



What to Look for in an Independent Director

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One of the first considerations when looking for an independent director is the underlying reason behind your search. Probably, given the spectacular hedge fund and corporate collapses in recent years, part of the reason is the desire for effective corporate governance. In today's environment, corporate governance is no longer a luxury, but a necessity, and often a requirement. Regulators and exchanges are increasing their scrutiny and investors are demanding it – so should you.

Aside from corporate governance, one of the driving factors is often tax-related. Independent directors may be appointed in a tax-neutral jurisdiction to assist with the tax planning of the investment manager or to secure the fund's offshore tax status by ensuring that the jurisdiction in which the mind, management and control of the company is exercised, is clearly offshore.

Regardless of the reason, a qualified, experienced, independent director will assist in meeting the underlying requirements. The question remains, however: how do you go about the selection process and determine who the right person for the job is?

So, Where do You Start?

Your legal counsel and administrator are a good starting point and will have a shortlist of those individuals they recommend. Once you have their recommendations you should make additional inquiries to find the individual who is right for the fund. Investigate your options and don't limit your search to the first name on the list. Keep in mind that independent directors come with varying backgrounds, experience, qualifications, styles, interpersonal skills and corporate support – check around to compare and contrast.

The process of looking for an independent director is somewhat analogous to the search for a new employee and corresponding interview. If you have been in the unfortunate position of hiring the wrong person for a job, you will understand the feeling of regret that comes upon you when it becomes evident you made the wrong choice. You now wish, with hindsight as your judge and jury, that you had performed more due diligence and asked more questions at the outset.

You will have some questions for the prospective director, and should expect that they will have some for you in return. Both parties need to be comfortable and confident with each other in order to have a conducive and effective working relationship. If you can meet the individual in person, it is better, although this is not usually a practical solution. A telephone conversation will suffice in most circumstances.

Now, What Should You be Asking?

There are obviously no hard and fast rules or an all encompassing list of questions you should ask; however, a suggested 'top ten' for consideration follows. Add and subtract as you will; it is by no means all-inclusive but it will hopefully point you in the right direction:

- 1) *Independence – Ask!* Is the prospective director independent of the investment manager, administrator, legal counsel and all other service providers?

Independence is the 'Holy Grail' of effective corporate governance. If a director is not independent, conflicts of interest will inevitably arise and interfere with the director's ability to act in the best interests of the fund.

- 2) *Experience – Ask!* Does the individual have relevant industry experience and experience with the fund's strategy specifically?

You will get a good idea of their experience from their 'bio', which will eventually appear in the offering document of your fund. You will also want to ask if they have sat on boards with similar strategies. Independent directors do not need to be experts; however, a general understanding of the fundamentals of the underlying strategy is essential.



3) *Qualifications – Ask!* Does the individual have relevant professional qualifications?

You will possess academic credentials and qualifications of your own, and expect it of the people you employ. You should require it from an independent director as well. Remember, the directors are ultimately responsible for the oversight of the fund's affairs. A legal, accounting, compliance, investment or other relevant qualification, combined with experience, will provide a good indication of where their specific expertise lies and how they will add value.

4) *Capacity – Ask!* How many boards does the director currently sit on and how many manager relationships do they service?

Everyone wants to know the magic number. Unfortunately, there is no definitive number as every relationship will be different and have its own nuances and complexities. If you receive a vague response or, worse yet, they just don't know the answer, it will be an indication of the level of responsiveness you can expect to receive from them. Directors should know exactly how many relationships and corresponding fund boards they serve on at any given time. You need to be able to assess if they will be able to devote enough time to fulfill their duties.

A related question is whether the director has the ability to remain in direct contact with the affairs of the fund from formation onwards. Each director must personally be aware of the fund's affairs, and having an adequate support infrastructure to gather information can facilitate this. Confirm with the candidate how they, or their company, are structured and operate in this regard.

5) *Back-up/Coverage – Ask!* Does the individual work for a director services company or are they a stand-alone operation?

Although most consideration should be given to the capabilities of the prospective director, there may be times when the actual person you have selected may not be available. People take vacations, encounter emergencies, come and go from an organisation or jurisdiction, and start-up businesses often fail. Confirm whether your director has a support organisation of long standing, with sufficient support infrastructure to cover these contingencies, and if they have colleagues who can be appointed in their place should the need arise. Selecting your director from a director services company can carry distinct advantages in such situations.

