

An aerial photograph showing a rugged, dark rock coastline. The water is a turbulent, golden-brown color, suggesting a strong current or rapids. The rocks are jagged and layered, with some white mineral deposits visible. The overall scene is dramatic and natural.

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Independent directors: a value proposition

Laura Knox, of Harbour Financial Services, considers the merits of independent directors

Bermuda continues to prioritise smart regulatory compliance measures which allow market participants to compete internationally, while attracting new business to our jurisdiction. Engaging independent directors can be a value proposition in the start-up process. Skilled, professional directors are able to reduce overall costs, mitigate risk, and provide valuable industry experience and insight. Here's how:

First duty is to the company

Using a hedge fund example, an independent director's first duty is to the fund – not to the manager. A non-executive director is able to ask challenging questions and ensure that an investment manager is keeping the company's interests at the forefront. An independent director can contribute constructive ideas like a reduction in management fees when appropriate or suggesting consultation with a specialised service provider, when an executive director might hesitate. In the worst case, and detailed more specifically below, an experienced independent director may be more likely to take steps to move a company into liquidation to ensure that remaining interests are maximised and distributed equitably.

Don't go with the flow

A recent working paper, "Powerful Independent Directors" © Kathy Fogel, Suffolk University, Liping Ma, University of Texas at Dallas, and Randall Morck, University of Alberta,



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concluded that "shareholder valuations are economically and statistically positively correlated with independent directors' power....We suggest that more powerful independent directors constitute a more informed and credible alternative voice of dissent against a wayward CEO, and can thus more reliably interrupt "groupthink" in the full board or relevant board committee". Translation? An independent director can have a more objective view on operations, and not so close of a relationship with other board members or investors, meaning the independent director may be more capable of properly filling her role without emotions, relationships, or personal financial interests blurring judgement.

Getting the most bang for your board meeting buck

Regular board meetings might cynically be viewed as an expensive "rubber stamp" without meaningful deliberations. Independent directors do have the authority and expertise to make board meetings a worthwhile effort. Are all relevant service providers invited and represented? Has meeting research been done ahead of time so stakeholders can hold robust, efficient discussions on critical matters, implement

decisions, and positively impact a company's results and future business path? For a fund, inviting all directors, the investment manager, administrator, auditor and legal counsel, when needed, to be part of the same conversation is invaluable in ensuring there is transparency amongst the service providers and that pertinent issues are raised and appropriately addressed. These board meetings establish communication channels which benefit all stakeholders.

Regulatory and tech hot topics

Entities organised in leading financial jurisdictions are obligated to consider regulatory frameworks presented by local governments, the IRS, and Common Reporting Standards (CRS) which are locally administered but are designed to follow the mandate of the Organisation of Economic Co-operation and Development (OECD). Bermuda is also impacted by the EU's General Data Protection Regulation (GDPR) and the Personal Information Protection Act (PIPA). A knowledgeable independent director can add value by sharing his expertise as to what procedures, information, storage practices, disclosures, or new service providers may be required for consideration in order to meet legal and regulatory requirements.

On the innovation side, it is useful to have a director on board who is conversant in tech themes which are currently being considered by many services firms and by the banking industry. Blockchain, cryptocurrency,

and robo-advisors are terms heard every day and a board member with an aptitude for tech themes may present useful insight into application of financial technologies.

When the going gets tough

Because independent directors typically sit on a breadth of corporate boards, they bring invaluable perspective drawn from their experience guiding funds through complete life cycles. This insight can be extremely valuable in the event that difficult or unexpected circumstances, like liquidity crunches or a high level of redemptions, arise. The directors will be familiar with all of the tools available to the fund (including gating, suspension, side pockets, in specie distribution) and what considerations are required in deciding if and how to deploy them. The guidance from these directors can be the difference between preservation of a fund's value and a lengthy, litigious end resulting in total losses.

Third-party views

Potential investors want to be confident an objective perspective is in place if, for example, non-arms-length transactions are permitted and being considered by a company. Independent directors are well-positioned to provide this perspective and can strengthen a company's search for new capital sources. An independent director adds a level of oversight which is positively considered by external auditors and by regulatory bodies.

Networking opportunities

In a blog post by Norbert Schwarz, MBA, delegate to two White House Conferences on small business, and having served on the economic advisory committee of the Kansas City Federal Reserve Bank, Schwarz notes, "In my experience, perhaps the most discernible benefits [of independent directors] come from individuals who can offer a network of contacts that may directly affect the company's revenues or profits. In one such instance, an advisory director has not only provided introductions to potentially valuable customers, but he has also offered professional advice on development of new products and markets that



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should prove very profitable to the company in the future." When company expansion is being contemplated or capital support for a new investment strategy is being considered, it may prove useful to have a director with a breadth of industry relationships onboard.

Complement board skill set

A theme of this article has been the value added to a board by objective views from an independent director. This value is multiplied when an independent director possesses a skill set which differs from existing

board members. Many small, mid-size, or closely held companies are governed by board members with similar backgrounds, potentially leading to a narrow consideration of issues. For example, an entity organised in an offshore financial centre can benefit from a local corporate lawyer providing a greater depth of insight in situations of jurisdictional reporting. An independent director with a strong accounting background can add value not just for routine audit procedures, but particularly valuable insight when complex financial issues, such as restatements, are encountered. This expertise may otherwise need to be obtained via a separate consulting arrangement which investors would prefer to avoid.

With these considerations in mind, it is clear that an independent director adds tangible value which is indispensable in a company's pursuit for regulatory compliance and for healthy growth. **HFM**



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