STANDARDS BOARD FOR ALTERNATIVE INVESTMENTS

Alternative Credit

Choice of Fund Structure

1. Introduction

Like private equity, alternative credit strategies often comprise illiquid private investments, requiring more prohibitive liquidity terms and structures to avoid asset liability mismatches in the fund. This memo reaffirms the standards and guidance included in SBAI's Alternative Investment Standards relating to the fund's structure and commercial terms and outlines advantages, disadvantages and other considerations for the two most common fund models employed by alternative credit managers: 1) the private equity model and 2) the hedge fund model.[1]

2. What the Alternative Investment Standards say

The Alternative Investment Standards[2] require disclosure of the commercial terms and other fund structuring considerations in the fund's offering document (Standard 2.1, 2.2)[3]:

- Fees, expenses (including methodology to calculate performance fees)
- Exit terms (in the case of open-ended funds), incl. notice period, redemption penalties, lockups
- Handling of situations where normal redemption mechanics might not apply (suspensions, gating, side pocketing, etc.)
- Approach to changes to fees/expenses or redemption rights (incl. ability to redeem prior to changes taking effect or shareholder consent)

Additional requirements are included in the Valuation section of the Standards, covering side pocketing (Standard 7.2)[4] and disclosure of hard-to-value assets (Standard 8.1, 8.2)[5].

3. Private Equity Model: closed-end liquidity

Alternative credit funds offered through the traditional private equity fund structure characteristically have a finite life and provide distributions of current income throughout their term, as well as a return of capital commitments and profits at the end.

The SBAI Toolbox is an additional aid to complement the SBAI's standard-setting activities. While alternative investment fund managers sign up to the Alternative Investment Standards on a comply-or-explain basis, the SBAI Toolbox materials serve as a guide only and are not formally part of the Standards or a prescriptive template.

[1] Regardless of fund model choice, nuanced blocker entities, treaty solutions, "season and sell" strategies, business development companies and other structures meant to minimize tax impacts are employed by alternative credit managers to accommodate various types of investments and investors. Accordingly, it is recommended that investors consult legal and tax advisors before engaging in any transaction.
[2] https://www.sbai.org/standards/
[3] See Appendix A
[4] See Appendix B
[5] See Appendix C

Typical characteristics:

- Given that there is an extended period for making or acquiring investments, investors are not obligated to provide their entire commitment at fund commencement. Rather, capital is commonly called during the investment period as opportunities arise
- Closed-end alternative credit funds typically have shorter investment periods and term than private equity funds: fund lives tend to last approximately six years, with investment periods commonly spanning two to four years, and the remaining period for harvesting investments (compared to investment periods of up to five years and fund lives of up to 10+ years in private equity)
- Credit funds can have recycling provisions enabling the manager to re-invest proceeds received. In private equity, proceeds from disposals are typically distributed to the limited partners in accordance with the waterfall provisions of the fund

A key benefit of alternative credit funds using the private equity fund structure is that, although investors must give up liquidity because of the required lock-up period attached to their capital commitments, this lock-up serves to limit asset/liability matching concerns previously voiced by regulators and other industry stakeholders.

Key questions for investors to ask

- One what date does the fund life commence (i.e., the fund's initial closing date or final closing date)?
- What are the recycling provisions of the fund?
- What is the expected impact of the recycling provisions on returns?
- What is the governance around fund life extension and to what extent are these disclosed in the Limited Partnership Agreement (LPA)?

3.1. Management & Performance Fees

Management fees in a typical private equity fund structure can be charged on capital commitments or invested capital (as a function of investor preference) during the fund's investment period, and afterwards on net invested capital (drawn capital less any permanent investment write-offs or write-downs). However, the alternative credit space sees more variants, with management fees charged on net capital commitments during the life of the fund and, separately, on the fund's Net Asset Value ("NAV"), which includes unrealized gains/losses. With the NAV often being the key input for the calculation of the management fee, it is important that managers have a robust approach to valuations (see separate SBAI Toolbox Memo*: Alternative Credit - Valuation)* since third-party market values are generally not available.

