

*Ernst & Young
Alumni Business
Event*

*Luxembourg Stock
Exchange
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The Effect of the Market Crisis on the Role of Fund Directors

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Associate of *The Directors’ Office***



Introduction / Contents

- Update on **fund governance regulatory framework**
- **Observations** from recent fund board practices

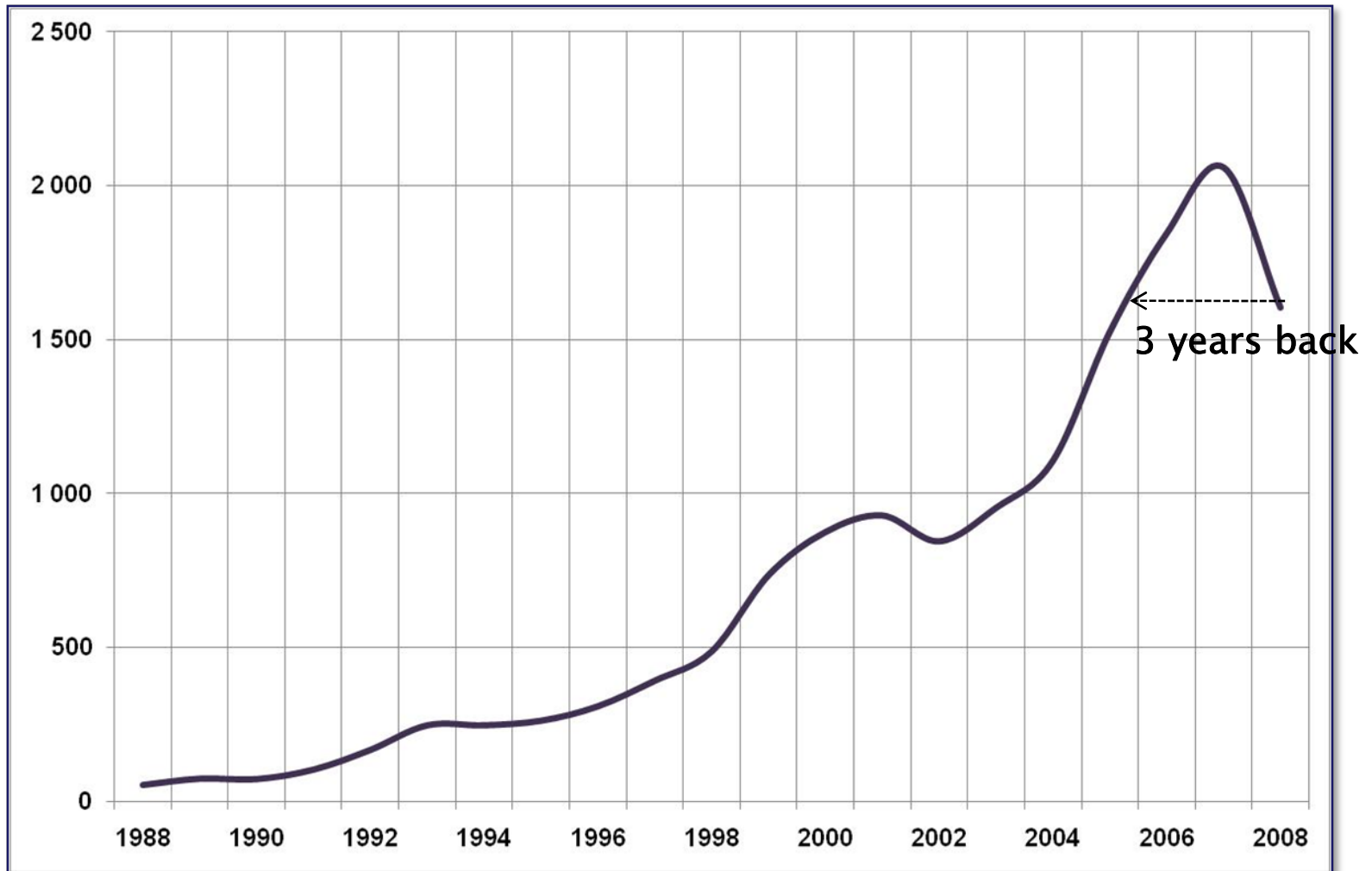


**But Before Trying to
Answer:**

***“When did the Crisis Start
Modifying
the Luxembourg Funds
Micro-Climate?”***



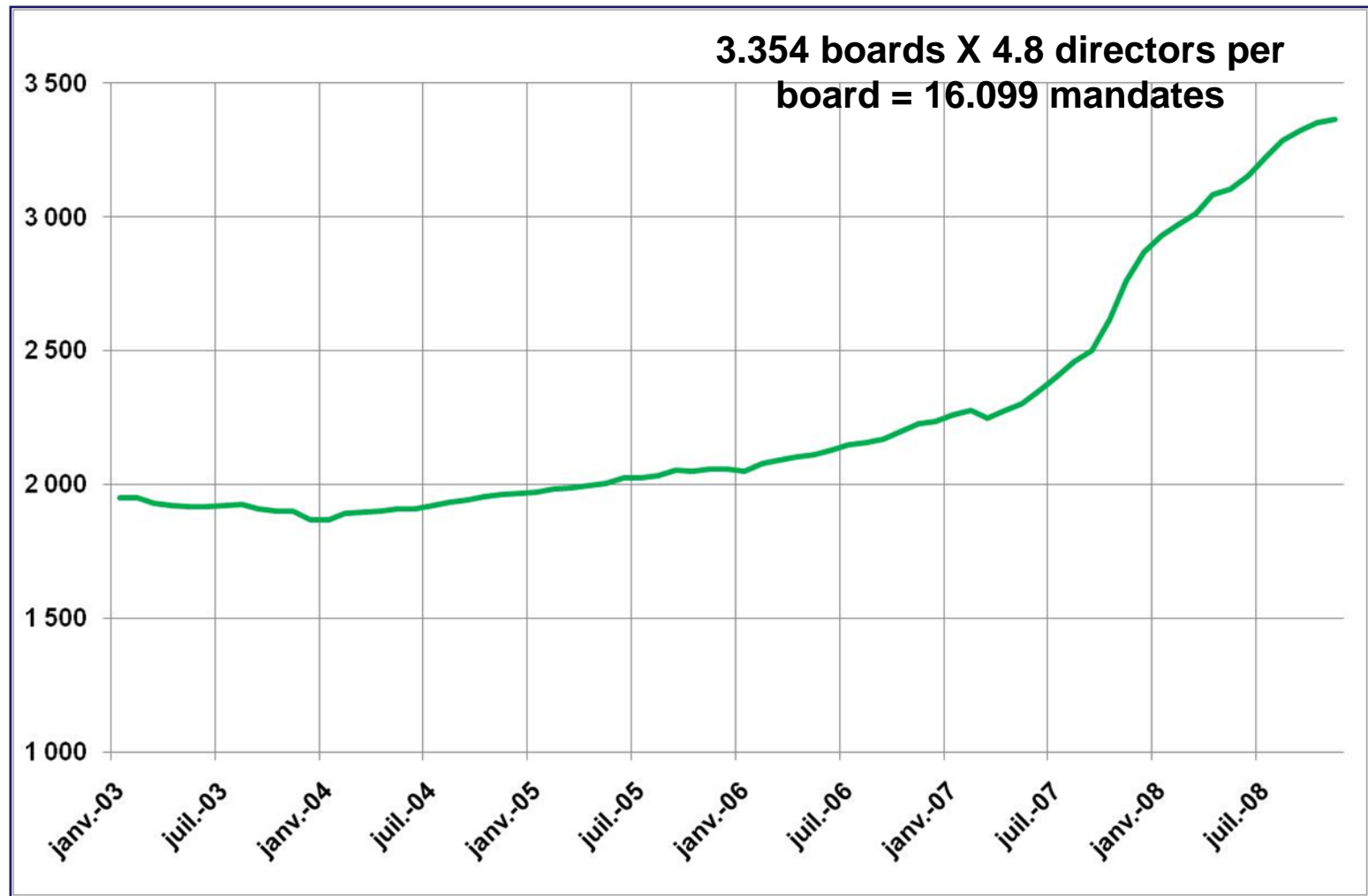
The Luxembourg funds micro-climate: Total fund assets [Euro billions]



