

Investment Funds

Guidance on duties of independent directors of investment funds

Guidance on duties of independent directors of investment funds : the Weaving judgment

Weaving Macro Fixed Income Fund Limited (in liquidation) v Stefan Peterson and Hans Ekstrom. (Grand Court of the Cayman Islands) August 2011

Summary

This case is particularly interesting for the judge's comments, obiter, about the minimum standards of attention and diligence that a court should be able to expect from fund directors.

The directors of the collapsed Weaving Macro Fixed Income Fund Limited (the "Fund") were found to have failed to perform their duties of supervision. It was held that, had such duties been correctly carried out, the circumstances which led to the collapse of the Fund might have been avoided. The Grand Court made an award of damages of US\$111 million representing the minimum amount of the Fund's loss occasioned by irrecoverable redemption payments made by the Fund during the extended period of its trading on the basis of falsely inflated NAV calculations.

Guidelines for fund directors

The judgment gives very specific examples of the ways in which the directors were held to have failed to fulfil their duties as directors of the Fund and sets out important guidelines for fund directors, including:

- proper preparation for board meetings - circulating an agenda of matters of be discussed which is compiled after consultation with service providers and the directors;
- analysing, or ensuring that someone with sufficient expertise of a fund's investment criteria and restrictions analyses, the fund's investments and performance - all investment fund directors should understand audit procedures and be able to read and interpret a balance sheet. Directors are not expected to have the technical expertise to monitor sophisticated investment strategies but should be able to understand and interpret financial results;
- requesting regular updates from any appointed investment manager or administrator in order to assess the fund's performance and financial condition and to satisfy themselves that the investment manager is operating within the scope of its remit: - directors should not just accept an investment manager's recommendations and should monitor the investment manager on an ongoing basis. Delegation to service providers should not constitute a dereliction of responsibility; and
- properly understanding the scope of work to be undertaken by any investment manager or other service provider in relation to financial reporting and the determination of the NAV – directors must satisfy themselves that the terms of such service providers' contracts, especially those that delegate the determination of the Fund's NAV, set out remuneration and limit service providers' liability, are reasonable and consistent with industry standards. Directors' duties are not met just by appointing reputable and experienced service providers, the directors should still engage with them on an ongoing basis.

Facts

The Fund collapsed in 2009, it having come to light that a series of interest rate swap transactions which had been presented as profitable - and to which the investment manager had heavily committed the Fund - were in fact a fictitious scheme designed to inflate the stated NAV and disguise the losses the Fund was actually bearing at the time. Day-to-day running of the Fund was delegated to the administrator and the investment manager and the principal of the latter was related to two of the directors (one was his brother, the other his elderly stepfather).

The Fund's liquidator made a claim against both of the directors claiming that they had failed to discharge their duty to exercise skill, care and diligence in the management of the Fund's affairs; in turn, the directors sought to rely on the standard exculpatory protection in the Fund's articles, indemnifying directors other than for loss arising out of wilful neglect or default.

Judgment

The Grand Court applied a two limb test of: (i) knowing or intentional breach of duty; or (ii) breach of duty by reckless omission. This case was deemed to fall under limb (i) and the Court concluded that the directors had not really attempted to perform their duties as directors, despite being aware of their obligations to do so, and that such default must be wilful. It was noted that the directors had made no attempt once the crisis hit to take steps to remedy the situation, such inactivity constituting wilful default.

The directors are appealing this judgment and it is worth noting that the Serious Fraud Office has dropped its investigation into the activities of the investment manager.

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