

Fund Management and Governance

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Governance problems of funds

- Industry successful in lobbying out of general corporate governance arrangements
- Principal – Agent at heart of governance problems
- Agent with control, Principal has economic risk
- Funds additional problems
- Principals are by definition not interested in monitoring, not willing to exercise control: pinnacle of apathy
- Principals outsource investment decisions
- Granting more control rights to Principals unlikely to be effective

Governance problems of funds

- Agent is loaded with conflict of interest
- Market timing, late trading
- Related party transactions
 - fee generation by intra group brokers and traders, churning
 - bad IPO dumped into managed funds
- Multiple funds
 - shifting costs and benefits to attract investors to new funds
- Fee structure
 - inappropriate levels and structures of fees
- Third party contracts
 - hard commissions, soft commissions

Industry ignores integrity

- Integrity is not just plain fraud
- Integrity is honouring your word and directly explaining to those affected if you no longer will or can and clean up the mess
- Fund managers WORD (as perceived by investors) is to only act in interest of fund and investors

Addressing problems

- More transparency
- Cost structure (TER)
- Related parties
- Helps, but just a bit when investors suffer from apathy
- More rules on conduct
- cf art. 14 Revised UCITS Directive
 - Member State rules of conduct
 - Commission implementing measures (CESR to advise

The problem with more rules

- More rules replace responsibility for behaviour with responsibility for compliance
- Erosion of real responsibility
- Moral wisdom dwindles
- No room to learn from mistakes

Underlying problem: no trustee

- No trustee function in fund system
- Proposal in the Netherlands:
 - every management company required to have board with majority of independent non-executives/supervisory directors
- Board to report on acting in interest of fund and investors
- Alternatives for trustee function: depository (nowhere real), auditor (limited insight), external regulator (limited insight)

- Restore explicit trustee function and reporting
- Regulatory scrutiny on level of integrity in terms of honouring your word: behavioural based