Funds Governance in 2021: What it Means to Investors

IFI Global Research

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Introduction

This is the first research study that The NED has conducted with investors on fund governance in five years. It is therefore the first time that we have surveyed investors on governance in the ESG era. We were interested to see if it had had any effect upon their views. We were also interested to know, after a five-year gap, if there had been any change in their views on any of the topics that we asked them about in 2016.

It is often said that investors' interest in fund governance is inversely correlated to the market. The more the market goes up, the less that matters that are dealt with by a fund's board are of interest to them. Provided everything is ticking along as it should, it is thought that many investors do not believe that they need to focus on the fund's governance.

In The NED's view, there is some truth to this but it should also be borne in mind that the vast majority of large institutional investors are surrounded by armies of advisors these days. Fund governance is very frequently something that will be outsourced to operational due diligence advisors.

Also, many large institutional investors now have direct access to the managers they want, through fund-of-one arrangements, co-investments and so forth. Until undertaking this research study The NED was unaware just how much has changed on this front since 2016. Most large investors have their managers exactly where they want them these days; they do not believe that they need to worry about fund boards.

Family offices, and many other professional investors who are outside the traditional pension fund or sovereign wealth categories, have tended not to have been all that animated by fund governance matters anyway. For

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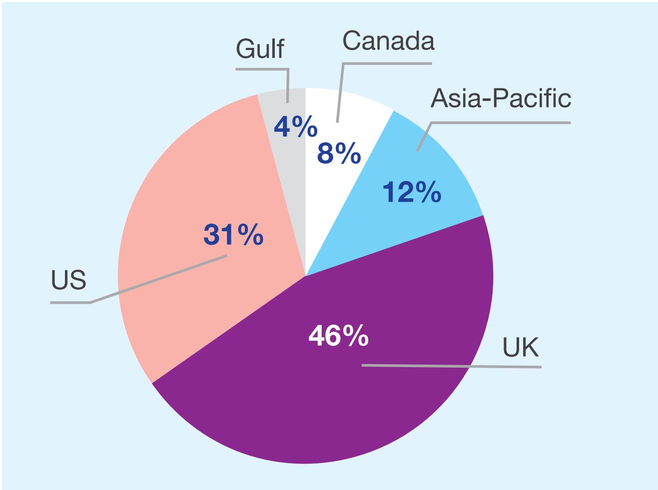
them, performance is all. They are frequently sophisticated users of technology and so are able to monitor what they are interested in following, often in considerable detail. And some of them have also found ways to get access to managers that also go around the structure of a traditional fund.

Perhaps the most interesting take-away from this research is the challenge governance presents to fund boards and to asset managers: what can they do to make fund governance more relevant to more investors?

There is a danger, at least outside a crisis occurring at a fund, that what the board does on a routine basis passes many, if not most, investors by. The big institutions, as referred to above, are increasingly working with managers as if they are their de facto part time employees. So, fund governance isn't of much use to them. And many other categories of investors, especially retail ones, have little to no knowledge of fund governance anyway.

The NED surveyed 26 investors and their advisors between April and mid-June 2021. 46% were in the UK; 31% in the US,12% in the Asia-Pacific region; 8% in Canada and 4% in the Gulf.



IFI Global and The NED would like to thank Jersey Finance for their support of this research study.

Overall conclusions

- Just over half of respondents believe that ESG considerations will have an impact on fund governance. It is perhaps surprising that it was only half and not more. But it is likely that if this question was asked in another year or two at least three quarters, or more, would say ESG would be playing a big part in fund governance.

> Only 8% said that they view fund governance to be very important

- Only 8% said that they view fund governance to be very important, which is coincidentally the same number who replied by saying it is not important. The overwhelming majority, 84%, think it is helpful but not that important.
- Everyone who participated in this study believes that the purpose of fund governance is to protect the interests of investors, rather than to serve the interests of the fund (when they might diverge, as they sometimes do).
- Experience is the quality that investors want to see in the directors of the funds that they invest with. This is closely followed by independence. Gender diversity on the board does not appear to be particularly important to them, by comparison.

