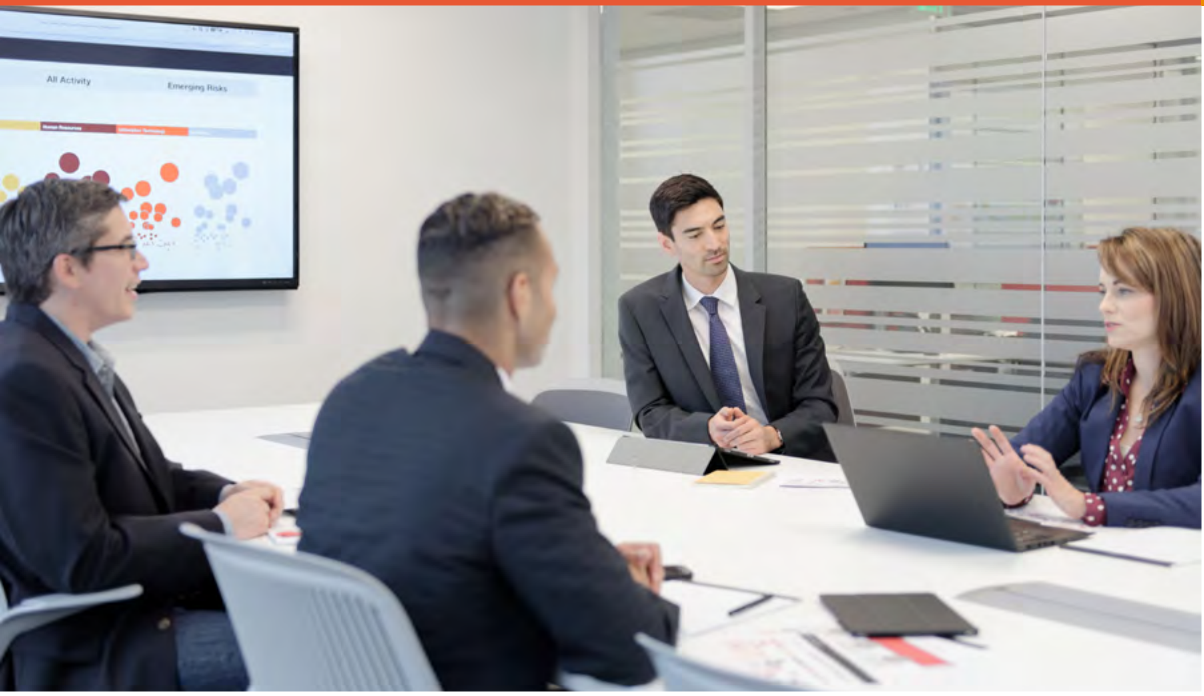
Luxembourg Fund Governance Survey 2018

January 2019



The voice of corporate governance in Luxembourg

Table of contents

Foreword

Michael Delano
ILA Fund Committee Chairman
PwC Luxembourg Partner

On behalf of PwC and the Institut Luxembourgeois des Administrateurs (ILA) it gives me great pleasure to introduce our latest edition of the Luxembourg Fund Governance Survey.

This is our 9th edition of the survey where we were fortunate enough to gather insights from close to 100 investment fund and management company boards covering both retail and alternative products. The level of participation to this year's survey clearly shows that the industry remains focused on governance.

The asset management industry has continued to be faced with regulatory change since the global financial crisis in 2008. The number of regulations at both national and international levels have increased significantly, many of which have a direct impact on fund and management company boards. You will see in the following pages that boards have risen to the challenge to keep on top of the ever-changing regulatory environment while also maintaining a keen focus on their main objective of investor protection.

In addition to early adoption of regulation, the Luxembourg asset management industry is very active in providing practical guidance to board members as evidenced by the numerous publications, events and courses developed by both ILA and ALFI several of which are referenced in the results to the survey.

Our aim in preparing this survey is to provide boards with insights into current good governance practices and to further strengthen the overall governance framework of the Luxembourg fund industry.

In conclusion, I would like to sincerely thank all of the respondents for the time they took to participate in the survey, the members of the ILA Fund Committee who designed the survey and analysed the results and last but not least, my colleagues from the PwC Luxembourg's Market Research Center who were instrumental in putting this together.

I trust you will find the contents useful.

Mike Delano
ILA Fund Committee Chairman
PwC Luxembourg Partner

Introduction

About the 2018 survey

At a time when governance models have never been under more scrutiny, this ninth edition of our Luxembourg Fund Governance Survey continues to delve into the various approaches to governance taken by the Luxembourg fund industry. Since 2010, regulators and industry associations – at both national and international levels – have considerably increased the number of rules and guidelines applying directly and indirectly to boards of funds and management companies.

Conducted every two years, the survey aims to gather insights from boards of Luxembourg-based investment funds and management companies in order to obtain a comprehensive assessment of governance practices within the Luxembourg fund industry.

The current edition of the survey was completed over a period of five months, between June and November 2018. It combines answers from 96 respondents who serve in the capacity of board chairpersons and directors, or as conducting officers or company secretaries supporting the boards, all with first-hand knowledge of the governance practices at their management companies and funds.

Highlights and key trends

This year's survey reveals that governance practices continue to evolve across the Luxembourg fund industry. Furthermore, practices within alternative investment entities has greatly matured since the introduction of the AIFM Directive four years ago and the resultant creation of the AIFM and AIF status.

New and revised regulations, such as GDPR, the 4th AML Directive, MiFID II and PRIPS, have been implemented since the last survey. These regulations have influenced not only fund management but also governance.

As the new CSSF Circular 18/698 was only released in August 2018, its effects will only be seen in the next edition of our survey. The main goal of the circular is to create convergence of practices across investment fund management entities by setting out the same requirements for both UCITS ManCos and AIFMs. Among other topics, it puts a special focus on delegates and the oversight of these delegates, defines thresholds on the number and time capacity of mandates directors can accept, aligns risk management requirements between UCITS and AIFs, and defines scenarios and rules with regards to AML/CTF.

Reflecting market response to both growing regulatory pressures, as well as increased calls for transparency from investors, responses show improvements across most areas. Trends noted included increased appointment of independent directors and chairs, as well as improved gender diversity, disclosure of information regarding the board (including on remuneration), and increased use of sub-committees, board performance reviews, and uptake of the ILA Certified Director Program.

General market information

Luxembourg is the world's second largest fund centre and Europe's largest with more than EUR 4.2 trillion in assets under management (AuM). Luxembourg has been at the forefront of the UCITS fund industry for many years and is the leading cross-border investment fund centre in the world, with Luxembourg-based funds offered in more than 80 countries.

Since the introduction of AIFMD, Luxembourg has also become a leading centre for alternative asset classes, including hedge funds, private equity, real estate, private debt and infrastructure. Alternative fund managers currently manage more than EUR 710 billion in alternative assets.

Our sample

This year's survey draws from a sample of 96 participants who answered on behalf of either the board of a Manco or the board of a fund. Their answers fall into the following five categories:

- Super ManCos[1]
- UCITS ManCos[2]
- AIF ManCos[3] (collectively "**ManCos**")
- UCITS[4]
- AIFs[5] (collectively "**funds**").

As in previous years, our survey brings together the viewpoints of a substantial section of Luxembourg's UCITS industry. Although the actual respondents are not always the same, this year our respondents account for approximately 50% of Luxembourg-based UCITS AuM and 26% of AIF AuM.

In this year's survey, we drew information from fund promoters originating from across the globe, from 20 different nations and three continents (North America, Europe, and Asia). Promoters from the UK, the US and Switzerland were well represented. It is important to point out, however, that the respondents differ significantly from our 2016 survey with roughly only a third being similar. You will also note when reading this that we refer, at various points, to the 2012 and 2014 as well as the 2016 editions of the survey. We included references to the previous surveys to better identify trends.

The number of management companies operating on a cross-border basis has increased since our 2016 survey, with the number of funds having appointed cross-border ManCos/AIFMs also having increased. Cross-border passporting – created by the European legal framework – is clearly valued by the market.

Luxembourg funds most often appoint a management company located in Luxembourg (63%), with the UK the second location of choice (16%). With the Brexit date fast approaching however, a majority of UCITS funds intend to appoint a Manco in an EU country other than the UK[6] in the coming 12 months, while many AIFs do not yet appear to have announced their contingency plans.

Alternative funds and AIFMs captured in this year's survey span a diverse mix of assets - including funds of funds, fixed income, equity, real estate, private equity, hedge fund, private debt/ loans and infrastructure – with none dominating the sample.

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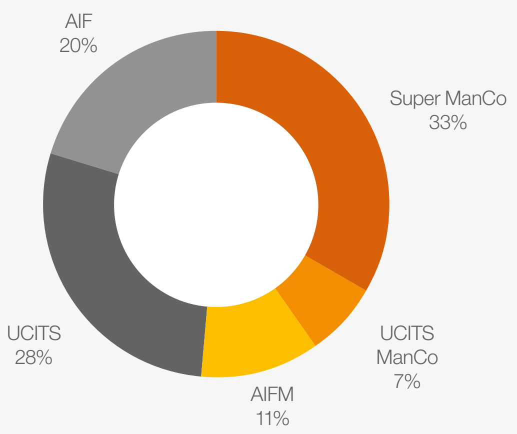
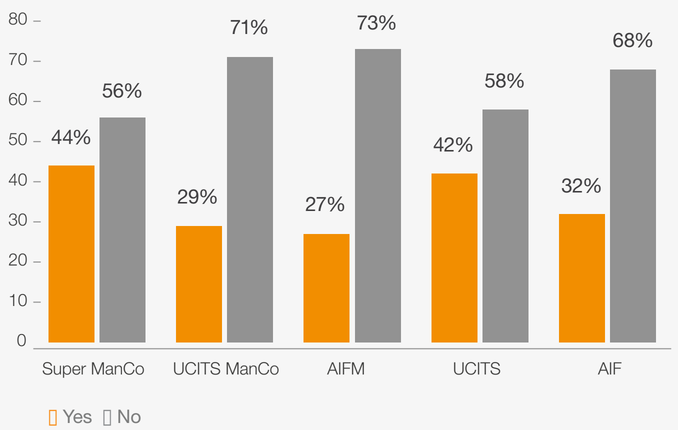
1. Large management companies overseeing both UCITS and alternative funds; regulated under both regimes described below.
2. Management companies overseeing UCITS funds only; regulated under Chapter 15 of the Law of 17 December 2010.
3. Management companies overseeing alternative funds only; regulated under Chapter 16 of the Law of 17 December 2010 or under Chapter 2 of the Law of 12 July 2013 transposing the AIF Directive into Luxembourg law.
4. UCITS funds; regulated under the Law of 17 December 2010 transposing Directive 2009/65/ EC relating to Undertakings for Collective Investment in Transferable Securities ("UCITS Directive").
5. Alternative Investment Funds; those funds that are not covered by the UCITS Directives.
6. At the time of print, the UK was an EU Member country.

