

# Guide to Sound Practices for Hedge Fund Administrators

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IRISH FUNDS  
INDUSTRY  
ASSOCIATION



Alternative Investment  
Management Association

September 2009

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## Foreword

The [Guide to Sound Practices for Hedge Fund Administrators](#) was originally published in September 2004 as a joint venture between the Alternative Investment Management Association (AIMA) and the Irish Funds Industry Association (IFIA). The Guide has now been revised to reflect various industry developments in areas such as valuations, tax and anti-money laundering (“AML” hereafter).

In particular, the new Guide includes key extracts from the AIMA Guide to Sound Practices for Hedge Fund Valuation. The area of valuation has been one of the hottest topics in the investment funds industry and the recommendations outlined represent a significant step forward in providing a roadmap to industry professionals, and comfort to investors, in recommending governance, control and risk mitigation processes in this area.

This Guide is not jurisdiction specific and is relevant to practitioners around the world. AIMA and IFIA would like to thank and congratulate the members and staff of both associations (listed in appendix 1), all of whom have volunteered their time and worked extremely hard to produce this Guide.

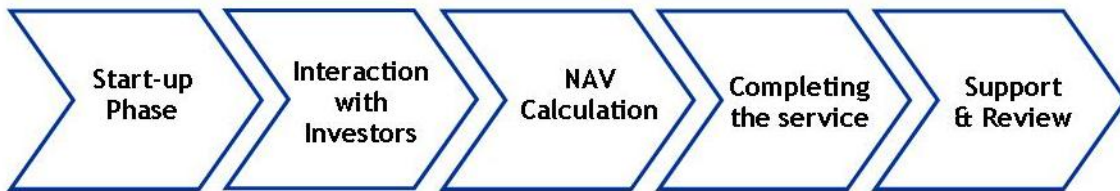
Andrew Baker  
Chief Executive Officer, AIMA

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### Disclaimer

*The Guide is not to be taken or treated as a substitute for specific advice, whether legal advice or otherwise. It does not seek to provide advice on any of the issues herein. The views expressed in this Guide do not necessarily represent the views of all of the participants of the Working Group.*

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## Introduction

This Guide discusses the main functions typically carried out by hedge fund administrators (“HFAs” hereafter), and describes the contribution made by HFAs to the overall management and administration of the hedge fund.

Firstly, the Guide acknowledges that there is no international standard definition of the phrase “hedge fund”. There are many investment funds which operate using all of the main hedge fund characteristics and there are investment funds which are clearly long-only, pay no performance fee and are highly regulated, thereby displaying none of the classic hedge fund features. There is a large and growing grey area in the middle.

This Guide, while produced with the hedge fund industry in mind, may also apply to other investment fund arenas and product types.

The Guide seeks to identify and recommend sound practice in hedge fund administration although, as befits an industry the size of the hedge fund administration industry, there will be differences between practices described herein and practices employed by individual HFAs. In this respect, the Guide should not be seen as prescriptive or as a checklist defining what HFAs should or should not do. It is intended, however, to provide guidance to hedge funds, investors and other service providers as to how sound practice has emerged in the field of hedge fund administration.

While the Guide acknowledges that the HFA has no formal role over the identification or prevention of fraudulent activity, the appointment of an HFA is strongly recommended as part of a governance framework that can provide assurances to investors that the fund is being managed in accordance with accepted best practice.

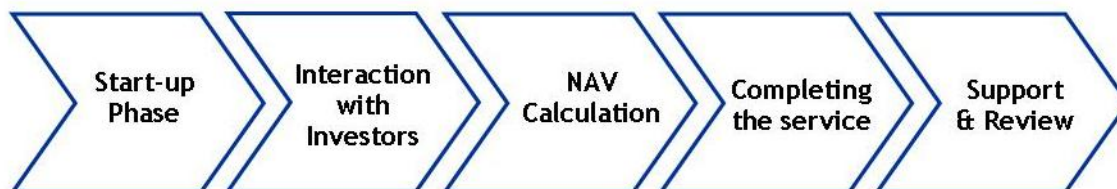
The topics covered by this Guide are:

- 1 Start-Up Phase
- 2 Interaction with Investors
- 3 NAV Calculation
- 4 Completing the Service
- 5 Support and Review

The Guide should be regarded as a general overview of the services typically provided by an HFA and not as a substitute for, or alternative to, professional advice. Except where specifically addressed, the Guide does not describe practices that conform to any single regulatory regime or domicile. It is intended to be neutral in this respect.

The Guide aims to present a practical and user-friendly tool, rather than a textbook. The Guide can be obtained from the following web sites:

[www.aima.org](http://www.aima.org)  
[www.irishfunds.ie](http://www.irishfunds.ie)



## Executive Summary

Since the release of the first Guide in 2004, the hedge fund industry has grown massively in size and scale. Even allowing for the 2008/9 financial crisis, assets have increased from USD 820 billion at the time of the first Guide to USD 1.4 trillion today - an increase of 76% - and the number of funds has grown by 47% to almost 9,000<sup>1</sup>. Such rapid expansion has had inevitable and substantial impact on those who service the funds, particularly administrators<sup>2</sup>.

There has been an increased development of new financial instruments, more complex fund structures and a shift in the source of assets away from private investors and toward institutional investors, including pension funds. Increasingly, hedge fund investors seek weekly and daily net asset value (“NAV” hereafter) information on funds.

The HFA community has had to meet, head on, this evolution and increase the variety of its services accordingly.

This Guide has been developed to offer to administrators and their clients a practical framework for all elements of the administrator’s role. This will inevitably include close interaction with each fund’s other service providers.

It should be noted that many of the themes in this document will equally apply to other investment fund types.

### Start-Up Phase

The Guide outlines the process that tends to be followed by managers when establishing a fund, reflecting the need for national expertise apropos tax and regulatory matters. It also touches on the fund documentation that should contain a wealth of information that is pertinent to the administrator, and includes the prospectus and various agreements. Topics addressed are AML; fees; expenses; instrument valuation; operational responsibilities; a background on how the fund will be managed and the expected relationship between all relevant parties.

### Interaction with Investors

The duties of the administrator pertaining to its interaction with funds’ investors are outlined. These typically include NAV reporting; maintenance of the share register; completion of AML checks; processing of fees, etc.

### NAV Calculation

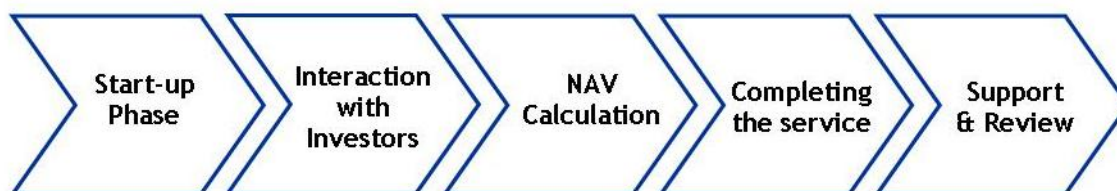
In this section, an explanation of the five main steps in the NAV calculation process is offered, namely: trade capture; security valuation; reconciliations; expense calculation; and NAV calculation and reporting. It is strongly advised that this Guide is read in conjunction with AIMA’s Guide to Sound Practices for Hedge Fund Valuation<sup>3</sup>.

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<sup>1</sup> Source: Hedge Fund Research, Inc. Year-end 2003 and Q2 2009 data comparisons.

<sup>2</sup> Referred to as Valuation Service Providers (VSPs) in AIMA’s Guide to Sound Practices for Hedge Fund Valuation.

<sup>3</sup> Appendix 5 for the Executive Summary. The full guide is available to purchase; [www.aima.org](http://www.aima.org).



## Completing the Service

In addition to the primary function of administrators, most administrators will offer additional services. This section covers those most commonly seen, such as custodial services; banking and foreign exchange (“FX” hereafter) services; tax services (where the Guide outlines specific tax issues for certain jurisdictions); and financial statements.

## Support and Review

With most jurisdictions requiring hedge funds (established as corporate vehicles) to appoint a company secretary, the Guide details the range of core duties required including, management of board meetings, share registration and a focus on corporate governance. The role and responsibilities of directors or, where a hedge fund is established as a limited partnership or unit trust, the general partner or manager, are discussed.

The [Appendices](#) offer considerable information on investor services and AML, including the processing of transactions and cash; investor communications and reporting; monitoring and controls; fraud prevention and other items such as side letter agreements. They provide definitions of terminology and practical examples of various fee equalisation methodologies. Included are AIMA’s 15 recommendations on governance; transparency; procedures, processes and systems; and sources, models and methodology. The Guide also builds substantially on AIMA’s Valuation Policy Document Outline, providing a detailed template for use by hedge funds.

This Guide does not seek to prescribe a legal, contractual or operational framework for the selection, appointment or ongoing relationship between a fund and its administrator.

Funds that do not employ third party administrators are a minority. The increase in institutional assets managed by hedge funds has demanded the use of administrators independent of the fund’s manager to undertake these numerous functions. Therefore, the Guide strongly recommends that the fund and the governing body employ the services of an independent, appropriately regulated administrator ensuring that the required services are documented and clearly agreed, on behalf of all parties.

With the Guide’s contributors all agreeing that lack of clarity of ownership, responsibility and service model and scope are the biggest areas of confusion and dispute between a fund and its administrator, this Guide has been designed to offer its readers a substantial resource in addressing any operational challenges and understanding the scope of services offered by the hedge fund administrative community.

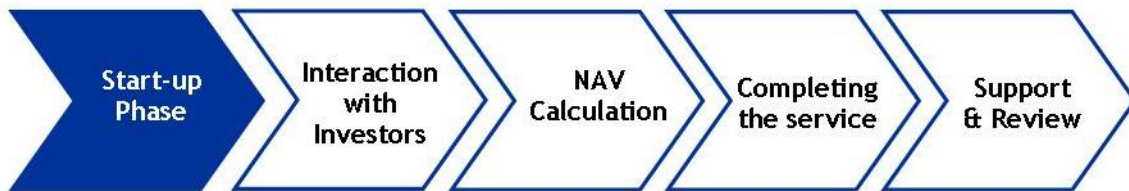
Finally, this Guide forms an important part of a much wider body of work on industry practices generated by the hedge fund industry during the last 10 years<sup>4</sup>. With the increased acceptance that hedge fund strategies are here to stay, the industry continues to focus on its practices and sees its work with policymakers, regulators and other bodies as central to its continued growth.

It is noted that there are a breadth of services, service models and product offerings available from the HFA and the Guide does not seek to recommend any particular model over others. However, it does strongly recommend that all parties clearly understand the service model, ideally via a legal agreement and service level agreement (“SLA” hereafter).

The recommendations within this Guide are not exhaustive and do not seek to replace the working practice of any administrator.

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<sup>4</sup> See appendix 8.



## 1. START-UP PHASE

### 1.1 Liaising with Lawyers

Most hedge fund managers will retain legal advisers who can advise in relation to the set up and establishment of future funds. Multiple law firms may be required depending on the particular construction of the relevant fund.

