

ACHIEVING SUCCESSFUL CORPORATE GOVERNANCE

JONATHAN LAW, OF DILLON EUSTACE EXPLAINS WHY DIRECTORS LOOKING TO ACHIEVE COMPLIANCE AND BEST MARKET PRACTICE SHOULD LOOK TO CIMA AND AIMA FOR GUIDANCE



Jonathan Law specialises in alternative investment funds, corporate law, advising fund sponsors/managers, administrators, brokers and custodians and advising institutional investors on establishment, operation, re-structuring of, participation in Cayman domiciled alternative fund structures, Cayman company, commercial and regulatory laws and trade and acquisition finance transactions.

The Cayman Islands Monetary Authority (CIMA) issued its ‘Statement of Guidance for Regulated Mutual Funds - Corporate Governance’ in December 2013 (the CIMA Statement). The CIMA Statement was the culmination of an extensive analysis of the existing practices and procedures affecting governance within regulated mutual fund structures. It also resulted from responses to a private sector survey commissioned by CIMA to gauge market opinion as to the desirability for change and improvement of the core legal and regulatory requirements applicable to directors of regulated funds established in the Cayman Islands.

On 29 April, 2015, the Alternative Investment Management Association (AIMA) published the third edition of its Fund Director’s Guide; the previous edition was released in 2008. It represents a timely update of the treatment of the practices and procedures, role and responsibilities of directors of funds who, since the financial crisis, have been operating under an increased level of scrutiny and with a much increased workload as a result of, for example, the implementation of the Alternative Investment Fund Managers Directive (AIFMD) and the Foreign Account Tax Compliance Act (Fatca).

The CIMA Statement and the AIMA Guide are very similar in their approach to, and treatment of, the question of how to achieve successful corporate governance. Prior to this issue, the CIMA Statement was the subject of a great deal of private sector debate and discussion and the end result is a clear, direct and manageable set of base requirements for directors of regulated funds to implement. Since its publication in December 2013, the industry has taken the CIMA Statement fully on board and it features as a standard topic for discussion for those seeking guidance on the corporate governance aspects of launching a Cayman Islands fund. The CIMA Statement taken together with the Directors Registration and Licensing Law (enacted in 2014) provide a regulatory environment within

which best market practice for those who provide directorship services can be developed and the industry better regulated. The AIMA Guide is a comprehensive treatment of the subject and offers expert practical and operational support to directors. Being the product of a working group made up from the membership of AIMA, it is a highly representative view of what is taking place in the industry at the moment.

“ IN WHAT FOLLOWS, WE HAVE HIGHLIGHTED SOME KEY AREAS OF COMMON APPROACH BETWEEN THE CIMA STATEMENT AND THE AIMA GUIDE ”

In what follows, we have highlighted some key areas of common approach between the CIMA Statement and the AIMA Guide. For directors of funds, in trying to achieve compliance but also implement best market practice, it should be borne in mind that the CIMA Statement has been issued by the Cayman Islands Monetary Authority under Section 34 of the Monetary Authority Law (Revised) and although a breach of any such guidance does not of itself constitute an offence, it is generally the expectation that directors will seek to comply with any such CIMA statements. CIMA however also makes it clear that the content of the CIMA Statement is to be regarded as setting out its minimum expectations for the sound and prudent governance of a regulated fund. Therefore, in addition to the

CIMA Statement, directors will doubtless look to the AIMA Guide for a more specific, detailed and practical treatment of the subject.

CONFLICTS OF INTEREST

(i) CIMA

The CIMA Statement is concise and clear on the requirements applicable to conflicts of interest, which are that directors are obliged to identify, disclose, monitor and manage all conflicts of interest and any such disclosed conflicts of interest must be documented. It is common practice for the board of directors of a fund to disclose any known or potential conflicts of interest which may arise in the conduct of their business. Typically, a director may also have a connection to one of the other service providers to the



fund and will disclose the nature of that interest to his/her fellow board members at the first opportunity. The Articles of Association of the fund will also typically contain specific requirements regarding the timing and nature of that disclosure and its effect on the ability of the conflicted director to participate in relevant board decisions.

(ii) AIMA

The AIMA Guide also requires identification, disclosure and documentation of conflicts. It does go further than the CIMA Statement, reminding directors that the text of any such disclosure should be specific to the conflict, actual or potential, rather than a broad narration that all relevant disclosures have been made. In addition, it indicates that the practical step of disclosing all recent past and existing business and family connections should be considered as a precautionary measure and, of course, any holding of shares in the fund by a director ought to be carefully treated.

BOARD MEETINGS

(i) CIMA

The board is recommended to meet at least twice a year, subject to the particular circumstances of the fund and any need to meet more frequently in order to adequately fulfill responsibilities. The board should, where necessary, request the participation of any of its service providers at these meetings.

(ii) AIMA

Frequency of meetings is driven by considerations of operational effectiveness together with any tax considerations. A commentary on the UK tax consequences of governance would indicate that quarterly meetings, in person, are a base requirement; that telephonic participation by directors should be avoided and that a majority of the board

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and any chairperson should not be resident onshore. The meeting agenda should be circulated in advance of each meeting and each topic fully discussed and explored during the course of the meeting – ‘rubber-stamp’ meetings are particularly problematic. Each of the directors should be properly informed as to the content of the topics being discussed and should express an opinion in the exercise of his/her own independent judgment.

RISK MANAGEMENT

(i) CIMA

Under the CIMA Statement the directors are given a direct and specific duty of oversight, mitigation and management of all risks affecting the business and operations of the fund. Any and all risks should be the subject of specific and detailed discussion at board meetings.

(ii) AIMA

Considered by the AIMA Guide to be, arguably, the two most important functions of the board are review of investment performance and review of the asset manager’s approach to risk management. As a result, the board should be intimately familiar with the operations of the asset manager, the performance statistics as contained in regular reports submitted to the board together with a market review and peer group analysis prepared by the asset manager. The directors should also typically be reviewing the risk report prepared by the asset manager and assessing whether the risk metrics reported are in line with the overall investment strategy of the fund.

OFFERING MATERIALS / CONSTITUTIONAL DOCUMENTS

(i) CIMA

The directors must ensure that the offering documents of the fund are properly prepared in line with market standard expectations together with the legal requirement that the shares in the fund being offered are adequately described in all material particulars so as to enable a potential investor to make an informed investment decision. Specifically, the fund’s investment program and associated risks should be clearly and fully stated and the fund’s policy on conflicts of interest should be separately treated in specific detail.

(ii) AIMA

As a part of their overall management obligations, the directors bear collective and individual responsibility for the content of the fund prospectus, the constitutional documents and the subscription agreement(s). The directors should review these carefully both before and during any offering, to ensure accuracy and proper disclosure and also to identify weaknesses in the documents which may be creating an unfavourable reaction with certain investors, for example the use of standardised terms. Variation of the prospectus and constitutional documents may trigger certain consent requirements from the investors as a whole, or a certain percentage of them, which should be carefully considered. ■