Figure 1: Sample composition



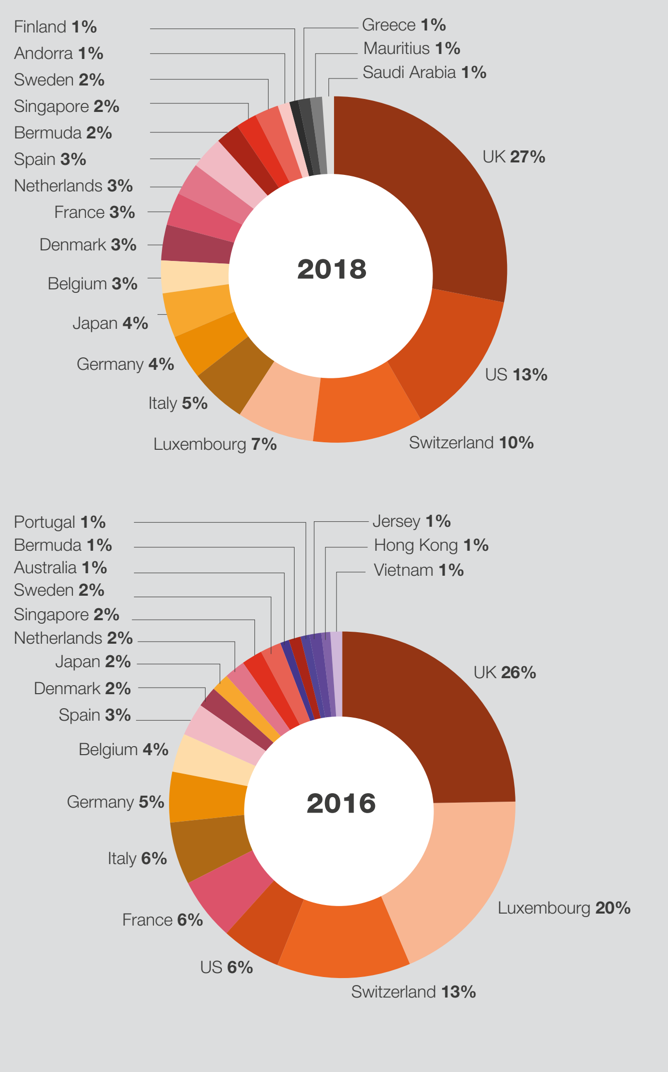
Source: PwC AWM Research Centre

Figure 3: Are you a cross-border ManCo? or have you appointed a cross-border ManCo?



Source: PwC AWM Research Centre

Figure 2: Where is the promoter located?



Percentages may not add up to 100% due to rounding.
Source: PwC AWM Research Centre

Breakdown of survey areas

The survey was divided into the following key areas of interest:

1

Board composition

deals with matters such as the profile of board members (independence, expertise, age, gender, tenure) as well as appointment procedures and remuneration practices.

2

Board organisation

presents the practical aspects of board sessions like location, attendance, duration of board meetings and agendas for those meetings.

3

Roles & responsibilities of the board

addresses key issues such as management style of the board, oversight responsibilities, performance evaluation, continuing education and the ILA certified director program.

4

Conflicts of interest and legal liabilities

features information regarding the management of conflicts of interest as well and management and mitigation of directors' liabilities.

5

Code of conduct

examines board implementation of their adopted code, and takes a closer look at the ALFI[7] code of conduct.

6

Looking forward

considers the implications of the latest regulations as well as areas that will require extra attention from the board over the next two years.

7. Association of the Luxembourg Fund Industry; the official representative body for the Luxembourg investment fund industry.

1 Board composition

Board size

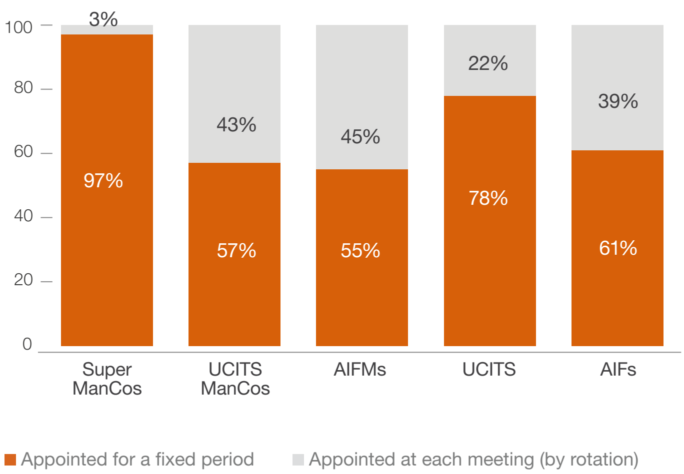
Our findings align with those of our 2014 survey, revealing that the average board of both ManCos and funds consists of 4 to 5 members, including the chairperson. In practice, however, this can differ vastly. The number of board members frequently increases in conjunction with increasing AuM or the number of sub-funds overseen. Among our sample, the largest board consisted of 12 members belonging to a large UCITS fund.

Chairperson appointment

In line with good governance practice, most boards appoint a board chairperson as a formal on-going position, which reflects to the continuous leadership role of a chairperson. Nonetheless, more than a third of UCITS ManCos, AIFMs and AIFs only appoint a chair of each meeting and no actual board chair, surprisingly with this seeming more common among Anglo-Saxon boards.

Appointing a strong board chairperson (in the corporate governance sense) is consistent with global corporate governance trends as leadership is much more than chairing an individual meeting - it is an on-going process over the entire year. In addition to matters related to meetings, such as steering discussions, setting the tone of the board and ensuring that conclusions are reached in a timely and transparent manner, the chairperson should also be involved in liaising with the Company Secretary and CEO. This is critical when setting meeting agendas, ensuring follow up of action points between meetings, being the first point of contact for board issues and escalation, and generally ensuring continued governance on an on-going basis.

Figure 4: Is the chairman position appointed for a fixed period or at each meeting?



Source: PwC AWM Research Centre

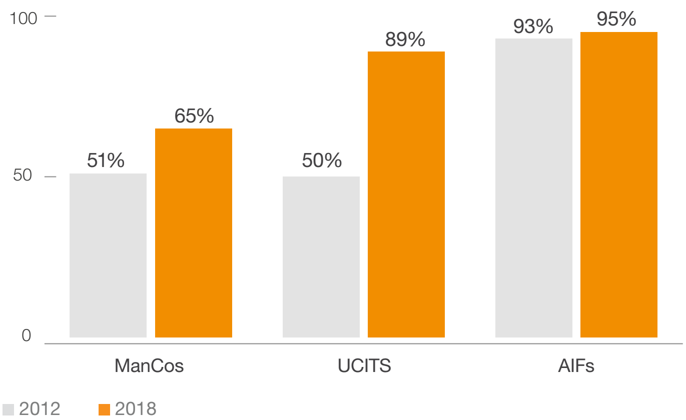
Independent and Non-Executive directors

Over the last decade independent and non-executive directors have come to play an increasingly important role in improving corporate governance and in ensuring companies follow ethical practices. As part of this trend, many companies ensure a certain percentage of their board are not affiliated with the company, i.e. individuals who are external to the company ("**Non-Executive Director**" or "**NED**"). Where the non-executive satisfies certain additional criteria, such as no current other business relationship with the company and not being a recent ex-employee, they may also be considered as an independent non-executive director ("**Independent Non-Executive Director**" or "**iNED**").[8]

This year we placed a special focus on the proportion of boards with at least one independent non-executive director and found a clear upwards trend since previous surveys. We noted, however, that fund boards, be it UCITS or AIFs, are still more likely to have at least one independent director than the boards of ManCos. Whilst this could be due to the fact ManCo boards are, in some cases, still seen as an extension of the promoter, we welcome the trend towards also appointing non-executive directors on ManCo boards.

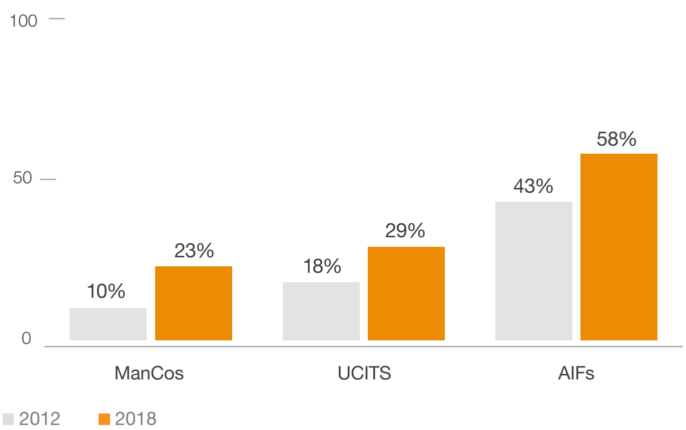
The appointment of an independent chairperson, also considered good governance practice, has seen an upwards trend. It is encouraging to note that the majority of AIFs who responded to our survey now have an independent chairperson. In its *2017 Annual Corporate Directors Survey*[9], based on the opinions of 886 directors on the boards of public companies in the U.S., PwC found that independent chairpersons are more likely to be challenging and prepared to have those difficult conversations which are necessary from time to time. The same survey found that directors on boards with non-executive chairs are more than twice as likely to say that their board decided not to re-nominate a director, or provided training or other support to a director (because of a more robust board assessment process).

Figure 5: Proportion of boards with at least one independent director



Source: PwC AWM Research Centre

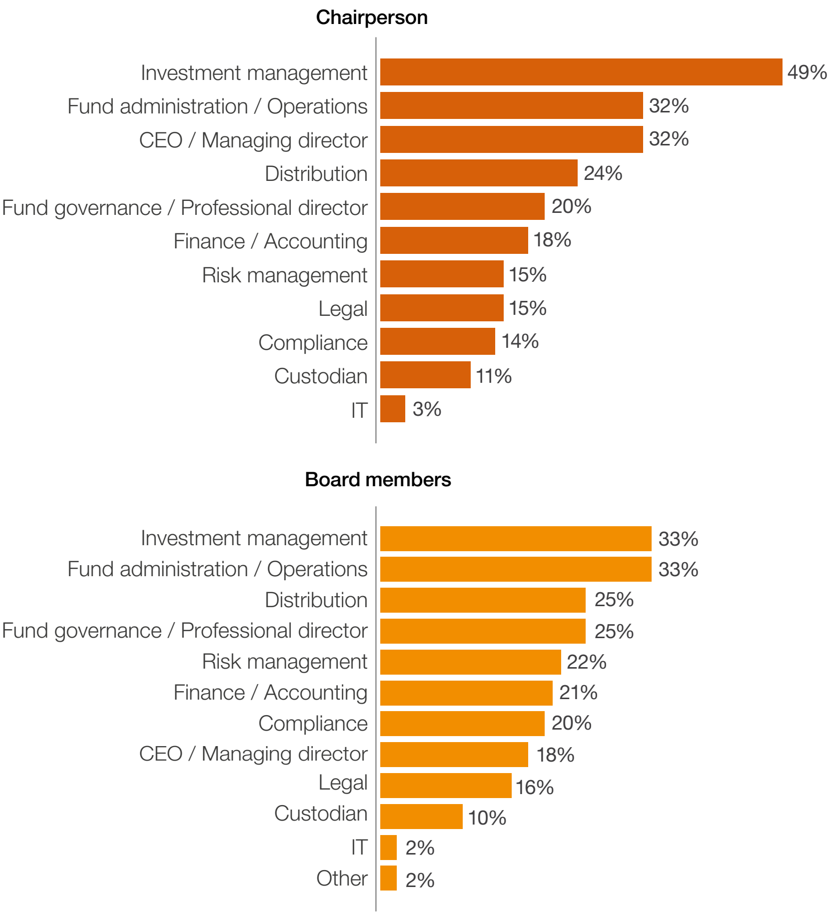
Figure 6: Proportion of boards with an independent chairperson



Source: PwC AWM Research Centre

8. For a fuller discussion on independence criteria, please refer to the "*Board Member Independence*" paper on the ILA and ALFI websites - http://www.alfi.lu/node/3168
9. PwC's *Annual Corporate Directors Survey* has gauged the views of public company directors from across the United States on a variety of corporate governance matters for more than a decade. In the summer of 2017, 886 directors participated in the survey. The respondents represent a cross-section of companies from over a dozen industries, a majority of which have annual revenues of more than USD 1 billion.

