SBai

Standards Board for Alternative Investments

The Alternative Investment Standards

1. Introduction

1.1 How to read the Standards

The Standards are set out in a consistent format in blue shaded boxes throughout this document. The formatting of the text within the boxes is differentiated to reflect the following elements*:*

- The Standards **(in bold)**
- Additional guidance and examples which are intended to assist and illustrate how compliance might be achieved (in normal text)
- Explanations and comments *(in italic)*.
- References to a “fund manager” or “manager” means an alternative investment manager that became a signatory to the Standards.

Illustration

- **The Standard is set out in bold text**

  - Lists of relevant sub-items which form part of the Standard are set out in bold text.

  Guidance on the Standard (and references to useful additional guidance, e.g., materials published by industry associations and regulators) and examples of how the Standard might be complied with are set out in normal text.

  Additional explanation and commentary to enhance understanding is set out in italics.

Fund manager signatories are required to conform with the Standards (in bold type) on a comply-or-explain basis. The Guidance and examples (in normal and italic type) are intended only to assist managers in complying with the Standards.

1.2 Applicability of the Standards to particular types of management activity

We should emphasise that the Standards have been designed to be applied to fund managers solely in respect of their management activities in relation to funds for which they act as the investment manager. They do not apply to other activities including, by way of example, management activities in relation to segregated accounts or fund of funds although certain of the Standards might, with or without adaptation, be appropriate for fund managers to utilise in carrying out those other activities.

We would have no objection if a fund manager, for the avoidance of any doubt, specified in its Disclosure Statement and on its website any areas of its business to which the Standards are applicable.

Certain of the Standards may also be applicable to other areas of the asset management industry. If participants in those areas find any of the Standards helpful and wish to adopt or adapt them for their circumstances, then they are of course free to do so and we would welcome that.

1.3. The Fund versus the Manager

The SBAI recognises that the power to ensure compliance with certain of the Standards rests with the fund or its governing body, rather than with the manager. For example, the requirement in Standard [5]: "to ensure that the fund puts in place valuation arrangements aimed at addressing and mitigating conflicts of interest in relation to asset valuation" requires action by the fund governing body and is outside the control of the manager. In such circumstances, the relevant Standard should be read as requiring the manager to do what it reasonably can to enable and encourage the fund governing body to ensure compliance with the relevant Standard. If despite the manager’s effort the governing body declines to comply, the manager should explain this in the Disclosure Statement.

1.4 Disclosure in the Manager's own Marketing Materials

Several Standards require a manager to make certain disclosures in its "marketing materials". Recognising that a manager's marketing materials will normally be comprised of various documents, sometimes including very short "teasers" or "flyers", the Standards should not be interpreted as requiring the same information to be included in each such document. Rather, such documents should, when taken as a whole and together with the fund's offering documents, contain the required disclosures and it is for the manager to decide which disclosures ought to be properly made in which documents with a view to ensuring that investors and prospective investors are provided with the information they would reasonably require in order to make a properly informed investment decision, i.e., wherever in the Standards it is required to provide disclosure in the manager's marketing materials, then this requirement is met if disclosure is provided in the fund's offering documents.

1.5 Comply or Explain

Conformity with the Standards is through a comply-or-explain regime, the foundation of which is disclosure. The alternative investment industry is diverse by size, strategy, and jurisdiction and therefore a one-size-fits-all approach is not suitable. A comply or explain regime has the advantage of allowing all managers to participate and gives investors more information on which to base their investment decisions. This is not to suggest that “explaining” is an inferior option to “complying”. The SBAI encourages managers to provide explanation even in those areas where it complies with the Standards, to enable better investor due diligence.

A. Disclosure to Investors and Counterparties [1]-[4]

Appropriate disclosure to investors is crucial in enabling well informed investment decisions. Also, counterparties require adequate information to satisfy their risk assessment and regulatory requirements and make well informed lending decisions.

The following areas are particularly relevant:

- Investment policy and associated risks, which relate to disclosure to investors of the fund's investment strategy and the risks involved in an investment in the fund (Standard [1])
- Commercial policy, which relates to disclosure of the commercial terms on which the manager has agreed to manage the fund and on which investors will invest (Standard [2])
- Performance measurement (Standard [3])
- Counterparty disclosures, such as to prime brokers (Standard [4]).

Investment Policy and Risk Disclosure - Standards and Guidance [1][10]

1.1 An appropriate level of disclosure and explanation of the fund's investment policy/strategy and associated risks should be included in the fund's offering documents.[11]

The SBAI envisages that in most circumstances such disclosure would, amongst other things, include:

- an appropriate description of the investment strategies and techniques employed, and prominent disclosure of the risks involved (Standards [16], [18], [20] and [22] also deal with risk disclosure);
- general details of the investments and instruments (including, for example, derivatives) likely to be included in the fund's portfolio;
- details of any investment restrictions or guidelines and of the procedures the manager will follow in respect of any breaches;
- an explanation of the circumstances in which the fund may use leverage, the sources of such leverage, details of any restrictions on the use of leverage, and, where applicable, an explanation of how the manager defines leverage and/or net exposure levels

Additional disclosures (not necessarily in the offering documents) might include:

- to the extent permitted by applicable law and regulation, the target return for the fund's strategy, if applicable;
- the target level of risk for the fund's strategy;
- to the extent permitted by applicable law and regulation, the historical track record of the fund's strategy, if applicable;
- details of the investment process, including internal reviews and controls;

---

[10] In conforming to these standards, managers may wish to consult the CFA Institute's Asset Manager Code of Conduct –Selection F (Disclosure) and other industry guidance.

[11] See introduction, chapter 1.3: The fund versus the manager

- upon request, the aggregate value of assets managed by the manager using the same investment strategy.

1.2 A fund manager should ensure that its own marketing materials refer to the fund's offering documents and make it clear that investors should rely only on the fund's offering documents when making any decision to invest.

It is recognised that incidental image or other short form marketing materials may not include such a cross reference to the fund's offering documents.

1.3 No change to the investment policy/strategy, which the fund governing body considers to be material, should become effective without (a) either obtaining investor consent in accordance with the provisions relating to shareholder voting/consent/approvals contained in the fund's constitution/offering document, or (b) providing advance notice sufficient for investors to redeem prior to the effective date of the changes without penalty.

1.4 A statement explaining how the fund has invested its assets during the relevant period in accordance with its published investment policy should be included in the fund's annual report.[12]

The SBAI envisages that such statement would comprise a high-level factual explanation as to how the fund has invested its assets during the period. It is not intended to be a review or confirmation of compliance with the fund's investment policy.

1.5 A fund manager should make periodic disclosures (generally monthly or quarterly) regarding material developments in the investment strategy, the manager's business and the fund's risk profile.

The SBAI envisages that, such disclosure would, amongst other things, include (in each case to the extent material and relevant to investors in the fund):

- changes in investment strategy or process (past and anticipated); and
- items in relation to the manager's business or the fund, such as key staff changes, new or terminated funds, or changes to any key service providers.

1.6 Upon reasonable request, a manager should (unless, and to the extent that, the manager is restricted from doing so pursuant to applicable law or regulation, is instructed not to do so by any governmental or regulatory body or is restricted from doing so under confidentiality obligations owed to a third party) disclose to investors (a) any material litigation in which it is involved and (b) any material formal regulatory enforcement proceedings against it.

- For these purposes, the SBAI considers by way of example, that in the U.K., the appointment of "specific" investigators under section 168 of FSMA, or the appointment of investigators to assist overseas regulators under section 169 of FSMA; and in the U.S., commencement of a formal inquiry by the Enforcement Division of the SEC or any action which would be required to be disclosed under Item 11 of SEC Form ADV (Part 1A) or CFTC Rules 4.34(k)(1) or 4.24(l)(1) (or the equivalents in jurisdictions outside the UK or US, as appropriate) would constitute "formal" regulatory enforcement proceedings.
- The SBAI considers that the appointment of "general" investigators under section 167 of FSMA or a request for information as part of a thematic review or otherwise pursuant to

[12] See introduction, chapter 1.3: The fund versus the manager

sections 165 or 165A of FSMA or a notice requiring the provisions of a report under section 166 of FSMA (or the equivalents in jurisdictions outside the UK) would not constitute "formal" regulatory enforcement proceedings.

- The SBAI considers that a routine examination of a US investment adviser under section 204 of the Investment Advisers Act, or the inclusion of an investment adviser in an SEC sweep exam, would not constitute "formal" regulatory enforcement proceedings.
- For the purposes of this Standard, proceedings which the manager considers to have been brought frivolously or vexatiously are not considered to be material litigation.

Commercial Terms Disclosure – Standards and Guidance [2][13]

2.1 The commercial terms applicable to the relevant interests being offered in a particular fund should be disclosed in the fund's offering documents in sufficient detail and with sufficient prominence (taking into account the identity and sophistication of potential investors).[14]

The SBAI envisages that in most circumstances such disclosure would, amongst other things, include:

- fees and expenses:
  - fair disclosure of the methodology used to calculate performance fees;
  - details of any other remuneration received by the manager in connection with its management of the fund (this will be relevant, for example, where a fund is a "feeder" fund into another fund managed by the same manager);
  - the basis of calculation for any base management fee and details of the nature of any expenses which may be payable or reimbursed by the fund to the manager;
  - to the extent possible, the amount of, and/or method of calculating, the periodic fees payable to the fund's other service providers;
  - to the extent known, a description of other material fees, costs, and charges which will be payable by the fund;
  - if applicable, the fact that the fees and expenses payable to service providers may change.
- termination rights:
  - details of the circumstances in which the fund is entitled to terminate the manager's appointment and the terms (e.g., in relation to termination fees) of such termination.
- exit terms (in the case of open-ended funds):
  - the period of notice investors are required to give to redeem their investment in the fund;
  - the circumstances in which redemption requests can be revoked (e.g., redemption requests may be irrevocable except with consent of the fund governing body);

[13] Managers may require further guidance, as set out by GIPS on disclosure of fees and cost (section F), www.gipsstandards.org

[14] See introduction, chapter 1.3: The fund versus the manager

- details of any redemption penalties (including, if relevant, any fee or penalty applicable where redemption requests are revoked);
- details of any "lock-up" periods during which the investor will be unable to redeem its investment in the fund and any limits on the extent of redemptions on any redemption date (i.e. redemption "gates"); and
- an indication of circumstances in which normal redemption mechanics might not apply or may be suspended, if any – these could include, amongst other things:
  - a significant reduction in the liquidity of the fund's underlying assets; and
  - distress of one or more of the fund's counterparties (including its prime broker(s)) leading to uncertainty as to the value of OTC contracts or access to / ownership of re-hypothecated assets.
- Details of any other measures which may be considered by the fund governing body in circumstances where normal redemption mechanics might not apply or may be suspended – for example:
  - fund level gating, investor level gating, lock-ups, suspension of redemptions, penalties for revoking redemption requests *(to the extent that the fund's constitutional documents/offering documents do not already provide for such mechanisms)*
  - side pocketing
  - restructuring the fund to incentivise investors to accept, or switch to an alternative share class offering reduced liquidity (for example, in exchange for lower fees)
- if relevant, an indication of any circumstances in which any changes to redemption terms may be made without shareholder consent;
- whether measures to enhance liquidity at the fund level may be considered when redemptions are suspended/restricted (e.g., facilitating transfers of shares/units in the fund subject to ensuring that investors satisfy investor eligibility requirements).

2.2 Changes to the fees and expenses payable by the fund to the manager or parties related to the manager, or the redemption rights available to investors which the fund governing body considers to be materially adverse to investors should not be effected without either (a) obtaining investor consent in accordance with the provisions relating to shareholder voting/consent/approvals contained in the fund's constitution or offering documents, or (b) providing advance notice sufficient for investors to redeem prior to the effective date of the changes without penalty.[15]

2.3 A fund manager should disclose the existence of side letters which contain "material terms"[16], and the nature of such terms. A fund manager is not required to disclose the existence of side letters which contain no material terms.

[15] See introduction, chapter 1.3: The fund versus the manager

[16] "Any term the effect of which might be reasonably expected to provide the investor with more favourable treatment than other holders of the same class of shares or interests which enhance that investor's ability either (i) to redeem shares or interests of that class or (ii) to determine as to whether to redeem shares or interests of that class, and which in either case might be reasonably expected to put other holders of shares or

2.4 Upon request, a fund manager should disclose

- **(a) Existence of funds, accounts or vehicles managed by it using the same or similar[17] investment strategy,[18]**
- **(b) any material adverse effects which the existence of such other funds, accounts or vehicles may have on investors in the fund,**
- **(c) the aggregate value of asset managed by the manager using the same or similar[17] investment strategy,**
- **(d) the aggregate size of employee or partner interests in the investment strategy,[19]**
- **(e) the existence of any other funds or accounts managed by it which follow the same or similar[17] investment strategy to the fund and which are available for investment only by partners or employees (or their connected persons) of the fund manager,[18, 20] and**
- **(f) in the case of (e) above, the size of such funds and accounts.**

Please see below an example of non-binding guidance to determine "similarity".