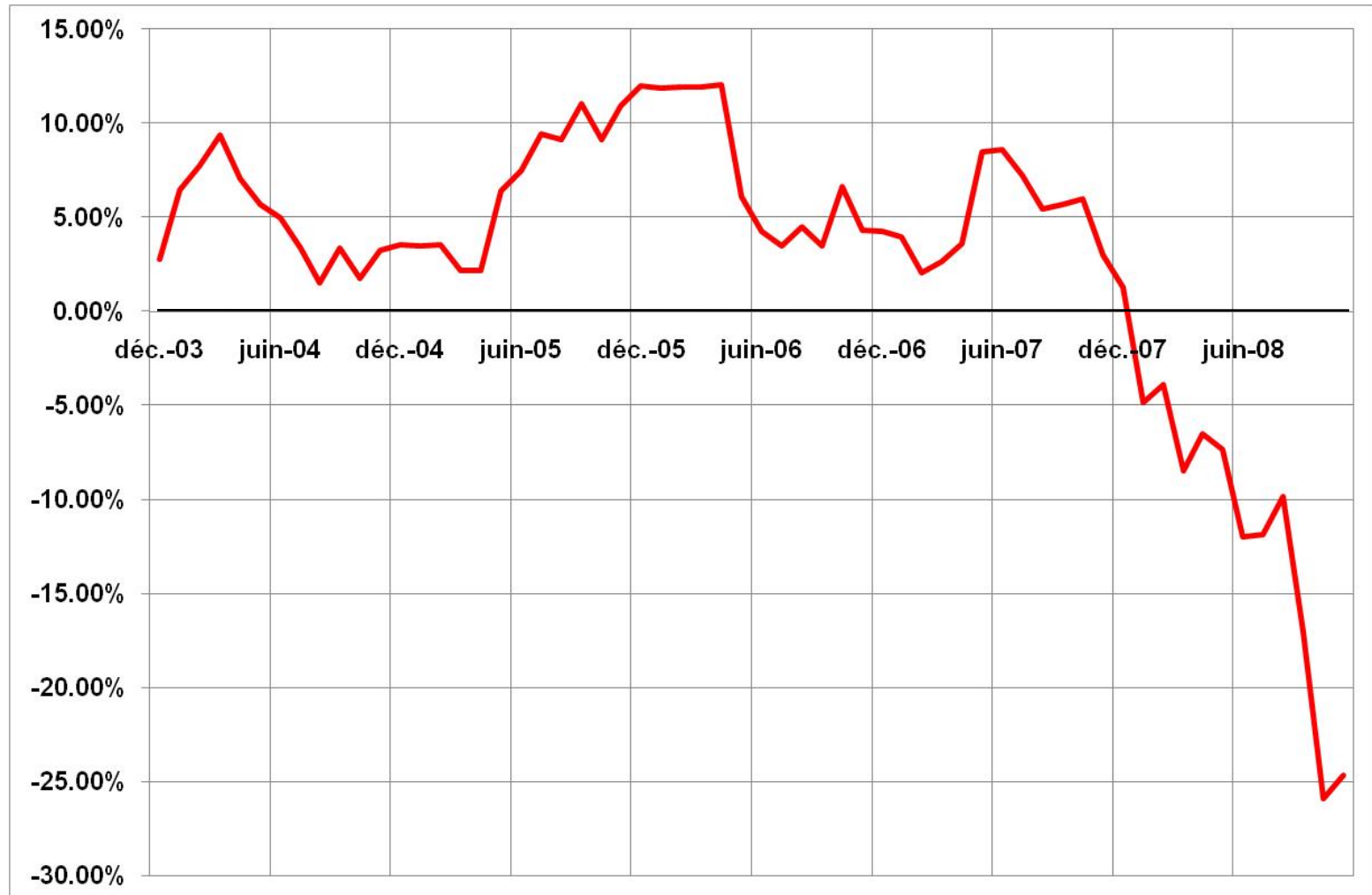
Source: CSSF monthly statistics

Slide 4

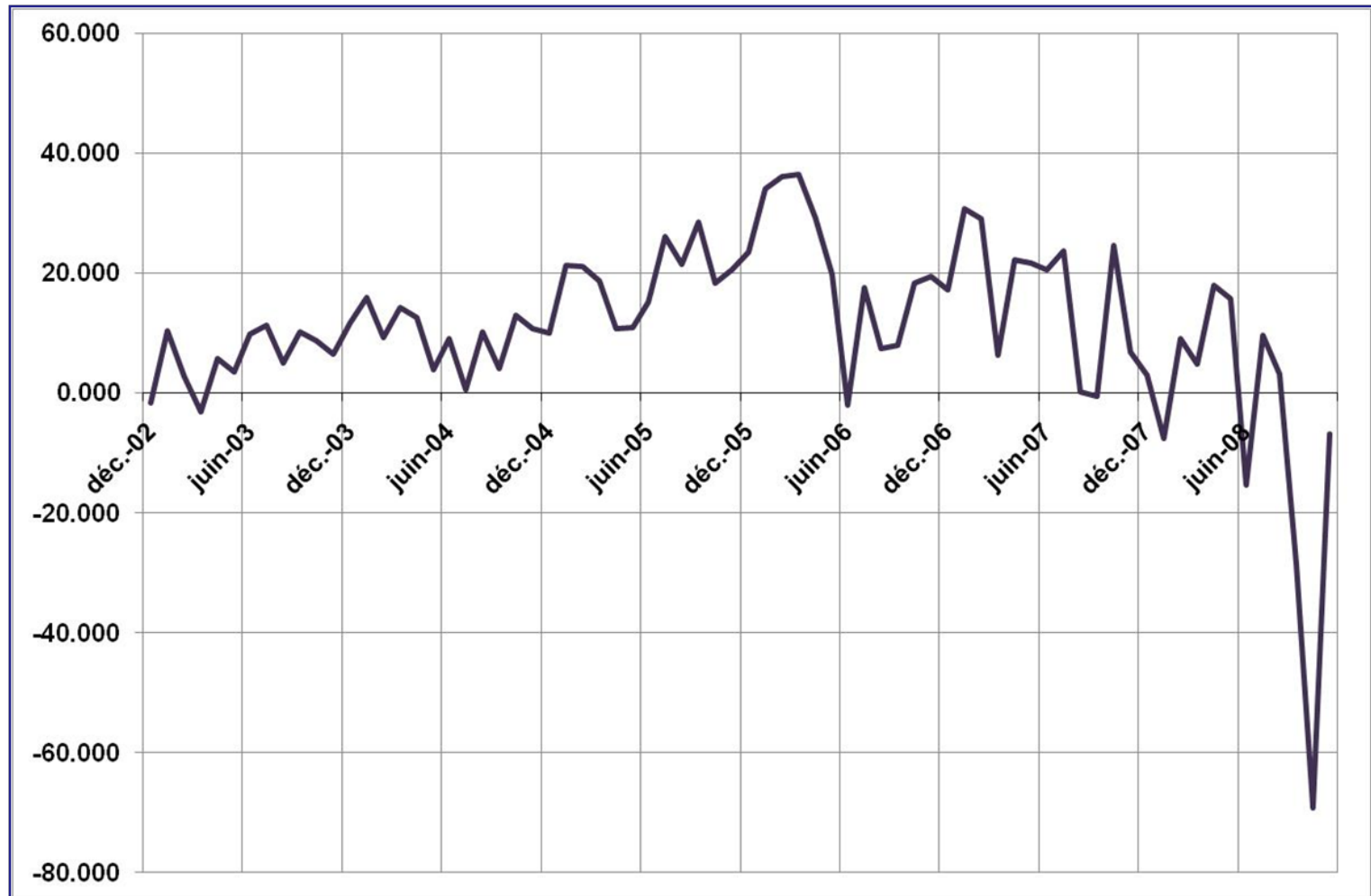
The Luxembourg funds micro-climate: Total number of funds and directorship mandates



