



ISLE OF MAN  
FINANCIAL SERVICES AUTHORITY

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*Lught-Reill Shirveishyn Argidoil Ellan Vannin*

# **DISCUSSION PAPER**

## **DP17-01/T02**

### **DRAFT GUIDANCE NOTE – GOVERNANCE OF COLLECTIVE INVESTMENT SCHEMES**

Issue Date: 19 May 2017

Closing Date: 14 July 2017

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## DISCUSSION PAPER

This Discussion Paper is issued by the Isle of Man Financial Services Authority, the regulatory body for the financial sector in the Isle of Man.

The purpose of this Discussion Paper is to obtain views in relation to the draft Guidance Note entitled 'Governance of Collective Investment Schemes' ('Draft Guidance Note'), and will be of interest to any person who acts or intends to act as a member of a governing body of an Isle of Man collective investment scheme and those persons who provide services to such schemes.

The closing date for comments is **14 July 2017**.

Please send comments in writing and preferably by email to:

**Ruth Baker**  
**Supervision Officer – Banking, Funds & Investments**  
**Isle of Man Financial Services Authority**  
PO Box 58, Finch Hill House  
Bucks Road, Douglas  
Isle of Man, IM99 1DT

**Email:** [ruth.baker@iomfsa.im](mailto:ruth.baker@iomfsa.im)

**Telephone:** +44 (0) 1624 689338

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*All information in responses, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2015 and the Data Protection Act 2002). If you want your response to remain confidential you should explain why confidentiality is necessary. Your request will be acceded to only if it is appropriate in the circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding.*

If you have a query in relation to how this discussion process has been carried out, please contact the Authority's Policy and Authorisations Division by email at [IOMFSAPOLAUTH@gov.im](mailto:IOMFSAPOLAUTH@gov.im) or by telephone on +44 (0) 1624 646000.

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## GLOSSARY OF TERMS

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<b>AIFMD</b>	Alternative Investment Fund Managers Directive
<b>Authority</b>	The Isle of Man Financial Services Authority
<b>CIS</b>	Collective Investment Scheme
<b>CISA08</b>	The Collective Investment Schemes Act 2008
<b>Draft Guidance Note</b>	The draft Guidance Note entitled 'Governance of Collective Investment Schemes'
<b>ESMA</b>	The European Securities and Markets Authority
<b>IOSCO</b>	The International Organization of Securities Commissions

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## 1 EXECUTIVE SUMMARY

### 1.1 Overview

The Authority has prepared a draft Guidance Note entitled ‘Governance of Collective Investment Schemes’ (‘Draft Guidance Note’), to assist members of governing bodies in performing their duties responsibly and within the laws of the Isle of Man. The Draft Guidance Note has been developed with reference to guidance issued by other jurisdictions and the Authority’s experience in supervising the Isle of Man’s funds sector. A copy of the Draft Guidance Note is attached to this Discussion Paper in Appendix B.

By way of example, IOSCO defines collective investment schemes governance as a *“framework for the organisation and operation of a CIS that seeks to ensure that CIS are organised and operated efficiently and exclusively in the interest of their investors”*. This illustrates that the governing body of a CIS therefore plays a key role in ensuring the interests of investors are upheld. The principles and recommendations detailed within the Draft Guidance Note are intended to promote strong and effective governance amongst those who act or intend to act as members of a governing body to CISs.

The Draft Guidance Note is neither exhaustive, nor prescriptive. It is the responsibility of the governing body to identify the most appropriate governance framework for the scheme.

Guidance is, by its nature, not law, however it is persuasive. Where a person follows guidance this would tend to indicate compliance with legislative provisions.

### 1.2 What is this Discussion Paper for?

This Discussion Paper invites relevant parties to consider and provide views on the Draft Guidance Note prior to its finalisation and formal issuance by the Authority.

Comments should be submitted to the Authority prior to the closing date of the discussion period.

### 1.3 Who is affected by this Discussion Paper?

This Discussion Paper is relevant to any person who acts or intends to act as a member of a governing body of a CIS, and those persons who provide services to CISs.

## 2 CONSULTATION PROCESS

### 2.1 The Authority’s regulatory objectives

The Authority’s regulatory objectives are set out in section 2(2) of the FSA08 as —

- (a) securing an appropriate degree of protection for policyholders, members of retirement benefits schemes and the customers of persons carrying on a regulated activity;
- (b) the reduction of financial crime; and
- (c) the maintenance of confidence in the Island’s financial services, insurance and pensions industries through effective regulation, thereby supporting the Island’s economy and its development as an international financial centre.

Proposals in this consultation are intended to secure objectives (a) and (c).

