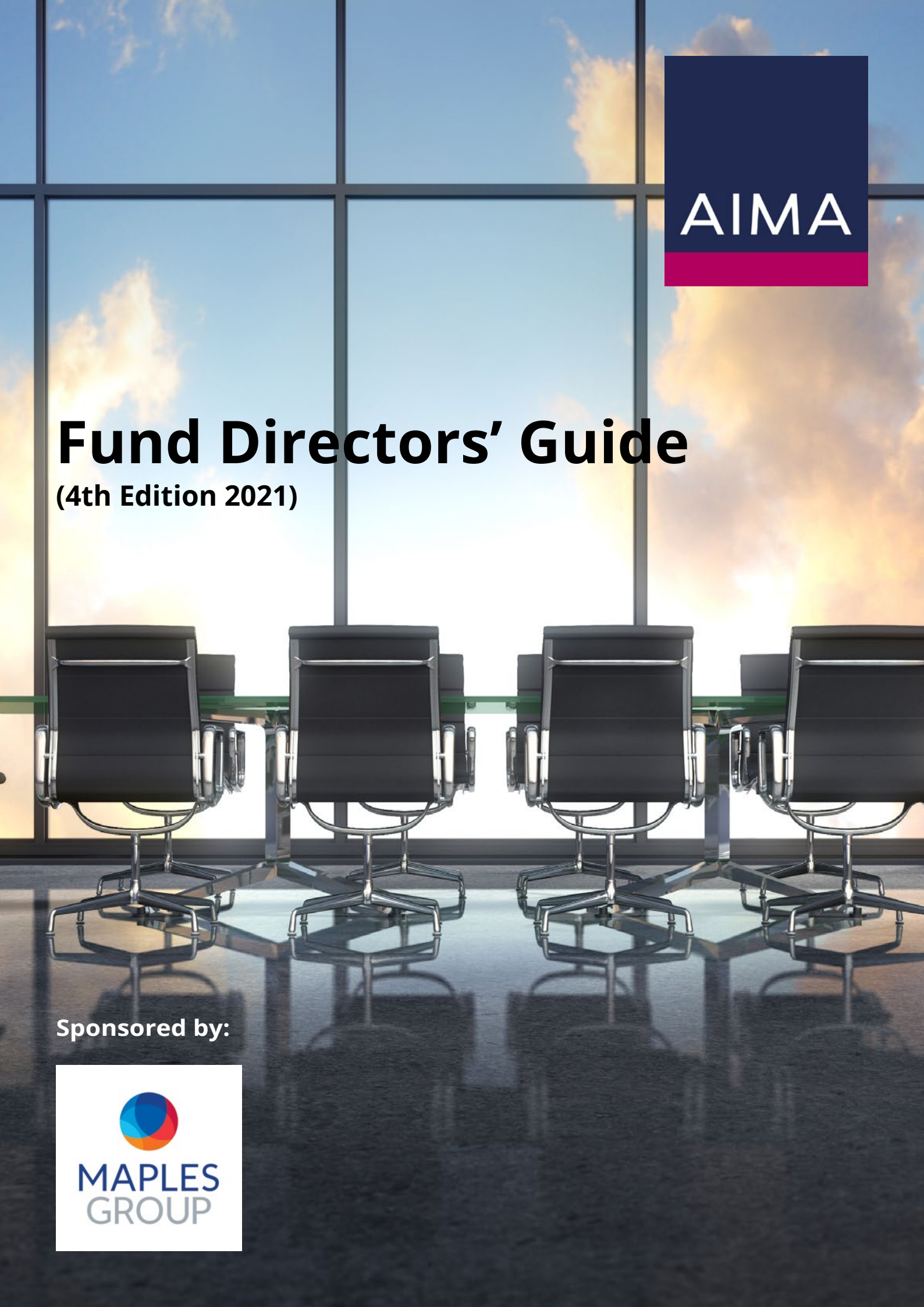


# Fund Directors' Guide

**(4th Edition 2021)**

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MAPLES GROUP

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# SPONSOR FOREWORD

The Fund Directors' Guide (the "Guide") is the initiative of AIMA's Sound Practices Committee. AIMA first published the Guide in June 2005 and revised it in 2008 and again in 2015.

The Guide seeks to provide assistance and information to the following three principal audiences:

- individuals who are, or who are considering becoming, members of the governing body of an alternative fund ("Directors"); and
- the appointed governing body of an alternative fund (the "Board"); and
- investment managers and promoters of alternative funds.

The Guide, which is jurisdiction neutral, provides an overview of the roles and duties of Directors, factors to consider when constructing the Board, the Board's operations including their ongoing role and some of the practical considerations when selecting and appointing Directors.

Having the correct Board is integral to Fund governance and successful operation of the Fund. The Guide contains general guidance on several important issues that should be examined when choosing a Board and the overall and ongoing principal duties and responsibilities of the Board.

The Guide is not a substitute for specific advice, whether legal, regulatory, tax or other advice, nor for professional judgment. It does not seek to provide detailed advice or recommendations on the wider ranging corporate governance issues, obligations and/or liabilities of which a Director must be aware.

We would like to thank the members of the working group (who are listed in Appendix B), all of whom have volunteered their time and worked hard to produce this revision of a valuable Guide. We intend to revise the Guide further as and when material developments occur.

**Peter Stapleton**

**Maples Group**

**Chair of the Working Group**

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# GLOSSARY

| | |
|---|---|
| AEOI | automatic exchange of information |
| AIF | an alternative investment fund as defined in Article 4(1)(a) of the AIFMD |
| AIFM | an alternative investment fund manager as defined in Article 4(1)(b) of the AIFMD |
| AIFMD | the EU version and the UK version of Directive 2011/61/EU of the European Parliament and the Council of 8 June 2011 on Alternative Investment Fund Managers, as amended (as applicable) |
| AIFMD Level 2 Regulation | the EU version and the UK version of Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (as applicable) |
| AML | anti-money laundering |
| AMLCO | an Anti-Money Laundering Compliance Officer |
| Board | the appointed governing body of a Fund |
| CTF | combating terrorist financing |
| Constitutional Documents | the articles of association/incorporation and by-laws of a Fund formed as a company, the limited partnership agreement of a Fund formed as a limited partnership, and in other contexts the official legal documents that are necessary for the establishment of the Fund in the jurisdiction where it is established |
| Director | as defined in Section 1.1 |
| DMLRO | a deputy MLRO |
| ERISA | the U.S. Employee Retirement Income Security Act of 1974 |
| ESG | environmental, social and governance |
| EU | European Union, consisting of 27 member states as of the date of publication of this Guide |
| FATCA | the U.S. Foreign Account Tax Compliance Act |
| FCA | the UK Financial Conduct Authority |
| Fund | as defined in Section 1.1 |
| governing body | a board of directors for an entity established as a company or, with respect to other types of entities, the body performing similar functions, which, depending on the legal structure, could include a management company, trustee or general partner and, in certain circumstances, includes an "independent review committee" under applicable Canadian law |

| | |
|---|---|
| IFRS | international financial reporting standards |
| IMA | investment manager agreement |
| investment manager | the entity that performs the day-to-day portfolio and risk management functions for a product and/or is responsible for the day-to-day business, operation or affairs of a product. An investment manager for purposes of this Guide may be: (i) a discretionary investment manager; (ii) a non-discretionary investment advisor; (iii) a registered investment adviser under the U.S. Investment Advisers Act of 1940; (iv) a commodity trading advisor under the U.S. Commodity Exchange Act; and/or (v) an AIFM. Depending on the circumstances, "portfolio manager" and "investment fund managers" (each as defined under applicable Canadian law) and any other similar entities under applicable local law may also be considered investment managers |
| KYC | know-your-customer |
| MLRO | money laundering reporting officer or AML compliance officer, depending on the jurisdiction |
| offering document | a collective phrase for all Fund offering documentation, including an investment memorandum, a private placement memorandum, an offering memorandum, a prospectus, etc. and any supplements thereto. The offering document is the formal document providing essential information to a prospective investor |
| UK | the United Kingdom of Great Britain and Northern Ireland |
| U.S. GAAP | U.S. generally accepted accounting principles |

# 1. The purpose of this Guide

The purpose of this Guide is to provide assistance to existing and potential Directors to help them better understand their role and responsibilities, as well as information for investment managers about what they should reasonably expect from Directors.

With the support of various AIMA and ACC Sponsoring Partners, a Fund Comparison Matrix has been prepared as an additional resource. The matrix covers jurisdiction-specific Director requirements, as well as describing the types of Fund structures available in each jurisdiction. The matrix allows for easy comparisons of Fund features within and across jurisdictions and provides an overview of the various Director qualification and governance requirements. Where applicable, the individual country matrices separate the Director requirements between those stemming from the applicable regulatory regimes and those originating from the laws governing the establishment of entities used as Fund vehicles in a jurisdiction. The Fund Comparison Matrix replace the jurisdiction-specific appendixes that were included the 3rd edition of the Guide and includes the following jurisdictions: Jersey, Guernsey, Hong Kong, the Cayman Islands, the United States and Luxembourg. Further jurisdictions may be added at a later stage.

## 1.1 Who is a "director" for purposes of the Guide?

The Guide uses the term "Director" to refer to those natural persons who are existing or potential members of an alternative fund's governing body (referred to as the "Board") and the term "Fund" to refer to the alternative fund vehicle(s), wherever domiciled and however legally structured, on whose Board the Director is or will be serving.

The term Director in this Guide, therefore, may in various contexts refer to an individual who serves on or is responsible for the governing body of a non-corporate entity, including the general partner of a limited partnership, the manager or trustee of a trust, the managing member or manager of a limited liability company or where an individual is otherwise responsible for management and/or oversight of certain aspects of an alternative fund structure.

The Guide focuses on information for Directors of Funds that are neither: (i) Undertakings for Collective Investment in Transferable Securities ("UCITS"); nor (ii) registered as investment companies under the U.S. Investment Company Act of 1940, as amended ("40 Act Funds"), even though UCITS and 40 Act Funds can utilise alternative asset strategies.

## 1.2 What are the role and duties of a Director?

The Board is responsible for the management of the Fund and overseeing that the Fund consistently operates in a manner that seeks to protect the best interests of the Fund and its investors as a whole. In addition to the oversight of the investment manager (including ensuring that the investment manager adheres to the objective, policy, strategy and restrictions of the Fund), key service providers and outsourced functions detailed below, such protections include, most broadly, the identification and mitigation of risks, the identification and management of conflicts of interest, ensuring investor communications are both clear and accurate and oversight of the financial controls of the Fund.

To achieve these aims, Directors need to have sufficient expertise, skills and experience to adequately discharge their responsibilities or be required to undertake relevant training. The Board should have in-depth knowledge of a number of key components of Fund operations, such as the contractual relationship with, and operational performance of, the various service providers

including, among others, the investment manager, administrator, custodian/depositary, auditor and prime broker(s). The Board should also have sufficient regulatory knowledge, either itself or through its advisors and compliance consultants, in relevant jurisdictions, enabling it to ensure that the Fund's activities comply with applicable laws and regulations.

The Board should act critically and independently so as to exercise objective and independent decision making. The Board should also strive to remain current with industry, legal and regulatory developments, including any threats or risks to the Fund that may develop in the market or through new conflicts of interest.

Ultimately, the role of the Board is both offensive and defensive: it should be actively working to ensure that the Fund achieves its stated goals, while simultaneously remaining vigilant for threats and risks to the short- and long-term viability and success of the Fund. Further details in relation to the ongoing role of the Board are set out in Section 6 of the Guide.

Fund governance is a framework for the organisation and operation of a Fund that seeks to ensure that the Fund is organised and operated efficiently and in the interests of investors. Fund governance represents the practices and procedures by which a Board manages and controls the Fund with the assistance of the Fund's service providers.

Fund governance should assist in aligning the interests of a Fund and its many stakeholders in order to achieve best the stated goals of the Fund. In most cases, the protection of the Fund equates to the protection of investors as a whole, but there could be significant divergence, such as when investors disagree or in the anticipation of insolvency; a scenario that requires a balance among all interests.

Where a Fund is organised as a corporate, the Directors owe the Fund a number of duties including a duty of loyalty and a duty of care, as set out in the law of the Fund's jurisdiction of establishment, any relevant regulations or statements of guidance or any relevant codes of conduct These duties are of a fiduciary nature and require that Directors must always act in good faith and in the best interests of the Fund and avoid conflicts of interest between their duties as Directors and their personal interests. They should disclose any relevant conflicts of interest to the Fund. Directors should act in accordance with the Fund's Constitutional Documents. Directors should not agree to restrictions of their exercise of independent judgment. Further, Directors should not make any undisclosed profit or receive any undisclosed benefit at the expense of the Fund. Finally, the Directors must act with reasonable judgment, skill, care and diligence at all times.

Where Funds are organised in other legal forms, the Board may have duties of a substantially similar or even identical nature to those applicable to corporate funds. In each instance, the nature of such duties, and to whom such duties are owed, may be dependent on whether the relationship is to a large extent contractual, such as in a partnership, or otherwise. Typically, the extent and nature of such duties and the applicable standard of care owed by a fiduciary will be prescribed in, and determined by reference to, the Fund's underlying Constitutional Documents.

Key/strategic decisions relating to a Fund shall be considered by the Board, including, but not limited to:

- creation/termination of new sub-funds and classes of shares;
- changes in investment objectives, policies and restrictions;
- approving leverage or borrowing limits;
- temporary suspension in the calculation of net asset value;

- satisfying withdrawal requests with in kind distributions;
- approval of dividends, fees and expenses;
- establishing reserves for liabilities and/or contingencies, other than standard audit holdbacks;
- supervising delegates;
- AML and CTF risks of the Fund;
- appointment and removal of service providers and approval of material contracts and material business arrangements, including but not limited to:
    - the investment management agreement;
    - the engagement of the auditors;
    - the administration agreement;
    - the depositary or custody agreement, as applicable;
    - the prime brokerage agreement, as well as any related agreements such as ISDAs, etc;
    - fund bank account arrangements;
    - side letters (if any);
- approval of financial statements of the Fund; and
- any other decisions of a strategic nature.

For Funds that are licensed or regulated, an enhanced and heightened level of responsibility and oversight is required in order to remain in good standing with regulators in the relevant jurisdiction.

## 1.3 To whom does the Director owe those duties?

A Director, by virtue of their management and oversight role, is typically a fiduciary and will owe duties to certain persons by virtue of that relationship. In a corporate context, a Director owes these duties to the Fund and the investors as a whole rather than the interests of any particular investor. There may be additional stakeholders to consider where the Director serves on a governing body that is itself a legal entity or where the Director serves on two or more vehicles in the same fund structure, such as a master-feeder structure.

Directors should also be aware of any specific obligations that are assumed and owed to regulators or specific investors by way of side letters or similar arrangements.

In an insolvency scenario, Directors have a duty to creditors to preserve the assets for the benefit of the Fund's creditors. Directors must also have regard to any employees of the Fund.

Regulators recognise the importance that Boards play in the effective oversight of Funds. In several instances, regulators mandate that Directors are personally licensed or registered in the relevant jurisdiction. While such licenses or registration does not change the duty that is owed to a Fund as a result of law, they typically require Boards and their members to be fit and proper and adhere to standards and obligations that extend beyond those owed to a specific Fund. This may involve a Director being subject to ongoing disclosure obligations pursuant to fitness and probity/ fit and proper person tests imposed by regulators in certain jurisdictions.

# 2. Governance for non-corporate fund structures

Funds may be structured as non-corporate entities. Set out below are some examples of non-corporate fund structures and details on Directors' roles and duties in such structures.

## 2.1 Limited partnerships

Limited partnerships may be structured differently across various jurisdictions.

Generally, a limited partnership must have a general partner, which has authority to legally bind the partnership and assumes liability for the debts and obligations of the partnership (as the partnership does not have separate legal personality). The Board will sit at the general partner level. The investors ("limited partners") cannot participate in the management of the partnership without the risk of losing their limited liability status. Day-to-day management and decision-making provisions are set out in a limited liability partnership agreement between the general partner and the limited partners. The general partner should consult the limited partners on strategic issues and may be required to obtain the consent of the limited partners in certain instances. Limited partners can generally perform certain internal activities, as set out in legislation specific to each jurisdiction, without affecting their limited liability.

## 2.2 Trusts

A unit trust operates as an investment fund and can be established under a trust deed made between (i) the management company and (ii) the trustee or the trustee only in certain cases. In some jurisdictions, a unit trust does not have separate legal personality so cannot enter into contracts itself, instead, contracts are entered into in respect of the unit trust by its trustee, its management company or, in certain cases, by its depositary (which also acts as the trustee).

## 2.3 Independent advisory committees and limited partner advisory committees

In certain Fund structures and in some cases where the general partner or other governing body is affiliated with the investment manager or is not otherwise independent of the investment manager, investors may request that a separate, independent advisory committee be established to provide oversight on matters that involve potential conflicts of interest or that could be materially adverse to investors. This is most commonly seen in master-feeder structures where the master fund, i.e., the entity holding the portfolio, is a limited partnership rather than a company. An investment advisory committee may also serve a regulatory purpose and be requested to exercise oversight or determine certain decisions on behalf of the general partner of a limited partnership to ensure they are made independently of the investment manager and its affiliates (which usually includes the general partner) to comply with relevant regulatory requirements.

The role and responsibilities of an independent advisory committee will be informed by the rationale for its establishment. A committee's scope and function, therefore, are typically only contractual in nature. For some Funds, roles and responsibilities will be set out in the Fund's Constitutional Documents, i.e., the partnership agreement for a limited partnership and for other Funds they may be prescribed in more detail in an advisory committee statement of understanding, terms of reference or similar. The responsibility for management of the master fund vehicle otherwise remains vested in the general partner (or other governing body).

The matters which an independent advisory committee member may be required to consider will often mirror the types of matters that require the consent of directors of the corporate feeder, and can include the following:

- review and approve material changes to the offering document or the Fund's Constitutional Documents;
- approve any changes to service providers to the Fund;
- approve any side letter agreements with prospective investors in the Fund;
- approve any compulsory or special redemption or wind down of the Fund;
- review and approve any advance or payment of indemnification expenses made by the Fund;
- approve any change of the procedures under which the independent advisory committee operates; and
- approve the appointment or removal of members of the independent advisory committee.

Limited partner advisory committees ("LPACs") provide a different form of oversight and governance for Funds and investment managers. As the name implies, these structures are generally comprised of Fund limited partners and serve primarily to address potential Fund-related conflicts of interest or changes to terms/timeframes for the fund structure. To be clear, LPACs are considered to be independent of the Fund and its operators. LPAC members typically only have a few specific duties/responsibilities that are as expressly provided for in the underlying contractual agreement governing the Fund.

## 2.4 Funds without a separate legal identity

Certain Funds across different jurisdictions may be structured as an unincorporated body without a separate legal identity. For example, the unit trust in certain jurisdictions, the common contractual fund ("CCF") and the *fonds commun de placement* ("FCP"). In such instances, the governing body of the management company of the unit trust, CCF and the FCP have responsibility for the Fund.

# 3. Constructing a Board

There are numerous factors and considerations that need to be taken into account when constructing the Fund's Board which are considered in further detail in this section. The Board needs to be comprised of Directors with a good balance of skills and expertise.

## 3.1 Board size

When selecting potential Directors one should consider the appropriate size of the Board. The Board should be of sufficient size and expertise to oversee adequately the operations of the Fund. While there are no specific requirements as to maximum Board size some jurisdictions have minimum Board size requirements. In general, most Boards tend to be comprised of three, four or five Directors. In practice, to alleviate the potential issue of a tied vote of Fund matters, having an odd number of Directors comprising the Board makes sense; the alternative is for the chairperson (if such a role has been established in the Constitutional Documents) to have the casting vote. Newer and smaller Funds often start with a smaller Board, and some may choose to increase the size of the Board at a later date if and when the size of the Fund has grown significantly. Having

more Directors has the benefit of increasing the breadth of knowledge and experience of the Board but will likely result in additional expense for the Fund.

## 3.2 Ratio of executive to non-executive (or independent) Directors

A key, if not essential, element of Board governance for institutional investors is their expectation that Boards will be composed of a majority of independent Directors. In some jurisdictions, there are requirements regarding the minimum number of independent Directors.

Notwithstanding the lack of explicit regulation in some jurisdictions, Funds have typically embraced the sound practice of having a majority of independent Directors. It is increasingly customary for Boards to be comprised of only independent Directors, although historically it has been commonplace to have one or more Directors who represent the investment manager and in some jurisdictions it is in fact recommended that at least one Director be a representative from the investment manager. Emerging investment managers may wish to control the Board, but there are a number of potential consequences of an investment manager wanting to structure the Board as majority affiliated. Those may include: (i) disenfranchising the Directors not affiliated with the investment manager; (ii) jeopardising the tax status of the Fund; and/or (iii) raising investor concerns that the Board could put investment manager interests ahead of investor interests and protection.

Non-independent Directors can pose potential conflicts of interest that need to be identified and either avoided entirely or managed and disclosed appropriately.

## 3.3 Factors to consider when identifying a potential Director

Factors that should be evaluated when determining a person's suitability to act as a Director include their (i) independence; (ii) capacity; (iii) tenure; (iv) other business relationships; (v) relationships with the Fund's investment manager or any of its related persons or staff; and (vi) investments in the Fund.

### Independence

The definition of what constitutes "independence" differs depending on the context. Independence can be considered as the ability to exercise sound judgement and decision making independent of the views of the investment manager, the service provider(s), political interests or inappropriate outside interests. What is considered "independent" depends on the circumstances and may be especially relevant when establishing a Fund. Factors that may be relevant in this regard include, among others:

- any financial or other obligation the individual may have or had to the Fund or a group entity, its directors, investment manager or service providers in the recent past;
- whether the individual represents a significant shareholder of the Fund, its promoter or its investment manager;
- any remuneration received directly or indirectly, by the Director in the course of providing non-director services to the Fund;

- whether the individual acts as a director to the investment manager or any other service provider to the Fund;
- the regulatory regime(s) governing the investment manager;
- the Fund's jurisdiction of formation;
- the regulatory regime(s) applicable directly or indirectly to the Fund;
- tenure;
- any applicable codes of corporate governance; and
- whether the Fund is to be listed on an exchange(s).

Sound practice/governance codes in some jurisdictions mandate a minimum number of Directors that must be independent on the Board and the criteria for assessing independence. The rules of certain stock exchanges must also be reviewed as they may impose requirements for a minimum number of independent Directors on the Boards of Funds that seek a listing for their shares. As part of a Director's appointment acceptance, the Director should be asked to certify that they are independent and are fully cognisant of the applicable regulatory rules in the applicable jurisdiction(s).

## Capacity

Persons selecting potential Directors should consider and assess whether the proposed Director has sufficient time to devote to the Fund to ensure they will be able to contribute effectively. The required time commitments should be specified and documented at the outset and on a periodic basis as appropriate. What is sufficient depends on each proposed Director's circumstances, experience of the Fund's strategy and their other commitments. Each proposed Director should provide candid answers to these basic questions, and the investment manager (in respect of a new Fund) or the incumbent Directors and the investment manager (in respect of an existing Fund) should do careful diligence on this issue to avoid problems arising later.

Regulators, politicians and the press also focus on the capacity of a Director to devote the necessary time to do the work for the Fund. While there is not a magic number that fits all contexts, Directors should have sufficient capacity to handle the number of mandates that they have. There may also be jurisdiction-specific considerations which will be required to be taken into account.

A number of factors may impact a Director's real or perceived capacity, including:

- number of investment managers sponsoring the Funds the Director serves (although consideration will still need to be given to the number of Funds and related entities served by the Director of any one investment manager);
- quality of the investment manager's infrastructure, controls and personnel;
- complexity of the Fund's strategy;
- the Fund's terms and commercial considerations that materially depart from industry norms (e.g., gates, side pockets, trade allocations);
- quality and engagement of the Fund's other Directors;
- organisational quality of the Board meetings, corporate secretariat, agenda information pack and timing, etc.;

- support (in terms of administration of mandates and keeping current with industry and regulatory developments);
- regulatory approval or status (whether the Director is regulated); and
- investor and public perception.

