



**Financial Services
Commission**

Response Paper Authorised EIF Directors & EIF Boards

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Introduction

The FSC sought participation from industry and other affected parties on its Consultation Paper "Authorised EIF Directors & EIF Boards" issued on 23 September 2009. Responses to the paper were requested to have been submitted by the 23 December 2009. The FSC kept the consultation period open until 26 February 2010 to receive belated responses.

At the end of the consultation period 4 responses were received.

Publication of this paper has been delayed due to subsequent discussions with respondents.

FSC's Considerations

The FSC is very grateful for the responses received to this consultation paper and wishes to thank all those who contributed to this process. The publication of this paper has been delayed due to some belated responses from industry.

The FSC has examined the responses received to both the paper in general and the individual questions posed. Where arguments made by industry are also supported by the FSC, the necessary amendments to the draft Guidance Note have been made. In other cases it has not been possible to accommodate the views of industry as the FSC considers that there is an overriding obligation to raise or maintain standards in certain areas.

It is clear from the responses that there are some concerns over some of the content of this draft Guidance Note. The FSC has revised the draft Guidance Note in order to address these concerns.

The next step

The FSC responses to the comments received are reproduced below. Rather than a detailed response to each and every comment received, the FSC has provided a response to the issue based on the comments received. Where necessary the FSC has revised the original draft. This draft document will then be sent to Government for approval.

Responses Received to the questions posed by the consultation paper

Q1. Do stakeholders consider the above residency test appropriate or that some other measure should be used?

Responses received

R1. Firstly, I believe that your proposed residency test will enable the supply of EIF directors to increase which is clearly desirable. Obviously when you broaden your search criteria then more candidates should become available.

In addition, I suggest that you should allow people to relocate to Gibraltar to become full time EIF directors. If suitably qualified and prepared to establish a full time business in Gibraltar as a director of multiple funds working on nothing else then this is to be encouraged.

I personally, if approved, would seek permission to establish and adopt a governance bureau approach. Once you have been appointed to say 5 funds, then 2 to 4 EIF directors, could collectively set up a business office in Gibraltar and make the role a full time occupation. As a bureau we would be much more pro active and should ensure the following:-

- increase the number of funds supported individually
- share technology and indeed design control reports etc.
- design common control practises i.e. control checklists etc..
- work with lawyers, auditors and fund administrators to determine best practise
- display complete independence from the legal and administration functions
- work more closely with the FSC as a collective group
- with a certain critical mass we can promote education and training
- we can more easily adopt your point on EIF director training and thereby increase the supply of EIF directors (limited licence)
- Share office and technology costs e.g. secretarial services and administration staff

Should the number of funds attracted to Gibraltar increase substantially over the next years then some form of EIF director bureau might become essential. EIF directors working alone and unorganised limits the Gibraltar fund market given the four eyes approach. Consideration would have to be given to confidentiality between funds and although a bureau approach is applied under a corporate umbrella each director would have personal responsibility for their relevant fund.

R2. I consider the residency test as proposed appropriate. Indeed, in my view, to be considered resident someone should either be physically resident in Gibraltar, or live within commuting distance from Gibraltar and have a professional activity therein.

R3. The proposed test is a sensible one given that the FSC needs to be in a position to be able exercise their regulatory influence and powers in Gibraltar over licensees.

However, there may be "early retirement" financial services professionals, who would be very suited to the role of EIF Directors, but who live over the border and post retirement, no longer have an employer, or a business in Gibraltar with whom they are associated, or may be newly relocated expats. It might be beneficial in these circumstances, if it were possible to extend the "tenable link" to include such persons, provided they can demonstrate a business address in Gibraltar and not necessarily a business in Gibraltar with which they are associated.



R4. The issue of whether a Director is resident or not is a difficult one. We believe that the interpretation outlined in the Consultation Paper is a sensible solution. For practical reasons, the FSC might consider insisting that any prospective EIF directors who do not actually live in Gibraltar should sign an agreement to submit to the jurisdiction of Gibraltar's courts in all matters related to any EIF and agreeing that any documents could be served on them at a Gibraltar address which they submit upon application. The FSC may also wish to consider directors who live across the border and who provide their services from a permanent office of their own or of an existing but have less of a link with that firm than that of employee or director. As long as the office permanently allocates the director a place from which to work and the director undertakes to carry out the majority of his or her work from that place, we consider this should be sufficient.

