



Institut Luxembourgeois
des Administrateurs

Luxembourg Fund Governance Survey 2010/2011

An Executive Summary released in association with the
Institut Luxembourgeois des Administrateurs



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Foreword

It gives me great pleasure to introduce the fifth Luxembourg Fund Governance Survey, in association with the *Institut Luxembourgeois des Administrateurs*. On this occasion, we publish our research against the backdrop of possibly the highest level debates ever to occur in Europe on governance matters.

Despite widespread political, public and media interest in the topic, I believe it is fair to say that the concept of governance is still misunderstood in some quarters. Many would view it as merely an expansion of the compliance and legal functions, complete with the attending administrative burden. This would be overly simplistic. Governance appears to rely most heavily on the legal and compliance functions purely because much of what we do takes place within legal and regulatory frameworks. However, governance comprises much more than an observance of the law. In reality good governance is reliant on sound decision-making in all areas of responsibility, including (but to name a few) risk analysis, marketing, distribution, personnel and so on. Good governance recognises that effective supervision is not simply a checklist exercise, but a real and ongoing challenge faced by boards on a daily basis.

A commitment to the highest standards of governance is therefore an ethical responsibility which is being steadily realised as an increasingly more important part of the fabric of financial services. A measure of superior governance is where an organisation has gone beyond satisfying basic legal requirements and asked what more could be done to safeguard the interests of its investors and stakeholders. Such efforts have a positive effect on the bottom line. It should come as no surprise that the quality of governance has been linked repeatedly to investor returns.

The importance of governance to our industry is clear. Good governance protects investor interests and strengthens our industry models and our international standing. Poor governance weakens our industry and our ability to compete.

Due to the crisis we are now viewing the rapid progression of many governance concepts into the formal regulatory framework which governs the European financial services industry. As one of Europe's leading financial services hubs we have much to gain or lose depending on not just the final shape of the regulations, but how far we embrace the spirit of governance. Luxembourg is currently a world leader in asset management and fund servicing and should similarly strive to be seen as a world leader in the adoption and formulation of sound fund governance practices.



John Parkhouse
ILA Fund Committee Chairman
Partner, PwC Luxembourg



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ILA Fund Committee Chairman
Partner, PwC Luxembourg

Introduction

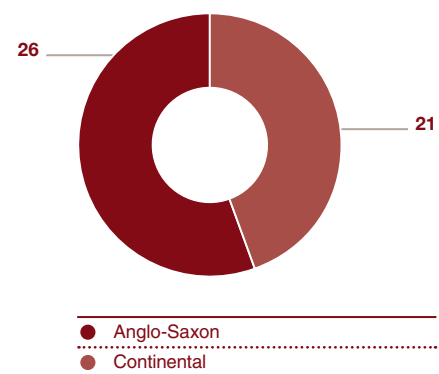
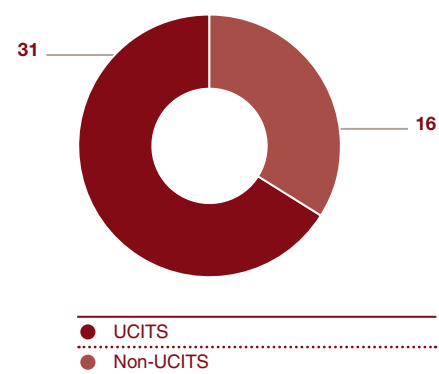
The fifth edition of our Luxembourg Fund Governance Survey, prepared jointly with the Funds Committee of the *Institut Luxembourgeois des Administrateurs* (ILA), coincides with a time of unprecedented focus on corporate governance regimes across Europe. In the wake of the financial meltdown, it was to be expected that regulators at both national and EU level would carry out in-depth investigations into the causes and challenges faced by existing governance models. In response, the local industry via the Association of the Luxembourg Fund Industry (ALFI) established their own Code of Conduct, and correspondingly we have devoted a full section of the survey to the take up of codes and guidelines within the Luxembourg industry. Additionally, the European Union Commission's publication in June 2010 of the green paper on corporate governance heralds a process which may in time lead to a sweeping transformation of European governance regimes. Whether this process will affect the Luxembourg funds industry is as yet unknown, however our dissection of current governance practices in 2010 serves to place any debate in context. Certainly we recommend to the Luxembourg fund industry participants that they be proactive in reviewing their governance methodologies, and where possible, strive to achieve best practice in the market. This is particularly so now, as the recent amendment to the law of 19 December 2002 requires all listed funds to disclose corporate governance information as a clearly identifiable section in their annual financial report.

This edition of our survey had 47 participants, representing 31 UCITS and for the first time 16 non-UCITS fund structures. The participants to the survey were board directors on funds which were affiliated to promoter groups, asset management firms, management companies or self-managed funds who cumulatively held almost \$ 1 trillion in AuM, or approximately 37% of the total Luxembourg fund industry AuM of \$ 2.6 trillion¹. There is also a large geographic diversity evident with a balanced divide between Anglo-Saxon and Continental European boards (see figure 1).

As usual there is a range of trends and patterns in the responses, mostly positive, but with some areas which could be improved. Some deficiencies are understandable, others less so and should be areas of focus for the future. Overall however, the results display a flexible and active approach to governance within the Luxembourg fund market, and a strong understanding of the critical issues facing the industry today.

¹ Based on records from Fitzrovia, December 2009

Figure 1: Breakdown of Respondents



The current Luxembourg Fund Governance Model

The Luxembourg Fund Governance Model can be seen in three different forms.

In the first model, where the fund is a legal entity, the fund board designates a ManCo to perform day-to-day management of the fund under their oversight.

In the second model of an FCP (or contractual form of the fund), the FCP is established and contracts a ManCo directly. As there is no fund board as such, here the ManCo board has responsibility for oversight.

In the third model (a self-managed SICAV), oversight is the responsibility of the fund board and monitoring and oversight of service provision is performed by the conducting officers as agents of the fund board.

To properly reflect these distinctions in our presentation of the data we have distinguished between responses from boards of ManCos, boards of SICAVs with ManCos and finally boards of self-managed SICAVs (see figure 2).

In both models, the fund boards serve as a nexus of both independent directors and those who are involved in the day-to-day running of the fund. Directors typically come from one of five categories:

- a representative of the promoter group;
- ‘dirigeants’ (conducting officers) of the fund;
- a member of the board employed by the ManCo;
- a member of the fund’s legal counsel (or similar provider);
- from other sources (i.e. not belonging to any of the other categories).

Figure 2: Participants’ profile

What is the top governing body on behalf of which you are answering?

