

CLIENT BRIEFING

An Expensive Reminder for All Directors

On 26 August 2011, the Financial Services Division of the Grand Court of the Cayman Islands found that two former directors of a Cayman Islands' registered fund, Weaving Macro Fixed Income Fund Limited (the "Fund"), had acted in willful neglect or default of their duties as directors

As a result of this judgment, the defendant directors were found personally liable for losses of US\$111 million sustained by the Fund.

The judgment serves as a salient reminder, for any person who acts as a director of a Cayman fund, of the importance of properly fulfilling their high-level supervisory role in the professional business-like manner that is required.

It has reiterated the view that the directors must play an active role in monitoring and supervising a fund's service providers.

Specifically, the Judge noted that whilst, in the context of investment fund structures, *"investment management, administration and accounting functions are invariably delegated to ... professional services providers ...; the exercise by the directors of their power of delegation in this way does not absolve them from the duty to supervise the delegated functions."*

The directors must continually apply their minds and exercise independent judgment. Fund directors must not simply "rubber stamp" minutes or resolutions, or any other documents, prepared by counsel or the investment manager.

Fund directors should meet regularly to hold meaningful discussions of the activities of the relevant fund, an agenda of the items to be discussed should be circulated prior to each board meeting and the directors should record proper minutes of these discussions.

Directors should, from time to time when necessary, interact directly with representatives of the fund's various service providers to address any queries or concerns they may have and to ensure open channels of communication. It should be noted that none of the Fund's service providers were found liable in respect of the losses suffered by the Fund in this particular case and, accordingly, administrators and auditors may well be considered beneficiaries of this decision.

In addition to the discussion of the ongoing supervisory role of the directors, some of the most interesting comments in the judgment relate to the duties of directors during the establishment phase of an investment fund.

The Judge found specifically that it would **not** be sufficient for the directors to satisfy themselves that the various agreements to which the fund was to be a party *"were prepared by suitable professional advisers"*, if those professional advisers had been appointed by the investment manager (rather than the fund), as is usually the case.

Rather, the directors would need to *"review the various contracts and satisfy themselves that each one is appropriate and consistent with industry standards and that, taken together, they do create an overall structure which will ensure a proper divi-*

CLIENT BRIEFING

sion of responsibility amongst the serviced providers. This is not a task which can be delegated to the lawyers retained by the ... investment manager”.

In addition, the Judge noted that “the directors had a duty to satisfy themselves that the Fund’s offering document complied with the requirements of ... the Mutual Funds Law”.

The Judge then went on to state that the directors “could not discharge their duty by saying to themselves that the content of the offering document must be all right because the promoter/investment manager, its lawyers, the prospective administrator, auditor and other service providers are all reputable firms having experience in their respective fields”.

Whilst the directors should not need to do any of the offering document verification exercise personally, to ensure that the offering document is accurate and complete, they “would normally need to do more than a desktop review”.

Rather, “at the very least, they will need to make enquiry of the lawyers who have coordinated the [offering document verification] work so as to gain a proper understanding of what has been done and with what result.”

In our view, these comments may impose a greater obligation on the directors of investment funds established in the Cayman Islands to take a very active role during the establishment phase than many directors may have previously understood.

We expect that, going forward, directors may wish to seek additional documentary comfort from investment managers, administrators and

other service providers in the form of representation letters, pursuant to which the various service providers provide representations and warranties as to the verification process that has been undertaken on the offering documents.

This recent decision of the Grand Court of the Cayman Islands is likely to further increase the appeal of appointing professional independent directors to investment funds established in the Cayman Islands, rather than using affiliates of the investment manager who may not be as familiar with the duties of directors or who, due to inherent conflicts of interest, may have greater difficulty in exercising the necessary independent judgment.

For further information on the matters referred to in this memorandum, please contact us.



Ian Dillon, Partner

Alistair Walters, Partner

Kirsten Houghton, Senior Associate

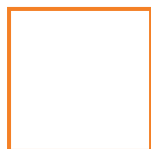
Marc Parrott, Senior Associate

idillon@campbells.com.ky

awalters@campbells.com.ky

khoughton@campbells.com.ky

mparrott@campbells.com.ky



T 345 949 2648

W www.campbells.com.ky

This memorandum has been prepared as a summary of the law as at August 2011 and is for general guidance only. It is not intended to be, nor should it be used for, a substitute for specific legal advice on any particular transaction or set of circumstances.