Q1. FSC Reply

The respondents highlighted the need to reflect those individuals who have retired and are living in Spain and no longer have a direct link to Gibraltar. This will be reviewed on a case by case basis provided that a prior link to Gibraltar can be demonstrated. A Gibraltar address will also be needed, which will be the address on the face of the license and to which correspondence can be sent.

This will be clarified in the Guidance Note.



Q2. Do stakeholders consider that the non prescriptive case by case approach detailed above is appropriate or consider that the numbers or EIF directorships undertaken by an individual should be formally capped and if so what would be considered the maximum amount?

Responses Received

R1. I believe that the number should be capped if it is not your full time occupation and something like 8 or 10 seems appropriate. I do not think that you should perform 2 functions within a single EIF. For example you should not, I believe, be the legal advisor and an EIF director for the same fund. Each key function should be performed by an independent person. I believe that you can be the legal advisor of fund A and an EIF director of fund B. But in this instance you should be limited to say 8 - 10 as your full time employment is that of a lawyer.

Should you be a full time EIF director then I believe that there should also be an appropriate limit set by the FSC. If that individual has established a proper and suitable business model to support many funds and this is evidenced and reviewable then a much higher number should be approved. Again the bureau approach detailed above in my opinion is the way forward. I see absolutely no reason why in excess of 25 funds cannot be supported full time with the right business model. This will depend on the amount and adequacy of the investment the EIF director puts into his role (bureau approach). You should also be careful not to make a liquidity squeeze in the price charged by an EIF director if a low limit is placed and market growth occurs.

R2. I consider that the non prescriptive case by case approach as detailed in the paper is the appropriate one. In my view, capping the EIF directorships would not be logical, as indeed as mentioned in your paper, the important elements to be taken into account, are

- (i) the nature and activities of each of the funds of which the individual is already a director
- (ii) whether the said individual is involved in a full time professional role or not.



R3. The nature, size and complexity of funds can vary significantly, and therefore a case by case approach is in my opinion the only solution to assessing the capacity of each individual. I would not support a standard maximum cap on the number of directorships any individual should have. The mention of 8 directorships in the consultation paper is arbitrary, and I would suggest that this is removed. However, the concerns raised here are relevant and I believe the FSC should make sufficient enquiries to satisfy themselves that an individual is sufficiently engaged in their duties as an EIF director to each fund that he acts for.

The director's role adds value in the governance and oversight of delegated duties and to be able to achieve this, each director has to devote energy and time to the fund. Such efforts have to be directed at ensuring that he receives management information of the right nature and at the required frequency to satisfy himself that the fund counterparties are performing their duties adequately. External factors are also important and a director should question and raise issues to the fund's board on key factors affecting the fund as if the fund were his own business. By its nature, such oversight does not necessarily only happen at formal board meetings, but is relevant on an ongoing basis. Those persons acting as EIF directors who also have other full time employment, such as lawyers and auditors as mentioned in the consultation paper, must be able to demonstrate to the FSC that they have sufficient resources to fulfil their tasks and that they have done so. In doing so, they should be permitted to point to the use of other resources or supporting services that they may have at their disposal.

I believe there is a distinction to be made between the time required for managed funds (those with an appointed regulated investment manager) and that for self managed funds, particularly where the self managed fund is a property or private equity fund, and not a tradable securities fund. Clearly, self managed funds do not delegate investment activity (even though one director may take an investment management role) and therefore the role of the EIF director is even more key to ensuring that the fund is run and governed in line with good regulations and business practice, and with investors expectations set by the offering memorandum.

Whilst I support the concerns raised in this section, however, the use of the term "day to day running" may not be appropriate. I would expect, for example, that the administrator and the investment manager would be involved in the day to day running of the fund, as these are the daily duties to be performed for which they have been appointed by the directors. Although properly advising directors that they cannot abrogate their duties, the FSC should avoid implying that directors should be involved in the daily minutiae.