There is arguably a trade off with respect to capacity in terms of a Director's time versus experience. A Director with fewer mandates generally has more time to focus on their mandates, but a Director with more mandates might have more experience that may be beneficial to all of their mandates.

Directors should also be made aware of the legal and regulatory obligations upon them in the jurisdiction of (i) establishment of the Fund concerned, and (ii) jurisdictions in which the Fund operates (e.g., where investments are made, where the investment manager is based and/or investors are based).

There are a number of professional director services providers worldwide that offer independent Directors to the alternative fund industry, and such firms can be a good source for investment managers. Over more recent years there has been discussion and debate among institutional investors, professional director firms and regulators over potential conflicts arising due to numbers of Board appointments per Director, individual fee concentrations with Directors serving on certain large platforms and most notably questioning capacity. An important point to highlight is it will be during times of market stress that Boards will likely be more active and hence the importance that this capacity theme is addressed by the investment manager when constructing the Board and ensuring it is appropriately addressed as part of ongoing due diligence.

## Tenure

There is no accepted norm for the length of time a Director can serve on a Board, in the alternative asset management industry but there may be local governance codes which set out requirements and/or recommendations in various jurisdictions. In practice, it is most typical for a Board change to be triggered by a change of circumstances of the Director (resigning) or the Fund's closure rather than there being a proactive determination for change(s) to be made to the Directors.

The alternative asset management industry can look to guidance emanating from other elements of governance found in the corporate world.

In the broader corporate world, especially in public companies, stakeholders increasingly acknowledge that Director rotation can help maintain good corporate governance standards. The concerns in the corporate arena are similar to those in the alternative asset management industry. Potential concerns of maintaining the same Board composition over the long term include: (i) Director entrenchment; (ii) conflicts of interest arising in part due to Directors cosying up to the investment manager's C-suite in order to keep their mandate; (iii) risk of "groupthink"; (iv) the loss of the new perspective brought by new Directors with "fresh eyes"; and (v) the enhanced discussion of topics when Directors bring different experiences and backgrounds to bear on an issue. Indeed, as new risks emerge for Funds, for example cyber security, alternative data, cloud technology, etc., the Board's skill sets may also need to evolve. This is especially so where the existing Directors have no familiarity with new technologies, their impacts on the business and the attendant risks.

However, determining Director changes based on tenure alone can be viewed as a very blunt instrument and may lead to a less effective solution. One can argue that a long tenured Director, who has built a strong knowledge of the Fund and investment manager over time, can use that

experience to manage the Fund through more difficult times such as the global financial crisis in 2008 and, to a lesser extent in 2020, when Covid-19 triggered market volatility and liquidity difficulties.

As investment managers explore whether Director tenure is an effective input to evaluating the effectiveness of the Board, a few factors need consideration. If the length of tenure is perceived too short, then this could lead to good quality independent directors rejecting the advances of the investment manager and hence the quality of the Board suffering as a result. A short tenure could also lead, consciously or sub-consciously, to independent Directors making shorter-term decisions (unless there was a staggered rotation policy to ensure longer-term continuity). If the tenure is set too long, then the perceived concerns outlined above could materialise and lead to challenge by investors.

So is there a sensible answer? AIMA is not advocating for immediate change, but it would be short-sighted for the alternative asset management industry not to observe the broader corporate community and associated evolving initiatives and norms. At this time, AIMA does not believe that a "one-size-fits-all" approach is in the best interests of the industry but rather, to satisfy investor expectations, non-executive director appointments should be reviewed regularly by the investment manager. If a time specific expectation becomes an accepted investor requirement, then a "comply-or-explain" approach may be a sensible way forward, provided that the Director sets out a realistic plan to address the issue in a tight timeframe.

## Other business relationships

The investment manager and Director needs to be cognisant of actual or perceived conflicts arising from other business relations to which the Director is party that could prompt questions about the independence of their appointment to the Board as well as conflicts arising from relationships with other core service providers. Examples could include the Director's other business interests providing paid services to the investment manager or Fund, or their firm investing into the Fund and the Director being privy to Fund sensitive information that could be acted upon ahead of other investors. As a matter of sound practice, before each Board meeting convenes, each Director should confirm for the minutes if they have any conflicts of interest which should be considered by the Board. See Section 6.1 of the Guide and Appendix A for further details regarding potential conflicts of interest.

## Relationships with the investment manager, its related persons or staff

If a decision has been made to operate a split Board, i.e., a mixture of independent and non-independent Directors, it is important to get the balance right. As highlighted earlier when talking about Board composition, consideration should be given to perceived or actual conflicts associated with the appointment of a past employee/officer of the investment manager as a Director.

An investment manager may, in identifying competent and trustworthy Directors, wish to consider appointing a retired employee. While this may benefit from the individual intimately knowing the investment manager's business and Fund, it does raise concerns from institutional investors about such an individual's "independence" given the likely relationship this Director has with senior officers at the investment manager. There is no industry accepted guideline as to when a past employee is no longer deemed affiliated, i.e., can be viewed as independent, but the passing of three years since departing the investment manager appears a reasonable assumption.

Similarly, a conflict of interest may arise where a Director is also appointed to the investment manager's corporate entity. While participation on the investment manager's board may provide Directors with insights that can potentially benefit the Board, on balance, institutional investors view such an arrangement as conflicted, with the Director(s) not able to make Board decisions that prioritise investor interests.

### Investments in the Fund

It is uncommon for an independent Director to personally invest into the Fund to which they are appointed as Director, other than in the listed-funds sector where small Director investments are typically made to evidence beneficial "skin-in-the-game". However, some investment managers include fund language that allows Directors to invest via specific share classes. While one can argue that personal investments align the Director's interests to that of other external Fund investors, the broader industry view is that such personal investments potentially compromise a Director's independence. An investment manager should consider these competing views when formulating policy on how to construct its Board.

## 3.4 Desirable skill sets for Directors

Any Director should have sufficient and relevant knowledge, skills and experience to carry out their duties as Director. As such, the following guidance may be helpful when choosing an appropriate Director for a Fund.

A diversity of skills, experience and backgrounds can be useful in ensuring balance and risk coverage within the Board composition and that key specialist areas are adequately covered. Examples of prior experience that could be desirable include:

- prior experience on alternative fund boards and/or of alternative funds;
- knowledge of risk management;
- knowledge of the principles of good governance and of industry trends;
- a legal background and knowledge of applicable regulatory regimes;
- technical knowledge as to the Fund's investment strategy;
- knowledge of accounting and fund administration;
- knowledge of valuation and instrument types;
- knowledge of cyber security issues; and/or
- relevant experience through cycles - economic, market and fund life cycles.

Some or all of these types of experience could have been gained through any one or more of the following types of roles, functions or experiences:

- asset management;
- risk management;
- legal/compliance;
- operational due diligence;

- audit;
- fund administration, including, but not limited to, AML;
- fund raising and distribution; and
- product specific skill sets.

While functional experience is very relevant, above all a Director must understand and commit to consistent application of good governance. They must have the ability to exercise strong judgement, particularly in times of stress and crisis, and also offer a pragmatic perspective while upholding key tenants of good governance.

Directors should be proactive, prepare for meetings in advance, raise questions or seek reports on areas which concern the Fund's business operations.

Directors should make their own assessment of risk and risk mitigation – i.e., as to how they are managing the risks perceived through delegation, controls, procedures, etc. which should frame the Board's agenda.

## 3.5 Diversity

Investors increasingly expect investment managers to acknowledge the importance of including personal traits such as gender, race and ethnicity into the broader running of the business and this extends to key service provider and stakeholder consideration. As such, the investment manager should include personal trait considerations when forming the Board and when changes to the Board are being made. Investment managers should be able to evidence to investors its framework for diversity and inclusion and provide details that underpin this framework.

## 3.6 Director residence and tax considerations

The selection of potential Directors should also consider the relevant tax issues, which may vary depending on the locations and individual tax status of the relevant Directors, where and how frequently Board meetings are going to be held in practice and on the location of the investment manager of the Fund. Specialist tax advice on these issues should be obtained as factors such as the location of Board meetings or composition of the Board can affect the Fund's susceptibility to tax or tax residence.

It is important that a Fund does not inadvertently subject itself to taxation in a taxing jurisdiction, thereby imposing an unnecessary tax burden on the Fund. Directors should be aware, or be made aware, by receiving briefing from tax experts, of these issues and their related consequences and operate the Fund accordingly. Particular consideration should always be given to the domestic law of the jurisdiction where the Fund's investment manager is based since this can often increase the risk of causing the Fund to become taxable in that jurisdiction.

When investment managers are selecting potential Directors, the investment manager should consider the location of each proposed Director's usual residence in relation to the investment manager's headquarters and any likely location for in-person Board meetings.

Before the Covid-19 pandemic, one factor was a Director's proximity to the Fund's domicile and the locations of the investment manager for the (generally) annual, in-person Board meetings (in doing so minimising Fund travel costs and the practicalities of a Director's travel time). In addition, it is common for Directors to perform due diligence of the investment manager's controls

and infrastructure on an annual basis, so again a similar consideration of travel costs and times. However, given the protracted Covid-19 travel restrictions together with the advent of improved video meeting technology, it is unclear whether post-Covid-19 Board meetings will return to pre-Covid-19 norms, or whether video technology services will serve as the primary means for Board meetings and investment manager due diligence. Again specific legal and tax advice should be sought on these matters.

Certain jurisdictions also impose regulatory requirements with regards to the residency of Directors which should be taken into consideration in addition to any tax driven residency requirements.

## 3.7 Statutory or regulatory qualifying conditions

Most jurisdictions will have statutory or regulatory conditions that must be fulfilled in order for a person to carry out the role of a Director. The qualifications can be generally described as a base or minimum standard to be considered in order to serve as a Director. Those include being a "natural person", being over the age of majority in that jurisdiction, demonstrating mental capacity and not being a bankrupt. In some jurisdictions, residency requirements may also need to be observed.

### Disqualifications

Once in place, a Director can be disqualified for a number of reasons. Many jurisdictions have explicit laws and rules and regulations regarding the disqualification of Directors. Those reasons range from falling below the qualifications standards set out above (i.e., becoming a bankrupt) to more serious transgressions such as a breach of the duty to act fairly and honestly and in the best interests of the corporation and improper or insider trading.

## 3.8 Due diligence

Investment managers should conduct formal due diligence on prospective Directors before making the appointment(s). The investment manager should use a structured framework to appraise a shortlist of prospective Directors to ensure the most appropriately skilled and best fit individuals are identified. Once the below approaches have been considered, arranging one or more meetings (in person or virtual) with the prospective Director should always be made to validate the due diligence findings and is the best way to answer the "fit" question.

It is also common for investors to enquire of the investment manager how each Director was identified, as investors are interested in understanding any potential conflicts or a "quick fix" appointment which may suggest the investment manager is not taking the role of the Board seriously.

Potential Directors should likewise carry out their own due diligence on the investment manager and the Fund (if already in existence) before accepting any appointment to the Board.

There are a number of approaches that an investment manager can take to complete its due diligence process (the investor perspective is also included to provide further insight):

### DDQ/self-certification

The investment manager may utilise a bespoke questionnaire or leverage the AIMA version (if a member) to consider many of the points discussed in this Guide to facilitate a comprehensive

appraisal. However, reviewing the questionnaire should be supplemented by other external checks to verify the questionnaire responses.

Increasingly, investors conduct operational due diligence on the Directors prior to allocating to Funds as the composition of the Board is important to investors as the Board's role includes overseeing the orderly management of key investor Fund risks.

Investors seek to gain comfort and assurance that the Board is overseeing these risks and not delegating responsibilities back to the investment manager. Please see Section 7.1 of the guide for more details on investor due diligence on Directors.

### Director services providers

Where Directors associated with a director services provider serve on the Board, the diversity of points of view represented on the Board may be improved by selecting no more than one Director from a single director services provider. The compensation model of the director services provider and the dependency on key relationships should be reviewed and considered when selecting a Director from director services providers. Persons selecting potential Directors should also consider whether any of the above could pose any conflicts of interest (see Section 6.1 of the Guide and Appendix A for a discussion regarding the identification, monitoring and disclosure of conflicts of interest).

### Public registers

The investment manager should review regulatory websites, as applicable, to ensure the Director(s) have not been disqualified (see Section 3.7 of the Guide).

### Third-party background checks

The investment manager may employ a third-party background check agency to conduct a formal review of the Director to validate past employment, current business interests and ensure there are no adverse regulatory or criminal records that may generate questions about the Director's integrity.

### References

The investment manager may consider speaking to other investment managers that have worked with the Director as a director to one or more of their funds to obtain insight into how well the Director performs their Director duties. It may be possible to obtain a few examples of how the Director acted in response to difficult Fund situations.

# 4. Board operations

Sound corporate governance promotes accountability, transparency in terms of roles and responsibilities, mitigates risk and underpins integrity. With ultimate responsibility for all aspects of management, a Board should maintain control over all operations, manage any conflicts and provide strategic direction for a Fund in accordance with relevant legal and regulatory requirements.

## 4.1 Role of the chairperson

At every meeting of the Board, a chairperson must be appointed. Traditionally, and as required in many jurisdictions, a Board always had a standing chairperson specifically appointed to the

role. However, Funds in certain jurisdictions may appoint a rotating director as chairperson, and it is then for the Board to decide who will act as chairperson at a particular meeting. Institutional investors generally expect that only a non-executive Director who is not involved in the investment management of the Fund would serve as the chairperson.

The chairperson should lead the Board objectively and impartially, consequently independence is key and sound practice is for the role of chairperson to be filled by an independent Board member.

In exercising procedural control over the meeting, the chairperson ensures that the meeting is quorate, the agenda items and any other business are dealt with adequately and facilitates open communication and effective contribution from both executive and non-executive Directors to foster a culture of challenge and debate.

A Fund's Constitutional Documents usually provide that resolutions will be passed by a majority of those present and voting and may afford the chairperson a casting vote in deadlock situations.

## 4.2 Meetings

The powers of the Directors are usually exercised collectively at a properly convened Board meeting.

### Frequency

The procedures for convening and holding meetings are usually set out in the Constitutional Documents.

Directors must meet sufficiently often to ensure that they are discharging their duties as directors. The appropriate frequency will depend on the Fund's circumstances including factors such as: (i) the size, nature and complexity of the Fund; (ii) the number of investors; (iii) the nature of the investment strategy, operations and structure of the Fund; and (iv) any particular challenges or issues that the Fund may be facing. Accordingly, the frequency of meetings should be re-assessed as issues and circumstances dictate. For most Funds, the Board should consider holding meetings at least quarterly with additional *ad hoc* meetings occurring as and when required.

The regularity of meetings should also be consistent with reporting frequency of the Fund's delegates and/or service providers to ensure that there is appropriate consideration and adequate opportunity to consider and discuss while matters are still relatively current.

Any jurisdiction-specific legal requirements or guidance for sound practice regarding the frequency of meetings should be taken into consideration.

### Physical vs. telephone/video conference meetings

The Board should consider holding at least one meeting in person and more physical meetings depending on legal or tax requirements. From a practical perspective, where it is not always possible or cost effective for an individual to attend every Board meeting in person, Directors may attend some Fund Board meetings via telephone or other video or other audio-visual link. With technological advances made during the pandemic, the quality of video communications has materially improved non-physical interactions and accelerated the adoption of these new means of distance communication.

As the global Covid-19 pandemic unfolded, due to health and safety protocols and restrictions in travel, holding physical Board meetings became almost impossible or certainly impracticable.

With respect to unforeseen or emergency circumstances affecting the Directors' ability to travel to attend a meeting in person, generally flexibility has been afforded.

In challenging times such as those seen in the Covid-19 pandemic, Boards should ensure that sufficient measures are in place so that Board meetings are quorate. In this regard, Directors should ensure the Constitutional Documents enable meetings to be validly held in such circumstances. The principles of the effective place of central management of a Fund for tax residency purposes should also be considered where Directors are participating in a meeting of a Fund and are not present in the country of the home state regulator at the time of the meeting. If, due to these challenging times, one or more meetings is held when no Director is present because of mandated travel restrictions or public health advice, it is common sense that is exceptional and operating contingencies should not give rise to queries as to the central management and control of the Fund or the tax residency of the Fund.

Directors could also consider the possibility of appointing an alternate Director to attend and participate in Board meetings where they are unable to do so, and Directors should have regard to the Constitutional Documents when appointing an alternate as well as any jurisdiction-specific legal, tax or regulatory filing requirements.

## Location of physical meetings

Consideration should be given to any jurisdiction-specific requirements, and in particular tax considerations, as to where Board meetings should, or should not, be held. For some jurisdictions, the Fund needs to ensure that the mind (i.e., control) and management of the Fund remain in the jurisdiction to avoid any adverse tax considerations.

It is often the case that the laws of jurisdictions outside the U.S. and EU do not require any Board meetings for a company incorporated in that jurisdiction to be held in any particular location.

If a Board chooses not to meet in the Fund's jurisdiction of incorporation, the Board should obtain and follow tax advice in respect of the jurisdictions where the Board proposes to meet. To reduce the risk of the Fund becoming subject to Fund-level taxation in any particular jurisdiction(s), it is generally appropriate to avoid holding meetings regularly in any single jurisdiction apart from the Fund's jurisdiction of incorporation.

Guidance on the broader tax issues is also relevant. If a Director of a Fund is ordinarily resident in a taxing country or regularly dials-in from a taxable jurisdiction, the Board should seek advice as to the tax implications for the Fund.

## Operation between meetings

The Board must decide how executive authority is to be exercised in between Board meetings as it is unrealistic to expect all governance decisions to be made only at the quarterly Board meetings.

The Board should always consult the Constitutional Documents in order to assess what is permissible. In general, several options are possible:

- A telephone, video or other virtual Board meeting can be called for each item as it arises;
- Decisions can be made via unanimous written resolutions, which generally may be executed in counterparts and passed electronically;
- Decisions can be delegated to an executive management group constituted as a formal committee of the Board with its own terms of reference;

- Decisions can be made by way of email approval and ratified at a later Board meeting; or
- Decisions can be delegated to one or other service providers (although this is the least preferred option).

While mitigating the need for full Board meetings may be sensible, the Board should avoid reaching decisions (whether by email or otherwise) without formally passing a resolution. Any informal decisions that are taken should be ratified by a resolution either passed at the next Board meeting or by way of unanimous written resolution.

Although Directors can delegate decision-making to other bodies, they cannot delegate responsibility for the decisions or actions thereby arising. The Directors should define in advance those more routine items of business the Board can delegate to a single Director, a committee (see Section 4.3 of the Guide), the investment manager or another service provider. The delegate should report any decisions to the Board in writing at the next regular Board meeting so that they can be ratified.

Delegation without oversight is not effective. Therefore, all delegated activities need effective monitoring and oversight as well as periodic upward reporting to the Board (including management being available to answer Director queries at meetings).

## 4.3 Whether or not to use committees

A Board may choose to delegate some of its functions to a committee if it has the power to do so, for example in circumstances when the Board considers that matters may be dealt with better or more quickly by a smaller, specialist decision-making sub-group in line with the relevant provisions of the Constitutional Documents and any local regulatory requirements. Any delegation must be monitored effectively by the Board.

The use of committees generally falls into one of two categories: (i) the use of standing committees, where a Board might choose to create committees in a number of areas, including but not limited to the following:

- pricing/valuation;
- risk management;
- audit;
- the process of granting discretionary waivers; and
- remuneration,

and (ii) on a case-by-case basis, there is a common practice of appointing a committee to approve the final drafts and sign documents relating to a particular transaction.

Any committees should be formally created and recorded in Board meeting minutes, with written terms of reference (e.g., number of meetings, voting rights, etc.) for standing committees and evidencing delegated authorities. Terms of reference should be formally approved by the Board. For standing committees, these should be reviewed annually.

Boards should be satisfied with the individuals appointed. In determining the membership of committees and the location of any meetings, the Directors must be mindful of tax implications and relevant governance obligations.

As with Board meetings, committee meetings must be properly documented and standing committees should report regularly to the Board regarding all of the committee's proceedings and decisions.

If the Board delegates decision-making power to a single Director or a formal committee of the Board, it is sound practice to delegate only to an independent Director or a majority-independent or wholly- independent committee. Delegation to an affiliated Director should only be for purely administrative decisions (e.g., approving transfers with no change in beneficial ownership or waiving minimum investments not below any legal minimum).

Any committee should seek the ratification by resolution of the full Board of any decisions taken by the committee. Boards are responsible for effective and prudent oversight and the overall supervision of the Fund and should consider all key strategic decisions that affect the Fund.

## 4.4 Ability to retain independent counsel

Occasions arise where it is practical and convenient for the Fund and the investment manager to retain the same legal counsel to advise them both. The Board should continually review this position, and the Board should consider whether a potential conflict of interest arises such that it might be more appropriate for the Fund to obtain separate counsel. This may be the case where the Fund requires legal advice concerning its relationship with the investment manager. In addition, Directors should be aware if a particular counsel is only counsel to the investment manager and not counsel to the Fund when taking such counsel's advice. Where, for example, the Board is considering questions relating to the payment of management or performance fees, or where stakeholders have made allegations of wrongdoing against the investment manager, the Board should consider seeking independent legal advice on these issues, independent of the investment manager's counsel.

In certain circumstances, an individual Director or a part of the Board may wish to retain independent counsel to advise only that Director or Directors (and not the Fund, through the whole Board). This may occur where a Director or Directors require advice about their own legal position. Questions may arise as to whether the cost of any such independent legal advice may properly be viewed as an expense payable by the Fund (notwithstanding that such cost may not have been approved by the Fund through the Board as a whole). The answers to those questions are fact sensitive and depend upon the terms of the Constitutional Documents, as well as any Directors' service agreements or terms of appointment. Typically, the Constitutional Documents, service agreements and terms of appointment will allow the Fund to reimburse such expenses in appropriate circumstances.

## 4.5 Ability to retain other experts and advisors

In addition to the legal advisors appointed to the Fund, who provide advice to the Directors on issues of law in relevant jurisdictions, the Board may wish to receive independent guidance from time to time on a specialist topic from a party other than one of the contracted service providers. In such circumstances, the Board can appoint a specialist advisor to provide advice on either a standing basis or a case-by-case basis. Such specialist topics could include liability insurance, taxation or valuation of illiquid assets for example.

The Directors should be aware of whether, and in what circumstances, they may appoint an expert or an advisor and whether the costs of doing so are chargeable to the Fund. The offering document and Constitutional Documents should provide guidance on what is permissible.

## 4.6 Standards set for Board deliberations

The guidance provided by the courts specifically in connection with Board deliberations is relatively limited. Directors' duties (particularly those discussed in this Guide) are the basis of the standards required of Directors in Board deliberations.

Directors can draw practical guidance as to appropriate standards for Board deliberations from the relevant decisions of the courts:

- An agenda should be circulated in reasonable time before each Board meeting. Where practicalities and timing permit, the Directors should also receive, in reasonable time before the meeting, the relevant documents and other materials for the meeting. Minutes of meetings should fairly and accurately record the matters considered and the decisions made, including the substance of the discussion between the Directors (at least to the extent necessary to understand the basis upon which the decisions were made);
- It is insufficient to hold Board meetings at which no discussion or debate takes place and whose purpose is solely to "rubber stamp" what the investment manager or other service providers have told the Directors about the Fund's performance or its operations more generally. The Directors of a Fund are required to inform themselves about the Fund's activities and have a proper understanding of its financial condition. Directors should review the most recent information at each Board meeting;
- Directors have a duty to exercise their own independent judgment. A Director is entitled to rely upon and consider the views of their fellow Directors, provided the Director believes that those views have been put forward in what the Director believes to be in the best interests of the Fund. Directors may also consider the views of appropriate experts who are advising the Fund in connection with their relevant fields of expertise. However, the Directors must not blindly or unthinkingly defer to experts or others when making their decisions and should be diligent in asking questions of service providers and experts; and
- Generally, appropriate representative(s) of the investment manager ought to attend Board meetings. Directors should also consider whether other service providers or delegates should attend as well (e.g., the administrator, auditor and legal counsel), depending on what is to be discussed at the meeting. Service provider attendance at the meeting may present greater scope for the Board to raise questions with a service provider, rather than simply receiving the service provider's written report.