Since the private equity fund structure allows for multiple closings during the commitment period, one consequence is that investors entering after the first close are required to pay fees as though they invested from day one, subject to an adjustment factor. For conventional private equity funds, the adjustment factor calculation is straightforward, by-and-large calculated on preferred return[6]. This is because the investment valuations of the underlying portfolio usually remain static until several years into the future, and distributions are unlikely to begin until the fund is well into its harvest period. With alternative credit funds, however, the adjustment factor calculation is more intricate: they need to account for potential distributions to first closers (many strategies commonly involve periodic interest payments) or changes to the Fund's asset value (because of a valuation adjustment). One approach to compensate

[6] A preferred return (or "hurdle rate") is a minimum threshold return that investors must receive before the manager can receive its carried interest (or "carry").

existing investors (first closers) in the fund are "ticking fees"[7] (disclosed in offering documents) which are applied (unless there is a valuation event).

Incentive compensation within the private equity fund structure is referred to as carried interest, which is allocated to the manager according to a distribution waterfall. A basic waterfall outlines the order of priority for return of capital, with investors receiving their contributed capital plus a specified preferred return or hurdle rate, the alternative credit manager then receiving a "catch up" on profits until a certain percentage of profit is reached , and finally investors and the alternative credit manager sharing any remaining sum in a predefined split thereafter (e.g., 80%/20%, respectively). Waterfall calculations for alternative credit funds may require specialised knowledge and expertise depending on their complexity, which increases clawback risk[8] for funds with non-standard waterfall structures.

Some funds provide for tax distributions to be paid periodically to the general partner in order to allow the general partner to pay income taxes due on accrued income. These distributions typically would be deducted from carried interest that would otherwise be due in the future.

Key questions for investors to ask

- Are management fees charged on commitments, NAV or invested capital?
- Does the fund consider write-downs and write-offs in the management fee calculation base?
- How does the calculation of fees evolve during and after the Fund's investment period (if at all)?
- How is the Fund's adjustment factor calculated?
- How is the accuracy of valuations ensured for investors entering the Fund subsequent to the first close? (see separate SBAI Toolbox Memo Alternative Credit - Valuation for more details)
- In relation to the Fund's incentive compensation, is the waterfall calculated on the whole Fund (i.e., European) or deal-by-deal basis (i.e., American)?
- What types of escrow provisions and other protections are in place in the case of a non-whole fund distribution waterfall model?
- Is the incentive calculation base net or gross profits?

3.2 Subscription Lines

Subscription lines are short-term credit facilities made to a private equity or alternative credit manager that are used to manage capital calls from limited partners. A subscription line allows a manager to fund an investment or multiple investments immediately, and then call investor capital in a more orderly fashion. Subscription lines can also be used to fund fees and expenses during the closing period to eliminate the need for equalization or portfolio re-balancing as new investor subscribe to a fund. These loans are typically backed by limited partner commitments to a fund. Subscription lines typically have a term of one to four years, normally expiring at the end of the fund's investment period. Repayment of drawdowns of the subscription line are normally made within six months but may be outstanding beyond one year. The result of using subscription lines, and thus delaying the calling of capital, is typically an increased *internal rate of return* (IRR), and a decreased *multiple of invested capital* (MOIC)[9]. The increased IRR results from

[7] Fee paid by investors coming in at subsequent closings to the initial investors to compensate them for the time value of money (while assets are held at cost in the fund). Where a closing is much later, the assets can be also held at Net Asset Value (NAV) and incoming investors' shares in the fund will then be calculated on that basis.
[8] Limited partners' right to reclaim part of the general partners' carried interest, in cases where subsequent losses mean the general partners received excess compensation.
[9] Multiple of Invested Capital: *MOIC = (Realised Value + Unrealised Value) / Total Amount invested.* The MOIC does not account for holding periods / timing of cash flows.

making an investment or investments without the need of putting capital to work right away, while the decreased MOIC results from the manager needing to pay interest on the loan.