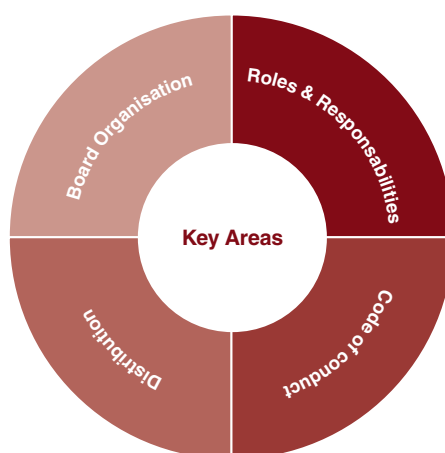
	UCITS	Non-UCITS	Total
Board of a ManCo	11	4	15
Board of a SICAV with a ManCo	7	4	11
Board of a self-managed SICAV	13	8	21
Total	31	16	47

Breakdown of Survey Areas

Our survey was divided into four key areas of interest, the select points of which we cover in this executive summary.

- Board Organisation contains the practical aspects of the board, including composition, skill-set, background of directors and so forth;
- The Roles and Responsibilities section examines the interaction of the board with executives and service providers to the fund;
- Distribution focuses on the selection, reporting and oversight of distributors;
- Finally, we analyse the take-up of Codes of Conduct within the industry, and practical implementation.

Figure 3: Structure of Survey



Board Organisation

Board Meetings

On average boards are composed of four (non-UCITS) to six (UCITS) members, including two members who are typically located in the fund domicile. Boards meet three or four times a year on average (excluding extraordinary board meetings), with more than 70% of the board meetings held in Luxembourg. We have also found the preparation time for meetings to be relatively stable, averaging in a narrow range of 6-8 hours over the last four years (8 hours in 2006, 6 hours in 2008 and 7 hours in 2010), making this the current industry norm. Regarding the duration of board meetings, although the average time has been falling consistently since 2006 (see figure 4), the median duration for each year has been a consistent three hours. So, while the average duration appears to be falling it is, in fact, simply approaching the industry's benchmark value (i.e. the median).

Luxembourg fund boards receive a broad array of information both before and during meetings. For example, the majority of UCITS boards receive as standards more than 20 different documents (see figures 5a and 5b). However a divide appears between UCITS and non-UCITS funds, with UCITS funds the clear leader in frequency and breadth of information. All UCITS respondents systematically receive financial statements, compliance reports and investment restriction breaches/errors reports. UCITS boards are also more likely to receive as standard a broader spectrum of reporting, including reports on investor complaints, AML/KYC and internal investor guideline breaches.

Boards meet 3 or 4 times a year

70%
of the board meetings are held in Luxembourg.

Figure 4: Duration of board meetings

What is the average duration of your board meetings?

	2010 Survey (UCITS)	2008 Survey (UCITS)	2006 Survey (UCITS)
Average duration of a board meeting in hours	3h06	3h36	4h15

Figure 5a: Information received prior to or during meetings

What information do board members receive at/for meetings?

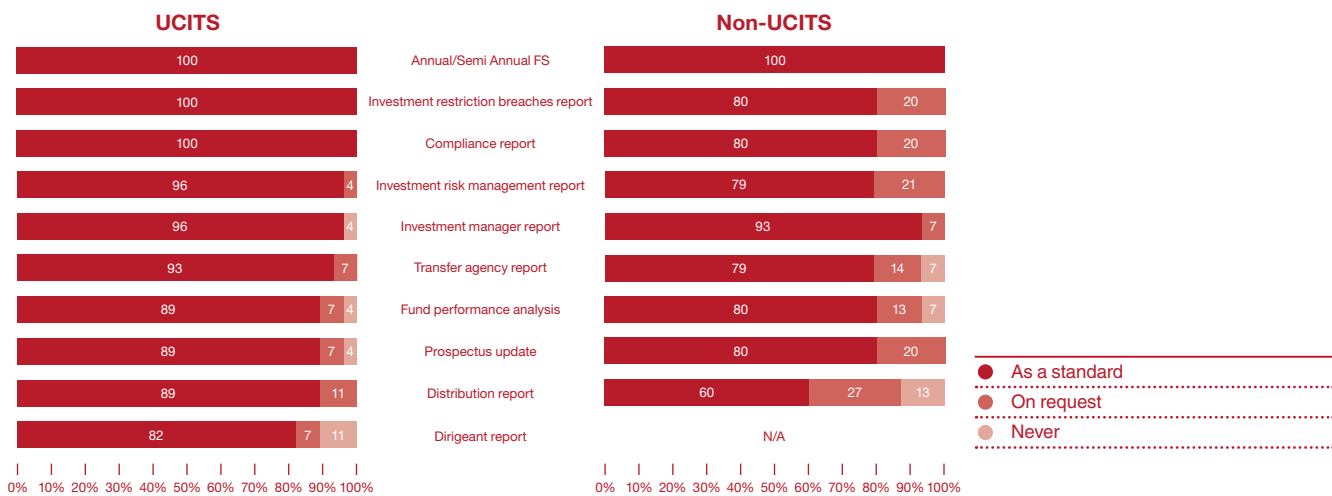
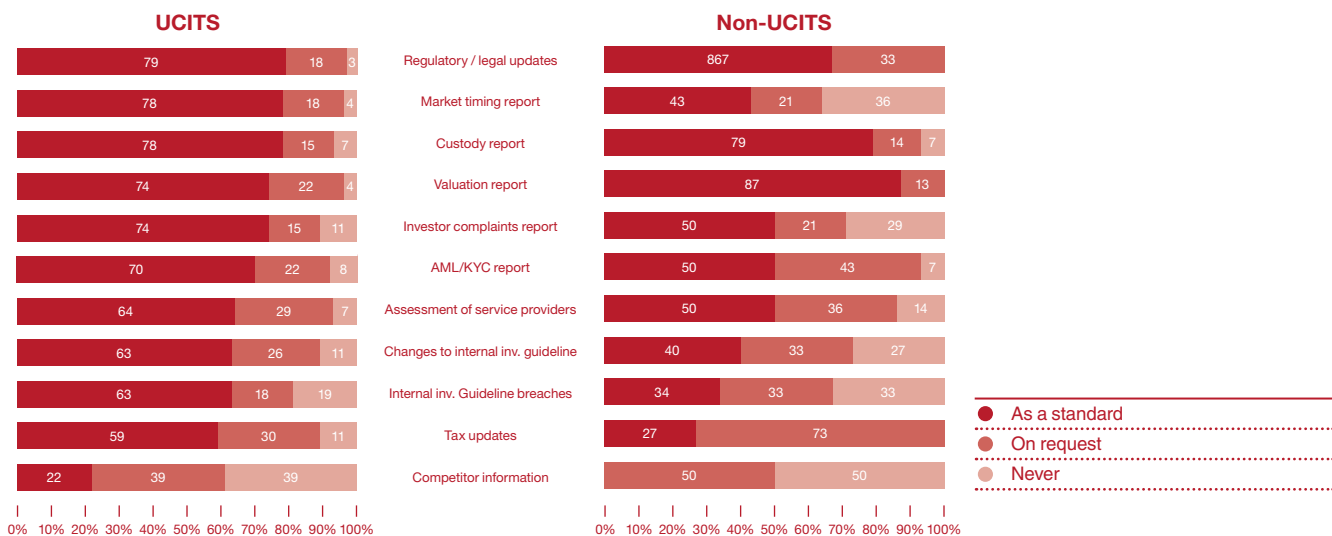