The Authority is required to give consideration to certain factors when undertaking its role in accordance with paragraph 3 of Schedule 1 to the FSA08. The factors that are most relevant to this proposal are as follows:

Factor	Information
the need to balance the regulatory objectives;	The governing bodies of CISs have a key role to perform in protecting the interests of investors, and in turn the maintenance of confidence in the Island’s financial services sector. The Draft Guidance Note is intended to clarify the Authority’s expectations in relation to the governance of CISs, whilst acknowledging that the application of principles and recommendations outlined within the guidance should be applied accordingly.
the desirability of implementing and applying recognised international standards;	IOSCO principle 24 states that “ <i>the regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme</i> ”. The Draft Guidance Note further elaborates upon the Authority’s expectations concerning the governance of collective investment schemes detailed within existing legislation and guidance. Furthermore, other jurisdictions have already published guidance in this area; the issuance of the guidance will therefore provide parity with such jurisdictions.
the need to safeguard the reputation of the island;	Failure in respect of an Isle of Man CIS due to malfeasance or negligence on the part of the governing body, poses a reputational risk to the Island as an international

Factor	Information
	financial centre. The principles and recommendations outlined within the Draft Guidance Note are intended to provide a framework for effective governance, thereby reducing the risk of such failures.

## 2.2 Responding to the Discussion Paper

The Authority considers open dialogue with stakeholders as essential in developing its proposals and greatly appreciates comments on the proposals in this document.

The purpose of this Discussion Paper is to gather views from which to make an informed decision on the final content of the draft Guidance Note.

Please note that your comments may not result in a change to the proposals.

The Authority wishes to encourage submission of views and confirms that **respondents will not be publicly identified**. However, please do not submit comments anonymously, as they will not be considered or included in the Feedback Statement.

Representative groups are asked when responding to provide a summary of the people and organisations that they represent and the methodology used to gain members' input.

A list of representative groups that have been sent this Discussion Paper is included at Appendix A.

## 3 PROPOSAL

### 3.1 Background

The Draft Guidance Note has been developed with reference to guidance issued by other jurisdictions and the Authority's experience in supervising the funds sector.

The Authority has engaged in preliminary discussions with the Isle of Man Wealth & Fund Services Association and the Institute of Directors concerning the Draft Guidance Note. Feedback provided during these discussions has been considered and where appropriate the Authority has made necessary amendments.

Governing bodies will be expected to review governance arrangements on a regular basis and maintain a record of such review.

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## **4 IMPACT ASSESSMENT**

The Authority does not consider that the publication of the Guidance Note will place undue additional burden or cost upon those who act or intend to act as a member of the governing body of a CIS. The guidance simply outlines existing best practice and relevant considerations when determining governance arrangements.

The Authority acknowledges that governance arrangements may vary according to the nature of the CIS; the content of the guidance should therefore be applied appropriately.

## **5 FEEDBACK ON THE DRAFT GUIDANCE**

The Draft Guidance Note is attached to this Discussion Paper in Appendix B for review. The Authority welcomes feedback from any interested parties on the form and content of the Draft Guidance Note. The Authority will review all feedback received and determine whether any changes to the Draft Guidance Note should be made prior to the document being finalised for publication.

## **6 NEXT STEPS**

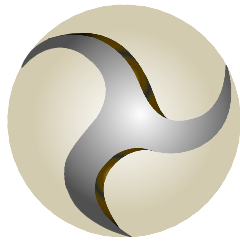
The Authority aims to publish a Feedback Statement within 3 months of the closing of the discussion period. The Feedback Statement will provide an analysis of the comments received and any changes to the Draft Guidance Note that will be made by the Authority as a result.



**APPENDIX A – LIST OF REPRESENTATIVE GROUPS WHO HAVE BEEN SENT THIS DISCUSSION PAPER**

- Alliance of Isle of Man Compliance Professionals
- Association of Chartered Certified Accountants
- Association of Corporate Service Providers
- Chartered Institute for Securities and Investment
- Institute of Chartered Secretaries and Administrators
- Institute of Directors
- IOM Wealth & Fund Services Association
- Isle of Man Law Society
- Manx Insurance Association

**APPENDIX B – DRAFT GUIDANCE NOTE**



**ISLE OF MAN  
FINANCIAL SERVICES AUTHORITY**

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*Lught-Reill Shirveishyn Argidoil Ellan Vannin*

