

THE IMPORTANCE OF TRANSPARENCY AND INDEPENDENCE

ROGER BUCKLEY OF CASTLEGATE FUND SERVICES EXPLAINS HOW THE APPOINTMENT OF AN INDEPENDENT FUND ADMINISTRATOR TOGETHER WITH EXPERIENCED INDEPENDENT DIRECTORS CAN FACILITATE A FUND'S CORPORATE GOVERNANCE CONSIDERATIONS, AND GIVES AN INSIGHT INTO CORPORATE GOVERNANCE DEVELOPMENTS IN MALTA



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Once again the theme of governance, and more specifically the transparency and independence of boards and functionaries, looks to be a predominant theme for 2013. For a taste of what's to come in Europe, it's worth examining the recent offshore reaction to governance concerns, as the traditional offshore centres tend to be more aggressive and proactive than their onshore rivals. The Cayman Islands Monetary Authority has recently issued new proposals to enhance and clarify corporate governance standards. Specific proposals include an extension of the current statement of guidance on corporate governance to all registrants, including registered mutual funds. It further aims to clarify the role and duties of fund directors in accordance with existing common law principles and international supervisory standards and suggests the setting up of a public database to facilitate due diligence and increase transparency. The main purpose of these proposals is to address increasing investor demands, ultimately aimed at increasing transparency and clarifying independence.

Prior to 2008, many investors rarely considered individual board member credentials or the quality/independence of functionaries. Instead, investors had primarily focused on financial returns and the investment strategies. Furthermore, during the boom years, there was a greater level of trust in the marketplace itself. Now investors are challenging the sources of all information, functionaries, counterparties and board composition. This is especially the case with institutional investors who are not prepared to take any risks when it comes to potential systemic failures or fraud. With over 70% of subscribers to hedge funds now institutional investors, they have more influence than ever over the market and investment managers. Consequently, it is commonplace for such investors to carry out vigorous vetting processes and due diligence

checks on funds, often requiring individual directors to provide detailed information about their background, skills and outside obligations.

Furthermore, according to the Ernst & Young 2012 Global Hedge Fund Market survey, over three quarters of investors said it was important for hedge funds to completely outsource valuation functions to an independent administrator. Moreover, the same survey revealed that two-thirds of both hedge funds and investors believe an independent administrator increases shareholder confidence in a fund. The call for independent administrators has also come from non-executive directors themselves, who feel a lot more comfortable in the knowledge that the fund's assets are being monitored and valued completely independently from the manager.

Accordingly, it is quickly becoming the case that if a fund does not have an independent administrator, the question is: why not? In summary, a 'comply or explain' type culture has emerged among many institutional investors.

For funds that choose to domicile in Malta, except in certain circumstances there are no local resident director or local service provider requirements. The minimum requirement of a fund is the appointment of a 'local representative'. The principle behind this relaxed regime was to encourage funds from various jurisdictions to redomicile or set up onshore funds mirroring their exist-

ing offshore vehicles. By allowing fund managers to continue using service providers with whom they have a working relationship and history, it was believed that Malta would have a competitive advantage over established European competitor jurisdictions, which have more restrictive licensing.

For Malta, there was a lack of fund specialist qualified individuals for the post of directorships; thus, this is another reason that the Malta Financial Services Authority (MFSA) had initially imposed fewer restrictions than rival jurisdictions. Having a range of individuals from diverse backgrounds can, of course, give the board a healthy bal-

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ance. However, problematically, many of the funds in Malta are predominantly small start-up operations and would be looking to appoint only one independent non-executive director. Therefore, they require individuals with longer-term, fund-specific experience to guide them through various start-up obstacles and initial operational hurdles. In particular, inexperienced or smaller investment managers can benefit hugely from well-rounded independent directors through their experience and understanding of the industry and foreseeable difficulties.

Ultimately, the true test of a director's effectiveness will be measured in times of difficulty, and if a director is not conversant with the principles such as gating, side-pockets, hedging techniques and the like then it is questionable what value that individual brings to the board. Fortunately, there has been an influx of talent into Malta with the likes of Castlegate Fund Services Ltd. (Castlegate), who have been firmly established in the jurisdiction since early 2011. The management team alone in Castlegate brings a wealth of fund knowledge to the jurisdiction with fund-specific experience covering the Cayman Islands, the British Virgin Islands, Ireland and Malta.

The MFSA is on the cusp of releasing a "Corporate Governance Manual" for directors of Maltese funds and investment companies. It has veered away from an actual corporate governance code, which it had previously signalled and many had anticipated. Within the manual it does, however, encourage that directors adopt a code of conduct, preferably "mandated by law, regulation or listing requirements (if applicable)". The current draft of the manual is simplistic, practical and user-friendly, being descriptive of best practice, rather than prescriptive in tone. In line with industry sentiment, the manual also emphasises the importance for every board to have at least one independent director.

It had been anticipated that the MFSA would impose some form of restriction on the number of directorships an individual director could hold. When it comes to the

debate on a maximum number of directorships, all parties involved have a different agenda, making it difficult to objectively identify a single model as the best solution. Each directorship is different, requiring different time commitments, which depends on factors such as the investor base and risks involved with the underlying securities. Therefore, any measures to determine the maximum number of appointments is fraught with exceptions and complications. Ironically, throughout the 2008-2009 turmoil, industry sentiment is that those directors criticised for having too many directorships actually did a good job, precisely because they had the long-term experience on a range of funds. Taking a pragmatic approach, the draft MFSA manual recognises that it is "impossible to derive a hard limit of fund directorships that a director may have". However, the manual goes on to state that each director must be able to defend the number of directorships held at any one time. In essence, the manual is a toe in the water for the regulator into the realm of corporate governance, and will no doubt be seen as a welcome step by both the local and international funds community.

The theme of governance has become somewhat blurred and perhaps clichéd, but undeniably it looks like a perpetual issue, and therefore cannot be ignored. Fortunately, the majority of market participants seem to be in agreement that decent corporate governance can only be achieved through independence and transparency, which is most tangibly achieved via independent third party administrators and independent non-executive directors. Castlegate specialises in fund administration and the provision of independent directors for funds domiciled in Malta and elsewhere. Industry-leading fund administration software married with a management team with over four decades of multi-jurisdictional fund experience gives Castlegate unique competencies. Castlegate has a strong focus on compliance and risk management, which ensures that all aspects of a fund's operation are individually examined in detail and attended to with professionalism. ■

