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Gibraltar Funds Review

THE ROLE OF THE INDEPENDENT FUND DIRECTOR POST WEAVERING



The role of the independent, non-executive fund director has come under the microscope in recent weeks. That is not to say that the Cayman case of *Weaving* Macro Fixed Income Fund Limited (In Liquidation) v Stefan Peterson (1) and Hans Ekstrom (2) (*Weaving*) will be the last word on this issue. The decision may yet be subject to appeal, and no other Court has yet had the opportunity to comment, interpret or apply its statements of general principle.

However, *Weaving* has served to provide us with a detailed set of expectations for an independent fund director, as well as highlighting the potential liability of those directors in not discharging their functions properly. In *Weaving* the Court took the long standing principles concerning the duties of non-executive directors in a conventional company structure and adapted them for the unique structure of a Hedge Fund. The Court set out expectations of the directors 1) at the outset of the Fund's life 2) during the Fund's life and 3) when issues arise within the Fund. There are various examples of how these

expectations should be met but very generally all include a real understanding, and high level active supervisory function.

In *Weaving* the Directors attended regular quarterly board meetings at which pro forma Minutes were signed and the signing of various documents was facilitated. The Minutes confirmed that the Investment Manager was acting in accordance with its investment criteria (which in fact it was not). The meetings did not provide a forum for review and an agenda was never prepared. Significant weight was given in the case to documentary evidence of Board meetings and the way in which these meetings were conducted, and the Minutes themselves were analysed in detail by the Court. From April 2005, the Directors started to receive quarterly reports from the Administrator which provided details of the Fund's NAV and performance, along with details of the Fund's investments, including details of valuable interest rate swaps, but did not contain the monthly management accounts. The Directors knew that the Fund's NAV was

calculated monthly and that this calculation formed the basis upon which subscriptions and redemptions were paid. However, the only accounts seen by the Directors were the annual audited financial statements and six monthly unaudited interim statements.

In the Court's view, had the Directors reviewed those reports and applied their professional experience it would have become clear that swaps were being closed out for no consideration and that the counterparty to those swaps was *Weaving* Capital Finance (another company in which the Directors were involved). The Court held that if the Directors were carrying out their supervisory functions properly, they would have realised that the investment criteria of the Fund was quite clearly being breached and that the balance sheet was being 'dressed-up' in order to inflate the Fund's NAV. It was this passive involvement, in not applying their minds to the fund's financial condition, for which the Directors were ultimately held to account. Redemptions based on these inflated NAV figures should not have been paid out, and the



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There are different ways to play the game

More and more international investment firms are calling Gibraltar their home. With attractive corporate and personal tax regimes, a sterling-based economy with a common-law legal system and all the lifestyle advantages of being at the gates to the Mediterranean, is it any wonder?

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losses in this regard, and ultimately the liability of the Directors was determined to be not less than \$111M USD. The Court found the Directors guilty of wilful default which disqualified them from relying on an indemnity (often seen by directors as protection) from the Fund which would otherwise have blocked the liquidators' claim.

The role of the Board of a Fund normally focuses on high level oversight, with those directors accepting a responsibility to supervise the activities of the business. This is a standard fiduciary duty of care that the directors owe to the Fund, along with the duty to use the powers conferred on them for their proper purposes and to exercise their skill and reasonable care when acting in the Fund's best interests. However, it is also important that directors are able to step in and ensure that the interests of investors are protected. Directors should be able to offer an internal safeguard and demonstrate a true independence (in particular of the Investment Manager) but this is only possible with real, active involvement in the business of the Fund, and also a clear understanding of the business or trading activity of the Fund within that Board.

It is simply not enough for directors to delegate functions to various third party service providers and assume that everything is in order, and investors should not minimise the importance of these individual directors. They must be active in judging whether the Fund's best interests are being served, and engage and enquire as to the business and activity of the Fund. Failure of directors carrying out their role effectively can result in a heavy cost both professionally and financially. The judge in *Weaving* did also

acknowledge that many independent directors may not have the technical experience to monitor sophisticated investment strategies, but in such cases they are still expected to satisfy themselves that such strategies fall within the investment criteria and restrictions and they should use their professional advisors to enable them to ensure that this is the case. The Directors in *Weaving* failed to exercise independent judgment and properly supervise, and paid a dear price. The facts in *Weaving* were extreme, but it is likely that in other cases, what constitutes high level of supervision will be subject to more scrutiny and debate. The next questions might consider to what degree a director may rely on the counterparties to the Fund (in particular the Administrator and Auditor) and their own reasonable care and skill in performing their duties but most will err on the side of caution in this regard.

What is certain is that investors, both institutional and individual, are likely to attach more importance to this safeguarding role in their due diligence operations. There has obviously been guidance on the importance of the individuals exercising management and control of the Fund prior to *Weaving* and this is clearly not a new phenomenon but *Weaving* has served to highlight the obvious gaps that there must be when individuals who act in this capacity are appointed to hundreds of Funds as is not uncommon in some jurisdictions.

The Financial Reporting Council's UK Stewardship Code says that investors should ensure that board and committee structures are effective, and that independent directors provide adequate oversight. The Alternative Investment Management Association (AIMA)

suggests that a Fund Board includes a diversity of skills, experience and backgrounds. It also says that directors must have the necessary collective experience to understand the Fund's trading. Similarly, the Walker Report, which was commissioned by the UK government to explore failings in the banking system suggests that non-executive directors have a knowledge and understanding of the business to enable them to contribute effectively. The Hedge Fund Standard Board concurs by advocating a majority of independent directors who can hold the manager directly to account.