## 4.7 Quality of information

The Board should seek information of an appropriate nature, scope and quality, with sufficient reporting frequency, as to enable the Board to consider and properly discharge its oversight responsibility. For example, such information may take the form of well thought out and targeted Board packs, which should include information of an appropriate quality and frequency to allow the Board to satisfy itself as to whether:

- The Fund is conducting its affairs in accordance with all applicable laws, acts, regulations, rules, statements of principles, statements of guidance and AML or CTF requirements;
- The Fund's service providers (including, but not limited to, the investment manager and administrator) are performing in accordance with their service agreements and to the expected service and performance levels;

- The Fund is operating in accordance with its Fund documents (for example, whether the investment manager is adhering to any defined investment criteria, strategy or investment restrictions and/or leverage ratios);
- Appropriate ongoing oversight of risk management exists; and
- There are any matters that the Board would otherwise need to be aware of (such as whether there might be complaints from investors, related party transactions, legal proceedings, side letter triggers, counterparty triggers/breaches, cross trades, trade errors, regulator thematic reviews, inspections or investigations, liquidity pressures mounting on the Fund, significant redemptions expected, or challenges to the Fund's investment proposition).

As noted above, where appropriate, the Board should consider inviting the Fund's service providers (such as the Fund's investment manager, administrator or auditor) to present their reports in person at Board meetings. Ultimately, this may assist the Board in establishing whether the Fund is being operated in accordance with all relevant requirements and help the Board form its views on whether the service providers are performing to the appropriate levels. The Board might also find it helpful to receive regulatory and legal updates from the Fund's external legal counsel(s) or compliance advisors from time to time.

## 4.8 Disagreement

The Board should endeavour to address any material disagreements with service providers by adhering to the following principles:

- The Directors should review the contractual relationship between the Fund and the service provider to understand the service provider's contractual obligations and to ensure that attempts to resolve any disagreement are in accordance with the terms of the relevant service provider agreement;
- The Directors should consider appointing a committee independent of the relevant service provider to gather information with a view to making a recommendation on how to address any disagreement with that service provider;
- Where appropriate, Directors should seek advice from the Fund's legal counsel;
- Any decision/course of action taken should be carefully minuted;
- Consideration should be given as to whether any investor notification is required; and
- If the relevant service provider refuses to address the Directors' concerns, the Directors should consider terminating the service provider and appointing a suitable replacement.

Disagreements with the investment manager, particularly where the investment manager is the Fund's promoter, can be a test of the Board's independence. Each Director, including investment manager-related Directors, owes duties to the Fund as a whole and needs to keep these duties in mind when determining how to address issues between the Fund and the investment manager. Ultimately, if a Director considers that the disagreement would result in the Director no longer being able to discharge properly the duties owed to the Fund, the Director should consider whether recusal or resignation is an appropriate course of action. In addition, in some circumstances it is entirely proper for the Board, in discharging its fiduciary duties, to vote against a course of action proposed by the investment manager.

# 4.9 Company secretarial matters

A company secretary plays a key role in both the governance and administration of a Fund.

## Control of the agenda and Board packs

Central to the Board's oversight of the service providers and the Fund's activities are the regularly scheduled Board meetings. Coordinating the gathering of reports from service providers, circulating meeting materials and acting as a focal point for the setting and circulation of the agenda can be time consuming. Funds should make arrangements so that a company secretary is engaged to convene the periodic Board meetings and to circulate all relevant documentation to Board meeting attendees.

Depending on the domicile of the Fund, there may not be a legal requirement for the formal appointment of a company secretary, but sound practice dictates that Funds should appoint an individual or service provider that is experienced in the provision of corporate secretarial services to attend Board meetings, take the minutes and to deal with follow up and ancillary matters. Often Boards choose to appoint a specialist company secretarial service provider to help them manage these matters. However, some choose not to do so, particularly if this role is performed by the investment manager's in-house function. In the absence of a dedicated company secretary, a particular Director should take responsibility for such matters.

The Board should set the dates for meetings in advance and request that service providers provide any supporting materials sufficiently ahead of time to allow the Directors to consider the materials and revert with any requests for the service providers to provide additional information at or before the meeting.

The elements that will generally apply are as follows:

- **Notice and agenda:** The secretary of the meeting should circulate a draft notice of the Board meeting, stating the place, date and time of the proposed Board meeting, together with a list of agenda items. This should be circulated to each of the Directors for their review of the proposed business of the meeting and to provide them with the opportunity to make amendments and add agenda items. Once finalised, it should be sent to all of the Board meeting attendees sufficiently in advance of the Board meeting so that they can prepare accordingly.
- **Co-ordination of participation in/attendance at the meeting**: In the case of meetings held virtually (e.g., by telephone or video conference), clear joining instructions should be provided along with rules of conduct and information on how Directors will communicate.
- **Board packs**: In addition to circulating the agenda, in advance of each Board meeting, the secretary should send to the Directors a Board pack that contains all the relevant documents for the forthcoming meeting. The Board pack will contain documents such as previous minutes and matters arising, report of the administrator, report of the investment manager, copies of any documents signed by one or more Directors that should be ratified by the whole Board, draft audited financial statements, audit findings report and auditors' letter of representation (typically annually or semi-annually only) and any other document relevant to other agenda items.
- **Minutes of the meeting**: The Board is responsible for ensuring that the Fund keeps a full, accurate and clear written record of any Board meeting and the secretary should prepare and circulate Board meeting minutes for comment and finalise these for signature by the chairperson.

- **Matters arising**: A list of action items should be compiled, and the secretary of the meeting should track the status of these and execution of the follow up matters.
- **Filing the minutes**: where applicable, the secretary should send copies of duly executed Board resolutions and attachments to the Fund's registered office for filing on the Fund's minute book.

## Example: Board meeting agenda

Some typical matters a Board might consider at its meetings, in addition to those matters discussed elsewhere in this Guide and not listed specifically include:

- review investment manager's report, including, for example:
  - Fund assets under management and investment performance;
  - adherence to investment policy and restrictions;
  - any issues regarding risk management, including:
    - portfolio liquidity vs. investor liquidity;
    - portfolio composition, key strategies/exposures/positions;
    - collateral and cash management;
    - any changes, new markets or instruments;
    - identified errors/breaches, resolutions of same and measures put in place to prevent it from happening again;
    - related party transactions;
    - leverage; and
    - counterparty allocations and counterparty risk management;
  - brokerage allocation, trade allocation and soft dollars/dealing commission matters;
  - any changes to the portfolio management team and senior investment manager personnel;
- review and approve key Fund policies (or material revisions thereof) such as policies regarding valuation, cash and asset movement, personal account dealing, valuation, AML, AEOI, etc.;
- review any issues regarding NAV calculation;
- review marketing and investor relations, including:
  - current and pending (gross and net) subscriptions and redemptions;
  - media mentions, especially any negative press;
  - make-up of the investor base, by investor types and domicile;
  - correspondence and Board communications to investors;
  - due diligence visits by prospective investors; and
  - investor feedback and/or complaints, if any;
- review the ERISA/pension plan asset status of the Fund, or the risks that this might be achieved if not intended where there are U.S. investors;
- exercise of discretionary powers, and appropriate sign-off for the exercise of such discretion, for example, to:

  - accept subscriptions below minimum;
  - accept redemptions at short notice;
  - waive any early redemption fee;
  - apply/dis-apply any gate;
  - compulsorily redeem any investor;
  - establish side pockets;
  - suspend redemptions/subscriptions/calculation of NAV;
  - review and approve side letter requests (and consider in light of other existing side letter terms such as MFNs (see Section 6.17 of the Guide)); and
  - if appropriate, approve the creation of new share classes;
- review compliance with listing rules and continuing obligations, where applicable;
- review compliance with regulations applicable from time to time;
- receive and review reports from other major service providers including the administrator, the prime broker, the custodian and any depositary;
- receive and review reports on information security;
- approve and sign the audit engagement letter and the audit management representation letter;
- approve and sign (where required) the Fund's semi-annual accounts;
- approve and sign the Fund's annual audited accounts;
- obtain and review adequacy of supporting comfort representation letters from delegates, where relevant;
- approve renewal of D&O liability insurance;
- review and approve the initial offering document and other documents and any proposed updates;
- review any AML compliance functions outsourced to the administrator or the investment manager, highlighting any investment, redemption or other activities involving politically exposed persons;
- receive and review reports from the Fund's AML officers (see Section 5.9 of the Guide);
- review the appointment and performance of the administrator, prime brokers, auditors and other relevant service providers;
- receive updates on matters of regulatory, accounting, audit or industry importance which may impact on the Fund;
- receive any updates or reports on any legal proceedings, and any investigations or inspections by any authorities;
- consider identification, monitoring and management of conflicts of interest;
- review and ratification of actions taken pursuant to delegations to committees, individual Directors and/or a service provider; and
- ensure that costs imposed in relation to the Fund are of a transparent nature and do not represent any undue cost for investors.

The list above is indicative and is not exhaustive. For example, additional and special considerations may apply for Board agendas at the launch of the Fund and in the period leading up to and during the wind down and liquidation of a Fund.

## Recordkeeping

Both for general corporate governance reasons and having regard to relevant guidance on the broader tax residence issues, the Fund may need to keep the documents and records (including minute books) for the Fund outside the jurisdiction in which the investment manager is resident. The jurisdiction of formation of a Fund may also impose recordkeeping requirements, such as a requirement that the Fund keep certain documents at a registered office in the jurisdiction or that certain records be retained for a minimum period of time after the date on which they were produced.

Further, in some jurisdictions, the Fund may also need to comply with the recordkeeping regulations applicable to the investment manager because regulators in some jurisdictions deem the Fund's records to be records of the investment manager.

Recordkeeping obligations specific to certain service providers may also apply either in relation to the Fund itself or in relation to a service provider's own regulatory obligations. For example, regulated services providers may have obligations to keep records for a certain period of time following cessation of the business relationship and each jurisdiction will have recordkeeping obligations relating to data protection, AML/CTF and tax laws and regulations.

## Quality and balance of content of the minutes

Minutes of meetings should fairly and accurately record the matters considered and the decisions made, including the substance of the discussion between the Directors. Consequently, when preparing the minutes of Board meetings, consideration should be given to what may be appropriate or necessary, depending on the nature of the business or the circumstances, to demonstrate that the Directors have observed their responsibilities to the Fund and complied with their legal and regulatory duties.

Evidence of the Board's deliberations should be reflected in the minutes. Minutes are the official record of the decisions the Fund has made through its Board, and it is therefore of vital importance that they be accurate. In particular, it is necessary to include items and issues that were considered to support each decision made at the meeting and the information requested from, and provided by, service providers and advisors. The minutes should therefore demonstrate the due care and attention taken by the Directors to the matters at hand, that the Directors took advice where necessary and considered all relevant information at the time the decision was made.

Regarding how much should be documented in the minutes, generally, the more important the decision and the more in depth the discussions, the more comprehensive the minutes should be. In the event that the Directors' actions are subject to challenge at a later date, the minutes can play an important role in providing evidence that due consideration was given to the various aspects of the matters at hand.

The minutes should record the information considered in a sufficient level of detail, and the Board should give direction on this. Too much information can be unhelpful and too little can cause ambiguity. The right balance needs to be struck. The level of detail may also be viewed differently on a jurisdictional basis, and certain Fund domiciles may have documented guidance on this issued by the regulator. In making decisions that will withstand judicial scrutiny, process is critical.

Minutes do not have to be detailed in order to reflect that a Board or committee took reasonable steps to be informed and to consider relevant issues before making a decision.

By way of summary, Board minutes should record:

- which Directors attended (by telephone, by video conference or in person), list what reports and information were received, and a summary of the items considered and the general response of the Board;
- any disclosed Director or other conflicts of interest;
- the rationale for the resolutions and decisions passed by the Board and the risks and associated factors which were considered by the Board;
- the resolutions passed; and
- significant issues raised by Directors and any votes by Directors against or abstaining.

However, it is not necessary/advisable to record:

- every Director's contribution, discussion or debate. The minutes should not be viewed as a transcript as this could rebut the principle that the Board is to act as a collective; and
- a granular level detail of discussions that have taken place. Over documenting which Director contributed and repeating their words verbatim could negatively impact the perception of Board dynamics.

If the minutes are inaccurate, the Board should not approve them until the errors are corrected.

It is not standard practice for meetings to be recorded, however, where a decision is made to make an audio recording of a meeting, there should be a reminder at the outset of the meeting that the meeting is being recorded. While transcripts of such recordings may contain detail, particularly on a complex or sensitive subject, current market practice is that meetings are minuted in the traditional manner.

## 4.10 Remuneration of Directors

Remuneration relates to fixed and variable pay and payments related to early termination and pensions, where relevant.

Investment managers structuring new Funds often set the initial remuneration payable to the independent Directors. Typically, Directors associated with a Fund's investment manager are not remunerated by the Fund for their service on the Board.

Currently, the typical remuneration for Directors varies between jurisdictions. Where there are "umbrella funds" or multiple portfolios within a Fund, a basic fee with an additional fee for each sub-fund or portfolio may apply. Directors should also be entitled to claim reasonable expenses; if they travel a considerable distance to attend meetings, they may have the right to claim travel and accommodation expenses and may also receive an "attendance fee", as compensation for time otherwise spent in travel. Remuneration increases may be reasonable if the number and complexity of sub-funds in the Fund has increased or the workload of the Directors has changed following the launch of the Fund; however, guaranteed or automatic increases in remuneration should be avoided.

Factors to be taken into account in setting remuneration include the likely demands on a Director's time, the complexity of the Fund and the investments that it makes, the scope and nature of the role and responsibilities taken on, the Director's skill and experience and who is responsible for obtaining and funding D&O insurance. Director remuneration would typically be set having regard to their core duties, including:

- attendance at quarterly Board meetings, with set agenda and written papers circulated in advance of the meeting, to allow proper preparation time;
- review and approval of annual audited accounts (unless there is an audit committee, which reports to the Board, that may approve accounts and associated documentation and review and approve semi-annual accounts);
- attendance at specially convened *ad hoc* meetings for discussion of "one-off" matters - e.g., nominations of additional or replacement Directors, changes to service providers' contracts or to the offering document or liquidity or risk management concerns; and
- participation on committees, such as a valuation committee.

Following the launch of a Fund, the Directors should have the power to set their own compensation (although Directors affiliated with the investment manager typically waive any compensation), to avoid potential conflicts in having it set by the investment manager they oversee, in consultation with the investment manager and other appropriate advisors. The level of remuneration set by the Directors themselves following the launch of a Fund is frequently informed by the Board's evaluation of its own performance and the performance of individual Directors.

Generally, a Board evaluation will involve a self-assessment, an evaluation of the chairperson (if one has been appointed) and an evaluation of the Board as a whole. The process can be carried out by the chairperson or a designated Director, or through the support of a consultant on corporate governance. Depending on the level of transparency and interaction among the Directors, the evaluations may be treated as confidential or discussed openly. Generally, an evaluation process is more useful with larger Boards (i.e., Boards with five or more Directors). Boards should take care that the evaluation exercise is not simply a formality – the evaluation should enable the Board and its members to be more efficient and effective in the discharge of their duties as Directors.

The initial level of Board compensation and any subsequent changes should be disclosed to Fund investors and prospective investors in the offering document.

## 4.11 Compliance with regulatory regimes affecting the Board

Each jurisdiction operates their own specific regulatory regime applicable to Directors or those performing designated management functions. Further Funds may be obligated to comply with corporate responsibility codes which may be jurisdiction- or sector-specific.

The Board must understand clearly, and ensure compliance with, regulatory and legal obligations. Regulators are increasingly focusing on the role of Directors and fines and sanctions have been imposed across the industry, often with an emphasis on ensuring that the Board fulfils its responsibilities described above.

# 4.12 Liability and insurance (D&O)

Directors and key members of the management of Funds face increasing pressure to be held personally accountable for their actions by both regulators and investors. High profile investigations and lawsuits have focused attention on the breadth and limits of insurance cover. A range of policy wordings and limit options are available, and it is important to obtain advice from a specialist insurance broker to help determine the best solution.

## Breadth of cover

A variety of insurer and broker drafted directors and officers ("D&O") insurance policy wordings are available. Most meet basic requirements in covering costs for handling regulatory investigations into Directors' and key person activity, costs of Directors in defending claims made against them and any damages awarded, but all vary in scope and operation of cover.

Policy wording often includes exclusions for:

- known claims or circumstances;
- bodily injury and property damage;
- fraudulent, dishonest or illegal acts; and
- payment of claims that would put insurers in breach of sanctions.

Such exclusions vary in scope from policy to policy and may be diluted; for example, one would expect a Director's and key person defence costs to be covered until a fraudulent or dishonest act was proven.

Regardless of the policy purchased, it is important that Directors and key persons understand the contract provisions regarding the reporting of circumstances and claims that could attach to the policy. Meeting these requirements is key to accessing the coverage.

Consideration and attention should also be paid to the information disclosed to insurers. The onus of disclosure is on the insured and failure to disclose material information may result in insurers voiding coverage or a claim. Often the submission to insurers, including, for example, any proposal form, will form the basis of the contract and so should be reviewed and approved by the Directors. Directors should review the non-avoidance clause in the contract wording to ensure non-disclosure free from intent to deceive or fraud cannot result in insurers avoiding a claim.

## Level of cover

Insurance policies are written with an aggregate monetary limit, which is the maximum amount that the insurers will pay out. This limit applies to claims made against past and current Directors of the Fund, which are reported to insurers during the period regardless of when the alleged act occurred or when any final settlement takes place.

Firms use many different methods to decide on the limits of cover to purchase. A broker can provide guidance in this area but ultimately the decision is one that is individual to each Fund and its Directors. Considerations include:

### Number of Funds and Directors to be covered by one limit

Funds commonly purchase an aggregate policy limit for the past, present and future Directors of a single Fund. Policy limits can also be arranged for one Director of a Fund, for all past, present and

future Directors of a group of Funds or to cover the Directors of both the Funds and a management entity.

There are many options for a group structure to purchase a management liability (D&O and professional indemnity) policy. It is possible for all entities within the group to share one aggregate limit, though this would not be recommended. Sharing a limit provides premium savings but each individual and entity can erode the available limit of indemnity potentially leaving other Directors with reduced limits or no protection at all. Insurance programmes can be structured to reduce the risk of this occurring by providing additional limits for each entity, Director or Fund. Funds commonly purchase a separate Fund D&O policy with the following points being key areas of that decision:

**(a) Erosion or exhaustion of aggregate limits**

The available cover could be eroded or exhausted by one party, leaving the other(s) unprotected. In particular where a claim affects only one insured, e.g., a regulatory investigation against the manager and/or its Directors which does not affect the Fund, it would seem inequitable for this to erode or exhaust cover for the other(s), particularly for Directors whose personal wealth is at risk.

**(b) Priority of payments**

With conflicting parties both trying to recover under the same insurance policy disputes can arise over order of payments and allocation of limits. This adds an unnecessary layer of complexity and negotiation in what may already be a stressful and time-consuming litigation defence process.

## Director indemnification

D&O insurance provides cover for Directors' personal liability and is structured to cater for the indemnification provisions in place between Funds and their Directors by providing cover in two main insuring clauses. The first provides cover to a Director where the Fund is not able to provide indemnification and the second provides cover to the Fund where it is able to indemnify a Director.

The way in which the clauses operate varies. Some policies presume that a Fund has indemnified the Director if the Fund is not legally prohibited from doing so. As this insuring clause traditionally has a self-insured amount attached to it (known as a deductible, excess or retention), it is beneficial to insurers for a claim to fall thereunder. In such cases, the policy may waive insurers' rights to apply said deductible in the event of financial impairment of the Fund.

# Key exposures to consider

A Director or key person is commonly liable to be held to account in the event of a breach of fiduciary duty to the Fund, breach of duty of skill and care to the Fund, breach of contract, breach of statutory duty, breach of duty to investors and breach of common law.

Claims are more likely to arise when the value of a Fund's investments falls, when a Fund's strategy or structure changes and when a Fund winds up. They may originate from:

- **Regulatory authorities** - for breach of statutory or local regulations. The global reach of regulators is growing to ensure Directors are held accountable and responsible for their actions;
- **Investors** - Directors owe a fiduciary duty to the Fund. Investors may seek redress if this duty is breached through a negligent act or omission of the Director;

- **The Fund** - for actions which are in breach of the Directors' duty to the Fund. If the Fund fails to take action, then in certain limited circumstances, an investor may enforce the Fund's rights by an action on behalf of themselves and all other investors;
- **Successor Board** - following a change in the composition of the Board or third-party advisor and management, generally as a result of hostile investor action, the Fund and its new Board may bring action against the predecessor Directors;
- **Creditors** - in the event of a Fund going into liquidation and/or failing to pay its creditors they may bring an action against any or all of the Directors, both past and present;
- **A receiver or liquidator** - in all types of winding up actions, a receiver or liquidator may apply for permission to examine the conduct of Directors, both past and present, and pursue litigation against them; and/or
- **Others** - anyone who suffers a loss as a result of a breach of warranty of authority to contract on the Fund's behalf.

# 5. Role of the Board on Fund start-up

The Board plays a critical role prior to the launch of the Fund. There are numerous processes requiring Board sign off that must run in parallel. Directors individually and collectively take overall responsibility for all matters relating to the Fund, including approval of the Fund's offering document and Constitutional Documents. They also have ultimate responsibility for the appointment of service providers, as well as the agreements outlining the contractual terms that bind the Fund as well as the service providers. The Directors should ensure the foundations for a strong governance structure are in place, including critical controls and key policies, with clear delineation of responsibilities. This governance structure should be designed to uphold the four pillars of investor protection, namely:

- The Fund will be managed in accordance with the Fund's stated investment objectives, policies and restrictions;
- The safekeeping of assets of the Fund, namely the holding in custody of financial instruments which belong to the Fund and verifying the Fund has an ownership interest in respect of all other assets;
- Upon redemption, investors will receive their pro rata share of the Fund's assets; and
- The Fund will be managed for the benefit of the Fund's interest holders (non-preferentially and as a whole) and not its service providers.

## 5.1 Timing and order of appointments matters

The Directors should be appointed as early as practical in the establishment of the Fund. With ultimate responsibility for key documents and appointments, affording them due time for review and input is important. The investment manager should be looking to leverage the Directors' experience and market perspective, on key terms, best practice and service providers. For the requisite timing to coincide on all matters that require disclosure in the offering document, early Director engagement is key. Some institutional investors will want to conduct their own due diligence of the Directors as their potential representatives prior to finalising their investment in the Fund.

The timing of appointment of service providers is typically dictated by their required input to the start-up process but in any event the administrator, auditor, prime brokers and depositaries/ custodians and lawyers for the Fund will need to be disclosed in the offering document. Time will be required to negotiate terms and finalise agreements. The offering document will also include an outline of services and scope, responsibilities and key provisions including indemnification. Early appointment of the administrator in particular is recommended to ensure agreement on key controls, policies and procedures, especially with regard to asset valuations.

The Directors are responsible for the appointment of the Fund's service providers including the administrator, prime broker, depositary/custodian and auditor. In addition they should approve the selection of others including, but not limited to, clearing brokers and ISDA counterparties although this function may be delegated to the investment manager. The investment manager is usually heavily involved with the selection process and typically provides the Directors with its recommendations.