Some HFAs take a more proactive role than others in the fund establishment process, helping to draft the documents, liaising with lawyers in the jurisdiction selected and generally acting as “project manager”.

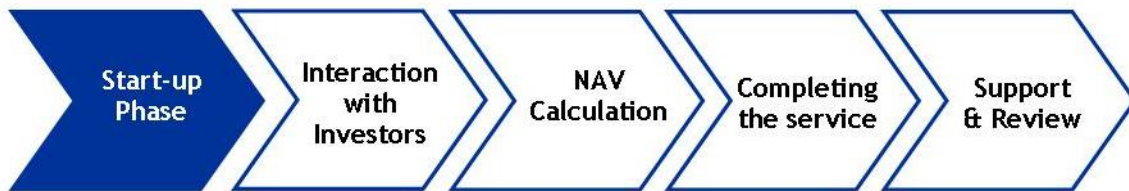
Fund managers establishing a fund in a jurisdiction for the first time will clearly have a number of questions ranging from complex operational points to regulatory issues, where applicable. A fund manager can obtain useful advice and guidance from the HFA regarding the establishment and ongoing operations of the fund in that jurisdiction.

Many fund managers select fund lawyers as a first step, with the choice of administrator often being made at a much later stage. However, there are benefits in choosing the administrator early on in the process as it enables the lawyers and the administrator to liaise in relation to operational aspects of the fund structure at the outset, thereby avoiding any practical difficulties that may arise at a later point in the establishment process.

The administrator may be able to provide useful guidance on various areas in respect of the fund which have an operational impact, although it is not its role or responsibility to provide legal or regulatory advice. Typically, the areas in which the administrator may assist will include: regulatory requirements (if applicable, e.g., compliance with the EU Savings Tax Directive); interaction with investment managers and/or prime brokers; fee structures (in particular, performance fees and equalisation measures); shareholder communication; currency class hedging; AML reviews and subscription, transfer and redemption procedures etc.

Both the administrator and the lawyers will have practical experience of the length of time it will take to establish a hedge fund in the relevant jurisdiction and the volume of documentation required. They will, therefore, be well placed to give the fund manager a realistic view of the time frame within which it can reasonably expect to be operating from that jurisdiction. Clearly, the time frame within which a fund can be established will vary greatly between jurisdictions, particularly if the fund and, in some instances, the manager undergo an authorisation or approval process by the regulator in that jurisdiction.

In summary, the HFA can be a useful source of information, intelligence and project management in dealing with fund lawyers.



## 1.2 Prospectus Review

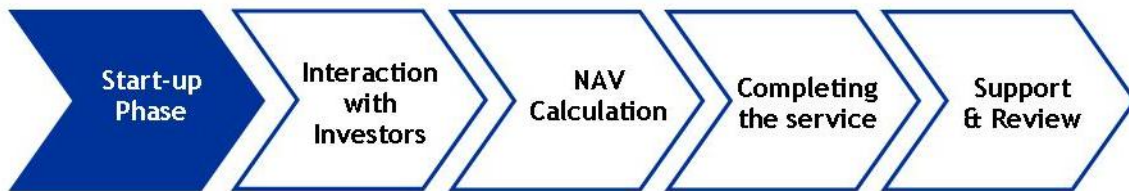
In this section, the word “prospectus” is being used as a collective phrase for all fund offering documentation, including PPMs, offering document etc. The phrase “board” is used to cover the funds’ governing body and could include a management company or general partner.

The prospectus is the formal offering document, providing essential information to a prospective investor. The investment manager and the fund’s board must ensure that the prospectus is accurate and discloses all relevant information, including the role of the administrator, relevant provisions of the administrator’s agreement, valuation provisions and subscription/redemption procedures. The administrator should review the operational aspects of the prospectus of the fund, in detail, prior to launch. It is essential that all operational and practical aspects of the fund are correctly reflected in the prospectus as the administrator will rely on the terms of the prospectus in operating the fund on an ongoing basis. Furthermore, it is important that the prospectus comprehensively describes the manner in which the administrator will perform its duties. While the prospectus is the formal responsibility of the fund’s board, all parties should review the document and ensure that it accurately and appropriately reflects how the fund will be managed, administered and operated as relevant to each party.

The following areas of the prospectus will have particular relevance to the administration function:

- a. Description and functions - a description of the administrator and a summary of the duties and functions it will undertake in respect of the fund should be provided. Such description and summary will be included in the prospectus in respect of all of the service providers;
- b. Interaction with investors - sections dealing with subscription, transfer and redemption procedures are required. It is important to ensure that the prospectus accurately reflects what will occur in practice (examples of this include the cut-off time by which redemption notices need to be received and, in the case of subscriptions, when application forms and subscription monies need to be received);
- c. AML and other regulatory issues - AML procedures should be set out clearly in the prospectus and the fund and the manager must ensure that the relevant checks and documents required from investors are properly reflected. The fund is responsible for compliance with the requirements of other regulations, including, *inter alia*, the EU Savings Tax Directive and the US “New Issues” regulations, where applicable. Investors and fund managers need to satisfy themselves that there is clarity of responsibility for compliance with various regulations. There may be circumstances where the administrator naturally takes this responsibility and there may be others where an alternative is required. In addition, the domicile of the HFA may impose additional AML provisions not specifically contemplated in the fund prospectus;
- d. Fees - the administrator will need to review the sections dealing with other fees, such as performance fees and whether performance fee equalisation will be applied and the mechanism to be used. Worked examples should be prepared, so that all parties can be sure that the fees are as envisaged;





- e. Circumstances where the NAV is to be suspended or redemptions deferred - examples might include one-off market events or closures, *force majeure*, significant events at the fund manager, significant volume of redemption requests, suspensions or deferrals of substantial elements of the portfolio; and
- f. Valuation of assets - all parties need to be satisfied that the prospectus reflects how the fund is to be valued, including valuation policies, *force majeure*, suspension provisions and the capital structure of the vehicle. It may be prudent for a dummy portfolio to be prepared and valued to ensure clarity of process, source and approach. Furthermore, the administrator should confirm that it is comfortable with, and can operate, the valuation principles.

It is essential that particular attention is paid to the valuation provisions in the document. There have been significant industry developments in this area since the Guide was originally produced, details of which are contained in section 3.2 below. Industry best practice now provides for:

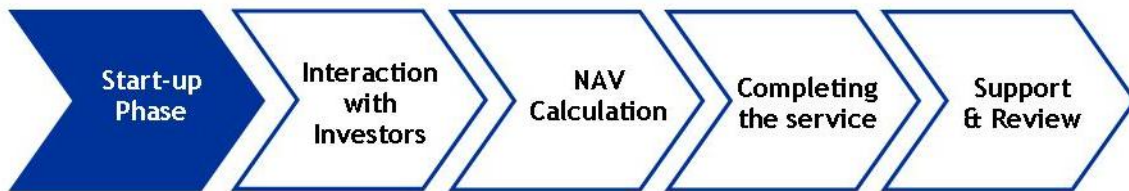
- a. A documented pricing policy document describing pricing sources, procedures, escalation policies and communication mechanisms;
- b. The board, or governing body, is the party responsible for accurate valuations. The execution of this function may be delegated to the HFA, or another party. While it is noted that the investment manager may be a party producing or advising on a specific valuation, it is recommended that such advice be considered by the board and/or the HFA in the context of an overall governance framework; and
- c. The creation of a pricing committee, comprising of key stakeholders including representatives from the board, the investment manager, the auditor, the HFA etc. This committee would then oversee the pricing process, taking reports and advice from the main participants.

### 1.3 Negotiating Agreements

The administration agreement is the contractual basis on which the fund has appointed the administrator. This agreement will set out, in detail, all of the duties which are to be undertaken by the administrator in its capacity as administrator of the fund. It is important for both the administrator and the fund to express, clearly, the manner in which these functions will be undertaken. As discussed below, administration agreements are frequently accompanied by SLAs which reflect, in greater detail, how the administrator will interact day-to-day with the fund, the investment manager and investors.

The administration agreement will generally cover the following areas:

- a. Services offered by the administrator, generally including:
  1. registrar and transfer agency functions, such as processing subscription, redemption and transfer requests, as well as maintaining the share register;
  2. NAV calculation; and potentially including:
  3. assistance with the preparation of financial statements and reports, including
  4. liaising with the fund's auditors,
  5. trade settlement support with fund managers or prime brokers; and
  6. ongoing support and review in relation to other reporting matters as agreed from time to time.

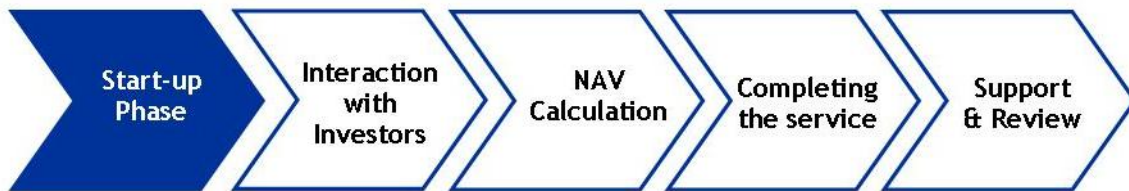


- b. Conditions to performance of administrative services - the administrator's ability to perform its services is generally conditioned upon the receipt of accurate, complete and timely information from the fund, its manager and any other third parties and the administrators entitlement to rely on reasonable instructions from authorised persons;
- c. Fees and expenses - the administration agreement should specify the level of fees payable to the administrator in respect of the administration services. Such clauses should also indicate how the relevant fees are calculated, accrued and paid;
- d. Liability/indemnity - the administration agreement should include a clause dealing with circumstances where the administrator may, or may not, be liable for any loss incurred as a result of the performance of its duties under the administration agreement. As there are a variety of services and service models covered by the agreement, there are likely to be variations in liability and indemnity provisions. This document does not seek to prescribe any specific standard, other than to recommend that all parties seek clarity on these areas;
- e. Termination - the agreement should set out the circumstances under which each party may terminate the agreement, covering notice periods, termination fees, pre-payment of notice period fees, penalties and default provisions;
- f. Governing law and jurisdiction - the agreement will generally be governed by, and construed in accordance with, the laws of the location of the administrator itself. In the event that the domicile of the fund and the administrator are different, the parties must determine which jurisdiction would more appropriately govern the agreement and any dispute arising in connection with it;
- g. Dispute resolution - the agreement may provide for alternative dispute resolution *in lieu* of a court proceeding to provide more efficient, cost-effective and confidential resolution of the dispute; and
- h. AML - the allocation of responsibilities for performing AML duties and reporting requirements should be clearly set out between the fund manager, administrator and any other parties concerned.

#### 1.4 SLAs

SLAs/Service Level Descriptions are not typically legally binding; they generally lay out an operational, escalation and communication framework under which it is envisaged that the fund, the administrator and other service providers will operate.