**Guidance Note - Governance of  
Collective Investment Schemes**

**May 2017**

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## Glossary

CIS Act	means the Collective Investment Schemes Act 2008
FS Act	means the Financial Services Act 2008
the Authority	means the Isle of Man Financial Services Authority
Fund	means a collective investment scheme as defined under the CIS Act and includes funds established as bodies corporate, unit trusts or partnerships
Functionary	includes manager, administrator, trustee, fiduciary custodian, custodian, registrar, asset manager, investment adviser, promoter, auditor and any other parties fulfilling significant functions for the fund
Governance	means, in relation to funds, <i>“a framework for the organisation and operation of funds that seeks to ensure that funds are organised and operated efficiently and exclusively in the interests of fund investors, and not in the interests of fund insiders”</i> (source IOSCO)
Governing body	means a person or body of persons responsible for the general supervision of the affairs of a fund (and is as defined under the CIS Act).
Investor/ participant	used interchangeably; both terms mean a person taking part in the fund arrangements (whether by becoming or being owners of the property or any part of it or otherwise) by participating in or receiving profits or income arising from the acquisition, holding, management or disposal of the fund property or sums paid out of those profits or income
Independent member of the governing body/ independent member	used interchangeably; the circumstances of the member should be considered when assessing their independence. A member who holds an executive position with a functionary of the fund or affiliated company would not normally be considered independent. A member who holds such a position may be independent providing they are not responsible for any work on behalf of the fund and that any potential conflicts of interest are appropriately managed.
Member of the governing body/ member	means a person appointed to the governing body of a fund

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## A. Introduction

This document provides guidance on governance in relation to funds under the CIS Act, whether constituted as bodies corporate, unit trusts or as partnerships.

### General Matters

A governing body that carries out its responsibilities effectively will understand the legal and regulatory environment in which the fund operates.

The purpose of this guidance is to assist those who act, or wish to act, as a member of a governing body of a fund, by setting out certain matters to consider in relation to good practice in the governance of funds.

The Authority recognises that funds will adopt governance practices which are appropriate to the regulatory type, size, structure, investor profile, investment profile, strategy, and risk profile of the fund.

The Authority expects fund governing bodies to be proactive and aware of specific practices related to governance of funds. Governing bodies should consider this guidance and adopt the specific elements which are appropriate to the Fund. This guidance is issued under section 20(1) of the CIS Act and is based upon the fundamental fund principles of:

- (i) pooling resources to gain sufficient size of portfolio to support diversification and cost-efficient operation;
- (ii) professional portfolio management to execute an investment strategy; and,
- (iii) operating the fund for the benefit of its investors.

The guidance is designed to apply to Isle of Man domiciled funds under the CIS Act. Funds which are not domiciled in the Isle of Man are subject to the regulatory regime of their home jurisdiction, including governance and accounting requirements.

The Authority expects that governing bodies of relevant funds will self-assess those funds' governance arrangements against this guidance on a regular basis and record the governing body's approval of the assessment and governance arrangements. The Authority may ask to see such self-assessments as part of its normal supervisory processes.

The guidance brings together themes from several existing sources including:

- the CIS Act;
- funds regulations and other legislation issued under the CIS Act;
- companies legislation, particularly the Companies Acts 1931 and 2006;
- partnership legislation, particularly the Partnership Act 1909;
- the [guidance note on the responsibilities and duties of directors under the laws of the Isle of Man](#), which is addressed to all Isle of Man companies; and,
- Relevant Accounting Standards, including matters relating to the directors report and statutory accounts.

For the avoidance of doubt this guidance does not:

- suggest that a particular form of structure is more appropriate than another, either generally or in any particular case;
- provide an interpretation of the law; or,
- impose an expectation in relation to investment outcomes.

The governing body of a fund has ultimate responsibility for fund governance. Whilst members of the governing body are not always involved in the day-to-day management of the fund, they are responsible for ensuring that the fund's functionaries undertake their roles in a manner which complies with the applicable legislation.

The system of governance should be appropriate, effective and proportionate in relation to the nature, scale and complexity of a fund.

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## **B. How the Authority may use the Guidance**

The Authority may have regard to the degree to which governing bodies, and their members, have taken account of this and other relevant guidance when considering the effectiveness of a fund's governance. The guidance could be considered when:

### **Assessing Fitness and Propriety under the CIS Act**

The Authority may consider this guidance when assessing the fitness and propriety of individuals who wish to be appointed, or are already appointed, as members of the governing body of a fund under schedule 1 or schedule 2 to the CIS Act.

### **Assessing behaviour under the CIS Act**

The Authority may refer to this guidance when considering whether any behaviours, actions or failures to act should result in action against individual members of a governing body of any fund type under the CIS Act, including action under:

- section 11A - Persons unfit to be members of a governing body;
- section 11B - Prohibitions (from being a member of a governing body); and,
- section 11F - Warning Notices (to a member of a governing body).

The Authority may refer to this guidance when considering whether any behaviours, actions or failures to act for any fund type should result in the Authority:

- issuing a direction to the governing body of the fund under section 12 of the CIS Act; or
- the appointment of a person to advise the scheme on the proper conduct of its affairs, or to assume control of the affairs of the scheme under section 13 of the CIS Act.