R4. We believe that the issue of how many directorships one person can handle is very much dependent upon their skills and the amount of time they have to devote to the fund. Also certain funds will require more time than others. We would hope that each director who puts themselves forward to a client has sufficient ability to assess whether they can provide the service to the client which they have offered.

We believe that the number of directorships should be removed from the Consultation Paper and the wording "However, cases where individuals provide directorships to more than 8 EIFs will be looked at closely in order to ascertain" should be changed to "However, the FSC may on a case by case basis look closely to ascertain..."

Also the industry would like to know how this potential restriction will be communicated. There is concern that if an EIF Director offers his services to a client and then has to withdraw (at any stage of the process) at the request of the FSC, this will undermine their credibility and could raise concerns with that client as to their ability to provide other services to the fund such as Administration or Legal services. Is it the intention that the FSC will contact now all EIF directors to advise whether or not there are current concerns with providing any further directorship sendees, (i.e. to pre-empt the next time they offer the service?) Or, is it the responsibility of each EIF Director to contact the FSC now to see if there will be an issue before they take on a new Directorship? The last thing the industry wants is to have a situation where services are offered to a client which then have to be withdrawn because the FSC do not feel the director should undertake the role. If the FSC can devise a warning mechanism to alert potential issues with a particular director the industry feels this would be of value.

Again the Consultation Paper states that the reason for looking at the number of funds a director provides services to is to "ensure that directors can be sufficiently involved in the day to day running of each individual EIF". As mentioned before with the administration and usually the Investment Management outsourced to regulated counterparties we cannot see that there is a need for the directors to be involved on a "day to day" basis with each fund that they provide services to. The directors are there to provide guidance and support to the counterparties and to exercise appropriate oversight of the functions performed but this will not necessarily be on a day to day basis. The industry would like to seek clarity as to what this term means to the FSC. For instance if a fund trades 200 trades on a daily basis and the administrator controls to the operation of this alongside an Investment manger who places the trades and a custodian who process the trades what other involvement would the FSC expect from the directors on a "day to day" basis? The industry is of the opinion that the directors should review the trading activity as frequently as they determine necessary for each fund, and at each board meeting to ensure that the PPM is being adhered to but they should not need to review these on a daily basis as each trade is placed. If such a requirement were in place it would not only be likely to prove unworkable but also questions the services being provided by any other service providers.

Further consideration should be given to the reality that the pool of experienced directors in Gibraltar is somewhat limited - although this is expanding. We would not wish for experienced directors who are able to provide proper service to funds to have to decline new funds in favour of less experienced directors just because they are approaching a certain number of directorships.

Q2. FSC Reply

Respondents appear to favour a non prescriptive case by case approach although this could prove problematic.

The Commission will continue to use an internal trigger of approximately 8 directorships at which stage EIF directors will be asked for further details to ascertain how the individuals are able to ascertain that they are able to satisfy the obligations entailed in exercising their duties as EIF director alongside their other professional and working commitments.

In seeking this information the Commission will aim to establish that despite the number of directorships held and any other business interests the individual is



able to effectively and efficiently undertake the role expected of an EIF director to all funds as and when required. At this stage of the process this would only be an information seeking exercise and would not bear any reflection on individual's ability or fitness and propriety to conduct the role of an EIF director. The Commission will also be proposing, to include within the new EIF Regulations, a cap on the number of directorships provided to EIFs and sub-funds. This cap may be exceeded where an individual can demonstrate sufficient time and expertise and this will be reviewed by the Commission on a case by case basis.

Further to comments raised in relation to the term 'day to day', the Commission will be rewording the Guidance Note so that instead of 'day to day' the document will be revised. The aim is to ensure that the directors have the time and ability to exercise effective corporate governance over the fund. The Commission would expect greater involvement in active EIFs. Additionally, the FSC will expect the directors of PCCs to spend sufficient time in relation to each cell particularly where the cells have different asset types.