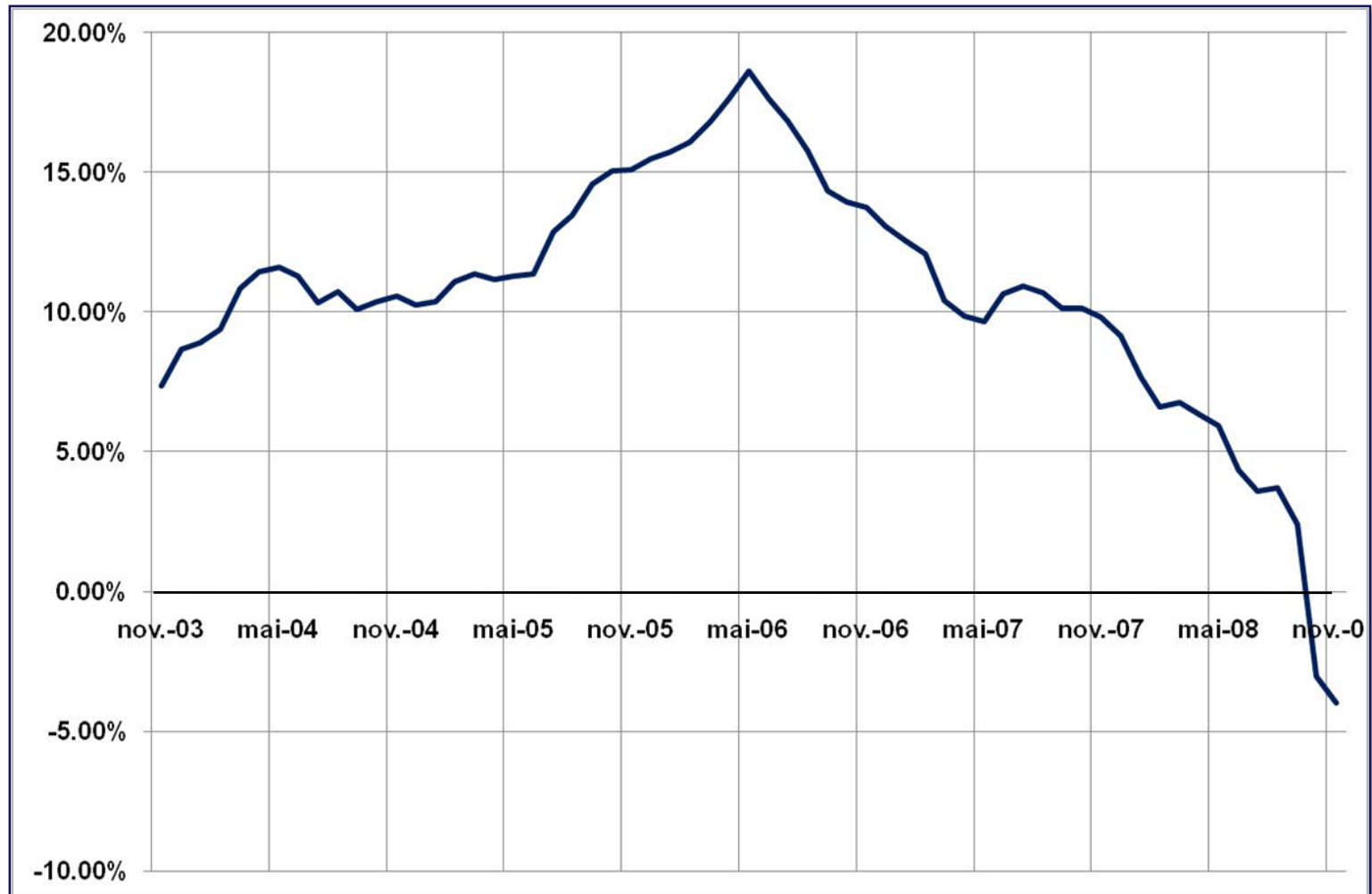
The Luxembourg funds micro-climate: Average annual market effect rate [% per annum]



The Luxembourg funds micro-climate: Monthly net subscriptions [Euro millions]

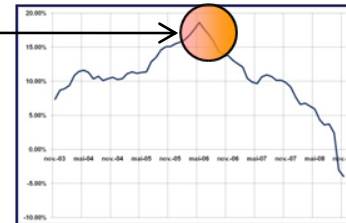


The Luxembourg funds micro-climate: Average annual net subscription rate [% per annum]

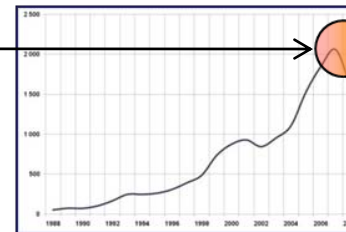


The Luxembourg funds micro-climate: Summing it up

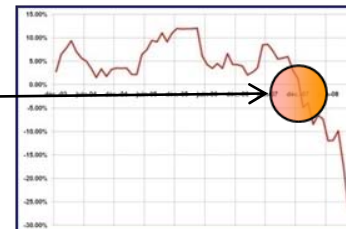
- June 2006: declining growth rate of net subscription



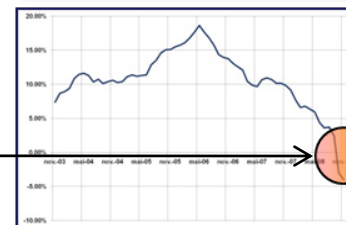
- October 2007: peak of total assets at Euro 2.123 billions



- December 2007: negative annual market effect.



- October 2008: negative net subscription growth rate



Update on Fund Governance Regulatory Framework



I. The rights of shareholders

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

II. The equitable treatment of shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

III. The role of stakeholders in corporate governance

The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders.

IV. Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance.

V. The responsibility of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board and the board's accountability and loyalty to the company and the shareholders.

The OECD Principles and the IOSCO reports are leading to the **five duties** of **funds directors**.

The duties of the board of directors of fund investment and/or management companies should generally include:

1. the **strategic guidance** of the company,
2. the effective **monitoring** of the management,
3. The **accountability and loyalty to the company and the shareholders**.

For fund directors, the nature of activities calls for particular care in:

4. the identification and resolution of **conflicts of interest**

As reminder, IOSCO 2005 report on governance stated that Collective Investment Schemes [CIS] governance is *“a framework for the organization and operation of CIS that seeks to ensure that CIS are organized and operated efficiently and exclusively in the interest of CIS investors, and not in the interest of CIS insiders”*.

Particularly needed in time of crisis, board directors should be collectively providing to the management:

5. the **experience** and the **judgment** in helping the company facing the unexpected.

