Corporate governance practices within the hedge fund industry

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Corporate governance practices for hedge fund firms are more closely examined today than at any other time in the history of the industry, hedge funds firms have experienced a shift in their investor composition from High Net Worth individual investors to institutional investors. Institutional investors have shown that they view the evaluation of governance and oversight as it relates to risk management, valuations, operational controls, transparency and the investment process as important as analysing a hedge fund manager's investment performance.'

Although many of the principles relating to a directors duties and responsibilities to a Fund are already enshrined in law, it is clear that this is a changing and evolving model in the fund universe. The idea behind the introduction of the Corporate Governance Code for Gibraltar Funds is to more specifically define, codify and develop this framework over time.

The reinforcement of governance of hedge fund boards is a key factor in the ongoing growth and development of the fund industry in Gibraltar. The Gibraltar Funds & Investments Association (GFIA) is trying to promote a good governance culture that investors and regulators want, and in fact need. Institutional investors in particular recognise the importance of good corporate governance.

To illustrate this point it is useful to consider the recent survey from Carne Global Financial Services of 100 of the largest allocators to hedge funds globally. In this survey, the following question was asked;

'Have you ever decided not to invest because of concerns over a fund's corporate governance?'

76% of the allocators responded that they had at some point chosen against investing in a fund because of corporate governance concerns. Poor corporate governance is an 'undiversifiable' risk for an investor. That is, a risk that an investor cannot receive a return. The obvious question is why this would or should ever be accepted?

The same Carne survey asked the even more direct question of *'would you choose not to invest as a result of poor corporate governance on a hedge fund?'*

91% responded in the affirmative which clearly demonstrates the importance of solid corporate governance arrangements.

Setting aside the issue of poor governance being a factor, or limiter, on the ability of a manager to raise capital, there have also been other important developments in the field of corporate governance of funds recently. Critical rulings such as that of Weavering have highlighted situations where directors without a clear understanding of their roles can face serious consequences.

Recent moves

There have also been recent moves in other jurisdictions to define and specifically tighten hedge fund corporate governance. The Cayman Monetary Authority (CIMA) commenced its consultation on corporate governance in January this year. This comes at a time when CIMA is attempting to respond to investor concerns relating to corporate governance as well as tightening regulatory oversight.

The CIMA is also proposing to include a recommendation to amend Cayman Companies Management Law to enable the regulation and supervision of individuals offering themselves to or acting as directors of six or more Cayman Islands registered entities. Gibraltar has in fact had a regulatory regime for Experienced Investor Fund Directors since 2005.

In Malta a corporate governance manual for directors of investment companies and collective investment schemes was introduced earlier this year by the Malta Financial Services Authority (MFSA). This quite prescriptive document aims to provide guidance to a director on how to implement good corporate governance practices for an investment fund. The Irish corporate governance code took effect in 2012, and although voluntary in nature, its adoption is strongly recommended by the Irish Funds Industry Association with a 'comply or explain' approach. The more substantial Irish code was a natural development of the Luxembourg Code of Conduct which is effectively a series of 8 separate high level principles, with a series of recommendations as to implementation of that particular principle.

A positive step

The Code of Conduct for Gibraltar Collective Investment Schemes is a positive step for the jurisdiction and will capture existing accepted principles of good practice and guidance. However, the value in the exercise will also be in developing these principles further, and capturing Gibraltar-specific issues such as the governance of self-managed funds and oversight of Experienced Investor Funds structured as Protected Cell Companies.

As well as dealing specifically with the role and responsibilities of a Fund Director, the Code seeks to set out Directors duties during each stage of the life cycle of a typical Fund. It will define what is expected in respect of the effective oversight and supervision of service providers to the Fund, and deal with specific elements of the composition of a Fund's Board and its collective skill set.

Gibraltar's Code of Conduct is another step in the right direction for its Fund industry. Following further consultation with industry and with the Financial Services Commission, the code is scheduled to be launched at a GFIA event at the end of May this year.

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