



*Independence*

*Flexibility*

*Commitment*

Trinity Fund Administration

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## **Fund Corporate Governance**

Series 1.1



## Fund Corporate Governance

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Awareness of the importance of fund governance has been gaining ground since the commencement of the financial crisis in 2008. While overall responsibility for good corporate governance lies with the board of directors, promoters also have a major role to play. Fund governance comprises systems which enable the proper control and direction of a fund and in particular the supervision of delegates.

The Board of Directors is required to act in the best interests of the fund, which usually means the fund's investors, but can also apply to other stakeholders, including creditors. It is important to ensure that sufficient numbers of the directors are independent, which is characterised by the lack of any links to companies in which the fund invests, or to significant service providers to the fund. A director, while acting on the board should declare any conflicts and act independently. Preferably he, or she should have a verifiable track record in the investment management industry.

While corporate governance remains within the official remit of the directors, an emerging trend is that more parties are becoming directly concerned with and involved in the good governance of a fund. Investors, risk management teams, service providers and regulators are all taking a greater interest in how a fund exercises proper control and direction.

### **Onshore versus Offshore**

A watershed case for many professionals in the fund industry was the Cayman Islands *Weaving case*, (*Weaving Macro Fixed Income Fund Limited (in liquidation) v. Stefan Peterson and Hans Ekstrom, Grand Court of the Cayman Islands Financial Services Division - FSD113 of 2012 AJJ*), where directors of the Weaving Macro Fixed Income Fund were found to be personally liable for redemption excesses of \$111m due to inflated net asset values of the fund. This case highlighted the high level of responsibility of each director of a fund and the importance of ensuring that each director carries out his or her myriad fiduciary, common law and company law duties properly. Cases, such as this, have driven investors to demand greater due diligence, as well as opening up a re-evaluation of how onshore and offshore funds are governed.

As discussed at the Regulatory Compliance Association symposium held in April 2012 in New York, there is often ambiguity regarding whether United States onshore domestic funds possess the same level of governance as offshore funds. The importance of board oversight is even more pronounced where onshore and offshore funds are managed side by side for example in a master-feeder structure, where the master fund is Cayman domiciled.

US onshore funds can use advisory boards rather than boards of directors if they have been established as limited liability companies or limited partnerships. This anomaly in corporate governance of onshore and offshore funds requires a robust code of good corporate governance which facilitates regulatory compliance and risk management in both the onshore and offshore entities, in order to protect the interests of the investors and other stakeholders.

U.S. advisory boards are typically composed of investors, third parties or ex-regulators, thus they often possess a high degree of expertise, however they do not carry the same fiduciary obligations as a board of directors. They are useful in terms of demonstrating commitment to independent oversight however.



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## **Code of Good Corporate Governance**

Robust corporate governance procedures should clearly lay out the board's terms of reference, the responsibilities of the directors, as well as the requirements for the appointment of a director, such as experience and independence. The code should include details of board meetings; how often they will take place, who should and should not attend, what should be covered in each meeting, the reporting requirements for delegates, as well as confidentiality requirements for material covered.

Some further items which need to be considered are potential conflicts of interest which may arise, operational activities including bank account opening and cross trades management, investor reporting and the fund's valuation policy. The last point is an item which is garnering particular attention due to cases such as Weaving.

Ireland, which is one of the most important fund domiciles in the world, has implemented a new Corporate Governance Code for collective investment schemes and management companies domiciled in Ireland. This code states certain minimum requirements to ensure strong corporate governance which facilitates effective oversight of activities, considering the nature, scale, complexity and any outsourcing arrangements. Although voluntary, it is strongly recommended by the Irish Central Bank that this code be adopted, and companies will be expected to produce a valid reason for why they could not comply at the end of the transitional period in December 2012.

## **Risk Management**

Risk management is one of the main mechanisms used to protect the interests of a fund and its stakeholders. In terms of corporate governance, the board of directors must oversee the fund's risk management policies and procedures, which can be outsourced to third parties, including the fund administrator.

Third party providers, such as fund administrators, are growing increasingly useful in the risk management arena. Managing counterparty exposure risk is achieved by diversifying beyond a single service provider (e.g. brokers) and is further enhanced by a service provider who works at arm's length, providing an additional layer of scrutiny, such as at Trinity Fund Administration. In much the same way as an experienced, independent director adds legitimacy to a board of directors, an experienced, independent service provider can add legitimacy to the robustness of a fund's risk management procedures

Risk management is strengthened through certain other operating procedures to which a third party administrator contributes, such as three way reconciliations whereby the daily trades are reconciled by three separate parties; the manager, the prime broker and the administrator. This can be extremely effective in reducing the risk of an error in the fund's accounts.



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## Conclusion

There are several ways in which a fund's approach to corporate governance can protect its investors and ensure that the fund is compliant with relevant regulations. As several related issues have shown, (Weaving, Madoff, Dynamic Decisions Capital) the most important mistake to avoid is complacency.

If the fund's board of directors remain vigilant and meet regularly and the fund's corporate governance is robust enough to facilitate sufficient control and direction, the fund should remain properly governed.

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