On the concept of independence of directors

The 2006 IOSCO report on governance of CIS:



1. The following **principles** are applicable to all Collective Investment Schemes
 - A **Independent Oversight Entities** [IOE] should be set up, composed, appointed or dismissed under conditions that prevent the decision making process from being tainted by any type of **conflict of interest** with the CIS Operator and its related parties.
 - The organization and the practical functioning of the IOE should allow them to be **out of the control or the influence** of the management of the CIS Operator or its related parties.
 - There should **not** be **any confusion of responsibilities** of the IOE when exercising their oversight function on the one side and the CIS Operator in its asset management role over the CIS on the other side.

2. The following **forms** of IOE of CIS can be identified:
 - Either directors unaffiliated to the CIS: as minimum percentage or number.
 - Or mandate independent review committee
 - Or a regulatory framework requiring depositary or trustee and the CIS operator to economically and functionally separate entities.

More from the IOSCO report on funds governance

On powers, functions and tasks of IOE



3. The following **powers** should be given to the IOE of CIS
 - The IOE should be entitled to receive **all relevant information** enabling them to perform their oversight function in a proper manner.
 - The IOE should be given **the necessary means** to carry out their duties without relying exclusively on the CIS Operators' assistance
 - The IOE should be given the right to **review the legal and operational conditions** of the CIS management in relation with the CIS in a reasonable way.

4. The IOE should carry out the following **functions and tasks**.
 - The IOE, **collectively**, should have the function of **overseeing the CIS Operator** and CIS Operator's activities.
 - The IOE, collectively, should have the function of ensuring that appropriate mechanisms are in place to prevent or **avoid the erosion or expropriation of CIS investors' wealth** in interest in the CIS.
 - The IOE should have the duty of **reporting** to the regulatory authorities or the CIS unit holders.

For listed companies: the EC Recommendation on the role of independent directors [IP/04/1182]



- **Balanced composition of boards:**

The administrative, managerial and supervisory bodies should include overall an appropriate balance of executive/managing and non-executive/supervisory directors so that no individual or small group can dominate decision-making.

- **Definition of independence:**

A director is considered independent when free from any business, family or other relationship - with the company, its controlling shareholder or the management - that creates a conflict of interest such as to jeopardise exercise of his or her free judgement.

- **Commitment and availability:**

All directors should devote to their duties the necessary time and attention. The significant professional commitments of a director should be disclosed.

- **Creation and role of board committees:**

Boards should be organised so that a sufficient number of independent non-executive or supervisory directors play an effective role in defining and dealing with potential conflicts of interest. To this end, nomination, remuneration and audit committees should normally be created within the (supervisory) board. The Recommendation defines minimum standards for the creation, composition and role of those committees.

With clear direct carve out for UCITS

For public interest companies: the revision of the EC 8th Directive on Audits. [EC 2006/43 & 2008/30]



- **Definition of “public interest” companies:**

- Listed companies
- Credit institutions
- Insurance companies

- **Audit Committees:**

- Each public interest entity shall have an audit committee AC.
- MS shall determined whether AC are composed of:
 - Either non executive members of the board of directors
 - Or members of a supervisory board
 - Or members appointed by the AGM.
- At least one member of the AC shall be independent and shall have competence in accounting and/or auditing.

With possible exemption for

- Subsidiary undertaking
- UCITS
- Asset backed securities
- Small banks

For all listed companies: the revision of the EC 2006/46 Directive on Annual Accounts



- All listed companies shall be obliged to disclose **an annual corporate governance statement** as a specific and identifiable section of their annual report.
- The Corporate Governance Statement will include:
 - Key information on the corporate governance practices actually applied, including a description [...] of **risk management** and **internal control** systems,
 - Description of any **provisions on CG** other than those provided by national law.
 - Regardless of whether those provisions are directly laid down in a **Corporate Governance code** to which the company is subject or in any CG code which the company has decided to apply.

No visible carve out for listed funds

The EFAMA paper on code of conduct: Fifteen “High Level Principles” [HLP] [1/2]



- 1. Acceptance of fiduciary duty:
... in the best interest of investors and the integrity of the markets.
- 2. Sound governance
...All directors of good professional standing and experience... The board must act in sufficient autonomy...
- 3. Conflict of interest
...identify, define rules, manage and disclose...in particular with related parties.
- 4. Organisation and procedures
Adequacy of means, resources and expertise...Segregation of business duties...But "Four-eyes" principle.
- 5. Compliance:
... constantly monitor compliance. Independence. Direct reporting to Board of Directors.
- 6. Delegation & services providers
...clear policy of selection & monitoring... in particular with related parties. No reduction in responsibilities
- 7. Investment decisions
Professional expertise. Adequate risk management. Compliance.
- 8. Best execution
Best possible execution taking into account price, costs, speed, quality, ...

The EFAMA paper on code of conduct: Fifteen “High Level Principles” [HLP] [2/2]