The legal agreement, i.e., the administration agreement which the fund (or its manager) will enter into with the administrator, should set out the contractual arrangements between the fund and the administrator. These agreements would not normally describe the individual steps that each party should undertake in performing its obligations under the relevant contract, nor would they describe, in detail, how the parties will work together. For this reason, the administration agreement is generally supplemented by a SLA.



The SLA would generally lay out the detailed operational responsibilities, workflows and expectations in plain language and should, ideally, present measurable objectives for all parties.

The intention is to provide a background for how the fund will be managed and administered and how the parties intend to interact. It is usually a living document which is likely to evolve over time and generally does not have the same legal or contractual impact as the legal agreement described above. For example, a SLA might indicate a detailed timeline for the communication and processing of trade instructions from execution of the deal at the fund manager to their incorporation in the books and records.

Funds and HFAs will agree on the level of detail and the degree to which the SLA is intended to be prescriptive or guidance in nature.

While every SLA will differ, the overriding objective of each one is to ensure that the fund administration process is documented, achievable and will result in a satisfactory administration service being delivered.

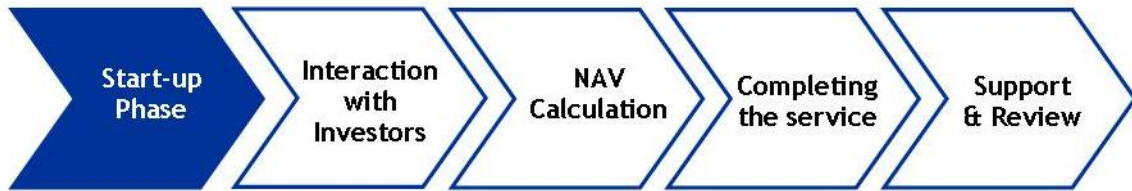
The SLA should ideally cover every area that the fund administrator will work on. It will cover most of the topics encompassed by this Guide including, *inter alia*:

- a. contact details for both parties;
- b. shareholder servicing;
- c. trade capture;
- d. NAV calculation (including details of valuation/pricing policy);
- e. performance fees (calculation method and examples);
- f. NAV deadlines;
- g. publication deadlines;
- h. expense payments;
- i. financial statement production;
- j. AML and related due diligence; and
- k. other relevant compliance matters, such as the EU Savings Tax Directive, “New Issues” regulations *et al.*

## 1.5 Fund structuring

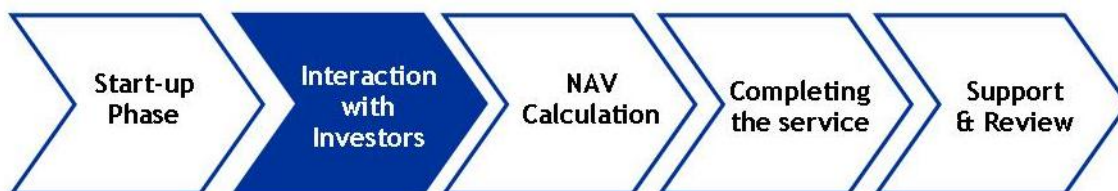
The fund promoter needs to determine the appropriate fund structure in advance of launch. Of particular importance are:

- a. fund domicile;
- b. tax restrictions and requirements;
- c. master feeder - multi class?;
- d. base currency - multi currency share classes?;
- e. service providers;
- f. valuation policy;
- g. investor dealing provisions; and
- h. NAV suspensions, i.e., side pockets, illiquid assets.



Particular attention is drawn to the last point, i.e., provisions surrounding NAV suspensions and various options for the treatment of illiquid assets etc. Given recent market turmoil, the Guide recommends that as far as possible, and as appropriate to the individual fund strategy promoters and HFAs, clarity should be set out as to how NAV suspensions are to be determined, and the latitude that the governing body/investment manager/fund has to create side pockets etc. While funds and investment managers may need to retain flexibility, the context in which that flexibility might be deployed should be clear to investors.

The HFA may be able to assist in many of these areas in terms of sharing experience and providing operational input into proposed structural issues.



## 2. INTERACTION WITH INVESTORS

### 2.1 Introduction to the role of the transfer agent

The traditional role of the transfer agent, that of processing investor transactions and issuing dealing confirmations, has long become more specialised as a result of the introduction of more complex fund structures, regulatory and compliance requirements and further elaborate distribution requirements.

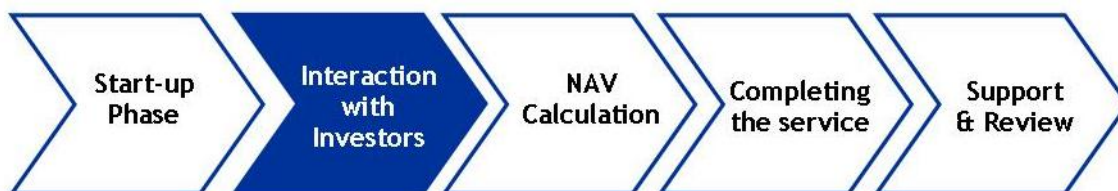
As the hedge fund industry has evolved and become increasingly institutionalised, the execution of the role of the transfer agent has changed significantly as investor bases have developed from primarily high net worth individuals to institutions, pension funds, funds of hedge funds and endowments.

The Guide acknowledges that with new regulation and legislation, the role of the transfer agent has become more complex with greater technical skill required. The Guide wishes to provide as much detail as possible and comprehensive descriptions of the key roles below are contained in appendix 2.

This section gives an overview of the main duties and reporting requirements of the transfer agent. For consistency, the shareholder services department/transfer agent/registrar will be referred to below as the “administrator”.

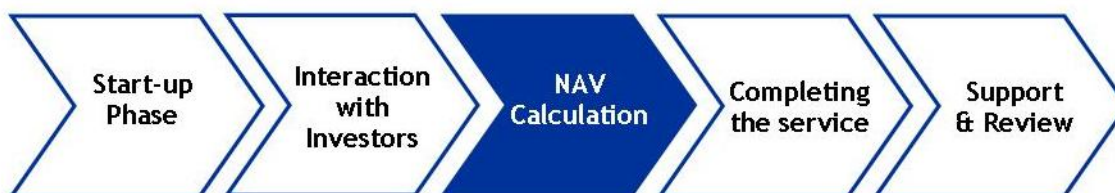
The following is a summary of the typical duties of the administrator as transfer agent:

- a. maintaining the share register and investor registration details;
- b. processing all dealing transactions including subscriptions, redemptions, exchanges, stock transfers;
- c. ensuring proper completion of subscription forms, with reference to requisite qualification requirements and monitoring new issue eligibility, benefit plan investors etc.;
- d. maintaining client subscription accounts and ensuring that transfers are made to the fund’s account on the relevant dealing day;
- e. holding current authorised signatory lists of investors;
- f. tracking underlying beneficial owner information of nominee investors;
- g. issuing redemption payments, including the hold back of partial amounts subject to the finalisation of performance fees, redemption penalties or the fund’s annual audit;
- h. issuing dealing confirmation statements and reports to investors and dealing with investor queries;
- i. providing reporting based on estimated or indicative NAV calculations;



- j. reporting all such dealings to the fund manager in a prompt and efficient manner;
- k. completing all appropriate AML and client identification checks or processing of designated body letters;
- l. maintaining fund documentation in accordance with local regulations, e.g., data protection laws, tracking investor lock in periods, where appropriate;
- m. where applicable, ensuring compliance with the EU Savings Tax Directive; German tax reporting; UK distributor/reporting fund; tax reporting; Austrian tax; PFIC; ERISA and K1 reporting information to the funds' tax advisors;
- n. reporting as required to stock exchanges;
- o. monitoring of maximum authorised share amounts across fund structures;
- p. processing performance fee equalisation;
- q. monitoring terms of side letters;
- r. assisting potential investors in carrying out due diligence; and
- s. providing relevant information to fund auditors.

This section provides for the formal role of transfer agent. Many HFAs may be in a position to offer ancillary services to the fund investors such as translation, document distribution and additional *ad hoc* fund reporting. Those extra services are typically agreed from time to time between the parties and do not normally form part of the formal transfer agency service range.



### 3. NAV CALCULATION

The calculation of the NAV is a core administrator task because it is the price at which investors buy and sell the shares or units of the fund. It is also the key determinant in reporting fund performance, calculating fees and producing financial reports. The accurate and timely calculation of the NAV, therefore, is vital. It should be noted that while there are multiple fund structures in existence, this section should be viewed in the context of two broad categories - unitised funds and limited partnerships. The mechanics of arriving at the overall net assets in both cases are broadly the same but the process of identifying individual investor valuations differ significantly.

A unitised fund strikes a NAV per share and issues units or shares to the investors. A limited partnership strikes an overall asset value and issues capital interests to the partners. A limited partnership is a form of partnership similar to a traditional partnership, except that it is required to have a general partner (which carries out the day to day management role) and the investors are limited partners.

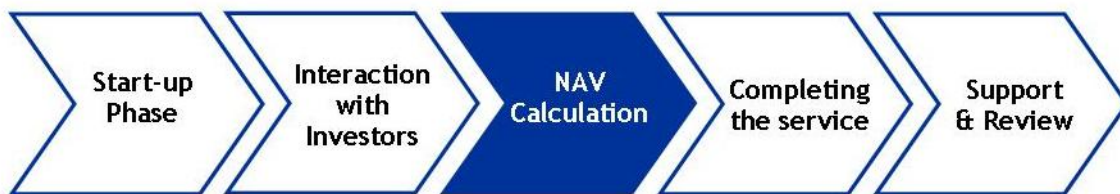
There are five main steps in the calculation of NAV:

- a. trade capture;
- b. security valuation;
- c. reconciliations;
- d. expense calculation; and
- e. holding current authorised signatory lists of investors.

#### 3.1 Trade Capture

There are two basic types of transactions that an administrator needs to process in the books and records - transactions reflecting investor activity and those reflecting trading activity. As most hedge funds only allow subscriptions and redemptions on a monthly or quarterly basis and tend to be aimed at high net worth or institutional investors, the investors' activity tends to be less voluminous in comparison with other types of investment funds. Nevertheless, efficient communication is required between the investor dealing teams and the valuation teams to ensure that the valuation system is updated for all investor dealing. Most administrators will have an electronic link between the investor dealing system and the valuation system. In some administration companies, these two functions may be combined.

The level of portfolio trading activity varies between hedge funds, depending on the strategy the fund is pursuing. It is essential that the trading activity of the fund is properly reflected in the valuation systems of the administrator. Most hedge funds and prime brokers have the capability to communicate electronic trade files on a daily basis, detailing all the trades done. The method of communication will differ, depending on the technological sophistication of the manager, but should be electronic. Common methods include SWIFT, FTP or CSV/Excel files that are pushed to the administrator.