Figure 7: What are the main areas of expertise of the chairperson and the board members?



Source: PwC AWM Research Centre

Board expertise

A boards' collective skills and expertise are critical for successfully fulfilling their mandate. In order to make informed decisions, board members should have expertise covering key aspects of the business. Survey participants indicated that most board members had two to three from our list of suggested areas of expertise.

Collectively, boards display a comprehensive knowledge in the key areas - investment management, fund administration, distribution, fund governance, risk management, finance and accounting, and compliance. Since our last survey, distribution has become more represented in line with the Commission de Surveillance du Secteur Financier (CSSF) having emphasised the requirements on distribution oversight which are further clarified in Circular 18/698.

On the other hand, IT expertise remains low on the list of board skills. With the CSSF focusing evermore on outsourcing/ delegation, as well as ICT dependency and data security risks increasing across all aspects of business, we expect boards will increasingly seek expertise in these areas in the coming years.

Appointment procedures

An increasing number of Luxembourg boards have formal procedures in place to appoint new members when compared to our previous surveys. That being said, it remains a non-systematic practice, as formal procedures often exist at head office or promoter level.

The existence of formal appointment procedures is good practice to ensure board member diversity. This includes having created a board skills matrix, a document offering a snapshot of desired skills across a particular board, along with those covered by the current board and providing an overview of missing skills. In Luxembourg, only a minority of boards maintain such document, however it can be invaluable in terms of professionalising board renewal processes in a manner to ensure boards are, and remain, appropriately composed (whether in terms of board training or in terms of board renewals and recruitment).

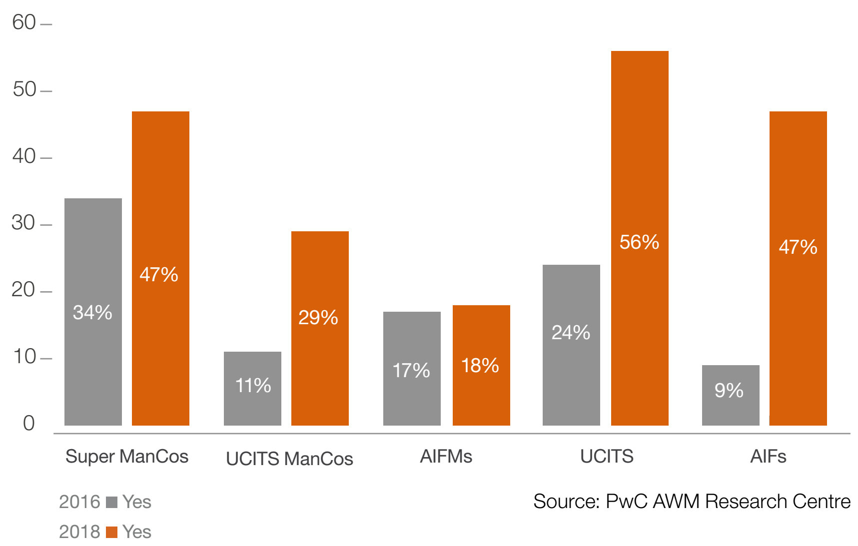
The ALFI Code of Conduct recommends board composition be balanced and diverse in order to help the board to have better discussions and hence make better-informed decisions. Board members should ideally have complementary knowledge and skills, with consideration given to including one or more board members who are deemed independent. Recent CSSF Circular 18/698 also sets out expectations, for example regarding personal skills to enable integrity and independence of mind, and regarding professional skills where the board as a whole should understand the various activities, with each individual also expected to understand the internal governance arrangements and their responsibilities within the entity.

ALFI and ILA provide guidelines[10] on board member letters of appointment, pointing out that these are useful to clarify various issues such as time commitment, remuneration, VAT application, D&O insurance[11] and on-going training offered to directors. Some letters also reference the company's policies and procedures.

A majority of boards have now put in place written terms of appointment for their non-executive and independent directors. We've seen an upwards trend since our 2010 survey when only 32% of UCITS boards had written terms of appointment for independent directors. However, we remain surprised that there is this distinction being made on this topic between executive directors (those that are employed by the promoter) and non-executive and independent directors.

A large majority of boards (84% overall) have procedures in place that allow directors to gain an understanding of the promoter group, management company and the funds managed. This due diligence takes place at various stages (prior to appointment, upon appointment and throughout the director's term).

Figure 8: Does the board have formal procedures to appoint new members?



Source: PwC AWM Research Centre

10. Available on the ILA and ALFI websites – for example in the *ALFI Code section* of the ALFI website (www.alfi.lu)

11. Directors and officers liability insurance; it offers indemnification for losses or advancement of defense costs in the event an insured suffers such a loss as a result of a legal action brought for alleged wrongful acts in their capacity as directors and officers.

Directors serving at both management company and fund level

A majority of respondents indicated that directors are frequently appointed on both the board of the ManCo and the board of a fund managed by the ManCo. On average, between one and three directors of the ManCo board are appointed to the boards of the various managed funds. At fund level, this typically translates into at least one director sitting also on the management company board.

This type of dual appointment opens up communication channels between the ManCo and managed funds, however one must remain vigilent to potential conflicts of interest. In light of this, the CSSF requires that a majority of directors be different.

Board diversity

The average age of board members, for both ManCos and funds, in Luxembourg is approximately 50 years old. This figure has remained stable since our 2014 survey, indicating boards in Luxembourg appear to have an acceptable turnover rate, albeit more frequently of the executive directors.

Terms vary across boards and functions. At chair level the average tenure varies between five and seven years, while at director level this is slightly lower at four to six. The majority of boards in Luxembourg do not limit how long a director can remain on a board and those who do (less than 10% of respondents) largely use length of service (rather than say a retirement age) to determine when a director should step down. Various EU texts consider that after 12 years a director will no longer be considered independent, which should feed into periodic renewal of the independent non-executive directors.

Figure 9: Are there written terms of appointment, which outline roles and responsibilities, for the following board members? (% yes)

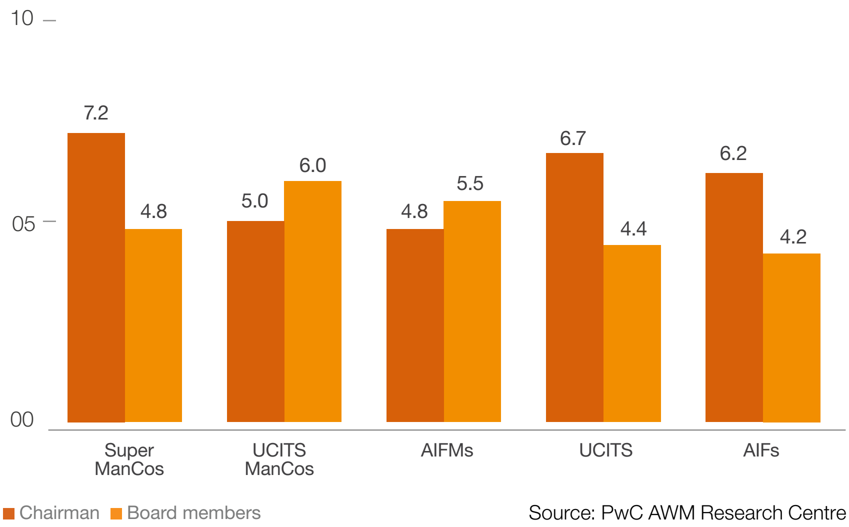
	Super ManCos	UCITS ManCos	AIFMs	UCITS	AIFs
Chairperson of the board	40%	17%	36%	41%	47%
Directors employed by the promoter or fund sponsor	37%	43%	30%	26%	53%
Directors employed by a service provider or advisor	37%	20%	33%	38%	50%
Independent directors	58%	67%	67%	88%	78%

Source: PwC AWM Research Centre

Across the Asset and Wealth Management industry gender diversity has become an important topic. Under-representation of women on boards remains an issue in Luxembourg with women making up less than a fifth of board members. While this has increased minimally since our 2012 survey, should gender equality become mandatory at board level, the investment fund industry would have a long way to go.

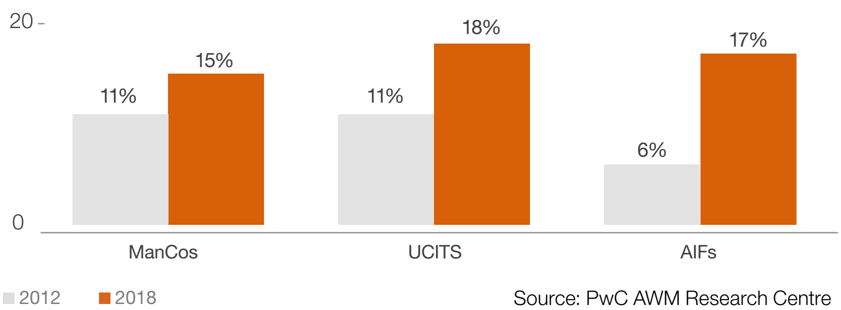
Beyond gender equality, diversity has, in recent years, been under regulators and investors' spotlight. Encompassing a range of factors such as age, skills, education, ethnicity, nationality, disability, beliefs, and social networks, among others, institutional investors are increasingly requiring more action to be taken on board diversity. This is not necessarily about equality – it is because they consider it good business. Increasingly research relating to behavioural economics topics such as group think, bias, and how both individuals and groups make decisions show the benefits of diverse thinking in all areas of business.

Figure 10: What is the approximate numbers of years the chairperson and the board members have served?



Source: PwC AWM Research Centre

Figure 11: Average percentage of female board members



Source: PwC AWM Research Centre

In its *2018 Annual Corporate Directors Survey*[12], PwC notes that many institutional shareholders have been discussing the need for, and benefits of, diverse boards for years, and are backing up their words with actions. They have been updating proxy voting policies, talking about their concerns, and even voting against directors whose boards fail to consider and promote diversity. Some examples of this include:

Investor developments on board diversity	
BlackRock	• Sent letters in February 2018 to all Russell 1000 companies that have fewer than two female directors on their board, asking them to explain their board diversity efforts and long term strategy. • Voted against directors at five companies in 2017 for failing to address investor concerns related to board diversity.
Vanguard	• Stated in August 2017 that gender diversity on boards would be a focus in the next few years. Cited research indicating boards with “a critical mass” of women perform better than those without.
State Street Global Advisors (SSGA)	• Voted against directors at 581 companies around the world in 2018 that had no female board members. • Stated that they will expect portfolio companies to detail and disclose gender diversity not only at the board level, but also across all levels of management for transparency into the development pipeline.
New York City Pension Funds	• Sent letters to 151 companies in fall of 2017 asking them to publicly disclose the skills, race and gender of board members in a matrix format, as well as their process for refreshing the board.
California Public Employees’ Retirement System (CalPERS)	• Sent letters to 504 companies in August 2017 that they believed lacked sufficient gender diversity. • Withheld votes from 271 directors at 85 companies in 2018 that had not improved diversity on their boards.
California State Teachers’ Retirement System (CalSTRS)	• Announced that it will now hold the entire board accountable—not just the nominating and governance committee—if board diversity is found to be lacking.

Source: PwC, 2018 Annual Corporate Directors Survey

12. PwC’s *Annual Corporate Directors Survey* has gauged the views of public company directors from across the United States on a variety of corporate governance matters for more than a decade. In the summer of 2018, 714 directors participated in the survey. The respondents represent a cross-section of companies from over a dozen industries, a majority of which have annual revenues of more than USD 1 billion.