2.5 The fees and expenses (including but not limited to management and performance fees) charged to the fund should be disclosed in the fund's audited financial statements.[15] This includes explanations in the annual report which allow investors to compare, readily, the fees and expenses charged with the description of such fees and expenses set out in the fund's offering documents where this is not obvious from the disclosure in the financial statements.

For example, the categories and captions in the fund's financial statements might correspond to those used in the fund's offering documents so that they can be easily compared.

Managers might also consider disclosure of a total expense ratio (TER) or gross vs. net return for the period under review.

2.6 On the establishment of a fund, a fund manager should liaise with the fund's administrator to ensure that the methodology for calculating fees payable to the manager (and in particular performance fees) is agreed in advance. Such methodology should be accurately described in the fund's offering documents.[15]

---

interests of that class who are in the same position at a material disadvantage based on the exercise of their redemption rights." (https://katten.com/files/19837_the_fsa_hedge_funds_and_side_letters.pdf)

[17] Similar strategies should be interpreted to include funds, accounts or vehicles managed by an investment management team or individual within the fund manager and which trade substantially in parallel, in whole or in part with the fund. Substantially similar trading patterns over time, rather than overlapping positions by themselves, is the key indicator (i.e., overlapping positions by themselves do not define similarity).

[18] For the avoidance of doubt, the Standard requires fund managers to disclose that they manage other funds, accounts, or vehicles, but does not require disclosure of specific details of such funds, accounts, or vehicles.

[19] For the avoidance of doubt, the Standard requires disclosure of aggregate partner/employee investment in the respective strategy, not a person-by-person break-down.

[20] For the avoidance of doubt, a feeder fund, accessible only to partners or employees (or their connected persons) which only invests into a master fund accessible to external investors through a different feeder does not fall under this disclosure.

Further guidance on this topic can be found in the SBAI's Toolbox Memo on Conflicts of Interest in Parallel Funds[21]*.*

Example of non-binding guidance to determine "similarity"

1) The Portfolio Manager or investment team, the investment mandate (i.e., equity, fixed income, macro) and the strategy or style (i.e., market neutral, relative value, trend following) will all need to be the same.

2) Additionally, the "similar" fund or separately managed account will have to have an 80% overlap in the following 4 areas (an example follows each item):

    a) ***Asset classes traded*** (i.e., mortgages, equity, credit, FX) - If the fund is 100% equities, then other funds/sleeves must have at least 80% in equities to be classified as similar.

    b) ***Target risk and return*** - Funds must have similar risk-return targets (measured by Sharpe or Information Ratio) to be classified as similar. Thus, if the fund targets a Sharpe ratio of 1, then "similar" funds must target a Sharpe between 0.8 and 1.2 (+/-20% band).

    c) ***Time horizon of positions*** - If the average holding period for the fund is 3 months, then the holding period for the similar fund needs to be between 2.4 to 3.6 months (+/- 20% band).

    d) ***Average liquidity of positions*** - If the average liquidity profile of the fund is 10 days, then the similar fund needs to have an average liquidity profile between 8 to 12 days to be classified as similar (+/- 20% band).

3) A multi-strategy fund would have to have 80% overlap of allocations among sub-strategies, and the sub-strategies would have to be substantially similar (80%), as in item 2 above.

Performance Measurement - Standards and Guidance [3]

Accurate and consistent reporting of investment performance enables investors to make well-informed judgments about their investments and allows them to compare different managers.

3.1 A fund manager should, in cases where, in its view, the fund has material exposure to hard-to-value assets, ensure that any disclosure in its own marketing materials relating to the fund's performance is accompanied by a reference to any factors which may be material to the

[21] https://www.sbai.org/wp-content/uploads/2016/04/Toolbox-Memo-Case-Study-Conflicts-of-interest-between-parallel-funds-6-March-2020.pdf

robustness of the performance calculation. Where the funds offering documents include references to the fund's performance, they should include similar references.[22]

Such factors might, amongst other things, include:

- the percentage of the portfolio invested in what the manager considers to be hard-to-value assets;
- the method used in valuing assets which the manager considers to be hard-to-value; and
- the use of side pockets.

The Global Investment Performance Standards (GIPS) provide a standardised approach to performance presentation to communicate investment results to clients and prospective clients. SBAI welcomes the initiative of GIPS to review the applicability of their existing principles to alternative investment funds.

Disclosure to Lenders/Prime Brokers/Dealers - Standards and Guidance [4]

4.1 A fund manager should, subject to obtaining the consent of the fund's governing body, provide, or do what it reasonably can to enable and encourage the fund's administrator to provide, any agreed information reports to the fund's counterparties in a timely manner.

B. Valuation [5]-[8]

While valuation is generally expressed as a single number it is important to recognise that the single number is merely the expression of a range of potential outcomes that derive from the valuation process. It follows that investors need to be informed about the valuation process and have confidence in its breadth and robustness. The following areas are of particular relevance in this context:

- Segregation of functions in valuation
- Approach to handling and valuing of hard-to-value assets
- Investor disclosure of the governance arrangements and hard-to-value assets

Further guidance on Valuation in Alternative Credit[23] and Insurance Linked Strategies[24] can be found in the SBAI Toolbox.

Segregation of Functions in Valuation – Governance Standards and Guidance [5]

5.1 Arrangements to address and mitigate conflicts of interest in the asset valuation process should be put in place.[25]

We believe appointment of an independent and competent third-party valuation service provider is the most satisfactory way to achieve this.[25]

The SBAI acknowledges, however, that in some cases it will not be possible in practice to achieve both independence and the required level of competence by appointing a third-party valuation

[22] See introduction, chapter 1.3: The fund versus the manager

[23] https://www.sbai.org/wp-content/uploads/2020/05/SBAI-Alternative-Credit-Valuations-Memo-20-May-2020.pdf

[24] https://www.sbai.org/wp-content/uploads/2019/05/SBAI-Valuation-of-Insurance-Linked-Funds-7-May-2019.pdf

[25] See introduction, chapter 1.3: The fund versus the manager

service provider, in which case the involvement of the fund manager in the asset valuation process will, to a greater or lesser extent, be unavoidable.

5.2 Where a fund manager performs valuations in-house or provides final prices to a valuation service provider therefore determining the asset price, the valuation function should be segregated from the portfolio management function. This approach should be explained to investors. If smaller or start-up managers consider this impractical this should be disclosed in marketing documents and the fund's offering documents.[25]

This will involve amongst other things:

- Relevant employees operating independently from the portfolio management team and minimising potential conflicts of interest,
- Ensuring that remuneration for the valuation team is not directly linked to fund performance,
- Where it is the case that the portfolio management team has necessary expertise and understanding required for asset valuation, information provided by that team should be properly documented and recorded, and
- Assisting fund governing bodies to satisfy themselves regularly that in-house valuations are handled appropriately.

Ways to achieve this might include:

- Valuation staff providing periodic reporting on the valuation process to the fund governing body,
- Forming a designated "valuation committee" (with non-investment personnel making up the majority of the committee's composition),**Error! Bookmark not defined.** and
- Using an appropriate external party to evaluate the effectiveness and robustness of the valuation procedures and report to the fund governing body or its valuation committee).

Fund managers also could refer to The SBAI Toolbox Memos on Valuation for Alternative Credit[26] and Insurance Linked Strategies[27], as well as publications by standard setters and regulators, including IOSCO's Principles for the Valuation of Collective Investment Schemes (2013)[28] and IOSCO's Principles for the Valuation of Hedge Funds (2007)[29] for further guidance in this area.

We acknowledge that in some cases it may not be practical to appoint a third-party valuation service provider. In these cases, the fund manager's involvement in the asset valuation process may be unavoidable.

5.3 Managers should be prepared to provide evidence that appropriate due diligence and vendor selection has taken place before appointing an external valuation service provider.

Managers should provide notice to the full partnership when the fund has engaged counsel or third parties to provide specialised advice, e.g., valuations experts.

Appropriate due diligence may include, but not be limited to:

---

[26] https://www.sbai.org/wp-content/uploads/2020/05/SBAI-Alternative-Credit-Valuations-Memo-20-May-2020.pdf

[27] https://www.sbai.org/wp-content/uploads/2019/05/SBAI-Valuation-of-Insurance-Linked-Funds-7-May-2019.pdf

[28] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD413.pdf

[29] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD240.pdf

- Documenting any perceived or actual conflicts of interest between the manager and the independent valuation provider, such as:
    - Past or current relationships with the manager, fund, portfolio companies, or LPs.
    - Any economic incentives that might impair independence.
- Review and consideration of a range of possible providers
- Assessment of the provider to be able to provide accurate and timely valuations of the type of assets in scope
- The resources available to the provider in terms of staffing
- The experience of the provider's staff
- Industry references and feedback
- Whether the provider is a member of a standard setting body such as the International Valuation Standards Council
- Ensuring that vendor selection has been conducted independently of the investment team

Where a manager engages and utilises more than one independent valuation provider, they should justify why and explain the process for selecting which to engage on each valuation/engagement and how to resolve differences in valuation outcomes.

Managers should be mindful that best practice requires ongoing performance monitoring of the outsourced provider. This could include:

- Periodic peer review or benchmarking of valuation conclusions.
- Feedback loop from LPACs or audit findings.
- Reconfirmation of independence on an annual basis.

5.4 Managers should disclose to Investors details of the service that will be delivered by any external valuation service provider such as externally calculated valuations, including what limitations in service provision may exist.

This should include whether the independent valuation provider will, for example:

- Value all portfolio positions, a sample of positions or materially large portfolio positions.
- Provide defined valuations, a range of possible values, or verification that they see no material issue with the managers calculated mark (e.g. positive assurance).
- Provide any verification of manager valuation models.
- Managers should be prepared to share any letter of engagement with investors as part of a due diligence process.
- IVSC's International Valuation Standards provide detailed guidance as to what an engagement letter should ideally contain:

The scope of work must state whether the valuation review is a valuation process review, a value review, or both.

a) A valuation process review addresses compliance with IVS.
b) A value review addresses the reasonableness of a value.

The scope of work of an engagement that is either a valuation process review or a value review, or both, must include the following at a minimum:

a) The type of review being conducted,
b) The agreed scope as to whether the review is a valuation process review, a value review or both,

c) The asset(s) and/or liability(ies) being reviewed,
d) The identity of the valuation reviewer,
e) the identity of the client,
f) The intended use,
g) The intended users, if applicable,
h) Significant or special assumptions and/or limiting conditions pertaining to the valuation to be reviewed,

5.5 Managers should disclose to Investors the legal or contractual requirement to accept or implement, independent valuations, when provided by an external valuation service provider. Managers should further disclose where independently derived valuations have been altered or ignored.

Managers should document and maintain clear records, including an audit trail, where independently derived valuations have not been adopted. Justifications for such decisions should be prepared contemporaneously, outlining the rationale, supporting evidence, and governance steps taken. Managers should be prepared to engage with investors to explain these circumstances and provide transparency around the basis for exercising professional judgment.

5.6 Upon appointment of an external valuation service provider, managers must ensure that valuation processes, decisions, and outcomes are free from actual or perceived conflicts of interest. Where potential conflicts exist, they should be identified, disclosed, and appropriately managed to safeguard the independence, objectivity, and integrity of the valuation process.

Conflicts of interest may arise in various forms, including but not limited to:

- Economic interests, such as fee or payment structures for third-party valuation agents that are contingent on valuation outcomes or linked to assets under management. External valuers should be remunerated by fixed-fee compensation structures where possible, to reduce incentive bias.
- Ownership or affiliation conflicts, where a valuation service provider is wholly or partly owned by private market participants or related parties.
- Influence or governance conflicts, where individuals involved in determining valuations may be subject to pressure from those who stand to benefit from higher or lower valuation outcomes.
- Dual roles, where a third-party valuer or internal team performs both advisory and valuation functions on the same asset or entity.

Managers should provide transparency around the nature of potential conflicts, including ownership structures, fee arrangements, and any other relevant relationships. Formal conflict of interest policies should be maintained. Conflicts should be recorded and documented, alongside any mitigating controls. Recusal procedures should be established in organisations where there are internal conflicts related to competing strategies.

5.7 Managers should select auditors who are competent, capable and with sufficient experience in the auditing of financial statements for funds which invest in illiquid or non-listed assets.

Managers should provide notice to the full partnership when the fund has engaged a new Auditor.

Appropriate due diligence may include, but not be limited to:

- Documenting any perceived or actual conflicts of interest between the manager and the audit provider, such as:

- Past or current relationships with the manager, fund, portfolio companies, or LPs.
- Any economic incentives that might impair independence.

- Review and consideration of a range of possible providers
- Assessment of the provider to be able to provide appropriate accounting scrutiny of the fund
- The resources available to the provider in terms of staffing
- The experience of the provider's staff, including specialist internal teams that may review valuations
- Industry references and feedback
- Whether the provider is a member of a standard setting body such as the Association of International Professional Accounts.

