



## The Forgotten Hedge Fund Master Board of Directors

There has been much attention paid recently to the board of directors of hedge funds offshore investment vehicles. When seeking advice as to how evaluate the role of the board, investors are increasingly deluged with buzzwords such as *independence*, *oversight* and the newly popular *governance*. But what do these words actually mean? Unfortunately, when the rubber hits the road during investor operational due diligence many of these high-flying aspirations for the board are sometimes either not evaluated, or even worse, once reviewed completely ignored in the final decision making process.

With the increasing popularity of jurisdictions such as the Cayman Islands, investors may have also noticed a seemingly continuing decrease in the diversity of the membership of fund boards. This has been replaced with the aggregation of professional directors among a handful of larger companies whose primary business is providing directorship services. Realizing that they have increasingly lost business to these professional director firms, investors may also have noticed that other firms such as a hedge fund's offshore legal counsel, or their affiliated entities, increasingly attempting to compete for lucrative fund directorship positions.

While it is easy to fire off a series of common aspersions against these professional directorship companies, for many hedge funds they present a compromise of cost versus independence. On the other hand, many investors may feel that the price paid in independence by these firms is too high, and the benefits of truly independent governance trumps concerns of the mere regulatory requirements of a fund's board.

Regardless of which side of the argument an investor falls, in the past there have been a number of standard objections raised against the perhaps nebulous issue of board member oversight responsibility that investors must resolve. As illustrated by certain decisions such as the *Weaving Macro Fund case*<sup>1</sup>, the courts have also focused on better defining the liabilities of the members of the board, particularly when problems arise.

To better evaluate a specific fund's directors and the role played by the board some standard questions investors tend to, or at least should, ask during the operational due diligence process in related to the board of directors include:

- How many members sit on the Board?
- Does the biography of the board members qualify them to sit on the board?
- How many other fund boards do these individuals sit on?
- How many members are affiliated with the hedge fund versus unaffiliated?
- How much are directors paid?
- What type of insurance coverage do directors maintain?
- Does the fund's indemnification of directors include advancement of litigation costs?

---

<sup>1</sup> See *Weaving Macro Fixed Income Fund Limited (In Liquidation) v. Stefan Peterson and Hans Ekstrom, and Weaving Capital (UK) Limited (In Liquidation) and Others v. Peterson and Others*



# CORGENTUM

- Have fund personnel actually met the directors? Similarly, have the directors ever visited the fund's offices?
- How many times throughout the year do the directors interact with the fund? How do these interactions occur?

While investors have increased their operational due diligence prowess in recent years and have focused in on the role of the board of directors of offshore funds, there is a large elephant in the room that is often ignored in fund's organized under master / feeder structures - the role of the board of the master fund.

## Why Should Investor's Care About the Board of the Master Fund?

Although the board of directors of the offshore fund has many duties and responsibilities, very similar in many cases to the General Partner of an onshore fund, the master fund sits on top of both of these funds. During the operational due diligence process, investors run the very real risk of being so focused on the board of directors of the offshore fund that they neglect to inquire about the board of the master fund. But why should investor's care?

From an investor's perspective, there are two primary reasons why board of the master fund matters. Firstly, depending on the legal structure of the master/feeder complex, and the way in which the legal documents are written, the master fund's board may have the ability to effectively trump any decisions made by the Board of Directors of the offshore fund.

Secondly, and arguably more importantly, hedge fund have traditionally viewed the board of directors of the master fund as effectively equivalent to General Partners of the onshore fund in the sense that both contain affiliated entities. As such, the board of the master fund may be an entity affiliated with the hedge fund manager. Another common scenario is that the board of the master fund will consist of a single member and this will be the firm's founder or Chief Investment Officer. Under either scenario, there is a distinct lack of independence in the relationship.

Perhaps one of the reasons for the lack of attention historically paid by investors to the board of the master fund, is that the master fund is not typically offered for direct investment. As such, in many cases master funds do not have similar legal documentation, such as an offering memorandum, as compared to their onshore and offshore counterparts. When investors do not have a document to collect and review, the onus is on them to remember to separately inquire about this issue, and they may not. Unfortunately, further aggravating the problem hedge funds may not be anxious to volunteer information which they believe investors may view as stymieing independent oversight, and this may be an example of such an issue.



# CORGENTUM

## Conclusion

Regardless of the historical reasons as to why investors have not traditionally concentrated on the board of the master fund, they are increasingly expanding the scope of their operational due diligence reviews to include previously neglected risk areas such as this. Recognizing the potential downside of these relationships and the potential conflicts of interest that may arise, investors are increasingly turning their attention to the board of the master fund. Without such inquiries the extensive due diligence often focused around the board of directors for the offshore funds may be rendered moot.

**For More**      [info@corgentum.com](mailto:info@corgentum.com)  
**Information**   [Corgentum.com](http://Corgentum.com) | [Blog](#) | [Twitter Feed](#)  
Tel. 201-360-2430