Publicly available information on directors

Transparency is often an important aspect of good governance, and the first step for investors to be able to assess whether a board has the required diversity of skills and other factors to optimise the exercise of its mandate. We've seen an encouraging trend in the increasing amount of information made publicly available regarding board composition. In particular, funds are increasing their disclosure of director titles, short biographies and skills brought to the board. In light of GDPR[13], we expect age and address to remain at a low disclosure rate, if not decreasing, in the coming years.

Guidance on board composition information disclosure can be found in the ILA/ALFI Guidance notes to the ALFI Code of Conduct: *"Guidance on Directors' Reports"*.[14] In particular, it suggests disclosing board members' length of service – which according to respondents only a third of UCITS funds currently do. Alongside this, the guideline encourages boards to publish a short bio of directors, as well as including a description of the board's policy on diversity.

13. The *General Data Protection Regulation 2016/679* is a regulation in EU law on data protection and privacy for all individuals within the European Union and the European Economic Area. It also addresses the export of personal data outside the EU and EEA areas.

14. Available on the ILA and ALFI websites – for example in the *ALFI Code section* of the ALFI website (www.alfi.lu)

Figure 12: Is the following information regarding directors provided in publicly available fund documentation? (% yes)

	UCITS	AIFs
Name	96%	100%
Job title	85%	83%
Short biography / Background	63%	78%
Address	48%	61%
Date of appointment / Number of years of service	33%	56%
Skills brought to the board	15%	28%
Age	7%	17%

Note: the question was asked only to respondents representing boards of UCITS or AIFs.

Source: PwC, 2018 Annual Corporate Directors Survey

Director remuneration

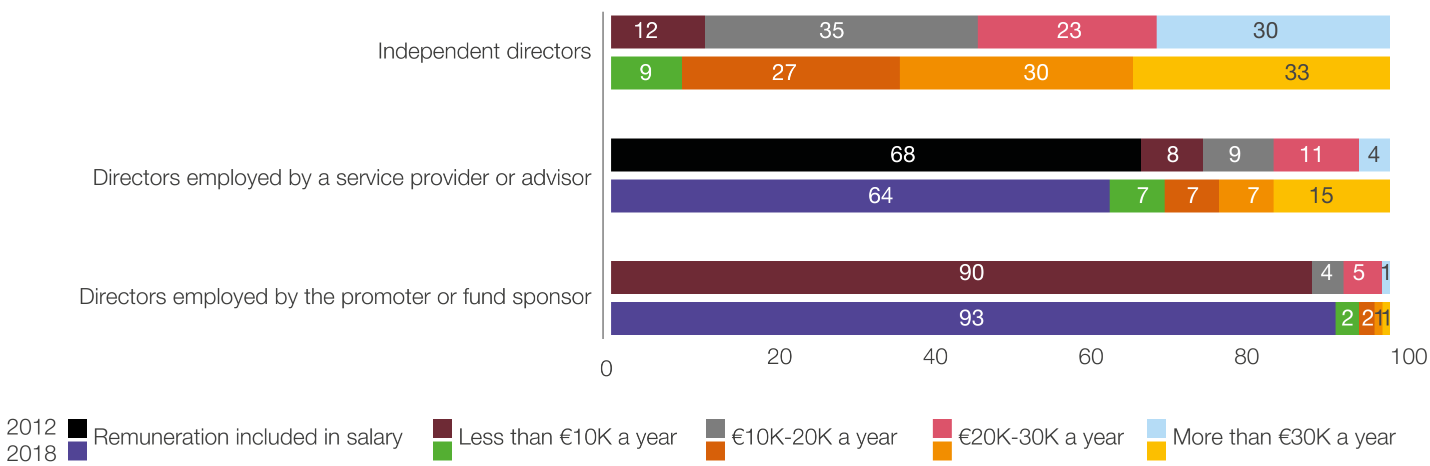
Similar to our previous surveys, board member remuneration varies depending on role – executive, non-executive or independent non-executive director. Executive directors, those employed directly by the promotor, tend not to receive remuneration specific to their position on a ManCo or fund level. On the other hand, non-executive and independent non-executive directors are specifically compensated for their role. Median remuneration for independent non-executive directors has increased slightly since 2012 to the EUR 20,000 to EUR 30,000 per year bracket.

Unrealistically low remuneration (less than EUR 10,000 per year) remains on the fringe and trends seem to indicate this is decreasing, although may be indicative of holding other better paid mandates for the same promoter. With the increasingly high levels of responsibility and expertise required from directors along with the new caps on numbers of mandates, we expect to see fees increasing over the next periods.

Meaningful comparisons of fees remain difficult due to many directors holding mandates on multiple vehicles for the same fund promoter. Typically, directors overseeing a flagship fund will earn higher remuneration than for other funds with the same promoter. This is largely because flagship funds will have a higher AuM and a larger number of sub-funds than others – implying more complexity and increased responsibility.

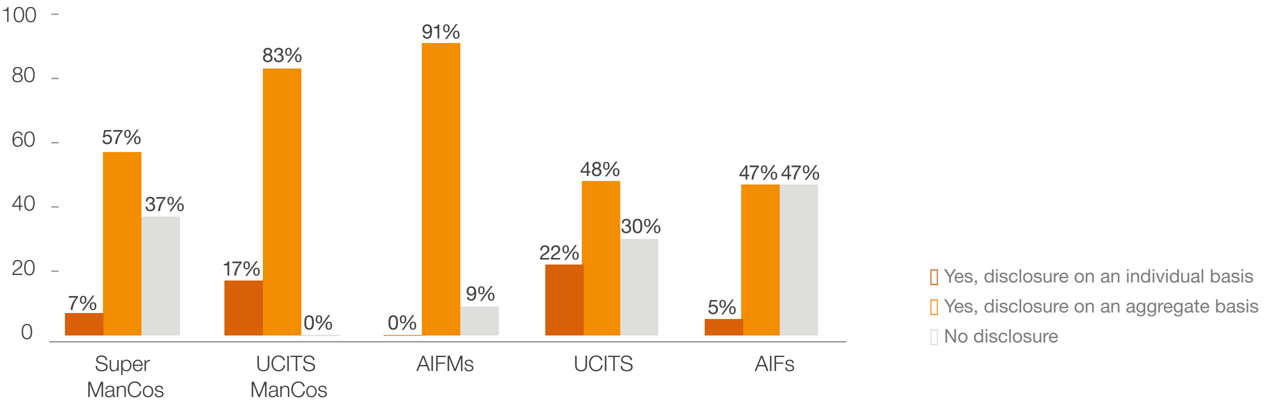
An increasing number of funds and ManCos have begun to disclose directors' remuneration in annual reports, which also makes sense given that the shareholders vote on director remuneration. It should be noted that the ALFI Code of Conduct recommends that board remuneration be disclosed either on an individual or collective basis.

Figure 13: **What is the remuneration received by individual board members?**



Source: PwC AWM Research Centre

Figure 14: **Is director's remuneration disclosed in the annual report?**



Source: PwC AWM Research Centre

2 Board organisation

Board meetings

Meeting frequency and attendance

Our survey shows that boards met on average 5.5 times a year, with this number increasing for AIFMs who met on average eight times a year. For boards to meet their duties to investors, shareholders and other stakeholders, it is critical that meetings be organised regularly throughout the year.

For ManCo boards it is usually considered they should meet at minimum on a quarterly basis for their scheduled reporting meetings, with a quarterly minimum now set out also in CSSF Circular 18/698. For funds, however, the frequency varies depending on asset class and factors such as whether the fund is open or closed-ended. Scheduled reporting meetings are often less frequent for funds with illiquid assets and who are closed-ended, such as funds with private equity or venture capital assets.

Regarding location, board meetings primarily take place in Luxembourg, with meetings outside the Grand Duchy being an exception. The majority of members physically attend meetings (77%), with only a minority attending by phone (13%), videoconference (8%) or by proxy (2%). Meetings held exclusively by phone appear significantly more common among AIFMs – likely as in addition to the periodic full meetings with the regular agendas and board packs, AIFMs and AIFs need to meet also at shorter notice and more often for certain other items such as approving new investments. A minority of Luxembourg-based funds publish attendance records, which is in line with previous surveys. This is surprising since the attendance record is very good for the great majority of boards that participated in the survey. We have, however, noted an increase in the number of AIFs that publish attendance records, up from 5% in 2016 to 11% in 2018.

The ILA/ALFI Guidance notes to the ALFI Code of Conduct: "*Guidance on Directors' Reports*"[15] suggests publishing director attendance in the annual board report. Institutional investors tend to consider board meeting attendance a serious matter, with the fact that – even if not published – Luxembourg's strong director attendance records should certainly be brought to their attention.

Circular resolutions

Over 80% of Luxembourg-based boards use circular resolutions on an ad-hoc basis to pass decisions outside of board meetings, although use has begun to wane since our last survey. Super ManCos and AIFMs used, on average, 11.3 circular resolutions a year.

Boards use circular resolutions for a mix of both urgent and routine matters. Some matters may need to be urgently decided between scheduled meetings, while others, such as changing an authorised signature list at the request of a service provider, are routine. While there is no legal requirement to ratify circular resolutions at the following board meeting, a majority of respondents stated they do so or otherwise list the circular resolutions taken in the period at the time of the next scheduled board meeting.

15. Available on the ILA and ALFI websites – for example in the *ALFI Code section* of the ALFI website (www.alfi.lu)

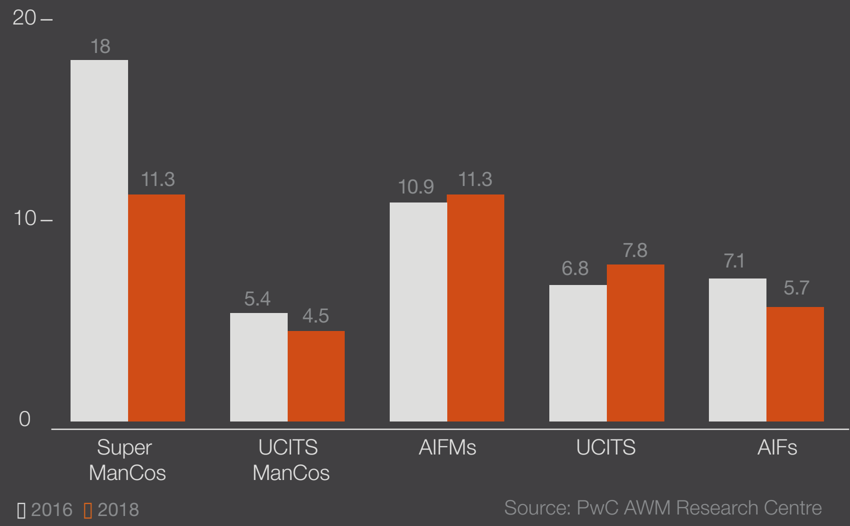
Meeting duration and agenda

Directors should commit a significant amount of time to both prepare and attend board meetings. On average, directors spend between 4 and 8 hours reviewing papers prior to meetings. The amount of time spent preparing for a meeting has increased since 2016, which is in line with an observed enlargement of board packs and responsibilities.

Board papers are typically disseminated five to six working days prior to board meetings, mostly via digital channels – largely email, but in some cases through a web-based application. Password protection of these documents has largely become industry standard among UCITS and AIFs since our last survey.