5.8 Explanation of the role of external auditors in the valuation process should be provided to Investors, including to the extent the auditors will independently gather and assess underlying asset data and perform underwriting of asset valuations.

Where auditors do not undertake independent underwriting of asset valuations, managers should disclose this limitation to ensure investors have clarity on the scope of auditor involvement. Managers should be prepared to discuss the level of assurance provided by audit procedures and how these interact with the manager's internal valuation governance framework.

Where an audit firm also offers dedicated valuation services, managers should disclose whether such services are used and explain the safeguards in place to preserve independence. Conflicts of interest should be assessed and documented, and managers should be prepared to confirm that individuals providing assurance services are separate from those providing valuation services. Any evaluation should focus on competence and capability, as well as value for money.

5.9 Managers should disclose to Investors any qualifications, comments, or concerns raised by auditors regarding valuations in a timely manner.

Such disclosure should explain the nature of the auditor's observations, their potential impact on fund reporting, and the steps the manager is taking to address or remediate the issues. Managers should ensure that these matters are documented and communicated consistently, with appropriate governance oversight, to maintain investor confidence in the valuation process.

Qualified audit opinions should be communicated to investors no later than 10 business days after receiving the auditor's formal communication. Other comments or concerns should be communicated at the next available reporting cycle, but not longer than three months.

Segregation of Functions in Valuation – Disclosure Standards and Guidance [6]

6.1 A Valuation Policy Document that covers all material aspects of valuation processes, procedures, and controls for the fund should be prepared.

The Valuation Policy should be reviewed regularly by the fund manager and fund governing body and be made available to investors on request on a confidential information (acknowledging it will contain proprietary information)..

In most circumstances the Valuation Policy Document should describe:

- The responsibilities of all parties involved in the valuation process. This should include defining who has responsibility for performing valuations from a functional perspective and how they interact with the firm's governance framework,

- The processes and procedures in place for effectively managing conflicts of interest,
- Relevant material provisions of any service level agreements (SLAs) with third parties responsible for or involved in the in the valuation process (excluding commercial provisions), and
- Controls and monitoring processes to ensure satisfactory performance where the valuation function is outsourced to a third party.

It is expected that the Valuation Policy should be formally reviewed at least annually to ensure it remains up to date and presents a true reflection of valuation processes and procedures.

6.2 A fund manager should disclose any material involvement of the portfolio management team, actual or likely, in the fund offering documents and its marketing materials. Investors should be informed, e.g., in manager newsletters, any material changes to this level of involvement.[30]

Examples of this disclosure could include:

- Who has functional responsibility for valuations, who contributes to the valuation process either through performing calculations or gathering data and who ultimately has responsibility from a governance perspective of deciding upon valuation marks. Communicating where any independence exists and explaining segregation of duties.
- Percentage of the fund's assets which are (or are expected to be) valued with some input from the portfolio management team, or
- A description of the types of assets where the portfolio management team would usually contribute to the valuation process

6.3 Manager-led secondaries, crossed-investments, or related party transactions, i.e., assets bought and sold between two vehicles managed by the same manager or transacted between related party entities, should be executed in accordance with managers' fiduciary obligations, disclosures to regulators and investors, and compliance policies and procedures governing the transactions.

Managers engaging in such transactions as those described above should commission an independent valuation or fairness opinion prior to the deal closing.

For the purpose of this Standard, 'related parties' refer to individuals or entities that have a direct or indirect pre-existing relationship (e.g., financial, managerial, or ownership-based) that could influence the terms, pricing, or governance of a transaction in the private markets.

In the context of private market valuation and cross trades, related parties typically include (but may not be limited to):

- The manager's affiliated entities, and their employees
- Portfolio companies under common control or influence
- Funds managed by the same sponsor or firm
- Senior executives or board members who sit across multiple related entities
- Advisors or service providers with financial interests in the outcome of the transaction

[30] See introduction, chapter 1.3: The fund versus the manager

For the purpose of this Standard, an independent valuation service is a professional, third-party valuation provider that operates without any financial, operational, or advisory ties to the asset being valued, its stakeholders, or any entity with a vested interest in the valuation outcome.

Further, the provider of the valuation service should:

- Be suitably qualified and experienced in valuation of the underlying asset
- Follow recognised valuation standards and be in compliance with global accounting standards, where applicable.
- Offer clearly documented assumptions, methodologies, and supporting data.
- Ensure appropriate information barriers are in place within its organisation to mitigate conflicts of interest and sharing of sensitive information.

When Managers initiate a sale process, they should be mindful of the following:

1. Transparency & Disclosure

Focus: Ensuring investors are well-informed and conflicts are clearly communicated.

- *Managers should disclose to investors about the possibility of cross trades in their fund documents and provide transparency in regular communications.*
- *Managers should be transparent regarding any potential conflicts of interest.*
- *Investors should be given access to the independent valuation report and should be given time to engage with the external valuer.*

2. Governance & Investor Engagement

Focus: Involving investors and governance bodies appropriately and at the right time.

- *Where possible, managers should offer clear participation options to all investors in GP-led transactions, including the right to opt out of continuation vehicles. While some LPs may be contractually bound, efforts should be made to maximise investor choice and avoid coercive structures.*
- *Managers must disclose the motivations and economic interests in any proposed transaction, including whether the manager will commit new capital, roll over existing interests, or receive fees. This ensures investors can evaluate alignment of interests and assess potential conflicts.*
- *There should be a reasonable and plausible logic for the proposed transaction (for example, managers should be prepared to explain why a GP-led transaction is being proposed, rather than a secondary market sale).*
- *Investors should be engaged as soon as reasonably possible and have adequate time to consider the proposal. This should include a summary of planned valuation approach. The independent valuation report should be shared at least 10–30 business days (additional time should be provided to review documentation when deals are considered complex) before any decision or consent is required. Allow time for investors to review and, if desired, raise questions with the manager or independent valuation provider.*
- *Formal Investor consent, if required, should be sought.*

- *Limited Partner Advisory Committees (LPAC) should be engaged where any Limited Partner Agreement requires some form of affirmative action or approval.*
- *Investors may wish to engage on an arms-length basis so not to breach any contractual or regulatory presumption that they are a passive investor.*
- *Managers operating both Primary and Secondary strategies should ensure that investment decision-making structures (e.g., investment committees or forums) for buy-side and sell-side activities remain independent and clearly delineated.*

3. Process Integrity & Execution Standards

Focus: Structuring and executing transactions in a fair, competitive, and efficient manner.

- *The process should be efficient and transparent; consideration could be given to any additional external competitive bids or auctions.*
- *Managers should strive for best execution in all cases.*
- *Ongoing monitoring of cross trades should be conducted, and proper records should be maintained.*

4. Pricing & Valuation

Focus: Ensuring fair pricing and the use of independent valuation mechanisms.

- *Cross trades for listed securities should be executed at a fair market price (typically the last traded price or the midpoint of the bid-ask spread).*
- *For listed securities, if there is low liquidity or low trading volumes, there is a heightened risk that the cross trade could negatively affect market prices.*
- *Careful consideration should be given to how the trade is structured and executed in such cases.*
- *Managers should be clear who bears the cost of the valuation.*

6.4 Managers should disclose in their Valuation Policy the valuation methodologies reasonably expected to be used during the life of the fund. Disclosure should be sufficiently detailed, wording such as 'any reasonable or justifiable methodology that the Managers chooses or sees fit' etc., should be avoided.

The selection of methodologies should be driven by the facts and circumstances of the investment and the market in which it would be transacted. Managers should give consideration to the appropriateness of the selection, ensuring that is does not differ materially from market or industry norms without good reason.

Managers should determine an appropriate valuation methodology for an asset upon acquisition and if it is likely that a change in methodology will be required in the future, to indicate what those methodologies may be, ahead of time.

Potential future changes of methodologies could include venture capital investments whereby an option pricing model may be appropriate when the asset is not yet revenue generating. If the business then evolved to generate revenue, then transitioning to an income-based valuation technique may be appropriate. Similarly, some infrastructure investments may be valued at cost

initially (representing costs of capital expenditure) before transitioning to a fair value valuation methodology when revenues are generated.

Another important consideration when selecting valuation methodologies is the differing requirements and flexibilities embedded in various accounting frameworks, which can materially influence the approaches applied. For example, under Lux-GAAP, both amortised cost and cost-less-impairment are permissible, two methods that are conceptually distinct yet often conflated (amortised cost involves effective interest rate adjustments, whereas cost-less-impairment does not). Unlike IFRS or US GAAP, which generally require amortised cost or fair value measurement for financial instruments, Lux-GAAP allows the simpler cost-less-impairment model, making it a common choice for private debt, real estate and infrastructure vehicles domiciled in Luxembourg. These variations underscore the need for GPs to align methodology selection not only with the asset's characteristics and the fund's investment strategy, but also with the applicable accounting rules, while ensuring that disclosures clearly articulate the implications for comparability across frameworks.

Examples of commonly utilised methodologies for various asset classes are provided below. This list should not be considered to be a complete representation of available methodologies, nor should it be construed that any particular methodology is being endorsed over another.

Asset Class	**Commonly Applied Valuation Methodologies**
Private Equity (Growth, Buyout)	- Market Approach (Comparable Companies or Precedent Transactions) - Income Approach (DCF)
Venture Capital	- Price of Recent Investment (Early stages) - Option Pricing Models - VC Scenario Valuation Model - Weighted Expected Return Model - Venture Capital Method - Calibration to Market Approach - DCF (later rounds)
Real Estate	- Income Capitalization Approach - Sales Comparison Approach - Discounted Cash Flow - Depreciated Replacement Cost - Amortised Cost
Infrastructure	- Amortised Cost (Initially) - Discounted Cash Flow (DCF) (Income generating)
Private Credit / Loans	- Market Yield Approach - Discounted Cash Flows - Broker Quotes (for syndicated debt) - Amortised Cost
Natural Resources and Energy	- DCF with Commodity Price Forecasts - Replacement Cost Approach
Distressed Assets	- Liquidation or Recovery Value Approach - Scenario-Based DCF

6.5 During the life of the fund, should the Manager depart from valuation methodologies outlined in the fund's Valuation Policy then Investors should be notified.

Managers should be prepared to provide a rationale for the introduction of any new, or departure from an established methodology.

Managers should be prepared to provide scenarios or describe market conditions under which a change in methodology may be appropriate.

Managers are encouraged to keep investors informed of any changes to valuation methodologies previously outlined in the Valuation Policies, ideally through regular interactions such as periodic reports, update calls, or due diligence meetings.

This approach promotes transparency and consistency in valuation practices while maintaining a practical balance, ensuring investors are appropriately informed without creating unrealistic expectations for communication frequency or depth. The overarching objective is to safeguard against discretionary or selective changes in methodology that could be perceived as "cherry-picking" outcomes.

Changes should be reviewed by a valuation committee (if in place) or other governance mechanism, prior to implementation. This review should ensure consistency with fund documentation, industry standards, and fiduciary obligations.

Any change in methodology must be clearly justified, with rationale based on:

- Material change in asset characteristics
- Evolving industry best practices or regulatory updates
- Better alignment with fair value principles under prevailing market conditions

Decisions should be formally documented, including the rationale, timing, and expected impact on valuation outcomes. Investors should be notified with a clear explanation of the change and its rationale. If required, updated Valuation Policies should be issued to investors.

Where there are contractual obligations to notify investors, the manager should:

- Notify the LPAC in advance of any material change.
- Seek LPAC feedback or approval if:
    - The change materially affects portfolio valuations or NAV
    - It introduces a new methodology not previously disclosed
    - There is potential for a conflict of interest (e.g., in a GP-led secondary or cross-trade)
- Provide sufficient time and information for LPAC members to assess the change

6.6 Managers should be prepared to provide details where a valuation is reached that includes a weighing of several methodologies or valuation components. Managers should be prepared to explain the process to calculate and apply weightings to each selected methodology.

Aggregation of valuation methodologies may be considered to be an appropriate mechanism for valuing an asset. However, managers should be transparent about the weightings ascribed to each methodology and the logic for methodology selection and aggregation.

If multiple valuation approaches create widely divergent valuation outcomes, simply averaging or weighting these outcomes to derive a valuation outcome should not be considered acceptable. Steps should be taken to understand why material differences exist and select the valuation approach which produces a value which is considered the most reliable.

6.7 Managers should be prepared to provide details on significant inputs, adjustments and assumptions used in the valuation process that could have a material impact upon the outcome. i.e., discount factor, growth rate, EBITDA adjustments, future, or unrealized cash flows etc.

1. Transparency & Disclosure

Managers should be prepared to provide transparency and disclosure related to key or material inputs, adjustments and assumptions used to reach an asset valuation. Managers should be prepared to engage with Investors on this topic and allow for discussion. Managers should set minimum expectations around how often valuation assumptions will be shared (e.g. monthly, quarterly etc.) and in which format they will be communicated (e.g. data room access, manager calls etc.).