The Authority may refer to this guidance when considering whether any behaviours, actions, or failures to act for any fund type should result in an application to Court under:

- section 15 for the removal of the governing body; or
- section 16 for the appointment of an inspector to the fund.

### **Holders of a Licence under the FS Act**

In relation to fund functionaries and professional officers licensed under section 7 of the FS Act, the Authority may consider this guidance when assessing the conduct of the licenceholder and relevant persons associated with the licenceholder.

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## C. Elements of Governance

There is no standard model of fund governance, and approaches will differ between governing bodies depending on the type of scheme. There may also be additional governance considerations. Therefore this guidance is not exhaustive and does not list every possible governance consideration. Instead it focuses on six core elements of governance:

1. Composition of the governing body;
2. Operation of, and balancing of power and responsibility within the governing body;
3. Decision-making. Management and control systems. Proper control by members where they delegate or contract for services;
4. Compliance with statutory obligations including regulatory requirements;
5. Management of risk; and
6. Operation of the fund in the interest of its participants.



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## 1. Composition of the Governing Body

### Key Concepts

The governing body is responsible for the sound and prudent management of the fund. Members have a fiduciary duty to ensure the fund is run in the interests of participants and are accountable to them. It may be appropriate for members' responsibilities to be documented.

### Composition of the Governing Body

The governing body should have the necessary combined knowledge, skills, experience and commitment to properly discharge its duties. When determining the governing body's composition the following matters should be considered:

- The diversity of knowledge, skills and experience across all members:
  - prior experience on fund governing bodies;
  - professional qualifications;
  - continuing professional development;
  - knowledge of the principles of good governance, current regulatory framework and issues and industry trends;
  - technical knowledge relating to the fund's investment strategy;
  - accounting and administration knowledge;
  - valuation methodologies appropriate to the fund's investment types;
  - sufficient assurance about/ knowledge of the promotion requirements in target jurisdictions to which the fund will be marketed, including any requirements applicable to target investor types; and
  - commercial and industry links, business connections, awareness in the relevant sector and experience dealing in the fund's asset classes.
- The balance between independent members and members affiliated to functionaries, sponsors or promoters of the fund. The governing body should meet any applicable regulatory requirements and as a minimum should include one appropriately qualified independent executive.
- The need to ensure that the governing body's performance is monitored, and membership is refreshed as appropriate.
- Practical considerations, including:
  - succession planning – continuity of skills and experience over time;
  - the establishment of the maximum term of office;
  - the rotation period for non-executive directors; and
  - service contracts, including any specifically allocated key accountabilities such as audit or risk.

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### Individual Members

In relation to individual members there should be ongoing consideration of how they contribute to the overall needs of the fund and the balance of the governing body. Considerations should include the competence, integrity and capacity of the individual to undertake the role, including the number of directorships held

#### Competence Considerations:

- professional experience;
- any relevant academic or professional qualifications held;
- appropriate understanding of the legal and regulatory obligations of a member of the governing body of the fund concerned;
- specialist knowledge relevant to the fund's investment objectives;
- previous experience in discharging duties for a fund of this nature (including consideration of any history of failed ventures, including funds, and the reasons for any such failures); and
- whether the individual's competence profile aligns with the needs of the governing body taking account of other members' competence.

#### Integrity Considerations:

- criminal convictions, in particular any offence involving dishonesty or breach of securities legislation, in any part of the world;
- unsatisfied court judgments;
- disqualification from acting as, or undertaking not to act as a company officer (even if the period of disqualification or undertaking has ended);
- regulatory sanctions against the individual or an entity to which they were appointed; and
- disqualification or suspension from a profession, or any sanction imposed by a professional body for breach of obligations as a member of that profession.

#### Capacity Considerations

- other commitments and the adequacy of the time available to fulfil their duties as a member of the governing body; and
- conflicts or potential conflicts of interest, including links to functionaries of the fund, and how such conflicts will be managed.

### Independent Members of the Governing Body

Governing bodies should include an appropriate number of independent members<sup>1</sup>. Any committees of the governing body should include independent members.

The remuneration of independent members should not include share options or performance related elements.

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<sup>1</sup> In certain circumstances, such as private scheme arrangements, it may not be possible or appropriate to appoint an independent member to the governing body of the scheme.

Independent members (and related party members) should be identified as such in the fund's annual reports. It may be appropriate to appoint independent members for specific periods of time in order to evaluate their continued independence.

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## 2. Operation of, and balancing power and responsibility within, the Governing Body

### Key Concepts

- All activities undertaken by or on behalf of the fund should be in the interests of investors in the fund.
- Each member of the governing body should make a meaningful contribution and add value to the strategy and oversight of the fund.
- Each member should be proactive, prepare for meetings and raise questions or seek reports on areas which concern them.
- Each member should make their own assessment of risk and risk mitigation and be satisfied that the risks perceived are appropriately managed through delegation, controls, procedures, etc. The Governing Body should collectively decide whether appropriate risk mitigation has been undertaken.
- Delegation without oversight is not effective – all delegated activities should have some level of effective upward reporting to the governing body on a regular basis.