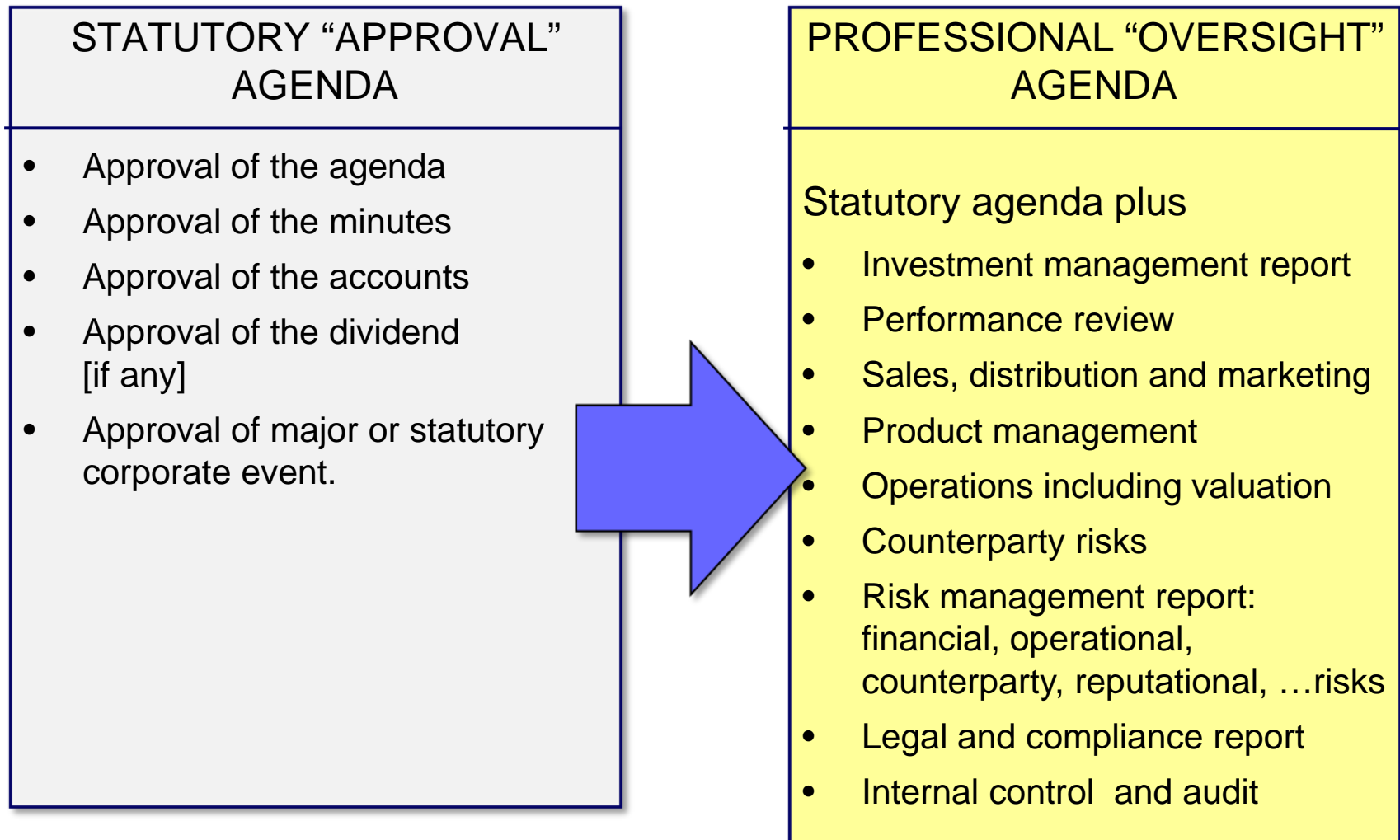
- 9. Broker relations:
... selection process taking into account execution capability and quality of research... Full disclosure of arrangements.
- 10. Asset valuation
... Portfolio must reflect the “fair value” of assets... Mark to market. Valuation performed independently from management function
- 11. Custody of portfolio assets
... always kept segregated
... depositary and IMC separate entities or sufficiently independent.
- 12. Fund Trading:
... procedures to discourage frequent trading and other harmful practices...
- 13. Shareholders and creditor rights
... define, document and disclose voting policy... attention to potential conflicts of interest if related...
- 14. Investor information
... true, fair, not misleading,
... respectful of standards... to allow comparability and consistency.
- 15. Clients and intermediaries
... suitability of advice and appropriateness of products

**Discussion
paper only
since 2006**

Observations from recent fund boards practices



Analysing the evolution of fund board agendas: from “rubber stamping” to professional oversight.



Analysing the evolution of fund board agendas: from professional oversight to “crisis issues management”

PROFESSIONAL “OVERSIGHT” AGENDA

Statutory agenda plus

- Investment management report
- Performance review
- Sales, distribution and marketing
- Product management
- Operations including valuation
- Counterparty risks
- Risk management report: financial, operational, counterparty, reputational, ...risks
- Legal and compliance report
- Internal control and audit

CRISIS ISSUES MANAGEMENT AGENDA

Oversight agenda plus issues

- Counterparties failures
- Redemptions
- Liquidity / Deleveraging / credit lines management
- Valuation / Fair pricing / Gates / Discount / Fire sales .
- Transfers of assets
- Suspension / liquidation
- Investor communications
- Parent company assistance
- Central banks intervention.

For funds directors: unexpected equations calling for new solutions: the “*crisis management*” toolbox: **borrowing [1/5]**

- Borrowing / leveraging
 - Commercial bank borrowing:
 - Depository bank / syndicate / other banks
 - Borrowing / Repo / Other
 - Straight / Confirmed / Committed
 - Terms: haircuts / margins / covenants / control of terms / repossession of assets
 - Chain of delegation: in drawdown / in covenant monitoring
 - Central bank refinancing / borrowing
 - Eligible assets
 - Risk sharing: funds / bank / SPV / central bank / government[s]
 - Capital requirements / waiving [full partial]

For funds directors: unexpected equations calling for new solutions: the “*crisis management*” toolbox: **valuation [2/5]**

- Valuation
 - Fair valuation: advantages & drawbacks
 - Decreased frequency of valuation
 - Discounted NAV
 - Categorization of assets
 - Illiquidity discounts
 - Verification of rates through low number of trades observations
 - Swing prices
 - Monitoring of adequacy of valuation parameters
Including third party challenges and opinions
 - Change / adaptation in processes & relationships between managers, depositary, administrative agent, data vendors, brokers, infrastructures, ...