2. Valuation Models

The International Valuation Standards Council defines a valuation model within its International Valuation Standards (General Standards: IVS 105 Valuation Models) as follows:

A valuation model is a tool used for the quantitative implementation of a valuation method in whole or in part. A valuation model converts inputs into outputs used in the development of a value, whereas a valuation method is a specific technique to develop a value.

Other important considerations raised by IVSC include:

- *Valuation models must be suitable for the intended use of the valuation and consistent with inputs.*
- *Valuation models can be developed internally or sourced externally from a specialist or service organisation.*
- *Valuation models used must be tested to ensure accuracy of the output is appropriate for the intended use, basis of value and the assets and/or liabilities being valued.*
- *In all cases the valuer must apply professional judgement and professional scepticism in the selection and use of valuation models and the application of inputs used in the valuation model.*

IVSC's Characteristics of Appropriate Valuation Models

The valuer must determine that the valuation model is appropriate, which for the purposes of IVS105 Valuation Models means 'fit for purpose' in terms of assets or liabilities being valued, the scope of work and the valuation method. The valuer must apply professional judgement to balance the characteristics of a valuation model in order to choose the most appropriate valuation model. The characteristics of appropriate valuation models are shown below:

A) Accuracy: The valuation model is free from error and functions in a manner consistent with the objectives of the valuation,

B) Completeness: the valuation model addresses all the features of the asset and or liability to determine value,

C) Timeliness: the valuation model reflects the market conditions as of the valuation date,

D) Transparency: all persons preparing and relying on the valuation model must understand how the valuation model works and its inherent limitations.

Some investors may wish to be given access to, or receive a demonstration of, valuation models. Investors may also wish to receive the underlying portfolio company or position level data to create their own proprietary model. Not all investors will have the sophistication to interpret this information, but there is a continuing trend of investors wishing to receive better transparency on the topic of valuation models. Managers should implement version-controlled models and audit trails of changes made to models or key assumptions over time. It is recognised that version controlled and auditable records of changes are easier to maintain in software or algorithmic based valuation models, however, even the most basic desktop-based models (such as excel) can be subject to basic principles of control and oversight. Appropriate oversight of models and the procedure around changes to how models operate or calculate outputs, should be given consideration also.

3. Evidence-Based Assumptions and Inputs

Managers should be prepared to defend their assumptions and inputs and be able to provide evidence to back up their assertions. It is recommended that managers document and disclose changes to key assumptions or inputs between reporting periods and the rationale for those changes (e.g., market movements, company performance, external factors).

Professional judgement, and scepticism, should be applied at all times. Data and inputs should be based on factual information (such as measurements or published prices, if available) and managers should maximise the use of observable data where possible. When relying on listed market prices, managers should also assess the liquidity, depth, and activity of the underlying market to determine whether such prices are genuinely representative of fair value. Thinly traded or inactive markets may produce quoted prices that do not reflect achievable exit values and should therefore be treated with caution.

The process to select data and inputs should be consistent, transparent and fully documented. Departure from observable data should be justified and supported by appropriate analysis and governance review. Further, valuation models should be aligned with the life and characteristics of the asset. Short-dated models (>10 years) may not capture accurately the complexities of valuing assets with longer economic lives or cash-flow horizons (e.g. infrastructure assets).

Managers should be mindful that assumptions and inputs not grounded in any sense of commercial or economic reality, undermine the confidence in private market valuations and raise doubts about the subjectivity inherent in the process.

Asset Class	Key Inputs and Assumptions Influencing Valuation Outcomes
Private Equity (Growth, Buyout)	- Selection of peer group and transaction comparables - Earnings base (EBITDA, revenue, etc.) and normalization adjustments - Market multiples (EV/EBITDA, P/E) - Discount rate or cost of capital (WACC) - Terminal value assumptions - Forecast growth rates and margins
Venture Capital	- Reliability and recency of last financing round - Probability weighting of scenarios (success/failure) - Expected time to exit and exit multiple

	- Discount rate or required rate of return - Volatility estimates (for option models) - Assumed dilution and follow-on funding rounds
Real Estate	- Market rents and rental growth assumptions - Capitalisation and discount rates - Vacancy and occupancy rates - Operating expenses and maintenance costs - Comparable transaction evidence - Remaining economic life and replacement cost estimates - Labour, materials and associated building costs
Infrastructure	- Cash flow projections (revenues, costs, inflation) - Discount rate or cost of equity - Concession length and residual value - Regulatory/tariff assumptions - Inflation and interest rate forecasts - Labour, materials and associated building costs
Private Credit / Loans	- Credit spreads and market yields for comparable instruments - Borrower credit quality and recovery assumptions - Prepayment and default probabilities - Discount rate and time to maturity - Quality and availability of broker quotes or secondary pricing - Collateral coverage and covenant terms
Natural Resources and Energy	- Commodity price curves and volatility - Production forecasts and decline rates - Capital expenditure and operating cost assumptions - Discount rate and cost of capital - Reserve estimates and depletion schedules - Replacement cost of reserves and infrastructure
Distressed Assets	- Recovery rate and liquidation value assumptions - Timing of recoveries and resolution scenarios - Discount rate (reflecting risk and illiquidity) - Legal or restructuring outcomes - Market appetite for distressed assets

4. Materiality Thresholds

Defining materiality is an inherently challenging task given the broad range of fund types, strategies, and asset classes across the industry. While a single uniform threshold may not be practical, thresholds should be determined using a consistent, principles-based framework that promotes fair investor treatment and sound governance.

The International Standards on Auditing (ISA 320) define materiality from an auditing perspective which can be extrapolated into a valuation focused definition as follows:

"Materiality in the context of valuation refers to any misstatement, omission, or assumption that, whether individually or collectively, could reasonably be expected to influence the decisions of

stakeholders relying on the valuation outcome, e.g., management, regulators, or other users of the valuation report."

Criteria that may be important in setting materiality thresholds may include:

- Whether the fund is open-ended or closed-ended
- Risk and volatility profile of the fund
- Investment policy and strategy of the fund
- Regulatory expectations and guidance
- Materiality thresholds defined in legal or contractual materials

We do not believe it is the role of the SBAI to define specific materiality thresholds. Instead, managers should define what constitutes 'material' inputs or assumptions, using quantitative or qualitative thresholds (e.g. inputs that would impact NAV by ≥X%, or have a ≥Y% impact on performance projections). Changes to inputs or assumptions that may be considered materially impactful, may include but are not limited to:

- Fund level NAV sensitivity of ≥ 1% of total NAV
- Position level valuation impact of ≥ 5% change in position value due to a singular input

Care should be given to portfolio level positions that have an outsized impact on NAV or are so significantly large that concentration is elevated.

6.8 Managers should be prepared to disclose the results of any sensitivity analyses performed on significant inputs, adjustments, or assumptions used in the valuation of fund assets.

Sensitivity analysis should be undertaken where changes in such factors could reasonably be expected to have a material impact on the concluded value. The disclosure should include the range of scenarios tested and the corresponding impact on valuation outcomes.

Common examples may include, but are not limited to, adjusting discount rates (e.g. ±0.5% or ±1.0%), exit multiples (e.g. ±0.5x or ±1.0x), or growth rates (e.g. ±1%–2%), each of which can significantly impact valuations. Other typical scenarios include changes to liquidity discounts, holding periods, credit spreads (for debt), asset income generating ability (e.g. lease value, rental income, occupancy rates), or FX rates (for cross-border assets). These analyses help identify material inputs and ensure valuations remain transparent, supportable, and aligned with market participant expectations.

Sensitivity analysis should be performed at a frequency consistent with the fund's dealing cycle and liquidity profile, and increased in frequency during periods of market stress or volatility.

6.9 Managers should disclose to Investors at the point of establishment of the fund or vehicle the accounting standards to be followed.

Managers should disclose to investors, at the outset of the fund or vehicle, the accounting standards to be applied (e.g., IFRS, US GAAP, local GAAP). Disclosure should include an explanation of why the chosen standard is appropriate given the fund's structure, jurisdiction, and investor base. Explanation and justification for any deviations from the previously adopted accounting standard over time should be explained to Investors with supporting evidence or materials provided.

6.10 Managers should be prepared to provide justification for not valuing assets in line with an industry recognised accounting standard.

Managers should maintain documentation to evidence and justify circumstances where asset valuations are not prepared in line with an industry-recognised accounting standard (e.g., IFRS, US GAAP). Such justifications should set out the reasons for divergence, the methodology applied, and the implications for comparability or transparency. Managers should be prepared to provide this information to investors upon request and be able to explain the rationale for applying an alternative approach. Managers should also provide guidance as to the circumstances or market conditions that would allow a recognised accounting standard to be implemented in the future.

6.11 If Managers oversee an asset or a fund in a jurisdiction that does not recognise or require globally recognised accounting standards such as US GAAP or IFRS, then Managers should adopt alternative standards such as the International Valuation Standards maintained by the International Valuations Standards Council.

Managers should provide transparency to investors regarding the framework selected, the rationale for its adoption, and how consistency of application will be maintained throughout the life of the fund. Where multiple frameworks could apply, managers should explain how conflicts or differences between standards are addressed to ensure that valuations remain reliable, comparable, and credible to investors.

Hard-to-Value Assets – Governance [7]+[8]

Hard-to-Value Assets – Governance Standards and Guidance [7]

7.1 Procedures ensuring a consistent approach for determining fair value, where a fund manager performs in-house valuation or is involved in providing final prices to the valuation service provider for hard to value assets, should be adopted and included in the Valuation Policy Document.[31]

These procedures could include:

- A hierarchy of pricing sources and models (where relevant) for each asset type,
- For broker quotes:
    - Reasonable efforts to identify and use multiple (typically 2-3) price sources where available,
    - Specifying acceptable tolerance ranges for these pricing sources and the approach for handling outliers,
    - There should be some allowance for the use of professional judgement in the selection of broker quotes, not all available quotes may be suitable for valuation purposes.
    - Being consistent to avoid "cherry picking" a favourable price source by using the same brokers at each valuation point, and
    - Instructing that any broker quotes are sent directly to the fund administrator or other third-party valuation service provider.

[31] See introduction, chapter 1.3: The fund versus the manager

- For pricing models:
  - An approval process for pricing models including back-testing, documentation, and approval by the fund governing body or valuation committee,
  - A monitoring and verification process to compare to observed market prices, and
  - Governance of manual overrides of model inputs or results including approval, documentation, and reporting to the fund governing body or valuation committee.

7.2 When using side pockets, the fund manager should consult with the fund governing body and get its consent to the circumstances in which side pockets may be used. In addition:

- **The side pocketing process and eligible assets should be described in the Valuation Policy Document.**
- **Side pockets should be created either at or around the time of purchase or at or around the time the asset becomes hard to value.**
- **On being side pocketed an asset should be valued at cost, the last available market price or a lower number, or zero.**
- **Any limit on total amount of assets that can be included in the side pocket disclosed in the fund's offering documents should not be breached.**
- **Side pocket management fees, if charged, should be calculated on the lower of cost (or last available market price where the asset was previously liquid), or fair value.**
- **Side pocket performance fees should be paid only at the point the asset is disposed of or a liquid market price is available. They should be accrued for the duration of the side pocket.**

  Note: Side pocketing of assets is a common feature of insurance linked strategies and can occur for a number of valid reasons. Creation of a side pocket immediately upon a loss event may not occur as there may be additional criteria a manager needs to consider before doing so. Additional guidance can be found in the SBAI's memo 'Side-Pocketing in ILS Funds'.

  Fund managers could also refer to the range of SBAI Toolbox Memos for further guidance on the valuation of hard-to-value assets, which can be found here: https://www.sbai.org/toolbox.html

Hard-to-Value Assets – Disclosure Standards and Guidance [8]

8.1 The percentage of the fund's portfolio that falls into each of the three levels prescribed by ASC 820, IFRS 13, or equivalent accounting standards or recognised definitions should be disclosed periodically e.g., via Administrator Transparency Reports (ATR).

Where meaningful and applicable the extent that internal pricing models or assumptions are used in the valuation of hard to value assets should also be disclosed.

Fund managers should consult the SBAI's ATR template[32].

[32] https://www.sbai.org/toolbox/administrator-transparency-reporting-atr.html

8.2 Any material increases in the percentage of the fund's portfolio invested in hard to value assets (as determined by the fund governing body) should be disclosed to investors in a timely manner e.g., in manager newsletters..

8.3 Side pocket values should be reported in the fund's audited annual accounts in accordance with applicable accounting standards.[33]

8.4 Material issues when valuing hard to value assets in-house (e.g., unavailability of sufficient number of pricing sources or broker quote ranges outside of tolerance levels) should be discussed with the fund governing body and disclosed to investors.[25]

8.5 Managers should conduct periodic stress testing and scenario analysis in relation to portfolio valuations.

Managers should be prepared to provide a summary of stress tests or scenario analyses performed to understand potential changes in asset values under different market conditions.