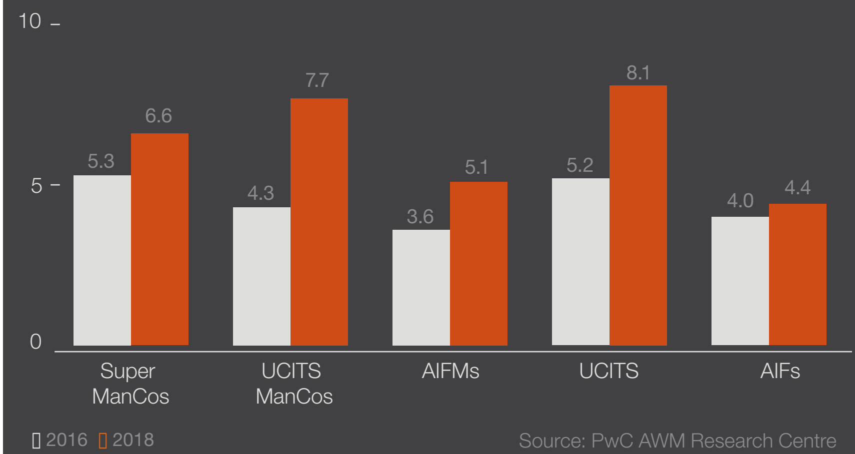
Board meetings typically lasted between 2 ½ hours and 4 ½ hours. An increase in time spent was especially noticeable among UCITS respondents – reflecting increasing complexity and responsibilities. The majority of respondents are pleased with the duration of board meetings, however we note that 27% of AIFM respondents and 11% of UCITS respondents feel that the meetings were too short. We encourage those who feel that board duration is not adequate to raise their concerns with their board chairperson and also during their board evaluation process.

Figure 15: How many circular resolutions does the board use on average per year?



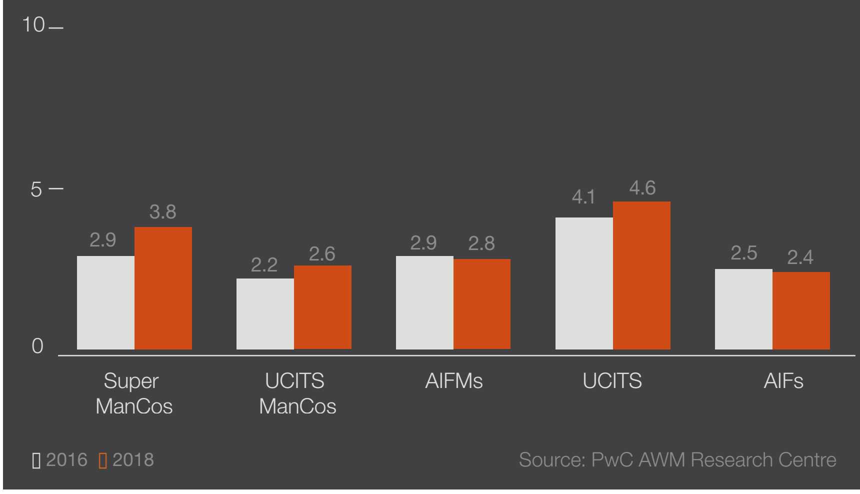
Source: PwC AWM Research Centre

Figure 16: What is the average estimated time directors spend reviewing the board papers prior to board meetings? (in hours)



Source: PwC AWM Research Centre

Figure 17: What is the average duration of board meetings? (in hours)



Source: PwC AWM Research Centre

Standard agendas have become commonplace for the majority of boards in particular with respect to the scheduled reporting meetings. While this ensures that regular matters are consistently attended to, ad hoc issues might suffer due to a lack of time. Agendas tend to include a vast array of reports that require attention, although the frequency of review varies by item. The table below summaries the review periodicity of items by board type:

Figure 18: **Review periodicity of the different items constituting the board agenda**

		Super ManCos	UCITS ManCos	AIFMs	UCITS	AIFs
AML/KYC report		At each meeting	At each meeting	Periodically	At each meeting	At each meeting
Audit	External audit findings report	Annually	Annually	Annually	Annually	Annually
	Internal audit report	Periodically	Periodically	Periodically	Ad-hoc	Ad-hoc
Budget and other fund costs (TER)		Periodically	Periodically	Periodically	Periodically	Periodically
Central administration report (includes fund administration and transfer agent report)		At each meeting	At each meeting	Periodically	At each meeting	At each meeting
Compliance report		At each meeting	At each meeting	At each meeting	At each meeting	Periodically
Conducting officer report		At each meeting	At each meeting	At each meeting	At each meeting	Periodically
Conflicts of interest		At each meeting	At each meeting	At each meeting	At each meeting	At each meeting
Custody report		At each meeting	At each meeting	Periodically	At each meeting	Periodically
Cybersecurity report		Ad-hoc	Periodically	Ad-hoc	Ad-hoc	Never
Distribution report		At each meeting	At each meeting	Periodically	At each meeting	Periodically
Fair valuation report		Periodically	At each meeting	Periodically	At each meeting	Periodically
Investment manager report		At each meeting	At each meeting	At each meeting	At each meeting	At each meeting
Investment restriction breaches report		At each meeting	At each meeting	At each meeting	At each meeting	Periodically
Investor complaint report		At each meeting	At each meeting	At each meeting	At each meeting	Periodically
Financial statements of the ManCo	Annual	Annually	Annually	Annually	Never	Never
	Semi-annual	Ad-hoc	Ad-hoc	Annually	Never	Never
	Monthly or quarterly	At each meeting	At each meeting	Periodically	Never	Ad-hoc
Financial statements of the fund	Annual	Annually	Annually	Annually	Annually	Annually
	Semi-annual	Ad-hoc	Ad-hoc	Annually	Annually	Ad-hoc
New product approval		At each meeting	At each meeting	Ad-hoc	Periodically	Ad-hoc
Prospectus update		At each meeting	Ad-hoc	Ad-hoc	Ad-hoc	Ad-hoc
Regulatory and legal updates		At each meeting	At each meeting	At each meeting	At each meeting	Periodically
Regulatory correspondence		At each meeting	Periodically	At each meeting	At each meeting	Periodically
Risk management report		At each meeting	At each meeting	At each meeting	At each meeting	Periodically
Tax update		Ad-hoc	Ad-hoc	Ad-hoc	Ad-hoc	Ad-hoc

Note: Average of respondent answers. The scale used was the following: "At each meeting", "Periodically", "Ad-hoc" and "Never" and for some items “Annually”, "Ad-hoc" and "Never".

Source: PwC AWM Research Centre

On average, boards of Super ManCos reviewed 16 reports at each meeting, while boards of AIFMs reviewed 9 at each meeting and 8 periodically. A noteworthy development has been the increased review of reports in the alternatives section since our 2014 survey, when little periodic review took place. It is also worth explaining that while AIFMs reviewed fewer reports at each meeting, they met more often than ManCos and Super ManCos. This is likely largely due to the nature of the underlying investments - for example, closed ended funds having less work in terms of monitoring changes in investors (who should rarely change), whilst certain alternative assets tend to require more frequent approval of investment decisions by the board (real estate and private equity for instance).

CSSF Circular 18/698 reinforces the importance of those reports mentioned in the table. For example:

- Chapter four stipulates that the meeting agenda must be documented in writing;
- Chapter five specifies that the board should receive the necessary information from the delegates in order to carry out an effective control over each delegate.

ILA has issued guidance[16] recommending that the board, prior to meetings, should receive a formal agenda of all matters to be reviewed, discussed and approved, along with sufficient supporting documentation.

Key reports and updates to be supplied periodically to the board according to ILA's guidance may include the following:

- Risk management report
- Investment manager report
- Investment restriction breaches report
- Compliance report
- Investment manager report
- Conducting officer report, or ManCo/AIFM Report
- Investor complaint report
- Central administration report
- Summary of regulatory correspondence
- AML/KYC report
- Distribution report
- Conflicts of interest
- Custody report
- Regulatory and legal updates
- Tax update
- New product approvals
- External audit findings report
- Annual financial statements (and semi-annual, where applicable)

Invitation of non-board members

Inviting a select group of external representatives to attend board meetings in person and to report on important topics is generally considered in line with good governance. The most frequently invited non-board members are the compliance officer, conducting officers, investment managers, risk manager and internal legal advisor.

ILA's guidance documents[17] suggest that boards consider inviting different non-members to board meetings from time to time:

- external counsel and external auditor, at least once per year, to discuss any major legal, regulatory or fiscal changes, and the results of the audit;
- investment manager, on a periodic basis;
- head of risk management and head of valuation, on a periodic basis;
- representatives of service providers (such as the depositary), on an ad-hoc basis.

16. See document titled "*Directors FAQ – Luxembourg investment funds*", available to ILA members on the ILA website (www.ila.lu)
17. See documents titled "*Directors FAQ – Luxembourg investment funds*" and "*AIF and AIFM – A practical guide for directors*" available to ILA members on the ILA website (www.ila.lu)

Figure 19: Invitation periodicity of non-board members to attend board meetings

	Super ManCos	UCITS ManCos	AIFMs	UCITS	AIFs
Compliance officer	At each meeting	At each meeting	At each meeting	At each meeting	Periodically
Conducting officer	At each meeting	At each meeting	At each meeting	At each meeting	Periodically
Depositary	Ad-hoc	Ad-hoc	Never	At each meeting	Periodically
External auditor	Annually	Annually	Annually	Annually	Annually
External legal advisor	Never	Ad-hoc	Ad-hoc	Ad-hoc	Ad-hoc
Fund administrator	Ad-hoc	Periodically	Periodically	At each meeting	Periodically
Global distributor	Ad-hoc	Ad-hoc	Never/Not applicable	At each meeting	Never/Not applicable
Internal auditor	Periodically	Periodically	Periodically	Ad-hoc	Never
Internal legal advisor	At each meeting	At each meeting	Ad-hoc	At each meeting	Ad-hoc
Investment manager	Periodically	At each meeting	At each meeting	At each meeting	At each meeting
Risk manager	At each meeting	At each meeting	At each meeting	At each meeting	Periodically
Transfer agent	Ad-hoc	Ad-hoc	Never	At each meeting	Periodically
Product development team	Periodically	Periodically	Ad-hoc	Periodically	Ad-hoc

Note: Average of respondent answers. The scale used was the following: "At each meeting", "Periodically", "Ad-hoc" and "Never" and for some items "Annually", "Ad-hoc" and "Never".

Source: PwC AWM Research Centre

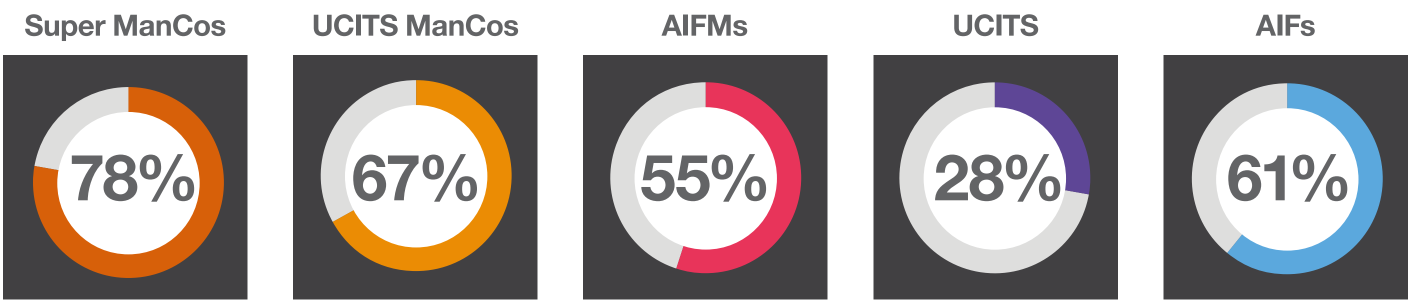
Formal committees

Specific sub-committees have become increasingly common among Luxembourg boards. These committees tackle specific issues, such as risk, audit, valuation or remuneration, and consist of members specifically responsible for oversight of those areas. Of course, the existence of sub-committees depends to some extent on the size of the board.

