



MAPLES
GROUP

20/20 GOVERNANCE FOR ALTERNATIVE INVESTMENT FUNDS

Sam Ellis | Senior Vice President



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The profound shift in attitudes towards corporate governance, over the past decade, has seen a convergence of best practices across the alternative investment fund landscape, with fully independent boards and an investor driven desire for the appointment of fiduciaries with the necessary breadth of experience.

Fund governance has rarely been far from the headlines during this period, from the Weaving case following the financial crisis to the 2019 collapse of UK mutual fund manager Woodford Investment Management, which has led the Financial Conduct Authority ("FCA") to examine governance of Authorised Corporate Directors. The current COVID-19 pandemic has led to some challenging situations for investment funds around the world, further sharpening the focus on governance. For the alternative investment fund sector, these events have provided a reminder that funds domiciled anywhere should have appropriate and sufficient oversight from directors that are independent from the manager and are actively engaged in the fund's activities and who possess the requisite skills to effectively discharge their duties. In a rapidly changing regulatory environment, with some funds hit by major losses from recent events, it is also crucial that directors have a thorough understanding of both the fund's investment strategy as well as the mechanisms available to protect value for investors.

Investors Raise Standards

While historically, Europe has led the way in terms of independent governance, in more recent years an increased focus on governance has become the norm in North America and Asia as well. For alternative investments, where governance trends have been driven by investor demands for high standards and independent fiduciary oversight, best practice has been enshrined across key fund domiciles, such as the UK, Ireland, Luxembourg and the Channel Islands, as well as the Cayman Islands, Bermuda, the US, Hong Kong and Singapore. Institutional investors have a very clear idea of their required governance framework in relation to the operation of fund boards and the experience, expertise and capacity of fund directors.

Notably, there has been a substantial increase in majority independent or fully independent boards for alternative investment funds. Regulatory demands have also influenced this trend. In the UK the FCA now requires the board of an Authorised Fund Manager to be comprised of at least 25% truly independent non-executive directors. Such enhancements to governance have also been becoming more prevalent

in the US, where there has been significant use of limited partnerships, leading to the introduction of independent governance committees.

In relation to board meetings, where independent directors review the reports of the investment manager and all service providers, there has been an increase in both the frequency and the length of meetings as boards now have much more to deal with in terms of the rapidly changing global regulatory landscape including the transparency initiatives around tax reporting such as FATCA and CRS, economic substance requirements, beneficial ownership registers, anti-money laundering and data protection. A significant amount of time is required for boards to focus on all regulatory matters and examine the service provider reports in fine detail, along with asking the appropriate questions based on their experience. This development runs in contrast to previous years where the focus in meetings tended to remain primarily on fund performance. Furthermore, this evolution has coincided with other cross border issues requiring fiduciary attention including cybersecurity, the economic, political and regulatory environment and sustainability factors which have impacted participants across the financial services industry.

Expertise and Added Value

The complexity of alternative investment funds, especially in situations where liquidity issues emerge, requires a certain level of expertise. In the same vein as corporate operating companies, there needs to be a full understanding of the fund's investment strategy, as well as the activities they are engaged in and their counterparties. Experience within the fields of asset management, accounting, fund administration, law and investment banking are particularly relevant to the alternative investment sector. This professional experience allows directors to understand and review agreements that have been entered into, as well as the various financial statements and annual accounts of the funds; and to engage with the investment manager, the fund administrator and the auditors in a challenging yet productive and meaningful way. Looking at the varying backgrounds of directors

provided by the Maples Group offers a good indication of the skill set required, for example in fund management and at private equity firms, within fund administrators, at auditors, at law firms, within regulators and at investment banks. Each of these directors is able to bring a unique perspective to bear upon issues that arise and by collaborating across teams, the benefit of this experience can be applied to clients across the a multitude of industries and asset classes, adding value and protecting the interests of investors.