Stress testing and scenario analysis is intended to be primarily a risk management exercise, helping managers and investors assess vulnerabilities in the portfolio. Results of these reviews may or may not lead to a revaluation of a fund asset, but they should be documented, periodically reviewed, and considered by the manager's governance framework (e.g., valuation or risk committee).

Stress tests should be tailored to the strategy and asset class. For example:

- Liquidity stress testing may not be a useful measure to assess in a closed ended investment structure but may be relevant for hybrid structures which offer some limited form of liquidity to investors (e.g. evergreen structures).
- Private market managers may wish to consider scenarios which model changes in financing costs, margins and sales for leveraged buyout portfolio companies.
- Private credit managers may wish to understand how different scenarios may affect duration impact, debt recovery levels and impacts on the timings of debt repayments.
- Real estate managers may consider how changes in rental income and occupancy levels could affect the value of the asset and cap rates.
- Venture capital managers may consider how changes in revenue growth assumptions, market sentiment or cash burn rates could affect valuations or the ability to IPO or raise additional funding rounds.
- Infrastructure managers may consider how changes in financing rates, government subsidies or supports or construction/maintenance costs may impact asset values.

These examples are not intended to be exhaustive, and private market managers should consider a full range of scenarios that could be applicable to their strategy. Managers and investors should also engage in dialogue to agree which scenarios are most relevant and how results will be communicated, whether through reporting packs, LPAC discussions, or periodic investor updates.

During periods of heightened market volatility or material stress events, managers should consider conducting more frequent stress tests to assess portfolio valuation stability and to calibrate valuations. Further, managers should increase the frequency and depth of communications with

[33] See introduction, chapter 1.3: The fund versus the manager

investors during such periods. This may include providing interim updates on valuation impacts, liquidity conditions, and portfolio risk exposures outside of the normal reporting cycle. Managers should ensure that such communications are clear, timely, and proportionate to the level of volatility, and be prepared to engage with investors through ad hoc calls, written updates, or LPAC briefings as appropriate.

8.6 Managers should conduct valuations of private market fund assets, no less frequently than quarterly. Where the structure of the fund provides for investor liquidity, or market conditions warrant, managers should perform valuations on a more frequent basis to ensure that asset values remain aligned with the redemption rights and liquidity profile of the fund.

Consideration should be given to the redemption rights of the fund; close-ended funds (whether valued internally or externally) should be valued at least quarterly. More frequent valuations should be conducted if the manager has the resources to do so. Evergreen structures (those which offer some degree of limited redemption rights) should be valued more frequently, typically in line with the redemption cycle.

Managers should be mindful of prevailing market and economic conditions. It is good to establish valuation 'triggers' or thresholds (e.g. a material market dislocation, significant change in asset performance, or macroeconomic shock) which would prompt an updated valuation to be conducted outside the normal valuation cycle. Such triggers should be documented in the fund's valuation policy.

Between formal valuation dates, managers may produce interim valuation estimates. While these should not replace full valuations, they represent good practice for investor communication, provided the methodology is consistent, assumptions are clearly disclosed, and limitations are explained. For example, it may be the case that such interim valuations or indicative NAVs may be calculated by internal teams, with official quarterly valuations conducted by external valuation service providers.

8.7 Managers should be prepared to provide a comparison of prior valuation estimates to actual outcomes (e.g., subsequent sale prices) to evaluate the accuracy of valuation methodologies over time.

These reviews should be documented and form part of the manager's valuation governance framework, helping to identify biases, improve consistency, and strengthen investor confidence in the valuation process. Managers should be prepared to share summaries of these reviews with investors, highlighting key findings and any refinements to methodologies that result.

Investors may have differing views regarding the minimum amount of information they should receive. Some may require only confirmation of the valuation mark or disposal price, whilst others may wish to receive the median deviation between prior valuations and sale prices across a portfolio or vintage. Managers should avoid holding asset values at artificially low or conservative prices before asset sales, as this may distort performance measurement and misrepresent the true fair value of the portfolio. Similarly, Managers should avoid valuing asset values artificially above their fair value during periods of asset raising for new or follow on funds. Investors and managers should agree the exact information to be shared and the appropriate reporting frequency.

8.8 Managers should be prepared to discuss how liquidity (or lack thereof) impacts the valuation of specific assets. This includes articulating whether and how a Discount for Lack of Marketability

(DLOM) or similar adjustment has been applied, as well as the basis for selecting the size of such discounts.

Managers should maintain documentation supporting these judgments, including references to market evidence, comparable transactions, or external valuation input where available. Investors should be provided with transparency on the rationale for liquidity adjustments and their impact on overall portfolio valuations.

C. Risk Management [9]-[20]

Risk management is a vital aspect of the fund management process. The following aspects of risk management are addressed in this section:

- Risk Framework [9]-[10]
- Portfolio Risk [11]-[16]
- Operational Risk [17]-[18]
- Outsourcing Risk [19]-[20]

Risk Framework – Governance Standards and Guidance [29]

9.1 A fund manager should put in place a risk framework which sets out the governance structure for its risk management activities and specifies the respective reporting lines, responsibilities and control mechanisms intended to ensure that risks remain within the manager's risk tolerance.

Risk tolerance is sometimes also referred to as risk appetite and describes the willingness of an organisation to assume risks. Management of the relevant organisation has to decide how much risk it is willing to take in each area of risk and then take action to manage or mitigate these risks accordingly. Therefore, for the risk manager, appetite refers to portfolio, operational and outsourcing risk.

9.2 The framework should cover all relevant categories of risk including portfolio, operational and outsourcing risks.

Risk Framework - Disclosure Standards and Guidance [10]

10.1 A fund manager should explain its approach to managing risk (its risk framework) to the fund governing body. Such risk framework should be explained to the appropriate extent, in the fund's offering documents.[34]

The following table provides an overview of the different risk categories which should be covered by the risk framework.

[34] See introduction, chapter 1.3: The fund versus the manager

Risk Category Overview

Category	Description	Risk for whom	Covered in Standards
Portfolio risks	Risk of losses in the investment portfolio	Direct risk for investors, indirect (reputational) risk for the manager	[11]-[16]
Operational risks	Risk of breakdowns in internal controls or systems which can lead to financial losses	Direct risk for the manager, indirect risk for investors	[17]-[18]
Outsourcing risks	Risk of failures in the delivery of services by third parties	Direct risk for the manager, indirect risk for investors	[19]-[20]

Portfolio Risk [11]-[16]

Portfolio Risk - Governance Standards and Guidance [11]

11.1 A fund manager should ensure that adequate risk management processes and resources are available and well understood by portfolio managers, traders, risk managers, senior staff and other staff related to the management of the portfolio. A fund manager should also discuss these risk management processes with the fund governing body and do what it reasonably can to assist the members of the fund governing body to understand such processes.

11.2 Potential conflicts of interests in the risk monitoring process should be managed by clearly separating the risk monitoring function from portfolio management. If a smaller or start-up manager considers it impractical to do so, this should be disclosed in the fund manager's marketing documents and in the fund's offering documents.[35]

The SBAI recognises that notwithstanding the separation of the risk monitoring and portfolio management functions, portfolio managers will typically provide input into the risk parameters to be applied to the portfolio (e.g., types of trades, degree of risk and areas of risk).

11.3 Risk monitoring reports should be made to the person or body which has ultimate responsibility for risk management (such as the manager's chief investment officer, chief executive officer or management committee).

11.4 A fund manager should put in place a written Risk Policy Document, a copy of which should be supplied to the fund governing body. This document should set out the responsibilities of and procedures to be employed by the fund manager's risk monitoring function.

The SBAI expects that in most circumstances the Risk Policy Document might, amongst other things, include:

- guidelines for distribution of risk mandates among individual sub-portfolio managers and the setting and changing of risk limits;
- routines for risk reporting, exceptions reporting and escalation procedures;
- routines for reviewing and testing the risk measurement framework;
- guidelines for risk monitoring and risk measurement during stressed periods; and

[35] See introduction, chapter 1.3: The fund versus the manager

- routines for communicating the above information to all relevant persons within the fund manager in a clear and understandable manner.

Liquidity Risk Management - Standards and Guidance [12]

12.1 A fund manager should develop a liquidity management framework, the primary role of which is to limit the risk that the liquidity profile of the fund's investments does not align with the fund's obligations.

This could include forecasting the liquidity position of the fund and tracking liquidity measures (e.g., ratios such as "available cash/Value-at-Risk") which allow the fund manager to assess the probable development of the fund's liquidity position relative to the portfolio's inherent risk.

The nature of this framework would depend on the categories of assets and leverage profile of the fund.

12.2 A fund manager should regularly conduct stress testing and scenario analysis of the fund's liquidity position.

Potential stress events could include:

- margin calls due to sudden severe market shocks (e.g., significant equity price falls);
- reduction in liquidity in certain market segments relevant to the fund;
- a sudden increase in collateral requirements for funding positions (thereby reducing assets available for sale to meet liquidity needs);
- investor redemptions (as per the fund's redemption policies) [where relevant[36]]; and
- cancellation of credit lines (as per notice periods agreed between the fund and counterparties such as prime brokers).

The stress testing/scenario analysis should also take account of the impact of market risk stresses on the liquidity position of the fund (see following market risk management standard).

It has been widely found that in stress situations unexpected correlations can appear. Some funds have faced sudden liquidation challenges due in part or in whole to rapid market movements, for example in currencies, commodities, or equities.

Market Risk Management - Standards and Guidance [13]

13.1 A fund manager should develop measures to identify market risk in the fund's portfolio. To overcome the shortcomings of individual measures, the fund manager should rely on multiple techniques.

These could include, amongst others:

- volatility measures;
- VaR type approaches;

[36] Will only be relevant to open-ended funds

- Monte Carlo simulation[37];
- stress tests/scenario analyses[38];
- impact of leverage; and
- portfolio concentration measures.

13.2 A fund manager should conduct regular stress testing/scenario analysis to assess the impact of extreme market occurrences on the value of the portfolio.

Extreme financial events may not receive sufficient attention when using classic risk measures such as volatility and VaR due to the scarcity of historical observations for such events. Stress testing/scenario analysis allows managers to overcome this shortcoming by accounting for the increased inter-correlation between different asset classes at times of market turmoil.[39]

Stresses could include, amongst other things, equity price drops, sudden shifts of interest rate curves and abrupt changes in foreign exchange rates. A scenario analysis would combine several of these “stresses” across markets at the same time based on extreme assumptions about correlations which may not occur in normal markets.

The analysis could include, amongst other things, scenarios based on historically observed crises (e.g., the 2000 new economy bubble burst or the sub-prime mortgage crisis in 2007) and newly developed (“made-up”) scenarios to incorporate emerging correlations and new risks, and their respective impact on the portfolio.

Fund managers should also assess basis risk arising from imperfect hedging strategies[40] and incorporate resultant uncertainties into their stress testing/scenario analysis approach.

13.3 A fund manager should account for valuation sensitivities under stressed conditions in its approach to risk measurement (e.g., VaR, stress testing/scenario analysis).

In times of abrupt market fluctuations, situations can arise where market liquidity is much lower than it is usually observed, making it difficult to trade positions at observed market prices. Under such circumstances, a fund’s net asset value may not only be hard to calculate, but also unattainable in the event sales are attempted. At the same time, the manager might be forced to sell positions, for example in order to meet redemption requests and/or margin calls.

The risk measurement framework should account for this, for example by applying valuation discounts for modelling purposes to positions that might have to be liquidated under stressed conditions (see Standard [12] *(Liquidity risk management)*).

13.4 A fund manager should translate the results of the analysis of market risks (stress tests/scenario analysis, etc.) into timely management action (e.g., adjustment of positions) as part of the control and risk management process.

---

[37] Monte Carlo simulation: statistical evaluation of risks, where a large number of "scenarios" is generated based on random examples of uncertain underlying variables

[38] A stress test simulates a significant market move (e.g. 30% equity price drop) and measures the impact on the fund’s value. In a scenario analysis, multiple stresses are applied simultaneously (e.g. 30% equity price drop, shift in interest rates, etc.)

[39] Also sometimes referred to as "fat tails", i.e. extreme occurrences are more likely than theoretically expected

[40] E.g., when the price of a future varies from the price of the underlying instrument as expiry approaches; the more immature the market, the more imperfect the hedging strategies are likely to be.

Counterparty Credit Risk Management - Standards and Guidance [14]

14.1 A fund manager should have a process for setting up trading relationships on behalf of the fund, including the assessment of creditworthiness and the setting of risk limits.

In setting up such trading relationships, a fund manager may, where relevant and appropriate, wish to consider putting netting agreements and appropriate collateral arrangements in place. For example, it may be possible for certain funds to agree two-way collateral posting with a trading counterparty.

14.2 Creditworthiness of the fund's trading counterparties should be monitored periodically, and risk limits adjusted, if required.

Control Processes - Standards and Guidance [15]

15.1 A fund manager should track a fund's adherence to its stated investment objectives, investment policy/strategy and investment and other restrictions and take appropriate corrective action if a breach of investment policy/strategy or of any restrictions or limits occurs.