Figure 5b: Information received prior to or during meetings

What information do board members receive at/for meetings?



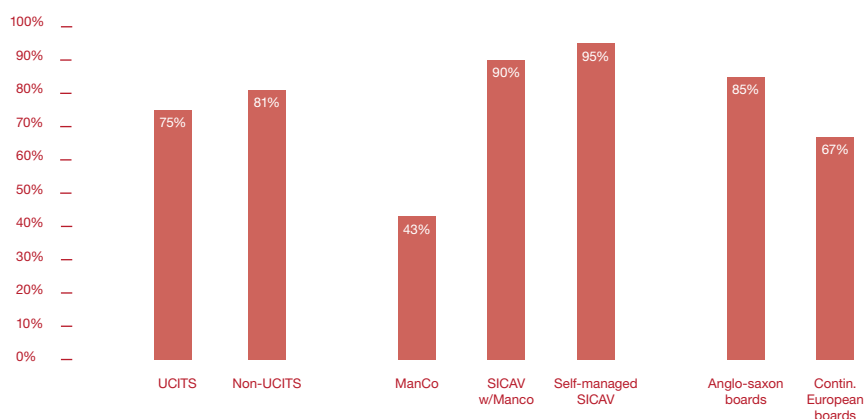
Composition

Regarding board composition, the clearest trend is the increase in independent directors on UCITS boards, both in the overall percentage of boards and in representation per board. This is in line with the trend observed in previous reports. The proportion of UCITS boards having at least one independent board member has grown between 2006 and 2010 (55% in 2006, 62% in 2008 and 75% in 2010, see figure 6), while within the board the proportion of independent directors has grown from 30% in 2008 to 43% in 2010 (see figure 7).

We find that the lowest presence of independent representation lies with ManCo boards, where 57% have no independent directors. This is perhaps unsurprising considering that in many cases ManCos are focused on the operational aspects of the fund and are in turn subject to oversight from the fund board (excluding the FCP model). We also find that continental European boards are twice as likely as their Anglo-Saxon counterparts to have no independent directors, with 33% of the continental boards having no independent director as opposed to 15% of Anglo-Saxon boards. This is despite these geographic areas being almost equally represented in survey responses.

Figure 6: Independent board members

Proportion of boards that have at least one independent board member:



Within those, the average proportion of independent board members in the board is the following:

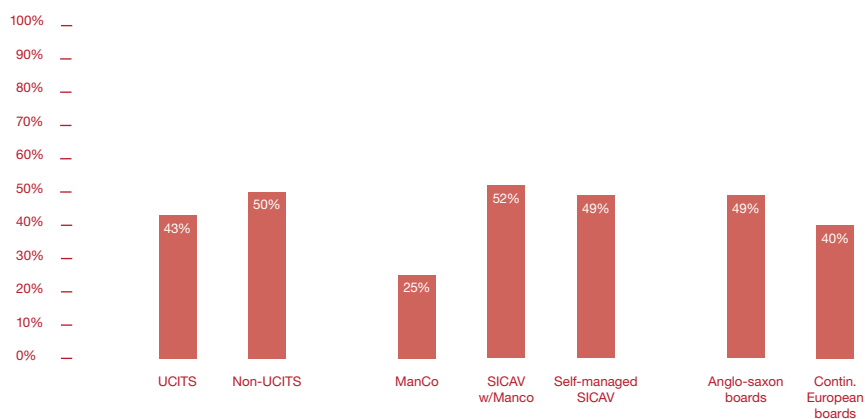


Figure 7: Independent directors

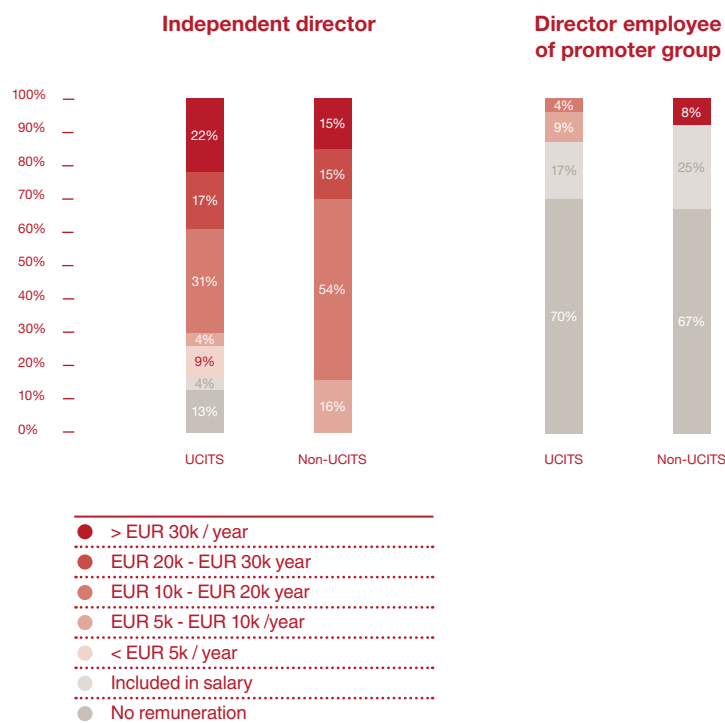
How are independent directors sourced?