Approximately 78% of Super ManCo boards have established one or more sub-committees.

Sub-committees are also frequently established in the alternative world, an indicator of alternative management companies and funds being well-organised following the introduction of the AIFMD. In line with our 2016 findings, the committees that tend to be the most established are valuation, risk, remuneration and audit.

Figure 20: Proportion of boards that have established one or more sub-committees



Source: PwC AWM Research Centre

As a result of the EU Audit Reform Directive, audit committees have become slightly more common. If an entity is qualified as a Public Interest Entity (PIE) this leads to extra requirements, such as the need to have an audit committee and to ensure periodic auditor rotation. ILA has issued a guidance paper[18] in this area, which includes considerations for whether or not to create an audit committee, and advice on how to create an effective audit committee (including sample terms of reference, composition, chair, committee meetings and remuneration).

ILA has issued various guidance papers which include discussions regarding the establishment of various board level committees within the Luxembourg fund industry.[19]

18. See document titled "*ILA Audit Committee Guide for Boards of Luxembourg Investment Funds and Management Companies*", available to ILA members on the ILA website (www.ila.lu)
19. See documents titled "*Directors FAQ – Luxembourg investment funds*" and "*AIF and AIFM – A practical guide for directors*", available to ILA members on the ILA website (www.ila.lu)

Figure 21: Formal committees established by the board

	Super ManCos	UCITS ManCos	AIFMs	UCITS	AIFs
Valuation / Price committee	56%	17%	45%	8%	39%
Risk committee	44%	-	18%	4%	6%
Remuneration committee	34%	-	18%	4%	-
Audit committee	25%	17%	18%	12%	17%
Investment management committee	22%	-	27%	4%	28%
Compliance committee	22%	-	27%	-	6%
Product committee	22%	-	-	-	6%
Other committees	19%	-	-	8%	-

Note: Other committees include Risk and control, Client acceptance, Distribution oversight, AML, Portfolio disclosure, Excessive trading, Fair valuation, Investment risk oversight

Source: PwC AWM Research Centre

3 Roles and responsibilities of the board

Management style and relationship with the promoter

Our 2018 survey confirms that the prevailing management style within Luxembourg boards is mainly "active board discussions on existing issues, high level oversight and management by exception".

At fund level, the board should pursue its own mandate and, as such, should have a relatively high degree of autonomy from the promoter or fund sponsor.

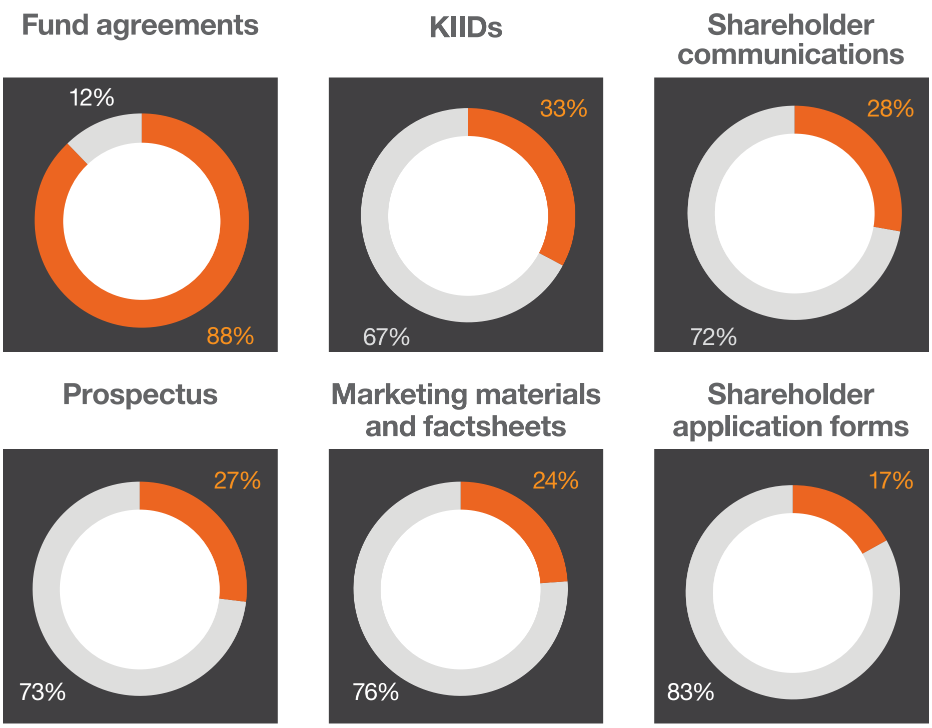
Our 2018 survey reveals that a strong majority of fund boards perceive themselves as independent. However, we note that about a quarter of UCITS and AIF boards saw themselves as an integral part of the promoter's operations (a figure that is in line with prior findings). We note the ALFI Code of Conduct requires boards to conduct themselves in a fair and independent manner, particularly in their relationship with the promoter or fund sponsor. The code also recommends that boards consider appointing independent non-executive directors.

Review of fund documentation

One of the key undertakings of boards is a review of fund documents. In Luxembourg, the majority of fund boards examine a variety of documents, including prospectus, financial statements, funds-related agreements and shareholder communications. More than half of UCITS boards surveyed also examined KIIDs (Key Investor Information Document). Notably however, timing of the boards' involvement varies greatly; fund agreements are generally reviewed on a systematic basis, while the majority of other documents are reviewed on an ad-hoc basis.

The practice of reviewing marketing materials and factsheets in Luxembourg boards depends to which extent the distribution function has been delegated. The newly released CSSF Circular 18/698 formalises that ManCos are responsible for ensuring that fund marketing is carried out in compliance with legal and regulatory provisions in place. ManCo boards should therefore ensure there are robust processes in place for the review of marketing materials.

Figure 22: If the board reviews the following documents, what is the timing of board involvement? (all respondents)



Systematic review (yearly, quarterly or more often)
Review at initial issuance or ad-hoc review

Source: PwC AWM Research Centre

ILA guidance[20] on this matter indicates that fund directors should approve changes to the prospectus, sign material fund related agreements and ensure that information on the fund's financial situation is disclosed in accordance with applicable legal and regulatory requirements.

Oversight of service providers

Oversight of service providers is another major responsibility of boards. We asked respondents what was their process of choice to ensure the quality and efficiency of services provided. Luxembourg boards are clearly aware of the importance and usefulness of performing such oversight. A majority of our respondents perform due diligence prior to initial appointment as well as periodical assessments of the following service providers:

- Risk manager
- Fund administrator
- Custodian / Depositary
- Global distributor
- External auditor
- Internal auditor
- Compliance function
- Transfer agent
- Investment manager / advisor
- Legal advisor

Additionally, a third of respondents perform periodical calls for tenders regarding the external auditor. For other service providers, periodical calls for tender only takes place at a minority of boards.

European regulators have placed oversight of outsourced activities front and centre. The CSSF's new circular also places a strong focus on delegation and oversight aspects applicable to all delegates. ILA's various fund-related guides[21] encourage AIFs and AIFMs to perform due diligence and ongoing monitoring of delegates (including the portfolio manager, the asset/property manager, etc.) and service providers.

Oversight of investment management

Circular 18/698 sets out that while the investment manager is responsible for taking investment decisions, the ManCo is ultimately responsible for this activity as well. In this sense, ManCos are responsible for ensuring that investments are made in compliance with the objectives and strategy of the fund, as well as for overseeing the performance of those investments.

The control requirement is relatively new for ManCos as historically the fund board was primarily responsible for monitoring investment compliance under Luxembourg law. Interestingly, our survey shows that in practice oversight of investment management is exercised both at the level of the ManCo board and fund board. In the majority of cases, respondents indicated that the board exercises oversight by receiving regular reports from the investment manager and monitors for investment restriction breaches and net asset value errors.

Concerning fund performance, respondents receive regular reports from the investment manager in order to monitor performance. However, approximately only one in four of boards stated they intervene in cases of underperformance. This raises the question of when it would be the role of boards to intervene in response to underperformance when the investment strategy chosen by the investors is nonetheless being adhered to.

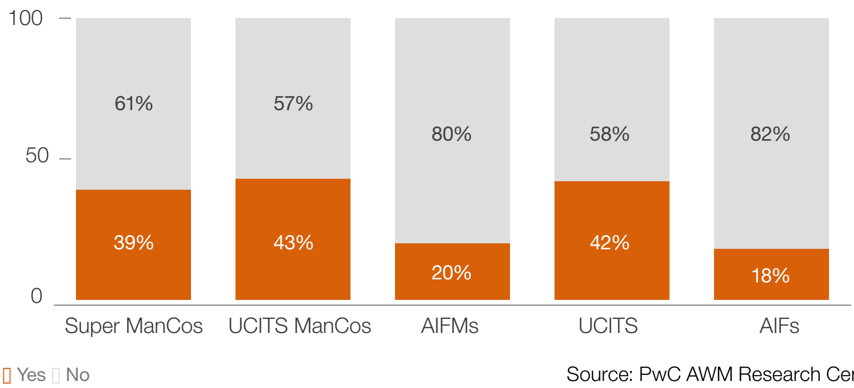
Oversight of fund expenses

Following the global financial crisis, investor protection, as a topic, has dominated fund industry discussions. A major part of these debates has concerned the transparency of expenses charged to shareholders. Some regulations such as RDR in the UK and MiFID II in Europe have put pressure on funds to unbundle expenses in the interest of improving transparency and investor protection. As calls for the industry to increase transparency continue, we believe fee pressures will increase in the coming years.[22]

In light of this, we asked respondents whether or not fund expenses were covered by a fixed TER (Total Expenses Ratio). Results show that the proportion of Luxembourg-based entities charging shareholders fixed TERs has increased slightly since 2014. The figures below tend to hide the divergence in the market. Some entities are moving away from fixed TERs in order to be more transparent, while others are adopting a fixed TER in order to guarantee a certain level of fixed expenses to shareholders.

20. See document titled "*Directors FAQ – Luxembourg investment funds*", available to ILA members on the ILA website (www.ila.lu)
21. See documents titled "*Directors FAQ – Luxembourg investment funds*", and "*AIF and AIFM – A practical guide for directors*" available to ILA members on the ILA website (www.ila.lu)
22. For more information on fee pressure and margin compression, read for example PwC's report titled "*Asset & Wealth Management Revolution: Pressure on profitability*" available on PwC website (www.pwc.com)

Figure 23: Are the expenses of the fund (flagship fund) covered by a fixed TER?



Source: PwC AWM Research Centre

Nevertheless, the ALFI Code of Conduct recommends reviewing fund expenses and their impact on fund returns in order to ensure that the expenses charged by the fund are reasonable, fair and appropriate. This year's survey reveals that the majority of boards are either involved in monitoring fund expenses or reviewing budgets vs. actual expenses. Interestingly less than a third of our respondents compare the fund's expenses to their competitors, this is notwithstanding that such an exercise is considered to be in the shareholders best interest.

Oversight of risk management

CSSF Circular 18/698 aligns regulatory risk management requirements for UCITS and AIFs, and details the prerequisites for implementing the risk management function. As implementation of each function is ultimately the responsibility of the board of directors, when the risk management function is delegated to a specialised service provider, the CSSF requires boards to implement robust oversight measures.

A majority of the boards we surveyed reviewed the effectiveness of risk management process, at least on an annual basis. Moreover, most boards (about 90%) believed that they receive adequate reporting on the different risks outlined in the regulations, e.g. market risk, counterparty risk, liquidity risk, valuation risk, operational risk and collateral risk.