The Board (or the investment manager as the Board's delegate) is responsible for agreeing terms and appointing providers of outsourced services such as middle office and risk, compliance, execution brokers, valuation/pricing and research some of whom may contract directly with the Fund. However, the Directors should satisfy themselves that there are no conflicts with the parties providing such services and the Fund and that they understand the terms of these agreements. Where the documentation relating to any such relationships, particularly prime brokerage, custodian and ISDA relationships, are complex, the Directors should recommend or require review of such documents by the Fund's external legal counsel.

The AML rules in some jurisdictions require the Fund to appoint an AMLCO, MLRO and/or DMLRO who will need to be in place to review AML policies and procedures before they are adopted by the Fund. These positions can usually be outsourced but Directors need to ensure that the individuals carrying out this delegated function meet the following criteria:

- The person has adequate and appropriate knowledge and expertise.
- A risk assessment has been conducted before entering into an agreement and placing reliance.
- There is a formalised agreement setting out responsibilities of each party.
- Policies and procedures applying to the person's role have been reviewed prior to entering into the reliance agreement. (These should also be tested from time to time.)

If the outsourced position is appointed to an employee of the Fund administrator who is also conducting AML procedures, the Directors should ensure that the AMLCO, MLRO and DMLRO, as applicable, have necessary processes in place to ensure an independent and objective execution of their role.

## 5.2 Establishing the Fund

The Directors both collectively and individually take overall responsibility for all matters relating to the Fund. A key part of this duty is the approval of the Fund's offering document, supplements, the IMA, the subscription documents, the Constitutional Documents and any material contracts, such as those with the administrator and prime brokers. The Fund Board usually formally approves these documents at one of the first official Board meetings having extensively reviewed, discussed and agreed any points of concern beforehand. In providing their approval, Directors should ensure that they are comfortable with the powers reserved to the Board and the duties delegated to the various service providers.

The Directors should review the Fund's documentation with a view to identifying any terms which are becoming standardised in the market or which may cause potential investors to turn away from the Fund. The Board may not alter certain core terms of the Fund documentation (e.g., those relating to the share class terms to the extent set out in the Fund's constitutional documents) for a specific investor by way of a side letter or otherwise without obtaining the consent from other investors as appropriate.

Key terms and other matters for Director consideration contained within the offering document and the Constitutional Documents are further outlined in the following sections but would include share class terms and voting rights, investment programme and restrictions, suspensions and side pockets, valuation, risk disclosures, attribution of costs to the Fund and conflicts of interest.

## The offering document generally

The offering document typically sets out the investment objectives, policy and restrictions of the Fund, the management of the Fund, how conflicts of interest will be dealt with, share dealing and valuation provisions, a summary of the fees and expenses payable and relevant taxation disclosures.

It will also outline details of key service providers to the Fund and reference the material agreements and their key terms.

The Directors have the authority to commit the Fund to the obligations under the various material contracts as well as the statements in the offering document.

When a Fund seeks to list its shares on a stock exchange, the offering document will also constitute listing particulars. Moreover, stock exchange listing rules also typically impose responsibility and potential liability for the contents of the offering document on the Directors.

The Directors should carry out a periodic review of the Fund's offering document, supplements and subscription documents (e.g., annually) to ensure that they remain up-to-date and compliant with relevant regulations. The Board should also review material contracts periodically, although less frequently. Additionally, the Directors should review such documents and provide sign-off before any material changes or revisions are made.

## Investment objectives and restrictions

Every Fund is required to state its investment objective, policies and restrictions in its offering document in order to make current and prospective investors aware of the types of investments the Fund may make and the goals it is trying to achieve. Regulated Funds may also have to comply with a further set of restrictions.

Directors should ensure the investment strategy is accurately described in the Fund's offering document. The offering document should also contain clear, reasonable and specific risk parameters. Directors should also review DDQs and marketing materials to ensure consistency with the disclosures on strategy, risk management and limits.

An important function of the Directors' role is to oversee the Fund's compliance with its stated investment policies and any restrictions, which would include leverage, asset class, geography and concentration limits.

## Side letters

It is common for investors in Funds, especially early or anchor investors and institutional investors (such as funds of funds, pension plans, sovereign wealth funds and government plans) to seek special terms and conditions to govern their investments. When such terms and conditions are agreed, the Fund and/or its investment manager often document the agreed terms and conditions in a "side letter" agreement with the investor.

The offering document should disclose the Fund's ability to enter into side letters and the extent of Directors' discretion to approve different rights and benefits assigned by these agreements to those investors. Further it should stipulate when prior consent from other investors is or is not required before offering differential terms.

Directors must ensure that they understand the terms of such side letters and obtain explanations from external counsel where necessary. In the interests of fairness to all investors, preferential liquidity provisions should be prohibited.

Investment managers may commit to further investment restrictions in side letters. Other common areas addressed are "most favoured nations" ("MFN") clauses, capacity rights and reporting and notification obligations.

AIMA's *Side Letter Guidance* (2015) sets out some general points that Directors should take into account when considering requests to enter into side letters.

## Environmental, social and governance ("ESG") factors

Trends and shifts in the industry such as those relating to socially responsible investing or ESG factors have created additional considerations for Boards and investment managers.

Where the Fund has an express ESG mandate, the offering document should be sufficiently explicit on relevant parameters regarding the investable universe and investment selection and in accordance with any jurisdiction-specific ESG disclosure requirements. Directors should review this with consideration for ongoing compliance, with particular sensitivity to the risk of appearance or reality of "greenwashing".

For non-ESG as well as ESG mandates, investors are increasingly looking for integration of ESG considerations in the investment process to manage the potential financial risk. Along with greenwashing, this has also become a strong focus of regulators with particular emphasis on climate change. Even where such regulation strictly applies to the investment manager, Directors should stay abreast of these developments to ensure they understand the potential or actual impact to the investable universe of the Fund, as well as to ensure the investment manager has sufficient resources and process to properly comply.

Directors should also be aware of any specific obligations that are assumed and owed to regulators or specific investors by way of side letters or similar arrangements in relation to ESG. Such requirements are increasingly mandated by regulators, service providers (who may themselves be subject to legal, regulatory investor and contractual obligations), and/or pension funds, sovereign wealth funds and other institutional investors in the context of complying with ESG principles to which such investors elect to adhere or are mandatorily subject.

In that context, Directors may be obliged to manage/mitigate ESG risks as part of their broader oversight function. Directors need to be aware of how such principles are adopted and reported back to regulators and/or investors, particularly recognising that reporting expectations may differ given there is no uniform global approach.

## Subscriptions and redemptions and exercising discretionary waivers

The Fund's offering document will outline all standard terms for subscription and redemption. Directors should be comfortable these terms are appropriate for the liquidity of the Fund's portfolio with respect to underlying assets and strategy.

It is normal practice for the Board to reserve the right to exercise a discretionary waiver, typically on request by an investor, over certain terms and conditions relating to subscription and redemption terms. All such areas of discretion should also be clearly set out in the Fund's offering document. In case of doubt, the Board should seek advice as deemed necessary.

The Board may reserve discretion in the following areas:

- accepting late subscription or redemption notices/monies after stipulated cut-off times in the offering document;
- accepting subscriptions or monies received outside the normal notice period from connected or related persons to the investment manager;
- accepting subscription amounts or permitting continuing investments that are less than the stated minimum in the offering document;
- transfers involving a change in beneficial ownership;
- waiver of a minimum lock-up period;
- accepting redemption documents and monies outside of the normal notice period;
- waiver of early redemption penalties;
- rescission of redemption requests; and
- exercising discretion as to whether or not to apply any gate (i.e., the power of the Fund to defer excess redemption requests if redemptions on any one dealing date exceed a stated maximum threshold).

When exercising a discretionary waiver, the Directors should consult with the investment manager to confirm the investment manager agrees that, in doing so, the Fund will not compromise the interests of existing investors. Directors should also ensure that a waiver on any particular dealing date is applied equitably across all subscribing or redeeming investors who are affected, though in certain instances, the Fund's offering document may give the Directors additional discretion to apply such waiver only to particular investors, subject always to their fiduciary duties to the Fund.

Because most requests for a waiver are made on short notice, the Directors may, for administrative efficiency, wish to delegate the authority to agree to a particular waiver to the investment manager, a single Director or a committee, each within certain pre-agreed parameters. Where the investment manager, a single Director or committee exercises this authority, such person should be required to report to the Board at regular Board meetings of any waivers granted and compliance with the pre-agreed parameters. Notwithstanding the Directors' right to delegate their discretion to waive certain terms to the investment manager, a single Director or committee, the Board should retain discretion over waivers that could materially impact investors or the Fund (e.g., waiver of the application of any gate).

## Liquidity risk management tools

Side pockets, gates and suspensions are generally not welcomed by investors but they do have legitimate uses. Directors need to consider the best interests of the Fund as a whole in determining what is appropriate. If the portfolio is highly liquid and easily priced then there is less justification for applying gates or suspensions, but otherwise these serve to protect remaining investors when the Fund is facing large redemptions. Side pockets allow for the removal of illiquid investments from the portfolio and fair valuation of the remaining assets. Directors should ensure that they are used appropriately and not simply to segregate poor performing assets to manipulate returns and associated fees.

## Key person events

The Fund offering document should define notification and redemption rights in the event a "key person" (as defined in the document) resigns, is removed, dies or is otherwise incapacitated. Directors must have the necessary authority to determine when this clause is triggered, if interpretation is required, and that any subsequent action taken is in the best interests of investors without prejudice.

# 5.3 Appointment of the investment manager

The Board has primary responsibility for overseeing the management of the Fund and may choose to delegate subject to its ongoing supervision obligations. The Directors appoint an investment manager who is responsible for performing discretionary asset management of the assets of the Fund in accordance with the Fund's investment objective, policies and restrictions.

## Due diligence

Directors should conduct due diligence of the investment manager with a view to establishing a long term, collaborative relationship. With respect to the investment manager and key personnel, they should satisfy themselves as to:

- investment experience and track record *vis-à-vis* the Fund's strategy;
- business culture;
- investment manager infrastructure, including its portfolio management system and operating management system framework;
- the potential to raise funds;
- investment in the management company and available working capital;
- business management and leadership experience;
- the risk and control environment;
- staffing; and
- quality of service provider selection.

In addition, the Board should understand the aspirations and expectations of the investment manager and particularly the founder(s) in the case of a start-up, how the leadership team intends to engage with the Board and the leadership team's understanding and appreciation for strong governance. In short, the Directors should feel confident of a constructive governance environment within which they will be able to fully exercise their fiduciary duties.

# Contents of the IMA

The IMA documents the formal appointment of the investment manager by the Fund and the acceptance of that appointment by the investment manager. It also outlines the services to be provided by the investment manager and the terms and conditions of the appointment, as well as any powers of discretion delegated by the Directors on behalf of the Fund.

The IMA should memorialise all of the matters in which the Board has granted discretion to the investment manager. In most cases, the investment manager needs discretion for day-to-day investment activity, dealing, portfolio construction and risk management. Other matters for which the Board may delegate include, among others:

- marketing units or shares of the Fund;
- proxy voting;
- providing instructions to service providers employed by the Fund;
- selection of ISDA counterparties and clearing brokers; and
- granting certain exceptions to standard subscription and redemption terms, as outlined previously.

The IMA must uphold the key governance relationships as laid out in the Fund's offering document and Constitutional Documents. For example, while the day-to-day provision of information to the administrator will fall to the investment manager, the terms of the agreement must not undermine the Directors' ultimate responsibility for valuation. Similarly, the investment manager may open and close bank and custody accounts and negotiate contracts deemed necessary on behalf of the Fund, but subject to the approval of the Directors.

The IMA should outline terms for termination by both the Fund and the Investment Manager, either with a stipulated notice period or immediate termination in the case of relevant events. These would typically include liquidation, material breach of the agreement, fraud or acts of wilful default, reckless misconduct or gross negligence.

## Delegation and oversight and testing of delegated functions

All services provided under the IMA remain subject to the control, direction and review of the Directors. The Directors must ensure they receive sufficient information to adequately supervise delegated functions. The IMA will dictate that information and data is made available to the Directors as they reasonably require. At a minimum this requires reports and discussion of the contents at quarterly Board meetings, including performance, counterparty lists, fund expenses, subscription/redemption waivers, compliance with the valuation policy, trade errors, fundraising and investor communication updates and so on. Directors may also request intra meeting reports as they deem necessary. Depending on the Fund's strategy, information relating to particular investment opportunities and market comparisons may be needed on a timelier basis. Stressed market conditions or material events such as a cyber-attack may also necessitate reporting between Board meetings.

## Additional functions performed by the investment manager

In addition to matters noted above, the IMA will typically require the investment manager to:

- keep all books and records as required by law and regulation;

- monitor compliance with the terms of side letters and provide any reporting and communication as required to the relevant investors. It is sound practice for a side letter register to be maintained summarising key terms to support compliance, as well as supervision by the Directors. It is also sound practice for a complaints register to be maintained;
- in the event of a wind down, manage realisation of the Fund's assets and distribution of proceeds;
- supply information to the administrator and auditors as reasonably required in preparation of reports and accounts of the Fund;
- review and confirm the administrator's calculation of NAV;
- monitor compliance with any specific regulatory investment limits as applicable; and
- undertake checks for identity of prospective investors and provenance and legitimacy of funds, unless the Fund delegates such tasks to the administrator.

The IMA will further outline the investment manager's duties to execute orders on best available terms and transact in compliance with all applicable laws and regulations.

## Matters arising from legislation

The duties that the investment manager owes to the Fund may be set out in laws, regulations or in common law court decisions. In some jurisdictions, the terms of the IMA may affect the extent to which those duties are owed to the Fund as well. More specifically, the Fund and the investment manager may limit the scope of these fiduciary duties by mutual agreement in some jurisdictions, although such limitations should be explicit and unambiguous. The informed consent of the Fund, as evidenced either in the IMA or otherwise (e.g., by Board action) is often a defence to a claim that the investment manager's fiduciary duties have been breached.

In addition to fiduciary duties, an investment manager may also have other obligations to the Fund for which the Fund may make a claim in case of breach. Depending on the terms of the IMA, these could include causes of action for:

- negligence/gross negligence or other breaches of relevant standards of care, as applicable;
- misrepresentation;
- breach of contract; and/or
- breach of regulatory requirements.

The Board's ongoing review of the investment manager's performance should necessarily include an evaluation of whether or not these duties have been fulfilled.

## Trading methods

The Board should consider the investment manager's trading and related practices. Globally, regulators have been increasing their emphasis and concern regarding such practices which are scrutinised during their reviews. Accordingly, the Board should seek to understand the trading practices engaged in on behalf of the Fund in order to ensure that the investment manager is fulfilling its fiduciary duty to the Fund. These include brokerage allocations, trade allocations, and the use of soft dollars/dealing commissions, addressed as follows:

### (a) Trade allocation

The Directors should conduct a review of the investment manager's trade allocation policy to ensure processes are in place to dictate (i) how the portfolio managers apply investment discretion for the allocation of trades to each strategy; and (ii) how the portfolio managers allocate trades where there are multiple portfolios within the respective strategy, so as to ensure allocations are made fairly and in the best interests of investors as a whole. Directors should be particularly aware of processes to manage allocation to proprietary accounts held by the investment manager.

### (b) Brokerage allocation

Directors should be aware of the methods and policies used by the Fund's investment manager in allocating trades to executing brokers.

In the initial phase, Directors should conduct a review of the investment manager's policies for best execution, broker allocation and treatment of trade errors. This should account for treatment of any potential conflicts of interest and include a review of the entertainment and gift policy and treatment for any related person transactions.

### (c) Use of soft dollars/dealing commission

The Directors should ensure that the Fund's best interests are at the forefront of an investment manager's trading practices especially where the use of soft dollars/dealing commissions and the obligation to seek best execution is concerned. Use of soft dollars and dealing commission has been a focus of financial regulators in recent times, in the U.S., the UK and Europe. Financial regulators' rules and guidance seek to prevent use of soft dollars/dealing commissions to pay for services that do not benefit clients but rather the investment manager, and should therefore be paid for by the latter, a source of potential conflict of interest. As one would expect, different regulators may have different approaches to what is allowable.

Steps for the Directors to consider:

- obtain an understanding of the regulatory framework on the subject matter, the differences in various regulator's approaches and keeping abreast of impending changes;
- obtain the policy adopted in respect of the Fund and understand its intended use;
- if it is unclear whether the nature of the expenses falls within the relevant regulator's framework, then the Board should request an external legal opinion from a reputable firm to provide further clarity;
- satisfy themselves that the investment manager has adequate controls and oversight over the entire process of using soft dollars/dealing commission through, for instance, periodic reporting from the investment manager's compliance function; and
- where an investment manager receives bundled services and part of the service would not be permissible under a regulatory framework, the Directors should review the investment manager's mixed-use assessment and recordkeeping thereof.

Ongoing monitoring to ensure consistent application of all of the above policies in the best interests of the Fund is a key responsibility of the Directors, and they will need to ensure they receive sufficient reporting from the investment manager in support of this.

# 5.4 Appointment of an administrator

Another key Fund service provider is its administrator. Given the importance of this relationship, AIMA has published a separate *Guide to Sound Practices for the Selection and Periodic Assessment of Administrators* (2017). Because there is a separate guide on considerations in this area, the section below is relatively high level and Directors should consider reviewing the separate guide for additional insights that may be relevant to their consideration of the appointment of an administrator.

## Service offerings

There are many types of services typically offered by administrators, including:

- transfer agency and payment agent services, including:
  - processing subscriptions, redemptions, capital calls (where applicable), transfers and assignments,
  - operating bank accounts and managing cash payments, subject to security protocols and signature requirements,
  - paying redemption proceeds and other distributions, and
  - payment of third-party expenses;
- AML/KYC/CTF and sanctions screening;
- fund accounting and NAV calculation (as distinct from asset valuation);
- portfolio levelling;
- investor communication and investor reporting; and
- supporting the production of required financial reports.

Many, but not all, administrators offer optional additional services although these are often subject to supplemental charges to the standard administration fee. Optional services can include:

- middle office services such as:
  - trade confirmations/external service integration,
  - cash and collateral management,
  - settlements and reconciliations,
  - prime broker trade transmission, and
  - other post-trade issues;
- putting forward an individual to serve as the Fund's MLRO;
- tax services;
- regulatory reporting services;
- company secretarial services;

- investor profiling to facilitate regulatory compliance;
- post-trade compliance restriction monitoring;
- performance measurement/attribution and risk analytics;
- technology solutions such as process monitoring, workflow tools, report building tools and trade capture; and
- depositary "lite" services.

However, sometimes specialist skills and services may be required. Some of the specialist services that only a subset of administrators offer include:

- expert valuation services for hard to value assets and/or specialist asset classes;
- environmental, social and governance portfolio scoring; and
- loan administration (see also the Alternative Credit Council's *Enhancing the Loan Administration function: Marrying capacity and customisation* (2017)).

## Due diligence

The best way to ensure that the Fund will receive the required mix of administration services at a competitive price is to perform quality due diligence. When selecting an administrator to put forward for the consideration and approval of the Board, the investment manager should make requests for proposals to multiple potential administrators to begin to narrow the field. Once the potential options have been narrowed on the basis of service offerings and fee levels, the investment manager should undertake due diligence on the candidates:

- organisational set up and group structure;
- regulatory authorisation;
- staffing and resources;
- client base;
- operational risk management procedures and controls, including compliance and internal audit;
- business continuity, cyber security and disaster recovery plans; and
- reputation.

AIMA has published an *Illustrative Questionnaire for the Due Diligence of Fund Administrators* (2017), which investment managers can use to assist them with is due diligence process.

## Common contractual features for administration

Directors should consider a few particular things about the form of the administration agreement before approving the appointment and the contract.

- **Valuation:** The terms of the administration agreement with respect to valuation and NAV calculation bear particular scrutiny. It is vital for the Board to understand how the administration agreement defines the valuation process and the respective responsibilities of the administrator, the investment manager and the Fund. Most frequently, the administrator will only commit to performing NAV calculations based on agreed valuation procedures setting

out the pricing sources to be used for each type of asset the Fund anticipates it may hold and a process for the involvement of the investment manager/Board in providing prices for any assets not available via the pricing services. If an administrator is willing to be involved in the valuation of assets (i.e., defining a price for the asset for purposes of the NAV calculation), those services will be defined specifically in the agreement or in a separate agreement, typically with both the Fund and the investment manager as parties to that arrangement. Regardless of the valuation arrangements, the Fund needs to be party to the contract with respect to these matters and the administrator should have a direct line of liability to the Fund and its investors.

- **Outsourcing and servicing from multiple locations:** Many administrators have developed global operations and sometimes this translates into having the services offered to a Fund being delivered via portions of the administrator's organisation away from the contracted entity via the administrator's outsourcing arrangements. In addition to understanding the applicable regulatory expectations and requirements regarding outsourcing, the Board should seek to understand with specificity from where and from which entity services for the Fund will be provided and should seek to be notified of any changes to the administrator's operating model which may materially affect the service provided to the Fund.
- **Liability:** Please refer to the 'Understanding contractual terms' details in Section 5.8 in relation to contractual terms. Directors should also be aware that liability caps are sometimes a feature of administration agreements.

## Board considerations

In advance of the meeting at which the appointment of the administrator will be considered, the Board should ask the investment manager to provide information on:

- the scope of the services the proposed administrator will be expected to undertake, and the service levels the investment manager and the Board will be expecting;
- the investment manager's assessment of proposed service offering and any capabilities of the proposed administrator;
- the scope and nature of the due diligence undertaken by the investment manager;
- the material findings of that due diligence (noting any potential areas of concern including any identified potential conflicts of interest);
- the factors listed in the paragraph below and any other material information; and
- the rationale for the investment manager's selection of the proposed administrator.

When weighing whether to approve the appointment of the proposed administrator and the contract and service level agreement, the Board should consider at least the following factors:

- the administrator's experience with funds running a similar investment strategy or investing in the same types of assets;
- the administrator's IT and cyber security infrastructure;
- the ability of the administrator to provide the expected services, especially specialist services, in a timely and competent manner;
- the nature and scope of the valuation, pricing and NAV calculation services to be provided;

- independence of the administrator and its related persons from the investment manager and its related persons;
- any identified conflicts of interest;
- the potential inclusion of liability caps in certain jurisdictions; and
- fees and the value for money of the services to be provided.

### Pre-launch matters

Once the administrator has been appointed and before the Fund is launched, the Board should request that the administrator review the disclosures set out in the offering document covering:

- the description of the role of the administrator and a summary of the duties and functions it will undertake in respect of the Fund;
- the description of the terms and procedures the administrator expects to use in connection with subscriptions/investor onboarding (e.g., deadlines for application forms and subscription monies, AML/KYC/CTF documentation and compliance processes, eligibility checking), transfers and redemptions (e.g., cut-offs for redemption notices);
- the types of disclosures that the Fund, the investment manager and/or the administrator may be required to make to regulatory authorities (e.g., in connection with AEOI regimes and beneficial ownership registers);
- fee calculation methodologies, including, where applicable, descriptions of the performance fee equalisation methodology to be applied; and
- how the Fund's assets are to be valued and the NAV calculated, in accordance with the pricing matrix agreed by the Fund, investment manager and administrator.

The administrator should also be asked to confirm that the subscription agreement contains the disclosure about the AML/KYC/CTF process and is properly designed to facilitate obtaining the information and documentation from investors necessary to meet regulatory requirements applicable to the administrator and to the Fund.

## 5.5 Appointment of prime broker(s)

Many, but not all, alternative asset funds appoint a prime broker. Reflecting on the complexity these relationships can represent, AIMA has published a separate *Guide to Sound Practices for Selecting a Prime Broker* (2014). The section below has been prepared at a relatively high level due to the existence of the separate guide, which Directors should consider reviewing for additional explanations of some of the matters in the summary below and for additional insights that may be relevant to their consideration of the appointment of a prime broker.

