do something, speak out”.

• is it a company you are interested in and can be passionate about?
• be respectful of the company and go with the flow of the business

“I do not have a plural career. Rather I am a Multiplex Director with something happening on every screen. Hopefully, not all are showing horror movies….”

“It is a great privilege to be in someone else’s boardroom. A Non-Executive Director occupies a special place to influence rather than provide direction”.

“Make sure the culture is right – it drives everything”.

• if going plural, recognise that you will lose your PA just when you need them to cover diary management, admin and travel arrangements
• initially focus on listening and understanding rather than contributing
• understand the character and relationships of the others on the Board – not their caricatures
• have humility and don’t take yourself too seriously
• make sure of your facts before speaking

“There will be a moment when you don’t agree with something. If it is about the way an action is being implemented – keep quiet and don’t teach the Executives to suck eggs. If it is about the decision to do something, speak out”.

• is it a company you are interested in and can be passionate about?
• be respectful of the company and go with the flow of the business

“I do not have a plural career. Rather I am a Multiplex Director with something happening on every screen. Hopefully, not all are showing horror movies….”

“It is a great privilege to be in someone else’s boardroom. A Non-Executive Director occupies a special place to influence rather than provide direction”.

“Make sure the culture is right – it drives everything”.

• if going plural, recognise that you will lose your PA just when you need them to cover diary management, admin and travel arrangements
• initially focus on listening and understanding rather than contributing
• understand the character and relationships of the others on the Board – not their caricatures
• have humility and don’t take yourself too seriously
• make sure of your facts before speaking

“There will be a moment when you don’t agree with something. If it is about the way an action is being implemented – keep quiet and don’t teach the Executives to suck eggs. If it is about the decision to do something, speak out”.

• is it a company you are interested in and can be passionate about?
• be respectful of the company and go with the flow of the business

“I do not have a plural career. Rather I am a Multiplex Director with something happening on every screen. Hopefully, not all are showing horror movies….”

“It is a great privilege to be in someone else’s boardroom. A Non-Executive Director occupies a special place to influence rather than provide direction”. 
Part 2:
The small print...
Chapter 6 - What is a director?

Definition

In short, a director is a person responsible for managing the affairs of a company who sits on the Board of directors of the company.

A statutory director is a director who is registered as such at Companies House. However, the fact that a person is not registered as a statutory director does not necessarily mean that he or she is not subject to the same responsibilities and duties as a statutory director. The Companies Act 2006 states that, for its purposes, a “director” includes any person occupying the position of a director, by whatever name called.

The Companies Act 2006 also provides for the concept of a “shadow director”, being a person in accordance with whose directions or instructions the directors of the company are accustomed to act. Shadow directors are, for many purposes, to be treated as directors.

Distinction between Executive and Non-Executive Directors

There is no statutory definition of an “Executive Director” or a “Non-Executive Director”. The collective understanding of what these two roles mean and represent has been developed via case law, corporate governance guidance and general market practice.

A “Non-Executive Director” is generally understood to be a director on the Board who does not form part of the executive management team and is not an employee of the company. Non-Executive Directors are expected to devote part, but not all, of their time to the company and their role is generally to provide an advisory or supervisory element to the Board, scrutinising and challenging the company’s strategy and management. By contrast, an “Executive Director” is typically an employee of the company who holds a senior management and executive role within the business.

Roles and responsibilities

In law, no distinction is recognised between the role and responsibilities of a Non-Executive Director and those of an Executive Director. Both types of director are subject to various statutory obligations, duties and responsibilities which are discussed in more detail later in this Guide. However, in practice, Non-Executive Directors and Executive Directors bring very different, but equally important, qualities and attributes to the table. Some of the key attributes which companies look for in a Non-Executive Director have been highlighted in Chapter 2 of this Guide.

The UK Corporate Governance Code (discussed further in Chapters 7, 9 and 10 of this Guide) states that “Non-Executive Directors should constructively challenge and help develop proposals on strategy”. More specifically:

“Non-Executive Directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of Executive Directors and have a prime role in appointing and, where necessary, removing Executive Directors, and in succession planning”.

What this means will be explored in more detail throughout this Guide.

Status - employee or contractor

Non-Executive Directors are usually appointed under a letter of appointment. This does not usually constitute an employment contract and Non-Executive Directors are therefore generally deemed to be “officers” of the company. They receive their remuneration by way of fees rather than a salary. These fees are subject to income tax and class 1 NI contributions like a salary. As part of the appointment process, Non-Executive Directors should consider their own tax status and tax arrangements.

Non-Executive Directors are covered by the UK anti-discrimination legislation, which includes age discrimination. However, certain other rights which are only available to employees do not apply to Non-Executive Directors. The most notable point is that Non-Executive Directors cannot bring a claim for unfair dismissal even though they can bring a claim for breach of contract regarding their terms of appointment.
Chapter 7 - Board composition

Having considered in the previous chapter what a director actually is, it is also important to understand who should sit on the Board and what makes an effective Board.

The UK Corporate Governance Code (the “Code”) provides guidance on the appropriate composition of a Board of a UK listed company. The Code is discussed in more detail in Chapter 10 of this Guide in the wider context of corporate governance more generally. However, this Chapter refers where appropriate to specific provisions of the Code where relevant to the issues of Board composition.

While the Code is only binding for public companies with a premium listing and some sections only apply to companies included on the FTSE 350, many companies included on AIM choose to comply with the Code (or parts of it) in the interests of best practice.

Overview

The Code provides that each listed company should be headed by an effective Board which is collectively responsible for the long-term success of the company. The Board should set the company’s strategic aims, its values and standards, and ensure that its obligations to its shareholders and others are understood and met.

The Board’s role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The Code provides guidance on the appropriate composition for Boards. The Financial Reporting Council (“FRC”) also published Guidance on Board Effectiveness in March 2011 (the “FRC Guidance”). This Chapter summarises some of the key relevant provisions of the Code and the FRC Guidance.

Board composition

One of the main principles of the Code is that:

“The Board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.”

Underlying this principle are more detailed supporting principles, including that the Board should be of sufficient size that the requirements of the business can be met and should not be so large as to be unwieldy. The Board should include an appropriate combination of Executive Directors and Non-Executive Directors such that no individual or small group of individuals can dominate the Board’s decision taking.

What this means in practice is that the Board should be of the appropriate size and shape, with the right mix of individuals and roles, for the particular business of the company in question. For FTSE 350 companies, at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent. A smaller company should have at least two independent Non-Executive Directors.

Recent trends show an increasing diversity of Boards, diversity being used in its broadest sense to include different sector experience and functional backgrounds as well as gender.

“Both breadth of experience, background and skills and deep sector/financial expertise are needed in the Non-Executive Director group taken as a whole. Even when looking for deep sector or functional expertise, ideally the Non-Executive Director should also bring breadth.”

Independence

Independence of thought is of particular importance to independent Non-Executive Directors, part of whose role is to provide an independent viewpoint on the Board and, when necessary, to challenge the Executive.

“Non-Executives need to be bravely independent and not swayed by the Executives.”

Non-Executive Directors are considered to be independent when the Board determines that they are independent in character and judgement, and that there are no relationships or circumstances which are likely to affect, or could appear to affect, their judgement. The Code sets out various relationships or circumstances that would usually be relevant to the Board’s determination of independence, including if the director:

- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either as a director, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
• has received or receives additional remuneration from the company apart from a director’s fee, participates in the company’s share option or a performance-related pay scheme, or is a member of the company’s pension scheme;
• has close family ties with any of the company’s advisers, directors or senior employees;
• holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
• represents a significant shareholder; or
• has served on the Board for more than nine years from the date of first election.

