

# IFC Fund Governance Assessment Progression Matrix for Funds

## Instruction Sheet

Incoming Monthly





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The economic and regulatory environment for funds has evolved significantly since the 2008 financial crisis and exposed IFC, one of the largest emerging markets fund investors, to new governance risks. IFC's Corporate Governance Group seeks to assess and improve fund governance, and thereby strengthen operational foundations and reduce risks of its investment into fund vehicles.

Effective funds require a strong alignment of interest between the general partner and limited partner(s); management of the investment vehicle by a capable execution team based on sound strategy; adequate risk and control mechanisms; and appropriate transparency and disclosure of information by the fund partnership members. Through contractual and procedural modalities that integrate governance principles into fund management and investment operations, funds can add significant commercial value to their portfolio investment companies. Sound governance also helps attract investor interest into the fund, lead to better fiduciary management of the fund's assets, and enable higher returns for investors from improved portfolio results. IFC's experience has shown that there is a strong relationship between fund performance and development impact. Furthermore, strong governance contributes to the growth and long-term sustainability of private equity investment flows into emerging markets.

### Using the Fund Governance Tools:

There are eight key tools that are used for analyzing the governance of funds. The Instruction Sheet, Fund Progression Matrix, Document and Information Request List, and the Fund Governance

Report Generator for funds have been adapted for the Fund Governance Paradigm. The explanatory note 'Why Corporate Governance?' Sample CGA or Investment Review Memorandum CG Section and Supervision Checklist are applicable across all CG paradigms.

The primary fund model contemplated for analysis is a limited partnership and the relationships between the limited partners and the general partner or fund manager. If the fund under consideration is an L.L.C., listed entity or other corporate structure, please incorporate the requisite paradigm, e.g., listed companies, family or founder-owned, or financial institutions, etc. For analysis of the governance of the fund's target or portfolio investee companies, refer to the relevant CG paradigm, such as the SME governance paradigm and supporting materials.

**1) Instruction Sheet:** The purpose of this Instruction Sheet is to describe each of the key fund governance tools, how they should be used and who should be interviewed for a Fund Governance Assessment (FGA) or a Fund Governance Review (FGR).

**2) Why is Corporate Governance Important?:** This note explains the rationale for sound corporate governance, and IFC's approach for value addition to its clients. *This explanatory note should be given to the client at the earliest opportunity during the pre-appraisal stage to explain the broader context of IFC's review of fund governance.*

**3) Progression Matrix:** The Progression Matrix relates the six areas of fund governance (commitment to fund and investee company governance;

structure and functioning of governing bodies – fund manager or general partner, limited partner advisory committee, investment committee; control environment; transparency and disclosure; treatment of limited partners, asset owners and investors; and governance of stakeholder engagement) to four levels of achievement. The use of a matrix emphasizes the importance of ongoing improvements in the governance practices of fund clients, rather than trying to apply rigid and static minimum standards. Moreover, the Progression Matrix allows the fund to assess its own governance against a simple framework. *This document should be given to the client at the earliest opportunity in the appraisal process.*

**4) Document & Information Request List:** These combined questionnaires support information gathering necessary for the fund governance review. The Document and Information Request List is organized along the same lines as the six areas of governance in the Progression Matrix. *For an FGA, the combined Document and Information Request List should be circulated to the fund at least three weeks in advance of the on-site visit.* The fund should identify a single officer who will be charged with responding to the Document and Information Request List by providing brief written answers of one or two paragraphs to each of the questions and deliver these to IFC prior to the on-site fund governance analysis. For the FGR, the Investment Officer must collect the required information from the documents or from interviews during the appraisal. If the Investment Officer elects to send a specially prepared information request ahead of the site visit, an amended 'questions-only' version of the Fund

Governance Report Generator (see below) can be sent to the client. Discussions relevant to IFC's understanding of the governance of the institution will arise throughout the appraisal and diligence process. IFC staff are encouraged to edit the information request as necessary before sending it to the client to avoid duplication.

**5) Fund Governance Report Generator:** This document is intended for use by Investment Officers (and CG Officers, in the case of detailed reviews) in conducting an FGR; preparing the fund governance section of an Investment Review Memorandum; responding to questions from Director at the Investment Review Meeting; and in presenting any major issues to the IFC Board. The Fund Governance Report Generator uses negative assertions to introduce each area of risk, then utilizes rhetorical questions to frame the risk issue and identify and assess relevant fund practices and procedures. The aim is to help Investment Officers determine how much the fund mitigates the risk. The Investment Officer is required to collect information about the fund and report in the Decision Book FG section. The Fund Governance Review Report Generator aids Investment Officers in preparing this FG section as it indicates the data that must be collected from the client while providing guidance on how to collect this information by interviewing individuals at or contracted by the fund, or by reviewing a specific legal document.

**6) Sample FGA or FG Section (for FGRs) in Investment Review Memorandum:** The FGA and FGR always generate a written section for the Investment Review Memorandum and sometimes this will include recommendations for improvements to be undertaken by the fund. The sample FGR Section provides a useful reference point for the Investment Officer's use, and a sample FGA provides a useful example for a CG Officer.

**7) Sample FG Improvement Programs or Sample Decision Book Section (for FGRs).** Sometimes, an FGA results in the need for the client to develop and implement a Fund Governance Improvement Program (FGIP). The FGIP should always be tailored to the circumstances and priorities of the fund. However, sample FGIPs give a good idea of what has been negotiated with clients in the past; therefore, they can be used as a reference point in the drafting process. The FGR always generates a section for the Decision Book, and sometimes this will include recommendations for improvements. The Sample FGR Decision Book Section provides a useful reference point for the Investment Officer's use.

**8) Supervision Checklist:** The Supervision Checklist provides a list of key issues that should be considered by investment staff while supervising IFC projects and, in particular, those implementing fund governance conditionalities.

### **Fund Governance Interviewees:**

To carry out a thorough FGR or FGA, those conducting the governance analysis should have direct discussions with people who play a variety of governance roles in the fund. A guiding list of potential interviewees is provided below. *However, funds differ significantly in how they apportion responsibilities and in the titles that they use for different positions, so it is important that Investment Officers or CG Officers, as applicable, meet with those who, as a practical matter, are responsible for the principal governance functions, irrespective of their job titles.*

1. Fund manager
2. Key limited partners / investors
3. Minority limited partners / investors
4. Investment committee chair
5. Limited partner advisory committee chair
6. Chief executive officer (or equivalent position)
7. Fund secretary (or equivalent position)
8. Chief financial officer (or senior accounting officer)
9. Chief of internal audit and internal controls
10. Audit committee chair
11. Risk management committee chair
12. Chief risk officer
13. Chief compliance officer
14. Independent external auditor
15. Sustainability officer







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