To assist in tracking a fund's adherence to its stated investment objectives, investment policy/strategy and investment and other restrictions, fund managers should carefully consider setting internal limits and sub-limits at the outset for the aggregate portfolio and, where applicable, to all individual sub-portfolios (each of which would be subject to override by the fund manager's chief executive officer, chief investment officer, management committee or similar). These limits could include general investment restrictions (e.g., eligible asset classes, geographic location of risk) and could also encompass various categories of risk such as market risk, funding liquidity risk, counterparty credit risk and other relevant risk factors such as concentrations (e.g. in relation to single names, sectors or hard-to-value assets).

Risk reporting should be put in place so that the investment decision-makers have a daily (or more frequent if appropriate) view of the risk position of the fund and are in a position to prevent breaches of any relevant limits and restrictions. Breaches of any relevant limits or restrictions should be immediately reported to the relevant fund manager, the manager of the trading activity and the compliance officer, with escalation as needed to the manager's chief executive officer, chief investment officer, management committee or similar. A process for determining when and how breaches should be reported to the fund governing body should be put in place (a manager will want to ensure that such process takes into account insurance related considerations).

The process should be designed to ensure that, if required, the findings of the stress testing/scenario analyses are translated into mitigating portfolio risks.

Portfolio Risk - Disclosure Standards and Guidance [16]

16.1 A fund manager should disclose and explain its investment and risk management approach in its own marketing materials. Such disclosure and explanation should also be included to the appropriate extent in the fund's offering documents.[41] In addition to disclosure recommended in

[41] See introduction, chapter 1.3: The fund versus the manager

Standard [1] (*Investment policy and risk disclosure*), a summary of the risk framework (processes and risk management techniques employed) should be disclosed.

Fund managers should also carefully consider whether it would be appropriate to disclose target ranges or averages as anticipated by the manager for specific risk parameters and how short-term deviations from such target ranges are handled and advise the fund governing body accordingly. This could include:

- volatility of returns;
- VaR or equivalent (e.g., potential loss arising from a stress event);
- leverage (according to the manner in which the manager measures leverage)[42]; and
- limits to the percentage of the portfolio which can be invested in non-marketable securities[43] (or another measure of liquidity).

16.2 A fund manager should ensure that the management report submitted with the audited annual accounts of the fund includes disclosures on the actual risk profile of the fund for the relevant period.

The SBAI envisages that this might include:

- the actual risk profile of the fund**,** where applicable using risk measures such as
  - realised volatility of returns;
  - VaR type measures (actual, average, range for observation period and decomposed by, for example, risk type and market); and
  - leverage (high, low, average for the respective observation period), if applicable;
- the percentage of the portfolio invested in what the manager considers to be hard-to-value assets (see more detailed disclosure requirements for hard-to-value assets in the Standards relating to valuation); and
- investment instruments used during the relevant period.

Fund managers should carefully consider whether providing more frequent (e.g., quarterly) disclosure of relevant performance and risk measures to investors through a suitable medium (e.g. newsletters) would be appropriate.

The SBAI acknowledges that investors may require more frequent disclosures via newsletters than the annual disclosures set out above. However, the frequency, required content and granularity of such disclosures will be a function of the fund's strategy. For example, high turnover strategies may require more frequent disclosure than private or distressed debt strategies. Risk measures used may also differ substantially between funds. Therefore, the SBAI has not sought to be prescriptive in this area.

[42] See Appendix A for examples of leverage measures

[43] Marketable Securities: Securities that can be easily liquidated, e.g. government securities, stock, bonds, notes, commercial paper, and other financial instruments that are regularly listed for sale on recognised public exchanges

Operational Risk [17]+[18]

Overview of areas covered:

- People and Governance [17a]
- Trading and Execution [17b]
- Fraud and Financial Crime Prevention [17c]
- Disaster Recovery [17d]
- Model Risks [17e]
- IT Security [17f]
- Legal and Regulatory Risk [17g]
- Personal Account Dealing [17h]
- Trade Allocation [17g]
- Conflicts of Interest [17j]

People and Governance - Governance Standards and Guidance [17a]

17a.1 In areas where potential conflicts of interest could arise (valuation, risk management, compliance), a fund manager should clearly divide these activities from the portfolio management function with separate reporting lines into the manager's chief executive officer or chief investment officer or similar. If a smaller or start-up manager considers it impractical to do so, it should disclose this in its marketing documents and such potential conflicts of interest should also be disclosed in the fund's offering documents.[44]

17a.2 A fund manager's staff remuneration should not set false incentives (e.g., by linking the compensation of the valuation team directly to fund performance).

17a.3 A fund manager should ensure that material aspects of its operational procedures are adequately documented, and training is provided to staff. This should include, amongst other things, areas such as compliance procedures, back-up/disaster recovery procedures, and client confidentiality. A fund manager should also periodically test its compliance procedures or have them audited by an external party.

17a.4 One or more third parties, independent of the manager, should be appointed to be responsible for the safekeeping of the property of the fund.[45]

- The SBAI acknowledges that in the case of master feeder structures, it will not be appropriate for the feeder fund, which will normally hold shares/interests in the master fund and some cash, to appoint a third party responsible for safekeeping its assets. In such circumstances, appropriate due diligence should be conducted on the master fund and the arrangements in place for the safekeeping of its assets.

[44] See introduction, chapter 1.3: The fund versus the manager

[45] See introduction, chapter 1.3: The fund versus the manager

- The SBAI acknowledges that prime brokers may take charges and/or security interests over the assets of a fund or may hold fund assets as collateral.

17a.5 A third party, independent of the manager, with responsibility for fund administration (including calculation of the NAV and the maintenance of the accounting records of the fund) should be appointed in order to ensure the segregation of functions and the avoidance of conflicts of interest in relation to the provision of fund administration services.

- The SBAI acknowledges, however, that in some cases, it will not be possible in practice to achieve both independence and the required level of competence and service quality by appointing a third-party provider.
  - In such instances the manager should ensure that the internal function in charge of the calculation of the NAV and the maintenance of the accounting records are kept segregated from the portfolio management and trading divisions. Such function should be properly resourced and carried out by staff who have appropriate expertise. This function should report to senior management of the firm.
  - The internal function in charge of the calculation of the NAV and the maintenance of the accounting records of the funds should be audited annually by an independent auditor.

Issues in relation to the valuation process are covered separately and included in Standards 5 and 6.

Issues in relation to due diligence of third-party service providers are also covered separately and included in Standard 19.

17a.6 The nature, structure and governance of these arrangements should be disclosed.

Issues in relation to disclosure of third-party service providers such as administrators are also covered included in Standard 20.

Operational Risk – Trading and Execution - Standards and Guidance [17b]

17b.1 To prevent trading and execution failures, a fund manager should put effective trading and counterparty procedures in place.

This might include the following aspects:

- entering into master agreements with trading counterparties;
- agreeing well defined termination and collateral policies;
- tracking changes in key provisions of any agreements with trading counterparties; and
- a robust trade confirmation and reconciliation process including, amongst other things:
  - sufficient back and middle-office capacity to handle trading volumes;
  - daily confirmation of trades and positions;
  - use of electronic matching and confirmation systems (depending on the scale of the manager - smaller managers and managers with low trading volumes may rely to a larger extent on manual handling);
  - timely reconciliation of complex over-the-counter trades and loans; and

- monitoring of corporate action events (e.g., voting, splits, spin-offs) on long and short equity derivative instruments and applying the events to fund accounts.

Operational Risk – Fraud and Financial Crime Prevention - Standards and Guidance [17c]

17c.1 A fund manager should be confident that it understands the applicable laws and regulations in the markets in which it deals and has effective systems and controls in place to enable it to identify, assess, monitor, and manage the risk that the fund manager might be used to further financial crimes.

This may apply to areas such as:

- anti-money laundering procedures[46] (although typically the fund's administrator will be responsible for compliance); and
- procedures to prevent market abuse offences (see also Standard [23] *(Prevention of market abuse))*.

17c.2 A fund manager should appoint a compliance officer who is independent of the portfolio management function to oversee all issues relating to regulatory compliance and market and professional conduct. If a smaller or start-up manager considers it impractical to do so, this should be disclosed in the fund's offering documents.[47] The compliance officer should report regularly to the manager's chief executive officer or management committee or equivalent. A fund manager should provide to the fund governing body a report on regulatory compliance prepared by the compliance officer on a regular basis.

17c.3 Where client money is held by the manager, the fund manager should put in place strict internal controls to prevent misappropriation of such money (e.g. co-signing policies).

Further guidance on this topic can be found in the SBAI's Governance Toolbox in the Cash Handling and Cyber Security Memo[48].

Operational Risk – Disaster Recovery - Standards and Guidance [17d]

17d.1 A fund manager should put in place measures designed to ensure that the provision of fund management services to the fund will remain possible in the event of a disaster. The level of tolerance should be agreed by the executive committee of the fund manager and, where relevant, be notified to the fund governing body.

Depending on the scale of the fund manager's business, this could include:

- a communication plan to contact important parties (such as senior management, prime broker, administrator and regulator);
- contingency plans (including a succession plan to address key man risk, fall back communications router and capabilities);

[46]

[47] See introduction, chapter 1.3: The fund versus the manager

[48] https://www.sbai.org/wp-content/uploads/2016/04/Toolbox-Memo-Cash-Handling-Cyber-Security-Final.pdf

- offsite data back-up facilities;
- back-up office space/infrastructure (applicable to larger fund managers); and
- regular testing of procedures/processes.

Operational Risk – Model Risk - Standards and Guidance [17e]

17e.1 As part of its operational risk management procedures, a fund manager should assess any exposure to model risk annually or as dictated by events and where model risk is perceived to be material to the performance of the manager, should implement appropriate procedures to ensure that material model risks are identified and mitigated where possible.

Such procedures might include:

- evaluation of model risk in the model selection process;
- frequent review of models, including parameterisation, calibration, assumptions and data integrity;
- stress testing of assumptions;
- sign-off and documentation of management overrides (overrides can become necessary when models produce unreasonable results so that human intervention becomes necessary, but such overrides need to be governed carefully);
- documentation of models to avoid key man risk; and
- security of algorithm and source code (back-up).

Further guidance on this topic can be found in the SBAI's Alternative Risk Premia Toolbox in the Back-testing Memo[49].

Operational Risk – IT Security - Standards and Guidance [17f]

17f.1 A fund manager should ensure security and integrity of systems and data.

Depending on the scale of the manager, this could include system testing, offsite IT and data back-up, disaster recovery procedures and supervision of contract IT resources.

Operational Risk – Legal and Regulatory Risk - Standards and Guidance [17g]

17g.1 A fund manager should ensure that it understands local conduct of business rules and regulations which apply in the jurisdictions in which it operates (including any rules governing the passporting of regulatory authorisations from one jurisdiction to another). A fund manager should also ensure that it understands laws and regulations relevant to the securities in which it trades (e.g., shareholding disclosure requirements and foreign ownership rules).

Operational Risk – Personal Account Dealing [17h]

17h.1 A fund manager should adopt a personal account dealing policy for its staff, ensure awareness of this, test compliance from time to time (e.g. comparing broker statements against trades for

[49] https://www.sbai.org/wp-content/uploads/2020/07/Toolbox-Memo-Backtesting-15-July-2020.pdf

which permission has been granted), and where a manager is not regulated, make a summary of the policy available to investors upon request.

Operational Risk – Trade Allocation policy [17i]

17i.1 A fund manager should put in place a trade allocation policy.

17i.2 Upon request, a manager should disclose the trade allocation policy to investors on a confidential basis.

Further guidance on this topic can be found in the SBAI's Governance Toolbox in the Conflicts of Interest in Parallel Funds Memo[50].

Operational risk – arrangements to address conflicts of interest [17j]

17j.1 A manager should ensure that it has internal arrangements to manage and mitigate conflicts of interest, and this should include documented compliance policies and procedures (e.g., conflicts of interest policy). Conflicts of interest should be recorded and reported to senior management on a periodic basis (e.g., monthly or quarterly) or, in the case of conflicts requiring the approval of senior management, escalated as soon as reasonably practical. Where applicable, conflicts of interest should be reported to the fund governing body.

Examples may include, but are not limited to:

a) Cross trades

b) Fair allocation of trades / opportunities across different funds or accounts

c) Employee/partners funds

d) Funds that in turn invest in other internal/external funds with incremental fees

e) Internal resource allocation across different funds/client accounts

f) Personal Account dealing policies

g) Allocation of expenses

h) Use of affiliated service providers

i) Lack of independent valuation

j) Differential terms or fees

k) Use of soft dollars/dealing commissions

l) Other business interests of investment manager employees

m) Gifts and entertainment

n) Suspension and/or gating of redemptions.