The Chairman

The Chairman is responsible for leadership of the Board and ensuring its effectiveness and the role is therefore pivotal to a well-functioning Board. The Chairman sets the style and tone of the Board.

“Good Boards are created by good Chairmen.”

The Chairman sets the Board’s agenda and ensures adequate time is available for discussion of all agenda items, in particular strategic issues. The Chairman should also promote a culture of openness and debate by facilitating the effective contribution of Non-Executive Directors in particular, and ensuring constructive relations between Executive and Non-Executive Directors. It is incumbent on him or her to ensure appropriate debate takes place. The Chairman’s working relationship with the CEO is of particular importance, where he or she needs to provide support and advice, whilst respecting the executive responsibility and retaining independence of thought. The Chairman is also responsible for ensuring that directors receive accurate, timely and clear information and should ensure effective communication with shareholders.

On appointment, the Chairman should meet the independence criteria. The CEO should not go on to be Chairman of the same company. However, if, exceptionally, a Board decides that a CEO should become Chairman, the Board should consult major shareholders in advance and explain its reasons.

The roles of the Chairman and CEO should not be exercised by the same individual as no one person should have unfettered decision making powers. There should be a clear division of responsibilities between the Chairman’s role of running the Board and the CEO’s executive responsibility for the running of the business.

The Chief Executive Officer (CEO)

The CEO has responsibility for proposing strategy to the Board and delivering against the agreed strategy. The CEO also has responsibility for communicating to the company’s employees the expectations of the Board in relation to the company’s culture, value and behaviours.

Non-Executive Directors

The attributes expected of a Non-Executive Director are outlined in Chapter 2 of this Guide. In addition, the Code provides guidance on the role of Non-Executive Directors, stating that they are expected to constructively challenge and help develop proposals on strategy, to scrutinise management performance and to satisfy themselves on the integrity of financial information and that financial controls and risk management systems are robust and defensible. It is expected that the Non-Executive Directors will hold separate meetings without Executive Directors or the Chairman present. Non-Executive Directors will have to undertake to the company that they have sufficient time to fulfil the role, and must disclose any other commitments or future new appointments.

The Senior Independent Director

One of the independent Non-Executive Directors should be appointed as the Senior Independent Director to provide a sounding board for the Chairman, to serve as an intermediary for the other directors and to be available to shareholders as necessary. During periods of stress within the Board, the Senior Independent Director will be expected to work with the Chairman, the other directors and shareholders to resolve significant issues, such as when there is a dispute between the Chairman and CEO; or when shareholders or Non-Executive Directors have expressed concerns that are not being addressed by the Chairman or CEO.

Committees

While the Board remains ultimately responsible for the management of the company, it may make use of committees to assist in various aspects of management. Committees are very important in many companies’ decision-making structures. As such, it is important to recruit Non-Executive Directors with the necessary technical skills and knowledge relating to the committees’ subject matter, as well as the potential to assume the role of committee Chairman. The Code also emphasises that there is value in ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals.
The most common committees are the Audit, Nomination and Remuneration Committees, each of which is discussed in brief below. Increasingly companies are also establishing Risk Committees, particularly in the financial services sector.

The Chairman should ensure that sufficient time is allowed at the Board for discussion of committee issues and recommendations.

**Nomination Committee**

The Nomination Committee leads the process for Board appointments and makes recommendations to the Board, following which it is then for the Board formally to approve any appointment. A majority of members of the Nomination Committee should be independent Non-Executive Directors. The Nomination Committee or the whole Board should evaluate the balance of skills, experience, independence and knowledge on the Board and, in light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

There is increasing emphasis on ensuring diversity within the Board and the Code now provides that the section of the annual report which describes the work of the Nomination Committee should include a description of the Board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.

**Remuneration Committee**

The objective of the Remuneration Committee is to ensure a formal and transparent procedure for developing policy on Executive remuneration, to fix the remuneration packages of individual directors and to ensure that no director is involved in deciding his or her remuneration. The Remuneration Committee should have at least three, or in the case of smaller companies two, independent Non-Executive Directors. It is the task of the Remuneration Committee to strike a balance between packages that will attract, retain and motivate the quality of Executive Directors that the company needs, and paying more than is necessary for the purpose. A significant proportion of remuneration for Executive Directors should be performance-related, and should be structured so as to link rewards to corporate and individual performance. The definition of “senior management” should be determined by the Board but it should normally include the first layer of management below Board level. The Committee should be responsible for appointing any consultants in respect of Executive Director remuneration.

Shareholders should be invited to approve all new long-term incentive schemes and significant changes to existing schemes. Given increasing shareholder interest in and disagreements over Executive pay, keeping shareholders informed and on-side is becoming increasingly important and time consuming for Chairmen of Remuneration Committees.

**Audit Committee**

It is the Board’s responsibility to present a balanced and understandable assessment of the company’s position and prospects in all financial and business reporting. The Audit Committee has delegated responsibility to establish formal and transparent arrangements for applying corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company’s auditors.

The Audit Committee should monitor the integrity of the financial statements and any significant financial reporting judgements; review the internal financial control and risk management control systems; review the scope and effectiveness of the audit, and the independence and objectivity of the auditors; and develop policy on the supply of non-audit services by the external audit firm.

The Audit Committee should consist of at least three, or in the case of smaller companies two, independent Non-Executive Directors. The Board should satisfy itself that at least one member of the Audit Committee has recent and relevant financial experience. It is desirable, but not an absolute requirement, for that member to have a professional qualification from one of the professional accountancy bodies.

Independence is particularly important for members of the Audit Committee as members should be able to challenge the Executive and express views which may differ from those of the management in an unrestricted manner.

**Risk Committee**

Listed companies are increasingly establishing Risk Committees, particularly in the financial services sector. The Walker Review (referred to in Chapter 10 of this Guide) recommended that Boards of FTSE 100 banks and financial institutions should establish a Risk Committee with responsibility for oversight and advice to the Board on current risk exposure and future risk strategy. Risk Committees are not always appropriate for all non-financial companies and therefore they have not been incorporated as a Code recommendation.
Chapter 8 - Board effectiveness

The Board’s role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed.

One of the key elements of Board effectiveness is appointing directors who are able to make a positive contribution. The FRC Guidance highlights the importance of having the right skill sets present in the boardroom in maximising the opportunities for the company’s success in the long term. Non-Executive Directors should possess critical skills of value to the Board and relevant to the challenges facing the company. Given that challenge as well as teamwork is essential, the FRC Guidance states that an effective Board should not necessarily be a comfortable place.

Diversity in Board composition is an important driver of a Board’s effectiveness, creating a breadth of perspective, and breaking down a tendency towards ‘group think’.

The FRC Guidance stresses the importance of considering a diversity of personal attributes among Board candidates, including critical assessment and judgement, courage, openness, honesty and tact; and the ability to listen, forge relationships and develop trust. It also notes that diversity of psychological type, background and gender is important to ensure that a Board is not composed solely of like-minded individuals. A Board requires directors who have the intellectual capability to suggest change to a proposed strategy, and to promulgate alternatives.

How to recognise an effective Board

An effective Board develops and promotes its collective vision of the company’s purpose, its culture, its values and the behaviours it wishes to promote in conducting its business. It has collective responsibility for achieving these goals. In particular the FRC Guidance suggests that an effective Board:

- provides direction for management;
- demonstrates ethical leadership, displaying – and promoting throughout the company – behaviours consistent with the culture and values it has defined for the organisation;
- creates a performance culture that drives value creation without exposing the company to excessive risk of value destruction;
- makes well-informed and high-quality decisions based on a clear line of sight into the business;
- creates the right framework for helping directors meet their statutory duties under the Companies Act 2006, and/or other relevant statutory and regulatory regimes;
- is accountable, particularly to those that provide the company’s capital; and
- thinks carefully about its governance arrangements and embraces evaluation of their effectiveness.

