Financial Institutions and their Supervisor (CBA)
Aruba Bankers' Association & Insurance Association of Aruba Seminar

"The supervision rules of central banks as related specifically to the liability of managing directors and supervisory board members"

Address by

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Ladies and Gentlemen!

First of all, I would like to thank the Aruba Bankers' Association and the Insurance Association of Aruba for inviting me to speak at this seminar.

Banks and insurance companies in Aruba, also being referred to as financial institutions, are examples of businesses organized as limited liability companies. In his famous volume *The Wealth of Nations* (1776), Adam Smith reasoned that corporations – with limited liability - should be used only in cases where the common weal[1] required their formation because of the amount of capital required or where there was a necessity for spreading risk, where the corporation would result in some public benefit, and that it might be used in cases in which government couldn't conveniently handle the matter. Therefore he approved corporations formed for the purposes of banking, insurance, the construction of turn pikes and water systems.[2]

Looking back at the history of corporations, in particular in the United States, it's interesting to remember that in earlier times managing directors used to be partners who were personally liable for losses.

So much for other times, now back to ours. I will start by explaining the Aruba statutory framework for the duties and liabilities of managing and supervisory directors of companies not supervised by the Central Bank of Aruba. Don't worry, just a few basics.

I will then focus on supervised institutions (banks and insurance companies) and, in particular, the risk of civil liability that managing directors and supervisory directors may suffer as a result of their organization's (and – thus - their own) failure to comply with regulatory rules and regulations.

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[1] I.e. the common welfare of the people.
[2] Frederick G. Kempin, *Limited liability in historical perspective*, American Business Law Association Bulletin Vol. 4, No. 1, March 1960, p. 14.

(I) Aruba statutory framework

(I.a) Directors' liability

I will refer only to the NV type of company, otherwise known as the public limited liability company, governed by the Commercial Code of Aruba. Furthermore, I will discuss only the basic concept of managing and supervisory directors' liability.

(I.b) Duties

Section 106(1) of the Aruba Commercial Code (ACC) provides that, in performing their duties, each member of the management board should focus on the interests of the NV. In accordance with the "stakeholder model", a.k.a. "stakeholder orientation", the board must take into account various interests, not only those of the company, its business and shareholders, but also those of other interested parties, such as employees and creditors. This provision is also relevant to the question of whether and to what extent a managing director can be held liable for poor performance.

The supervisory board is responsible for supervising the company as a whole, including the management board (Section 118(2) ACC). Like the management board, the supervisory board must take into account the interests of the company, its business and shareholders, as well as those of all the other stakeholders. The supervisory board represents the interests of all the stakeholders in a balanced way.

With respect to both boards, the leading principle is that they have collective powers and responsibilities, also in the event that the tasks within the management or supervisory board are divided.

(I.c) Internal liability

The members of the management board are personally and severally liable towards the NV for any loss caused by the improper performance of duties, even if certain activities or tasks fall within the scope of activities addressed to one or more particular managing directors. This is called internal liability.

So the board members are held collectively liable due to the collective responsibility. However, any member of the board who can prove that he cannot be blamed for such improper performance and that he hasn't been negligent in taking steps to avert the related consequences, is not liable (Section 106(2) ACC).

On the basis of established (Dutch) case law, the obligation of the members of the management board of an NV to properly carry out their duties is interpreted in such a manner that liability based on this obligation requires serious fault ('*ernstig verwijt*') to be attributed to such members.

Therefore, a managing director of an NV can be held liable by the NV only if serious negligence in the performance of his duties is attributable to him.[3] A finding of serious negligence on the

[3] See the case of Ontvanger v. Roelofsen, *Hoge Raad* (Dutch Supreme Court) 8 December 2006, *JOR* 2007, 38.

part of a managing director depends on the circumstances of the case. Actions that conflict with specific statutory provisions or the articles of association may constitute improper management, rising to a level of serious negligence.

According to the standard applicable to the liability of an ordinary managing director, apparent improper performance of duties will exist only if no managing director thinking reasonably - under the same circumstances - would have acted thus.