> Gender diversity on the board does not appear to be particularly important

- Term limits for directors are wanted by the overwhelming majority of the respondents, 85%.
- Nobody surveyed said that the quality and experience of the board is a determining factor when deciding whether to invest in a fund. But a number of interviewees made the point that if there is a problem with the board, the manager will make changes to avoid losing the investment.

> 81% said that they would like to see more transparency in fund governance

- 81% said that they would like to see more transparency in fund governance, including in the selection process of directors. They would also like to see information on board composition be made publicly available, including for private funds domiciled offshore.

Research results

Please rank out of 10 (with 10 being the highest score) what attributes you value the most in the directors of the boards of funds that you are invested with:

Experience	8.7
Independence	8.3
Gender diversity	4.9

What skills and experience do you believe are most under-represented on fund boards?

(In order of mentions)

Portfolio management/experience in the strategy

Industry business management/senior non-exec directors

Risk management

What skills and experience do you believe are most over-represented on fund boards?

(In order of mentions)

Administration/industry service providers

Accounting

Law

Do you think that there should be term limits for independent directors on fund boards?

Yes	85%
No	15%

Does it matter if the majority of the fund board is independent or not?

Would like the majority to be independent	88%
Not a particular concern	12%

Do you think that you have about the right amount of contact with the directors of funds you are invested with?

Yes	69%
No, would like more*	31%

*Some who replied no said that this is only necessary if a problem arises

What do you think the main purpose of fund governance is?

To protect the interests of investors in the fund	100%
To serve the interests of the fund	0%
Other (please state)	0%

How important is the quality and experience of the board when determining whether to invest in a fund?

Of little to no importance	54%
Helpful but not that important	46%
Important	0%

Would you decline to invest in a fund if it had a weak board (however defined)?

No	69%**
Yes	31%*

*Some respondents said it could be a consideration if there were also operational issues of concern

**Those who said no often made the point that they had not come across a board that was so poor to prevent their organisation from investing (although one said he had agitated for changes on one occasion)

Research results

Do you prefer to have independent directors from any of the following categories on your boards?

Makes no difference	42%**
Work for themselves	27%*
Are part of large, established firms	19%*
Are part of boutique firms	12%*

*Some respondents said that they like to see a mixture of the 3

**What matters to many who went for this option is the quality of the individual. That is more important than the entity he or she works for

Do you think that ESG considerations will have an impact upon fund governance?

Yes	54%
No	46%

If you answered yes to the previous question, please would you say how ESG will impact fund governance?

Most of those who said yes believe ESG will enhance diversity on fund boards, especially with more female directors coming forward

Would you like to have more comparative analysis on the composition of asset managers' fund boards (including on board size, ratio of independents to executives, gender diversity etc)?

Yes	81%
No	19%

Would you like to see more transparency in fund governance practices including in director selection and fund board composition?

Yes	85%
No	15%

2016 vs 2021: any differences?

The results of The NED's 2021 survey with investors are similar to those gathered in 2016, but it should be noted that some of the same people have participated in both research studies.

The results in 2016 were more uniform than they were this year. Back then, over 90% of respondents thought the following:

- The majority of the board should be independent
- The purpose of fund governance is to protect the interests of investors
- Directors of funds owe their fiduciary duties primarily to investors
- Investors should have more direct communication with directors
- Independence is the most important quality in a director
- Conflicts of interest are a major concern
- Director transparency (or the lack of it) is also a major concern
- Standards of fund governance vary by domicile
- Fund boards lack people with portfolio and risk management experience
- Most investors would decline to invest in a fund with weak governance

The differences with this year are that most did not say they would decline to invest in a fund because of weak governance. Also, the majority of respondents do not want more direct communication with investors.

Otherwise, the two sets of results are very similar. Transparency (or the lack of it) was a major concern back then and still is now. If anything, the desire for more transparency is even greater today.

Will investors get what they want on fund governance? Possibly, but it is likely be a long time before that happens on any scale.

About Jersey Finance

Jersey Finance is a future-focussed organisation established in 2001 to represent and promote the island of Jersey, an award-winning international finance centre.

In 2019, Jersey Finance launched an office in New York and it also has offices in Jersey, Dubai and Hong Kong, representation in London, Johannesburg and Shanghai, plus a virtual office in Mumbai.

If you would like to learn to more about using Jersey, please email jersey@jerseyfinance.je to arrange a meeting.

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