“Non-Executives need to challenge without putting people’s backs up, and be supportive rather than try to score points.”

An effective Board challenges the executive appropriately. Well-informed decision-making is key to an effective Board. Poor decision making is not necessarily indicative of flawed motives or intentions, however, poor decision making can be minimised if Boards invest time and thought in the design of their decision-making policies and processes, including the contribution of committees.

High quality and timely Board documentation is key, as is allowing sufficient time for debate and challenge, particularly for complex, contentious and business critical issues. Clarity on the timescales and responsibilities for actions agreed is also vital.
Factors which can limit effective decision-making

The FRC Guidance states that Boards should be aware of factors which can limit effective decision making, such as:

- a dominant personality or group of directors on the Board, which can inhibit contribution from other directors;
- insufficient attention to risk, and treating risk as a compliance issue rather than as part of the decision-making process, especially in cases where the level of risk involved in a project could endanger the stability and sustainability of the business itself;
- a reluctance to involve Non-Executive Directors;
- matters being brought to the Board for sign-off rather than debate;
- complacent or intransigent attitudes;
- a weak organisational culture; or
- inadequate information or analysis.

In addition, it is worth noting the following factors which can limit a Board’s effectiveness:

- a Chairman who leads with his or her opinion rather than asking others for comments before giving any views;
- “group-think”/lack of diversity;
- failure to give Non-Executive Directors the opportunity to express their views and questions; and
- too much information which does not focus on key issues or obscures the real issues.

Some factors known to distort judgment in decision making are conflicts of interest, emotional attachments, and inappropriate reliance on previous experience and previous decisions. Boards may, therefore, consider additional safeguards for major decisions.

“There is one Board I regret joining and looking back there were the warning signs I should have spotted - the Chairman was difficult and arrogant and the Chairman/CEO dynamic was not good.”

Board evaluation

The principle that a Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors is laid out in the Code. For FTSE 350 companies the recommendation is that the evaluation should be externally facilitated at least every three years.

It is the responsibility of the Chairman to act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the Board. Individual evaluations aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role, which includes appropriate commitment of time. The Non-Executive Directors, led by the Senior Independent Director, are responsible for the performance evaluation of the Chairman, taking into account the views of the Executive Directors.

“Even for a well-functioning Board, the evaluation process provides useful time for reflection.”

“In my opinion, a Non-Executive adds the greatest value after their first year and before their sixth year. During their first year, they are learning about the business and the issues. After their sixth year they are less likely to challenge having contributed to previous decisions.”
Chapter 9 - Appointment terms and fees

Selection/appointment procedure

The Code states that there should be a formal, rigorous and transparent procedure for the appointment of new directors. As noted in Chapter 7, the Nomination Committee should lead the appointment process and make recommendations to the Board based on merit, against objective criteria and with due regard for the benefits of diversity on the Board (including gender).

Significant time commitments of a prospective new director must be disclosed to the Board before the appointment, including an indication of the amount of time involved, and the Board should be informed of any subsequent changes in those commitments. In the case of the appointment of a new Chairman, a job specification should be prepared, including an assessment of the time commitment required, and the Chairman’s other time commitments should be disclosed in the annual report.

The Nomination Committee and the Board will need to consider whether the prospective director can be treated as independent for Code purposes, as FTSE company Boards need to meet Code requirements in relation to the number of independent Non-Executive Directors on the Board. Whether or not a director is independent also impacts on whether the prospective director can, under the Code provisions, be a member of the various Board committees as an independent Non-Executive Director. Chapter 7 of this Guide provides further information about determining the independence of a director.

Once a new director has been selected, there will usually be a meeting of the Nomination Committee to approve the proposed appointment and recommend the appointment to the Board. The Board will then need to approve the appointment, including terms of appointment, fees and any conflicts of interest which the new director may have (for example in relation to other appointments or interests). The appointment will usually also need to be approved by shareholders at the next general meeting.

Under the Listing Rules, the company must announce a new Board appointment via a regulatory information service (RIS) as soon as possible, and by no later than the end of the business day after it has made any decision on the appointment of a new director. The company must also announce, either at the same time or within five business days of the decision, certain details relating to any new director, including details of all directorships held in any other publicly quoted companies and details (if any) in relation to any liquidations or administrations of companies of which he or she was a director.

Remuneration/share options

General

The Code provides that levels of remuneration for Non-Executive Directors should reflect the time commitment and responsibilities of the role. As mentioned in Chapter 6 of this Guide, Non-Executive Directors receive fees rather than a salary. However, they may receive some of their remuneration in shares.

Payment in shares

While payment in shares is not expressly dealt with in the Code, the Higgs Review (see Chapter 10 for more information) recommended that Non-Executive Directors should have the opportunity to take part of their remuneration in the form of shares.

The ABI principles of remuneration published by the Association of British Insurers state that shareholders should encourage Non-Executive Directors to be remunerated in shares bought at market price. The rationale for permitting this is that it creates an alignment of interests between the Non-Executive Directors and the company’s other shareholders as they are both exposed to share price fluctuations.

However, it should be noted that the Model Code (discussed further in Chapter 12 of this Guide) limits the circumstances in which directors (and certain other persons) can deal in shares. The Model Code is annexed to chapter 9 of the Listing Rules (also discussed further in Chapter 12 of this Guide). Under the Listing Rules, every listed company must require its directors (and certain other persons) to comply with the Model Code. Under the Model Code a director may, among other things, enter into arrangements in which shares in the company are purchased or acquired by way of part payment of a director’s remuneration.

The arrangement cannot be entered into during a “prohibited period” (being a specified “close period” or any period in which there exists any price sensitive information relating to the company) unless it is entered into upon the director’s appointment to the Board.
In addition, the director must not carry out the purchase of shares under the arrangement during a prohibited period unless the arrangement was entered into at a time when the company was not in a prohibited period and the director is irrevocably bound under the terms of the arrangement to carry out the purchase of shares at a fixed point in time which falls in a prohibited period.

The director must obtain clearance from the Chairman (or director designated by the Board for this purpose) under the Model Code before carrying out any share sales or entering into, cancelling or varying the terms of any arrangement to buy shares in the company.

Share options

The Code states that remuneration for Non-Executive Directors should not include share options or other performance-related elements. The logic for this is that, as noted above, while allowing a director to acquire shares in the company creates an alignment of interests between directors and shareholders, the granting of options to directors does not result in a loss to the directors if the share price falls. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the Non-Executive Director leaves the Board. Holding of share options could also be relevant to the determination of a Non-Executive Director’s independence. It is worth noting that option schemes or other performance-related share awards for Non-Executive Directors may also attract criticism from institutional investors.

Time commitment

The Code states that the letter of appointment of a Non-Executive Director should set out the expected time commitment. Non-Executive Directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the Board before appointment, with a broad indication of the time involved and the Board should be informed of subsequent changes.

The FRC Guidance recommends that the letter should also indicate the possibility of additional time commitment when the company is undergoing a period of particularly increased activity, such as an acquisition or takeover, or as a result of some major difficulty with one or more of its operations.

In relation to the Chairman, specifically, the Code states that:

“For the appointment of a Chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A Chairman’s other significant commitments should be disclosed to the Board before appointment and included in the annual report. Changes to such commitments should be reported to the Board as they arise, and their impact explained in the next annual report.”

The FRC Guidance also recommends that Non-Executive Directors should, on appointment, devote time to a comprehensive, formal and tailored induction which should extend beyond the boardroom. It suggests that initiatives such as partnering a Non-Executive Director with an Executive Director may speed up the process of him or her acquiring an understanding of the main areas of business activity, especially areas involving significant risk. The director should expect to visit, and talk with, senior and middle managers in these areas.
Term and reappointment

The Code provides that Non-Executive Directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director. Any term beyond six years for a Non-Executive Director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the Board.