Rank	2010 (UCITS)	2008 (UCITS)	2006 (UCITS)
1	Professional firms	Professional firms	Professional firms
2	Promoter's network of professional contacts	Prominent industry figures	Prominent industry figures
3	Prominent industry figures	Executive search	Ex-employees
4	Ex-employees	Ex-employees	UCITS III substance service providers
5	UCITS III substance service providers	Service provider	Executive search

Despite the increase in representation of independent directors per board and throughout the industry, we also notice a subtle shift in the way in which independents are sourced from the marketplace (see figure 8). While the number one means of sourcing independent directors (professional firms) remains unchanged since 2006, the number two source has changed from prominent industry figures (2006 and 2008) to the Promoter's network of professional contacts in 2010, a category which was only introduced to the survey this year, to be followed by Prominent industry figures in third place, Ex-employees in fourth place and Service providers in fifth place.

The source which did not make the top five for 2010, despite ranking in both 2006 and 2008, was Executive search. Whether this indicates an increased desire for directors with personal ties to the fund complex, or perhaps greater availability of networked professionals post-crisis, is unclear. However, the results do underline the importance of industry links for independent directors.

Figure 8: Board members remuneration



Remuneration

For UCITS funds there is a wide disparity in fee levels. Over one third of independent directors earn a minimum of €20,000, approximately one third earn between €10,000 and €20,000, and one third earn €10,000 or less (see figure 8, first two columns only). Overall, the median remuneration rate lies in the €10,000 to €20,000 band per board, with a third of independent directors on UCITS boards and one quarter of independent directors on non-UCITS boards earning above this range, perhaps substantially more. It should be noted that lawyers serving as directors tend to charge hourly fees and not a board fee as such.

Also, qualitative feedback on this matter has suggested that a simple fee per fund may be misleading, as directors may receive a negotiated fee based on their relationship with a promoter group and therefore the number and type of funds under consideration may fluctuate. Similarly, the vast majority (87% of UCITS and 92% of non-UCITS) of directors who are also employees of the promoter group either receive no remuneration or have their remuneration included in their salary.

These figures display a strong level of stability as the median value (the €10,000 to €20,000 range) has been the most persistent value to be recorded over our previous surveys.

Support to the Board

Regarding terms of appointment for directors, 18% of UCITS board members have not been given an outline of their roles and responsibilities before accepting an appointment. In addition to this, for a majority of boards there is no process for director's induction (69% for UCITS and 75% for non-UCITS, see figure 9). Whether these statistics are merely indicative of the familiarity between incoming directors and their mandates is unclear, however neither would be in line with what may be considered as industry best practices.

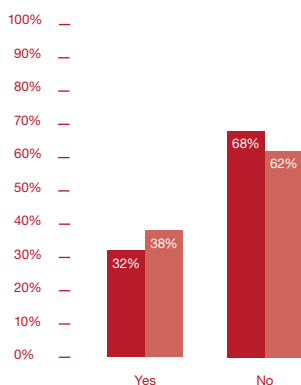
Another of the clear trends in board organisation relates to the very different attitudes toward professional education and information for board members over the last six years. In 2006 only 9% of board members spent two days or more in professional education and in 2008 this figure had risen to 19%. This year the figure is 52%, reflecting a huge surge in professional training and information requirements for board members by contrast to the previous years (see figure 10).

The costs of the education for non-UCITS board members are borne predominantly by the promoter (75%) while for UCITS it is paid primarily out of the director's own pocket (50%) and secondly by the promoter (33%).

Figure 9: Terms of appointments

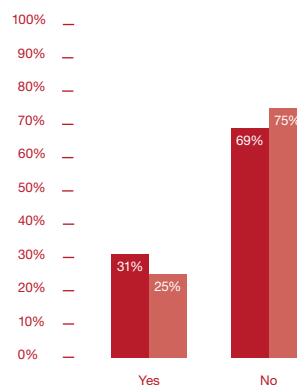
Only 32% of UCITS boards have written terms of appointment for independent directors. Only 10% of UCITS boards have written terms of appointment for representatives of the promoter

Are there written terms of appointment for independent directors?



● UCITS
● Non UCITS

Once appointed, is there a process for directors' induction?



● UCITS
● Non UCITS

However, despite the surge in professional training, a majority of UCITS and non-UCITS boards (72% and 81% respectively) do not have any process in place for their director's professional education and information, suggesting that training practices still remain very much an ad hoc affair rather than a specific component of governance practice. Time will tell whether ongoing professional training for directors will become a permanent feature of board service or if it will diminish in less trying market conditions.

On the subject of board performance, none of the respondents had any mechanism for evaluation of the board's performance, however just over half of the UCITS and non-UCITS respondents agreed that this would be a good idea (see figure 11). This should be seen as a healthy reaction, displaying both an awareness of the limitations of subjective evaluation and a desire for greater exposure to what may be considered as industry best practices.

Figure 11: Board performance

Do you evaluate board performance?

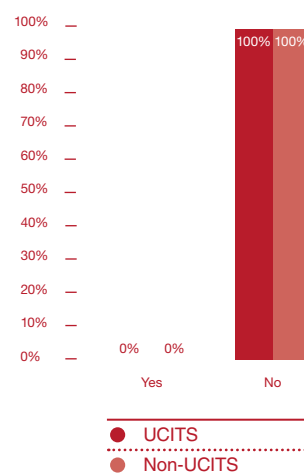
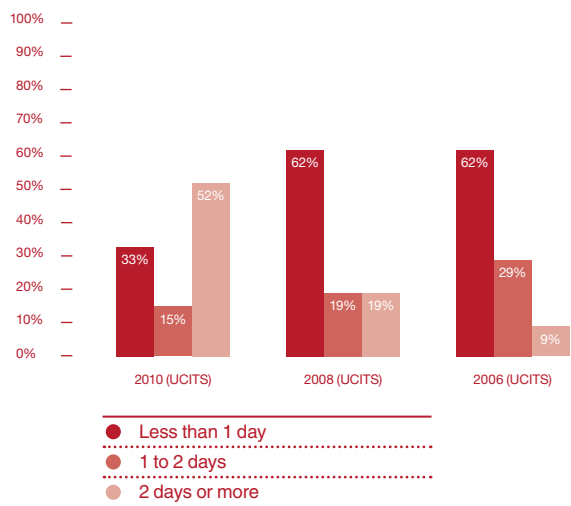
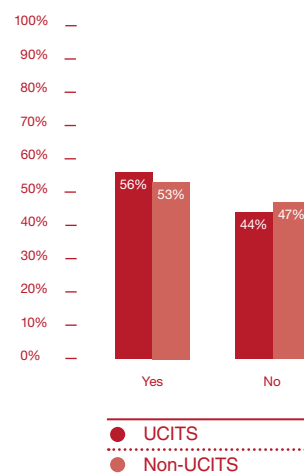


Figure 10: Professional education and information

In the context of roles and responsibilities as board members, how many days have directors spent on professional education and information in the last twelve months?