The same internal liability standard also applies to supervisory board members, taking into account their statutory and other legal duties.

(I.d) External liability

According to Section 116 of the Aruba Commercial Code, liability of a managing director of an NV towards the bankrupt estate may arise in the event of bankruptcy of the NV if such bankruptcy is wholly or partially caused by the director's serious acts of negligence. Where that is the case the bankruptcy trustee may file a claim for compensation on behalf of the estate. This is called external liability.

Also, management board members are personally liable to third parties for the NV's debts if matters have been misrepresented in the annual accounts, the interim figures or the annual report (Section 117 ACC).

The same external liability standards also apply to supervisory board members (Sections 127 and 129 ACC). They can be held liable when they cross a clear line that deserves sanction: liability applies to damage suffered only when the actions and omissions of the supervisory directors, in the light of their statutory and other legal[4] duties, wouldn't have been carried out or wouldn't have been omitted by a reasonably acting supervisory director. So it isn't about just second guessing their judgments made in good faith.

(II) Supervised financial institutions

What makes financial institutions like banks and insurance companies special is that the scope of duties of managing and supervisory directors – i.e. the scope of corporate governance - goes beyond that of non-financial businesses, to include not only account holders, debt holders, insurance policy holders and other creditors who have put their trust - and money – in them, but also the financial system as a whole and thus the reputation of Aruba as a member of the global community. Public trust and confidence are the very essence of financial institutions like banks and insurance companies.

According to the *Guidance Notes for the Supervisory Board of Supervised Financial Institutions*, issued by the Central Bank of Curaçao and Sint Maarten in 2001: "*An institution's Supervisory Board is ultimately responsible for the conduct of the institution's affairs. The Supervisory Board controls the institution's direction and, hence, its overall policy. In doing this, the Supervisory Board determines how the institution will conduct its business in the long term*"…

[4] Other: articles of association.

I beg to differ! When you dress a lizard in a suit you'll have trouble with his tail![5] One size doesn't fit all. Legislation and regulations should be designed to fit the particular role supervisory directors play. I will come to that in a moment.

The Central Bank and the supervised institutions have a common interest in maintaining and safeguarding their good reputation as well as the good reputation of Aruba.

In order to achieve this common goal it is required that (i) the legislation and regulations with regard to financial institutions are clear, consistent and reasonably practical, and that (ii) the Central Bank and the institutions placed under supervision understand each other well and have mutual respect. But first something about that first aspect.

Pursuant to the Aruba Commercial Code, the management duties must be carried out properly. If that doesn't happen, this can lead to personal liability. In government companies at Curacao and St. Maarten the standards framework of the Corporate Governance Code can play a role in the question of whether directors and supervisory directors can be personally liable. At institutions under the supervision of a Central Bank the supervisory legislation with the guidelines based on it can play a role in the question of whether a director or supervisory director is personally liable. This is because this regulatory legislation and these guidelines also determine the details of the duties of directors and supervisory directors.

I don't just say this as such, but in this connection I refer to ground for decision 4.4.2 of the ruling in the ASMI case by the Dutch Supreme Court of 9 July 2010.[6] The Supreme Court held that the Tabaksblat Code 2008, just like its predecessor: the Tabaksblat Code 2003 - this is the Dutch Corporate Governance Code - forms an expression of the predominant legal view in the Netherlands. According to the Supreme Court that predominant legal view in the Netherlands partly gives shape to the requirements of reasonableness and fairness (according to which requirements the parties who are involved by law or under the articles of association in the legal entity must behave towards each other), and - and here it comes - to the requirements arising from a proper performance of the duties to which every managing director and supervisory director is obliged.

So this means that the regulatory legislation and the guidelines of the Central Bank not only affect the nature and extent of the duties of managing directors and supervisory directors but because of this also the question of cases in which they can be held personally liable. After all, in answering the question of whether they performed their duties properly the question will also be considered of whether they violated standards laid down in the regulatory legislation or in guidelines of the Central Bank based on it.