Once received, the administrator will process the transaction activity into the books and records. For many asset types, most administrators will have the capability to upload these trade details in an automated fashion. Some asset types, especially various exotic over the counter (“OTC” hereafter) instruments may require manual intervention. To ensure independence of record keeping the administrator should receive all trades from the investment manager and then reconcile all transactions with the relevant prime broker, counterparty or custodian.

### 3.2 Security Valuation

There are two main aspects to the valuation process, price collection and price governance. Price collection covers the mechanical process of collecting prices from agreed sources at agreed times. Price governance covers the process by which the pricing policy, controls, responsibilities, disputes and issues are escalated and resolved.

Accepted international sound practice provides for the establishment of a pricing committee and the creation of a pricing policy document. Detailed provisions can be found in the AIMA Guide to Sound Practices for Hedge Fund Valuation - a link to the executive summary of this paper is attached in appendix 5 and the IFIA sample pricing policy document is attached in appendix 6.

The price collection process should then be documented in the pricing policy document (sample attached in appendix 6) and should provide for pricing sources, cut off times etc., as well as for hierarchies, tolerances, escalation procedures and approvals and manual processing, where relevant.

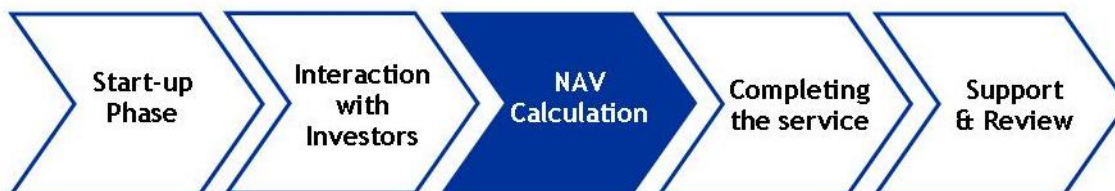
In all cases, it is important to consider the independence of the pricing process. Wherever possible, but subject in all cases to the fund’s pricing policy, the administrator should seek independent sources for the valuation of the assets of the fund. However, there will be occasions when valuations of certain instruments can only be made by the manager and the issuer of the instrument, or by the manager alone. In such situations, it is important that the method of valuation is documented, checked where a secondary source is available and reported to the pricing committee or board, periodically.

Particular consideration should be given to OTC or unquoted instruments, i.e., securities that are not quoted that may be highly illiquid and difficult to value accurately. Considerations include whether counterparty valuations are available and/or appropriate and whether the instruments can be valued by independent vendors.

The pricing policy document will provide clarity on the relative priority of sources and tolerances between various sources available. It should also be noted that certain jurisdictions place greater reliance on a counterparty price and any specific jurisdictional requirements need to be reflected in the pricing policy.

The pricing policy document should be approved by the board or governing body of the fund on a regular basis (annually or when altered).





It should be noted that while some HFAs have people, teams and service models which are capable of, and expert in, the calculation of recommended prices for individual securities, many others are not. A hedge fund manager or investor should not automatically assume that the HFA offers this service, employs this expertise or takes this responsibility.

Particular attention should be given to the governance aspects of the AIMA Guide to Sound Practices for Hedge Fund Valuation, as the observance of their principles should avoid any misunderstanding or lack of clarity around pricing and responsibility.

The Guide notes that the area of valuation has been topical and, in some cases, controversial. The role of the HFA has regularly been questioned and many investors and other industry participants have asked: “Is the HFA responsible for valuations?”

The Guide notes (and agrees) that both the AIMA and IOSCO documents suggest that it is the governing body that is ultimately responsible for the valuation of assets. In most cases, this is a board of directors or a general partner. Typically, the board will set a pricing policy.

The governing body and the HFA, together with the investment manager, will then agree on how that pricing policy is to be executed. There may be specific responsibilities placed on the HFA in the execution of this policy but investors should not automatically assume a standard model.

### 3.3 Reconciliations

In calculating a reliable NAV, a thorough and complete reconciliation of cash and trading positions to the prime broker and other brokers needs to be carried out, ideally, on a traded and settled basis (although a settled and traded reconciliation may not always be possible).

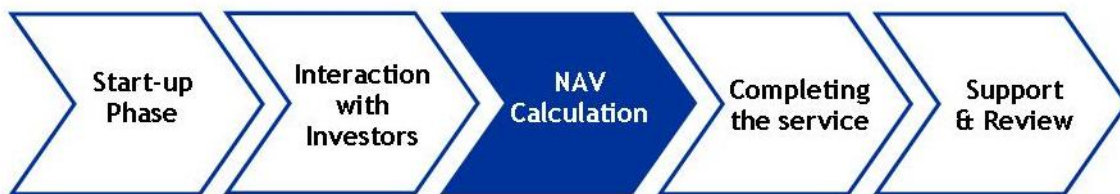
All assets held by the fund should be reconciled between the administrator’s records and those of the relevant third parties; this will include assets or collateral held with prime brokers, futures brokers, CFD counterparties, OTC counterparties, custodians or any other group, with all material differences and breaks understood and documented prior to NAV determination.

The reconciliations should encompass nominal holdings, value and transactions entered into during the period. The administrator should normally be able to show that the prime broker is reflecting the same trades, holding the same positions and valuing those positions in line with the administrator’s own records and that any break can be explained satisfactorily.

Some administrators may offer a three-way reconciliation facility where the books of the administrator, prime broker and fund manager are reconciled periodically.

### 3.4 Expense Calculation

The fund must accrue its expenses accurately and on a timely basis in order to strike an accurate NAV.



All known variable and fixed fees including management; administration; custody; performance; audit fees; listing expenses; establishment costs; legal expenses and directors' fees need to be accrued. Many funds and administrators will agree an expense budget or schedule in advance of fund launch to govern the accrual process. The annual budget should be agreed with the client at the start of each fiscal year.

Of these expenses, potentially the most complex fee is the performance fee, which can be calculated using multiple different methods. Discussion of and examples of these methods can be found in appendix 3. It should be noted that some regulators require sight of the performance fee wording and a worked example in order to approve the fund.

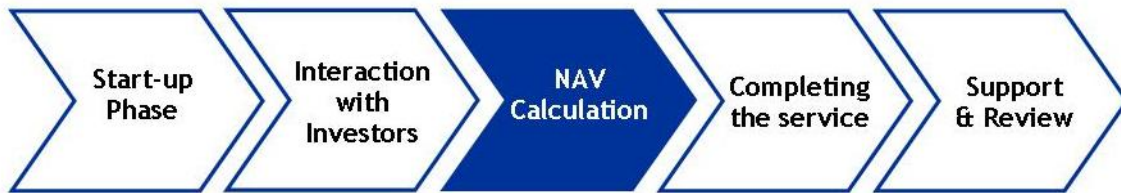
### 3.5 NAV Calculation and Reporting

The final step in calculating the NAV of the fund is to calculate the NAV per share of each class in issue. In order to do this, the administrator will typically do the following:

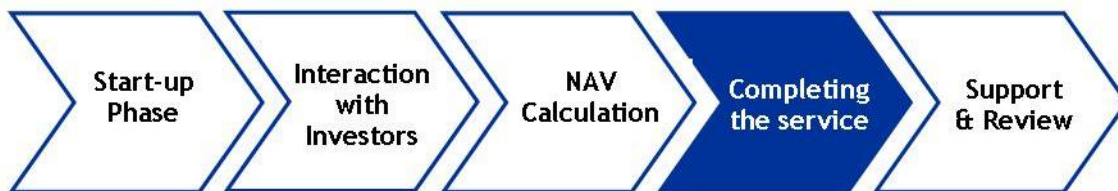
- a. calculate the allocation ratio for each class in issue (N.B., there are a number of different methods for determining allocation ratios. This document does not seek to prescribe any specific method but recommends clarity of approach, possible via the SLA);
- b. allocate the income, expenses, gains and losses for the fund based on the above allocation ratio;
- c. adjust for any share class specific items, such as any hedging gain/loss, new issue profits, differing management and performance fees;
- d. calculate the NAV per share;
- e. agree the NAV with the fund manager; and
- f. distribute the NAV.

In addition, there may be a set of variables which may require additional processing or consideration including:

- a. multi class/multi currency processing and hedging, i.e., where classes of shares are issued in a currency other than the base currency. The fund manager may decide to hedge currency exposure. As mentioned above, there are multiple hedging methods and the Guide does not recommend one over another but recommends clarity, likely via the SLA.
- b. some fees may be deferred or reinvested and any such arrangement will require processing;
- c. some hedge funds may offer shares at a discount or premium, arising from fees or charges; and
- d. if the fund is subject to adverse or unusual market conditions, additional market or valuation provisions may be required.



Many hedge funds agree a process up front of launch where the NAV is subject to a review by the fund manager in advance of its release to investors. This review is generally an additional control which assists in ensuring that the records are reconciled with those of the fund manager. It is not intended to replace any control within the HFA and is not intended to absolve the administrator from agreed and documented contractual responsibility.



## 4. COMPLETING THE SERVICE

It is the primary job of the HFA to calculate the fund's NAV and deal with its investors but, it may well be the case that the administrator offers other services. A number of these services are dealt with in this section. This list is not intended to be exhaustive or complete. There may be other services regularly employed by HFAs but the intention of this section is to describe the more common aspects of the HFA service and provides for some discussion of sound practice in these areas. It should be noted that the provision of the services below may, by definition, require a different contractual appointment, e.g., the appointment of a bank, FX counterparty or custodian.

### 4.1 Custody Services

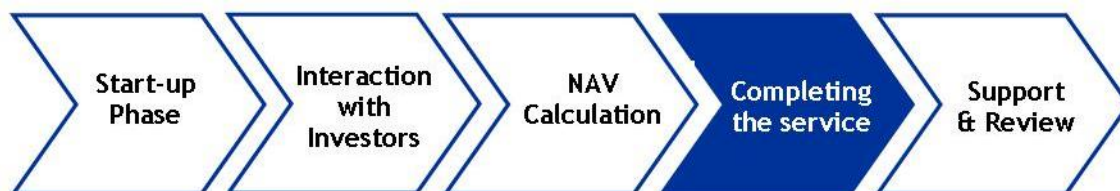
Custodial services are more complicated for hedge funds than for long only funds. Hedge funds will generally take long and short positions in securities, which will require ready access to securities lending and financing facilities. Hedge funds typically have more elaborate derivative strategies than long only funds; in turn, this implies more complicated custody and collateral arrangements. As a result, a hedge fund will usually engage a prime broker to take care of many of the custodial services required. This is in contrast to the long only mutual fund business.

It should be noted that in some jurisdictions, particularly those within the European Union, there may be a regulatory requirement to appoint a custodian in addition to a prime broker. In these circumstances the custody role is, in essence, a trustee or fiduciary role where the physical custody is retained by the prime broker. It should also be noted that some jurisdictions provide for specific contractual and other requirements covering the prime broker appointment.

One notable exception to the above is in the area of funds of hedge funds, where the investment strategy of the hedge fund is to invest in other hedge funds. All of the provisions and principles of this document apply to funds of hedge funds and specific considerations and requirements for this sector are covered in appendix 4.