The Code separately provides that notice periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.

In terms of re-election, the Code provides that all directors of FTSE 350 companies should be subject to annual election by shareholders. All other directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. Non-Executive Directors who have served longer than nine years should be subject to annual re-election. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election. The Board should set out to shareholders in the papers accompanying a resolution to elect a Non-Executive Director why they believe an individual should be elected. The Chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual’s performance continues to be effective and to demonstrate commitment to the role.

Plurality of appointments

The Code states that a full-time Executive Director should not take on more than one Non-Executive directorship and should not become Chairman of a FTSE 100 company.

There is no guidance on the maximum number of Non-Executive directorships an individual who is not in full time employment should hold. Derek Higgs expressly did not include such guidance in his report as he deemed it “arbitrary and unrealistic”, because different appointments have such varied levels of time commitment involved. Consideration of a prospective Non-Executive Director’s time capacity is certainly a factor and the trend is towards individuals holding fewer appointments overall.
Chapter 10 - UK Corporate Governance Code

Corporate governance is of ever-increasing importance to listed companies and to investors. The core principles of corporate governance best practice are set out in the Code which has been supplemented by related guidance.

Brief history of corporate governance in the UK

Corporate governance is a relatively new concept. 20 years ago, few companies would have considered it to be a strategically important issue. The first formal corporate governance guidance appeared in the UK in form of a report called ‘The financial aspects of corporate governance’ (usually known as the Cadbury Report). Published in December 1992, this contained a number of recommendations as to how the standards in corporate governance could be raised. However, it was not until the corporate scandals of the early 2000s, such as Enron and Worldcom, that the topic gained a wider public profile. Some key milestones of the development of corporate governance in the UK are set out below and illustrate the relatively swift development of a structured corporate governance code of conduct, compliance with which is viewed as best practice by both listed companies and, to a lesser extent, other traded and public companies throughout the UK.

The Turnbull Report

In September 1999 the Institute of Chartered Accountants of England and Wales published guidance on internal controls (the Turnbull Report). This guidance provided assistance to directors of listed companies on implementing the internal control recommendations set out in the Combined Code, helping them to ensure that they have in place effective risk management and internal control systems. An updated version of the Turnbull Report was published in 2005.

The Higgs/Smith Report

In April 2002, Derek Higgs was asked by the government to review the role and effectiveness of Non-Executive Directors. Sir Ronald Smith was asked to develop further guidance for the benefit of audit committees. Their reports were published in 2003. As a result of these reports, the FRC, the UK’s independent regulator responsible for promoting confidence in corporate reporting and governance, approved the final text of the Combined Code in 2003.

Amendments to the Combined Code

During 2005 the FRC reviewed the Combined Code and began consulting in 2006 on the possibility of making some changes to the Combined Code. The result was the amended Combined Code published in 2006, which was subsequently amended in 2008 and again in 2010.

The Walker review

On 16 July 2009, HM Treasury published an independent review of corporate governance in UK banks and other financial institutions. The review was conducted by Sir David Walker. The report was open for consultation until October 2009 and the final report was published in November 2009. Most of the recommendations were implemented by inclusion into the Code.

Who does the Code apply to?

The Code applies to all companies with a premium listing of equity shares in the UK, regardless of whether they are incorporated in the UK or elsewhere, with reporting years beginning on or after 29 June 2010. In practice, this means that most companies began to apply the Code in 2011.

These companies should include a statement in their annual financial reports indicating how they apply the principles of the Code. There are also parts of the Code which apply only to FTSE 350 companies, for example the provisions on annual re-election of directors and external facilitation of Board evaluations.

As noted in Chapter 7, while the Code is only binding for public companies with a premium listing and some sections only apply to companies included in the FTSE 350, many companies traded on AIM choose to comply with the Code (or parts of it) in the interests of best practice.
Structure of the Code

The Code is not a set of rigid rules and so non-compliance with certain of its provisions may be justified if good governance can be achieved by other means. The Code consists of principles of good governance dealing with the following areas:

- leadership (the role of the Board; division of responsibilities; the Chairman; and Non-Executive Directors);
- effectiveness (the composition of the Board; commitment; development; information and support; evaluation; and re-election);
- accountability (financial and business reporting; risk management and internal control; and audit committee and auditors);
- remuneration (the level and components of remuneration; and procedure); and
- relations with shareholders (dialogue with shareholders; and constructive use of the AGM).

Issues covered by “leadership”, “effectiveness” and “accountability” above are addressed in Chapter 7 of this Guide. “Remuneration” and the provisions of the Code regarding appointment and re-appointment of Non-Executive Directors are addressed in Chapter 9 of this Guide. For completeness, those provisions of the Code which relate to “relations with shareholders” are summarised below.

Relations with shareholders

The Code provides that there should be a dialogue between a company and its shareholders, based on the mutual understanding of objectives, and that the Board should use the Annual General Meeting to communicate with investors and to encourage their participation. The annual report is also an important means of communicating with shareholders which can be used to provide disclosures on the company’s governance arrangements and the Board evaluation exercise.

The Senior Independent Director (see Chapter 7 of this Guide) should attend sufficient meetings with major shareholders to form a balanced understanding of shareholders’ issues and concerns. Non-Executive Directors should be offered the opportunity to attend scheduled meetings from time to time, and should expect to do so if requested by major shareholders. Major shareholders should be offered the opportunity to meet new Non-Executive Directors on appointment.

Companies should arrange for notices of annual general meetings to be sent to shareholders at least 20 working days before the meeting. At the meeting, the chairmen of each of the Board committees should be available to answer questions and should be encouraged to report personally about Board leadership and effectiveness in the corporate governance statement in the annual report.

The Code requires that a “vote withheld” option on proxy appointment forms should be provided to enable shareholders to indicate if they have reservations on a resolution but do not wish to vote against it and recommends that companies publish on their website the details of proxies lodged at a general meeting where votes are taken on a show of hands.

Institutional shareholders

Institutional shareholders have a responsibility to make considered use of their votes, and are expected to comply with the code of activism issued by the Institutional Shareholders’ Committee. Active participation by institutional shareholders in the affairs of the companies in which they invest is steadily growing.

Institutional shareholders should give careful consideration to explanations given by companies for departure from the Code. They should enter into a dialogue with the Company if they do not accept the Company’s position, and they should avoid a “box-ticking” approach to assessing the Company’s corporate governance.

Disclosures regarding compliance with the Code

The Listing Rules require listed companies to state in their annual report and accounts how they have applied the main principles of the Code. This allows some flexibility in adapting the application of the Code to particular circumstances. Listed companies must also state in their annual report and accounts whether or not they have complied with the Code provisions and, where they have not complied, give their reasons for such non-compliance. Certain information must be included in the company’s annual report and accounts although some of that information can be made available on the company’s website (for example the terms of reference of Board committees).
Under the Disclosure and Transparency Rules, a corporate governance statement must be included as a specific section in the directors report section of the annual report. This statement must contain reference to the relevant corporate governance code to which the company is subject (being the Code, for UK issuers) and all relevant information about the corporate governance practices applied over and above those required by national law. As under the Listing Rules, there is a requirement to state the extent to which the company departs from the code and its reasons for doing so. If the company complies with the Listing Rule requirements it will be deemed to comply with the majority of the Disclosure and Transparency Rule requirements. Under the Disclosure and Transparency Rules the corporate governance statement must contain a description of:

• the main features of the company’s internal control and risk management systems in relation to the financial reporting system;
• certain accounting information; and
• the composition and operation of the company’s Boards and committees.

