Guidance note

Liability of non-executive directors: care, skill and diligence

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Introduction

1 It is important that non-executive directors think particularly carefully about the steps they should, and might, take to ensure not only that they are effective in their role, but that they are also not exposing themselves to liability through doing the wrong things or not doing the right things. This guidance note suggests ways in which non-executive directors can approach their work in a way which would allow them to demonstrate to a regulator, or in a court of law, that they had taken appropriate steps to exercise care, skill and diligence in the execution of their roles and responsibilities.

2 Although non-executive directors and executive directors have, as board members, the same legal duties and objectives, the time devoted to the company's affairs is likely to be less for non-executive directors than for executive directors. However, given the emphasis that the UK Corporate Governance Code (the 'Code') places on the role of non-executive directors on the board and its committees, it is important to realise that the time commitment necessary to fulfil the expectations of the role may be significant, and possibly greater than has previously been expected.

3 Non-executive directors cannot reasonably be expected to have the same detailed knowledge and experience of a company's affairs as executive directors. However, when determining whether a non-executive director has breached his or her duty to exercise reasonable care, skill and diligence, a court would consider the steps a reasonably diligent non-executive director in the same position would have taken to familiarise themselves with the company's business and operations.
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4 In this context, certain elements of the Code that describe the role and responsibilities of a non-executive director are likely to be relevant to the court’s assessment, and these are set out in the Appendix to this guidance note. It is the responsibility of each non-executive director to reach a view as to what is necessary in particular circumstances to comply with the duty of care, skill and diligence they owe as a director to the company. In considering whether or not a person is in breach of that duty, a court would take into account all relevant circumstances.

5 It is possible to mitigate the personal exposure of directors through Directors and Officers (D&O) Insurance, and through indemnification of directors by the company, although a UK company’s ability to indemnify directors against liability incurred in office is subject to certain limitations under law. The Code recommends that the company should arrange appropriate insurance cover in respect of legal action against its directors.¹ This insurance should include ‘run off’ cover for a period after a director has resigned from a board, and a period of six years might be considered appropriate. The company may also wish to consider whether indemnities should be provided to the directors.

6 Non-executive directors should also note the points set out below. These cover areas of best practice set out in the FRC Guidance on Board Effectiveness, other guidance notes published by ICSA, and the experience of company secretaries of UK listed companies.

Before joining a board

Prior to joining a board, prospective non-executive directors should:

6.1 undertake their own due diligence to satisfy themselves that it is an organisation in which they can have confidence, and can make a strong and value added contribution. Detailed guidance on the enquiries a prospective director should make before agreeing to join a board are set out in a separate ICSA guidance note

6.2 understand that more is expected from a director with a specific skill or specific experience. A director’s duty is to exercise the care, skill and diligence that would be exercised by a reasonably diligent person with:

¹ UK Corporate Governance Code provision A.1.3
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a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (‘the objective test’), and

b) the general knowledge, skill and experience that the director has2 (‘the subjective test’).

Prospective non-executive directors should ensure they have, or can acquire, the skills needed to serve on a particular board, and should devote time to developing and refreshing their knowledge and skills3

6.3 recognise that part of a non-executive director’s role is to uphold high standards of integrity and probity, and to support the chairman and executive directors in instilling the appropriate culture, values and behaviours in the boardroom and beyond.4 During the discussions held prior to being offered a directorship, new non-executive directors should use the opportunity to ask questions about, and make a judgement on, the culture, values and behaviours associated with the board

6.4 review the letter of appointment, and raise any concerns before signing. In particular, the letter should state the minimum time commitment expected, and the possibility of additional time commitments.5 Prospective non-executive directors should ensure they can devote the time necessary to discharge their responsibilities for the particular board and any committees, including any additional time commitment that might be required when the company is undergoing a period of particularly increased activity.6 Directors should recognise the need to be available at all times, particularly to meet the needs of the company at times of significant challenge or crisis

6.5 understand the requirements of the Companies Act 2006 in relation to conflicts of interest, and gifts and hospitality,7 and declare any potential or actual conflicts of interest before appointment to the board.

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2 s174 Companies Act 2006
3 FRC Guidance on Board Effectiveness paragraph 1.19
4 FRC Guidance on Board Effectiveness paragraph 1.21
5 FRC Guidance on Board Effectiveness paragraph 1.20
6 FRC Guidance on Board Effectiveness paragraph 1.20
7 ss175-177 and ss182-185 Companies Act 2006
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On appointment to a board

Detailed guidance on the induction of directors is set out in a separate ICSA guidance note.