If no, do you think it would be a valuable exercise?



Roles and Responsibilities of the Board

Primary areas of Focus

There has been change in the priorities for the board in relation to its primary functions regarding fund performance. In 2006 and 2008, the board saw its primary function as monitoring the investment performance of the fund. In this year's survey, the primary role of the board was establishing and reviewing risk management, displaying a clear shift from a passive, oversight role to an active role (see figure 12).

Confirming the focus of the board on risk matters, respondents revealed that both UCITS and non-UCITS boards receive adequate reporting on a majority of risks. However, they still do not consider themselves to be receiving adequate reporting on reputation risk, coverage risk and mis-selling risk (see figure 13 and figure 16 where mis-selling was identified as the greatest risk in the area of distribution).

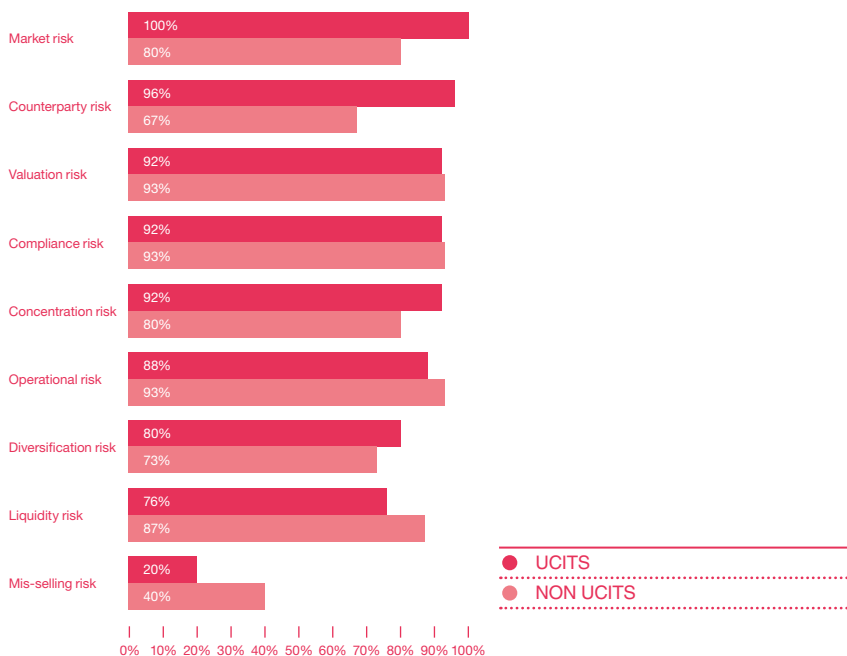
Figure 12: Primary board focus on fund performance

Regarding the investment performance of the fund, what is the primary function of the board?

Rank	2010 (UCITS)	2008 (UCITS)	2006 (UCITS)
1	Establish and review risk management	Continuously monitor the investment performance	Continuously monitor the investment performance
2	Continuously monitor the investment performance	Establish and review risk management	Set performance and risk targets
3	Verify coherence of investments with prospectus	Verify coherence of investments with prospectus	Regularly review performance targets

Figure 13: Assessing risk

Does the board receive adequate reporting on: (% of positive answers)





Regarding the review of risk management processes, while the responses look outwardly positive, there could be improvement. A quarter of UCITS boards and a third of non-UCITS boards do not regularly review the effectiveness of risk management processes, while of those that do, roughly half do so on an *ad hoc* or annual basis.

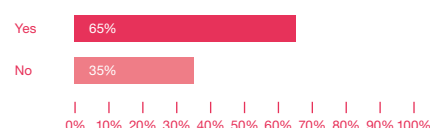
Regarding risk management methodologies, while in 2008 two-thirds of UCITS respondents believed that the usage of VaR would increase in the following two years, by 2010 two-thirds of respondents had changed this opinion, and now do not forecast any increase in the usage of VaR techniques (see figure 14). This response is in line with many statements in the media after the 2008 crisis when the limitations of VaR were highlighted following its apparent failure to indicate the extent of the turbulence suffered by the financial markets at that time².

² See for example, *The risk of value at risk*, Financial Times, FTfm, October 17, 2010, *Value at Risk should be summarily exorcised*, Financial Times, FTfm, September 6, 2009, *Volatility wrecks financial world's value at risk models*, Financial Times, October 12, 2007

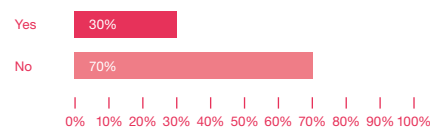
In spite of the outwardly positive responses, the review of risk management could be improved.

Figure 14: Usage of VaR

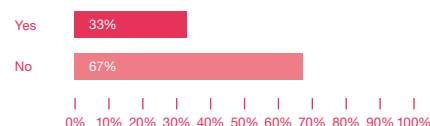
2008 UCITS answers
Will the usage of VaR increase in the next 24 months?



2010 UCITS answers
Has the usage of VaR increased in the past 24 months?



2010 UCITS answers
Will the usage of VaR increase in the next 24 months?



100%
of the
respondents

said that management of conflicts of interest was a key role

Conflicts of Interest

100% of the respondents said that management of conflicts of interest was a key role. Boards also appear to actively follow this up in practice, as a majority of respondents have either identified potential conflicts of interest (65% of UCITS and 81% of non-UCITS, see figure 15), or actually dealt with them (60%). This is in spite of the fact that 90% of respondents confirmed that conflicts of interest are not a part of the board's standard agenda.

While these responses give credit to the board's awareness of conflicts, more practical methods for management are lacking. Almost 90% of participants hadn't established a systematic mechanism to oversee all identified conflicts, while 84% of UCITS and 62% of non-UCITS had not prioritised key potential conflict areas. Additionally, more than 75% of participants indicated that they do not have a register of board members' interests and, of those that do, 63% of UCITS and 25% of non-UCITS participants do not update it regularly. Overall these results display that, while the boards may be focused on conflicts of interest, there is still a lot of ground to cover before widespread, methodical responses to these conflicts become the norm instead of the exception. However, the implementation of UCITS IV from 1 July 2011 will require a much greater focus on systematic identification and management of conflicts so we anticipate that this will be reflected in future surveys.