In Gibraltar, it is worth noting that the Financial Services Commission was engaged with each and every licensed Experienced Investor Fund Director in issuing appropriate guidance prior to *Weaving* as well as engaging with Directors on how they fulfil their roles in respect of specific Funds to which they provide directorship services. Furthermore, the Regulator has bucked a trend by ensuring that a list of all Experienced Investor Fund Directors is publicly available (through their website). There has been criticism in other jurisdictions that information on directors was simply not available, and that these appointments were clouded in secrecy. This has never been the case in Gibraltar, where the local regime requires an appointment of at least two previously licensed and regulated directors with the requisite knowledge and experience (collectively as a board) to fulfill the expected role in respect of each Gibraltar Experienced Investor Fund.

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ISOLAS attends Fund Domiciles.com's Domicile and Service Provider selection for Start-up Panel Discussion



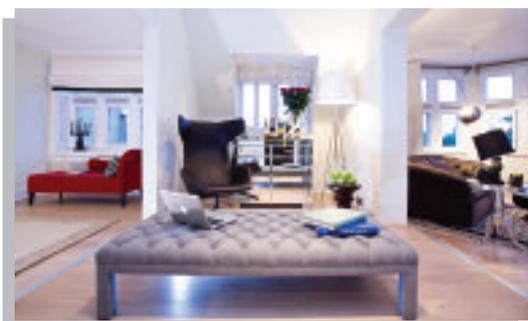
Joey Garcia represented ISOLAS on the panel at the funddomiciles.com event held at Grosvenor House Hotel in London on the 5th October. The event dealt with the 'domicile and service provider selection for start-up managers.' Discussion and debate revolved around the research results published by funddomiciles.com at the event which reflected a few interesting facts. 78% of respondents to the survey said that the asset management industry could benefit from having more jurisdictions to choose from, and 58% responded that being in the EU was an important factor in selecting a domicile. Regulatory recognition was also an important factor. Joey Garcia highlighted the memorandum of understanding in place between the Gibraltar Financial Services Commission and the UK Financial Services Authority on

equivalent supervisory standards, and the facility for Gibraltar managers to passport their services across the EU.

The panel headed an open floor discussion on the steps in launching a fund in difficult market conditions as well as counterparty selection and the availability of independent advice on domicile and service provider selection.

The panel was made up of Joey Garcia, ISOLAS, Mark Mathias, Partner of Absolute Partners, Michael Wilson, Executive Vice President of State Street, and Simon Osborn Editor and project leader on IFI Globals start up advisory service.

Hideaways Launches Second Gibraltar EIF



access to a diverse portfolio of magnificent properties fully serviced by a bespoke Concierge Service, ensuring hassle free ownership and an unrivalled experience. Unlike many equivalent operations, the Hideaways Club Funds allows participants to actually participate in the equity ownership of the properties



The Hideaways Club recently launched its second Gibraltar Experienced Investor Fund, the Hideaways Club City Collection Property Company Limited. The Fund allows investors to benefit from an equity share in an international portfolio of luxury apartments, while also granting members usage rights to those apartments through an innovative membership points system. Only investors in the fund (owners of the properties) are entitled to become private members of the Club. Members enjoy exclusive year-round

owned by the Fund, and as such, to benefit from any future capital growth in the portfolio of properties.

The City Collection offers Members a global portfolio of fully serviced apartments located in the world's most exciting cities. Launched earlier this year, the first locations include New York, Miami, London, Barcelona, Paris, Florence, Rome, Berlin, Vienna, Prague, Istanbul, Bangkok, Dubai, Singapore and Kuala Lumpur. The number of members is limited with the Fund also maintaining a

ratio of members to properties at all times. Investment in the Fund is also limited to Experienced Investors (under Gibraltar Law).

Hideaway has been awarded the International Destination Club of the Year 2009 & 2010 award issued by Destination Club News as well as the Best Destination Club of the Year 2011 awarded by Fractionallife.com

For further information please visit www.thehideawaysclub.com

Recruitment at ISOLAS

The funds team at ISOLAS has, as a result of the continuing growth in activity in the local funds industry, recruited two new members in recent weeks. Julian Sacarello, who had been with the firm for the last year and, Michael Podesta have both joined the team headed up by Albert Isola and Senior Associate Joey Garcia. Jonathan Garcia and Christian Caetano, the other two practitioners in this team which has experienced significant growth in the last couple of years, complete the team.

ISOLAS has also recently had the pleasure of welcoming another two lawyers to its team in addition to Michael Podesta. Marisa Hernandez and Danielle Victor joined the

ranks of Gibraltar's longest established law firm at the beginning of October.

The news follows on the heels of the recent announcement that Steven Caetano joined the partnership. ISOLAS' focus on organic growth and development has seen it recruit steadily in response to the growing needs of its clients and partners.

Selwyn Figueras, ISOLAS' Business Development Manager, explained how 'over the last few years ISOLAS has experienced significant yet measured growth. We've recruited a number of very experienced lawyers to bolster the firm's experience in certain key areas creating, thereby, the kind of solutions driven and close personal service



Left:
Michael Podesta
Right:
Julian Sacarello

we're all very proud of. The recruitment of three newly qualified lawyers now provides us with the opportunity of passing on that experience to a team of people who can help us to continue developing our participation in the key sectors of local practice. I'm looking forward, as are the rest of the lawyers at ISOLAS, to working with them and to providing them with all the tools and guidance they need to quickly create and develop their own professional profiles in the market."

For more information or for any enquiries please don't hesitate to contact the Funds Team: log on to our website for more information.



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