Details of compliance with the Code and summaries of the terms of reference of the audit and remuneration committees must be disclosed under the Prospectus Rules in every prospectus issued by a company.
Chapter 11 - Roles and responsibilities (duties and liabilities)

Common law / fiduciary duties

For the most part, as noted in Chapter 6 of this Guide, there is no distinction between the duties of a Non-Executive Director and those of an Executive Director. Under common law, directors have historically been subject to a number of fiduciary duties. These were given a statutory footing under the Companies Act 2006. Sections 170-181 of the Companies Act 2006 contain a statutory statement of the general duties of a director. These statutory duties replaced the historical common law duties and equitable principles on which they are based.

Companies Act 2006

The duties and responsibilities of directors are owed to the company as a whole. The directors’ general duties are contained in sections 170 to 177 of the Companies Act 2006, being:

- Section 171 - Duty to act within powers as a company director (i.e. in accordance with the company’s constitution and to only exercise powers for the purposes for which they are conferred).
  As well as acting in accordance with the company’s articles of association, directors are required to act in accordance with decisions of shareholders, however taken, and of the Board. Thus, if the authority was given (or restricted) by the shareholders or the Board, then directors must act within such an authority (or restriction).
- Section 172 - Duty to promote the success of the company by acting in the way the director considers, in good faith, to be most likely to promote the success of the company for the benefit of its members as a whole. When doing this, the director must have regard to the following factors:
  - the likely consequences of any decision in the long term;
  - the interests of the company’s employees;
  - the need to foster the company’s business relationships with suppliers, customers and others;
  - the impact of the company’s operations on the community and the environment;
  - the desirability of the company maintaining a reputation for high standards of business conduct; and
  - the need to act fairly between the members of the company.
This duty is known as “enlightened shareholder value”. Although it replaced the common law duty to act bona fide in the best interests of the company, the terminology remains relatively new, and so it is not clear how existing case law will be used to interpret it.

At the time the new duty was introduced the UK government indicated that the decision as to what will promote the success of a company is for a director’s good faith judgement. In having regard to the relevant factors, a director will also be under the duty to exercise reasonable care, skill and diligence. Directors are advised to ensure that the company has adequate procedures in place so that if a challenge is brought, they are able to justify their decisions and the factors considered in reaching them.

- Section 173 - Duty to exercise independent judgment.
- Section 174 - Duty to exercise reasonable care, skill and diligence which would be exercised by a reasonably diligent person with both:
  - the general knowledge, skill and experience that may reasonably be expected of a person carrying out his or her functions in relation to the company (e.g. a Non-Executive Director who is a qualified accountant will be expected to have a greater understanding of a company’s accounts than a director (Non-Executive or Executive) who does not have this qualification) (i.e. an “objective” test); and
  - the general knowledge, skill and experience that the director actually has (i.e. a “subjective” test).
- Section 175 - Duty to avoid conflicts of interest.
A director must avoid a direct or indirect interest that conflicts, or may possibly conflict, with the company’s interests. A conflict can be authorised by the remainder of the Board who are independent of the conflict, provided, in the case of a public company, the company’s constitution specifically allows this and a special resolution has been passed.
Note that the duty to avoid conflicts does not apply to a conflict arising in respect of a transaction which the director seeks to enter into with the company - in such cases the duty to declare an interest in a transaction (referred to below) will apply instead.

• Section 176 - Duty not to accept benefits from third parties.
• Section 177 - Duty to declare interest in proposed transaction or arrangement with the company. The director must make such declaration in writing either at a Board meeting or by a specific or general notice to the other directors, and before the company enters into the transaction.

The Companies Act 2006 also contains a separate requirement in section 182 for directors to declare interests in existing transactions with the company (as opposed to proposed transactions under section 177). Breach of section 182 is a criminal offence.

The UK government has issued the following high-level guidance as to how directors should act to ensure compliance with their general duties. A director should:

- act in the company’s best interests, taking everything he or she thinks is relevant into account;
- obey the company’s constitution and decisions taken under it;
- be honest, and remember that the company’s property belongs to the company and not to the director or to its shareholders;
- be diligent, careful and well informed about the company’s affairs. If the director has any special skills or experience, he or she should use them;
- make sure the company keeps records of the director’s decisions;
- remember that the director remains responsible for the work he or she gives to others;
- avoid situations where the director’s interests conflict with those of the company. When in doubt he or she must disclose potential conflicts quickly; and
- seek external advice where necessary, particularly if the company is in financial difficulty.

### Former directors

Section 170(2) of the Companies Act 2006 provides that when a person ceases to be a director, he or she will continue to be subject to:

- the duty to avoid conflicts of interest with regards to the exploitation of any property, information or opportunity of which he or she became aware at the time when he or she was a director; and
- the duty not to accept benefits from third parties with regards to things done or omitted to be done by him or her before he or she ceases to be a director.

### Liability for breach

Breach of these general statutory duties leads to civil liability. Subject to certain specific exceptions, the effect of the duties is cumulative, so it is necessary to comply with every duty that applies in any given case. Compliance with one duty will not justify the breach of another.

A shareholder can bring a court action in relation to the breach on behalf of the company but needs to obtain the permission of the court before filing the claim. In certain circumstances, the court must refuse such permission - in particular, where it concludes that no person acting to promote the success of the company would continue the claim. Other factors the court must consider are whether the claim is brought in good faith and the opinions of shareholders who have no personal interest in the matter.

Where an act or omission has been ratified by the company’s shareholders (see below under “Relief from liability” for further information), it is no longer possible to bring a claim in relation to that act or omission.

### Practical consequences

In practice, the general statutory statement of directors’ duties must be carefully reviewed and adhered to by each director. In order to help protect a director from personal liability, due consideration of these duties needs to become embedded in the Board’s decision making and the culture of the company more generally.
It is strongly advisable for all directors (and relevant senior managers involved in taking decisions and preparing Board papers) to be given training on their duties and for the duties to be referred to in:

- Executive Directors’ service agreements;
- Non-Executive Directors’ letters of appointment;
- the terms of reference of any Board or committee; and
- Board packs circulated to directors prior to meetings.

In addition, although not every decision of a company will be minuted, in relation to key decisions it is advisable that Board minutes in some way recognise and reflect that proper consideration has been given to the statutory duties in the context of those matters to be resolved at the Board meeting. Ideally all the factors should have been considered prior to the relevant Board meeting at which the key decision is to be taken and therefore should not require detailed analysis within the Board minutes themselves.

To whom are directors’ duties owed?

Directors’ duties are owed to the company and not to the shareholders directly. However, sections 260 to 264 of the Companies Act 2006 provide a statutory right for shareholders to bring a derivative claim on behalf of the company against a director in the event of negligence, default or breach of duty or trust by a director.

What happens when a company is financially distressed

When a company gets into financial difficulties, at a certain point a director’s general duties to the company are replaced by a primary duty towards creditors. It is important for a director in such circumstances to take professional advice from a restructuring lawyer, and to take it in good time. Where a director knows or, taking into account his or her general knowledge, skill and experience, ought to conclude that there is no reasonable prospect of his or her company avoiding insolvent liquidation, the director then has a duty to advise the Board of this, and to ensure that every step is taken to minimise loss to creditors. Resignation as a director in these circumstances is generally inconsistent with this duty. Failure to fulfil this duty may, if there is eventually an insolvent liquidation, lead to a liquidator seeking a court order against a defaulting director to contribute to the assets of the company personally.