[50] https://www.sbai.org/wp-content/uploads/2016/04/Toolbox-Memo-Case-Study-Conflicts-of-interest-between-parallel-funds-6-March-2020.pdf

Operational Risk - Disclosure Standards and Guidance [18]

18.1 To enable investors and creditors to be confident that operational risks are managed satisfactorily, a fund manager should make available a summary of its procedures and controls applying to the management of operational risk to investors and creditors undertaking due diligence.

Additional disclosures might include:

- **the manager's "soft-dollar" policy or "use of dealing commissions" policy and practices.**

Outsourcing Risk [19]+[20]

The alternative investment industry is traditionally based on a strongly unbundled business model, with managers focusing on what they are best at – managing the portfolio – while third parties provide other services such as administration, valuation, custody, and prime brokerage.

All of these services are vital to the success of funds. Ensuring that the selection and monitoring of third-party service providers are properly managed, is therefore of great importance to investors.

Outsourcing Risk - Governance Standards and Guidance [19]

Third party services are normally provided under a contract between the fund and the entity providing the service.

19.1 A fund manager should ensure that careful due diligence on third party service providers is conducted before recommending them to the fund governing body.

This could include using Due Diligence Questionnaires or evaluating "reports on controls" from an independent reporting accountant issued by the respective third-party service provider.[51]

19.2 Third party service providers should be regularly reviewed.[52]

<u>**Valuation and administration**</u>

19.3 Where appropriate, a service level agreement ("SLA") should be put in place with relevant service providers (commonly, this will be attached as a schedule to the agreement between the fund and the relevant service provider).[53]

An SLA would normally be expected to:

- set out in precise detail the services to be provided by the relevant service provider along with deadlines for completion of the services;
- make clear accountability and responsibility for the orderly operation of all administration or other functions performed by the relevant service provider on behalf of investors; and

[51] Reports on controls under the ISAE 3402 (international), SAE16 (US), AAF 01/06 (UK) or other standards include a report from an independent service auditor

[52] See introduction, chapter 1.3: The fund versus the manager

[53] See introduction, chapter 1.3: The fund versus the manager

- include "Key Performance Indicators" to provide fund managers and fund governing bodies with a means of measuring whether the objectives set out in the SLA are met by the relevant service provider.

Further examples of the contents of SLAs are provided in Appendix B.

19.4 The services provided by the relevant service provider should be reviewed and monitored against contractual or other agreed standards.[54]

19.5 The manager should report to the fund governing body any material concerns it may have in relation to the quality of such services.

Prime brokers

19.6 A fund manager of a large fund should carefully consider whether it is appropriate for the fund to appoint more than one prime broker (taking into account in particular the potential advantages of diversification of funding and other services).

The SBAI is aware that there is a spectrum of criteria to consider when choosing a prime broker, including efficiency and operational risk considerations.

In carrying out due diligence on a prime broker, a fund manager should consider the potential prime broker's credit rating, policy on re-hypothecation and general ability to fulfil all process functions accurately and efficiently.

Auditors

19.7 Reputable auditors should be appointed to audit the financial statements of the fund.[55]

Outsourcing Risk - Disclosure Standards and Guidance [20]

20.1 A fund manager should disclose the names of its principal third party service providers in its due diligence documents or upon request.

20.2 A fund manager should, to the extent it is able or permitted to do so, provide information on the fund's committed funding or financing arrangements with prime brokers/lenders to investors in its due diligence documents or upon request.

20.3 A fund manager should disclose the nature of any special commercial terms with its third-party service providers which result in potential conflicts of interest (e.g., in-house brokerage or rebates).

20.4 A fund manager to the extent applicable should disclose the monitoring procedures in relation to its third-party service providers in its due diligence documents or upon request.

[54] See introduction, chapter 1.3: The fund versus the manager

[55] See introduction, chapter 1.3: The fund versus the manager

D. Fund Governance [21]+[22]

Potential conflicts of interest can arise between fund managers, the funds which they manage and investors in those funds. To mitigate these potential conflicts, appropriate governance mechanisms and oversight are required.

An important issue to consider on establishing a fund, therefore, is the mechanism for addressing and containing such potential conflicts of interest. This issue may not have been accorded great importance when the alternative investment industry was in its infancy; perhaps reflecting the fact that the relationships between managers and their relatively few private investors were more informal or that managers themselves may have been the main investors. As such, these relationships were essentially based on mutual knowledge and trust at that time. As the industry has grown, however, the investor base has broadened with more and more institutional investors (insurance companies, pension funds, endowments and so on) and funds of funds starting to invest in alternative investment funds. The SBAI considers that this change in the investor base requires a reinforcement of oversight processes.

Of course, not all alternative investment funds are the same and so practices in any particular case may need to reflect the investor base, the size and age of a fund and other relevant factors. The legal structure will also need to be taken into account, with the governance mechanism applicable in the case of a fund structured as a company, for example, differing from that applicable in the case of a limited partnership or unit trust. This indicates a “spectrum” of acceptable governance approaches.

Conceptually, the SBAI believes that in most cases the preferred model involves establishing a fund governing body comprising a majority of independent directors, who are suitably qualified and experienced such that they are comfortable holding the manager to account for its performance and conduct. The SBAI recognises, however, that, amongst other things, the nature of the investor base, market practice in certain jurisdictions, the legal structure of the fund and the availability of individuals to serve on fund governing bodies will in some cases legitimately result in alternative governance mechanisms being adopted.

Where the preferred model outlined above is not adopted (for whatever reason), the SBAI believes that it is appropriate to consider whether the fund’s constitution or offering documents should provide for certain decisions or actions (for example, material changes to fees, investment strategy, etc.) to be made or taken only with investor consent (obtained in accordance with the provisions relating to investor voting/ consent/approvals contained in the fund's constitutional documentation or offering documents) or, if applicable, where advance notice has been given sufficient for investors to redeem their investments before such decisions or actions take effect.

Of course, the SBAI acknowledges that irrespective of the chosen governance approach, in practical terms, investors usually choose a manager to invest with rather than appointing a fund governing body with a mandate to select an appropriate manager.

Further Guidance can be found in the SBAI’s Governance Toolbox on running a Fund Board meeting and a standardised Board Agenda[56].

[56] https://www.sbai.org/wp-content/uploads/2016/04/Standardised-Board-Agenda-6-November-2019.pdf

Fund Governance - Standards and Guidance [21]

21.1 Prior to the establishment of a fund, a fund manager should assess where the fund governance structure should lie on the "spectrum" (see above). In light of that assessment, the manager should be proactive in seeking to ensure that a fund governance structure which is suitable and robust to oversee and handle potential conflicts of interest is put in place at the outset.

In determining the fund governance structure which is suitable in the case of any particular fund, the SBAI believes that managers will wish to consider:

- the range of relevant skills and experience of the members of the fund governing body and the extent to which the fund governing body is able adequately to supervise, and hold to account, the fund manager; and
- the extent to which the fund governing body is able to operate independently of the fund manager.

21.2 Where a majority of the individual members of the fund governing body are not independent of the manager or where there is no fund governing body, certain key actions such as (a) material adverse changes to: the fees and expenses payable by the fund to the manager or the redemption rights available to investors, or (b) material changes to the fund's stated investment strategy or legal structure should (unless required by law or regulation) only be taken with investor consent (obtained in accordance with the provisions relating to investor voting/consent/approval contained in the fund's constitution or offering documents) or if advance notice is provided sufficient for investors to redeem before such actions take effect.

For the purposes of this Standard, the SBAI would not consider a member of a fund governing body to be independent if he or she is a director, employee, partner or officer of the fund's manager or of any member of the manager's group with the following exceptions:

The SBAI acknowledges that in certain structures, an entity within a manager's group may act as the governing body to certain funds managed (e.g., as a general partner to a limited partnership fund). Where an individual acts as a director of such an entity and, but for this, would be considered independent of the manager, then, such an individual may still be viewed as independent for the purposes of this Standard.

21.3 Members of the fund governing body should have suitable experience and integrity in order to discharge effectively their role with the appropriate level of independence.[57]

21.4 The composition of the fund governing body and the governance processes in place should be monitored and, if necessary, adjusted throughout the life of the fund to ensure that they remain effective and appropriate in light of, amongst other things, changes in the nature of the fund and its investors.[58]

21.5 The fund governing body should meet regularly and conduct such meetings in a manner which safeguards the intended legal, regulatory and tax status of the fund. Such meetings should be appropriately documented.[59]

---

[57] See introduction, chapter 1.3: The fund versus the manager

[58] See introduction, chapter 1.3: The fund versus the manager

[59] See introduction, chapter 1.3: The fund versus the manager

- In normal circumstances the SBAI would expect fund governing bodies to meet at least quarterly.

21.6 Careful consideration should be given to the extent to which the adoption by the fund governing body of all or parts of established codes of corporate governance or other director guidance is appropriate. [61] Fund governing bodies should be adequately resourced in order to comply with any such corporate governance code or director guidance.[60] This includes ensuring that the fund governing body has adequate resources to comply with any such corporate governance code or director guidance.

Whilst the SBAI recognises that managers cannot legally require independent boards to adopt good practice principles for their governance, they should nevertheless use their influence to encourage adoption and compliance. Naturally, the SBAI is also aware that the Standards in no way override legal, technical, contractual and tax realities.

As guidance to managers when considering which corporate governance code or director guidance are appropriate for fund governing bodies to adopt, the SBAI has set out below a selection of those principles contained in the corporate governance codes and director guidance published by AIC and AIMA which it considers to be of greatest importance[61]. The SBAI recognises, however, that not all of these principles will be applicable to all types of alternative investment funds:

- directors' potential conflicts of interest should be disclosed fully to the fund's investors (through the fund's offering documents) and the board as a whole (at the first available meeting);
- fund boards should have sufficient collective expertise, availability and be otherwise qualified to understand the investment policy and strategies of the fund and the attendant risks (AIC 6) . Expertise should include areas, such as investment management, regulatory issues, accounting, administration and technical understanding of the fund's strategies;
- the board should put in place a policy on tenure of directors and disclose it in the fund's offering documents and its annual report (AIC 4);
- directors' remuneration should reflect their duties and responsibilities, and the value of their time spent (AIC 8);
- regular face to face board meetings should be held, preferably quarterly. Typical board agendas may include approval of accounts, investment performance review, review of any relevant regulatory breaches and review of the performance of third-party service providers, such as the administrator and prime broker(s), review of the manager's risk management procedures;
- there should be regular review of adherence by the manager to investment policy and investment restrictions, review and approval of side letters, compliance and valuation functions and regular review of business continuity.
- the manager, external valuation agent and administrator should be required to report regularly to the fund directors regarding performance, subscriptions, redemptions and adherence to

[60] See introduction, chapter 1.3: The fund versus the manager

[61] AIC: Association of Investment Companies: The AIC Code of Corporate Governance, https://www.theaic.co.uk/sites/default/files/documents/AIC2019AICCodeofCorporateGovernanceFeb19.pdf

investment policy and restrictions and applicable anti-money laundering requirements (including direct reporting from the compliance officer and any in-house valuation function)

- the fund directors should be made aware of their personal responsibility for the issuance and legality of side letters or discretionary waivers (AIMA 6.9 and 6.11); and
- the directors should consider whether the fund should take out D&O insurance proportional to any liabilities relating to the directors' role with respect to the fund.

21.7 Regular reports on compliance with laws and regulations (in particular those relating to anti-money laundering) applicable to activities which are performed by the administrator on behalf of the fund should be obtained by the fund governing body from the fund's administrator.[62]

Fund Governance – Disclosure Standards and Guidance [22]

22.1 Details of the fund governance structure which is put in place should be disclosed in the fund's offering documents.[63]

This could include elements such as:

- biographies of each director setting out details of his/her experience relevant to performing the role of a member of the fund governing body;
- an indication as to whether each member of the fund governing body is independent of the fund manager; and
- details of any corporate governance code or director guidance with which the fund governing body has agreed to comply.

22.2 The existence of any class of shares which are held only by the manager (or an entity connected with the manager) and which carry voting rights affecting any aspect of decision-making in respect of the fund should be disclosed in the fund's offering documents.[64]

Such classes of shares are often known as "founder" or "management" shares and carry rights to, amongst other things, vote (to the exclusion of any other shareholders) on the appointment or removal of directors and/or the termination of the investment management agreement between the fund and its manager.

E. Shareholder conduct, including activism [23]-[28]

This section focuses on fostering behaviours which contribute to market integrity and shareholder engagement. The following areas are covered:

- Prevention of Market Abuse [23] + [24]
- Proxy Voting [25] + [26]
- Disclosure of Derivative Positions [28]
- Borrowing Stock (to vote) [27]

[62] See introduction, chapter 1.3: The fund versus the manager

[63] See introduction, chapter 1.3: The fund versus the manager

[64] See introduction, chapter 1.3: The fund versus the manager

Prevention of Market Abuse – Governance Standards and Guidance [23]

23.1 A fund manager should ensure that it has internal compliance arrangements which are designed to identify, detect, and prevent breaches of market abuse laws and regulations.