Key questions for investors to ask

- What is the maximum allowable size of subscription line? I.e. what is the cap in terms of percentage of uncalled capital?
- What is the repayment duration of the subscription line?
- What is the interest rate paid on the subscription line?
- What are the allowable uses of the subscription line? i.e. Is the subscription line allowed to be used to pay dividends, fees, or other fund expenses?

4. Hedge Fund Model: open-end liquidity

Alternative credit portfolios may also be housed in a typical hedge fund structure. While the private equity model is often characterized by a closed-end structure and a finite life, the hedge fund model is open-ended or "evergreen", allowing investors to continuously make contributions and redemptions over time, subject to a Fund's stated redemption provisions. Since windows for contributions and redemptions typically occur at month or quarter-end, the main advantage of the hedge fund structure for investors is its flexible liquidity.

Regular Redemption Provisions[10]

Lock up period	Predetermined period-of-time during which the investor cannot redeem its initial investment.
Redemption frequency	Investors can only redeem at certain points in time. For instance, if the redemption frequency is three months, an investor can only withdraw funds every three months after the lockup period has expired.
Redemption notice	Investors are generally required to give advance notice before any redemption. This minimum notice period is known as the redemption notice.

Conversely, flexible liquidity terms can also represent a key area of concern for alternative credit strategies as flexible terms could allow investors to request redemptions beyond a fund's ability to repay them. This can be due to either stressed market conditions or the inherent illiquidity of positions themselves. Such concerns can be mitigated by setting up additional liquidity mechanisms to more closely match portfolio liquidity (a fund's assets) with investor liquidity (a fund's liabilities).

Such additional liquidity mechanisms include gates (i.e., limitations on withdrawals, typically triggered based on a percentage of NAV) and side pockets (i.e., asset segregation of particularly illiquid assets from the general portfolio of the commingled fund). The objective is to ensure fair treatment of investors (i.e. redeeming vs. remaining investors) and reduce the incentives for investors to "race to the exits" (run on a fund) in situations where investors are rapidly seeking liquidity.

[10] Source: CAIA: Investment Considerations in Illiquid Assets (https://caia.org/aiar/access/article-859)

SBAI Consultation on handling of redemptions in situations of liquidity distress

The SBAI Consultation Paper CP1 (2009) [11] *assessed potential negative externalities that can arise in situations of liquidity distress, and Standards and guidance has since been implemented to address these issues, including improved disclosure requirements regarding the handling of redemptions such as 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, such as gating, side pocketing and restructuring the fund.*

Investors need to also consider the impact that the overall "package" of redemption provisions has on the liquidity levels that the manager needs to maintain in the fund to honour redemptions requests: More generous liquidity terms can adversely impact performance as managers a) need to maintain a cash buffer, or b) might be forced to monetise positions at inopportune times, to meet redemptions.

Key questions for investors to ask

- To gauge the liquidity of a Fund's positions:
  - What is the breakdown of the portfolio into Level 1, 2 and 3 assets? [12]
  - What percentage of the Fund's portfolio represents positions that are "manager marked" (or have oversight from a third-party valuation agent)?
- How concentrated is the Fund's investor base (and what percentage of capital base is off terms of lock up)?
- Have all the Fund's prior redemptions been serviced in cash?
- Do the Fund's projected cash flows from investments appear to be sufficient to meet maximum permitted redemptions in any given period?

4.1 Gates

A gate[13] limits the impact of outflows on the value, liquidity and concentration of a fund's portfolio by slowing down the pace of redemptions. [14] Simply put, gates ensure that capital outflows proceed according to an orderly schedule and mitigate the risk of rapid and steeply-discounted asset sales (e.g. to meet large withdrawal requests) or distortions of the portfolio due to sale of the most liquid portfolio assets to raise cash to honour the redemption request. Gates are different from a full suspension of redemptions which is a temporary halting of fund outflows altogether. Gates are usually suitable for funds that own less liquid assets, such as alternative credit instruments.