It should be noted that although a Pool of EIF directors is available a number of directors are not active. There are currently 79 registered EIFs and 82 authorised EIF directors of which 34 are not active.¹

The Guidance Note will be amended accordingly.

¹ Figures as of 27 October 2010



Q3. Do stakeholders consider that there should be a minimum number of board meetings held annually?

Responses received

R1. Yes at least one in Gibraltar with physical attendance required (to approve annual audited accounts). Obviously the number of board meetings depends on the complexity of the individual EIF. I personally believe that they should be held quarterly, so 4 in total, whatever the complexity involved but 3 could be held by conference call. They are required to evidence actions and control.

Of equal importance, there should be a management reporting process which may minimise the number of meetings required. If certain revaluation and or liquidity **triggers are hit then a meeting should arise and occur**. Likewise should any pre stipulated irregularities arise from the audit review, or arise from new cash flows and or from information relating to new investors with know your client and appropriateness issues. A sound control process, established by the EIF director, should reduce the amount of work required to govern. These controls will not differ substantially from one fund to another. They do not require a complete redesign merely to be tailored to the type of underlying asset. Triggers should also apply to great success in the fund, for example, extremely large revaluation gains may mask a problem.

R2. As mentioned in your paper, I consider that it must be up to the Board to decide on the number of meetings to be held each calendar year, to be based, of course, on the nature and level of activity of the fund. However, I consider that, in any case, there should be a strict minimum of 2 board meetings for each EIF per year.

R3. In my opinion, the nature, size and complexity of each fund should determine the number of board meetings to be held each year and the consultation quite rightly states that **"each EIF board will, as natural, decide the number of board meetings to be held for each EIF in each calendar year,,,,"**. I do not see the real benefit of mandating a minimum number of board meetings to be held annually.

However conversely, where only a minimum number of meetings are held each year, I would expect the FSC to task the EIF director to be able to demonstrate how effective ongoing oversight of the fund activities has been achieved outside of the infrequent meetings. My comments earlier, above, in respect of exercising oversight on an ongoing basis outside of board meetings are also relevant here.

R4. The industry does not feel that there should be a prescriptive minimum amount of meetings to be held each year. This board activity will very much be driven by each specific EIF and what it does and this can vary enormously. We believe that the board of directors should be of sufficient standing to decide the right amount of meetings to be held for that particular fund.



Q3. FSC Reply

In general, respondents agree that the number of board meetings should be determined on a case by case basis. Some respondents thought that the minimum statutory requirement was sufficient. The FSC is of the view that the number of board meetings should be dependant on the individual fund.

The Commission would expect EIF directors to have involvement in the fund other than via board meetings and be able to evidence this.

The Commission will therefore not be specific in its guidance note but will expect each fund to consider an adequate number of meetings to be held and for this to consider the level of activity and complexity of the fund as well as any issues that the fund may be facing. The Commission will deal with this on a case by case basis with funds.



Q4. Do stakeholders consider that oversight responsibilities should be a matter for the board as a whole or, given the importance placed by the EIF regime on approved directors, that oversight responsibilities of the approved directors should be separately codified?

Responses received

R1. Although my answer is both - I think that the responsibilities should be codified separately for the avoidance of any doubt. If one EIF director fails in his responsibilities then they devalue the whole process and other EIF directors hard work. If outline responsibilities are written down then they can be easily referenced as required. These will be useful during board disputes relating to responsibilities and in such instances the EIF director can refer to the FSC high level guidance. Some current EIF directors may only cover 2 or 3 funds and as such are rarely active and thus may always have to remember their responsibilities. Others may currently cover too many funds (plus another full time role) and have no time for real governance to be applied. Both types of practitioner should benefit from a codified guidance sheet. Again this is why I believe that the current legislation points toward a bureau approach to governance. Several organised EIF directors can cover very effectively many funds.

R2. I consider that the oversight responsibilities should be a matter for the board as a whole. I believe it would be inappropriate to separately codify the duties of one or the other of the Directors. Having said that, I believe that the authorised EIF directors, should make it a point to be particularly vigilant to ensure that strict compliance at all times, of the regulations applying to the EIF.