The sheer volume of global regulatory changes in recent years has created an extremely challenging environment both for established funds and new launches. This has significantly increased the amount of time required to be spent to ensure adherence to these matters and is an additional factor reinforcing the importance of appropriately qualified and experienced directors. The evolution of the alternative investment fund industry has been constant due to rapidly evolving markets and altered tax landscapes, along with issues that have come to the forefront more recently such as climate change, cybersecurity and geopolitics. In all of these areas, independent directors who have experience and visibility across various investment funds, can provide direction and advice which is informed by what is going on across the market and can stay abreast of how these changes are impacting alternative investment funds.

A Guiding Hand

As has been highlighted by the market volatility we have seen this year, across the life of a fund, issues may be encountered which were not necessarily anticipated at the outset. Experienced directors who have dealt with these issues previously are able to help navigate a fund through the complexity. Events that could create such stress include the change of an investment manager, a decision to close down an investment fund, litigation in respect of the fund or an investment, as well as unexpected liquidity issues. One would hope that most of these events will not impact an investment fund, but on the occasion that they do occur, an experienced independent director with significant

institutional support and know-how and who has dealt with these kind of scenarios before can add significant value. During these times, the incentives for various service providers may change and an experienced independent fund director can help oversee a successful outcome of such an event and ensure that investor interests are looked after.

While a fund can anticipate unexpected events and numerous eventualities from the outset there is always the possibility of a true black swan event, just as the COVID-19 pandemic has proven to be. No matter how much preparation is done and what is noted in fund documents, it is impossible to plan for every eventuality. Markets can move quickly and funds can find themselves in trouble, which can be exacerbated for investors if the fund directors do not have the right skills, experience and resources. It is often at these times that the fund documents give discretion to directors and when investors and investment managers will be reliant on the skill and judgment of those directors to help steer the funds through these types of events. In addition, the current environment has demonstrated the importance of working with service providers who can demonstrate stability through robust business continuity planning.

As the investment fund world becomes more complex and the regulatory landscape presents an ever more challenging environment for investment managers, investors remain exposed to heightened levels of risk. Professional independent directors will act diligently to protect the interests of the fund and its investors. For alternative investment funds, particularly in the current volatile marketplace, it is crucial that the directors have a broad and in depth understanding of the alternative investment fund industry to be in a position to steer the fund through any unexpected events or liquidity issues. The Maples Group in the UK and across other key financial centres around the world, including the Cayman Islands, Delaware, Dubai, Hong Kong, Ireland, Jersey, Luxembourg, the Netherlands and Singapore,

provides independent directors, with expertise across the investment sector, to a large portfolio of alternative investment funds, including those from many of the world's most prestigious investment managers, overseeing the actions of the manager and those of the service providers to offer guidance and support that ensures the highest standards of corporate governance.

About the Author

Sam Ellis

Sam serves as an independent director on a wide range of alternative investment funds including hedge funds, fund of funds, segregated portfolio companies, private equity vehicles and related structures. Sam joined the Maples Group in 2011 and carries over 15 years' experience in the legal and financial services industry. Prior to the transition to the firm's London office in 2014, Sam was a Senior Vice President in the fiduciary services team in the Cayman Islands office providing director and advisory committee services to a variety of complex alternative investment structures domiciled in the Cayman Islands. From 2003 to 2011, Sam was a Vice President at Macquarie Group in the London and Melbourne offices working on equity capital markets and merger and acquisition transactions across a variety of sectors and regions. Sam began his professional career in law with Freshfields Bruckhaus Deringer in Brussels, Belgium focusing on EU merger clearances and antitrust cases. Sam has a Bachelor of Commerce degree and a Bachelor Law degree (1st Class Honours) from the University of Melbourne. He is a chartered accountant and member of the Institute of Chartered Accountants in Australia and the Institute of Directors in the United Kingdom. Sam also holds the Accredited Director designation from the Institute of Chartered Secretaries and Administrators Canada and is fluent in German.