Duties to other third parties

Although a director owes his or her duties as a director only to the company, he or she may find in the course of carrying out those duties, that he or she has put himself or herself in a position where he or she also owes duties to other persons:

- a director may, in certain circumstances, owe a fiduciary duty, for example, to shareholders to be honest and not to mislead (e.g. in the context of recommending a takeover);
- a director is not normally liable in relation to contracts made between a company and third parties. However, a director may be personally liable if he or she had not made it clear during negotiations or in the contract itself that he or she was acting as an agent of the company and not in his or her personal capacity. He or she may also be personally liable if he or she makes fraudulent or negligent misrepresentations in the course of negotiating a contract involving his or her company. In such circumstances, he or she may also be liable to such company for any loss or damage suffered by it. A director is also personally liable for contracts entered into by his or her company with his or her knowledge or connivance where he or she knew, or ought to have known, that the company had no reasonable prospect of fulfilling its obligations;
• a director may be liable for losses suffered by third parties as a result of acts or omissions of the company or its employees or agents where it is shown that he or she committed, authorised, directed or procured or otherwise brought about the act or omission or because it occurred due to his or her negligence. Examples include breach of copyright, trespass and patent infringement. A director may also be liable for negligent misstatement if it can be shown that the director owes a duty of care to persons who rely on such statements and suffer loss as a result;

• a director of a company engaged in or facilitating the commission of a fraud may be personally liable and called to account for funds which have passed through such a company as if the director had actual knowledge of the fraud; and

• a director who consents to or connives at the non-payment by the company of national insurance contributions (or where the non-payment of such contributions is due to their neglect), will be guilty of a criminal offence.

**Relief from liability**

If a director is subject to personal liability in respect of an act or omission undertaken by him or her in his or her capacity as a director (which may extend to acts or omissions under the Companies Act 2006 or otherwise) there are a number of ways in which he or she may seek relief or release from liability.

• **Shareholder ratification** - Under the Companies Act 2006, the shareholders of a company have the ability by ordinary resolution (subject to any more stringent requirement - e.g. a special resolution - under the company’s articles of association) to ratify a director’s conduct amounting to negligence, default, breach of duty or breach of trust in relation to the company. The votes cast by a director or any shareholder connected with him or her in respect of any such resolution must be disregarded in determining whether the resolution is passed.

• **Court sanctioned** - A court may relieve a director wholly or partly from liability to a company (but not to third parties) if it appears to the court that he or she has acted honestly and reasonably and that, having regard to all the circumstances of the case, he or she ought fairly to be excused.

• **Indemnification** - It is permissible for a company to provide an indemnity for its directors against liabilities incurred by directors to third parties (and against liabilities incurred by directors in connection with a company’s activities as trustee of a qualifying pension scheme) and to provide funding in advance for the costs to be incurred by directors in defending proceedings against themselves, subject to certain conditions. Note that such an indemnity will not provide protection for a director in respect of fines imposed in criminal proceedings or penalties imposed by a regulatory authority. Nor will it provide protection to a director in defending any proceedings in respect of which the director is convicted, in defending any civil proceedings brought by the company (or an associated company) in respect of which judgement is given against the director, or in connection with certain applications for relief in respect of which the court refuses to grant the director relief. If such an indemnity is in force at the time the directors’ report in the annual report and accounts is approved (or has been in force during the financial year to which the directors’ report relates) the company must disclose this fact in such directors’ report.

• **Insurance** - It is also permissible, although not compulsory, for a company to purchase and maintain for its directors insurance (typically referred to as “directors’ and officers’” or “D&O” insurance) against civil liability for negligence, default, breach of duty or breach of trust. A D&O insurance policy will typically cover defence costs, awards and damages and settlements that the director is legally liable to pay but will not include criminal fines or penalties. The Code provides that companies with a premium listing of equity shares “should arrange appropriate insurance cover in respect of legal action against its directors”. As such, while such insurance is not legally required it is expected that listed companies will have such an insurance policy in place for its directors.
Other specific Companies Act 2006 requirements

There are also a large number of specific statutory requirements applicable to directors in addition to the general duties outlined above. While it is not intended to list all of them in this Guide, some of these additional requirements merit brief mention below.

- **Sections 215-222 - Payments for loss of office.** Shareholder approval is required for any:
  - payment to a director for loss of, or relating to retirement from, office or employment in connection with the management of the affairs of the company;
  - payment to a director for loss of office or employment in connection with the management of the affairs of any of the company’s subsidiary undertakings; and
  - any such payments which are made to persons connected with a director or made to any person at the direction of, or for the benefit of, a director or person connected with him or her.

Shareholder approval is not needed if payments are made in good faith: (a) in discharge, or by way of damages for breach, of an existing legal obligation; (b) by way of settlement or compromise of any claim in connection with the termination of a person’s office or employment; or (c) by way of a pension.

Payments for loss of office in connection with a takeover must also be disclosed in any offer document sent to shareholders.

- **Section 190 - Substantial property transactions.** Arrangements between the company and a director (or a connected person) in respect of a non-cash asset must be approved by the company’s shareholders in general meeting. The non-cash asset must be worth more than (1) £100,000 or (2) 10 per cent. of the company’s net assets (subject to a minimum threshold of £5,000), and includes any property, interest in property other than cash and the discharge of a liability. It is possible to enter into an arrangement without prior shareholder approval, provided such arrangement is conditional upon such approval being obtained.

- **Section 41 - Transactions involving directors.** Any transaction entered into by a company with a third party acting in good faith and which includes a director (or a connected person) as party to that transaction may be set aside at the instance of the company if it exceeds any limitation under the company’s constitution.

Such director (or connected person) who is a party to the transaction and any director who authorised the transaction will be liable to account to the company for any profit made, and to indemnify the company for any loss or damage resulting from the transaction.

- **Sections 197-214 - Loans to directors.** The ability of a director (and in certain circumstances connected persons) to take loans or enter into similar arrangements with the company are restricted. However loans of up to £10,000 can be made to a director, and loans in excess of that are allowed subject to shareholder approval. Breach of these provisions is no longer a criminal offence but there may be civil law consequences in that the transaction will in certain circumstances be voidable by the company.

- **Internal management.** There are a considerable number of specific statutory duties under the Companies Act 2006 which are the personal responsibility of each director. These mainly relate to matters of internal management, including the keeping of accounting records, preparation of annual accounts, filing of documents with the Registrar of Companies and the keeping of statutory books. Failure to comply with these duties may expose a director to fines, daily default fines and, in some cases, imprisonment.

Other provisions of the Companies Act 2006 relevant to directors

**Age restrictions - section 157 of the Companies Act 2006**

A company director must be at least 16 years old.

**Requirement for at least one director to be a natural person - section 155 of the Companies Act 2006**

Every company is required to have at least one director who is a natural person. This is to ensure that there is at least one individual who can be held accountable for a company’s failings.

**Directors’ home addresses**

The Companies Act 2006 provides that a company’s register of directors is only required to contain a service address, rather than a residential address, for each director. Companies are required to keep a separate register of usual residential addresses, but this is not open to public inspection. Such residential addresses are “protected information” and do not need to appear on the public register maintained by Companies House (who may only disclose it in certain circumstances) to specified public authorities and credit reference agencies.
Other legislation

Financial Services and Markets Act 2000 (“FSMA”) and the Financial Services Act 2012 (the “FS” Act”)

FSMA contains provisions which concern the activities of directors of companies listed on AIM or the main market, breach of which could result in criminal or personal liability, including those summarised below.

Market abuse

Sections 118-123 of FSMA allow the Financial Conduct Authority (“FCA”) (previously the Financial Services Authority or “FSA”) to impose a penalty on any person where the FCA is satisfied that such person has engaged in market abuse or has required or encouraged another person to engage in market abuse. The definition of behaviour constituting market abuse is detailed but includes, among other behaviours, dealing on the basis of inside information, disclosing inside information other than in the proper course, misuse of inside information, transactions which give a false or misleading impression as to supply, demand, price or value of qualifying investments, transactions which employ deception, disseminating information which could give a false or misleading impression as to a qualifying investment and other behaviour which gives a false or misleading impression as to a qualifying investment or which distorts the market.