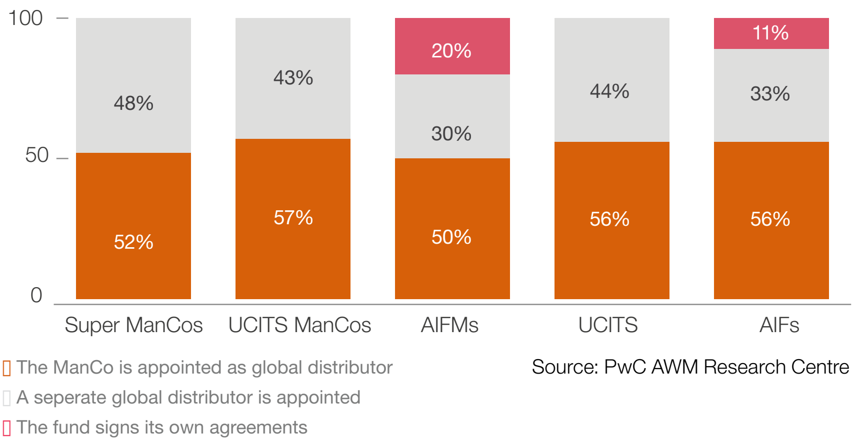
However, fraud risk has been on the mind of some respondents, with a third of respondents feeling they do not receive adequate reporting on this topic. Fraud risk reports vary greatly depending on the underlying asset class of the fund. To be effective, fraud risk reports should include items such as:

- an estimate of the likelihood of occurrence of various fraudulent activities; and
- a description of preventative measures and controls currently in place to prevent fraud.

As noted earlier, cybersecurity is a hot topic at the moment. More than 80% of respondents believed that they do not receive adequate reporting on cybersecurity risk. In fact, the World Economic Forum's *Global Risks Report 2018* ranks cyberattacks as the third-likeliest risk for companies, behind data fraud and theft. Therefore, we expect technology risk to be of paramount importance for the industry and for regulators in the coming years. ILA has also recently launched cybersecurity courses specifically tailored to boards.

Overall however, boards appear well versed in risk management issues. All respondents indicated that collectively the board has sufficient knowledge, and a fifth of respondents indicated that each individual director at their board is knowledgeable in risk management.

Figure 24: **How does the fund (flagship fund) handle global distribution?**



Source: PwC AWM Research Centre

Oversight of distribution

The industry overall makes use of various distribution models. Global distribution is either performed in-house by the ManCo or by a delegated third-party institution. This decision depends, at least in part, on the funds' AuM. Benefits of scale are apparent here, with ManCos with more than EUR 50 billion in assets having indicated that they are more likely to perform the distribution function themselves.

A majority of ManCo and fund boards indicated they perform due diligence of their distribution function. This is most often performed internally, with the exception of AIFs. Two third of AIFs do not perform due diligence on their distributor. This is likely as the result of differences in model where the ManCo is doing so or it could be attributed to differences in the lifecycles of AIFs (e.g. a closed ended fund once it is fully committed).

Similarly to risk management, the ManCo is ultimately held responsible for implementing and ensuring the follow-up of the marketing policy and distribution of the funds it oversees. When distribution is delegated to a third party, boards remain responsible for the oversight of said delegate. Despite the tendency to have a layered distribution, from ManCo to global distributor to local sub-distributor, the ManCo remains ultimately responsible for the function. ILA's guidance brochures[23] include good practice advice to directors of Luxembourg funds in the field of distribution oversight.

Global distribution, by its very nature, is a complex activity due to the variety of investors (retail and institutional) and the large number of countries where the funds are being distributed. As such, there are a variety of risks that can affect distribution. This year's participants highlighted AML compliance and failure to comply with local jurisdiction sales and marketing laws as the most important risks.

It is hardly surprising that AML compliance is currently is the spotlight. The 4th AML directive entered into effect in June 2017 and MiFID II became applicable as of January 2018. These regulations strengthen the rules in a number of areas, including reporting obligations, penalties for non-compliance, data privacy and respect of country-specific regulations.

23. See documents titled "*Directors FAQ – Luxembourg investment funds*" and "*AIF and AIFM – A practical guide for directors*", available to ILA members on the ILA website (www.ila.lu)

Involvement outside of board meetings

The roles and responsibilities of board members do not stop at board meetings. There is an increasing demand on director's time outside of board meetings. Our respondents this year confirmed that outside of scheduled board meetings they were largely involved in ad-hoc meetings (84%) and signing agreements (75%). More than a third were also involved in performing due diligence on investment managers and other service providers, instructing payments, meeting with investors and other various tasks.

As institutional investors become more involved with their investments, directors have begun to perform or undergo due diligence at the request of investors. This trend was unheard of five years ago, with now 27% of respondents performing this task.

CSSF Circular 18/698 emphasises that board members must devote the necessary time and attention to their duties, and even defines a threshold on the time spent and number of mandates for board members (maximum 1,920 hours per annum and 20 mandates). ALFI and ILA have both issued guidance[24] on time capacity to help directors assess their time commitment.

Board performance reviews

As institutional investors and regulators pay increased attention to board effectiveness, the number of boards undergoing performance evaluations has increased notably.

Of those who performed a board evaluation, they tended to do so once a year. About a fifth of boards perform their evaluation every 2 to 3 years or on an ad-hoc basis. We expect the practice to become more prevalent in the coming years as it is also a requirement of most codes of conduct, and has also become an important tool in the global corporate governance toolkit.

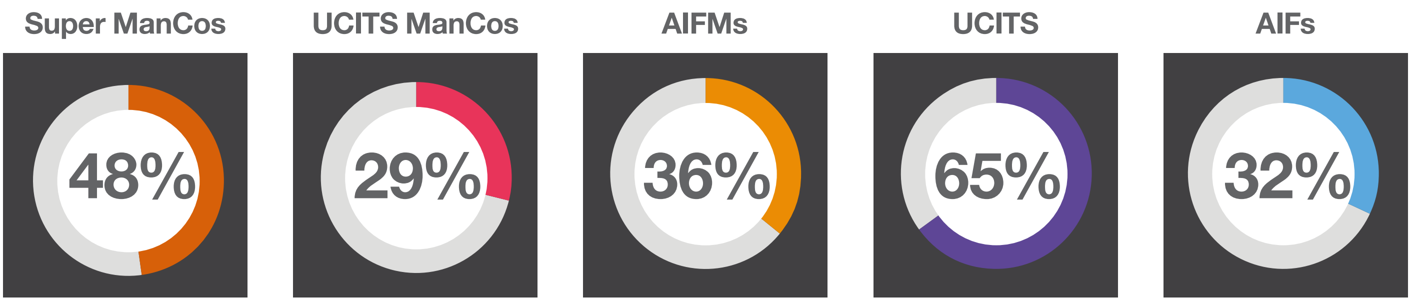
The ALFI Code of Conduct recommends boards ensure that directors are collectively competent to fulfil the board's responsibilities. In line with this, ILA and ALFI have issued guidance notes[25] on board evaluations in an effort to assist boards with getting comfortable with the practice in Luxembourg. To complement the guidance on board evaluations, ILA has issued a *Board evaluation form*[26] containing more than 120 quick multiple-choice questions to answer.

Board training

A majority of board members spent more than three days of training on a personal basis annually, with many spending more than five days per year. While the most sought after areas included training in AML/KYC, legal and regulatory developments, and risk management, nearly half of directors surveyed were pursuing training in cybersecurity, which has become an increasingly popular

24. See document titled "*Board member time capacity*" available on the ILA and ALFI websites (www.alfi.lu), and document titled "*Getting on Board – A guide for accepting company Directors' mandates*" available to ILA members on the ILA website (www.ila.lu)
25. See brochure titled "*Board evaluations – Enhancing Board Effectiveness* " available to ILA members on the ILA website (www.ila.lu) and the note "*Board evaluations*" available on the ILA and ALFI websites (www.alfi.lu)
26. Available to ILA members on the ILA website (www.ila.lu)

Figure 25: Proportion of boards that are evaluating their performance



Source: PwC AWM Research Centre

topic. Other areas of interest included tax, ethics, products, digitalisation and crisis management.

Disappointingly, continuing education provided to the board by the promoter remains limited, however, amounting to no more than two days a year, in line with previous years' findings. We hope that boards will in future be offered more opportunities to train as a group.

In-house training was most often in the areas of AML/CTF, and legal and regulatory developments. As Circular 18/698 lays out new reporting requirements and introduces scenarios in the area of AML/CTF, we expect boards to continue receiving extensive training provided by the promoter in this area.

Furthermore, certain codes and regulations require formal director induction and training programmes to be in place. The AIFM Directive requires induction and training of members of the AIFM body, while the *X Principles of Corporate Governance* of the Luxembourg Stock Exchange stipulate that the company shall allocate adequate resources to induction and on-going training of its directors. More information is available from ILA guides.[27]

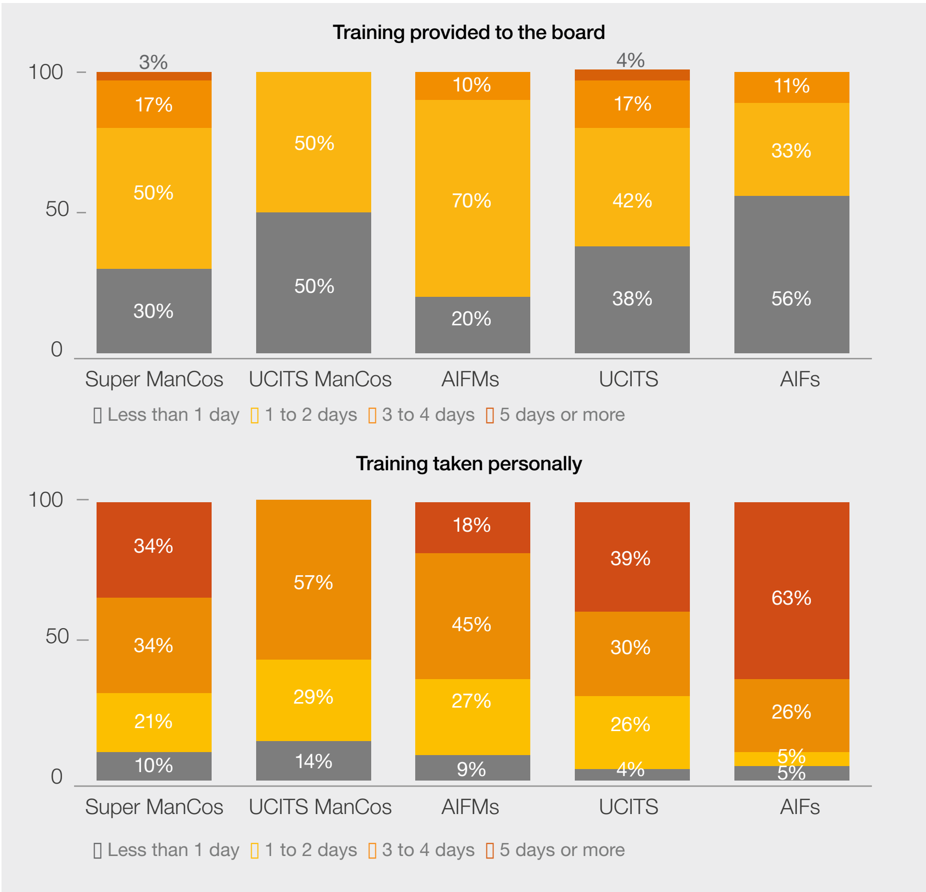
ILA Certified Director program

In 2012, ILA introduced a certification program for directors sitting on Luxembourg boards. This forms part of its aim to develop members into highly qualified, effective and respected directors. Additionally, this ensures continued promotion of good practices in Luxembourg in the corporate governance field.