### 4.2 Middle Office Services

Outside of the core NAV calculation role a fund might choose to outsource middle office functions to its administrator. Many of these services provided by administrators were traditionally performed by the operations and finance teams of the investment manager. It should be noted that while many administrators offer this service, many others do not. The fund and the investment manager need to understand the administrator's capabilities in this area, should a middle office service be of interest.



The phrase “middle office” is not defined but services provided by administrators on a daily basis typically include, but are not limited to, trade capture and confirmation procedures; corporate action procedures; cash; trade and position reconciliations; portfolio profit and loss calculation; and analysis and detailed portfolio reporting. They also can incorporate, and not necessarily on a daily basis, collateral management; cash balance management; risk management; performance measurement; pricing procedures and technology services, including maintenance of the applicable technology and more. When deciding on an operating model the fund should not just research the services that administrators can offer, but determine what services the fund is willing for the administrator to exert more control over.

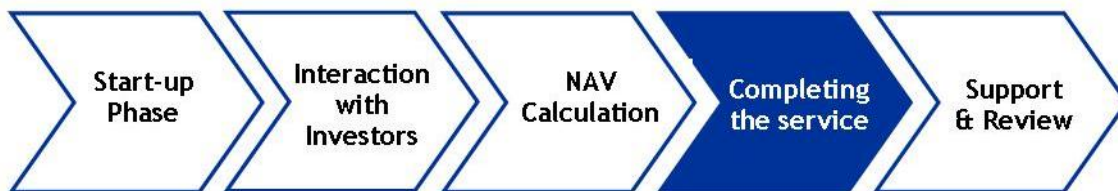
The decision to outsource operational functions for a start-up fund is typically arrived at after the senior appointments have been made within the start-up management firm. As the functions outsourced will have a critical impact on the daily running of the fund, it is important that the senior management agree on the services that they are comfortable with the administrator performing. In addition, a full understanding of how these services will be provided by the administrator is important. Making the decision to outsource middle office functions prior to having a fund COO or CFO in place might lead to uncertainty at a later stage, in terms of how the fund will operate, and some of the advantages of outsourcing may be lost.

To effectively manage outsourced services, such as those listed above, the administrator will require technology to efficiently capture, process and store trading activity. Technology capable of storing and processing data required for operational processes, valuation and portfolio analysis such as yield curves, security static or corporate action information, forms the basis of any outsourced solution.

Many administrators will provide daily portfolio accounting and performance as part of a middle office solution. This service requires the administrator’s technology to be advanced enough to capture and present all relevant data to perform the portfolio calculations required for this function. In many cases, the administrator’s technology will be able to support the viewing of near real time profit and loss information for each position held by the fund. The fund may make the decision that the trade capture and portfolio technology employed by the administrator to provide such services is sufficiently powerful to adequately support the operating model chosen for the fund. In this instance, the fund avoids incurring the additional overhead costs of separate order and portfolio management systems.

Dependent on what is to be outsourced, a clear operating model must be established and understood by the fund and the administrator. The sections of the operating model outsourced to the administrator and the SLA that supports it becomes the product the fund has invested in. Over time, this product will need to develop as the fund’s assets expand and as additional products and complexity are added. Therefore, when choosing a service provider to outsource functions to, the fund should look at the scalability that the administrator offers, both in terms of technology and staff expertise. The fund must then decide if the administrator has the ability to support the operating model agreed, given potential expansion in the future.

The middle office services provided by the administrator will generally require that any SLA or equivalent document between the two parties be more detailed than a situation where back office services are provided. An additional level of operational risk is introduced if there is not a complete understanding of the fund’s operating model, across both organisations. This understanding of the SLA is also part of ensuring a successful relationship between the two organisations which becomes increasingly important when outsourcing functions.



The outsourcing of operational functions, such as daily reconciliations and feeds to risk providers will require enhanced connectivity regarding the technology employed in the operating model. The time required to implement this technology infrastructure will vary depending on complexity. This connectivity is critical for the smooth operating of a fund and therefore needs to be considered early during the fund’s start-up or conversion process.

### 4.3 Banking and FX Services

Hedge funds present banking issues which do not often arise with traditional mutual funds. These include the use of cash collateral for security lending transactions and margining for certain types of derivatives. Cash management and cash forecasting are generally more important in the hedge fund environment, given the limited dealing and liquidity compared to mutual funds. In addition, there may be more parties involved in the banking relationship, including prime brokers and other brokers as well as the custodian.

The HFA may be able to assist in these areas. One of the basic things they can do is to arrange to have a bank account opened for the hedge fund, with either an affiliated custodian or third party bank. This will maintain independent accounts, reducing the manager’s ability to access the cash inappropriately, and allowing many cash transactions to be carried out under the supervision of the administrator, thereby lightening the burden on the manager. It is imperative that the manager is not able to give any third party payment instructions on behalf of the fund without the administrator’s countersignature; this is to avoid any conflict of interest and, also, to provide security for investors, who are increasingly concerned that a manager should not have any such ability.

Unless it is authorised to do so, the administrator must ensure that it does not carry out any investment management or investment advice on behalf of the fund. Subject to that overriding caution, services that the administrator may offer in connection with such an account include:

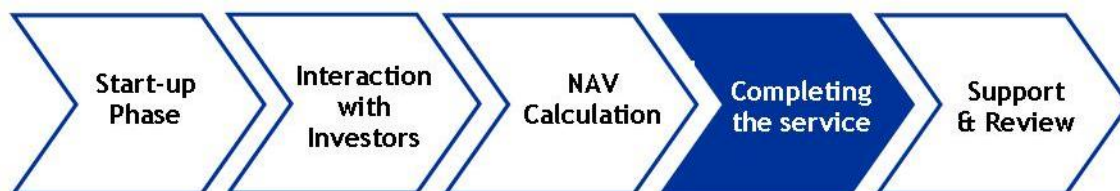
- a. investor transactions;
- b. cash collateral;
- c. margin calls;
- d. dealing cash flow forecasting;
- e. cash management/treasury; and
- f. foreign currency.

#### 4.3.1 Investor Transactions

The administrator will collect subscriptions prior to the money being passed to the prime broker; it will also pay out redemptions to investors.

#### 4.3.2 Cash Collateral

The use of collateral is a key part of securities lending arrangements. The administrator can help with these arrangements by monitoring collateral accounts, advising of any surplus or deficit collateral balances and even paying money to, or receiving money from, such accounts.



#### 4.3.3 Margin Calls

Margin payments are required when transacting business in exchange traded derivatives and some securities. These margin payments are set by the exchanges and clearing houses to protect against price movements. Increasingly, there is a requirement to provide margin on OTC transactions either at a clearing house or directly with the counterparty to the transaction. This is a methodology for reducing credit risk and thereby facilitating larger trading limits. The administrator should ensure that the cash flows associated with all margin amounts are accurately and completely reflected in the fund's accounts. Some administrators offer a service to managers, which effectively takes over the management of all margin related activity.

#### 4.3.4 Dealing Cash Flow Forecasting

Dealing in the units of hedge funds generally occurs on a monthly basis, although some funds may deal more or less frequently. Accordingly, the forecasting of cash available to the manager for investor dealing is very important. The administrator may be responsible for this task. If so, it will need to ensure that it has systems and procedures in place to communicate with the various parties (including the prime broker) in order to provide accurate forecasts.

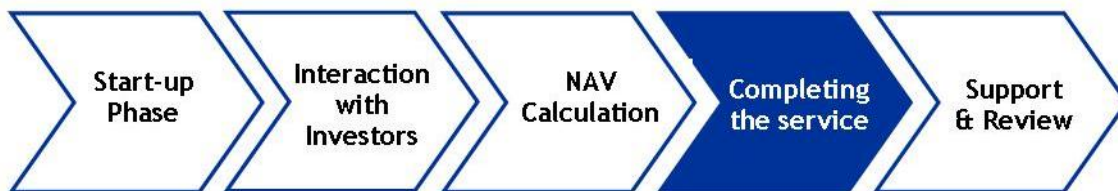
#### 4.3.5 Cash Management/Treasury

Cash management and treasury activities may be complex in a hedge fund environment where there may be various accounts maintained with several parties. The fund may be charged interest for borrowing money from one party when, in fact, it is in a net cash surplus position overall. The interest rate earned on surplus funds from one party may not be as high as from another. In general, cash management is the responsibility of the manager however, in some cases, the administrator may provide a platform for assisting the manager in investing the fund's cash.

#### 4.3.6 Foreign Currency

The administrator may be able to assist in the management of FX transactions and in some cases offer fully automated and integrated share class hedging services executing forward contracts and rollover positions. Examples may include, converting foreign currency subscriptions to US dollars or payment of redemptions in non-US dollar balances. The administrator may also be able to provide, or arrange for an associated company to provide, FX facilities to the fund manager, thereby allowing them to trade FX, if they so wish. All trading decisions, however, must be made by the manager and not the administrator.

As with all cash accounts, the administrator must ensure that it has adequate provisions to ensure that only authorised movements are approved, that payments/receipts are not missed and that there is appropriate segregation of control over the cash accounts. Administrators that offer this service in-house (as opposed to outsourcing to a cash manager) must ensure that they are properly authorised/licensed to provide these services by their own regulator.



## 4.4 Tax Services

The Guide notes that as the hedge fund industry has grown since the original document, a greater number of tax codes are becoming relevant for hedge funds, the administrator and the investor. This document is not intended to be a substitute for professional tax advice.

The main jurisdictions giving rise to tax considerations faced by international hedge funds are discussed below. The reader should only treat this information as background and it should not be relied upon for tax planning or other tax filings or submissions.

### 4.4.1 United States

The following is a brief overview of some of the US tax issues facing US funds and non-US funds that have US investors and a summary of the more frequently encountered matters related to the structural and reporting requirements of hedge funds. Advice should, of course, be obtained from US tax advisers in respect of any vehicle or transaction under consideration.

Many hedge funds seek to attract US investors (both taxable and non-taxable) to invest in their funds. If they do, this may give rise to a requirement for US tax reporting requirements. Administrators will therefore need to have staff and systems to produce the often intricate information required for US tax reporting. In addition, the administrator should be able to identify when a tax decision has to be made and alert the relevant tax decision makers, while not taking responsibility for the tax decision.

#### 1. Background - Structuring:

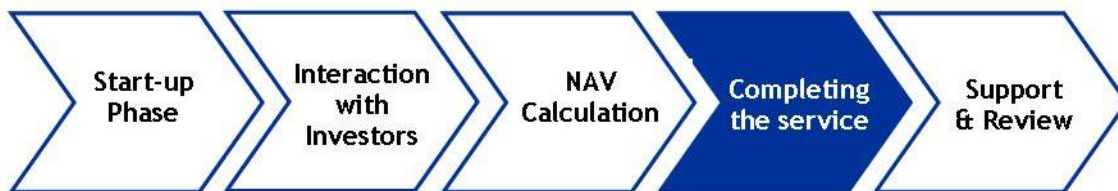
Structuring of the hedge fund is of key importance from the outset. For US tax payers, the use of a “flow-through” entity (i.e., an entity that is classified as a partnership for US tax purposes) is necessary to avoid double taxation and to preserve the tax attributes of the income derived by the entity. The limited partnership and the limited liability company have generally emerged as the entities of choice for US based investment vehicles. Typically, they are established in Delaware.