Persons who commit market abuse will be liable to be punished by unlimited fines or by public censure and may also be ordered to make restitution. These penalties can also be imposed upon a person who encourages or requires another person to engage in market abuse. The FCA has published the Code of Market Conduct which is designed to assist in determining whether or not certain conduct amounts to market abuse.

Market abuse should be considered in the context of keeping the market informed by the issue of announcements. Failing to make an announcement that should (with the benefit of hindsight) have been made may result in a breach of the market abuse regime.

Creation of a false market

Under section 89 - 90 of the FS Act it is an offence to:

- make a statement which is known to be misleading or false or dishonestly to conceal any material facts or recklessly make a statement which is false or misleading, in each case if done with the intention of inducing, or being reckless as to whether it may induce, another person to acquire shares; or
- create a false or misleading impression as to the market in, or the price or value of, any investments if done with the intention of creating that impression and thereby to induce any person to acquire, dispose of, subscribe for or underwrite those investments resulting in a gain to the person creating the false or misleading impression or to another person or a loss or risk of loss to another person. A director will be guilty if he knows the impression is false or misleading or is reckless as to whether it is.

The penalty on conviction for an offence under these sections is imprisonment and/or a fine.

Financial promotion

Section 21 FSMA deals with restrictions on financial promotion. A person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless (a) he or she is an authorised person; or (b) the content of the communication is approved by an authorised person; or (c) the communication is covered by an exemption, and the communication is made in or from, or is capable of having effect in, the UK. Documents involved in the raising of money and the issue of shares, as well as in the acquisition or disposal of companies, can fall within this restriction (or statutory exemption), and advice should always be taken when appropriate.
Financial penalties

Under section 91 of FSMA, the FCA is able to impose financial penalties on listed companies and other issuers of listed securities and their “persons discharging managerial responsibilities” as well as on applicants for listing and their directors, or alternatively to censure any of those parties publicly. The FCA has a published policy with respect to the imposition and amount of penalties under those provisions. The FCA intends to adopt a flexible and proportionate response and does not propose to adopt a tariff of penalties for different kinds of contravention.

Insider dealing - Criminal Justice Act 1993

Statutory restrictions on insider dealing are to be found in Part V of the Criminal Justice Act 1993 (“CJA”). Under the CJA it is a criminal offence to:

- deal in securities when in possession of inside information;
- encourage another to do so, when in possession of inside information; or
- disclose inside information otherwise than in the proper performance of the functions of any employment, office or profession.

In relation to each of the above offences:

- the expression “dealing” would include not only acquisitions or disposals by an individual but also situations where an individual procures another to effect an acquisition or disposal on his or her behalf. It covers not only dealing on a regulated market but also off-market transactions where a professional intermediary (including an investment bank) is involved;
- the CJA applies to dealings in all classes of the company’s securities, including traded options or other derivative securities. The CJA also applies to dealings in the securities of other companies even where there is no direct connection between the “insider” and the company concerned;
- the CJA is only concerned with “inside information”. The information must be precise or specific and not relate to securities or issuers generally. It must not have been made public and if it were to be made public it must be likely to have a significant effect on the price of any securities. Examples of inside information are the company’s annual or interim results prior to publication, or the intention to make a significant acquisition or carry out a capital raising exercise; and
- in order to be guilty of one of the above offences, it is also necessary to know that the information is “inside information” and that it was acquired knowingly from an inside source. Information is obtained from an inside source if the individual in question obtained it, for example, because he or she is a director or employee of an issuer or because he or she had access to the information by virtue of his or her employment or office. The information is also considered to be from an inside source if it is obtained directly or indirectly from a person who obtained it in one of the above two ways.

The offences outlined above are criminal offences carrying, on conviction, a fine and/or a sentence of up to seven years’ imprisonment. It is also possible that an insider dealer could face civil sanctions such as being called to account for the profits made by such insider dealing. It is therefore imperative that careful consideration should be given to imposing appropriate restrictions on the way in which and extent to which inside information is disseminated throughout the company, in cases where that information is not public.

Ultra vires

Directors are personally liable for acts and transactions which go beyond the powers the director or the objects of the company. The director will be liable to the company for any loss or damage suffered by the company as a result of the act and will have to account to the company for any profits arising from it.

The shareholders can pass a resolution absolving the director from such liability for the act or transaction.

Disqualification

What does disqualification mean?

If a disqualification order is made by a court then for the period specified in that order the person must not be a director of a company or insolvency practitioner, or in any way (directly or indirectly) be concerned or take part in the promotion, formation or management of a company unless he or she has the leave of the court.

A director can be disqualified for a period of between two and 15 years.
The Secretary of State is under an obligation to maintain a register of disqualification orders and undertakings at Companies Registry and a record of a grant of leave. This register is open to inspection by the public on payment of a fee. Thus, there is a burden of stigma associated with disqualification.

**Disqualification at the discretion of the court**

The court may, for example, make a disqualification order where:

- a director is convicted of an indictable offence in connection with the promotion, formation, management, liquidation or striking off of a company;
- it appears to the court that a director has been persistently in default in relation to provisions of any companies legislation requiring any documents to be filed with, or notice to be given to, the registrar of companies, or the director is convicted in consequence of a contravention of or failure to comply with provisions of companies legislation relating to any such filing or notification; or
- in the course of the winding-up of a company, it appears that the director:
  - has been guilty of an offence for which he or she is liable (whether convicted or not) in relation to fraudulent trading; or
  - has otherwise been guilty, while an officer or liquidator of the company or receiver or manager of its property, of any fraud in relation to the company or of any breach of his duty in any capacity referred to above.

**Mandatory disqualification**

The court also has a duty to disqualify a person from being a director in certain circumstances, for example a person who has been a director of a company which became insolvent where the court is satisfied that his or her conduct as a director of that company makes him or her unfit to be concerned in the management of a company.
Continuing obligations

It is a requirement for all listed companies that they must comply with the continuing obligations that are set out in the Listing Rules and the Disclosure and Transparency Rules.

The continuing obligations are designed to ensure the maintenance of an orderly market in a company’s shares and that all users of the market have simultaneous access to the same information about the company and its listed shares. The two overriding principles underpinning a listed company’s continuing obligations are the disclosure of information and equal treatment of all shareholders.

The rules apply to companies listed, or applying for listing, on the Official List, and to their sponsors. The Listing Rules also include the Listing Principles which were established to ensure compliance with the spirit as well as the letter of the Listing Rules. There is a two-tier listing regime. From 6 April 2010, all listings are either premium listings or standard listings. A company with a standard listing has fewer obligations under the Listing Rules than a company with a premium listing.

While outside the scope of this Guide, it is also worth noting that the FCA has also published Prospectus Rules which apply to listed companies, and which govern the circumstances in which such a company must publish a prospectus in connection with an application for a further listing of shares.

The Listing Rules and Disclosure and Transparency Rules are fairly detailed and, as such, this Guide aims to provide an overview only of the issues covered by those rules.

Listing Rules

Detailed provisions in the Listing Rules are underpinned by principles which require each listed company to:

- take reasonable steps to enable its directors to understand their responsibilities and obligations;
- take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations;
- act with integrity towards shareholders and potential shareholders;
- communicate information to shareholders and potential shareholders so as to avoid the creation or continuance of a false market in its listed shares;
- ensure that it treats all shareholders of the same class equally; and
- deal with the FCA in an open and co-operative manner.