Prime brokers offer a range of services. Not all of these services will be relevant to all Funds. Some Funds may not need a prime broker at all. Typical prime brokerage service ranges will include, among other things:

- acting as a financing counterparty to enable the Fund to borrow cash and/or securities subject to collateral and margin requirements;

- providing centralised cash and securities facilities to enable custody (directly or as a sub-custodian for an appointed depositary (see Section 5.6 below)), settlement and clearing processes for the Fund;
- processing both voluntary and mandatory corporate actions for those securities held in its custody;
- reporting and processing services, for example withholding tax reporting, proxy voting and short sales reporting;
- "synthetic" prime brokerage, exchange-traded derivatives and OTC clearing;
- foreign exchange prime brokerage;
- client services and consulting;
- capital introduction;
- research; and
- regulatory reporting, such as transaction reporting and systemic risk reporting.

## Due diligence on prime brokers

A short list of prime brokers should be selected by the investment manager, subject to final appointments being approved by the Board. AIMA has produced an *Illustrative Questionnaire for the Due Diligence of Prime Brokers* (2017) which the investment manager may consider using to aid the due diligence process.

Depending on the anticipated size of the Fund and the types of assets in which the Fund is expected to be investing, the investment manager may consider it appropriate to set up additional prime brokers to address specific business needs, including with expedited implementation. In such cases, these prime brokers should be subject to the same due diligence and approvals requirements, except possibly in a more targeted format.

The Board should request that the investment manager explain the reasons for its choices and evidence the due diligence exercised in selecting and monitoring such prime brokers. The investment manager should be able to provide evidence to the Board of its regular and ongoing monitoring of prime brokerage relationships and assessment of ongoing risks posed by each relationship.

## Common contractual features on prime brokerage

The key areas of a prime brokerage arrangement that a Board should understand before appointing the prime broker and approving the contract include, among other things:

- the exposure calculation (including any cross-product or cross-agreement netting, which will inform when margin calls are to be made), the margin process and any collateral recall/ substitution mechanisms;
- any circumstances in which the prime broker is permitted to refuse to accept a trade for settlement or clearance;
- any permitted rehypothecation and the permitted reuses of Fund assets;

- whether and how the Fund's assets are to be segregated from the assets of other clients and from the assets of the prime broker, as well as the locations where Fund assets will be held;
- the treatment of cash balances; and
- the interaction expected with the depositary, if any.

All of these features as well as other common features of prime brokerage arrangements, are described in further detail in the *Guide to Sound Practices for Selecting a Prime Broker* (2014).

# 5.6 Appointment of depositary/custodian

Safekeeping of the Fund's assets is a basic requirement for all Funds that invest in custody assets. The Directors should understand how the depositary/custodian that they are considering appointing intends to achieve this and where and how the Fund's assets will be held in custody, especially where this involves a sub-custody network.

## Due diligence on depositaries/custodians

When selecting a depositary/custodian to put forward for the consideration and approval of the Board, the investment manager should make requests for proposals to multiple potential providers. Once the potential options have been narrowed on the basis of service offerings and fee levels, the investment manager should undertake due diligence on the candidates covering:

- organisational set up and group structure;
- regulatory authorisation;
- staffing and resources;
- client base;
- the geographic scope of the sub-custody network and any other specialist custody services offered;
- operational risk management procedures and controls, including compliance and internal audit;
- business continuity, cyber security and disaster recovery plans; and
- reputation.

## Board considerations

In advance of the meeting at which the appointment of the depositary/custodian will be considered, the Board should ask the investment manager to provide information on:

- the scope of the services the proposed depositary/custodian will be expected to undertake, and the service levels that the investment manager and the Board will be expecting;
- the investment manager's assessment of proposed service offering and any capabilities of the proposed depositary/custodian;
- the scope and nature of the due diligence undertaken by the investment manager;

- the material findings of that due diligence (noting any potential areas of concern including any identified potential conflicts of interest);
- the factors listed in the paragraph below and any other material information; and
- the rationale for the investment manager's selection of the proposed depositary/custodian.

When weighing whether to approve the appointment of the proposed depositary/custodian and the contract and service level agreement, the Board should consider at least the following factors:

- the depositary/custodian's experience with funds running a similar investment strategy or investing in the same types of assets;
- the nature and scope of the services to be provided;
- the ability of the depositary/custodian to provide the expected services, especially specialist services, in a timely and competent manner;
- independence of the administrator and its related persons from the investment manager and its related persons;
- any identified conflicts of interest; and
- fees and the value for money of the services to be provided.

Where the depositary/custodian is delegating any functions (which is frequently the case), the Board should consider the representations of the depositary/custodian with respect to (i) its compliance with applicable legal requirements in relation to such delegations, (ii) its processes for monitoring delegates' activities, and (iii) its process for conducting risk analysis on or otherwise assessing the suitability of its delegates. The Board should understand who the delegates are and what functions are being delegated (especially where this relates to the safekeeping of Fund assets). The Board should also (i) satisfy itself that the delegate is able to assume the delegated responsibilities and (ii) monitor the delegate on an ongoing basis to ascertain that it continues to be a suitable delegate and that the interests of the investors in the Fund are not compromised.

### Common contractual features for depositaries/custodians

The key areas of a depositary/custodian arrangement that a Board should understand before appointing the depositary/custodian and approving the contract include, among other things:

- whether and how the Fund's assets are to be segregated from the assets of other clients and from the assets of the depositary/custodian (and any sub-custodians all the way down the custody chain), as well as the locations where and how Fund assets will be held;
- the treatment of cash balances; and
- the interaction expected with the prime broker, where applicable.

## 5.7 Appointment of an auditor

The selection of the Fund auditor is normally undertaken by the investment manager prior to launch of the Fund and this selection and the proposed letter of engagement is presented for the Board's consideration at a meeting prior to the launch of the Fund. A letter of engagement is an agreement between the Fund and the auditor which normally governs the terms of appointment

and typically sets out a wide variety of matters, including any limitation of liability on the part of the auditor and any local statutory requirements relating to the auditor.

When selecting a Fund auditor, the investment manager should request proposals from a variety of potential providers and undertake due diligence on the auditor and the proposed audit partner before determining which auditor the investment manager is going to recommend. The Board should ask the investment manager to provide information on (i) the scope and nature of the due diligence undertaken, (ii) the material findings of that due diligence (noting any potential areas of concern including any identified potential conflicts of interest), (iii) the factors listed in the paragraph below and any other material information, and (iv) the rationale for the investment manager's selection of the proposed auditor.

When weighing whether to approve the appointment of the auditor suggested by the investment manager and the related letter of engagement, the Board should consider at least the following factors:

- the auditor's knowledge and understanding of the investment strategy;
- the ability of the auditor to complete the audit within deadlines;
- independence of the auditor from the investment manager and its related persons;
- the potential inclusion of liability caps in certain jurisdictions;
- any identified conflicts of interest;
- the necessity for any additional tax reconciliations (i.e., where IFRS is used but reporting must be in U.S. GAAP) and reporting (e.g., PFIC reporting or K-1s for U.S. taxable investors);
- whether additional sign off by an auditor in the Fund's jurisdiction of incorporation is required; and
- fees.

## 5.8 Other service providers

Other key Fund service providers may include (i) a non-discretionary investment advisor, (ii) a distributor or other third-party marketer, (iii) registration services agent (whether global, national, State or local in coverage), (iv) listing agent, (v) a secretary, (vi) MLRO, and (vii) legal advisors.

While the Directors are typically responsible for the appointment of these service providers, the investment manager will usually be heavily involved in the selection process and will provide the Directors with its recommendations. The investment manager, depending on the terms of the IMA, may retain discretion to appoint sub-delegates.

Directors should also be aware of any applicable regulatory responsibilities related to the appointment and ongoing monitoring of service providers. (See, for example, Section 11 of the Guide discussing the requirements of the AIFMD in this regard).

### Due diligence and understanding of alternative providers

When selecting service providers to be put forward for the consideration and approval of the Board, the investment manager should make requests for proposals to multiple potential providers. Once

the potential options have been narrowed down on the basis of service offerings and fee levels, the investment manager should undertake due diligence on the candidates which should include:

- organisational set up and group structure;
- regulatory authorisation (if applicable);
- staffing and resources;
- client base;
- operational risk management procedures and controls, including compliance and internal audit;
- business continuity, cyber security and disaster recovery plans; and
- reputation.

Directors should consider putting in place a structure for regular reviews of the service providers. This may include annual (or more frequent) meetings with, or onsite due diligence of, the primary service providers. Those meetings should cover compliance with regulations, investment guidelines, KYC/AML, payments and corporate action processes among other things. Any Director, investment manager or committee responsible for conducting any face-to-face review with the service providers should report to the Board their findings in a timely manner.

If the review of the performance of other service providers identifies areas where a service provider is not meeting the terms of their service agreement, the Board should discuss and agree how the specific matter will be resolved. The Board may decide to include the investment manager in this discussion. If the matter is serious, or not resolved in a timely manner, the Directors need to consider if the service provider should be put on notice, replaced and the service agreement terminated.

## Understanding contractual terms

The Board (or the investment manager as the Board's delegate) is responsible for agreeing terms and appointing service providers. However, as discussed above, the Directors should satisfy themselves that there are no conflicts with the parties providing services and the Fund and that they understand the terms of their service agreements. Where the documentation relating to any such relationship are complex, the Directors should recommend or require review of such documents by the Fund's external legal counsel.

Directors should also be aware that liability caps are sometimes a feature of agreements with fund service providers. A liability cap places a financial cap on the liability of the service providers for any losses arising out of a failure by the service provider that falls short of a certain level (such as fraud, wilful default, etc.). The level of such a financial cap is typically a multiple of the annual service fee or, alternatively, a fixed monetary amount. The Directors should consider whether it is appropriate to accept such a cap and whether it is market standard.

Service providers may seek to exclude certain types of loss altogether, such as indirect or consequential loss, and loss of profit. They may also request inclusion of a clause on "proportionality" whereby there is an allocation of losses and liability to various parties based upon their contribution to those losses. Additionally, language is typically used to exclude liability arising from use of defective information provided by the Fund or its agents. The Directors should be aware of market practice in this area, discuss the matter with the Fund's service providers, the

Fund's external legal counsel and consider whether it is appropriate to make relevant disclosure in the Fund's offering document.

Applicable rules of certain Funds' jurisdictions of establishment prohibit service providers from imposing such a liability cap.

## 5.9 Fund policies and procedures

Policies and procedures should be put in place to accurately reflect the ongoing administration and operation of the Fund in practice. We have set out a non-exhaustive example of policies a Fund would typically be expected to have in place.

### Conflicts of interest policy

Directors should ensure that they are aware of the relevant laws relating to conflicts of interest to which they are subject, as well as the relevant provisions in the Fund's offering document and Constitutional Documents. Examples of potential conflicts of interest relating to Directors and the investment manager are set out in Appendix A.

The Board should maintain a conflicts of interest policy which details how conflicts of interest are identified and dealt with.

Directors should always be aware of the investment manager's and other service providers' potential and actual conflicts of interest in managing a Fund and exercise their oversight appropriately.

Directors should bear in mind the guiding principle that the interests of the Fund are paramount, even if the interests of the Fund as a whole may not sometimes entirely align with the interests of particular investors or groups of investors. In such case, the Board should ensure that the Fund always treats investors fairly as between each other.

The offering document should sufficiently disclose all existing and potential conflicts of interest, typically within the dedicated "Director Biographies" and/or "Conflicts of Interest" section. Directors should, generally speaking, and whenever possible, seek to avoid any potential conflicts of interest. Where that is not possible, the Directors should appropriately mitigate, monitor and manage any conflicts arising.

### Allocations between classes of interests

The Fund should maintain a distribution policy which details the priority and rules for distributing the net distribution proceeds in accordance with the investors' share classes. The calculation of the distribution is generally undertaken by the administrator and verified by the depositary. The rights attaching to each share class and entitlements upon distribution should be described in the Fund's offering document.

### Valuation

The Fund should operate written policies and procedures to ensure a sound, transparent, comprehensive and appropriately documented valuation process. The administrator may be involved in the valuation of assets and NAV calculations and the valuation procedures should be clearly defined in the administration agreement, as discussed in further detail at Section 5.4 above.

# Financial procedures

Accounting policies and procedures should be maintained to enable the Fund to deliver in a timely manner financial reports which reflect a true and fair view of its financial position and which comply with all applicable accounting standards and rules. The Fund should maintain adequate accounting records for the purposes of financial control and management. Applicable rules of some Funds' jurisdictions of establishment will require various accounts to be filed with the domestic regulator.

# AML and CTF

AML and CTF laws and regulations differ from jurisdiction to jurisdiction and are detailed and technical in nature. The standards and rules with which a Fund is required to comply is therefore jurisdiction-specific, and potentially Fund-specific. A comprehensive explanation of the AML and CTF laws and regulations currently in force in all relevant jurisdictions for all types of Funds is beyond the scope of this Guide. The Board should consult legal counsel to the Fund if there is any doubt as to the applicable requirements.

Despite the jurisdiction- and Fund-specific nature of the relevant laws and requirements, it is possible to distil numerous general principles and recommendations of sound practice for Boards in the AML/CTF context. These are set out below.

## Understanding of the AML/CTF requirements and obligations of the Fund

The Board should have a clear understanding of the AML/CTF requirements that apply to the Fund, including:

- the functions to be performed;
- any mandatory obligations;
- whether performance of the necessary functions and/or procedures may be delegated, as is often the case, to the administrator, a third-party distributor or other suitable third party such as the investment manager;
- on what terms the Fund may make any delegations; and
- supervision and oversight of an entity to which any functions have been delegated.

There may be a jurisdictional requirement, and in any event, it is sound practice for all Directors to receive periodic, usually annual, AML/CTF training. The AML/CTF training would relate to all applicable laws including the AML/CTF laws and regulations of the jurisdiction of establishment of the Fund and would typically cover the Fund and the Board's obligations under such AML/CTF regime and all applicable AML/CTF laws.

## AML/CTF policies and procedures

The Board should document, by resolution or otherwise, the manner in which the Fund has decided to meet its AML/CTF obligations. This will generally involve adoption of AML/CTF policies and procedures including testing the adequacy of these together with internal controls/risk management and implementation thereof. The Board should ensure that the Fund promptly addresses any changes in the applicable AML/CTF laws and regulations and should amend the Fund's AML policies and procedures to reflect such changes if necessary.

## Delegation/placing reliance on a third party

The Board should consider whether performance of the necessary functions and/or policies and procedures may be delegated to, or reliance may be placed on, a third party to carry out the AML/CTF functions (the "Delegate"). Usually this will be the Fund administrator or sometimes it will be performed by another suitable third party such as the investment manager.

The Board must consider on what terms the Fund may make any delegations/place reliance on a Delegate and the appropriateness of the proposed Delegate to fulfil this function.

Where the Board has put delegation arrangements in place/is placing reliance on a service provider to fulfil the AML/CTF function, the Board should ensure that it understands the scope of the delegation and that the arrangements are fully in accordance with the AML/CTF laws and regulations applicable to the Fund. The Board should be able to provide written evidence of the arrangements and demonstrate the suitability of the Delegate to perform the relevant procedures and functions and should regularly satisfy itself of the reliability of the Delegate's systems and procedures. In particular, the Board should obtain regular feedback from the Delegate to ascertain that the Delegate is adhering to the formal procedures in place and that any suspicious findings have been raised and investigated accordingly.

Subject to laws applicable to the Delegate and the nature of the procedures undertaken and relied upon, the Delegate should promptly report any suspicious findings and the results of the subsequent investigation to the Board and, in some instances, also to the relevant competent authorities and/or enforcement authorities (see below for further information). In addition, the Board should obtain and review the Delegate's SSAE 16 report (or equivalent controls report, if it has one) covering all aspects of the Delegate's operations, including its AML/CTF policies and procedures, as well as the exit letter from regulator investigations/audits carried out in respect of the Delegate, if either exists. If no such report exists, the Board should consider the need for such a report, having regard to the risk profile of the Fund.

The AML/CTF policies and procedures adopted by the Delegate should comply with the AML/CTF laws and regulations applicable to the Fund in the Delegate's jurisdiction, which should be at least equivalent to those AML/CTF laws and regulations that apply in the Fund's jurisdiction of establishment. Specific requirements vary from jurisdiction to jurisdiction and some jurisdictions may require the Fund to adopt its own Fund level AML policies and procedures compliant with the Fund's jurisdictional AML/CTF laws and regulations and these should be reflected in the policies and procedures of the Delegate.

Generally, however, the policies and procedures adopted should ensure that, until the Delegate completes its AML/CTF procedures satisfactorily, any new subscription monies remain in the subscriptions bank account. Ordinarily, the policies and procedures should also ensure that the Fund pays redemption proceeds into the account from which the investor wired the original investment. If the redeeming investor requests payment of redemption proceeds into an account different from that from which the investment was paid, the Delegate should normally ask the redeeming investor to substantiate in writing the reason(s) for the new account. In the event that the Delegate accepts a subscription without receipt of the full AML/CTF documentation from the new investor, the Fund should retain redemption proceeds until the investor provides the outstanding documentation.

## AMLCO, MLRO and Deputy MLRO ("AML officers")

The primary responsibility of an MLRO is to report suspicions of money laundering in the Fund and to oversee the performance of the individual responsible for guarding against the Fund being

used for AML/CTF purposes ("Designated Party"). In some jurisdictions, the designated MLRO and Deputy MLRO may be provided by the Delegate, however the Board should consider any jurisdictional requirement to appoint a natural person (at management level) as MLRO and Deputy MLRO specifically for the Fund (as opposed to the MLRO at the Delegate level). If this is the case, then typically the third-party service provider supplying the individual to act as AML Compliance Officer would generally also provide these officers and one individual may act as both AMLCO as well as MLRO or Deputy MLRO although obviously the same person cannot act as both MLRO and Deputy MLRO. The Board should again consider who is appropriate to fulfil these roles.

Notwithstanding that the Board may have delegated AML obligations to a third party, ultimate responsibility for ensuring the Fund complies with its obligations rests with the Board.

The MLRO should perform regular reviews of the Designated Party's AML policies, procedures and controls. The MLRO is responsible for evaluating suspicious transactions and determining whether such transaction should, depending on the jurisdiction involved, be reported to the relevant authorities. The MLRO should understand the monitoring procedures used by the Designated Party to capture potential suspicious transactions.

Further, the MLRO should ensure that the Designated Party's staff has undergone regular training in AML procedures and are aware of their legal obligations.

### Potential conflicts of interest depending on the identity of the relevant officers

Conflicts of interest may arise if the MLRO holds another position within or for the Fund whereby there is a higher risk of money laundering (e.g., if they work for the administrator or the investment manager). This conflict may adversely impact the MLRO's ability to carry out AML duties effectively and impartially. Risk can be minimised by appointing an independent MLRO.

### Suspicious activity reporting

The Board need to be aware of and understand the procedure for reporting suspicious activity. The MLRO will be the point of contact for all suspicious activity reports for the Fund and with the remit to report suspicious activity to the competent authorities.

## Business continuity and disaster recovery

Another area for the Board's consideration, recently brought into focus as a result of Covid-19, is that of business continuity planning and/or disaster recovery ("BCP/DR") in respect of the Fund's service providers, including the investment manager and the administrator. The ability of the Fund's service providers to cope with such an event provides comfort both to the Board and to investors.

These events can vary from a service provider system outage impacting daily deliverables to a major force majeure event which necessitates a wider business recovery action. Assessment and monitoring of this by the Board is an important part of understanding if the service providers are the most suitable partners.

The basic considerations and questions which a Board should consider include:

- Is there a well-documented written BCP/DR plan?
- Is there a dedicated BCP/DR crisis team for oversight of key issues?

- Is the BCP/DR plan managed by senior management at the relevant service provider (for example, the COO or CFO at the investment manager)?
- Is data appropriately backed up and housed at a suitable offsite venue?
- Is there an appropriate level of documentation on the service provider's BCP/DR plan, with a step-by-step guide to facilitate the best return to full operations?
- Is the BCP/DR plan regularly stress tested (at least once a year)?
- Key person(s) risk at the relevant service provider should be considered, with appropriate policies in place to address the same.
- Are any details available to the Board in respect of the last testing of the BCP/DR plan, along with any findings?

While this is not an exhaustive list, answers to these questions will provide the Board with greater transparency on the robustness of the business continuity planning in place.

Additional and more detailed information on BCP/DR issues is available in AIMA's *Guide to Sound Practices for Business Continuity Management* (2020).

Finally, the Board should monitor the Fund's potential cyber security vulnerability. Cyber security, particularly in the context of the financial services industry, is a growing industry threat, and is subject to increasing regulator and investor scrutiny. This has become an area of increased concern as a result of Covid-19 and the fact that many people are now working from home. The Board should regularly seek confirmation that the Fund's service providers are effectively protecting the Fund from cyber-attacks and any resulting loss of key Fund and/or investor data. Section 8.1 addresses further the data protection and cyber responsibilities of Directors. Additional and more detailed information on cyber security issues is available in AIMA's *Guide to Sound Practices for Cyber Security* (2019).

## 5.10 Fees and expenses

Details of expenses for establishing the Fund, organisational expenses and ongoing expenses are typically specified in the Fund's offering document. The fees and expenses for each service provider should also be detailed in the Fund's offering document and further detailed in the relevant service agreements entered into with each service provider. In general, any fees and expenses borne by a Fund should be reviewed by the Board and only approved if such fees and expenses are considered to be appropriate in the context of the relevant Fund. The Board has a duty to ensure that no undue costs are charged to the Fund.

It is sound practice, and in some jurisdictions mandatory, for the investment manager to maintain a remuneration policy for certain categories of senior staff (including the Directors) who can materially impact the risk profile of the Fund or on the assets it manages on behalf of the Fund. The policy needs to be consistent with and promote sound and effective risk management. Certain jurisdictions impose a cap on the level of fixed and variable remuneration which may be received.

# 6. Ongoing role of the Board

The Board has ultimate responsibility for all aspects of management of the Fund. While Boards may delegate tasks internally, it is also common for certain tasks to be delegated externally. Such delegation, and the legal responsibilities of delegates, does not reduce the Board's ultimate

responsibility. It follows that the Board must, notwithstanding any such delegation, at all times retain and exercise overall control of the relevant Fund's management. There are also limits on the extent to which delegation is legally permissible in certain jurisdictions.

In general terms, Boards are expected to exercise prudent judgement having regard to, but not necessarily confining themselves to, widely accepted standards of good governance and to have regard to the particular challenges of the relevant Fund.

## 6.1 Monitoring for conflicts of interest

The current regulatory and investor environment places a significant emphasis on the independence of Directors and proper Fund governance. The extent of possible conflicts is infinitely varied and may not necessarily be easy to identify, but Directors should seek to identify, in consultation with the investment manager and other service providers and disclose to investors any potential conflicts of interest that may affect the Fund. Examples of potential conflicts of interest relating to Directors and the investment manager are set out in Appendix A.

Given the breadth of potential conflicts, this Guide has split these into: (i) conflicts affecting a Director, and (ii) conflicts affecting the investment manager or other service providers.

Directors should be aware that what may appear to represent an alignment of interests could represent, under the same or different circumstances, a conflict of interest, e.g., a Director having an investment in a Fund for which they also serve as Director. In case of doubt, the Director should always disclose any potential, actual or apparent conflict of interest at the first available opportunity (e.g., Board meeting) and, depending on the circumstances, may need to abstain from voting on any related matter. A Fund's Constitutional Documents typically require such disclosure as well.

The Board should document all disclosed conflicts in the Board meeting minutes specifically, rather than relying upon boilerplate language stating that the Directors have disclosed all their relevant interests. In addition, the secretary should request Directors to disclose any new potential conflicts of interest at each periodic meeting and may wish to maintain a register to record such conflicts.