Figure 15: Conflicts of interest

Actions taken by the board with regard to conflicts of interest



Distribution

Distribution Risk

When it comes to distribution matters, the respondents to our survey had clear ideas regarding both the greatest risks and their confidence in the management of these risks. For both UCITS and non-UCITS, mis-selling (either by misinformation or to ineligible investors) was the single most important risk that the board faced in distribution (see figure 16). Yet at the same time, over 90% of respondents believed that their distribution risks were adequately managed (an increase from 88% in 2008).

However, other responses suggest that, to an extent, the high level of confidence is reflective of the trust the board places in the global distributor rather than a measure of the practical control exerted by the board. Boards rely heavily on the global distributor for information on the distribution practices, and as such may not be well positioned to perform a critical evaluation.

Figure 16: Greatest risk regarding distribution

**What do you believe is your greatest risk with regard to distribution?
(open ended answers)**

UCITS	Times cited
Mis-selling / ineligible investors / misinformation to investors	9
AML / KYC	5
Loss of distribution and assets due to poor performance	2
Compliance with local jurisdiction sales law	2
Loss of institutional tax rate	1
Insufficient distribution	1
Favoured treatment to major institutional relationships	1
Overseeing global distributor / promoter	1

Non-UCITS	Times cited
Mis-selling / ineligible investors / misinformation to investors	10
AML / KYC	1
Compliance with local jurisdiction sales law	1
Investments are very long term	1
Content of side letters	1

For both UCITS and non-UCITS, mis-selling was the single most important risk that the board faced in distribution

While a majority of UCITS and non-UCITS boards have appointed a global distributor, just under half of non-UCITS boards and half of self-managed SICAV boards were not involved in sub-distributor selection (see figure 17). Perhaps less surprisingly given their focus on day-to-day operations, a large majority of ManCo boards approve all new distributor relationships (67%).

Moreover, a majority of UCITS and non-UCITS boards rely upon the global distributor when it comes to distribution agreements and retrocessions or rebate levels. Here again a difference exists between boards of ManCos and SICAVs, as boards of ManCos are more likely to approve individual agreements while boards of SICAVs are more likely to depend on the global distributor. Interestingly, Anglo-Saxon boards were more likely to count on the distributor (70%) than Continental European boards (35%).

However when it came to distributor due diligence reports, a large majority of boards relied upon the global distributor themselves. Furthermore, as the breakdown of reporting (see figure 13 above) demonstrates, only a minority of respondents for both UCITS and non-UCITS funds received adequate reporting on mis-selling risk (for example). Taking all factors into account it would seem clear that there should be greater focus placed on distribution risks and related reporting to the board as a whole.

Figure 17: Role of board in sub-distributor selection

What is the role of the board when it comes to distributor selection?

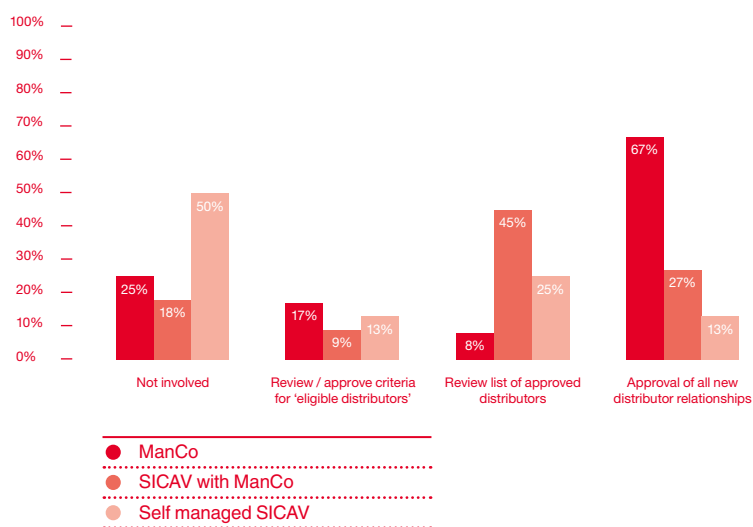
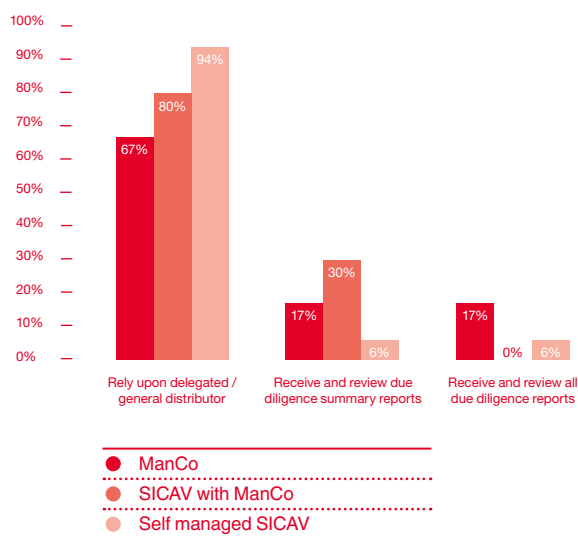


Figure 18a: Distributor due diligence

What is the role of the board when it comes to distributor due diligence reports?



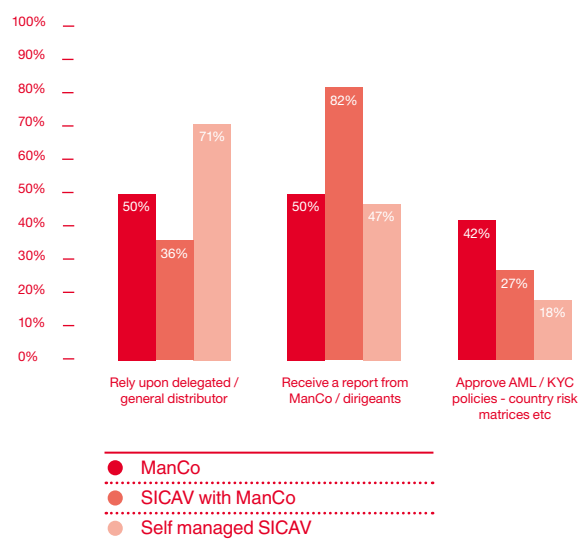
AML/KYC

Similarly for AML and KYC compliance, boards rely heavily upon the global distributor or receive a report from the ManCo or ‘dirigeants’ in relation to these activities.

However, a requirement in Luxembourg for a regulated Transfer Agent (Registrar) to be involved is key to understanding the approach of the board. Boards tend to place a high degree of reliance on the global distributor and Transfer Agents (the latter as regulated entities) to oversee the proper execution of AML/KYC requirements, and as such it is unsurprising for high percentages of respondents to be relying on either the global distributor or ManCo/‘dirigeants’ in this area.