The gate mechanisms are disclosed in the fund's offering documents and may be different across various share classes. Two types of gating mechanisms exist: fund level and investor level gates (also referred to as staggered redemption).

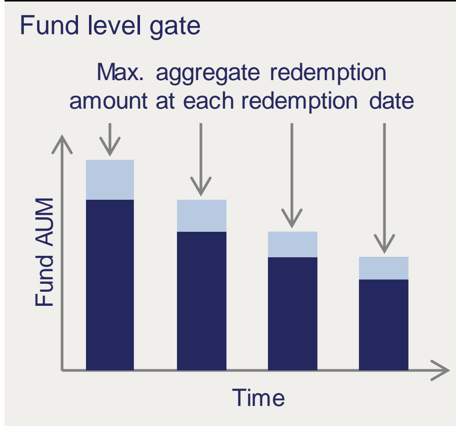
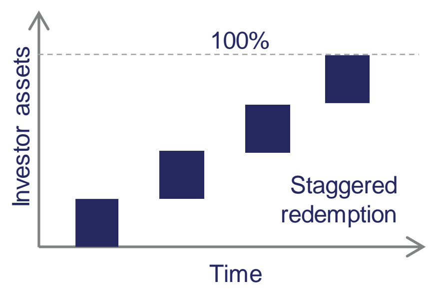
[11] See Consultation Paper CP1 (and Feedback Statement):

[12] Accounting Standards (i.e. US-GAAP, IASB) provide a "Fair Value" hierarchy categorising the inputs used in valuation into three levels (Level 1: inputs are quoted prices in active markets; Level 2: directly or indirectly observable inputs other than quoted market prices; Level 3: inputs are unobservable). Note: The "Fair Value" hierarchy is not a direct measure of an asset's liquidity but is often used as a proxy thereof.

[13] The Alternative Investment Standards cover gating, including the disclosure in offering documents (Standard 2.1 – see Appendix A).

[14] See Hedge Funds – Withdrawals and Redemptions, Gates – A primer: https://www.sidley.com/~/media/files/publications/2011/09/gates-a-primer/files/view-article/fileattachment/sclr--gates-a-primer.pdf

Gate classification

Type	Description	Observation
Fund level gate 	Limits the **aggregate amount that all investors** in a fund are permitted to redeem (i.e. all investor redemption requests are combined and compared against an overall threshold [e.g. % of AUM]).	• Gives individual investors greater redemption flexibility than an investor level gate in situations where investors redeem for idiosyncratic reasons (the fund level gate only activates during a run on the fund when redemptions exceed the threshold) • Liquidity less predictable from an investor perspective
Investor level gate 	**Investor-by-investor limitation that restricts the amount that an individual investor** may redeem, irrespective of what other investors have redeemed.	• Staggers the redemption payment and thereby extends the average "time to redemption" in all scenarios (liquidity distress, or not) • Has no regard to the amounts other investors are redeeming (i.e. also limits an investor if they are the only one redeeming) • Liquidity predictable from an investor perspective

Current market practice suggests that investor level gates are more popular than fund level gates, which indicates that investors prefer more certainty over redemptions (even if it means in most scenarios slower redemptions). Other mechanisms exist to disincentivise outflows, such as "soft" locks[15] where investors can redeem by paying a redemption fee to the fund to compensate the remaining investors for absorbing the liquidity required to pay out the redemption.

Within a Master-Feeder structure, a fund level gate can be applied at the master-fund or feeder-fund level. Fund level gates are typically applied to all investors on a pro-rata basis, based on the size of the investors' investments in the fund, and not based on the timing or size of an investor's redemption request.