Subject to confidentiality laws in the relevant jurisdictions, Directors should disclose recent past and existing business (including any other directorships) and close family relationships within the industry to the Fund as a precautionary measure (i) at the time of their appointment to the Board, and (ii) on an ongoing basis. Directors should view disclosure of their interests as protecting themselves given that the obligation to do so is often a legal and fiduciary obligation on the Director.

The Directors should also disclose any holding, purchase, redemption or sale of their interests in a Fund to the Board. The Fund would not ordinarily inform investors of such an event unless such a provision were contained in a separate side letter.

In the event that a conflict of interest does arise, a Director may determine they have no choice but to resign from the Board due to the extent of a conflict. Depending on the nature of the conflict, the Board and investment manager may determine to disclose the specific conflict of interest within the Fund's offering document.

Directors should bear in mind the guiding principle that the interests of the Fund and its shareholders are paramount, even if the interests of the Fund as a whole may not sometimes entirely align with the interests of particular investors or groups of investors. In such case, the Board should ensure that the Fund always treats investors fairly as between each other.

Directors should ensure that they are aware of the relevant laws relating to conflicts of interest to which they are subject, as well as the relevant provisions in the Fund's offering document and Constitutional Documents. This description of conflicts of interest is not a statement of, or guidance as to, the law relating to conflicts of interest, and readers should not treat it as such.

Directors should always be aware of the investment manager's and other service providers' potential and actual conflicts of interest in managing a Fund and exercise their oversight appropriately.

## 6.2 Review of investment performance and approach to risk management

The review of investment performance and the investment manager's approach to risk management are arguably two of the most important functions of the Board as they not only relate to the key deliverable, performance, but also relate to reviewing the risks taken to achieve such results. The investment manager should keep the Board informed of the Fund's performance on a regular basis. Directors should receive a frequent, dedicated report from the investment manager featuring the latest performance estimates and any other material items which have arisen with respect to performance. In addition to the above, reporting for the quarterly Board meeting normally includes a performance report for the period in review. A market review, peer group analysis, performance attribution report and risk report prepared by the investment manager are also typically included. The Board should ensure that the reported risk metrics are relevant and complete for the strategy in review. Finally, the investment manager should report on any problems encountered. To the extent that a Fund employs a benchmark, the Board should consider whether the benchmark is a reasonable comparative for the Fund's strategy and whether the use of the benchmark (and the disclosure thereof) may be in any way misleading to investors.

The Board should look at how the performance compares both with the Fund's investment objective as well as with a representative sample of peer managers and the underlying markets. The Board should also understand how the investment manager achieved that performance and what risk profile the investment manager adopted to generate those returns.

The investment manager should also promptly notify the Board of any material changes within the investment manager that may affect the investment manager's performance.

## 6.3 Monitoring adherence to investment policies and restrictions

Every Fund is required to state its investment policies and restrictions in its offering document in order to make current and prospective investors aware of the types of investments the Fund may make and the goals it is trying to achieve. Depending on the regulatory status of the Fund, investment managers also commit to further restrictions in side letters or in material given to investors such as presentations and due diligence questionnaires. Regulated Funds may also have to comply with a further set of legal or regulatory restrictions.

An important function of the Directors' role is to oversee the Fund's compliance with its stated investment policies and any restrictions. Therefore, the Directors should ask the investment manager's compliance officer to include in its report any breach of the Fund's stated investment policies and any restrictions for consideration at each Board meeting. Should a serious breach of the investment policies or any restrictions occur then the Board would expect the investment

manager's compliance officer to notify the Board as soon as reasonably practicable with details of the breach.

## 6.4 Product governance; investment management reporting and review of fund performance

The Board, through scrutiny of the performance report as set out in Section 6.2, should ensure that investment performance must be fairly represented including whether the information relating to the Fund's risk/reward relationships are appropriate to investors' specific needs. Information regarding the risks taken, the costs incurred, and the results achieved allow investors to understand their portfolio's performance and fairly evaluate their investment managers. As such, the Board should ensure that annual and interim financial statements include statements, such as net assets, operations, investment portfolio, summaries of portfolio investments, cash flows or statement of changes in net assets, financial highlights and explanatory notes, and auditor reports on annual financial statements.

## 6.5 Monitoring of trading practices

The Board should consider the investment manager's trading and related policies and practices. Globally, regulators have been increasing their emphasis and concern regarding such practices which are scrutinised during their reviews. Accordingly, the Board should seek to understand the trading practices engaged on behalf of the Fund in order to ensure that the investment manager is fulfilling its fiduciary duty to the Fund. These include brokerage allocations, trade allocations, and the use of soft dollars/dealing commissions.

### Trade allocation

The oversight of the investment manager's trade allocation policy and procedures is an ongoing responsibility of the Board.

The investment manager needs to provide the Board with sufficient information relating to the following two key factors: (i) how the portfolio managers apply investment discretion for the allocation of trades to each strategy; and (ii) how the portfolio managers allocate trades where there are multiple portfolios within the respective strategy.

Steps for the Directors to consider:

- perform an initial review of the trade allocation policy in place;
- have the investment manager provide the Board with a detailed explanation of the trade allocation procedures;
- during each Board meeting, an agenda item should be established to address any changes to the trade allocation policy or additions/terminations of any portfolio accounts; and
- as part of the materials provided to the Board for each Board meeting, the investment manager should, if applicable, summarise all the portfolios maintained showing, among other items, the following attributes: (i) gross and net return; (ii) strategy grouping; (iii) investor specific overrides; and (iv) explanation of return variances within a strategy grouping.

The Directors should consider the above steps and evolve the monitoring procedures to fit the nature of the investment manager's business and the Fund.

## Brokerage allocation

Directors should be made aware of the methods and policies used by the Fund's investment manager in allocating trades to executing brokers. The Directors' attention could focus on, among other things, the following areas:

- review of the investment manager's broker allocation procedures, including the quality and cost of services provided by executing brokers;
- review of the broker allocations made against the procedures provided which may include a review of the trading desk and sample trades and their corresponding allocations;
- review of any potential conflicts of interest, including review of the entertainment and gift policy and logs as well as any transactions with connected persons; and
- review of the investment manager's best execution policy, including the minutes of any periodic review meetings of individual executing brokers which should include:
    - new relationships with executing brokers;
    - soft dollar relationships;
    - trading errors by specific executing brokers; and
    - the fairness of the order in which executing brokers are contacted and/or client trades are executed.

## Use of soft dollars/dealing commission

The Directors should ensure that the Fund's best interests are at the forefront of an investment manager's trading practices, especially where the use of soft dollars/dealing commissions and the obligation to seek best execution is concerned. Use of soft dollars and dealing commission has been a focus of financial regulators in recent times, both in the U.S. and Europe. Financial regulators' rules and guidance seek to prevent use of soft dollars/dealing commissions to pay for services that do not benefit clients but rather only the investment manager. In such cases, those soft dollars/dealing commissions should be paid for by the latter, thereby alleviating a source of potential conflict of interest. As one would expect, different regulators may have different approaches to what is allowable.

Steps for the Directors to consider:

- obtain an understanding of the regulatory framework on the subject matter, the differences in various regulator's approaches and keep themselves abreast of impending changes;
- obtain the policy adopted in respect of the Fund and understand its intended use;
- periodically understand the nature of expenses paid for using soft dollars/dealing commission, and determine whether the expenses fall within the relevant regulator's framework;
- if it is unclear whether the nature of the expenses fall within the relevant regulator's framework, then the Board should request an external legal opinion from a reputable firm to provide further clarity;

- satisfy themselves that the investment manager has adequate controls and oversight over the entire process of using soft dollars/dealing commission through, for instance, periodic reporting from the investment manager's compliance function; and
- where an investment manager receives bundled services and part of the service would not be permissible under a regulatory framework, the Directors should review the investment manager's mixed-use assessment and recordkeeping thereof.

## 6.6 Monitoring implementation of valuation policy and NAV calculations

Notwithstanding any delegation to a third party, the Board retains ultimate responsibility for oversight and supervision of valuation and NAV calculation. The Board must review and approve at least annually the Fund's valuation policy and any applicable pricing models and must be cognisant of regulatory obligations placed on the Fund in its jurisdiction of domicile.

The Board should document and approve a valuation policy in advance of the Fund's launch and disclose an appropriate summary of it in the Fund's offering document.

The administrator, and in some instances the investment manager, must ensure compliance with the valuation policy and the valuation provisions disclosed in the Fund's offering document. However, another very important function of the investment manager and the administrator where valuation is concerned is to communicate with the Board on valuation issues regularly. A formalised process for reporting valuation issues (for example, stale pricing, liquidity, difficult trading markets, illiquid assets, side pockets or subjectivity) to the Board and its valuation committee, if any, on a regular basis should be put in place. This allows the Board to fulfil the requirement that there is adequate oversight and supervision.

AIMA's *Guide to Sound Practices for the Valuation of Investments* (2018) makes 17 recommendations in respect of valuations of investments - as to governance, transparency, procedures, processes and systems and sources, models and methodology.

## 6.7 Monitoring marketing and investor relations

In terms of new business activities, the Directors should be made aware of the overall plans that the investment manager, and any distributors it has appointed, have to promote the Fund. The Directors should also be made aware what the target client base is, what the capacity of the Fund is and what restrictions may or may not apply on marketing in certain jurisdictions. A report should be available quarterly, summarising gross and net subscriptions, so that the Board can monitor the size of the Fund against its theoretical capacity. Periodically, the Board should ask for a new business presentation by the investment manager so that the Board may ensure that the proposition to the investors is consistent with the Fund's offering document.

In terms of relations with existing investors, the investment manager and the administrator/ transfer agent should provide the Board with a quarterly summary of investor correspondence, highlighting key issues raised so that the Board is aware of common themes such as concerns about performance or concerns about efficient administration. Directors should be aware of the size of the investor base and how it breaks down by type of investor.

## 6.8 Relationship with the investment manager

The duties that the investment manager owes to the Fund may be set out in contract, laws, regulations or in common law court decisions. In some jurisdictions, the terms of the IMA may affect the extent to which those duties are owed to the Fund as well. More specifically, the Fund and the investment manager may limit the scope of these fiduciary duties by mutual agreement in some jurisdictions, although such limitations should be explicit and unambiguous. The informed consent of the Fund, as evidenced either in the IMA or otherwise (e.g., by Board action) is often a defence to a claim that the investment manager's fiduciary duties have been breached.

In addition to fiduciary duties, an investment manager may also have other obligations to the Fund for which the Fund may make a claim in case of breach. Depending on the terms of the IMA, these could include causes of action for:

- negligence/gross negligence or other breaches of relevant standards of care, as applicable;
- misrepresentation;
- breach of contract; and/or
- breach of regulatory requirements.

The Board's ongoing review of the investment manager's performance should necessarily include an evaluation of whether or not these duties have been fulfilled.

### Nature and frequency of information supplied to the Board regarding performance, subscriptions and redemptions

The Board's information requirements depend on the particular strategy or activities of the Fund. Such information should include copies of information the Fund provides (directly or through its service providers) to all investors (usually monthly or quarterly newsletters), together with key documents filed on behalf of the Fund with regulatory agencies and exchanges. The investment manager should expand on this information at quarterly Board meetings, to incorporate a more detailed explanation behind any performance or valuation figures.

The future prospects for the Fund are also a responsibility of the Board. To monitor this, they will need information on subscriptions, redemptions, marketing, asset-raising strategies (typically delegated by the Board to be the day-to-day responsibility of the investment manager, under the IMA, or of a third-party distributor, under a separate distribution agreement), and the potential impact of such activities on the strategy and performance of the Fund.

In terms of frequency of information, subscriptions and redemptions should be reported at regular Board meetings. Subscriptions and redemptions information should also be reported at any special Board meeting that occurs at a critical time for the Fund, for example, where redemption requests have built up and would have a considerable impact on a particular dealing day. Other examples of circumstances where more frequent or immediate information may be required include:

- subscriptions made near the time the Fund is due to close (to new subscriptions);
- ERISA/pension plan assets that may have an impact on current investors;
- large redemptions which could destabilise/affect the portfolio;
- large redemptions which could trigger a gate;

- valuation of illiquid securities which may impact the NAV; and
- material investment losses during the month triggering covenants in Fund counterparty agreements.

Redemption information is particularly critical for Funds investing in less liquid assets or strategies.

## Board monitoring responsibilities

Many of the key operational issues for which the Board has responsibility either involve the actions of the investment manager, the administrator or other service providers or are dependent on information provided by, or sourced from, the investment manager, the administrator or other service providers.

At every Board meeting, the Board should assess the performance of the investment manager, the administrator and other service providers. Such an exercise is, in large part, a forward-looking exercise. As such, the Board should not base its decisions solely on past performance. The Directors should also consider such related factors as the expertise and skill of the specific individuals within the investment manager, the administrator and other service providers responsible for the Fund; and the resources and commitment provided to the Fund by the investment manager, the administrator or other service providers.

# 6.9 Relationship with the auditor

The Board typically needs to appoint the Fund's auditor annually (or appoint a different one, as applicable). This annual engagement should be approved in advance of the end of the relevant financial year end which will be the subject of the audited financial statements. The Board should also review the annual audit scope and process proposed by the auditor, in consultation with the investment manager, the depositary (if any) and the administrator, before approving the annual engagement. Directors should consider the re-appointment or replacement of an auditor in the same manner as the initial appointment of an auditor.

## Supervision of the Fund's accounts and the audit process

It is a requirement in many locations for a Fund to produce annual financial statements and in some jurisdictions semi-annual accounts.

The Board is responsible for:

- the preparation of the financial statements;
- selecting suitable accounting policies and applying them on a consistent basis;
- making estimates that are reasonable and prudent; and
- preparing the financial statements on a going concern basis, unless the Fund is unlikely to continue in business.

In practice, the Directors delegate responsibility for maintaining the Fund's books and accounts and the preparation of year-end accounts to the administrator and, to this end, the Directors may wish to seek an appropriate letter of comfort from the administrator.

Auditing standards require auditors to communicate certain matters with "those charged with governance". These matters cover such areas as independence, changes in accounting policies,

going concern issues, material misstatements, etc. These communications should be in writing. The auditors should present their audit plan to the Board in advance of the audit work commencing and present their audit findings to the Board following the audit. The Board should review any material audit findings before approving the accounts. If the auditor reports that there are non-material findings, the auditor will still present a management letter but the formal review of non-material items should not necessarily hold up the approval of the accounts.

## Letters of representation and comfort letters

After conducting the audit and before signing the audit opinion, auditors seek a letter of representation ("L/R") from the Directors as to a variety of matters of a factual and opinion nature relating to the records, systems and situation of the Fund. The content of L/Rs often varies as between audit firms, between jurisdictions and from year to year and according to the nature of the Fund and the applicable audit standards. Matters typically covered, however, include, but are not limited to:

- an acknowledgement of responsibilities;
- belief that the accounts are fairly presented;
- a representation that all the appropriate books and records have been made available;
- a representation that all material transactions have been properly recorded;
- an acknowledgement of responsibility for establishing and maintaining adequate internal controls;
- ownership of the Fund's assets;
- a representation that the investments and other financial instruments are valued in accordance with the criteria set out in the Fund's offering document;
- representation that all connected party transactions have been disclosed;
- representation that all contingent liabilities have been made known to the auditors;
- a statement of unadjusted differences which the Directors approve as immaterial for restatement of the financial statements; and
- management's responsibility for assessing fraud risk.

Directors should review the accounts and the L/R carefully. If the accounts or the representations prove inaccurate, Directors may be personally liable. Such a review might focus on several areas:

- contents of the accounts, particularly as to the auditor's report, and whether the auditors have expressed an unqualified opinion;
- the schedule of investments, to ensure no breaches of investment restrictions, as outlined in the offering document, have occurred and that the Fund is following its documented investment mandate;
- liquidity checks and any changes or matters of significance which have arisen in the period;
- content of the L/R, particularly identifying any areas where the Directors might wish to seek limitations (see below) or obtain comfort;

- a "representation comfort letter" from the Fund's administrator and the Fund's investment manager, particularly as to all matters within their respective knowledge or control (which in practice will be many items);
- the availability and content of a similar "representation comfort letter" from the Fund's depositary or custodian, if there is one;
- good practice would be to ensure that each set of accounts, the letter of engagement (where applicable, as it may not be reissued at every audit) and L/R are submitted to all Directors to give each Director sufficient time to review the contents and in context. Audit and accounts production timetables can often become quite tight, so an adequate Director review period should be built into the timetable at the outset; and
- where the accounts have been reviewed by the investment manager or administrator (both of whom would normally be expected to be closely involved), the relevant service provider should be asked to highlight for the Directors any matters of significance arising during the year and to provide an explanation of any queries the Directors may have.

When considering how Directors manage their responsibility under the L/R, they may wish to consider these factors:

- being non-executive does not absolve a Director from the responsibility for the preparation and accuracy of the accounts;
- representation may be sought by the Directors from those relevant organisations, as to the delegated areas covered;
- the service providers so appointed are not mere delegates but are independent contractors acting in a professional capacity. There should be some reflection of that fact in the L/R as to ask non-executive Directors to take unqualified responsibility would often be unreasonable. This approach will assist in reflecting appropriately the audit process and documenting the responsibilities of the Directors and those of other providers; and
- audit practice may differ in some jurisdictions, mainly arising from differences between accounting standards (for example, U.S. GAAP vs. IFRS), audit standards, or Fund law, regulation and practice (and therefore auditors' assessment of their risk and responsibility).

If the auditor needs representations from the administrator or investment manager and the representations requested are appropriate, the administrator or investment manager, as applicable, should tailor the representations to their knowledge or role. Directors may need to obtain back-to-back representations in a comfort letter from service providers in certain cases. Directors signing the L/R should make sure that the entire Board has approved/ratified the execution.

## 6.10 Relationship with the administrator

Detail in relation to the Board's oversight and supervision of the administrator (as well as other service providers) is set out in Section 6.13 below. As noted, the primary method of reporting to the Board will be through quarterly reports and presentations made at Board meetings. Directors should expect the administrator's report to cover, at a minimum, the following details pertaining to the period covered by the report:

- details of pricing errors;

- details of breaches of investment or borrowing restrictions;
- details of suspicious transactions;
- details in relation to regulatory reports filed or due to be filed;
- confirmation that the administrator has performed AML checks on all investors and have identified any politically exposed persons and high risk investors;
- confirmation that the administrator has sufficient cyber security policies and procedures in place;
- details of any cyber security or data security breaches or incidents;
- detail of any material issues relating to business continuity and disaster recovery processes;
- confirmation that the administrator adheres with all guidance in relation to outsourcing arrangements;
- late delivery of NAVs;
- details of investor complaints;
- AEOI compliance;
- capital exceptions; and
- details of any cash log exceptions.

## 6.11 Relationship with the depositary/custodian

Detail in relation to the Board's oversight and supervision of the depositary (as well as other service providers) is set out in Section 6.13 of the Guide. As is the case in respect of the administrator, the primary method of reporting to the Board will be through quarterly reports and presentations made at Board meetings. Directors should expect the depositary's report to cover, at a minimum, the following details pertaining to the period covered by the report:

- confirmation that the Fund has been managed in accordance with the limitations imposed by the investment and borrowing powers outlined within Fund documentation and applicable laws;
- detail of any advertent or inadvertent breaches, if applicable;
- detail of any material NAV or transfer agency error, if applicable;
- any material issues in relation to:
  - cash flow monitoring,
  - safekeeping of other assets/asset verification,
  - investor dealing,
  - reconciliations,
  - income,
  - expenses, and
  - pricing;

- due diligence on service providers;
- detail in relation to any cyber security incidents; and
- confirmation the depositary has adequate business continuity procedures in place and detail of any impact on ability to provide services to Fund.

## 6.12 Reviewing the performance of other service providers

The Directors should approve the selection of other service providers including, but not limited to clearing brokers and ISDA counterparts although this function is sometimes delegated to the investment manager. The investment manager is usually heavily involved with the selection process and providing the Directors with its recommendations.

The Board (or the investment manager as the Board's delegate) is responsible for agreeing terms and appointing providers of outsourced services such as middle office and risk, compliance, execution brokers, valuation/pricing and research, some of whom may contract directly with the Fund. However, the Directors should satisfy themselves that the delegates are suitably qualified, that there are no conflicts with the parties providing such services and the Fund and that they understand the terms of these agreements. Where the documentation relating to any such relationships, particularly prime brokerage, custodian and ISDA relationships, are complex, the Directors should recommend or require review of such documents by the Fund's external legal counsel.

Directors should consider putting in place a structure for regular reviews of the service providers. This may include annual (or more frequent) meetings with the primary service providers. Those meetings should cover compliance with regulations, investment guidelines, KYC/AML/CTF, payments and corporate action processes among other things. Any Director or committee responsible for conducting any face-to-face review with the service providers should in a timely manner report their findings to the Board.

Should the review of the performance of other service providers identify areas where a service provider is not meeting the terms of their service agreement, the Board should discuss and agree how the specific matter will be resolved. The Board may decide to include the investment manager in this discussion. If the matter is serious or not resolved in a timely manner, the Directors need to consider if the service provider should be put on notice, the service agreement terminated and a replacement service provider sought.

Directors should also be aware of any applicable regulatory responsibilities for the monitoring of service providers.

## 6.13 Periodic due diligence on service providers

The delegation of the activities of the Fund to service providers should not be confused with a delegation of responsibilities. Delegation without proper oversight of the delegated functions is ineffective and a breach of the Directors' fiduciary duties which can lead to unpredictable consequences. Directors must have in place the proper monitoring processes to ensure that service providers continue to perform their respective functions in accordance with applicable laws and in the best interests of investors.

Directors should require regular reporting from each service provider to monitor and assess the quality of the services provided. Receipt of reporting, and scrutiny and challenge of same, is the primary method of maintaining oversight of delegated tasks. However, a Board should also consider whether any of the following options should also be carried out:

- onsite visits to service providers;
- meetings with senior management in the relevant service provider; and
- regular presentations and reports from delegates to address compliance with legal and regulatory requirements, business continuity planning, audit reviews, breaches, errors, etc.

Furthermore, where an issue arises relating to the performance of a service provider, the Board may need to put in place controls to prevent a re-occurrence and/or update its oversight arrangements/policies.

## 6.14 Interactions with regulators

While interaction between Fund and the relevant regulator will primarily go through legal counsel as an intermediary, Directors, as the individuals with ultimate responsibility for the Fund, must be aware that they shall be subject to supervision of the regulator in the Fund's jurisdiction. Interactions with the regulators will primarily focus on documentary evidence and, as such, it is the Board's responsibility to ensure that adequate books and records of the Fund are kept and accessible, including minutes of all meetings, in order to refer to those books and records as and when necessary.

Interaction may also take the form of a request for participation in industry-wide questionnaires or requests for feedback in relation to certain topical areas which will be issued directly to the Board. In such instances, feedback should be discussed by the Board in consultation with the appropriate service provider with considered responses to be provided by the regulatory deadline imposed.

## 6.15 Oversight of updates to the offering document

The Directors are solely responsible for the Fund's offering document and the contents therein. As such, oversight must be focused on updates to the offering document. Boards should ensure processes are in place such that no updates are made without prior Board approval at a meeting of the Board.

Directors should expect to receive a document showing all amendments proposed to the offering document and should also receive a report/presentation from a representative of the manager, investment manager or legal counsel (as appropriate) outlining the effect of and rationale for the changes and verifying compliance with current legal and regulatory requirements. In particular, Directors must consider whether the change is of a material nature and, as a result, requires investor approval or notification.

