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Fund Management

Shaky start for the new guardians of the fund industry

Arrival of independent directors sparks fears of 'old boys' club' comeback

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The UK fund industry next week welcomes a new cohort of governance guardians with responsibility for standing up for investors and holding executives to account on everything from investment charges to manager performance.

The arrival of independent non-executive directors on UK fund boards has been touted as revolutionary for the governance of open-ended funds. The move brings the sector closer to the world of investment trusts, which are overseen by separate boards of directors responsible for defending shareholders' interests.

The new regime, which requires fund boards to appoint at least two independent non-executives, equivalent to one-quarter of their membership, came in response to failings in the investment sector uncovered in a landmark report by the Financial Conduct Authority, the UK regulator.

However, the early signs from the recruitment of independent directors suggest that the shift to more robust governance has got off to a slow start, with some asset managers being accused of cutting corners.

The crisis at Neil Woodford's business and a scandal last year at Swiss fund house GAM have highlighted the need for better standards and accountability at a time when the investment industry is attempting to restore trust.

Industry professionals are asking whether revamped fund boards will be up to the task of enhancing standards.

Paul Boughton, founding partner of MosaicNED, a training provider for independent directors, says the governance regime "is a step in the right direction but is not as ambitious as we would have hoped". He fears that some asset managers have favoured "the cheapest and easiest way" to comply with the new rules. "Some of the things that have happened are not in the spirit of the FCA's asset management [reforms]," says Mr Boughton.

A warning sign is the approach some asset managers take to appointing independent directors. Recruiters say that a large number of groups do not embark on a formal recruitment process and instead approach people they already know.

"Some of the biggest asset managers have not gone through a proper process," says one recruiter. "Many firms have been creative, using their own networks or appointing board members from another group entity."

While the FCA originally predicted that 480 directors would need to be hired to fill the positions, the recruiter says that fewer directors have been hired as a result of groups being resourceful.

Mr Boughton says that fund managers phoning contacts who are about to retire and enlisting them as independent board directors perpetuates the image of an "old boys' club" that has long dogged the industry. Moreover the practice of bringing on board directors from another group subsidiary undermines the spirit of true independent oversight enshrined in the FCA rules, he adds.

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"The one thing we need is for independent non-executive directors to be truly independent," says Mr Boughton. "Unless they are, the FCA initiative won't work."

In many cases, it is legitimate for a fund company to hand directorships to existing independent non-executives at the group. Equally, FCA rules allow asset managers to appoint former executives as directors, provided that five years have passed since the executive ended their employment with the company.

However, high-profile cases such as the board of the Woodford Patient Capital Trust have raised concerns about how the definition of independence can be pushed to its limits. Questions were asked about conflicts of interest at Mr Woodford's namesake investment trust, since the chair and three directors had connections to the companies in which the portfolio was invested.

Shiv Taneja, chief executive of the Fund Boards Council, an organisation for directors of fund boards, says that such cases demonstrate the importance of ensuring appointments "pass the smell test of good governance" as well as meeting all the legal and regulatory requirements.

FCA rules also state that asset managers must consider any circumstances that "could appear to affect [an individual's] judgment" in deeming if they are independent.

Another question about the incoming cohort of directors is the risk of the individuals taking on too many directorships. The FCA has not imposed a limit on the number of boards on which fund directors can sit, which some fear could open the door to abuse of the system.

Mr Taneja notes that among new directors "there is a tendency to want to try and replace the income earned whilst a full-time employed executive", causing them to "run the risk of becoming very overboarded, and, if not handled carefully, quite conflicted".

Concerns about so-called overboarding also come from the investment trust sector, which is often accused of tapping into a small candidate pool when appointing independent directors. Yet the Fund Boards Council's study of more than 180 investment trusts found that 78 per cent of directors sit on a single board, confounding many of these claims.

Mr Taneja believes the risk of fund board directors becoming overboarded is mitigated by the fact that some fund managers are reluctant to appoint directors who sit on the boards of competitors, as well as the surplus of available directors compared with the number of roles. Recruitment company Nurole says it received up to 80 applications per position in some cases.

> **There are varying degrees of how much fund boards think the directors will be involved**
> **Tamara Dupree**

Experts say that a more pressing question is whether independent fund board directors realise the time and responsibility their position requires. Under FCA rules, the directors are supposed to provide input and challenge into the assessment of value process that fund managers must carry out to demonstrate they are providing good investor outcomes. Experts say this requires a significant workload, something that not all asset managers have grasped.

"There are varying degrees of how much fund boards think the directors will be involved," says Tamara Dupree, head of asset management at Nurole. Some roles have been advertised as requiring as little as eight days per year. Ms Dupree believes this underestimates the level of work involved in overseeing fund value assessments, which will entail "considerably more [time] and be a much more arduous task".

Mr Boughton estimates that directors need to commit at least 30 days to their new role but this varies according to the nature of the fund manager. In a case such as Woodford or GAM, directors will need to dedicate significantly more time, he adds.

If directors fail to fulfill their responsibilities, they could be booted off the board and face significant reputational damage. But for those directors who serve as fund board chair, even more is at stake. Under new accountability rules that come into force in December, known as the senior managers and certification regime, board chairs will be considered senior managers, meaning they have a legal duty to act in the best interests of fund investors and are individually liable for any negligence.

Many believe that good practices for recruiting independent directors will evolve over time, as public and regulatory scrutiny puts pressure on companies and individuals that are deemed to be cutting corners. Mr Boughton says that the quality of the directors will be reflected in the quality of the value assessments, which will be made public soon. If regulators find these audits are not to scratch, managers may look to replace independent directors.

According to Mr Boughton, it is in managers' interests to embrace better board governance now, as the requirements will only increase in future. "We anticipate the FCA will push this initiative forward and within a short space of time require a majority of independent directors of fund boards," he says. "That will really start to change things properly."

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