For funds directors: unexpected equations calling for new solutions: the “*crisis management*” toolbox: **redemptions [3/5]**

- Redemption
 - Redemption charges
 - Redemption levy in favour of sub-funds / of sub-asset class.
 - Gates:
 - Levels / priority order
 - Systematic or at board discretion
 - Always / unless
 - Side pocketing
 - Suspension [total / partial][occasional / repeated] / liquidation
 - Redemption offset: by group subscription / by others
 - [Last minutes] cancellation of redemptions
 - Redemptions in species
 - Monitoring of adequacy of redemption parameters

For funds directors: unexpected equations calling for new solutions: the “*crisis management*” toolbox: **disposals [4/5]**

- Disposals of assets
 - Transfer of assets between portfolios / funds / others
 - Disposal of illiquid / distressed assets by auction / by others.
 - Acquisition of illiquid assets by banking group
 - Chivallery acts from group holding [reputation protection / publicity versus privacy]
- Liability sharing
 - Group intervention
 - Forms: transfer of assets / liquidity / subsidy / capital / loans / syndicate / others
 - Management accountability: retention / bonus impacts / dilution of impacts.
 - Bearing of operational or counterparty failure risks.

For funds directors: unexpected equations: the “*crisis management*” toolbox: **accompanying measures [5/5]**

- General crisis management
Availability / competence / contingency / escalation...
- Client communications
 - Relationship management
 - The emotional side: either panicking or playing the ostrich.
The “worst-is-behind” syndrome.
 - Absence of communication may do worse.
 - Chivallery act may backfire generating more suspicions than renewed trust
 - Professional secrecy: how to apply any “equal level playing” rule in crisis situation.
How to be simultaneous and still private? How to test ideas without generating self-fulfilling prophecies?
- Directors liabilities
 - How to avoid being castrated by possible individual liabilities? How to care about shareholders more than about oneself, yet without ever forgetting to protect oneself?

Changing circumstances leading to changing elements making totally different style of boards

ELEMENT	BEFORE THE CRISIS	NOW
Frequency	Seasonal [quarterly]	On 24 hours notice
Place	Around board table	On Polycom phones
Attendance	A must	More than a must: vital
Tone	Always courteous	Less. Rougher.
Documents	Board pack: thicker or thinner	1-2 mails with attachments at best.
Preparation	One week end	Often none. Instant discovery of facts.
Sequence	Dialogue	Sequential: one by one
Agenda	Yearly plan	Unexpected

CONCLUSION

**Less “minimalist” policies.
More accent on integrity
and governance.**



Either new regulations, or improved governance practices: on boards

- On board composition and functioning on the Continent and Luxembourg:
 - Greater awareness that directors' **responsibilities** are equating directors' **liabilities**.
 - In particular, the liabilities of the **chairman** is not equal to the one of other directors.
 - Better understanding that if **the majority of seats** in a board may secure voting power [although seldom used], it also leads to global liability in case of failure.
 - For avoidance of conflicts of interests, **internal ban of institutional services providers** in having executives elected to boards of clients. Particularly applicable to depositary banks, law firms and consultants.

Either new regulations, or improved governance practices: on local funds peculiarities

- On the roles and responsibilities of the fund « **promoter** »
 - Better understanding that the promotership concept remains **ambiguous** and **unknown** in international area. Untested in front of courts.
 - Realization that the concept of funds promotership has **distracted** operators from the sound exercise of judgment.
 - The effective role of **conducting persons** not members of funds boards has proven to be weak.
- On the design of funds structures
 - Clear **segregation** of duties **between management and depositary**
 - Clearer interpretation of the forms and spirit of **EC regulations**, including UCITS III as it relates to conflicts of interest.

*L'INSTITUT
LUXEMBOURGEOIS
DES
ADMINISTRATEURS*



“*Institut Luxembourgeois des Administrateurs*”:

In a few words...

- ILA was created as a **non-profit association** in 2005. Its mission is to foster the good practices, the development and the promotion of the profession of directors of all origins, be independent or executive directors. Its denomination of “Institute” stems from its mission of research and education.
- ILA benefits from the support of its **individual members** as well as of its **master corporate members** including AIG Europe, Arcelor, Bourse de Luxembourg, BDO Compagnie Financière, Chambre de Commerce de Luxembourg, Deloitte, Dexia Banque Internationale Luxembourg, Ernst & Young, Fortis Banque Luxembourg, Le Foyer SA, Korn & Ferry, KPMG, PricewaterhouseCoopers and SES .
- ILA governance is structured on an **executive committee** supervised by a **board of directors** [Romain Bausch, Marie-Jeanne Chevremont, André Elvinger, Alain Georges, Pierre Gramegna, Michel Maquil, Didier Mouget, Raymond Schadeck, François Tesch, Eric Van de Kerkhove, Michel Wurth and Patrick Zurstrassen (Chair)].
- The **General Secretary** of ILA is Marie Chambourdon. The association is hosted by the Chamber of Commerce of Luxembourg.