## 6.16 Provision of information to investors

The Board is responsible for ensuring that investors receive, at a minimum, the information which the offering document indicates will be made available. Such information typically includes audited annual accounts and periodic valuations. The Board should seek positive assurance from the administrator as to what communications the administrator has sent to investors on

the Fund's behalf and that those have occurred within statutory deadlines and any deadlines set in the Constitutional Documents and/or any side letters. This assurance should be in writing and could form part of the administrator's periodic report on its provision of services. Directors should be interested in the Fund maintaining a continuing dialogue with investors and encourage the investment manager to issue periodic manager commentary on the Fund's performance and material business changes.

Directors should also add themselves to investor relations mailing lists maintained by the investment manager for periodic performance, market commentary and sales updates. A diligent Director should not only review the investment update but also be comfortable that information provided is timely, accurate and relevant.

As a guiding principle, Directors should seek to ensure that investors receive the same information at the same time in order to avoid any risk of treating certain investors preferentially, particularly where this information may be pertinent as to a decision to invest or remain invested in the Fund. For example, forewarning a certain investor of an impending gate or suspension on redemptions and thereby permitting such investor to redeem in advance would not be compliant with the principle of fair treatment of investors.

A Fund may sometimes disclose more information to some investors as opposed to others, for example during a detailed due diligence process or pursuant to a side letter. The Directors should establish parameters around permitted disclosures to manage the risks around doing so bearing in mind that the Fund should treat investors fairly, irrespective of the size or perceived importance of the potential or existing investor. See Section 6.17 below particularly regarding the provision of additional Fund transparency information to certain investors. Directors should consider these matters and take particular care when they receive direct enquiries from one or more investors.

## 6.17 Side letters

See Section 5.2 regarding the implementation of side letters and Director responsibilities in relation to this. Section 5.4 notes the need for the investment manager to keep a register of side letters and key terms, to assist with ongoing supervision of compliance with the side letters. A register of capacity rights and the extent to which these have been taken up is also useful for Directors in monitoring capital movements relating to investors covered by the side letters.

## 6.18 Exercising discretionary waivers

It is normal practice for the Board to reserve the right to exercise a discretionary waiver, typically on request by an investor, over certain terms and conditions relating to subscription and redemption terms and/or terms restricting an investor from transferring its interest in the Fund. All such areas of discretion should be clearly set out in the Fund's offering document. In case of doubt, the Board should seek advice as deemed necessary.

The Board may reserve discretion in the following areas:

- accepting late subscription or redemption notices/monies after stipulated cut-off times;
- accepting subscription amounts or permitting continuing investments that are less than the stated minimum;
- waiver of a minimum lock-up period;

- waiver of early redemption penalties;
- rescission of redemption requests; and
- exercising discretion as to whether or not to apply any gate (i.e., the power of the Fund to defer excess redemption requests if redemptions on any one dealing date exceed a stated maximum threshold).

When exercising a discretionary waiver, the Directors should consult with the investment manager to confirm the investment manager agrees that, in doing so, the Fund will not compromise the interests of existing investors. Directors should also ensure that a waiver on any dealing date is applied equitably across all subscribing or redeeming investors who are affected. In certain instances, the Fund's offering document may give the Directors additional discretion to apply such waiver only to specific investors, subject always to their fiduciary duties to the Fund.

Because most requests for a waiver are made on short notice, the Directors may, for administrative efficiency, wish to delegate the authority to agree to a particular waiver to the investment manager, a single Director or a committee, each within certain pre-agreed parameters. Where the investment manager, single Director or committee exercises this authority, such person should be required to report to the Board at regular Board meetings of any waivers granted and compliance with the pre-agreed parameters. Notwithstanding the Directors' right to delegate their discretion to waive certain terms to the investment manager, a single Director or committee, the Board should retain discretion over waivers that could materially impact investors or the Fund (e.g., waiver of the application of any gate).

## 6.19 Triggering liquidity risk management tools

Certain economic considerations or market circumstances may require liquidity risk management tools to be utilised. In each case, the Board should consider and approve any course of action proposed with the reasons for their decisions being clearly documented, noting that prior engagement with the regulator may be required depending on the circumstance.

Liquidity risk management tools which are available to Funds, in certain instances provided they are permitted by the Fund's offering document and Constitutional Documents, include:

- redemption gates;
- temporary suspension of redemptions;
- *in specie* redemptions;
- creation of side pocket share classes;
- application of anti-dilution levy or redemption fees; and
- borrowing arrangements to fund redemptions.

Directors should remain mindful that deployment of liquidity management tools should be done in a transparent and proportionate manner, taking into account the best interests of investors. Where possible, dialogue with investors, through the Fund manager, can help to manage liquidity risk, particularly in the case of large investors whose redemptions could significantly affect the ability of the Fund to meet redemption requests received.

## 6.20 Oversight of insider trading and market manipulation risks

The laws and regulations in many jurisdictions prohibit market manipulation, and civil and criminal sanctions may apply. Investment management firms must consider and, where applicable, control the risk of the firm being involved in insider trading or market manipulation. Such laws and regulations typically apply when an investment manager, a Director or a connected person executes a trade in the relevant market, regardless of the location and regulatory status of the investment manager, Director or connected person. In many jurisdictions, the scope of the relevant regulatory regimes is very broad and may cover not only trading in equities or fixed income securities, but also trading in commodities.

Prosecutors in many countries continue to focus their efforts on the enforcement of insider trading and market manipulation laws and regulations. The financial services regulators in many jurisdictions have increased their focus on the practices and procedures adopted by investment managers to safeguard against the risks of committing insider trading and market manipulation.

While the primary responsibility for compliance with insider trading and market manipulation laws and regulations rests with the investment manager, the Board should have a basic understanding of the practical steps and procedures that the investment manager has implemented to manage insider trading and market manipulation risks in addition to ensuring that they comply with relevant law and regulation. These would typically include procedures to:

- minimise the risk of receiving but not identifying material non-public information or "inside" information;
- control access to information received to mitigate the risk of improper disclosure (or tipping);
- use pre-trade controls to reduce the risk of insider trading and market manipulation;
- conduct post-trade surveillance to monitor and investigate potentially suspicious trades and report suspicious transactions to the relevant regulator or the relevant exchange;
- control personal account dealing; and
- train the investment manager's staff to ensure awareness of insider trading and market manipulation issues.

The investment manager should inform the Board if the Board receives material non-public information or inside information relevant to the Fund and its portfolio. In this scenario, the Board must observe confidentiality and the individual members of the Board must not deal in any relevant securities while in possession of such information.

## 6.21 Business continuity and disaster recovery

The Board should ensure that the Fund has a business continuity plan in place to ensure that when an interruption occurs the Fund can maintain operational resilience. Importantly, the Board must also ensure that each of the Fund's service providers have appropriate business continuity and disaster recovery arrangements in place on an ongoing basis.

AIMA's *Guide to Sound Practices for Business Continuity Management* (2020) sets key considerations Directors should take into account in relation to business continuity and disaster recovery. Please also see Section 8 and Section 10.3 of the Guide.

## 6.22 Automatic exchange of information ("AEOI") regimes

AEOI initiatives involve governments obtaining information from their financial institutions and exchanging data automatically with other nations that have signed up to the applicable AEOI regime. A number of AEOI regimes have evolved over time including FATCA and the OECD's global CRS.

The Board should be aware that the Fund might have obligations to gather and report information about its investors AEOI regimes and under local laws introduced by many fund jurisdictions to facilitate compliance with the requirements of AEOI reporting regimes.

The main points that the Board should be aware of in this context are as follows:

- The Fund may be required to register with one or more international tax authorities and obtain various identification numbers for reporting purposes;
- The Fund will need to put in place investor due diligence and information gathering procedures for new investors (either as part of the subscription documents or in freestanding tax forms and self-certification forms) and adopt due diligence procedures in respect of certain pre-existing investors, in each case to determine the status of those investors under various AEOI regimes; and
- The Fund will have obligations to make annual reports to its local tax authority or certain international tax authorities directly (depending on where the Fund was established) under various AEOI regimes.

Where responsibility for implementing the necessary investor due diligence and reporting procedures is delegated to the administrator or other AEOI service provider, as is often the case, the Board should ensure that they have a working understanding of the Fund's obligations sufficient to oversee the performance of the delegated activities. The Board also needs to factor the time needed to complete these formalities into the Fund's launch timetable.

## 6.23 Compliance with ongoing listing/trading rules

If the Fund's shares are admitted to listing and/or trading on a stock exchange, both the Fund itself and the Fund's Directors will be responsible for ensuring that the Fund complies with the continuing obligations imposed by the rules of that stock exchange.

Breaches of the listing rules or the rules of the relevant exchange can lead to the relevant exchange imposing sanctions on the Fund or the Fund's Directors (such as financial penalties or a public statement censuring the Fund, such as a temporary suspension of listing/trading or even a permanent removal of the Fund's shares from the relevant exchange).

Directors of listed and/or traded Funds should develop an understanding of the nature and detail of the rules applicable and be able to monitor compliance with them.

# 7. Interactions with investors

Investors in alternative funds value transparency and openness from the Directors of the Funds in which they invest.

## 7.1 Investor due diligence on Directors

As previously noted in Section 3.8 of the Guide, due diligence on Directors is a key component of the operational due diligence process of investors (or indeed third-party distributors acting on behalf of investors) as they consider new fund investments as well as for ongoing reviews of existing investment managers. Directors are considered, by investors, to be another service provider supporting the operations/functioning of a Fund and thereby a key step in the due diligence process. Evaluating the abilities of a Director to serve on a Board and provide strong independent oversight/governance is key to the diligence process and a factor in allocation decision making.

The Director due diligence effort may include a review of the Director's credentials, experience, expertise and skills, reference checks and potentially the completion of a DDQ or a direct conversation to assess the Director's abilities to serve on the Board. It would not be unusual for investors to ask for and receive Director CVs, firm DDQs, details on Board appointments and capacity, registrations/credentials, residency and other relevant materials. As Directors may operate within different business models, investor due diligence may also incorporate a review of the Director's firm, associates/partners, capabilities/services, protections in place with respect to IT and compliance, plus firm-related initiatives on ESG.

With respect to ongoing due diligence of Directors, investors may solicit feedback from the investment manager or other Directors regarding participation, engagement, value-add and effectiveness in representing the best interests of all investors and fulfilling their fiduciary duties as a Director for the Fund.

## 7.2 Regular communications

From an investor perspective, it is critical and expected that in addition to regularly scheduled Board meetings, the Directors have ongoing communications with the investment manager and staff, as well as relevant service providers and counterparties as appropriate. While there is a limited expectation from investors that they receive regular communications from the Directors, it is expected that the Directors do communicate concerns, issues or proposed changes directly to investors in a timely manner.

## 7.3 Investor access to Directors

While investors generally would not expect Directors to be involved in or intimately familiar with all details of the Fund's day-to-day operations, the ability for investors to communicate directly with Directors is key to a strong independent governance process. Directors should be available via phone/video/email to discuss matters related to Fund governance, structure, proposed changes to terms/service providers or staff and any other type of investment manager activity that potentially may impact investors. Investors do expect access to the Directors to discuss Fund-related business freely and separately from the investment manager or other staff.

Some investment managers may want to control this type of direct communication, although the investment manager involvement should primarily be to facilitate the interaction and not to limit interaction or topics to be discussed. That said, Directors should consider dissemination of sensitive Fund-related information and ensure that all investors are provided the opportunity to have the same access to information.

# 8. Data protection and cyber security responsibilities of Directors

The Covid-19 pandemic in 2020-21 was unprecedented and showcased to all enterprises the importance of having a robust data protection and cyber security framework in place. With many cyber-attacks witnessed in 2020-21, data protection and cyber security continue to be topics of wide discussion and heightened scrutiny by investors and regulators alike. It is therefore imperative that Directors understand the cyber security framework implemented by a Board, irrespective of size, but also fund service providers, to mitigate existing and emerging risks.

## 8.1 Having or obtaining the relevant expertise

Section 3 of the Guide describes the diversity of skills, experience and background that is considered useful for a Director to possess to ensure a well-balanced Board.

While it has not been common practice for a Director to expressly possess IT and cyber security expertise, the nature, scale and complexity of the relevant entity should be considered when establishing a Board's composition. A Director, however, should understand the nature and scope of the institution's vulnerabilities, and the Board should review and monitor contractual agreements with service providers to ensure there are effective measures in place to safeguard the Fund data and remain cognisant of the evolving industry threats and applicable jurisdictional requirements that the Fund must adhere to.

## 8.2 Establishing a policy

The Board, in conjunction with the investment manager, is responsible for establishing a governance framework to monitor and manage data and cyber security risks. With the ever-evolving regulatory and legal environment in data protection and cyber security, written policies and procedures of an entity should be succinct and focussed. To ensure the successful implementation of an entity's data and cyber security framework, it must be supportive top down. As captioned in the AIMA's *Guide to Sound Practices for Cyber Security* (2019), an entity's cyber security policy should be designed to prevent breaches, protect data and mitigate cyber security risks. It should preserve the confidentiality and integrity of the firm's information and risk management systems.

Cyber security and data policies and procedures cannot be written in insolation without consideration to the information technology, risk management and compliance controls. Consideration should be given to:

- the overall business strategy;
- vulnerabilities and risk tolerance of the investment manager;
- the role and responsibilities of key employees, senior management and the Board;
- risk categorisation of data;
- data flows – what data resides where, inclusive of outsourced service providers;
- data protection and privacy;
- system network controls and use of the internet;

- use of multi-factor authentication to control network/data access;
- encryption and network segmentation;
- user privileges;
- periodic reviews, testing and monitoring;
- jurisdictional requirements;
- an incident response plan encompassing various scenarios;
- communication – to whom and when;
- training and awareness – table-top training;
- breaches and penalties of institution and operating jurisdiction(s); and
- cyber and data loss insurance coverage.

While Directors do not specifically hold investor records or personally identifiable information, Directors may hold copies of the Fund's Constitutional Documents, contractual agreements, policies and procedures, postdate portfolio detail, audited financial statements and KYC documentation of the principals/owners of the investment manager and Board members. (The list of these documents is not exhaustive).

## 8.3 Identification and mitigation of risks arising from technology setups of Directors

Individual Directors should comply with the cyber security policies of each Board. Directors should also be aware of the general risks of remote working and should have regard for best practice in this area to mitigate cyber security risk. Please refer to AIMA's *Guide to Sound Practices for Cyber Security* (2019) in respect of personal protection, home and mobile working and education.

## 8.4 Due diligence on data protection and cyber security programmes of potential and existing service providers

The Board is ultimately responsible for ensuring that data protection and cyber security programmes at third-party service providers that have contractual obligations to the Fund are adequate. Indemnification and liability provisions within written agreements for data and cyber breaches with key service providers must be explicit. Jurisdictional obligations including data privacy laws, regulator-imposed requirements, penalties of breaches and reporting requirements by third-party service providers must be considered by Directors.

To better understand the cyber security and data protection framework implemented by key service providers, each Board should conduct cyber security due diligence on contracted service providers and build cyber security into the procurement assessment methodology upon which third-party service providers are selected. Such due diligence should be risk-based and should take into consideration the types of data or systems the vendor will handle on behalf of the investment manager and Fund (e.g., are they handling client data, personally identifiable information, or is the system being outsourced?).

Third-party vendor due diligence should be conducted annually or at a frequency based on its risk assessment. While Covid-19 prohibited onsite due diligence visits in 2020-2021, onsite due diligence visits remain recommended for high-risk relationships when travel is possible and when there are no social distancing restrictions.

A third-party vendor due diligence questionnaire may ask for information regarding the vendor's cyber security planning and data protection, including:

- business environment;
- governance – policies and procedures, internal roles and external partners and consultants to review its data protection controls;
- physical devices and systems;
- risk management strategy;
- access control;
- testing and vulnerability scanning;
- business continuity plans;
- information protection;
- incident alerts, anomalies, events;
- security monitoring;
- detection processes;
- breach response plans;
- jurisdictional requirements and reporting; and
- communication.

Directors should endeavour to obtain technology or security certification on a third-party service provider, such as an ISO 27001 or a SOC 2 report.

The Board should recognise the role of each service provider in meeting its cyber security and data privacy obligations so that such topics can be tabled as a recurring Board agenda item and Directors can obtain a regular IT security report. The Board should request that the service providers each deliver an IT security report quarterly to allow the Board to better understand the level of cyber and data threats, threat events blocked or unsuccessfully blocked, quarterly trends and the security controls in place.

## 8.5 Handling a breach

An entity's cyber security policy must outline the process for handling a data or cyber incident. The Policy should identify the team that will be responsible for identifying, analysing and managing the incident. The Directors should be notified immediately of a data or cyber incident.

Employees should report all suspected cyber security/data breaches to the relevant IT/Cyber/Data Officer with clear and concise details of the breach.

To understand the magnitude and/or severity of any incident it is important for incidents to be risk categorised. In addition, there should be a risk-assessed incident response plan for various scenarios, including a malicious attack, ransomware, theft (data and financial), etc. and clear lines of communication should be established identifying who needs to be notified within the entity

(i.e., General Counsel, Chief Data Privacy Officer, etc.) and externally (i.e., respective regulator(s), investors, the insurance company, forensic experts, etc.).

Following an incident, a report should be completed summarising the event and noting the severity of same and any action taken. An analysis of the impact of the incident and the remediation of the vulnerabilities should also be undertaken. It is also important that the relevant IT/Cyber/Data Officer reviews and updates the cyber security/data incident response plan, procedures and processes. Additionally, all incident records should be regularly reviewed to help:

- evaluate patterns and trends of cyber security/data incidents;
- identify common factors that have influenced cyber security/data incidents;
- determine the effectiveness of controls and defence mechanisms; and
- understand the costs and impacts associated with cyber security/data incidents.

# 9. Measuring Board effectiveness

As Boards become subject to increasing scrutiny from investors, it is worth considering how to monitor and measure the ongoing effectiveness of a Board. Assuming due consideration was given at the outset to Board composition, in particular with regard to Director capacity, diversity and skill set, the challenge becomes how to ensure that the Board continues to function efficiently and effectively, as intended, over time.

## 9.1 Developing a method of Board self-assessment

Increasingly, corporate codes recommend, and in many cases, mandate, that Boards engage in a self-assessment exercise on a periodic basis. Assessment methodologies remain open-ended and flexible, as a single, pre-defined process would not suit every Board, but key areas of assessment might include:

- the frequency of meetings, and attendance at such meetings;
- contribution at meetings;
- approval and execution of documentation;
- availability and responsiveness outside of formal Board meetings (consultation, votes, signatures, requests from regulators, etc.);
- access to, and engagement with, information provided to the Board;
- conflicts of interest;
- appropriateness of committees;
- evidence of sufficient independence, i.e., the Director's ability and willingness to challenge;
- sufficiency of applicable skills (especially in the event of any material changes in Fund strategy over time); and
- Board composition and the chairperson of the Board.

The assessment may be performed by the Board's chairperson, the Board or an external third party, and may include both quantitative and qualitative factors. In addition to any written assessment,

which should include discreet channels for feedback, it is suggested that the Board table an open discussion to discuss the functionality, operation and composition of the Board. The scope of assessment may also include individual Director evaluation. Such evaluation can take the form of a self-assessment and/or include a 360-style peer component. Critically, the assessment should result in the identification of any weaknesses of the Board and implementation of a remediation plan. Finally, the assessment process itself should be subject to evaluation and evolution in order that it remains fit-for-purpose, and not a box-ticking exercise. It is prudent to consider documenting the Board assessment in Board minutes or otherwise.

Regard should be had to jurisdiction-specific requirements in respect of Board assessment when considering the above.

## 9.2 Mechanisms for making changes in the event of under-performance

A Board assessment may result in the need for intervention, or changes to be imposed, at the Board level. Such intervention or change could result from a poor assessment of the Director's additive value due to (i) a material change in Fund strategy which renders a Director's skill set less beneficial, or (ii) the Director demonstrating insufficient capacity to pay due attention to Board matters (which can be evidenced by factors such as poor attendance and/or participation at meetings or lack of availability to respond to *ad hoc* requests). As Boards are often small, an underperforming Director can have a material effect on the proper functioning of the Board, so intervention and/or change at the Board level, while potentially uncomfortable in the short term, may be warranted.

Where conflict between a Director and a Fund arises, often the easiest way to manage the situation is to seek to have the Director resign their position voluntary.

In the first instance, a review of any assessment and a forthright discussion with the Director in question may be all that is required. However, should such a discussion fail to trigger the necessary changes, the other Directors may need to take the more extreme action of removing the Director from the Board via the mechanisms set out in the Constitutional Documents and in accordance with the legal and regulatory obligations of the relevant jurisdiction. Regard should be had to any legal or regulatory filing requirements following a change in Board composition.

# 10. Crisis management

While to err may be human, being unprepared for a crisis may be careless and can certainly cause anxiety. Even with the best crafted compliance and risk management policies, bad/unexpected things can happen. However, with planning and communication Boards can support a Fund through trouble, uphold their duty of care and seek to mitigate risk and limit liability.

## 10.1 Dealing with investor complaints

Investor complaints against a Fund, its investment managers and its Board may span a myriad of topics, including performance and valuation, strategic direction, distribution, conflicts of interest, and governance. Whether the complaints are valid they can give rise to regulatory, governmental or legal inquiries and complaints not dealt with swiftly can inflict significant financial damage on firms, increase administrative costs and tarnish reputations. While Boards are not necessarily the primary line of defence when it comes to investor complaints, there are steps Boards can take to

confirm Fund management is prepared to effectively investigate and address complaints should they arise. These steps include:

- confirming that policies and procedures include guidance for recording and escalating investor complaints;
- ensuring complaints are passed to the appropriate person immediately on receipt of same;
- ensuring complaints are acknowledged;
- ensuring regular updates are provided to the Board;
- reviewing investors complaint logs and whistleblower logs at quarterly Board meetings and making sure that the investment manager or relevant service provider provides adequate detail of the complaint, and any response or resulting actions taken; and
- to the extent an investor reaches out to the Board directly, understanding jurisdictional requirements for regulatory reporting and confidentiality and consider whether it is appropriate to escalate with Fund management.

## 10.2 Dealing with regulatory inquiries and investigations

Global regulators continue to expand their supervisory powers and AIMA expects this trend to continue. While in some cases regulatory inquiries and investigations will be addressed directly to investment managers and their staff, regulatory staff may also want to speak directly with the Board. To prepare for potential regulatory outreach, Boards may wish to consider the following agenda items for periodic meetings with Fund management:

- quarterly review of notifiable events and regulatory filing logs;
- quarterly discussion of any communications with regulators during the prior quarter; and
- regular discussion with legal and compliance staff about compliance monitoring and the regulatory horizon.

If a regulator reaches out directly to the Board, the Directors should consider engaging legal counsel before responding or sending documents in response to regulatory requests. In certain jurisdictions, including legal counsel in the line of communication may preserve privilege or other legal rights. In all cases, Boards should be careful to only answer questions about actions and activities for which they have actual knowledge.

## 10.3 Dealing with service provider mistakes, reputational issues or failures

Fund service provider errors and reputational issues can be imputed to the actions of the Fund. The potential consequence is a loss of investor confidence or irreparable harm to a Fund's or investment manager's reputation. Ultimately, if a service provider failure has occurred, regulators may question the sufficiency of a Fund's policies and procedures and whether the Fund's management has responsibly discharged its duties in the selection of third parties to advise and assist in the operation of the Fund. Globally, regulators have placed renewed emphasis on third-party service provider, counterparty and vendor management. The expectation is that policies for onboarding a new provider be reasonably designed to establish their competency and compliance with sound practices. Ongoing due diligence should be conducted to mitigate exposure to failings

or mistakes, legal liability and reputational risk. Boards should consider the following actions/ topics for discussion with Fund management:

- review annually the Fund's list of counterparties, third-party service providers or outsourced services;
- review annually business continuity plans;
- review third party initial and ongoing due diligence policies and procedures;
- request quarterly reports regarding any incidents impacting counterparties, third-party service providers or outsourced services;
- confirm that incident response plans include notification to the Board in the event of mistakes, breaches or material negative news regarding any counterparties, third-party service providers or outsourced services including a report to the Board discussing the materiality of the impact of such event on the Fund; and
- discuss the Fund's operational resilience plans in the event that the impact of such mistake, breach or negative news materially impacts the ability of the Fund to maintain its business, materially impacts the Fund's reputation or gives rise to legal or regulatory obligations. Many of these issues arise in relation to cyber security and data privacy breaches so consider alignment of such cyber and data protection policies with counterparty, third-party service providers or outsourced service provider due diligence.