Key questions for investors to ask

- At what level is the gate trigger calculated? (master fund, feeder fund, share class, investor)?
- Could a situation arise in which one feeder's gate is triggered and the other's is not?
- Is the gate trigger mandatory or imposed at the manager's or fund board's discretion? [16]
- For fund level gates: How are investor redemption requests allocated?
  - Pro rata based on requested redemption amount or pro rata based on an investor's investment amount?[17]

[15] Opposed to "hard" lockups, which is the initial typically one- to three-year period during which capital cannot be redeemed
[16] There could be concern that a manager is reluctant to voluntarily impose gates because of the associated reputational risk
[17] Pro rata based on an investor's investment amount is usually preferred since it reduces the incentive to for investors to put in larger redemption requests than what they actually want to redeem (if they anticipate other investors to redeem) to maximise their share of the overall redemption payment.

- Are early redemption requests given priority?[18]

- How are offsetting subscriptions treated?
- Does the gate provision include a “clean-up” feature that allows an investor to redeem their remaining balance in full after having taken the full amount permitted by the gate for a certain number of consecutive redemption periods?

4.2 Side Pockets

Side pocketing refers to the concept of segregating assets that have become illiquid or hard-to-value from the liquid portfolio within a hedge fund structure. When an asset is designated to a side pocket, only the participating investors in the main fund at the time of the creation of the side pocket will hold a pro rata share in the side pocket, future investors in the fund will not participate in the side pocket. While the side pocket is in place, exiting investors will only redeem their share of the liquid portfolio, but will remain invested in the side pocket (until it is liquidated). Side pockets can be a useful feature in an alternative credit hedge fund, as it can help to ensure both redeeming and remaining investors are treated equitably by helping them avoiding entering or exiting a fund in the absence of reliable valuations.

Side pocketing is covered in the Alternative Investment Standards, covering aspects such as ex ante disclosure of the side pocketing process in the fund’s valuation policy document.

What the Standards and SBAI Toolbox say about side pocketing[19]

Disclosure in offering documents

- Disclosure of details of measures which may be considered by the fund governing body in circumstances where normal redemption mechanics might not apply or may be suspended (incl. side pocketing) [Standard 2.1].
- Disclosure of side pocketing process (Standard 7.1)

Approach (Standard 7.2)

- Timing of side pocketing (Side-pocketing should occur either on or about the time the relevant asset is purchased or on or about the point at which the relevant asset becomes hard-to-value)
- Types of assets eligible for side pocketing should be described in the Valuation Policy Document
- Valuation: The initial valuation of an asset on entering a side-pocket should be at cost (Footnote: may be subject to regional accounting standards), the last available market price (as appropriate) or a lower number or nil.

Governance arrangements

- Consulting with and consent by Fund Governing Body to circumstances in which side pocketing may be used (Standard 7.1)
- SBAI Standardised Board Agenda[20] for fund directors: “Review (approval of) side pockets”

Reporting

- The value of side pockets should be reported periodically in the fund’s audited annual accounts (in accordance with applicable accounting standards)

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[18] Note: Can create a harmful incentive to redeem sooner and faster
[19] See Appendix A-C
[20] See https://www.sbai.org/toolbox/standardised-board-agenda/ (Section 5)

Key questions for investors to ask

- Does the manager have a side pocketing policy (e.g. as part of Valuation Policy Document)? Is it disclosed to investors?
- What are the mechanics for creating a side pocket (criteria for side pocketing individual positions, materiality threshold/sizing, timing of designation[21])
- Approach to charging fees (handling of performance fees, netting across side pocket and main fund, crystallisation) are potential losses netted against main fund gains? What is the approach?
- Do investors have choices ("opt-in" for participation, opt-out (this provision will usually have a ceiling))?
- What are the governance arrangements (involvement of fund governing body in process (incl. designation of assets))?
- What is the treatment of side pockets in representation of past performance?

A variation of the side pocket provision is the "fast pay/slow pay" mechanism, a fund liquidity term utilised by certain alternative credit funds wherein a portion of the more liquid or "fast pay" assets are paid after a redemption date, while the illiquid or "slow pay" assets are not affected by redemption requests, but are instead liquidated under their normal expected investment timelines. The fast pay/slow pay mechanism can be attractive when compared to longer lock-up fund structures given that it balances investors' ability to receive redemptions with the alternative credit manager's portfolio considerations. Since in most cases the manager has substantial discretion to determine which assets are considered illiquid, alternative credit investors should ensure to understand the details of fees, participation and any limitations.