Figure 18b: AML/KYC compliance

What is the role of the board when it comes to AML / KYC compliance?



‘Similarly for AML and KYC compliance, boards rely heavily upon the global distributor or receive a report from the ManCo or ‘dirigeants’ in relation to these activities.’

Code of Conduct

Use of Codes

Despite the recent focus on governance across the financial services industry, the take up of either codes and/or specific guidelines regarding internal governance has not seen a massive acceleration, although there has been a positive move forward. While a majority of respondents have now adopted either the ALFI or another Code of Conduct (see figure 19), more generally there has been a lag in the take up of a board level Code of Conduct or similar documents for non-UCITS.

This is perhaps understandable in the context of the market. While the funds industry is still navigating its way through a shaky economic recovery, boards are likely to be absorbed by what is seen as short-term 'bread and butter' issues of fund performance and risk analysis as opposed to the long-term implementation of a more defined governance regime. Similarly, unlike the banking sector, the fund industry was not deemed to have suffered any wholesale governance failures. The combination of both factors probably explains a more gradual adoption of specific codes and guidelines. However, since the amendment of the 19 December 2002 law the adoption of such has become mandatory for all listed funds, and therefore can be expected to drive take-up.

As a case in point the number of boards with some form of written guidelines has increased from 17% in 2008 to 50% this year for UCITS (see figure 20). While this appears to be a significant jump, the figure might credibly have been expected to be higher. Only 33% of ManCos have adopted a Code of Conduct compared to 55% of SICAVs and 50% of self-managed SICAVs.

Figure 19: Adopting a code of conduct

Has the board adopted the ALFI code of conduct or another code of conduct?

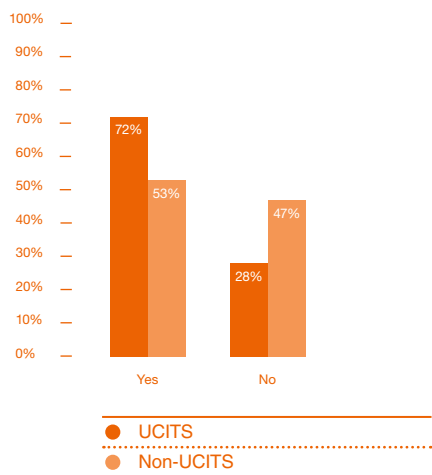
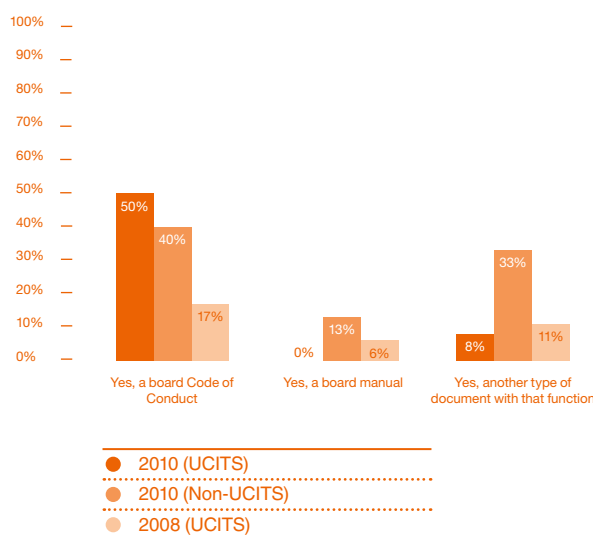


Figure 20: Documents on duties and responsibilities

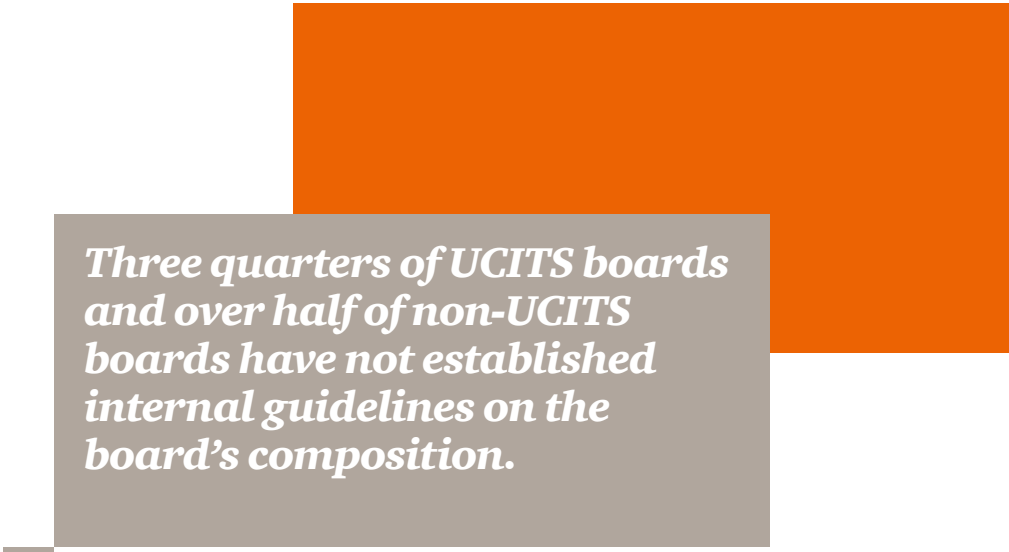
Has the board endorsed a document on its duties and responsibilities?



Internal Guidelines

Three quarters of UCITS boards and over half of non-UCITS boards have not established internal guidelines on the board's composition and the skills of board members and do not plan to introduce such internal guidelines in the future, a position which should be reviewed given the need to have various skills present at the board level in order to deliver effective oversight. However, a majority of boards do ensure that investment managers and service providers comply with their own compliance and internal audit obligations, and two-thirds of UCITS boards have established guidelines when dealing with affiliated/related parties (while only a third of non-UCITS boards have done so). So, while there could be more focus given to the skill composition at the board level, UCITS boards are displaying diligence in relation to the selection and monitoring of service providers.

A further positive trend is the increase of group and specific policies in relation to the composition and functioning of the fund board. The implementation of policies has increased for the responding UCITS funds since 2006 (from 45% to 76% between 2006 and 2010 for group policies and from 31% to 44% for specific policies). Non-UCITS boards are in line with this increase, with 64% currently using group policies or guidelines. While the direction of the trend is positive, even higher rates of take-up are to be recommended in this area, with more focus to be given to local, specific policies so that group wide policies can be given meaningful impact at the local level.



Three quarters of UCITS boards and over half of non-UCITS boards have not established internal guidelines on the board's composition.

