Industry Professionals serving as non-executive directors to Alternative Funds

This edition of IPAF's newsletter brings you news from Luxembourg. Frédérique Bouchet is IPAF's Luxembourg representative.

Raising the standards of directors in Luxembourg: the CRD IV DIRECTIVE

The bill of law (n.6660), currently being discussed by the Luxembourg parliament and likely to come into force in the autumn, will have a significant impact on the governance of credit institutions and investment firms, including hedge funds, through the introduction of a number of core European Governance principles:

- the fit and proper test,
- the collective fitness test,
- the limitation of the number of directorships held by any one person,
- continuous training for directors,
- diversity.

1. The Fit and Proper Test

Under the new regulations, all directors and managers will need to be approved by the Commission de Surveillance du Secteur Financier (the 'CSSF'). Until now, the CSSF has acted selectively in trying to deter directors from new mandates when the CSSF deemed them to have too many. From the date of the enforcement of the bill, the CSSF will have the power to exclude/refuse a director, which they currently have no legal grounds to do. Honourability will no longer be enough: knowledge and competence will be also required. The profile of board members and management committee members (collectively known as "management"), must be in line with European standards. The CSSF will interview candidates applying for management positions to determine whether they will be approved or not. The Luxembourg market is currently adjusting to the fact that the CSSF approval can no longer be considered a mere formality. It will also take longer to obtain approval than it did previously.

2. The Collective Fitness Test

The board of directors of a regulated entity must reflect (i) a variety of experience and (ii) collectively have the necessary knowledge, experience and competence to understand all the activities of and the risks incurred by the regulated entity. The profiles of the members must not only reflect the activities and risks involved, but also ensure variety and a global knowledge and view of the entity across the board. In addition to the need for industry expertise, board members need a certain global understanding of all the relevant activities and risks and of the environment in which the entity is operating. Board packs have to be adapted and include more executive summaries and key points analysis. The focus has switched from assessing the board members' competence as individuals to collective assessment.

3. Limitation of the number of directorships

CSSF is attempting to address the issues of directors with too many mandates and a lack of diversity on boards which the CSSF considers to be examples of unhealthy governance. Limits have been introduced, particularly for boards of an entity of significant importance, due to its size, internal organization, the scope and complexity of its activities. There are still discussions regarding the definition of a significant entity, but the trend is set. Such directors will only be able to hold either an executive function and two non-executive functions or four non-executive functions. Generally, functions exercised within the same group will be considered as one mandate. The CSSF aims to counter the substantial accumulation of mandates by some directors allowing insufficient time to be dedicated to each role. Some directors will have to reorganise their mandates. Some will have a limited ability to accept new mandates and there will be more opportunity for directors with smaller portfolios.

4. Continuous training for directors

Regulated entities will be obliged to have the adequate human and financial resources to initiate and train members of management, which includes their directors. Directors' training is already being organized by the larger entities; it is clear that not all regulated entities will have the resources to do this in house. However, all directors (regardless of their profile) will be expected to attend regular training and it is anticipated that records will be kept.

5. Diversity

The law will require regulated entities to ensure that their board has a wide range of competence and qualities. The law also requires that policies encouraging diversity in the board composition are put in place. Analysis of board composition over the last ten years has shown that board compositions is still reserved to a limited number of (similar) profiles and has rarely included women, younger directors or other "board minorities". It is still unclear what the real impact of the CSSF's diversity criteria will be in practice. However, many Luxembourg financial professionals have recognized the need to appoint non-traditional profiles to add value to the board discussions, and have started "recruiting" accordingly. More diversity in board composition is needed to enhance the discussions being held around the board table and ultimately deliver the best value for shareholders.

What will the real impact of this law be?

IPAF welcomes the new law and definitely considers it to be a move in the right direction. There is, however, a big caveat in that there are no real sanctions in case of non-compliance and therefore, in reality, practices will not catch up that easily or quickly.

About Frédérique Bouchet

Frédérique Bouchet is a former hedge fund COO and a veteran of the prime brokerage industry. Her areas of expertise are operations and risk management. She holds an MBA from ESSEC and Kellogg School of Management – Northwestern University. Frédérique joined Paribas in 1979 where she spent 26 years. In the early years of her career she was responsible for the financial management of international operations, acting as Secretary to the Board and holding directorships of several subsidiaries. In 1992 she moved to London to set up BNP's counterparty and market risk systems, followed by a secondment to Banque de France to represent the French Banking Commission in the Basel Committee working group. Between 1996 and 2000, she was deputy head of BNP Paribas Securities Services Bank. Frédérique launched BNP's global prime brokerage business in 2000. She left in 2004 to re-engineer Credit Agricole's US prime brokerage activities. In 2006, she helped found Reech Alternative Investment Management Group in London and Luxembourg where she was partner, COO, CRO and CFO and served as a director on the fund and management company boards. This was followed by a similar role for a Paris based boutique hedge fund. She left in 2012 to focus on independent directorships.

About IPAF

IPAF provides Industry Professionals – independent, knowledgeable and experienced people - as non-executive directors to Alternative Funds. IPAF is run from London with a panel of 16 directors across 9 jurisdictions: Cayman, Luxembourg, Ireland, Switzerland, the Channel Islands, Malta, Bermuda, Barbados and the UK. All the IPAF directors are independent of each other and no additional fee is charged by IPAF to a fund that selects a member of its panel: the fund only pays the director's fees. For more information please telephone 020 7340 6316 or email info@ipafgroup.com.

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