

**Duties and Liabilities of
Corporate Fund Directors
The View of the Industry**

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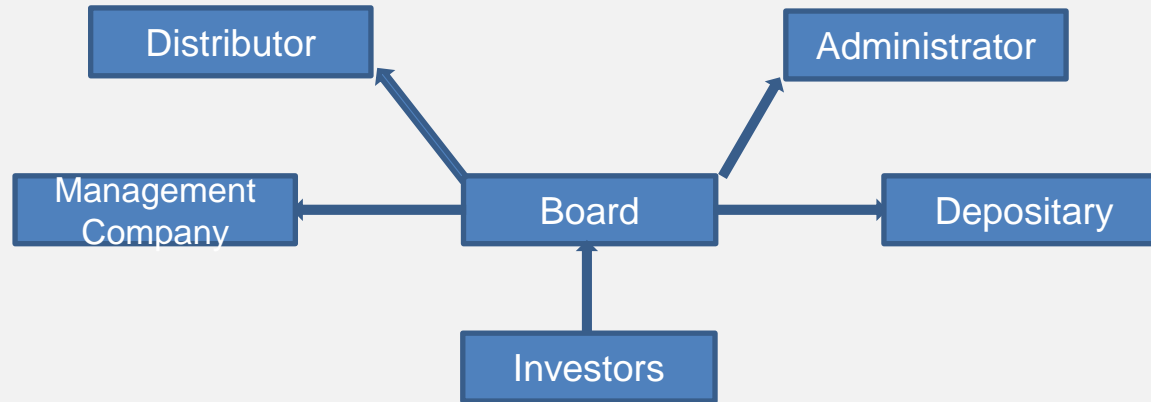
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I. Features of corporate fund directors' regime

1. The board of a corporate fund is at the center of a contractual nexus:
 - The role of third-party agents is very important as corporate funds, generally, **delegate** most of their day-to-day business.

Typical self-managed corporate fund scheme



- There is a need to manage “agency” relationships and potential conflicts of interest (e.g.: concerning fees) with third-party providers in addition to the fiduciary relationship with investors.

I. Features of corporate fund directors' regime

2. Corporate fund directors have a duty to act in the best interest of investors.

For “regular” companies, the concept of “best interest of the company” **is construed differently from one country to another** [the restrictive approach (*the interest of the shareholders*) vs. the extensive approach (*the interest of all the stakeholders – including creditors, employees...*)].

With respect to investment funds, the best interest of the company is assimilated as being the best interest of the investors (e.g.: art. 14(1)(a) Directive 2009/65/EC; Principle 1. of the 2006 EFAMA Code of Conduct: [...] “*always act in the best interest of the investor(...)*”).

I. Features of corporate fund directors' regime

3. Corporate fund directors are subject to an accumulation of laws and regulations:

i. **Company Law**

- Directors are subject to company law which will apply whenever investment fund laws **do not specifically provide for a rule** (e.g.: general meetings of shareholders; functioning of the board).
- Corporate law is not completely harmonized across Europe, as such, corporate fund directors are often unaware of their duties, particularly with regard to **local regulations**.

I. Features of corporate fund directors' regime

ii. Investment Fund Law

- Legislation is more and more unified across Europe with respect to **UCITS** and further harmonization will come with the implementation of the **AIFMD** in respect of alternative investment funds.

iii. Codes of Conduct (self-regulation)

- These codes of conduct are mostly issued by **professional trade organizations** (e.g.: EFAMA) and create industry standards expected to be met.
- The EFAMA Code of Conduct was released in 2006. The Code sets forth high-level principles, which EFAMA regards as key elements of proper business conduct. Such principles are complemented and interpreted by best practice recommendations. The Code should serve as guidelines, in coordination with national laws and legal requirements, for members of EFAMA without a code of conduct or wishing to update an existing one.
- **91%** of institutional investors estimate that poor governance would cause them not to invest in a fund, even if it met other operational and performance criteria (Source: *Corporate Governance in hedge funds: investor survey 2011, Carne Global Financial Services*).

II. Role of corporate fund directors

In an environment where cross-border fund distribution becomes more and more significant (40% of European funds are sold on a cross-border basis), corporate fund directors face a complex legal and regulatory framework which is not uniformly and consistently applied from one jurisdiction to another.

II. Role of corporate fund directors

1. Corporate fund directors are the “watchdogs” of the fund.

- It is a **common mistake** of corporate fund directors to believe that because a large portion of the day-to-day activities are delegated to third party providers, their own duties are limited.
- They have an unlimited duty with regard to overall responsibility and control. “Breakfast” directors misunderstand their role.
- A distinction must be made between self-managed corporate funds and corporate funds that have designated a management company (“ManCo”):
 - **Self-managed corporate funds:** Directors must monitor and control the delegated activities. They must ensure that the duties of the service providers (including the duty to prevent, disclose and mitigate conflicts of interest) are properly documented, that they receive regular reporting and that they carry on a critical review of these reports.
 - **Corporate funds having designated a ManCo:** Directors can rely, to a certain extent, on the checks performed by the ManCo on the service providers appointed by the ManCo (mainly administrators and distributors). Directors still have to exercise a critical review of the activities of the ManCo and of those service providers directly appointed by the investment fund (mainly the depositary).

II. Role of corporate fund directors

- Compliance checks are an important duty of the board but they should not divert the board from its **primary function** which is to be a forum where debates are held, where directors exchange and confront their views to make the most of the collective competence of the board.
- What is the “ideal” competence of a corporate fund director?
- What is the expected level of competence of an “independent” director?

II. Role of corporate fund directors

2. Corporate fund directors must act in the best interest of investors.

- Directors must be able to assess the expectations of the investor base of the corporate fund, taking into account the **various types of investors** (long term vs. short term; institutional vs. retail).
- It is sometimes difficult to know the end-investors of a fund due to a complex distribution scheme.
- Possible conflicts of interest if investor base is not homogeneous (retail plus institutional). e.g.: impact on liquidity risk control process in funds which commit to daily liquidity and redemptions.

III. Role of “independent” directors

- Appointing **independent directors** might help the board to deal with issues related to conflicts of interest and compliance with local laws and regulations.
- There is **no market practice** for the use of independent directors in **Europe**. The presence of independent directors will mainly be a cultural choice of the fund sponsor.

III. Role of “independent” directors

- Anglo-Saxon sponsors will tend to use independent directors more frequently following the **U.S. model**.
- The U.S. has put in place a **corporate governance model** for mutual funds that focuses on the role of independent directors:
 - The 1940 Act requires that independent directors represent at least 40% of board composition.
 - The 1999 ICI Best Practices Reports recommend that each board have a 2/3 majority of independent directors. This rule is applied on a voluntary basis.
 - As of 2008, 88% of the funds had more than 75% of independent directors. (Source: Investment Company Institute and Independent Directors Council).

III. Role of “independent” directors

- Should Europe follow the **same model** as the U.S.? If so, should independent directors be in charge of **specific duties** (such as representing the shareholders vis-à-vis the fund’s management company)? Would we therefore have two categories of directors with different duties?
- The European Commission’s Green Papers on Corporate governance in financial institutions and remuneration policies (2010) and EU corporate governance framework (2011) do not address the specific roles independent directors could play although they recognize the important role of the independent judgment of board members.
- The action plan of the European Commission on European company law and corporate governance has not yet been released but its impact on the status of independent directors (as well as on the overall duties and liabilities of the directors) will have to be closely monitored.