### Conduct of the Governing Body

The governing body should meet with sufficient frequency (including at short notice in relation to unforeseen matters) to carry out the duties imposed on it by law and by the fund's constitutional documents. In determining sufficient frequency, the governing body should consider: the nature of the fund; its regulatory status; its investment restrictions, the frequency of its valuation and dealing, and its investor base. The minimum number of Board meetings and frequency should be defined within the Board's Terms of Reference. The modus operandi for meetings and standing agenda items should be agreed and documented. Meetings should be held in an appropriate and confidential environment.

Sufficient information should be made available to members about matters to be considered at each meeting. This should include a formal agenda and papers issued in advance to enable members to prepare for the meeting. If a member requires additional information, arrangements should be made for all relevant functionaries to attend the meeting or to provide the information in advance.

The chair of governing body meetings should conduct them so that all members can express their views openly and honestly and vote upon matters as they see fit.

Records of the governing body meetings provide primary evidence of how the governing body operates within its fund governance framework. The governing body should ensure adequate meeting minutes are maintained which record decisions taken with sufficient details of how and why decisions were reached, and, if appropriate, who has been given delegated authority to take any required action.

As the fund is likely to have outsourced administrative functions to functionaries, it may not be appropriate for the fund's governing body to have committees. If committees are put in

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place they should have clear responsibilities and accountabilities as well as Terms of Reference.

### **Appraisal of the Governing Body**

Governing bodies should consider undertaking periodic appraisals of their own performance and that of each individual member.

The appraisal could be used to recognise collective and individual strengths of the governing body and to address any weaknesses, including, where appropriate, proposing new members or seeking the resignation of members.

### **Fees and Expenses**

The governing body should ensure that all fees and expenses related to the fund (including those paid to members of the governing body and appointed functionaries, and any initial fees taken from subscription or redemption amounts) are reasonable, justifiable and transparent

The governing body should only approve fees and expenses that are consistent with the nature of the fund and interests of investors. The nature and level of fees should be reviewed by the governing body to ensure they remain appropriate and competitive. Relevant considerations include whether the fees:

- are appropriate to the size and nature of the fund, its scale and complexity;
- take account of the role and responsibilities of the governing body, members of the governing body, and functionaries;
- are inappropriate or undermine the interests of investors. Where the interests of investors in the fund diverge from the interests of any members of the governing body or appointed functionaries, the interests of investors should be given precedence;
- are structured in such a way that they create inappropriate misalignment of incentives and consequential conflicts of interest ;
- are structured to avoid the encouragement of improper or imprudent behaviour;
- are clearly disclosed and explained in the fund particulars and relevant details included in the fund's financial statements; and
- encourage excessive risk taking outside the parameters of the fund objectives or those based on short term gains

### **3. Decision-making. Management and Control Systems. Proper Control by Members where they Delegate or Contract for Services**

#### **Key Concepts**

Key or strategic decisions relating to a fund should be taken by its governing body and be in line with the appropriate legislative and regulatory framework and the fund's constitutional and offering documents. Such matters may include, but are not limited to consideration of:

- alterations to the fund's investment objectives, investment allocations (if any) or restrictions;
- alterations to benchmarks, watermarks and any other factors used as the basis of calculating incentive fees;
- the creation or termination of new sub-funds or classes of units;
- the approval of financial statements and the payment of any dividends;
- entering into contracts with functionaries;
- the appointment of any sub advisers by the fund's asset manager;
- reviewing progress over disputes, and litigation, between the fund and any party;
- suspensions and side pocketing;
- winding up; and,
- any other decisions of a strategic nature.

There is an ongoing need for the governing body to consider the necessity of updating offering and constitutional documents, agreements and regulatory and other notifications.

There should be a record maintained of powers, which powers are retained and which are delegated by the governing body and, in the case of delegations, to whom those powers are delegated.

#### **Oversight of the performance of functionaries and other service providers**

The governing body is responsible for oversight of services provided by functionaries and other service providers ("appointees"). It is recommended that the governing body:

- Receive and consider regular reports from appointees about the service (see section 4 below);
- Consider on a regular basis whether the appointees remain suitable to continue or should be replaced;
- Consider on a regular basis whether the terms of appointment remain suitable or should be renegotiated;
- Monitor the investment performance of the fund against agreed benchmarks and where appropriate challenge and obtain explanations from the investment manager about any significant variations;
- Review with the investment manager, at intervals appropriate to the investment and at least annually, whether the investment objectives and restrictions and investment allocations of the fund remain appropriate. Where necessary update the investment objectives and restrictions and matters related to investment allocations; and
- Consider whether the fund's control systems are appropriate and effective.

