



## USS's Expectations of Governance of Hedge Funds

### Overview

- Challenge is that the hedge Fund community represents a very diverse group of organisations.
- Key advantage for investors is that hedge funds can be niche/opportunistic re: strategies that are employed.
- Difficult to define and prescribe industry wide-standards for broad range of strategies
- Improvement of governance of 'institutional investor quality' hedge funds should be top of the industry's agenda as a way of demonstrating willingness to improve accountability and oversight.
- Starting point would be to ensure good, competent and independent directors are appointed to the boards of hedge funds.
- USS would expect a majority of independent directors with requisite skills-sets and experiences to be appointed to all boards including an independent chair.
- The other key priority should be for hedge fund managers to clearly and transparently disclose details of the Fund governance structure which is in place.
- We would also want to see independent administration, good quality service providers
- The recommendations listed below *are* presented as best practice guidelines which we would expect the hedge funds in which we invest to commit to implementing. They are presented on a 'comply or explain' basis.
- There are six key areas addressed below:

### 1. Board structure

- Optimal number of board members – 5.
- An executive director should be a member of the board.
- Majority of directors should be independent and non-corporate services.
- The chairman should be appointed from the cohort of independent directors who will have the casting vote.
- 1 person to fulfil the role of a company secretarial function who will be domiciled in the market in which the Fund is registered and will be familiar with local regulatory practices.

### 2. Definitions of independence

- Free from **current** managerial (professional and/or personal) relationships or associations and other potential conflicts of interest (such as cross-shareholdings).

- Tenure not to exceed 9 years – after which the director should be subjected to annual re-election by investors.
- Most important characteristic – independent frame of mind and ability to provide impartial oversight and to challenge management.

### **3. Independent director's role and key responsibilities**

- Fiduciary responsibility to shareholders to ensure the Fund is run in investors' interests and directors are held accountable to them for the stewardship of the Fund.
- To attend – in person – all board meetings.
- To provide an impartial and objective perspective on Fund-related matters.
- To provide appropriate oversight of financial statements to ensure management is investing in a manner and into securities and instruments that are consistent with the stated objectives of the Fund.
- To review and approve periodic valuations that have been supplied by third parties and to be the final arbiter in resolving disputes over valuations.
- To assess and approve:
  - the imposition of suspensions of redemptions
  - the imposition of gates
  - the reasonableness of discretionary fees charged
  - the appointment of key service providers such as auditors and administrators.
- To oversee the work undertaken by the service providers to ensure that it meets the needs and requirements of the Fund – the directors should be granted unfettered access to the auditors and administrators for this purpose.
- To address and resolve any potential conflicts of interest that may arise between the managers and the shareholders.
- To ensure that the fees and expenses incurred by the Fund are fair and reasonable.
- In the event of a wind-down of the Fund, the directors are responsible for ensuring and overseeing an orderly and expedient liquidation of the Fund's assets and the equitable dispersal of proceeds.

### **4. Time commitment and fee**

- Shareholders will expect independent directors to allocate sufficient time to the Funds to which they are appointed to undertake their role and carry out their responsibilities effectively.
- The maximum number of directorships which any one individual (independent directors) should take on board is likely to be between 10-15 – appropriate consideration to be given for Master-Feeder relationships and Families of Funds.
- Directors' fees to be commensurate with their enhanced role and responsibilities.

### **5. Skill sets/characteristics/background**

- Important to ensure that the skill-sets and backgrounds of board members (chairman's responsibility) are complementary. Skills to be represented include:
  - Minimum of 15 years experience in financial services
  - Buy-side investment experience, preferably in the hedge fund sector
  - Accounting/legal experience

- Familiarity with the markets in which the Fund is engaged
- Proven ability of holding managers to account

#### **6. Voting rights for shareholders**

Shareholders should be afforded the right to vote on the following areas at an annual meeting. The resolutions will need to be carried by at least 75% of the votes. The Manager to be excluded from the vote.

- To appoint and remove the Manager/Investment Manager/Advisor
- To approve the election of directors
- To approve the winding-up of the Fund
- To approve directors' fees
- To approve changes to material terms of the Fund – PPM &/or Mem & Arts

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22 February 2010