Since the program's inception there has been clear interest from directors. The number of Super ManCo boards with at least one director in the program or having completed the certification rose from 18% in 2014 to 44% in 2018. At the same time, the number of UCITS boards with one director involved in the program or certified rose from 19% to 58%.

The majority of directors participating in such program are independent non-executive directors. On average, between 1 and 2 independent directors sitting on a board are in the process or were ILA certified. Encouragingly, we noted a trend in Super ManCos to have in-house directors also enrolled in the program or certified, which seems a welcome new trend. Once certified, directors are required to maintain their knowledge by participating in training to hone their professional skills, and have annual continuing development requirements.

Figure 26: **How many days have directors spent on average on continuing professional education in the last twelve months?**



Source: PwC AWM Research Centre

27. See documents titled "*Directors FAQ – Luxembourg investment funds*" and "*AIF and AIFM – A practical guide for directors*", available to ILA members on the ILA website (www.ila.lu)

4 Conflicts of interest and legal liabilities

Conflicts of interest

Over the past few years, conflicts of interest have been at the forefront of regulatory focus, especially in the alternative investment space as a result of several cases pursued by the SEC and the FCA. These put a spotlight on deficiencies in private equity, venture capital and hedge fund structures due to the large asymmetry of information between managers and investors. More generally, in the overall industry there is a certain level of misalignment between the manager's and the investors' respective interests in a fund.[28] CSSF Circular 18/698 also sets out minimum requirements on how conflicts of interest should be dealt with by Luxembourg-based ManCos. It outlines requirements such as having a clear conflicts of interest policy in place, along with obligations to keep records of conflicts of interest, and in certain cases obligations to inform investors.

The majority of Luxembourg-based boards, 93% of ManCo boards and 91% of AIFM boards, indicated that there is a written policy in place for identifying and handling conflicts of interest. Additionally, as can be seen in figure 27 below, the number of boards having a conflicts of interest declaration on their standard board agenda has increased from past surveys.

In Luxembourg, there are no legal requirements preventing directors from investing in the funds they oversee. In fact, our survey reveals that a large majority of boards in the UCITS world allow directors to invest in the funds they oversee, albeit often with restrictions such as pre-trade compliance and disclosure. However, about 50% of AIFM boards prohibit directors from investing in the funds they oversee, to avoid potential for conflicts of interest.

Legal liability

Legal liability is an important issue in an intensely regulated industry. Liability may potentially arise from breaches of a vast array of obligations, such as inadequate implementation and oversight of risk management, errors in accounts, incorrect valuations, not filing accounts within legal or regulatory deadlines, or improper uses of corporate assets. That is why it is paramount for directors to be made aware of their liability, including potential sanctions.

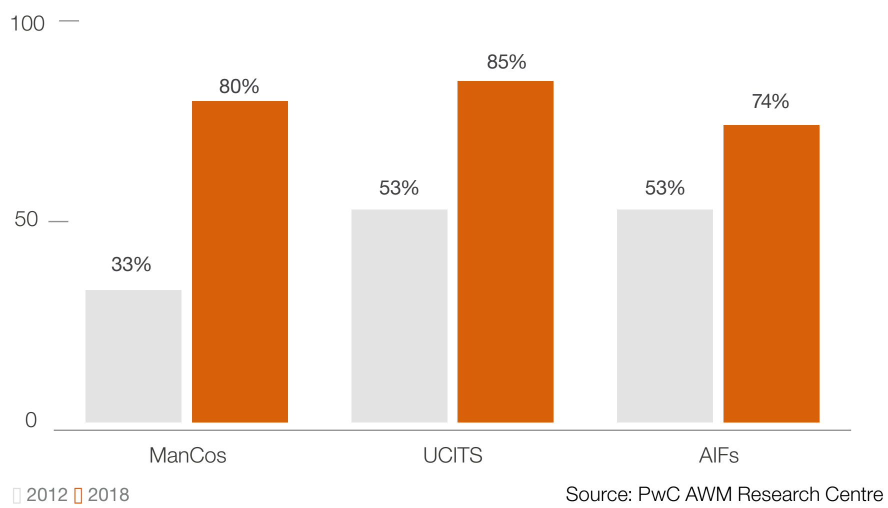
28. For example, the carried interest compensation structure typically found in many alternative funds can give the manager an incentive to make riskier or more speculative investments than what would normally be in the best interests of the fund's investors in order to generate greater compensation.

According to our survey, on 70% of boards directors self-inform on legal liability. In addition, 32% of boards were informed of their legal liabilities at induction through the letters of appointment. Furthermore, about 63% received either specific training or a briefing by an internal or external counsel. We believe that these briefings to the board as a whole should become more common given the clear trend towards increased sanctions and fines by regulators. It is important that all members of a board are fully aware of their duties and their responsibilities.

Mitigation of director liability remains an eminently important issue. In the past, promoters have traditionally insured both independent and executive directors. This year's survey shows that insurance is being provided by the promoter and ManCo, while both the promoter and fund provide indemnities.

Self-insurance was also important for independent directors, with the majority of independent directors having subscribed their own insurance.

Figure 27: Proportion of boards asking for conflicts of interest to be declared at each board meeting as a standard agenda item



Source: PwC AWM Research Centre

5 Codes of conduct

Regulators and institutional investors are increasingly placing importance on the adoption of a code of conduct that ensures all board members are aligned with the stated principles and practices of the board. While a variety of these codes exist, however they all tend to place emphasis on principles such as honesty, fairness, fiduciary duties towards shareholders, respect for the integrity of markets, competence, transparency, and, finally, respect for rules and regulation.

A large majority, more than 80% in the case of UCITS respondents, have adopted a code of conduct, with the ALFI code being the most common for Luxembourg-based boards. While 91% of AIFMs have adopted a code, ALFI is not necessarily the preferred choice; AIFs lag behind with only 63% having adopted a code.

Overall, about 68% of boards that have adopted a code of conduct have disclosed this adoption. While this figure has increased from past surveys, we would expect such disclosure to be higher given the positive message that adopting a code sends to the market, providing of course that the board actually follows its principles and recommendations.

When asked whether the board regularly checks how it complies with its adopted code of conduct, two thirds of respondents said yes. The checks, which are recommended by ALFI, should ideally be done once a year as a mapping exercise, and can be linked as a reference for the board's evaluation assessment.

The ALFI Code of Conduct

The purpose of the ALFI Code of Conduct is to provide boards with a framework of high-level principles and best practice recommendations for the governance of Luxembourg-based investment funds and ManCos. The code is principles-based rather than rules-based in that it relies upon good judgement rather than prescription. As such, the recommendations recognise that the "right approach" for many issues depends on the circumstances.

All respondents were positive when asked how they perceive the ALFI code, with nearly all believing that the principles-based approach of the code is appropriate. However, this year we note that a quarter of AIFM respondents thought that the code should be more prescriptive or rules-based. As the AIFM status is still relatively new, we gather that AIFM practitioners would like more prescriptive guidelines to help them navigate corporate governance issues.

Finally, in an effort to keep the code up-to-date and practical we asked which issues were currently not addressed. Respondents indicated that ESG[29], gender diversity, tenure and technology should be introduced or expanded upon to keep the ALFI Code of Conduct up-to-date and relevant.

29. ESG stands for Environmental, Social and Governance factors - those that are central in measuring the sustainability and ethical impact of an investment in a company or business.

6 Looking forward

In order to prepare boards for the coming years and to highlight the governance outlook, we have included a looking forward section in which we explore participants' views for the coming two years.

With the uptick of regulatory directives in recent years, many are likely to have a strong impact on operations and boards in the coming years. While the majority of boards have reviewed the implications of these directives (GDPR, 4th AML directive, MiFID II and PRIPS), both strategically and operationally, we note that AIFs are somewhat lagging behind the pack. Should their AIFMs be responsible for keeping new regulations under review on their behalf, then this makes more sense.

A majority of participants reviewed Brexit at least strategically - of course those having operations or distribution in the UK are more likely to be impacted. However, the Capital Markets Union (a plan by the European Union to build a true single market for capital across all member states) was not on our participants' radars for the moment. However, respondents were likely to begin reviewing this once the EU rolls out a more operational plan for the CMU.

Figure 28: Has the board reviewed the implications of the following regulations?

	Super ManCos	UCITS ManCos	AIFMs	UCITS	AIFs
GDPR (General Data Protection Regulation)	Yes, operationally	Yes, operationally	Yes, operationally	Yes, operationally	Yes, operationally
4th AML Directive	Yes, operationally	Yes, operationally	Yes, operationally	Yes, operationally	Yes, strategically
MiFID II	Yes, operationally	Yes, operationally	Yes, operationally	Yes, operationally	No
PRIPS (Package Retail Investment Products)	Yes, operationally	Yes, operationally	No	Yes, operationally	No
Brexit	Yes, strategically	Yes, strategically	Yes, strategically	Yes, strategically	Yes, strategically
CMU (Capital Market Union)	No	No	No	No	No

Secondly, boards indicated that impact investing topics, such as ESG, SRI, sustainability and climate risk, have increasingly come to the fore in recent years. These are becoming evermore prevalent across the entire Asset & Wealth Management industry, and a majority of directors on ManCos, UCITS and AIFM boards have seen such topics appear on board agendas in the past twelve months. We expect such areas to require more attention from a governance standpoint in the coming years.

Finally, we examined what the main points of attention will be for boards in the coming 12-24 months. As one would expect, the focus of the industry remains on law & regulation changes as well as governance & compliance. This is due to the growing regulatory burden that takes a lot of time and energy from directors who must be constantly focused on their primary goal of investor protection.

Figure 29: Top 5 areas requiring additional attention from the board in the coming 12-24 months

	Super ManCos	UCITS ManCos	AIFMs	UCITS	AIFs
#1	Law & regulation changes	Law & regulation changes	Law & regulation changes - Governance & compliance	Law & regulation changes	Law & regulation changes - Investment performance
#2	Governance & compliance	Governance & compliance	Valuation & pricing	Governance & compliance	Governance & compliance
#3	Investment performance	Risk management - Transparency & investor needs	Risk management	Distribution - Transparency & investor needs	Valuation & pricing
#4	Risk management	Distribution	Transparency & investor needs	Market developments	Transparency & investor needs
#5	Distribution - Performance of vendors & service providers	Performance of vendors & service providers	Investment performance	Investment performance	Market developments

Conclusion

Governance practices continue to improve as the Luxembourg fund industry grows. Luxembourg, being the world's second largest fund domicile, has a history of strong governance practices and our respondents this year clearly indicate they plan to continue this tradition. Following the introduction of the AIFM Directive, we have noticed that practices among alternative entities have become significantly more robust.

Many new and revised regulations, such as GDPR, 4th AML directive, MiFID II and PRIPS, have been implemented since the last survey. These regulations naturally influence both fund management and governance. However, updated guidance from industry associations as well as boards' continued interest to perform their mandates mean that the industry is largely prepared to tackle these. The effect of CSSF Circular 18/698 will be captured in the next edition of the survey, where we expect increased convergence of practices within UCITS and alternative investment entities as a result of the circular.

Growing regulatory pressures, as well as increased calls for transparency from both investors and regulators have been well noted by market players. Responses from participants show improvements regarding the appointment of independent directors and chairs, gender diversity, disclosure of information on directors (including on remuneration), the use of sub-committees, board performance review, uptake of the ILA Certified Director Program, and declarations of conflicts of interest.

We are pleased with the respondents' continual adoption of new governance policies. We have also highlighted areas that should be addressed more vigorously in the future. The high response rate to the survey underscores the fact that governance is a key focus for participants in the Luxembourg fund industry.

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