Newly-appointed non-executive directors should:

6.6 receive a comprehensive, tailored induction programme. Non-executive directors should have input into the planning of their induction programme, which should be tailored to their needs in relation to content, timing and delivery, and ensure they request further meetings or training as and when the need becomes apparent. They should take responsibility for their ongoing training and continuous development, including keeping abreast of developments within the company, its sector, and the legal, regulatory and governance environment. Non-executive directors should request support from the company with this as necessary.

6.7 understand that their role is to provide independence, oversight and constructive challenge to the board. This governance role contrasts with the role of the executive team which is to manage the business. Non-executive directors should contribute to the development of strategy, bringing their experience and expertise to bear, and should hold the executive to account for delivery of the strategy, effectiveness of the internal controls, oversight of risk etc. They should also bring their specific relevant expertise to the workings of board committees.

6.8 ensure they receive a schedule of future board and committee meetings, planned well in advance so that they have the opportunity to attend.

6.9 insist on receiving high-quality information sufficiently in advance of meetings, which is accurate, clear, comprehensive, up-to-date and timely. In addition, non-executive directors should insist they receive any other important information between meetings, at the time it comes to light.

6.10 speak to the company’s executives at any time over any concerns they may have, and speak to the company’s advisers (for example, the external auditor) if they consider it necessary. They should also take independent professional advice at the company’s expense if they consider it necessary to discharge their responsibilities as directors.

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8 For further information see the FRC Guidance on Board Effectiveness
9 FRC Guidance on Board Effectiveness paragraph 1.22
10 as provided by UK Corporate Governance Code provision B.5.1
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6.11 ensure they make all decisions objectively in the interests of the company; a director should therefore be sure that they are not sufficiently dependent on the income received from their non-executive appointment to the extent that it could affect their independent judgement.

6.12 familiarise themselves with the company's procedures for recording directors’ potential or actual conflicts of interest, and for recording gifts and hospitality received by directors, and ensure that they report any changes or new circumstances.

6.13 appreciate that circumstances may arise such that they may need to consider resigning from a board. At such times they should talk first to the chairman, senior independent director, company secretary and/or other directors, and consider taking independent advice.¹¹

¹¹ as provided by UK Corporate Governance Code provision B.5.1
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Appendix

The UK Corporate Governance Code (the Code) states that:

1. letters of appointment of directors should set out the expected time commitment (Code provision B.3.2)

2. boards should be supplied in a timely manner with information in a form and of a quality appropriate to enable them to discharge their duties. Chairmen are responsible for ensuring that directors are provided by management with accurate, timely and clear information (Code principle and supporting principle B.5)

3. boards should ensure that directors, especially non-executive directors, have sufficient resources and have access to independent professional advice at the company's expense (Code provision B.5.1)

4. chairmen should ensure that new directors receive a full, formal and tailored induction on joining the board and regularly review and agree with each director their training and development needs (Code provisions B.4.1 and B.4.2)

5. chairmen should hold meetings with the non-executive directors without the executives present (Code provision A.4.2).

In addition, the Code states that non-executive directors should:

6. constructively challenge and help develop proposals on strategy. This involves scrutinising the performance of management in meeting agreed goals and objectives, monitoring the reporting of performance, satisfying themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible (Code principle and supporting principle A.4)

7. be 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 (Code supporting principle A.4)
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8 undertake appropriate induction and regularly update and refresh their skills and knowledge. As part of this they should regularly agree with the chairman their training and development needs (Code principle B.4 and Code provisions B.4.1 and B.4.2)

9 avail themselves of opportunities to meet major shareholders (Code provision B.4.1)

10 undertake that they will have sufficient time to meet what is expected of them, and disclose their other significant commitments and the time involved to the board before appointment, and on an ongoing basis whenever those commitments change (Code provision B.3.2)

11 seek appropriate clarification or amplification of information and, where necessary, take independent professional advice (Code supporting principle B.5 and provision B.5.1)

12 meet without the chairman present at least annually to appraise the chairman's performance, and on such other occasions as are deemed appropriate (Code provision A.4.2)

13 where they have concerns about the running of the company, or a proposed action, ensure that these are addressed by the board and, to the extent that they are not resolved, ensure that they are recorded in the board minutes (Code provision A.4.3)

14 give a written statement to the chairman, for circulation to the board, if they have such unresolved concerns on resignation (Code provision A.4.3).

Working group

This guidance note has been prepared with the assistance of a working group comprising members of the ICSA Company Secretaries Forum and of Slaughter and May.
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