**The role of External Auditor**

For all Isle of Man funds [and overseas funds] there is a provision within the CIS Act which permits auditors to report matters to the Authority. Legislation requires that, for Isle of Man Funds (other than exempt schemes), external auditors report to the Authority on any matters of material significance.

In accordance with auditing standards, auditors are also required to communicate certain matters to the governing body. It is considered good practice for auditors to present their audit plan to the governing body prior to its engagement, and present their audit findings to the governing body prior to the approval of the financial statements.

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## 4. Compliance with statutory obligations including regulatory requirements

### Key Concepts

A governing body should ensure that the fund complies with all statutory obligations, including obligations under the CIS Act and relevant secondary legislation.

### Functionaries

When appointing a functionary to the fund the governing body is responsible for ensuring that functionary is suitable and meets any statutory qualifications and criteria for appointment and that the terms of appointment are and remain appropriate. This applies both initially and on an ongoing basis. The governing body should retain evidence of its due diligence and reviews in this regard.

It is recommended that the governing body regularly receives and reviews appropriate reports from appointed functionaries in relation to:

- The performance of services and whether they were in accordance with the applicable agreement;
- Any identified issues concerning the fund's adherence to its constitutional and offering documents, the CIS Act and relevant secondary legislation;
- The compliance monitoring arrangements of the fund;
- The compliance standards of its service providers in relation to the provision by the functionary of services to the fund; and
- The adherence of the fund and the functionaries to those standards.

Where issues have been identified, or are foreseen, the governing body should engage with appointees and establish steps to be taken to remediate and prevent a recurrence.

The governing body should consider requesting confirmation from each functionary, at least annually, that the compliance standards of the fund, and the functionaries so far as they relate to the fund, conform to the current requirements.

Where appointed a trustee/ fiduciary custodian has responsibilities for oversight of the fund and its functionaries' compliance with the applicable legislation. The governing body should consider whether the trustee/ fiduciary custodian has met its obligations in this regard.

### Fund Documentation

Compliance with any document constituting the fund, and the offering document in respect of the fund, is a requirement of the CIS Act.



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The governing body has ultimate responsibility for ensuring that the offering document and the documents constituting the fund are up to date in respect of material matters and comply with the legislative and regulatory requirements<sup>2</sup>.

### **Regulatory and Statutory Notifications**

The governing body is ultimately responsible for a fund's regulatory and statutory notifications. Under the CIS Act and relevant legislation, there are a number of statutory notification requirements for the governing body. Whilst it is common practice for the actual submission of notifications to be made by the manager or administrator of the fund, the governing body ultimately remains responsible for such notifications.

### **Accounts and Valuations**

The governing body of a fund should ensure arrangements are in place to maintain proper accounting records and that annual financial statements are prepared and audited in compliance with applicable Isle of Man legislation and any relevant accounting standards.

The governing body is ultimately responsible for putting in place appropriate arrangements for the valuation of the fund's assets and therefore the governing body should consider accounting and valuation policies periodically, and in all circumstances where market conditions affecting those assets have materially changed.

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<sup>2</sup> Where a fund is not open to subscription it may be permissible for the offering document to not be updated providing all material matters have been notified to investors.

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## 5. Management of Risk

### Key Concepts

**The governing body should ensure that documented policies and procedures are in place for identifying, evaluating and managing its risks. These should be appropriate to the operation of the fund and consistent with the attitude to risks disclosed in the fund's offering document. There should be a clear process for monitoring and managing risk, and where appropriate a risk register should be maintained and presented to the governing body at least annually.**

The governing body should satisfy itself that the fund's objectives are reasonably capable of being achieved taking account of its legal structure (including consideration of underlying entities), governance arrangements and liquidity and funding requirements at outset and on a continuing basis.

The governing body should satisfy itself that the fund has appropriate mechanisms to identify and address the risks that are relevant to the fund and its investors and that there are suitable arrangements to mitigate and manage such risks.

### Risk Identification and Management

Due to the variety of funds and investment objectives, it is not possible, or appropriate, to set out an all-encompassing list of potential risks. Common risks which could affect funds include:

- Risks arising from inadequate identification and management of conflicts of interest and potential conflicts of interest including those relating to the fund, related parties and entities and its functionaries;
- Risks associated with the appointed functionaries and other persons associated with the fund;
- Risks connected to a failure to ensure that the fund has appropriate ownership and control of its assets;
- Financial control risks, including failure to actively understand, monitor and manage liquidity requirements and cash flow;
- Risks of significant non-delivery, unforeseen insolvency or cessation of the operations of a service provider or counterparty;
- Investment management risks including the use of derivatives, incorrect security prices, stock reconciliation, failed trades, market timing, late trading;
- Risks relating to the use of estimated/forecasted asset valuations, 'straight line'/discounted future valuations or other models and methodologies, where the market price of assets cannot be determined until a future date;
- Risks arising from no or inadequate insurance cover held by the fund or any of its service providers; and
- Regulatory compliance and legal risks (Isle of Man and elsewhere; for example, marketing or promotion related legislation in target jurisdictions).