R3. I strongly believe that governance and oversight is a matter for the entire board and that this principle is firmly based in law and practice. I am unsure whether a separately codified list of responsibilities assigned only to the EIF director, might be seen as relieving the other directors from their duties, which could prove detrimental overall.

Also if the oversight duties were to be codified separately for the EIF director, this would restrict officers of the various counterparties from acting as an EIF director to the funds that they service.

At present, there are no specified restrictions in the EIF regulations concerning the relationship of the EIF director with the other fund counterparties. So, for example, it is not unusual for one or both of the EIF directors to be an officer of the administrator or lawyer or other counterparty (although I understand in practice, officers of the depositary have not been permitted). Despite the obvious benefits that for example an officer of the administrator can bring to the fund as its EIF director, nevertheless, this can give rise to potential conflicts of interest. Such conflicts are easily handled by disclosure and by declining to act/vote at the board on specific issues, such as re appointments, fees or review of performance and services. If these duties were not a matter for the entire board but were reserved solely to the EIF director, such appointments would not be possible.

Breaches

The consultation states that **“responsibility for ensuring that a fund continues to comply with the requirements of the EIF Regulations lies with the persons having the management and control of the Fund. This clearly includes the board of directors and more specifically, the authorised EIF directors”**

In line with my comments above, I do not think that this statement is wholly correct. All directors of the board share the responsibility for compliance with the Regulations. However, I would agree that the duty to notify and report to the FSC lies with the EIF director. Responsibility and reporting are different issues and this should be made clearer.



R4. The industry believes that all directors are accountable for overseeing the functions that they have agreed to delegate and that each director should satisfy himself as to how this is carried out and evidenced, rather than this being separately codified. This is generally carried out by having a discussion that is centred around the activities of the administrator, custodian or investment manager. We do not believe that the EIF approved directors should carry the sole accountability for the oversight functions as this would seem to reduce the overall accountability of the board as a whole which is possibly contrary to the position in law.

Section entitled "Breaches"

We are conscious here that there are plans in place to change the EIF Regulations to allow for more flexibility. Given the changes proposed, we would prefer a shortened "breaches" section, which is not focussed on the regulatory references, so that this consultation paper and the resultant guidance note do not become outdated once new Regulations have been agreed upon.

In addition, we would encourage the FSC, wherever reasonable, to exercise discretion in not de-registering a fund as an EIF if, for instance, just cause for a breach can be provided, e.g. the delay in the provision of audited financial statements which might be due to circumstances beyond a fund's control. Moreover, in general, deregistering a fund should to our mind be the course of action of last resort, particularly if, for example, breaches are caused by a service provider to the fund rather than the fund itself (in which case appropriate corrective steps should be taken by the service provider).

In conclusion *the* industry would like to note the primary roles of the EIF directors to be as follows:

- a. To ensure that the fund's assets are safeguarded and not misused (i.e. in the absence of truly extenuating circumstances, only regulated entities such as the EIF directors and/or the administrator should be able to transfer money out of the fund's control.
- b. To ensure that the funds' assets are deployed in accordance with the memorandum and articles and prospectus of the fund and with the principles of law.
- c. To ensure that the fund constantly complies with its regulatory and legal obligations.
- d. To ensure that the fund's service providers (the other directors, the investment manager/adviser, the administrator, custodian/prime broker, lawyers and auditors) are performing adequately and to monitor such performance.

However, this is not all encompassing.



Q4. FSC Reply

The Commission believes that the board as a whole is responsible for the oversight responsibilities of EIFs, however, as the EIF directors are licensed, it is on these directors that the FSC, as regulator, relies on. The respondents appear to be in agreement with this and the Guidance Note will be amended to reflect this.

In terms of breaches, there are occasions, e.g. with the deregistration of EIFs for non submission of audited financial services, where the Commission is unable to grant extensions due to the legislation not giving the Commission this flexibility. Requests have been made for the legislation to be amended. The Commission believes that, where possible, it has been extremely flexible. The Commission will consider making relevant changes to the Guidance Note, in line with suggestions from respondent 4, to mitigate changes to regulations.