A sound approach might include the following components:

- a dedicated compliance officer who is not involved in the investment management process;
- a written compliance document describing all relevant compliance procedures;
- documentation of all compliance incidents by the compliance officer in accordance with, where relevant, applicable regulatory requirements;
- training/education of investment management and other staff to ensure that the relevant laws and regulations, the relevant compliance procedures and what constitutes inside information are all understood and adhered to;
- the provision of regular compliance reports to the fund governing body;
- seeking legal and regulatory guidance to ensure that compliance arrangements are designed to prevent regulatory breaches; and
- open relations with its regulator.

The table below provides some examples of procedures which may support the application of good practices.

Examples of compliance procedures designed to identify, detect, and prevent market abuse

Abuse	Procedure
Insider dealing	▪ Notification to the compliance officer if an employee believes he/she has received inside information. ▪ Compliance officer to determine whether information is material and non-public. ▪ If information is material and non-public, the securities of the issuer concerned should be placed on the restricted list (in which case such stocks cannot be traded) or on a grey list (non-disclosed restricted list, which prevents such information from being shared with the entire firm such that it might allow personnel to second guess why something was restricted). ▪ Securities (shares, bonds, etc.) of companies on the restricted list in which the entire firm would be excluded from dealing (e.g. restricted in the order management system). ▪ Where practicable, use of Chinese walls to prevent, for example, individual portfolio managers who are members of a creditors' committee of a distressed or bankrupt company (and who therefore have access to confidential information) from also trading such company's debt or equity. ▪ In instances where inside information is known to employees who have no active involvement in the investment management function, documentation of details of this knowledge should be placed on a separate (non-publicised) register.

Dissemination of inside information	▪ Managers should have policies to restrict dissemination of material non-public information including, for example, the manager's own intention actively to engage with a company (e.g. by advocating/suggesting a corporate restructuring).
Non-disclosure of shareholdings when disclosure thresholds have been exceeded	▪ Managers should document arrangements with other parties (e.g. other managers) together with which it has adopted a "lasting common policy towards the management of the issuer in question". ▪ Relevant disclosures should take place if disclosure thresholds are exceeded, accounting for collective share ownership of all parties involved.
Prevention of market manipulation	▪ Public relations policies regarding public statements of intent to seek to ensure that no false or misleading impressions are given to the market.

Prevention of Market Abuse – Disclosure Standards and Guidance [24]

24.1 A fund manager shall have a policy to prevent market abuse. For managers that are not regulated, a summary of the policy should be made available to investors upon request.

Examples of potential inside information

- Knowledge of another fund manager's intention to engage in activist behaviour (which is not publicly disclosed).
- Inside information obtained by a manager while serving on a creditor committee in a bankruptcy work-out situation.
- Information on upcoming securities offerings, which have not yet been publicly announced by the issuer.

Proxy Voting – Governance Standards and Guidance [25]

25.1 A fund manager should have a proxy voting policy which allows investors to evaluate the general approach the manager takes towards proxy voting. A summary thereof should be made available to investee companies on request.

The SBAI envisages that a voting policy might include the following elements:

- guidelines as to the process to be followed to decide how to exercise voting rights, including responsibility to vote and mechanisms to resolve potential conflicts of interest;
- a mechanism to review proposals that are not considered to be in the best overall interests of a company in which the fund is invested;
- a process for deciding when and how to communicate with an investee company's management or board of directors and other shareholders; and
- a process for determining whether to join the efforts of other concerned investors, with due regard to compliance procedures to prevent market abuse (see Guidance in Standard [24] *(Prevention of market abuse)*).

It is acknowledged that prime brokers will often not undertake to notify funds or their managers of corporate events. The proxy voting policy may well state, therefore, that the manager's ability to follow such policy will depend on its being aware of the opportunity to vote.

The SBAI acknowledges that it may not be part of a manager's strategy to vote all proxies (e.g., "black box" traders[65]) and a manager might, for cost benefit considerations, adopt a systematic approach, for example never voting except in exceptional circumstances rather than evaluating each proxy situation. In such circumstances, this should be explained to investors in accordance with the comply or explain regime.

Proxy Voting – Disclosure Standards and Guidance [26]

26.1 A fund manager's proxy voting policy should be made available to investors upon request. A fund manager should also document cases where the voting policy has not been followed and report accordingly to the fund governing body.

Disclosure of Derivative Positions [27]

Derivatives such as Contracts for Difference ("CFDs") allow investors to obtain economic exposure to stocks. There are many reasons for seeking exposure via derivatives rather than buying the stock directly, including market access, stamp tax and funding/leverage[66]. These derivatives do not normally fall under the same disclosure requirements (in the UK, for example, under the FSA's Disclosure and Transparency Rules[67]) as shares owned outright.[68]

Disclosure of Derivative Positions

The SBAI acknowledges that companies have a right to know who owns them or who has an ability to easily obtain significant voting power.

However, the voluntary adoption of enhanced disclosure requirements by fund managers (or any other particular sector of the market) would cause distortions in the marketplace because they would not apply to all market participants but only to fund managers.

Borrowing Stock to Vote [28]

Borrowing Stock to Vote – Governance Standards and Guidance [28]

28.1 A fund manager should not borrow stock in order to vote.

The SBAI acknowledges that there might be specific situations where it should be acceptable to vote on borrowed stock, e.g., when a fund is invested in shares (and the trade has settled), but the shares have not transferred into their name.

---

[65] Black box trader: computerised, automated trading system, which generates buy and sell signals based on proprietary algorithms, often executing a larger number of trades.

[66] When buying stock, the investor will have to pay the market value of the holding. In the case of a derivative, the investor might only be exposed to the changes in value of the underlying stock, but with no need to fund the position at the outset and save for the posting of margin.

[67] Disclosure and Transparency Rules, e.g. requiring disclosure of share ownership if certain thresholds are exceeded

[68] NB: There is a disclosure obligation if under the terms of the derivative the fund can require physical delivery of the underlying securities

Appendix A: Examples for Leverage

"Leverage is the sensitivity of the portfolio to changes in risk factors such as market prices. There are several drawbacks that complicate the use or comparison of leverage "numbers":

- There is no single agreed definition of leverage. Definitions cover a spectrum ranging from traditional balance sheet type leverage measures to risk based measures (the latter incorporating underlying risk factors such as Value-at-Risk) and dynamic leverage measures (see table below)
- Classic "financial statement based" leverage is not an independent source of risk, so additional information on the underlying risk factors is required.
- Leverage "numbers" have to be considered carefully and may not always contain meaningful information. In some instances, a risk reducing transaction can increase some leverage measures while decreasing others.

It may therefore be difficult accurately to compare leverage between different funds. However, in managing a fund and communicating with investors, fund managers should come up with a leverage definition which is meaningful in their context and track changes in leverage over time.

Classic financial statement based leverage definitions are not stand alone risk measures and fail to incorporate off-balance sheet positions (for example, derivatives), which could increase or decrease leverage. Risk based leverage measures try to overcome the shortcomings of classic measures by relating a risk measure (for example, market risk) to the fund's capacity to absorb this risk (for example, the fund's equity). More sophisticated dynamic measures of leverage incorporate a fund manager's ability to adjust its risk position during periods of market stress."

Examples of leverage measures:

Type of measure	Definition	Observations
Financial statement / asset based (classic)	• Gross assets/equity • Gross debt/equity	• Does not incorporate on-balance sheet hedges and off-balance sheet instruments
	• Net assets/equity • Net debt/equity	• Does incorporate on-balance sheet hedges (therefore "net"), but does not include off-balance sheet instruments
Risk based	• Portfolio volatility/equity • VAR/equity • Stress loss/equity • Other loss measure/equity	• Usually incorporates all (on- and off-balance sheet) hedge positions • But does not account for mitigating measures by manager in times of distress

Appendix B: Examples of Functions often covered by Service Level Agreements (SLA)

Net Asset Value and Share Price calculation	• Timing of NAV release (including estimated NAVs) • Process for NAV sign-off (roles and responsibilities) • NAV and other reporting requirements • Valuation policy (particular reference to hard-to-value instruments and use of estimates) • Process for ensuring completeness and existence of positions (reconciliations of cash and positions, trade confirmations etc) • Sign off and notification of share price to external parties • Errors policy in place
Shareholder Services	• Subscriptions/Redemptions & Transfers ○ Accurate receipt of application/redemption instructions from investors in line with fund prospectus ○ Timely provision of subscription note/contract notes to investors ○ Reconciliation of cash transferred to/from the subscription/redemption account to/from the custody/trading accounts on a monthly basis ○ Timely payment of redemption monies in line with local regulatory requirements and fund prospectus • End Investor Servicing ○ Timely provision of investor statements containing holdings, latest NAV per share and market value of holding ○ Timely responses to investor/manager queries ○ Timely and accurate notification and process of corporate action ○ Money laundering – Ensure there are policies and procedures that meet or exceed requirements imposed by the anti-money laundering (AML) regulations set by their local regulator ○ Application of AML/know-your-customer (KYC) requirements in line with jurisdictional and prospectus requirements ○ Monitoring and reporting of suspicious activity • Regulatory Filings ○ Completion and submission of statutory/listing filings as required (in conjunction with Corporate Secretary) • Monitoring ○ Employment retirement income security act (ERISA) and other investor tax requirements
Transaction Processing	• Ability to handle Security and FX trades • Ability to handle corporate actions • Definitions of accounting policies for interest and income accruals

	• Charges and expenses including performance fees • Subscriptions, redemptions and transfers – trade orders, order confirmation, trade confirmation • Cash management – cash balance review, cash movements • Reconciliations – when performed and detail of reconciliation • Monthly custodian reporting – reporting contents, for example, settled positions, latest prices, market value
Compliance	• Pricing control • Error and breach reporting
Accounting and Financial	• Accounting standards used • Filing or accounts
Corporate Secetrarial	• Maintenance of all statutory books and records • Provision of registered office facilities • Organisation of opening of subscription, holding, redemption, brokerage accounts as well as trading and any other bank accounts as required • Annual Reports and organisation of annual meetings and emergency general meetings • Arrangement execution of legal documents by fund directors • Submission of required information to relevant regulatory body

Appendix C: Examples of Compliance Procedures Designed to Identify, Detect and Prevent Market Abuse

Abuse	**Procedure**
Insider dealing	Notification to the compliance officer if an employee believes he/she has received inside information. Compliance officer to determine whether information is material and non-public. If information is material and non-public, the securities of the issuer concerned should be placed on the restricted list (in which case such stocks cannot be traded) or on a grey list (non-disclosed restricted list, which prevents such information from being shared with the entire firm such that it might allow personnel to second guess why something was restricted). Securities (shares, bonds, etc) of companies on the restricted list in which the entire firm would be excluded from dealing (e.g. restricted in the order management system). Where practicable, use of Chinese walls to prevent, for example, individual portfolio managers who are members of a creditors' committee of a distressed or bankrupt company (and who therefore have access to confidential information) from also trading such company's debt or equity. In instances where inside information is known to employees who have no active involvement in the investment management function, documentation of details of this knowledge should be placed on a separate (non-publicised) register.

Dissemination of inside information	Managers should have policies to restrict dissemination of material non-public information including, for example, the manager’s own intention actively to engage with a company (e.g. by advocating/suggesting a corporate restructuring).
Non-disclosure of shareholdings when disclosure thresholds have been exceeded	Managers should document arrangements with other parties (e.g. other managers) together with which it has adopted a “lasting common policy towards the management of the issuer in question”. Relevant disclosures should take place if disclosure thresholds are exceeded, accounting for collective share ownership of all parties involved.
Prevention of market manipulation	Public relations policies regarding public statements of intent to seek to ensure that no false or misleading impressions are given to the market.

Appendix D: Examples of Non-Binding Guidance to Determine “Similarity”

1)	The Portfolio Manager or investment team, the investment mandate (i.e., equity, fixed income, macro) and the strategy or style (i.e., market neutral, relative value, trend following) will all need to be the same.
2)	Additionally, the “similar” fund or separately managed account will have to have an 80% overlap in the following 4 areas (an example follows each item): a) **Asset classes traded** (i.e., mortgages, equity, credit, FX) - If the fund is 100% equities, then other funds/sleeves must have at least 80% in equities to be classified as similar. b) **Target risk and return** - Funds must have similar risk-return targets (measured by Sharpe or Information Ratio) to be classified as similar. Thus, if the fund targets a Sharpe ratio of 1, then “similar” funds must target a Sharpe between 0.8 and 1.2 (+/-20% band). c) **Time horizon of positions** - If the average holding period for the fund is 3 months, then the holding period for the similar fund needs to be between 2.4 to 3.6 months (+/- 20% band). d) **Average liquidity of positions** - If the average liquidity profile of the fund is 10 days, then the similar fund needs to have an average liquidity profile between 8 to 12 days to be classified as similar (+/- 20% band).
3)	A multi-strategy fund would have to have 80% overlap of allocations among sub-strategies, and the sub-strategies would have to be substantially similar (80%), as in item 2 above.