## 10.4 Dealing with a hostile approach

Merger and acquisition activity in the investment management sector has continued to rise, as has activist activity. For Boards this may mean challenges to governance mechanics and even the fitness and experience of the Board. Investors may request direct meetings with the Board which, in hostile situations, may pit the Board against Fund personnel, as in such circumstances the Board will need to determine whether or not it is in the Fund's best interests to retain or replace an investment manager or wind-up the Fund. In addition, if a Fund is listed, specific regulatory requirements may apply under the takeover rules of a stock exchange and Boards may wish to seek independent legal advice on their duties and obligations in such circumstances.

## 10.5 Crisis preparation

Ultimately, the best defence to a crisis is preparation. Boards can protect themselves by requesting enhanced reporting by Fund management, reviewing insurance coverage annually and identifying key third parties to assist in a crisis. This may include legal counsel, insurance professionals, forensic specialists and even PR professionals. Experts should be familiar with the Fund, the industry and approaches that other companies have employed. Boards should insist on periodic updates regarding preparedness and may wish to conduct joint or separate tabletop exercises to test their crisis management skills.

# 11. AIFMD considerations

The AIFMD primarily regulates the entity which manages (i.e., provides portfolio management and/ or risk management for) an AIF. The manager of an AIF is referred to as an alternative investment fund manager, or "AIFM", and must comply with a wide range of compliance, risk, organisational, valuation, reporting, oversight, audit, disclosure and marketing related requirements under the

AIFMD. In practice, most alternative investment funds managed from or marketed in the EU and the UK are AIFs for purposes of the AIFMD, and the managers or investment managers of those Funds are AIFMs. However, it is important to note that the AIFMD makes a distinction between an AIFM which is EU based, and one which is non-EU based.

The AIFMD is a European regulatory regime that also applies in the UK in a very similar way, as it was "onshored" to UK law with effect from 1 January 2021 by virtue of the UK European Union (Withdrawal) Act 2018 (the "Withdrawal Act"), as amended. In this Guide, where references are made to any EU directive, EU regulation, EU decision, EU tertiary legislation or provision of the EEA agreement, including, without limitation, the AIFMD (an "EU Matter") in the context of the UK, then it should be read as a reference to that EU Matter as it forms part of UK domestic law pursuant to the Withdrawal Act and as modified by UK domestic law from time to time.

## 11.1 EU and UK AIFMs

An AIFM established, or with its principal office, in an EU Member State ("EU AIFM") or in the UK ("UK AIFM") is required to obtain authorisation or registration, if it is an EU AIFM, with its home Member State regulatory authority and, if it is a UK AIFM, with the FCA, as an AIFM and must, as a consequence of such authorisation or registration, comply with a wide range of AIFMD requirements. The AIF(s) under the management of such an AIFM are subject to the AIFMD indirectly and must either comply or arrange their affairs to enable the AIFM to comply, with a series of AIFMD requirements (especially those around valuation, the appointment of a depositary, annual report and audit, disclosure to investors and marketing).

## 11.2 Non-EU AIFMs

An AIFM established, or with its principal office, outside the EU ("non-EU AIFM") and the UK ("non-UK AIFM") is currently only subject to certain limited aspects of the AIFMD if it manages an EU or UK-domiciled AIF (an "EU AIF" or "UK AIF" (as applicable)) or markets in the EU a non-EU domiciled AIF (a "non-EU AIF") or a UK AIF, or markets in the UK a non-UK domiciled AIF. The AIFMD obligations currently imposed on AIFMs that are non-EU AIFMs and non-UK AIFMs are significantly lighter than those imposed on EU AIFMs and UK AIFMs and are limited to those relating to the relevant AIF's annual report, disclosure to investors, reporting obligations to regulators, marketing in the EU and the UK and, if relevant to the AIF, the various obligations relating to investment in EU and UK private equity.

## 11.3 Management of an AIFM

The qualifications required for a member of the AIFM's governing body often involve a higher degree of regulatory specification, although the contours of this may vary among jurisdictions.

### Fit and proper

Any individual appointed to the AIFM's governing body should have sufficient and relevant knowledge and experience to carry out their duties. This is highlighted in the AIFMD through the overarching principle that the AIFM is required to act honestly, with due skill, care and diligence and fairly in conducting their activities.

The AIFMD Level 2 Regulation expands upon the overarching principle in further detail but in summary requires that AIFMs are able to demonstrate that the AIFM's governing body has adequate

knowledge, skill and experience to understand the AIFMs activities, risks and the assets the AIF invests in; that the members of the governing body act with honesty, integrity and independence of mind and commit sufficient time to properly perform their functions. The level of knowledge, skill and experience required for a member of the governing body will vary depending on the nature, scale and complexity of the AIFM's operations and the AIFs under its management.

Under the AIFMD, compliance by AIFMs with these obligations is supervised and enforced not only by AIFM but also by regulators. The AIFMD Level 2 Regulation imposes obligations on the national competent authorities to satisfy themselves that the obligations outlined above are complied with. There has been a consequent development of a number of "fit and proper" regimes by regulators. Ultimately however, the AIFM itself will have the first line of responsibility under any fit and proper regime and an AIFM must ensure proposed appointees are fit and proper at the outset and on an ongoing basis.

## Senior management considerations

As mentioned above, the senior management of the AIFM are effectively the people who conduct the business of an AIFM. The AIFMD again requires these people to be of "sufficiently good repute" and "sufficiently experienced" in relation to the investment strategies pursued by the AIFs managed by the AIFM. Consideration should again be given to the nature, scale and complexity of the AIFs under management and senior management appointments should be resourced accordingly.

The AIFM's senior management have overall responsibility for approving each AIF's investment strategy and ensuring general adherence to the investment policy and risk limits for each AIF.

Senior management are also responsible for the effectiveness of the AIFM's compliance arrangements, including its valuation policies and procedures, compliance function, risk management policy and procedures and remuneration policy.

## Designated persons

Many fund management companies operate models which make extensive use of outsourcing. Frequently, this involves the delegation of certain management functions to specifically appointed designated persons ("Designated Persons").

The composition of an AIFM's Designated Persons is a matter for the AIFM to determine, subject to any requirements or approvals from the relevant regulator. It does not necessarily follow that a Director should act as a Designated Person although equally it is open for them to do so (subject to available time commitments). The roles of Director and Designated Person are quite different. Directors are involved in controlling and directing the AIFM while Designated Persons perform the managerial function which they have been assigned and escalate issues identified in accordance with the AIFM's escalation procedure. Persons fulfilling Designated Person functions should receive separate letters of appointment covering the scope and expectations of their role, remuneration receivable and time commitment for that specific role.

# 11.4 AIFM operations

The AIFMD contains a broad set of general principles with which an authorised AIFM must comply.

Chapter III of the AIFMD Level 2 Regulation provides much greater level of detail in respect of the operations for AIFMs and highlights a number of procedures, policies and internal structures (for

example separation of personnel carrying out risk functions with the operating units of the AIFM) an authorised AIFM will need to maintain to comply.

The AIFMD Level 2 Regulation stipulates the frequency with which an AIFM must review such procedures and policies and when the governing body and/or senior management of the AIFM should be involved in, or be made aware of, such decision-making.

## 11.5 Role of the AIFM on fund start up

While the formulation of the policy or strategy of a new Fund would typically come from the investment manager, such policy or strategy would be subject to the overall approval of the governing body which should maintain all major strategic and operational decisions affecting the AIFM including any proposed new AIF it manages. Accordingly, while the governing body may seek the advice and recommendations, in the form of a report or presentation from the investment manager with regard to a new Fund, it should also reserve the right not to act on such advice and recommendations, if considered appropriate.

## 11.6 Ongoing role of the AIFM

The AIFM's governing body will have an ongoing responsibility for monitoring compliance by the AIFM with its obligations under the AIFMD and will need to see evidence of such compliance monitoring. The AIFMD Level 2 Regulation specifies areas where ongoing control is required by the governing body, senior management and, where it exists, the supervisory function. These range in areas from formulating and overseeing the general investment strategies of the AIF to ensuring the AIFM's obligations under the AIFMD are met with respect to valuation, compliance and risk.

Compliance with the above can, to a large extent, be ensured through the adoption and review of a comprehensive suite of policies and procedures to cover areas including, but not limited to, delegation arrangements, valuation, conflicts of interest, risk management, conduct of business, due diligence processes and remuneration practices, responsibilities of senior management and oversight of the governing body. To the extent that reliance is placed on the policies and procedures of delegates, periodic review of such reliance should be carried out to ensure their appropriateness.

Notwithstanding any delegation of tasks and, given the definition of the "governing body" contained in the AIFMD, it is the governing body, however, that should retain the ultimate decision-making authority in an AIFM and, accordingly, should retain responsibility for all major strategic and operational decisions affecting the AIFM.

## 11.7 Oversight function of the Board of the AIF

While the AIFMD is almost silent on the role of an AIF's Board, the overall management of an AIF remains the legal responsibility of the AIF's Board under most company law regimes and the Constitutional Documents of most AIFs typically state that the AIF's Board is responsible for the management of the AIF's affairs. Investors also continue to expect that the AIF's Board will look after their best interests as investors.

Despite there being no specific AIFMD measures which directly relate to the role of the Board of the AIF, the AIFMD does have a significant indirect impact on the management and operation of

an AIF and thus on Fund governance generally. This arises from the obligations and requirements imposed on the AIFM (which the AIF's Board needs to understand fully in order to monitor appropriately the AIFM's compliance) and from the need for the Board to arrange the AIF's affairs and delegation arrangements appropriately so as to enable the AIFM to comply with its obligations which relate to the AIF.

## 11.8 General AIFMD driven governance considerations

When Fund governance is viewed in this wider sense, the AIFMD requirements which have an impact on the functioning of the Fund governing body include:

**(a) EU AIFM and UK AIFM authorisation**

- Carry out initial due diligence to review and understand how the core functions of managing an AIF (being portfolio management and risk management) are configured in the context of the investment manager's group and the AIF in question;
- Where the AIFM is seeking authorisation as an AIFM for the first time, the AIFM should provide the Board with an overview of its application for authorisation and a summary of its organisational structure and policies and procedures to assist the Board in assessing the ability of the AIFM to comply with the AIFMD requirements;
- Confirm that authorisation has been granted;
- Perform ongoing monitoring to assess whether the AIFM is complying with its AIFMD obligations; and
- Consider asking the AIFM to provide the Board with one or more periodic reports covering risk management and compliance with regulatory requirements relating to the AIF.

**(b) Non-EU AIFM and non-UK AIFM**

- Carry out initial due diligence to review and understand how the core functions of managing an AIF (being portfolio management and risk management) are configured in the context of the investment manager's group and the AIF in question; and
- Confirm that the AIFM is indeed a non-EU AIFM and a non-UK AIFM and does not require authorisation in the EU as an AIFM.

**(c) Depositary (Note that this is not applicable to a non-EU AIFM and a non-UK AIFM)**

- Review and confirm that appropriate depositary arrangements have been or are being entered into in writing. While it is the AIFM's obligation to ensure the appointment of a depositary, the agreement with the depositary is often entered into by each of the depositary, the AIFM and the AIF. The principal contact between the AIF and the depositary will, in most cases, centre on the negotiation of the depositary agreement and monitoring of the contractual relationship;
- Consider the parties to the relevant agreement or agreements and ensure that the AIF is party to the relevant agreement or agreements, particularly any separate oversight provider agreement. (Note that while the AIFMD does not require that the AIFM is a party to the contract appointing the depositary, merely that the AIFM ensures that one is appointed by the AIF, in practice, most depositary agreements are tri-partite between the AIF, the AIFM and the depositary);

- At the negotiation stage, check and confirm that the depositary agreement adequately reflects the depositary's obligations under the AIFMD and meets the specific content requirements imposed by the AIFMD Level 2 Regulation. This can be challenging; an AIFM managing multiple AIFs may want a framework agreement with a depositary to cover multiple AIFs. Regardless, the Board of the AIF must make the interests of that AIF's investors their sole priority, and ascertain those interests are not subordinated to the interests of the AIFM, or to the interests of other AIF's managed by that AIFM;
- If the Board takes a view that the AIF requires functions that exceed those prescribed by the AIFMD and the AIFMD Regulation, this would need to be raised at negotiation stage, adequately reflected in the agreement with the depositary, and monitored on an ongoing basis by the AIF's Board;
- After the depositary agreement has been signed, continue to monitor and liaise with the depositary in the performance of its contractual and statutory functions;
- Understand the depositary's oversight role and responsibility from an AIFMD point of view. Effectively, a depositary has a policing and enforcement role and must take steps to ensure that remedial action is taken; and
- Be aware of the requirement for the depositary to have an escalation procedure and consider asking to see a copy of the escalation procedure as sent to the depositary's regulator. (Note that the AIFMD Regulation requires a depositary to establish a clear and comprehensive escalation procedure to deal with situations where irregularities are detected in the course of its oversight duties, and these must be made available to the depositary's regulator on request).

**(d) The AIF's annual report and audit**

- Review the preparation of the AIF's annual report with regard to compliance with the AIFMD content and audit requirements and confirm filing.

**(e) Valuation**

- Understand the AIFM's role and responsibility for valuation from an AIFMD point of view and consider the roles of the administrator and the Board in that context. (Note that this sub-section, is not applicable to a non-EU AIFM and a non-UK AIFM);
- Ensure that the AIF is party to the relevant agreement or agreements affecting valuation matters;
- Review the AIFM's proposed valuation policy and carry out basic checks to confirm that it (i) is AIFMD compliant, (ii) is consistent with the administrator's approach and procedures, and (iii) envisages an appropriate role for the Board relative to the valuation agent;
- Approve the valuation policy for use in respect of the AIF;
- Receive appropriate valuation and NAV calculation information on a regular basis;
- Review and confirm that the NAV is calculated and published in accordance with the valuation policy; and
- Review the valuation policy at appropriate intervals and, if necessary, ensure it is amended.

**(f) Preferential treatment**

- Be aware of the prohibition under the AIFMD on the grant by the AIFM of preferential treatment which results in an overall material disadvantage to other investors. (Note that this prohibition is not applicable to a non-EU AIFM and a non-UK AIFM);
- Review and approve the grant of any proposed preferential treatment; and
- Monitor and confirm that appropriate disclosure is made of any preferential treatment granted.

**(g) Disclosure to investors**

- Be aware of the specific prior and ongoing disclosure requirements under the AIFMD and understand how and where they are being provided – whether in the AIF's offering document or the AIFM's regular newsletter or website, etc.; and
- Monitor the AIFM's ongoing disclosures (e.g., as to the current risk profile of the AIF and as to leverage).

**(h) Liquidity management**

- Review a copy of the AIFM's liquidity policy document, confirm that it is has the right focus, addresses what would happen in a distressed scenario and that the escalation measures are meaningful and appropriate. (Note that this is not applicable to a non-EU AIFM or a non-UK AIFM);
- Review the liquidity policy at appropriate intervals and, if necessary, ensure it is amended; and
- Consider with the AIFM whether it is appropriate for the AIF to adopt any limits on the liquidity or illiquidity of its assets and, if any limits are adopted, monitor them from time to time.

**(i) Reporting to regulators**

- Consider and confirm with the AIFM the required frequency of the Annex IV reports;
- Understand what resources and infrastructure the AIFM will use to prepare the Annex IV reports (e.g., in-house, assistance from the administrator or a specialist third-party provider or use of software tools);
- Monitor the AIFM's compliance with the relevant filing deadlines; and
- Receive and consider copies of the Annex IV reports when produced in order to fully assess the situation of the AIF.

**(j) Leverage**

- Be informed of the maximum leverage limits set by the AIFM and consider with the AIFM the reasonableness of those limits. (Note that this is not applicable to a non-EU AIFM or non-UK AIFM); and
- Monitor compliance with the maximum leverage limits from time to time.

**(k) Risk Management**

- Receive and consider a copy of the AIFM's risk management policy to enable the Board to better understand the nature of the AIFM's obligations and to inform the Board's thinking. (Note that this is not applicable to a non-EU AIFM);

- Consider the effectiveness of the risk management system and confirm that its key focus is on the types of risks inherent in the AIF in question;
- Monitor compliance with any adopted risk limits from time to time; and
- If the Board's view of a given situation varies from the investment manager's, consider setting scenario tasks for the investment manager to consider.

**(l) Marketing an AIF in the EU and the UK**

- Understand the marketing/distribution model adopted by the AIFM (e.g., marketing by the AIFM itself or the appointment of a third-party distributor or placement agent) and whether use is made of the AIFMD marketing passport, the national private placement regimes ("NPPRs") or "reverse inquiry";
- Perform initial and ongoing due diligence on any third-party distributor or placement agent;
- Understand the proposed target investors and their geographical location;
- Be aware of the general AIFMD requirements as to marketing;
- Be aware of the conditions under which EU AIFMs can engage in pre-marketing. New rules aim to allow EU AIFMs to gauge market interest before establishing an AIF or registering an AIF under a marketing passport (subject to certain conditions);
- Where marketing is to occur under one or more of the NPPRs, understand which EU countries require prior notification before marketing occurs, which require both prior notification and the grant of approval before marketing occurs and which require prior registration of the AIF with the local regulator. In the UK, prior notification to the FCA is required;
- Confirm that the AIFM will ensure that the AIF complies with the relevant requirements and how this will be achieved in practice; and
- Where the AIFM does not intend to carry out any marketing as defined by the AIFMD and chooses instead to adopt a reverse inquiry stance, discuss and confirm with the AIFM that the procedures adopted are robust and credible.

# APPENDIX A: CONFLICTS OF INTEREST

A catalogue of actual or perceived conflicts of interest could be an inexhaustible list given the number of ways that individuals, companies and their respective interests intersect and is accordingly beyond the scope of this Guide. For our purposes however, a few examples of potential conflicts to be aware of include where a Director sits on both the Boards of the Fund and of the investment manager, where the Director was recently an employee of the Fund or previously worked directly with the partners of the investment manager, where the Director is engaged as an employee or director of a competing enterprise and where the Director has assets that are partly owned by the Fund. The following are interesting situations to be cognisant of:

- An independent Director may hold directorships on numerous Funds established by a large investment manager. In such cases, a Director's remuneration may be sizeable in relation to their client portfolio and could arguably discourage the Director's propensity to ask difficult questions of the investment manager.
- Similarly, the retainer fee or wage of a Director can have a significant impact on their behaviour. If the remuneration of a Director is set too high, that Director may align themselves with the investment manager rather than the Fund, in the interests of retaining their directorship. On the other hand, a Director who is paid too little may spend commensurately little time and effort exercising their duties as an independent Director. Remuneration below market in circumstances where an investor expects the Director and the investment manager to be an arms' length relationship may be indicative of a hidden close relationship between that Director and the investment manager.
- A long-standing independent Director on a Board may over time form a close relationship with the investment manager, rendering them overly familiar of the investment manager and possibly impacting their exercise of appropriate vigilance.
- Professional Directors with numerous Directorships may find themselves over-burdened with work and incapable of realistically devoting the time and attention necessary to discharge their duties properly to a Fund. This risk will increase during trying economic times when numerous Funds may be vying for the frequent time and attention of those professional Directors.
- Directors may seek to assist the Fund in its marketing activities, or introduce investment partners to the Fund, or otherwise actively seek to assist the Fund's activities beyond a solely management and oversight role. In doing so, the Director runs the risk of being conflicted. A Director could be conflicted if they receive any remuneration/fee or gain from such activities.
- Boards and investment managers should be aware of the possibility of Directors sitting on the Boards of Funds established by competing investment managers. In such cases, Directors may find themselves in the position of seeking to act in accordance with their fiduciary duties to a Fund while simultaneously seeking to maintain their confidentiality obligations to another Fund. It is virtually impossible for a Director to maintain an information barrier within their own mind, given the information being received from multiple Funds.
- A Director sitting on the Board of a fund of funds which invests into a Fund where the same person also acts as a Director will be conflicted when voting or being present in discussions relating to such investment relationship due to their knowledge of the fund of funds.
- Directors should also be aware of the following tensions that arise where the investment manager is incentivised to undertake, or not actively discouraged from undertaking, certain inappropriate behaviours:

- Investment manager incentive to inflate valuations of investments, given that management fees and performance fees increase with an increasing Fund net asset value.
- Investment manager incentive to deflate Fund valuations if the investment manager/ principals hold a large portion of the Fund and there are significant third-party redemptions.
- Investment manager incentive to allocate expenses to the Fund, rather than pay for them itself. Attention should be paid not only to the Fund documentation, but also what is fair and represents good market practice.
- Investment manager incentive to allocate trades to brokers otherwise than in the interests of investors on a best execution basis, e.g., because of commission sharing arrangements. Directors should also pay close attention to the nature and quality of the policies put in place to regulate such behaviour by the Fund manager.
- Investment manager incentive to allocate trades other than equitably on a *pro rata* basis between different Funds, e.g., to favour one or more Funds or accounts holding significant investment manager/principal capital or where the investment manager earns a higher management and/or performance fee.
- Employees of the investment manager may engage in market abuse/insider trading, front-running (Personal Account Dealing) or receive inappropriate gifts and entertainment, etc.
- Investment manager incentive to avoid adequate disclosure in the Fund documentation of the existence of preferential terms in side letters.
- It may be appropriate for Directors to take separate professional advice from different advisors as the investment manager in relation to matters where the Director considers that a professional advisor may be under pressure from the investment manager to reach a certain conclusion, which is favourable to the investment manager and opposed to the interests of the Fund.

These tensions can be mitigated by the Directors periodically, typically annually, performing their own due diligence on the investment manager's policies, procedures and controls to satisfy themselves of the controls that can be relied upon when considering Fund governance.

# APPENDIX B: AIMA WORKING GROUP MEMBERS

| | |
|---|---|
| Peter Stapleton (Chair) | Maples Group |
| Allison Nolan | Athena International Management Limited |
| Chris Capewell | Maples Group |
| Craig Lindsay | Independent fund director |
| David Warsoff | J.P. Morgan Alternative Asset Management |
| Greg Bennett | Danesmead Partners |
| Josephine Orgill | HFL Advisors Limited |
| Justin Griffiths | Deloitte SA |
| Lisa Roitman | Pollen Street Capital (US) LLC |
| Michèle McCarthy | Independent Review Inc. |
| Paul Parkins-Godwin | Man FRM |
| Peter Huber | Maples Fiduciary Services (Cayman) Limited |
| Reggie Dodge | Emso Asset Management Limited |
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AIMA and the Working Group would also like to thank the following people who also contributed toward the drafting and production of this Guide:

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# APPENDIX C: ABOUT AIMA

The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in hedge fund and private credit assets.

AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry.

AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 200 members that manage $450 billion of private credit assets globally.

AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

For further information, please visit AIMA's website, www.aima.org.

# APPENDIX D: ABOUT THE SPONSOR

**Maples Group**

The Maples Group is a leading service provider offering a comprehensive range of legal services on the laws of the British Virgin Islands, the Cayman Islands, Ireland, Jersey and Luxembourg and is an independent provider of fiduciary, fund services, regulatory and compliance, and entity formation and management services. We distinguish ourselves with a client-focused approach, providing solutions tailored to their specific needs. Our global network of lawyers and industry professionals are strategically located in the Americas, Europe, Asia and the Middle East to ensure that clients gain immediate access to expert advice and bespoke support, within convenient time zones. For more information, please visit: www.maples.com.

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