4.3 Management & Performance Fees

The fund's fees, expenses (including methodology to calculate performance fees) should be disclosed in the fund's offering document (Standard 2.1) and investors are encouraged to review this, including the methodology used to calculate performance fees.

Since management and performance fees are based on NAV (which includes unrealized gains/losses) a robust valuation framework is required to address potential conflicts of interest that can arise between the managers and their investors as well as between different investors in the same fund. The valuation section of the Standards (Standards 5-8) provide a detailed perspective on the detailed arrangements, including segregation of functions in valuation, approach to handling and valuing hard-to-value assets and investor disclosure of the governance arrangements. The separate SBAI Toolbox Memo *Alternative Credit - Valuation* provides a detailed perspective on key questions investors might wish to ask to assess a manager's approach.

[21] The Standard 7.2: Side-pocketing should occur either on or about the time the relevant asset is purchased or on or about the point at which the relevant asset becomes hard-to-value

Appendix A: Alternative Investment Standard 2.1: Commercial Terms Disclosure

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).**[22]

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);
- 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)

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

- 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.**[23]

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

- Further guidance on this Standard is contained in AIMA's Industry Guidance Note on Side Letters.[24]

2.4 **Upon request, a fund manager should disclose**

(a) Existence of funds, accounts or vehicles managed by it using the same or similar[25] investment strategy,[26]

(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 assets managed by the manager using the same or similar**Error! Bookmark not defined.** investment strategy,

(d) the aggregate size of employee or partner interests in the investment strategy,[27]

(e) the existence of any other funds or accounts managed by it which follow the same or similar**Error! Bookmark not defined.** investment strategy to the fund and which are available for investment only by partners or employees (or their connected persons) of the fund manager,**Error! Bookmark not defined.**, [28] 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.**

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

[24] AIMA's Industry Guidance Note on Side Letters and Supplement No. 1 thereto: http://www.aima.org/download.cfm/docid/5520727E-1DBF-4979-84C80FC279339312

[25] 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).

[26] 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.

[27] 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.

[28] 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.

- 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]**

Appendix B: Alternative Investment Standard 7.2: Valuation of Hard-to-Value Assets (Side Pockets)

(…)

7.2 **If using side pockets, a fund manager should ensure that the fund governing body has been consulted on, and consented to, the circumstances in which side-pockets may be used. Furthermore; [29]**

- The types of asset eligible for side pocketing should be described in the Valuation Policy Document and the side pocketing process should be disclosed in the fund's offering documents
- Side-pocketing should occur either on or about the time the relevant asset is purchased or on or about the point at which the relevant asset becomes hard-to-value. The initial valuation of an asset on entering a side-pocket should be at cost[30], the last available market price (as appropriate) or a lower number or nil
- Where a limit to the total amount of assets which may be included in side-pockets is disclosed in the fund's offering documents, such limit should not be breached
- Management fees, for the side pocketed assets, if charged, should be calculated on no more than the lower of cost (or last available market price in the case of a previously liquid asset) or fair value
- Any performance fees should accrue for the duration of the existence of the side pocket and should be paid only at the point at which the asset is finally disposed of or a liquid market price is available

(…)

Appendix C: Alternative Investment Standards 8.1, 8.2: Valuation (Disclosure)

8.1 **The percentage of the fund's portfolio that falls into each of the three "levels" prescribed by ASC 820[31] or IFRS 7, or equivalent account standards or recognised definitions (and, where meaningful and applicable, the extent to which internal pricing models or assumptions are used to value certain components of the fund's portfolio invested in hard-to-value assets) should be periodically disclosed (e.g. via newsletters).**

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

(…)

[29] See introduction to the Standards, chapter 1.3: The fund versus the manager: https://www.sbai.org/wp-content/uploads/2016/04/SBAI-Standards-2017.pdf
[30] May be subject to regional accounting standards
[31] Formerly FAS 157