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Cayman Islands dives into deep water

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The evolution of hedge fund investors from mainly funds of funds and high-net-worth individuals to predominantly institutional investors, acting in a fiduciary responsibility to their clients, has resulted in a greater focus on corporate governance.

One area under close scrutiny is fund directorships. Investors are asking if a limit on directorships per person should be imposed.

The Cayman Islands Monetary Authority, known as Cima, last month outlined proposals to create its first public database of funds domiciled on the islands and their directors.

The regulator, which looks after the world's leading offshore jurisdiction, home to almost 10,000 funds, has asked accountancy firm Ernst & Young to carry out an anonymous online opinion poll on the optimum number of directorships.

According to Peter Heaps, a managing director at Cayman Islands independent fund directors Carne Group, US consultancy Greenwich Associates is gathering responses.
Cima did not respond to requests for comment.

Heaps

Heaps said Cima has proposed pre-approval of additional directorships for those who hold six or more and requires all directors of Cima-regulated funds to register, whether or not they are resident in Cayman.

Market participants are divided over whether there should be a cap on the number of fund directorships that individuals can hold.

Many director services firms and law firms, which provide professional directors, argue that the diversity of governance models – and the heterogeneity of director remits – render a cap unnecessary. Others go further and suggest that a ceiling on directorships could actually be harmful.

Michelle Carroll, partner of investment management at accounting and advisory firm BDO, said a cap could become an arbitrary signal: "Deeming a maximum suggests that a strong director can be identified purely by knowing how many directorships they have. That could ultimately weaken the quality of the director market."

The scope of directors' duties varies between jurisdictions and fund structures, and according to service level agreements that specify what is expected of them, the nature of strategies, and different economic climates.

Heaps said: "A typical master-feeder fund structure would mean being appointed to the board of say, three companies, but is in effect a single fund".

The type of strategy a fund is running must also be taken into account.

Mark Baak, director of Privium Fund Management, which provides platforms for hedge funds, said that illiquid strategies can take twice as much time to monitor as more liquid approaches.

Kevin Ryan, founder and chief executive of director services group HedgeDirector, said complex strategies are more labour intensive.

The number of director duties can vary depending on economic conditions or other external pressures.

Jérôme Lussan, chief executive of consulting and law firm Laven Partners, said: "Under special circumstances, such as litigation, the fund may demand special attention and the hours could grow twofold."
In a survey from Carne, which was published in September 2011 and received responses from investors representing almost 30% of industry assets, 58% of respondents said that an independent director should have no more than 20 to 30 manager relationships.

Sascha Klamp, founder and chief investment officer of incubation platform CITE Investments, suggests no director should hold more than six.

Conversely Trevor Simon, a partner at fund of hedge funds firm Hilltop Fund Management, estimates that one director could handle 50 funds.

Varying views on optimum numbers of directorships derive from differing perceptions about the time needed to do the job.

Caroline Hoare, founder of IPAF, which provides independent non-executive directors to alternative funds, said the firm binds its directors to between 12 and 15 days per year, which would imply a limit of around 20 such roles for a full-time fund director. However IPAF does not want a statutory limit.

Laven's Lussan estimates a similar time frame of 100 hours a year for directors, under normal circumstances.

Klamp sees a more hands-on role and thinks directors ideally need front-office and trading experience; while Simon reckons four days a year may be enough if there are four meetings a year.

Costs are also a factor in the debate, and cost-benefit analysis appears on the first page of the Cayman consultation document. IPAF views annual fees of about $25,000 as commensurate with the service and experience it expects from its directors.

Cost-conscious smaller funds might prefer fees of $5,000 per director: three directors costing $25,000 each adds 0.75% to the total expense ratio of a $10m fund – almost half of the standard 2% management fee.

Regarding the potential for conflicts arising from directors sitting on boards of competing funds operating the same strategy, market participants said they did not want an absolute prohibition, but that full disclosure of other relationships was essential.

Carroll at BDO said multiple similar directorships could be beneficial in times of crisis: "In a market emergency situation, having a director who can discuss his experiences across a number of similar funds can mean getting to a good solution more quickly," she said.

But Heaps said directors' duty of confidentiality could restrict how much information they could, in practice, share between funds.

Eelco Fiole, a lecturer in finance ethics at the University of Lausanne, who gained a PhD in corporate governance, said directors face conflicts.

Cima's proposed database is a result of pressure for more transparency from institutional investors such as the UK's Universities Superannuation Scheme pension fund, and fund of funds firms FRM and Mesirow Financial.

One pension fund manager said a database might end the controversy over fund directors because it would let investors make informed judgments about whether individual directors could fulfil their duties without conflicts.

A database could also bring Cayman in line with other jurisdictions. Ireland requires directors to document and disclose their interests and associated time commitments to all of their clients, without any hard limit.

Other offshore domiciles such as Gibraltar toyed with the idea of capping directorships at eight but then decided against a maximum. Guernsey has a code of corporate governance but no absolute ceiling.

• A director's duty...

Fund directors are vitally important as the guardians of investor interests. They owe a fiduciary duty to investors to verify that the fund manager and external service providers are fulfilling their specified duties.

Fund directors sign off on whether the fund manager is compliant with the mandate, on valuation and pricing by administrators and auditors, and on the accuracy and legal compliance of communication to investors, including offering documents and any side letters.

Fund directors can take professional advice but ultimately they must exercise independent judgment. Concerns about excessive numbers of directorships exist because overstretched directors might not have enough time to check that a fund's assets are being fairly valued, or that its documents fully educate investors on crisis provisions.

Many investors were caught out in 2008, when fund documents allowed redemptions to be suspended or investments to be moved into side pockets.

Correction: A previous version of this story said BDO was a law firm. It has been corrected to show that it is an accounting and advisory firm.