An entity which is classified as a partnership is a flow-through entity for tax purposes, meaning that the investors, not the fund, are taxable on income, expenses, gains and losses incurred by the fund. The investors recognise the tax effects of the fund’s operations, regardless of whether any distribution is made to such investors. This differs from a US domestic corporation, which incurs an entity-level tax on its earnings and whose shareholders may incur a second level of tax when the corporation’s profits are distributed to them.

A typical master feeder structure usually has three entities involved:

1. a master fund (usually, a foreign limited liability entity which elects to be treated as a partnership for US tax purposes);
2. a US feeder fund (a US flow through entity, e.g, a Delaware limited partnership); and
3. a foreign feeder fund (usually a foreign limited liability entity), e.g., Cayman, Irish or Luxembourg company.





Usually, US tax exempt entities invest in the foreign feeder fund because the foreign feeder blocks the application of UBTI and a US taxable person invests in the US feeder so that he/she/it receives its flow through income.

**2. Administrator Operational Issues:**

The administrator needs to have an understanding of the tax reporting requirements, as well as the systems and staff to support these requirements. It should also be aware of election dates and will alert the fund manager of such time sensitive requirements.

**3. K-1s:**

Investors in flow-through fund vehicles are partners and must pay tax, currently, on their share of the taxable income generated by the fund, regardless of whether there are any distributions. In order for a partner to know what its share of taxable income is, a partnership must prepare a Form 1065, which includes individual Schedule K-1s (partner's share in income, credits, deductions, etc.), and provide the Schedule K-1s to the respective partners. This is required for every partner who had an interest in the fund during the tax year and/or who received an allocation of income earned by the fund during the tax year. Most administrators will have the systems to provide the informational input to the K-1s.

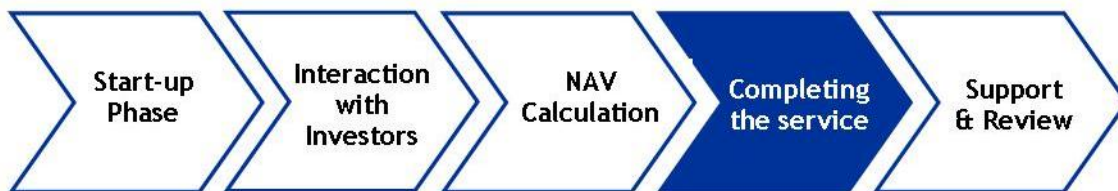
Form 1065 must be filed with the IRS by the 15th day of the fourth month following the fund's year end, although an extension may be granted. However, many partnership agreements require that the K-1s be provided to the partners within 90 days of the fund's year end. The general partner also typically provides a letter with the K-1s, explaining unusual items and state/local information. Timing is usually crucial and a well prepared and organised HFA works to meet the deadline.

**4. Effect of Foreign Partners in a Fund:**

If a US domestic fund has foreign partners, certain withholding requirements may arise. Withholding issues on funds conducting securities activities are complex. An investment partnership with foreign partners will also have a withholding obligation on certain income items. Generally, the income which is subject to withholding tax is withheld at a rate of 30% on US dividends (unless reduced by treaty); for example, for US dividends paid to a foreign person at USD 100, the federal tax withholding would usually be USD 30. The administrator needs to be aware of this withholding obligation, should receive copies of the relevant Forms W-8 BEN and have systems in place to record and withhold as necessary.

**5. PFIC Reporting:**

PFIC reporting issues will arise when a US taxable investor invests in a foreign feeder or a foreign fund which is treated as a corporation for US tax purposes. As this investment vehicle is a corporation and not a flow-through vehicle, a US taxable investor does not currently include their share of the taxable income of the fund on their tax return. The US investor will then pay tax plus interest on disposition of the interest in the PFIC and be subject to an onerous taxing regime. As an alternative, if a fund decides that it is willing to provide PFIC statements to its investors, a US investor may make a Qualified Electing Fund (QEF) election and include his/her share of the fund's taxable income. It should be noted that there is no requirement by the



Internal Revenue Code that a fund should provide PFIC statements, although funds or their documents may agree to provide them along with a time frame for doing so. It also should be noted that if PFIC statements are to be provided, there is no specific “filing” time other than that provided in the fund documents or specified by the fund manager. Finally, allocations of taxable income for purposes of calculating the income on the PFIC statements are not made in a fashion similar to the partnership feeder, but are typically based on a weighted capital average for the year.

#### 4.4.2 Germany

Over the last few years, hedge funds have started to distribute in Germany. A number of taxation and regulatory provisions have been issued which present operational challenges for the hedge fund and the HFA.

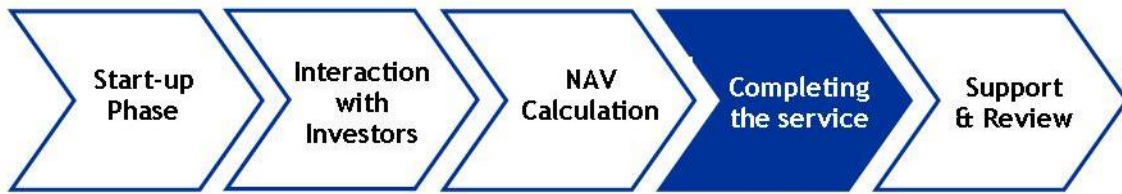
With effect from 1 January 2009, there has been a change in the tax legislation in Germany. As this legislation is very complex and subject to individual fund and investor variations, it is advised that professional advice be obtained.

#### 4.5 Financial Statements

Hedge funds usually produce two sets of financial statements each year, comprising audited annual financial statements and unaudited semi-annual financial statements. The board or general partner is generally responsible for the preparation of the financial statements, although the role of formally compiling the accounts is usually delegated to the administrator, with key inputs and advice from the investment manager and auditor, where appropriate.

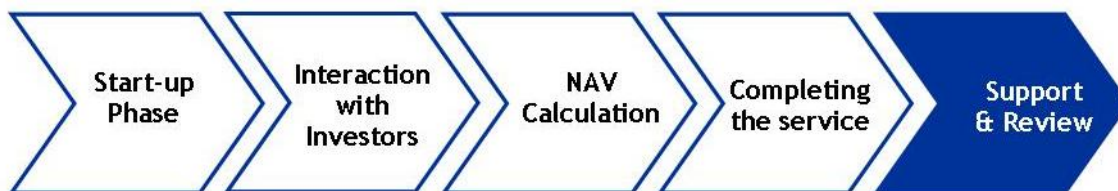
Where hedge funds are established as investment companies, the company law provisions of the relevant jurisdiction will invariably require that an audited set of accounts be prepared in respect of the preceding financial year. Similar requirements (whether legislative or regulatory) are generally imposed on non-corporate fund vehicles such as unit trusts and limited partnerships. While some jurisdictions do not require a fund to produce semi-annual financial statements, very often listing requirements or investor expectations will dictate that such statements are produced.

The content of financial statements will vary from jurisdiction to jurisdiction but, at a minimum, both sets of financial statements will include a profit and loss account, balance sheet and commentary from the fund manager on the performance of the fund for the period under review. The annual audited financial statements will also include an auditor’s report. Both the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) are continuously updating standards which may have a significant impact on the financial statements of an investment fund. Most recently, the revisions to IAS 39 Financial Instruments: Recognition and Measurement, FAS 157 “Fair Value Measurements” and IFRS 7 Financial Instruments: Disclosure, have been reflective of this evolving environment particularly with respect to the techniques used for measuring and managing each fund’s exposure to risks arising from financial instruments. Administrators must consistently upgrade and enhance their IT infrastructure and reporting capabilities to ensure synchronicity with the latest requirements.



The administrator's role in producing both sets of financial statements is central. There must be adequate mapping of balances from the administrator's systems to the financial statements and data collection for certain disclosures. For the annual statements, the administrator will liaise with the auditors to ensure that the audit review is conducted on an orderly basis and that all queries are addressed in a timely manner.

Semi-annual financial statements might be prepared by the administrator without referral to the fund's auditors, who would not be expected to issue a report on such statements. The administrator may facilitate the filing of financial statements with the relevant authorities within the required deadlines, depending on the fund structure, regulatory guidelines and service levels agreed.



## 5. SUPPORT AND REVIEW

### 5.1 Relationship Management

The hedge fund administration industry encompasses service providers with widely differing business models, ranging from the institutional structure of custodian banks to the more boutique nature of niche service providers. As a consequence, HFAs approach the area of client relationship management in very different ways. Some groups have dedicated relationship managers whilst others see relationship management as an extension of the operational staffs' core responsibilities.

This document does not prescribe any particular model and only recommends that the hedge fund manager and HFA agree on the relationship management process with clarity, possibly via the SLA.

### 5.2 Monitoring of the Restrictions placed on the Fund's Activity

Unlike long only funds, hedge funds, generally, are not available for purchase by the general public and therefore, typically, are not subject to the regulations and investment restrictions relevant for retail investment vehicles.

Some funds are domiciled in so called "regulated centres" and may have a set of regulatory guidelines that should be followed. Others may have no such regulatory provisions but may have self imposed investment or other guidelines. Equally, many hedge funds are listed on a stock exchange, which may bring reporting or structural requirements.

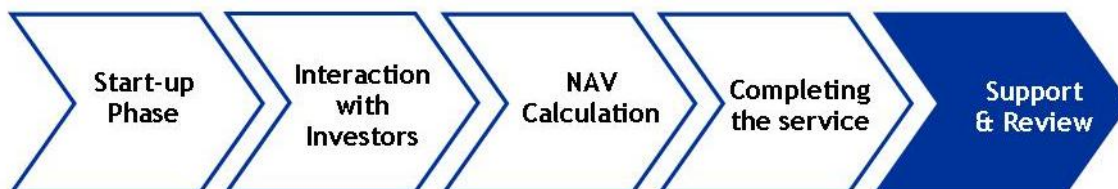
There is no formal requirement for the administrator to take responsibility for monitoring either of these categories and any such arrangement is a matter for discussion between the parties.