The Listing Rules set out continuing obligations for companies in the following areas:

- specific market notifications, communications with shareholders and share dealing restrictions and corporate governance;
- transactions outside the ordinary course of business;
- transactions entered into between the company and related parties (directors and major shareholders);
- purchase by a company of its own shares; and
- circulars to shareholders.

A listed company must ensure that its directors accept full responsibility, collectively and individually, for the company’s compliance with the Listing Rules.

Disclosure and Transparency Rules

The Disclosure and Transparency Rules also set out certain continuing obligations to be observed by listed companies including those relating to:

- market notifications of inside information by the company;
- information to be provided to holders of shares and debt securities;
- corporate governance; and
- obligations on individual directors and certain other managers to disclose share dealings.

Both the Listing Rules and the Disclosure Rules contain continuing obligations in relation to the publication of financial information.
While a summary of all these obligations is outside the scope of this Guide, some of the continuing obligations which are of general ongoing application to listed companies and their directors are summarised briefly below:

**Announcement requirements**

The Listing Rules and the Disclosure and Transparency Rules contain a number of specific announcement requirements, where an immediate market announcement is required - for example, among others there is a requirement to make an announcement if the company proposes to make changes to its capital structure or share rights, if it proposes to pay a dividend or upon any changes to certain material interests in shares of the company or any changes to the Board.

There is also a general obligation of disclosure upon companies, requiring the timely disclosure of inside information to the market.

A listed company must make a market notification as soon as possible of any inside information which directly concerns the issuer. “Inside information” comprises information of a precise nature which (a) is not generally available; (b) relates to the company or to qualifying investments (e.g. the company’s shares); and (c) would, if generally available, be likely to have a significant effect on the price of the qualifying investments or related investments.

Guidance is set out in the Disclosure and Transparency Rules, and the Technical Notes of the UK Listing Authority (“UKLA”) also provide informal indications on interpretation. Listed companies should establish a framework for investor communications and consider making regular statements as to their position.

In general, information required to be notified to the market must not be given to a third party prior to such notification; in other words confidentiality must be maintained at all times so that no one is in a position to take advantage of that information until the market as a whole has been informed.

Nevertheless, a listed company may give information about impending developments or matters in the course of negotiation in strict confidence to a limited number of people without notifying the market – for example, the company’s advisers or anyone else involved or who may be involved in the matter and persons which whom it is negotiating, or intends to negotiate, with a view to a transaction or raising finance.

**Regulatory Information Services**

Each listed company must establish a link with at least one of the Regulatory Information Services for the purpose of releasing market notifications. A link may be direct, or through the company’s sponsor. The Regulatory Information Services supply information to secondary information providers, which in turn make the information available to journalists and other information retailers.

The company’s obligations under the Disclosure and Transparency Rules to make market notifications will be satisfied by notifying the relevant information to a Regulatory Information Service.

**Financial reporting**

The Disclosure and Transparency Rules contain requirements in relation to financial reporting – in particular, they contain requirements in relation to preparation of interim reports, annual reports and accounts and interim management statements. It is worth noting that individual directors can be found liable to the company for any loss suffered by the company resulting from any false or misleading statement or omission in the following sections of the company’s annual report:

- the directors’ report (including the business review); and
- the directors’ remuneration report; and
- any summary financial statement derived from either report.

The director will only be liable where he or she knew the statement was untrue or misleading or was reckless as to the same or knew the omission to be a dishonest concealment of a material fact.

**Obligations on directors to notify company of transactions in shares/related financial products**

The Disclosure and Transparency Rules provide that a director must disclose in writing to the company details of all transactions relating to shares or related financial products in the company (including the grant of options or other rights/obligations to acquire or dispose of shares in the company) by either the director or any person connected to him or her within four business days of such transaction. The FSA issued guidance in January 2009 confirming that the granting of security over shares is a “transaction” for these purposes and therefore must be disclosed. The company is then required to make a market notification without delay (by the end of the following business day) of such information.
Insider lists

Under the Disclosure and Transparency Rules, the company must establish and maintain an insider list, and must ensure that its advisers also do so. An insider list is a standing list of all persons within the company (or adviser, as the case may be) who has access, whether regular or occasional, to inside information. The company’s insider list will comprise those people who are subject to the restrictions of the Model Code (see below) together with employees who have access to inside information.

Model Code on dealings in securities

The Model Code (also discussed in Chapter 9 of this Guide), which is annexed to Chapter 9 of the Listing Rules, governs dealings in the securities of a company by “persons discharging managerial responsibility” – and provides rules as to when and in what circumstances such dealings may take place. Under the Listing Rules, every listed company must require the persons discharging managerial responsibility to comply with the Model Code, and must take all proper and reasonable steps to secure such compliance. Companies may impose more rigorous dealing restrictions if they so wish and some may consider it appropriate for their share dealing code to cover “employee insiders”.

The purpose of the Model Code is to ensure that directors, certain other managers and persons connected with each of them, do not abuse, and do not place themselves under suspicion of abusing, inside information that they may have or be thought to have, especially in periods leading up to an announcement of results and dividends.

The Model Code should be seen as setting a minimum standard of good practice. While all listed companies are required to comply with the Model Code, companies may establish their own code which is more stringent than the Model Code and many listed companies therefore have their own code of conduct with respect to dealings in securities in place and each director and person discharging managerial responsibility should be made aware of such code.

Compliance with the Model Code will not be a defence to an action for insider dealing under the Criminal Justice Act 1993.

Sanctions in respect of the Listing Rules and the Disclosure and Transparency Rules

In the first instance, the company itself is responsible for compliance with the Listing Rules and Disclosure and Transparency Rules. However, directors who knowingly breach these rules can still be held liable by the FCA. The FCA’s enforcement mechanisms are fines and public censure of the relevant individual.

Takeover Code

The City Code on Takeovers and Mergers (the “Takeover Code”) governs takeover bids in the United Kingdom. It applies to offers for all listed and unlisted public companies based in the United Kingdom, and is founded on a set of principles which underpin its more detailed rules. Before entering into a transaction which would amount to a takeover or merger, professional advice should be sought to ensure compliance with the Takeover Code.
Chapter 13 - About Norman Broadbent and Eversheds

About Eversheds

Eversheds is a progressive international law firm providing high quality legal services with a unique business approach, with offices across Europe, the Middle East and Asia. We combine local market expertise with exceptional consistency of quality and service delivery. Clients range from large multinationals to local owner-managed and financial institutions. Our strength is in our difference - we redefine the client experience with our collaborative ways of working. We are well known in the market for our client-focused approach to service delivery and client relationships. It is the approach that makes Eversheds such a distinctive and innovative force in the legal world. It is what makes us 21st century lawyers.

www.eversheds.com

About Norman Broadbent

Norman Broadbent is one of the world’s leading Board search firms. Headquartered in the UK, the group has a far reaching international footprint with offices in North and South America, Asia, the Middle East and Europe. We are a key partner, working with Boards across all sectors, from leading multinationals through to small, medium sized enterprises. Our philosophy of ‘looking beyond the obvious’ enables us time and again to deliver exceptional results for both executive and non-executive searches for our clients.

www.normanbroadbent.com
Appendix: Useful links

Financial Reporting Council: www.frc.org.uk

UK Corporate Governance Code: www.frc.org.uk/our-work/publications/corporate-governance

Listing Rules: www.fshandbook.info/FS/html/handbook/LR


The Takeover Panel: www.thetakeoverpanel.org.uk
This information is for guidance purposes only and should not be regarded as a substitute for taking legal advice. This Guide contains general information and does not constitute advice on any specific legal or other professional matter. Information in this Guide is current at the date of publication and does not necessarily reflect the present law or regulations. Eversheds and Norman Broadbent do not accept any responsibility for any loss or damage which may arise from reliance on the information contained in the Guide.