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In addition the governing body along with the other functionaries should consider risks inherent to the type of assets of the fund and its manner of operation.

The governing body of a fund retains ownership of risk and should satisfy itself that all material risks are being appropriately managed by the relevant functionary to the fund. The fund's governing body should receive regular risk management reports from the functionaries of the fund, and should consider engaging other suitable advisers where appropriate, for example, to verify any asset valuation models and methodologies being used.

### **Stress/ Scenario Testing**

Stress/ scenario tests can be a useful risk management and decision making tool helping to identify, quantify and manage risks that may adversely affect a fund or aspects of a fund.

Such tests can assist in highlighting potential issues concerning liquidity, solvency and funding, cash management, and investment and valuation policies. They can be used to establish whether at outset, the fund objective has a reasonable prospect of being realised and on an ongoing basis whether, in the light of current circumstances and experiences the funds objective remains valid and achievable.

Stress/ scenario testing can assess how a fund will fare when the assumptions about rates of subscriptions and redemptions or asset growth are not achieved. This can assist in better planning for such occurrences.

Governing bodies should consider commissioning or undertaking stress/ scenario tests at outset and on a periodic basis to assess how a fund will respond to hypothetical extreme or unfavourable, yet also plausible, economic/financial positions. The Authority may consider the results of such stress tests when undertaking its regulatory considerations.

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## 6. Operation of the fund in the interest of its participants

### Key Concepts

The members of the governing body should ensure that the fund operates in the interest of its participants.

The members of a governing body should consider the interests of the participants as a whole, specific classes of participants and where relevant particular minority interests, before making any decision in relation to the fund, its activities or its assets, including whether or not to exercise a discretion. It is important that the governing body can demonstrate the rationale for its decisions.

### Fair Exercise of Discretion

Governing bodies of funds must ensure that they exercise their discretion fairly. Any areas of discretion should be clearly set out in the offering documents of the fund.

Areas of discretion may include, but are not limited to:

- accepting subscriptions and redemptions after stipulated cut-off times;
- accepting subscription amounts or permitting continuing investments that are less than the stated minimum;
- waiver of a minimum lock-up period; and,
- waiver of early redemption penalties.

Many waivers are sought at short notice, therefore it may be appropriate for the governing body to delegate the authority to agree a waiver. If this is the case a report should be given to the governing body of any waivers granted and the rationale for them.

### Conflicts of Interest (including related parties)

The governing body should ensure that a procedure is in place to identify and maintain an appropriate central record of all conflicts of interest and potential conflicts of interest, which also sets out how these are monitored and managed. Where a conflict arises, the interests of the investors should be paramount. Where a conflict of interest arises which had not already been disclosed, the scheme particulars should be updated accordingly.

When considering the appointment of any functionary or member of the governing body, the governing body should document its consideration of potential and actual conflicts of interest.

There should be a documented policy and procedures for dealing with conflicts of interest (this will normally be maintained by the appointed manager or administrator); compliance with which should be reviewed by the governing body at least annually.

Where a member believes they may have a conflict in relation to a matter to be considered by the governing body, they should disclose the conflict to the governing body before the

issue is considered. It may be appropriate for them to be excluded from the part of any meeting that considers the matter and from receiving information about the matter.

### **Investor Relations**

The governing body should ensure that procedures are in place to allow effective communication between the investors and the governing body.

The governing body should ensure adequate information is provided to investors to give a fair, balanced and understandable assessment of the fund's position. Communication between the governing body and investors should include corporate governance and strategy.

The fund's Annual General Meeting ("AGM") is an important method of communication with investors. The AGM should have a separate resolution for each issue, including a resolution for the Annual Report and Accounts. The members of the governing body should attend the AGM.

The annual report is another important method of communication with investors, and it is important that this and the annual accounts are provided to investors in a timely manner.

### **Disclosure and Transparency**

The governing body of a fund is required to ensure timely and balanced disclosure to investors and regulators of all material matters concerning the fund. The governing body has a duty to ensure that information is made available as required by applicable rules, regulations, and codes. In respect of constitutional documents, offering documents and marketing materials, the governing body along with the other functionaries should ensure that the disclosure of material matters is clear, targeted to the appropriate type of investor, and does not utilise unexplained technical jargon. This extends to written and electronic communication methods.

