Thoughts on Weavering

The Weavering judgement should be resounding loud and strong in the Hedge Fund land and more specifically in the world of Non Executive Directors ("NEDs") on the board of those funds and asset management companies: this judgment reminds all parties – in a rather expensive way – that funds and asset managers are corporate; as such they have a board responsible for the supervision of all activities, as well as for setting business strategy and direction. In this instance Board supervision was found wanting.

The details of the case are better expressed in the judgement itself but let's sum up the key events: a macro fund went bankrupt after having inflated its assets via a number of large OTC transactions with a bogus, created, counterparty. These trades caused a number of breaches in the various limits that were communicated in marketing and offering documents but those breaches failed to be noticed [in due course?] and were not then acted upon until the situation became untenable.

In general terms, Justice Jones begins by placing the role of a Hedge Fund NED in the context of the law, reminding the reader that *"Directors.... acquire and maintain a sufficient knowledge and understanding of the company's business"* , and that *"delegation does not absolve a Director from the duty to supervise the discharge of the delegated functions."*

Justice Jones in his judgement then goes further into detail, stipulating that *"non executive directors are expected to satisfy themselves (on a continuous basis) that the investment manager's strategy is fairly described in the offering document and that the investment manager is complying with whatever investment criteria and restrictions have been adopted by the fund".*

Interestingly he later looks into the compensation side of an NED position and makes the point that *"the compensation must be commensurate to the responsibilities and the time and attention which*

must be devoted to discharging their duties". In this particular instance compensation was nil, which Justice Jones interpreted as *"... they never intended to perform their duties, or at least in a serious way, and were merely lending their names to the Macro Fund as a favour*...".

He restates that it is *"the duty of directors to exercise independent judgement in what they consider to be the best interests of the company which, in this context, means its potential investors...".* this mean not only that they should be ready to oppose decisions taken by the manager but if needs be to "...*stand back, review the various contracts and satisfy themselves that each one is appropriate and consistent with industry standards and taken together, they do create an overall structure which will ensure a proper division of responsibilities amongst service providers."*

There is an interesting parallel between this judgement and recent and announced pieces of regulation; in Europe namely UCITS 3 and AIFMD. It is striking how those two major directives emphasize on the corporate governance of funds and asset managers and more specifically on the responsibility of senior management in the oversight of the risk monitoring process, in making sure the fund does "what it says on the tin" and that reporting contains all the information necessary for management and the Board to take any necessary decisions. It seems clear that it is not acceptable anymore to rely on "an implied" risk management process, based on the combined length of experience of the management teams, but that it is necessary to put in place a process and the appropriate infrastructure and resources to measure, monitor and report risks as relevant to the strategies and markets the fund is involved in. And ultimately, placed in the context of corporate law, the responsibility lays on the Board to make sure this happens and that they are given the information they need to make informed decisions.

The bill for not complying was pretty stiff in the case of Weavering: each director got fined $110 million, a sharp reminder that NEDs of Hedge Funds, and UCITS funds for that matter, run the risk at their peril if they fail to ensure adequate standards of corporate governance, risk reporting processes and effective, adequate reporting. As the markets remain difficult, it is to be expected that angry investors will, in case of disappointing performance, look into all means to recoup their losses. Should the Risk Management governance prove inadequate, they will find the Regulators and the Courts on their side. NEDs should pay attention.