### 5.3 Company Secretary

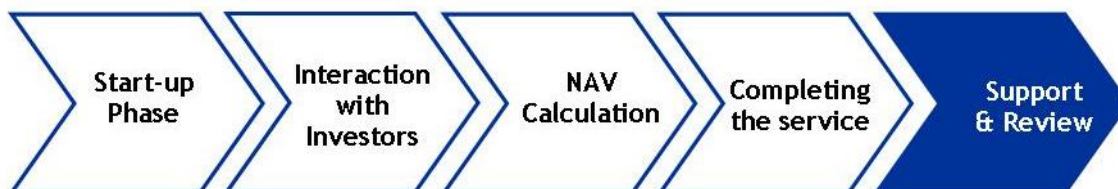
Most jurisdictions will require that hedge funds established as corporate vehicles must appoint a company secretary. A number of the company secretarial duties, in particular, those duties relating to shareholder services, tend to overlap with certain of the administrator's duties. Since the administrator, rather than the company secretary, maintains and updates the share register of the fund, the former is the primary point of contact for the shareholders. Therefore, some administrators are well placed to provide company secretarial services to corporate hedge fund vehicles, whether as company secretary of record or at a practical level only, with a director or other person/entity being named as the secretary of record.

The company secretary has a wide range of core duties which can be summarised as follows:

- a. **Board Meetings:**  
Organise all board meetings of the company; collect, organise, and circulate agendas and board papers in advance of the meeting; arrange board meeting attendees and presentations and take the minutes of the meeting.



- b. **General Meetings:**  
Ensure the annual general meeting is organised and held once a year. Prepare all board papers to approve the accounts and convene the annual general meeting including notice, consents to short notice, proxies and minutes of the annual general meeting.
- c. **Extraordinary Meetings:**  
Organise any extraordinary meetings.
- d. **Statutory Registers:**  
Maintain and update registers relating to members, directors and secretary, allotments, charges, directors' interest in shares and debentures.
- e. **Statutory Returns:**  
Comply with the Companies Acts regarding filing statutory returns. Observe filing deadlines in relation to annual return and accounts; changes in directors and secretary; amendments to the memorandum and articles of association; changes to authorised and issued share capital and notice of change of auditors.
- f. **Share Registration:**  
File return of allotments, stamp share transfer forms, and update statutory registers in relation to shareholders.
- g. **Shareholder Communications:**  
The company secretary is the focal point for shareholder communication and forwards all financial statements, responses, notice of meetings, proxy forms, circulars and other notifications in relation to the company to the shareholders. The company secretary will also liaise with shareholders regarding dividend payments, calls on shares, transfers, forfeiture issues and general enquires in relation to shares.
- h. **Share and Capital Issues and Restructuring:**  
Implement properly authorised changes in the structure of the company's share capital.
- i. **Non-Executive Directors:**  
Act as a channel of communication and information for non-executive directors.
- j. **Company Seal:**  
Ensure safe custody and proper use of the company seal and maintain a register of sealing.
- k. **Registered Office:** Maintain the statutory requirements for a registered office address, ensuring public inspection of documents, ensuring all business letters, order forms, faxes, emails and website show the name of the company, registered number etc., and comply with current legislation.
- l. **Authenticate documents of the company; and**
- m. **Sign company documents under seal.**



## 5.4 Directors

A hedge fund will usually require directors, either for the fund itself or the management company. Furthermore, a number of jurisdictions (e.g., Ireland, Jersey and, in certain circumstances, Bermuda) will require that at least two directors of the fund be resident in the jurisdiction in which the fund is established. Where a fund has an Irish listing, it is required to have two directors independent of the investment manager.

It should be noted that fund directors have similar legal and fiduciary responsibilities as any other director and appropriate due care and attention should be given to their appointment, and ongoing execution of their duties. There is no requirement for the administrator to provide such a director. Particular emphasis should be given to the director's role in the context of emerging best practice around valuations and the clarification of board responsibility.

## 5.5 Management Companies/General Partners

Where a hedge fund is established as a unit trust, the trust does not have a legal personality in its own right and is therefore unable to contract with other parties directly. Although the trustee acts as principal on behalf of the trust, the trust deed establishing the trust will appoint a management company to carry out the management and, sometimes, the administration of the trust. Some funds will appoint a manager and an administrator. The directors of the management company will assume similar responsibilities to the directors of a corporate fund vehicle.

It is sometimes the case that a corporate hedge fund will appoint a management company which will be established by the promoter and appointed by the corporate fund as manager of the fund. The establishment of a management company in these circumstances is often for tax purposes. Where a hedge fund is established as a limited partnership and therefore requires the services of a general partner, the lawyers will normally assist in the establishment and operation of the general partner. The administrator may also be able to offer this service.

## APPENDIX 1 Working Group

Co-ordinated by AIMA and the IFIA

### Administrators

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Morgan Stanley Fund Services  
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Fiona Treble

AIMA and the IFIA wish to offer their sincere gratitude to all Working Group members for their unstinting commitment that they gave towards the creation of this document.

## APPENDIX 2 Investor Services/Anti-Money Laundering

### Transaction Processing

When an investor submits a transaction request to subscribe, redeem or transfer holdings in a fund, the administrator may take the following approach to processing the transaction:

- a. review the transaction document for completeness, ensuring a formal document is signed by an authorised signatory of the investor; and
- b. ensure the transaction attributes meet the fund's terms as outlined in the prospectus. For example:
  1. does the amount subscribed meet minimum investment requirements?;
  2. does the dealing date requested meet the fund's liquidity terms?;
  3. does the investor hold enough shares to meet the redemption request?;
  4. does a lock-in period apply to the investors' holdings and should a redemption penalty be applied?; and
  5. does information contained in the redemption request reconcile appropriately with the relevant detail provided on subscription?
- c. input transaction information to their transfer agency system. Ensure that the transfer agency system is appropriately updated to track investor new issue eligibility; whether they are a benefit plan investor etc.; and
- d. communicate receipt of the transaction document to the investor, investment manager or other relevant parties, confirming the date that the transaction will be processed and requesting any additional information (e.g., AML documentation) that may be required in order to complete the transaction.

Once a NAV per share is finalised, the transaction application can be fully processed. A transaction confirmation detailing the final terms of the transaction should be issued to the investor. The confirmation will typically show the number of shares issued/redeemed, the transaction price and the transaction dealing/NAV date. The confirmation may also show any applicable charges, e.g., up-front sales charges, equalisation credits/depreciation deposits, early redemption exit fees, etc.

### Cash Processing

Cash management is a very important aspect of the administrator's role. Cash accounts should be reconciled daily to ensure cash received or cash paid has been recorded appropriately to enable adequate cash flow management within the fund.

### Cash Receipts

Once a subscription order has been received, the administrator should ensure the timely receipt of the cash from the investor. It may be necessary for the administrator to follow up with the investor to ascertain the expected receipt date of the monies in order to assist the investment manager with the fund's cash flow management.

Upon receipt of the monies, the administrator should identify the source of the monies and that it meets appropriate AML regulations, i.e., the monies were received from an account in the name of the investor and from a financial institution/intermediary located in an approved jurisdiction. It may be a requirement that monies received which do not meet local AML regulations may have to be returned to the sender. If the funds received meet the local requirements the cash may be processed and recorded appropriately.



Communicate receipt of monies to the investor and investment manager, confirming the date the monies were received and the date the transaction will be processed. The confirmation may also request any additional information (e.g., banker's letter confirming source of funds) that may be required in order to complete the transaction.

### Cash Payments

It is advisable to have appropriate segregation of duties between personnel inputting a cash payment request, a verifier of the payment and a final authoriser (appropriate authorised signatory) of the payment.

### Invoice Payments

Upon receipt of an invoice from a service provider to the fund, the administrator should seek approval from an authorised signatory of the fund to make the requested payment. The administrator should ensure adequate monies are held in the fund's account to make the payment or seek funds to be transferred from the trading account accordingly. Upon receipt of the payment approval, the operating expense payments should be processed.

### Transfer to Custodial/Prime Brokerage/Underlying Investment Account

If prior instructions have not been received from the investment manager as to the handling of subscription monies received, timely communication should be made notifying the investment manager of the amount(s) received along with any known outgoings that will impact the total amount available for investment. Upon receipt of instruction from the investment manager, the wire transfer should be processed accordingly. Wire transfers to an underlying investment account for a fund of hedge funds vehicle may be followed up with a phone call or email to obtain confirmation that the monies were received and the investment will be processed for the requested transaction date.

### Redemption Payments

In accordance with the terms of the fund's prospectus, redemption payments may be made in instalments (based on estimate or final NAV) with amounts being held back for early redemption penalties, the transaction date final NAV or the fund's annual audit. For AML purposes, payments to investors should be made to an account registered in the name of the redeeming investor, as indicated in the subscription documents. If the complete AML due diligence information has not been received from a redeeming investor, the administrator should block payment of the redemption proceeds to the delinquent investor until the administrator receives all of the necessary information in the proper form.

Communication regarding the payment of monies to the investor should be made, confirming the date the monies were paid out and whether the amount is partial or full consideration of the total redemption. The confirmation may also show any applicable charges, e.g., early redemption exit fees.

### Monitoring and Controls

Risk reduction is a vital part of the administrator's responsibilities. The ongoing use of appropriate procedures and checklists allows the administrator to mitigate potential risks to the fund. Such procedures or checklists may include:

- a. **Transaction processing;**
  1. transaction specific checklists listing documents to be obtained prior to finalising a transaction;
  2. source of fund checks as part of AML procedures. Prompt follow up if information deviates from standard requirements;
  3. periodically check investors against OFAC and NCCT schedules;
  4. reference checklists to ensure appropriate transaction processing flags have been raised for an investor to track new issue eligibility, benefit plan investors, EUSD requirements etc.; and
  5. line management approval prior to finalisation of transactions.
- b. **Cash reconciliations; and**
  1. daily reconciliation between fund bank/investment accounts and transactions processed and recorded in the fund's general ledger; and
  2. unreconciled items documented, followed up promptly and resolved.
- c. **Wire transfers.**
  1. obtain letter from remitting bank confirming incoming wire details for investor subscription monies; and
  2. implement appropriate segregation of duties between personnel inputting a cash payment request, a verifier of the payment and a final authoriser (appropriate authorised signatory) of the payment.

It is critical that proper checks and balances are incorporated as part of the control process for investor dealing. Overall checks should also be incorporated into procedures ensuring that all information is sent out to investors in a timely and accurate manner. The administrator should ensure that the "four eyes" principle is adopted before any information becomes final on its system or is released to outside departments, investors and/or clients.

### Investor Communication and Reporting

In communicating with the investor, the administrator effectively becomes the fund's back office. The administrator's contact details will appear on transaction confirmations and statements issued to investors. The administrator should add value to the fund through efficient processing of investor transaction requests, cash receipts/payments and investor reporting. This is achieved through:

- a. transaction request, cash receipt or cash payment confirmations being sent to investors within an agreed time frame;
- b. final transaction confirmations and regular valuation statements being issued within an agreed time frame after the NAV per share becomes available;
- c. issuing statements on a consolidated basis where an investor has multiple accounts within the same fund family rather than on an account by account basis;
- d. other correspondence may include AML reminder letters for any outstanding documentation, change of address notification, etc.;
- e. convenient and secure means of communication with investors via a number of different channels, including automated email, fax delivery and secure web reporting platforms;

- f. investor queries being acknowledged and resolved promptly; and
- g. complaints and error reports being logged and made available for inspection.