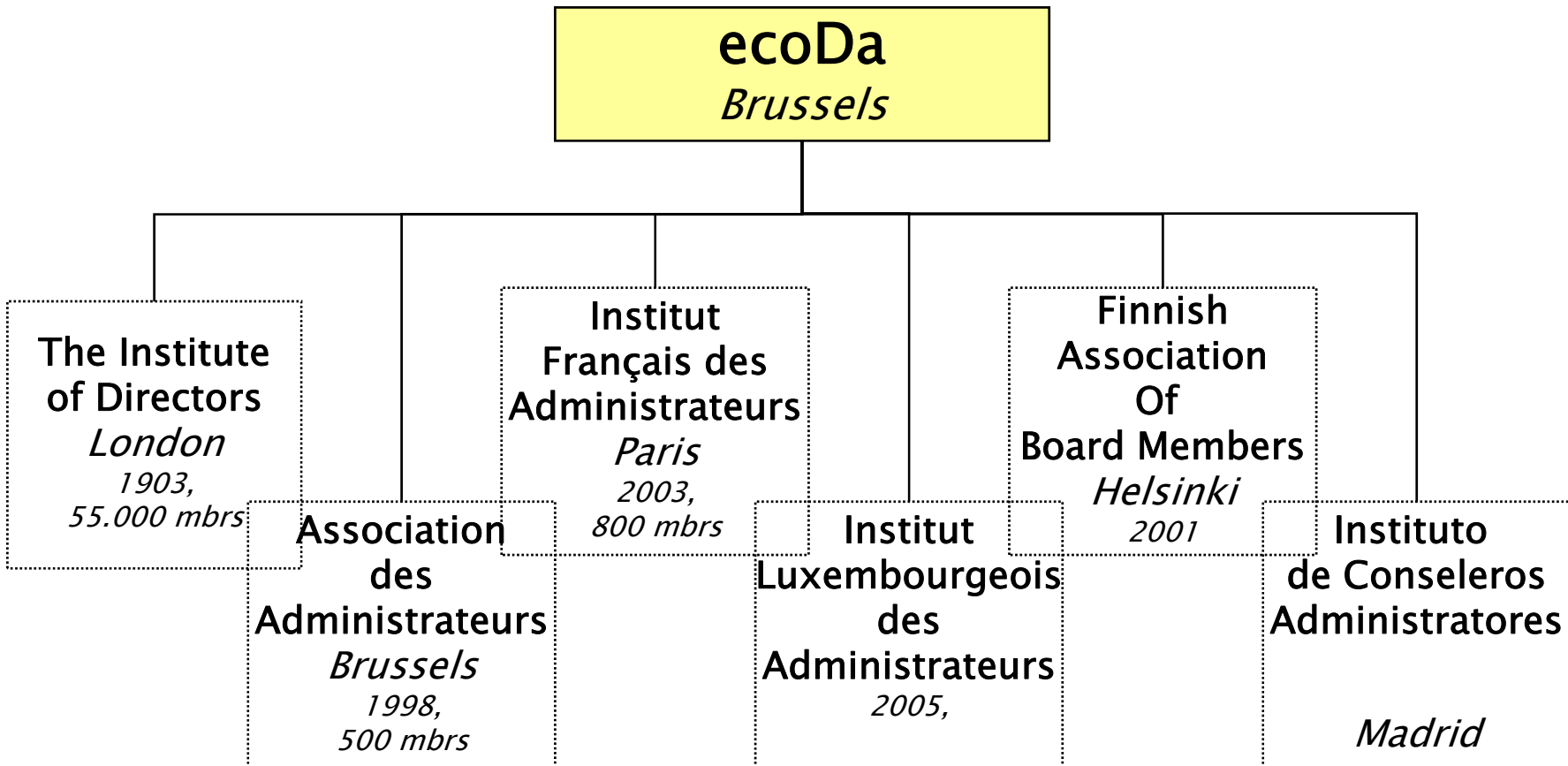


The “*Institut Luxembourgeois des Administrateurs*”: Participating in its working committees

Type		Chair	Master Corporate Member
Regular Committees			
	Law & Practices	Philippe Hoss	EHP
	External Relations & Communications	Pierre Margue	SES
Sectorial Committees			
	State owned bodies	Jeannot Weyer	Ernst & Young
	Listed Companies	Christophe Jung	Arcelor Mittal
	Investment Companies	John Parkhouse	PwC
	Finance Companies	Jean-Philippe Drescher	Deloitte
Committees on Board Activities			
	Audit Committee	John Li	KPMG
	Remuneration Committee	Bernhard Dedenbach	Korn & Ferry



Through ecoDa [The European Confederation of Directors' Associations] and cross-membership...



+ Czech Republic, Poland & Slovenia.

Institut Luxembourgeois des Administrateurs:

Membership: benefits and conditions

- **Benefits:**

- Participation to education **seminars**
- Attendance to ILA and ecoDa **conferences**
- Contribution to ILA **working groups**. Exchange of board practices within industry sector. Same with board committees.
- Access to original **researches** on corporate governance
- Information with **European Commission** on CG initiative.
- **Cross-membership** with French, Belgian and British Institutes of Directors
- Second rank defence cost D&O **insurance policy** to all ILA members

- **Conditions [from 2009]:**

- **Individual** members: Euro 275 pa
- **Group** membership [board and company]
 1. Major listed companies [market capitalization > 500 millions] and master corporate members: **Euro 5.000**
 2. Other companies [Staff > 100; Sales > Euro 10 millions] and major funds [Assets > Euro 1 bio]: **Euro 1.200**
 3. SME and other funds: **Euro 600**



The screenshot shows the homepage of the Institut Luxembourgeois des Administrateurs (ILA). The header features the ILA logo and the text 'Institut Luxembourgeois des Administrateurs'. A navigation menu includes 'Accueil', 'Nous contacter', and 'Liens utiles'. A sidebar on the left lists menu items such as 'Présentation', 'Les commissions', 'News', 'ILA et ecoDa', 'Les sociétés membres', 'Devenir membre', 'ILA et les Institutions Européennes', and 'Les autres associations'. The main content area is titled 'ILA: Une association pour aider et accompagner les administrateurs dans l'exercice de leur fonction'. Below this title, there is a paragraph describing the association's purpose and a section for the 'Composition du Conseil d'administration'. A callout box in the foreground identifies Marie Chambourdon as the General Secretary, providing her phone number (+352-26 86 77 30) and email address (m.chambourdon@ila.lu). The right sidebar contains a newsletter subscription form and a 'Latest news' section with several news items, including 'Conférence ecoDa', 'Article Luxemburger Wort', 'Assemblée Générale de l'ILA', 'Conférence ILA-PwC', and 'Conférence organisée par EcoDa'. The footer includes logos for the Chamber of Commerce of Luxembourg and PricewaterhouseCoopers.

**Marie Chambourdon,
General Secretary**

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