

Ede Conyers, Brian Desmond and Kristin Steele of **ISIS Fund Services** explain how an administrator can help you achieve a robust, independent corporate governance programme

The value of independence

If you answer 'no' or 'not sure' to any of the following questions then this article will help you to clarify your position.

1) Do you have a process whereby your board of directors or general partner is informed of exceptions to the subscription/redemption process, investment restriction breaches and other transactions under the terms of your offering document where they need to exercise their discretion and is this always properly documented?

2) Are you always aware of exceptions or breaches being made?

3) Do you know if side-pockets are contemplated by your constitutive documents and what to do if they aren't but you need to create them?

4) Do you know what to do if you want to cease trading and wind up your fund?

5) As an investor, do you know if the fund you are invested in has a corporate governance programme?

The value of a robust corporate governance programme encouraged and supported by the investment manager for its offshore and onshore fund(s) goes a long way with investors, potential investors and overall professional reputation. In the post-Madoff era, investors, particularly institutional investors, are looking to partner with investment managers who not only know how to make a buck, but who also provide legitimacy to their business by appointing independent directors to their fund(s) board of directors and who also employ a strong corporate governance programme.

Institutional investors are also vocalising their conviction that there should be some consistency between offshore and onshore in terms of appointing independent directors or committees to onshore funds and holding board or committee meetings. Maintaining a robust corporate governance programme has become important to an investment manager's business in order to attract large institutional investors and to develop and maintain a stellar reputation in the hedge fund industry.

Stringent rules

Corporate governance is more widely known and understood in the offshore hedge fund world than in the onshore world. Once an offshore fund is set up in Bermuda, for example, directors need to be appointed and certain meetings and filings need to be held on an annual basis. The investment manager's offshore legal counsel and administrator are the parties that assist in navigating through the initial

process. In most cases, the administrator is not in a position to offer legal advice but can help to determine if and when it is required.

Of the three offshore jurisdictions we operate in, Bermuda, by far, has the strongest corporate governance legislation, and those administrators located in Bermuda with corporate secretarial practices, are best poised to help the manager deliver a thorough and efficient corporate governance programme. For example, under Bermuda law, companies must have a certain number of board and shareholder meetings each year to approve the audited financial statements (these can be waived in certain instances); appoint officers and directors; set director fees; and appoint auditors, if applicable, each year.

No matter in which offshore jurisdiction a fund is registered (Bermuda, Cayman Islands or the British Virgin Islands (BVI) for example), it is essential for an investment manager to have a corporate governance process in place. Administrators who offer corporate secretarial services are in the best position to facilitate the process as they are essentially the nexus that pulls everything together.

So often, investment managers and other service providers in the industry only think of the administrator in terms of pricing the portfolio, calculating net asset values (NAVs) and processing subscriptions and redemptions, when in fact administrators can add much more value in terms of good corporate governance and anti-money laundering services.

What also is commonly misunderstood is that Bermuda-based administrators can and presently do provide fund administration and corporate secretarial services to hedge funds not only registered in Bermuda, but also in Cayman and BVI.

Substantial scope

Appointing independent directors to your fund's board of directors is a good first step, but investment managers should employ an administrator's corporate secretarial services as they are well placed to deliver thorough corporate governance.

A fund's legal counsel can also deliver a strong corporate governance programme, but at a significantly higher cost than an administrator who offers these services, and they would be wholly reliant on obtaining the necessary information in order to take the appropriate actions.

Reliable communication is difficult at the best of times so, being at the hub of the activity, the administrator can

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proactively guide the process and bring the necessary parties together. Independent administrators, such as ISIS, have corporate secretarial professionals and can add value to investment managers and boards of directors.

The scope of an administrator's corporate secretarial team's responsibilities is substantial; they are an integral part of the fund's formation process and maintain the fund during its lifetime. Its duties include facilitating and assisting with the launch; co-ordinating and preparing board meetings (either conference calls or in person) which should be held at least once a year, co-ordinating and distributing board papers before meetings and taking the minutes; advising on the process of appointing and removing directors; ensuring that any deviations from the terms and conditions set forth in the offering document are brought to the attention of the board and documented; maintaining the statutory books and records; and facilitating and/or making any necessary filings.

Having a strong corporate governance programme will assist investment managers and the board of directors with maintaining complete and accurate corporate records and avoiding missed filing deadlines. Often the corporate governance process is not viewed as a priority compared with other obligations of running a hedge fund, but knowing these matters are in safe and knowledgeable hands should provide investors and the directors with a feeling that the manager takes the running of its hedge fund business seriously.

US legislation

US investment managers are not subject to the same corporate governance requirements onshore as offshore or really any governance – yet. Part of this has to do with the legal formation of the funds as, typically, limited partnerships are not required to appoint independent directors and for years have been self-administered.

Additionally, private investment companies in the US have avoided the typical regulations for public or registered investment companies because of exceptions in the laws. Those exceptions are set out in sections 3(c)1 and 3(c)7 of the Investment Company Act of 1940. To comply with 3(c)1 and 3(c)7, hedge funds raise capital via private place-

ments, cannot engage in any advertising or general solicitation activities, and limit investment to investors who meet certain qualification standards.

Also, many US hedge fund investment managers have avoided registration because of exemptions in the Investment Advisers Act of 1940. However, based on proposed legislation in the US Congress, it is likely that at some time in the near future certain hedge fund investment managers will be required to register as investment advisers with the US Securities and Exchange Commission (SEC), and therefore be subject to oversight by a governmental body and have to adhere to reporting requirements and deadlines.

The scope of how hedge funds operate in the US is changing and to a certain degree, US investment managers may become subject to similar regulatory requirements as offshore hedge funds. As such, it is very important that investment managers consider the administrator's expertise in the corporate governance area when performing due diligence on potential administrators for both onshore and offshore products.

Time for change

The landscape for how hedge fund managers and investment funds in the US and in offshore jurisdictions are regulated and do business is ever-changing. These changes are not only precipitated by the Madoff ponzi investment-type schemes, but also driven by large, institutional investors looking for independence.

Investment managers are strongly encouraged to appoint independent directors to their funds and to develop robust corporate governance programmes. Hedge fund administrators, such as ISIS, who have a strong corporate secretarial team in place, are in the best position to deliver a solid corporate governance programme as they have the experience, expertise and are most entrenched in the day-to-day operations of the fund.

Corporate governance and independent directors will become an integral part of fund operations in the not too distant future, and with a convergence between onshore and offshore, it would certainly bring in a higher and more consistent standard. ■