Investors and potential investors use published material to make investment decisions. Transparent disclosure can help improve investors' understanding of a fund. The governing body should promulgate:

- the fund's vision and values;
- the fund's strategy and its associated risks including, but not limited to, risks related to:-
  - investment types;
  - valuation methodologies;
  - technology and innovation;
  - jurisdiction of assets or operations;
  - leverage and borrowing;
  - long-term nature of investments and real property;
  - use of Special Purpose Vehicles to hold fund property;

- 
- a review of the fund's activities and performance and a forward looking assessment of the business environment it operates in;
  - a statement of how the governing body operates, including a high level statement of delegated duties;
  - a list of the members and, if necessary, the reasons specific members are considered to be independent; and
  - a summary of the fund's activities.

### **Suspension and Problem Situations**

When unforeseen events occur which may directly affect the fund, the governing body should seek advice and take timely action to ensure that the effect of the events on the normal operation of the fund is minimised whilst, at the same time, the interests of the investors as a whole are safeguarded and that all investors are treated fairly.

When cash flow problems arise, it is important that timely consideration is given to the appropriateness of suspending the fund.

The governing body should seek advice on matters relating to solvency etc. The governing body should be cognisant of its duties and responsibilities to the fund's creditors and ensure that any action it takes is in line with these duties and responsibilities.

Members of governing bodies are referred to the Authority's Guidance Note (["Funds – Valuation and Fees Charging"](#)) which provides an example of circumstances where it is desirable to review the appropriateness of ongoing fees.

In the case of suspension, or other problem situations, the governing body must ensure that the fund continues to meet all applicable statutory and regulatory requirements. The governing body must ensure that any action it takes is in the best interests of investors and the investors are kept up to date with developments.

## Appendix 1 – Useful website links and further reading

### Standard-setting and Professional Bodies

ACCA: Association of Chartered Certified Accountants	<a href="http://www.acca.co.uk">www.acca.co.uk</a>
FCA: Financial Conduct Authority	<a href="http://www.fca.org.uk">www.fca.org.uk</a>
FRC: Financial Reporting Council	<a href="http://www.frc.org.uk">www.frc.org.uk</a>
<i>Combined Code - Derived from the Cadbury and Greenbury Reports</i>	
ICSA: Institute of Chartered Secretaries and Administrators	<a href="http://www.icsa.org.uk">www.icsa.org.uk</a>
ICAEW: Institute of Chartered Accountants in England and Wales	<a href="http://www.icaew.com">www.icaew.com</a>
IoD: Institute of Directors	<a href="http://www.iod.com">www.iod.com</a>
IOSCO	<a href="http://www.iosco.org">www.iosco.org</a>
OECD: Organisation for Economic Co-operation & Development	<a href="http://www.oecd.org">www.oecd.org</a>

### Reports on Corporate Governance

AIMA	<a href="http://www.aima.org">www.aima.org</a>
IOSCO	<a href="http://www.iosco.org">www.iosco.org</a>
European Confederation of Directors' Associations	<a href="http://www.ecoda.org">www.ecoda.org</a>
The European Corporate Governance Institute has available on its site an <a href="#">Index of Codes page</a> which includes the main reports on corporate governance published worldwide (listed by country). The UK list includes amongst other entries:	<a href="http://www.ecgi.org">www.ecgi.org</a>

- Cadbury (1993 – financial aspects of corporate governance)
- Greenbury (1995 - remuneration)
- Hampel (1998 – review of the Cadbury code)
- Higgs (2003 – effectiveness of NEDs)

Other than in the case of a fund which is listed on a recognised stock exchange, the recommendations in the reports above may be inapplicable or inappropriately burdensome to funds; the members of the governing bodies of such funds should have regard and implement such principles as are necessary or appropriate in the circumstances.

Members of the governing bodies of funds who are interested in researching corporate governance further, might wish to read the [Corporate Governance Guidance and Principles for Unlisted Companies in Europe](#) published in March 2010 by the European Confederation of Directors' Associations "ECODA". ECODA is a pan-European body to which the Institute of Directors is affiliated. The report concentrates on how good corporate governance can contribute to the success of small and medium enterprises.

### Other relevant Guidance issued by the Authority

- Funds/ Investment Business Sector Specific AML/CFT Guidance Notes
- Fund take on guidance [under development]
- [Funds – Valuation and Fees Charging](#)

- [Training and Competence Policy](#)

#### Other relevant Isle of Man guidance

- [Guidance note on the responsibilities and duties of directors under the laws of the Isle of Man](#)

*Status of Guidance: The Isle of Man Financial Services Authority issues guidance for various purposes, including to illustrate good practice, to assist in complying with legislation and to provide examples or illustrations. Guidance is, by its nature, not law, however it is persuasive. Where a person follows guidance this would tend to indicate compliance with the legislative provisions, and vice versa. Each case will be considered on its own merits however so that following guidance will not, in itself, be conclusive.*