Factors to consider when selecting a director services company are: how long it has been in business, its reputation, whether it is licensed and regulated in relation to the fund services it provides, is it sufficiently capitalised, and can the company supply more than one director if required.

Last, but not least – 'what if'? Those of us who live and work in the Cayman Islands, or other disaster-prone geographies, know that 'what ifs' do happen. Hurricane Ivan was a wake-up call to Cayman and inevitably tested most, if not all, disaster recovery plans. Ascertain whether a director, or directorship services company, has a formal and documented disaster recovery plan in place. Confirm if it has ever been put to the test and whether it was a success. The reality is that 'what ifs' do happen, and it is critical to know that a director will be able to continue to serve the fund.

6) *Regulatory Approval or Refusal – Ask!* Has the individual or entity by which they are employed, been approved or refused by a regulatory body?

An individual or entity, who is approved and subject to a regulatory body's ongoing scrutiny can offer the reassurance and credibility that they are not only fit and proper, but also familiar with the jurisdiction's legal and regulatory regime.

7) *Charges/Convictions/Investigations – Ask!* Has the individual ever been charged or convicted of an offence or are they currently under investigation?

Pick your choice of words, but this question needs to be asked. Adverse events such as fund blow-ups or fraud that generate negative publicity do happen. By itself, it does not mean that a director implicated is incapable or guilty of any wrongdoing. The question is whether it is in the fund's best interests to be associated with any potential headline risk and corresponding reputational risk.



Confirm if the candidate has ever been censured, disciplined or criticised by any professional bodies. If so, ascertain the underlying reasons and confirm whether there was a satisfactory resolution.

- 8) *Insurance – Ask!* Does the director require the fund to hold directors and officers' liability insurance or does the director carry adequate insurance?

Directors and officers' liability insurance is becoming increasingly necessary given today's litigious environment. Depending on the individual candidate and the specifics of the fund, some directors will require insurance to be provided by the fund. Others will maintain their own policy or have one provided by their company. Still, some will 'roll the dice' and not have coverage at all. Confirmation that insurance coverage is maintained will provide an indication of the financial standing of the individual and organisation, as well as provide comfort that they have an understanding of the litigation risks prevalent in today's environment.

- 9) *Remuneration – Ask!* How much will they charge?

Now that the right individual has been found they must be compensated fairly. Remember, the directors oversee the affairs of the fund, and time and effort is required to effectively fulfill their duties. Directors have personal liability, and the penalties associated with a failure in fulfilling their duties will far exceed the fees received from their post.

The remuneration of a director needs to be sufficient to attract and equitably compensate high-quality individuals. Remuneration may comprise an annual fee and compensation for time spent, or it may be a fixed annual charge. Out-of-pocket expenses will also be incurred, which may include standard administrative expenses in addition to travel, lodging and other expenses properly incurred attending meetings or in connection with the business of the fund. Whatever the arrangement, be sure to compensate directors fairly. As the saying goes, "you get what you pay for".

- 10) *References – Ask!* Who will vouch for them?

Any thorough 'interview' will end with the question of references. You are half way there if your lawyer or administrator has put in a good word for the candidate. It would, however, be prudent to receive some positive feedback from clients who utilise the candidate's services or who serve on the board with the individual. Ask for a couple of references and follow through with these.

So, What Next?

You have had some questions for the prospective director, and you should expect that they will have some for you. To a substantial degree, the answers to their questions will be ascertainable through a review of the offering document, so expect them to request a copy for review. They will inquire about the following: details of the fund's structure; investment manager and key personnel; identification of other service providers; investment objective, strategy, universe and restrictions; proposed board's composition; targeted investor base; frequency of dealings and valuations; and whether the fund will be listed.

Looking for an independent director does not have to be an arduous, time-consuming process; however, the decision should not be taken lightly. Your objective is to find a competent individual with a commercial mindset, who will be responsive to the affairs of the fund. A reasonable degree of due diligence should be conducted to satisfy yourself that they have the knowledge, skills, qualifications, experience and time to make a positive contribution to the board. Remember, the directors are accountable for promoting the fund's success by leading and directing its affairs. It is an important decision. Be thorough and remember to *Ask!*

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