

FOLIO CORPORATE SERVICES LIMITED

Principles of Good Corporate Governance



Calum McKenzie is the Director of Folio Corporate Services Limited.

"Each individual director owes duties to the company to inform himself about its affairs and to join with his co-directors in supervising and controlling them. A proper degree of delegation and division of responsibility is permissible and often necessary, but total abrogation of responsibility is not. A board of directors must not permit one individual to dominate them and use them"

- (Jones J) Weaving Macro Fixed Income Fund Limited (in liquidation) v Peterson and Ekstrom 2011 ("Weaving")

The circumstances, commentary and findings in Weaving put corporate governance front and centre in the financial services arena. Despite this there appears to be a continued reticence on the part of principals or sponsors when it comes to appointing professional independent directors rather than 'amateurs' with a direct or personal connection to a company.

In Weaving, the directors were found guilty of willful default and were deemed to have subordinated their judgment to that of the investment manager. Thus they were deemed to have breached their duty of care, skill and diligence. As opposed to a breach of their fiduciary duties of loyalty, honesty and good faith.

The commentary and judgment set-out in Weaving has led to certain principles of good corporate governance, both theoretical and practical, being adopted. In reality it means that principals and sponsors should review the composition of their boards and consider more fully the benefits professional independent directors can bring. The following is a brief summary of what we consider to be the main practical points to be drawn from Weaving which if considered can be of assistance to both directors and principals considering the appointment of professional independent directors;

- **Skill** Any director accepting a position should be satisfied they have the skills, experience and knowledge to fulfill their obligations (notwithstanding that for certain vehicles such as funds, the directors will outsource most of the day to day functions or operations). If the company in question operates in a specialist field such as a hedge fund or captive insurance

company, then directors with specific knowledge of the relevant field can add substance and value. It should be noted however simply because a director has specialist knowledge, it does not mean he should seek to overtly interfere with the specialist operations, e.g. a director should not seek to be a pseudo-investment manager. The director should perform a "high level supervisory role" making sure that the company, its structure and its operations (contracts, service agreements etc.) are in line with industry standards.

- **Application** Directors must exercise independent judgment and should not become an automaton or subordinate their judgment. A director must apply their own mind and judgment based on circumstances and not merely rely on explanations or information provided by connected or related parties.

- **Communication & Board Meetings** Directors should educate themselves about the business of the company and each director should acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors. This is a continuous process on the part of the director and it is where tailored regimes and methodologies specific to the mandate will add value for all concerned. Regular substantive board meetings need to take place, with a proposed agenda circulated and agreed upon prior to a meeting. Meetings should not be a matter of going through the motions as such meetings are pointless and add no value. Substance will be achieved through having the relevant matters at hand (as per the pre-agreed and circulated agenda) dealt with. This is where the knowledge and involvement of the mandate by the director is key and where each director can aim to add substantive value in an effective manner.

- **Crisis management** In times of a crisis the correct course of action for a director is not to retreat into a shell and do nothing or indeed resign and attempt to distance themselves from the crisis. A director should research, consider and if necessary or appropriate debate matters in a logical and reasoned manner then apply their knowledge and understanding of the mandate and the circumstances to create an effective or optimum resolution for all concerned.

- **Indemnities** Be it one entrenched in the constitutional documents of a company or a separate agreement, an indemnity

is intended to protect conscientious, well meaning directors from frivolous actions. Not those who have no intention of fulfilling their obligations from the outset. Principals and potential directors should use this as the basis to discuss and agree the requirements of each party, set expectations of the other and establish, agree and understand the scope of the work to be carried out by service providers and third parties.

- **Recordkeeping** In line with current industry best practices and policies, recordkeeping by directors is now of paramount importance. As professional independent directors will usually be supported and assisted by professionally qualified and experienced staff, they will have sufficient resources to follow industry best practices and will be able to demonstrate how they have applied their minds to the decisions they have taken.

- **Fees** Fees payable to directors should be commensurate such that directors have sufficient time and scope to discharge their obligations and responsibilities.

In summary, principals and stakeholders should view an experienced and professional independent board, employing the findings of Weaving, along with established good corporate governance principles, as an added protection mechanism. In practical terms, stakeholders should demand constant vigilance and the application of considerable professionalism, time and expertise from directors in the discharge of their duties. For stakeholders using this professional approach can surely only be viewed as a positive development.



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