Therefore it is important, particularly in the guidelines issued by the Central Bank, that the specific duties of the management board as well as the specific duties of the supervisory board are taken into account as they are laid down in the Commercial Code. Supervisors such as the Central Bank tend to impose obligations on the supervisory directors in particular which differ from the legal system and thereby create a much heavier responsibility on the supervisory directors than is desirable. Of course, it is the case that the responsibility is something other than liability, but unnecessary disquiet and confusion is created because the nature and extent of the

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[5] Dito Arends – "*Ora bo bisti lagadishi un flus bo lo tin problema cu sur abo.*"
[6] See the case of ASMI, *Hoge Raad* (Dutch Supreme Court) 9 July 2010, *JOR* 2010, 228 annotated by Van Ginneken.

duties of the supervisory directors aren't properly born in mind. Supervisory directors aren't the highest power in a company and neither are they the ones who ultimately determine the policy or direction of the business: but they do review the policy or proposals for that policy or their implementation. So supervisory directors aren't 100% responsible for the policy and neither are they the ones who are ultimately responsible. The key actors in financial institutions are the managing directors.

Supervisory directors are a type of baywatchers. They should obviously have certain qualities, but their primary duty is to exercise supervision. The swimmers and surfers (the managing directors) themselves determine what they do and how they do it and in what direction they swim or surf. The baywatchers can - and if it involves supervisory directors in relation to directors: they must - join in the conversation, become informed, ask questions and advise, but in the end the swimmers and surfers themselves decide what they do. They should do this responsibly though. If they take too big risks or they put themselves in danger, or they cause a dangerous situation for others, or if there is even a threat that everything goes wrong, and someone might drown, the baywatchers have to intervene. That is (also) their duty.

Ongoing regulatory actions in many countries continue to increase the duties and responsibilities of supervisory directors. In the regulatory legislation and in particular in the guidelines of the Central Bank the supervisory directors' own position and duties must be taken into account. This doesn't always happen to a sufficient extent. This also applies to the guidelines of the Basel Committee, which guidelines have influenced banking laws and regulations in many jurisdictions. And it isn't for nothing that in response to the criticism of the 2010 guidelines[7] it was decided to suggest adjustments, for instance to replace the word "ensure" in several cases by the word "oversee", which is of course closer to "supervise". We should also keep in mind that certain guidelines may be beneficial in some countries but may be less beneficial in other countries. The Basel Committee itself stated that there are significant differences in the legislative and regulatory frameworks across countries and that each jurisdiction should apply the provisions as the national authorities see fit.

As I said before, supervised institutions and the Central Bank have a common goal: guarding their own reputation and that of Aruba. And although they each have their own responsibility in this connection, it is desirable that a more intensive cooperation is formed between the Central Bank and the supervised institutions. A major step in the right direction would be if the issue of guidelines would be preceded by sound consultations. I suggest the Central Bank considers offering via its website the option for people to take note of draft guidelines and to give people the opportunity to comment on it, say within six weeks. This could lead to the issuing of better quality guidelines that are better matched with the opportunities which supervised institutions have.

In addition, it would be beneficial if several times a year there would be consultations between the Central Bank and supervised institutions.[8] These should be consultations in the sense of an open and free discussion about matters current in Aruba or topical elsewhere in the world but which affect Aruba. With due observance of and respect for everybody's role and responsibility, a form of benevolent cooperation could be useful for everybody. Particularly due to the small

[7] Basel Committee on Banking Supervision, Guidelines, *Principles for enhancing corporate governance* (current version July 2015).

[8] "*It is not once nor twice but times without number that the same ideas make their appearance in the world.*" - Aristotle

size of Aruba, there are opportunities in the area of cooperation to ensure jointly that the quality of the financial institutions as well as their supervision comply with internationally accepted standards and that directors and supervisory directors are prevented from being charged with responsibilities which don’t belong to the nature of their duties and are thereby unnecessarily faced with unwished-for potential liability risks.

According to the 2015 Guidelines of the Basel Committee, one of the supervisory board’s overall responsibilities is to ensure that the financial institution maintains an effective relationship with its supervisors. This, ladies and gentleman, truly is a responsibility of a collective nature. This is a shared responsibility for the entire financial community.

Thank you for your attention!