Conclusion

The governance developments within the Luxembourg funds industry over the last two years have been largely positive, with boards comprising increased numbers of independent directors, and becoming more proactive and responsive to market changes. There are still opportunities for improvement, and we note some areas where boards must become more engaged in order to deliver more enhanced governance. Tracking against previous surveys we note the following changes (see figure 21).

Figure 21: Status of market benchmarked against best practices

	Key Areas	Practice Evolution
Board Organisation	<ul style="list-style-type: none"> • Representation of independent directors • Detailed outlines of roles and responsibilities and written terms • Induction and education process • Regularity and duration of board meetings • Standard and variety of information received from dirigeants 	Improvement
Roles & Responsibilities	<ul style="list-style-type: none"> • Defined interaction with the dirigeants, service providers, promoter • Risk management strategy in place with regular reporting and review • Practical measures to deal with conflicts of interest 	Improvement
Distribution	<ul style="list-style-type: none"> • Involvement and/or review of distributor agreement • Adequate reporting on distribution risk • Review of due diligence reports 	Marginal Improvement
Code of conduct	<ul style="list-style-type: none"> • Adoption of Code of Conduct • Mapping of policies and procedures to code • Publication of governance information 	Significant Improvement

There are still opportunities for improvement.



Board Organisation

Regarding Board Organisation the trend toward increased representation of independent directors, both as a proportion of fund board composition and appearance on greater numbers of boards, is to be applauded as it has occurred without any regulatory driving force and demonstrates the industry's ongoing flexibility. It also appears that the costs of the fund board – as far as defined by director's fees – are relatively stable and the 'going rates' of directorships appear to be well defined regardless of whether they are based on a relationship or a per fund approach. On a qualitative basis, we understand that there may in fact be downward pressures on fees at the moment due to a greater availability of qualified individuals, however this has not reached thresholds which can be clearly seen right now. Our next survey may yield more identifiable trends in this regard.

Our recommendations to improve board organisation involve the appointment and regular skill enhancement of directors reinforced by a periodic evaluation of the board. In terms of appointing directors, we believe the use of defined terms of appointment should be strongly encouraged. For example, even if directors have either a long-standing relationship with a mandate or whether they are already paid employees, clarification of role, responsibilities and liabilities should be offered in writing from the outset and updated as required. Where this approach is eschewed, we believe it should be a conscious decision on the part of the director. Moreover, we believe a formal induction process for appointees should be encouraged and where appropriate the appointee should include preliminary due diligence on the fund.

Similarly, group and specific policies regarding composition of the board are to be encouraged as they offer clarity and transparency as well as ensuring minimum levels of technical skills.

Ongoing education for directors should be incorporated as an integral part of the director's role, with a minimum of one day of training to be received every six months. This would assist the board to become more proactive rather than reactive. Conducting a regular board evaluation should also be considered as the governance framework evolves.



Roles and Responsibilities

We have already seen how the board's primary function regarding fund performance has shifted from simply monitoring performance to a more active role with a greater focus on risk management. Within this context, VaR has been broadly adopted but, as a result of the crisis, boards have also understood the need for other measures. Therefore, most boards do not foresee an increase of VaR in the next two years, although the UCITS IV development may impact this view.

Key to the roles and responsibilities of the board is a focus on conflicts of interest. However, despite a unanimous agreement on this point, practical application of systematic processes is not as widespread as it should be. We recommend that all boards implement practical procedures to underpin their conflict management approach. Generally speaking, there should be a regularly maintained register of conflicts, a prioritisation of specific conflict types which occur frequently, and the development of a series of specific responses to such conflicts based on best practice and investor interests. The procedures should then be reviewed on a periodic basis in order to keep up-to-date with the industry best practices and regulatory guidelines.

Generally speaking, there should be a regularly maintained register of conflicts, a prioritisation of specific conflict types which occur frequently, and the development of a series of specific responses to such conflicts based on best practice and investor interests.

Distribution

In the context of previous surveys, the area of distribution appears to require the most focus going forward. Although respondents widely believed that their distribution risks were adequately managed, the responses received during this survey display that issues remain.

Increasing the extent of reporting on distribution risk while at the same time reducing reliance on the global distributor for critical information will be a challenge for boards, and one that faces practical difficulties. There are, however, some approaches which could be of potential benefit. As a first step, we believe boards should consider agreeing standard terms, and receiving summary reports on due diligence. Boards could also review the standard contract used with distributors and satisfy themselves as to the appropriateness of the agreement. Thereafter they could consider defining a level of reporting on distribution which is in line with the perceived risks of the agreement and the distribution strategy.

As there is likely to be a continuing reliance on the global distributor for information on distribution activities, in-depth and pro-active questioning by the board on areas of concern is to be recommended.

While these suggestions do not form a comprehensive solution in their own right, we believe they would, at a minimum, empower the board to a greater extent in its relationship with the global distributor, and provide a good first step toward a more transparent relationship.

Code of Conduct

Finally, we come to the Code of Conduct. With the recent amendment to the Law of 19 December 2002 it will now be compulsory for all listed funds to publish details on their corporate governance processes and adherence to codes. However, while we can expect this to lead to an acceleration of the adoption of codes of conduct within the industry, we believe the take-up should be universal, particularly as codes (e.g. the ALFI Code of Conduct) tend to be broad, principle-based documents.

Fund boards should adopt a code as a general framework for good governance practices, and commence a mapping of their policies and procedures in accordance with the code in order to identify and remedy any shortfalls. Thereafter the code can be used to guide the board on the creation of more specific policies in the areas of reporting and decision-making, some examples of which we have covered briefly above. Even funds which do not come under the range of the amendment should engage in these exercises as the current debates on governance approaches may result in a more widespread regime in the near future. Even if a new governance model is not forthcoming, a voluntary implementation of more clearly defined governance practices can only benefit the industry.



Contacts

PwC Luxembourg

John Parkhouse
Partner
john.m.parkhouse@lu.pwc.com
+352 49 48 48 2133

Michael Delano
Partner
michael.delano@lu.pwc.com
+352 49 48 48 2109

Dariusz Yazdani
Head of Asset Management Research Unit
dariusz.yazdani@lu.pwc.com
+352 49 48 48 2566

ILA

John Parkhouse
ILA Fund Committee Chairman
john.m.parkhouse@lu.pwc.com
+352 49 48 48 2133

Patrick Zurstrassen
ILA Chairman
patrick.zurstrassen@ila.lu
+352 26 00 21 500

www.pwc.lu
www.ila.lu

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