### Fund Manager's Report

Some administrators may also send out the fund manager's investment report along with the investors' statements. Typically, the manager will send the investment report to the administrator electronically and the administrator will attach the manager's report to the investor statements. The administrator should ensure that it is made clear that figures and comments outlined in the report originated from the manager, so that the administrator assumes no responsibility for, and does not verify, the manager's numbers.

### Share Dealing Report/Creation and Liquidation Report

When a dealing cycle is completed, a share dealing report should be produced, detailing the total movement in capital and shares for the particular dealing cycle. This information is typically reported to the fund manager and the NAV calculation department of the administrator. This report can be used to ensure the total shares recorded in the funds share register matches that of the prior period share total as adjusted for capital or share movements in the period.

### Ad Hoc Reporting

The administrator should be in a position to provide other *ad hoc* reports such as an analysis of investors and their percentage holdings, investor activity levels over the life of the fund and NAV track record.

### Anti-Money Laundering

Source of funds, client identification, monitoring of suspicious transactions and redemption payments are important elements of the AML process and the fund administrator is best placed to carry out the AML functions of the fund. Administrators are expected to have procedures in place to carry out functions such as checking investor names (and underlying investor names) against US Office of Foreign Asset Control (OFAC) and EU blocked person lists and to comply with the EU Savings Tax Directive (see below) where applicable. All regulatory requirements must be strictly followed with regard to AML issues and the administrator must ensure that all staff are provided with appropriate training at regular intervals.

This section is designed to provide an overview of the current legal framework affecting administrators based in the major financial centres of the world. In this context, it must be stressed that the administrator must find out which AML regulations apply in the jurisdiction of the fund, as well as its own jurisdiction, if that is different, and ensure that the fund complies with those regulations. As a matter of prudence, it is recommended that administrators should use the most comprehensive requirements of all jurisdictions, regardless of where the fund is set up.

Money laundering is the criminal practice of disguising the ownership and movement of criminal funds, derived from, or used to commit, offences ranging from narcotics trafficking, terrorism, arms smuggling, and trafficking in human beings, to financial fraud. It now also includes tax evasion. The ill-gotten or "dirty" money is filtered through a maze or series of transactions, so the funds are "cleaned" to look like the proceeds from legal activities.

European states were directed to introduce measures to counteract money laundering by the EU Council Directive (91/308/EEC) and The Forty Recommendations of the Financial Action Task Force (FATF) (an OECD sponsored body set up to counteract money laundering on a global basis). While individual countries will have framed legislation differently, the goal is to establish a level playing field for AML across Europe.

The main provisions of the European approach to AML can probably most readily be illustrated using Ireland as an example. The relevant legislation in Ireland is The Criminal Justice Act, 1994. This Act imposes certain obligations on “designated bodies” (principally, financial institutions) with respect to the:

- a. identification of customers;
- b. reporting of suspicious transactions; and
- c. retention of documents and records of transactions.

For the avoidance of doubt, a HFA operating in Ireland would be regarded as a “designated body” and should follow the steps below when performing AML procedures for a hedge fund.

### Identification of Customers

As part of the investor identification procedures, generally, administrators should only accept new investors into a fund after:

- a. confirming the identity of the investor and, if applicable and appropriate, the principal beneficial owners on whose behalf it is making the investment; investment in many jurisdictions applies a standard as to beneficial ownership requiring identification of those with 10% or greater ownership or control of any legal entity, although some jurisdictions differ, such as Guernsey, which imposes a 5% reporting threshold; or
- b. if the investor is investing on behalf of other underlying investors, confirming the identity of the investor and those underlying investors; or
- c. determining that it is acceptable to rely on the investor due diligence performed by a third party with regard to the investor, provided that third party is a “designated body in a prescribed jurisdiction. Where the designated body is not in a prescribed jurisdiction incremental due diligence should be performed”.

The typical documentation required to verify investor identity is listed below.

### Reporting of Suspicious Transactions

All employees are required to report suspicious activities immediately to their AML compliance officer, also referred to as the Money Laundering Reporting Officer (“MLRO” hereafter). The MLRO is responsible for investigating suspicious activities and determining (sometimes, if appropriate, in consultation with legal counsel) whether to file suspicious activity reports with the authorities, usually the police.

The MLRO should maintain a copy of all suspicious activities reports submitted to the authorities and their response. These records are usually required to be maintained for five years after the relationship with the investor/client has ceased, although there may be a requirement to hold them for longer in some jurisdictions.

## Retention of Documents and Records of Transactions

### a. Material Verifying Evidence of Identity:

Copies of all documents used to identify an investor must be maintained for a period of at least five years after the relationship with the customer has ended, unless the requirement in the jurisdiction of domicile of the fund is that they should be held for a longer period.

The following are examples of the types of documents that the administrator should retain as part of its investor records retention policy:

1. original subscription applications, redemption requests and any instructions from the investor pertaining to account maintenance issues; in some jurisdictions, copies of these documents may suffice;
2. copies of all documentation reviewed in connection with investor identification procedures or enhanced due diligence procedures;
3. the completed AML check list or similar due diligence documentation;
4. any reports or documents submitted to law enforcement or regulatory authorities concerning suspicious activities of an investor and
5. investor correspondence (hard copy and electronic).

All inactive or closed account files should normally be maintained in an offsite storage facility. Inactive or closed accounts are defined as investors who have fully redeemed from a fund and for whom there are no pending transactions on the account. All such files may be stored on disk but all original documentation should be maintained in an offsite storage facility and may also be copied onto disk.

### b. Transaction Records

Original transaction records must be maintained for a period of at least five years and, in some jurisdictions, may be required to be held for a longer period. Copies may be acceptable in some jurisdictions. Copies of bank statements evidencing individual transactions should also be maintained for at least five years and, in some jurisdictions, for longer.

## The 3rd Money Laundering Directive

The most recent development within AML legislation in the EU has been the introduction of The 3rd Money Laundering Directive. The 3rd Money Laundering Directive introduces a new regime (effective from 15 December 2007) throughout the EU for combating money laundering and terrorist financing. The Directive is based upon the recommendations of the Financial Action Task Force (FAFT).

The key features of the Directive are as follows:

- a. the obligation on designated bodies to apply customer due diligence (“CDD” hereafter) procedures to their customers in specific circumstances, which not only require the initial identification and verification of identity but also require the ongoing monitoring of the business relationship with customers for suspicions of money laundering and terrorist financing;
- b. the obligation to also identify and verify where applicable the beneficial owners of customers;

- c. the application of the CDD obligations on a risk-based approach to better provide for allocation of resources in the fight against money laundering and the financing of terrorism
- d. in line with the risk-based approach the Directive sets down when both enhanced and simplified CDD procedures should be applied to specified customer types
- e. designated bodies are permitted to rely on third parties to meet the CDD requirements with the exception of the obligation for ongoing monitoring of the business relationship. However, ultimate responsibility for ensuring compliance with the full CDD obligation still resides with the designated body which relies on a third party;
- f. designated bodies covered by the Directive are obliged to promptly report suspicions of money laundering or terrorist financing to the appropriate authorities; and
- g. the Directive imposes further obligations on designated bodies in relation to recordkeeping, staff training and the maintenance of appropriate procedures and controls pertaining to the obligations imposed by the Directive.

The risk-based approach is the foundation upon which the Third Directive is based and is what distinguishes it, in the main, from the money laundering and terrorist financing regimes established by the First and Second Directives which applied “a one size fits all approach” to every customer. By providing for a risk-based approach, the Directive enables designated bodies to ensure that measures to mitigate money laundering and terrorist financing are commensurate to the risks identified. The principle is that resources should be directed in accordance with priorities so that the greatest risks receive the highest attention. The Directive does not oblige designated bodies to apply CDD on a risk-based approach. However, by not doing so designated bodies will not be able to apply reduced CDD measures to customers and may lose out on the resource benefits arising as a result. In practice, designated bodies who do not adopt the risk-based approach may have to apply a level of due diligence to their customers, above the level that other designated bodies would apply to customers presenting a standard risk of money laundering or terrorist financing.

A reasonably designed and effectively implemented risk-based approach will provide an appropriate and effective control structure to manage identifiable money laundering and terrorist financing risks. However, it must be recognised that any reasonably applied money laundering controls, including controls implemented as a result of a reasonably implemented risk-based approach will not identify and detect all instances of money laundering. Therefore, regulators, law enforcement and judicial authorities should take into account and give due consideration to a designated body’s well-reasoned risk-based approach. When designated bodies do not effectively mitigate money laundering and terrorist financing risks due to a failure to implement an adequate risk-based approach or failure of a risk-based process that was not adequate at its inception, regulators, law enforcement or judicial authorities will take necessary action, including penalties, fines or other enforcement remedies, as appropriate.

A risk-based approach takes a number of discrete steps in assessing the most cost-effective and proportionate way to manage and mitigate the money laundering and terrorist financing risks faced by the designated body. These steps are to:

- a. identify the money laundering and terrorist financing risks that are relevant to the designated body;
- b. assess the risks presented by the designated body’s particular
  - 1. customers;
  - 2. products;
  - 3. delivery channels; and
  - 4. geographical areas of operation;

- c. design and implement controls to manage and mitigate these assessed risks;
- d. monitor and improve the effective operation of these controls; and
- e. record appropriately what has been done, and why.

To assist the overall objective to prevent money laundering and terrorist financing, a risk-based approach:

- a. recognises that the money laundering/terrorist financing threat to designated bodies varies across customers, jurisdictions, products and delivery channels;
- b. allows management to differentiate between their customers in a way that matches the risk in their particular business;
- c. allows senior management to apply its own approach to the designated body's procedures, systems and controls, and arrangements in particular circumstances; and
- d. helps to produce a more cost-effective system.

Please refer to the guidance notes prepared by the industry which:

- a. outline the legal requirements for AML/CDD set down by the Directive;
- b. provide guidance on the requirements of the Directive, and how designated bodies covered by its provisions can best meet their obligations;
- c. indicate best industry practice in AML/CDD procedures through a proportionate, risk-based approach;
- d. assist designated bodies to design and implement the systems and controls necessary to mitigate the risks of the designated body being used in connection with money laundering and the financing of terrorism.

For further detail see:

[www.irishfunds.ie](http://www.irishfunds.ie)  
[www.aima.org](http://www.aima.org)

## Other Tasks

### Lock-Up Periods

The administrator should have systems or procedures in place to track investor lock-up periods for each subscription made. A lock-up period is a period of time when an investor may not redeem or sell their shares (hard lock-up) or they may redeem or sell their shares but will incur a significant penalty (soft lock-up). A lock-up helps the fund manager avoid liquidity issues while investing in less liquid investments.

It is best practice to ensure that the lock-up periods are noted on the fund's offering documents, especially the subscription agreement, as the investor should be aware of the lock-up and will be legally bound by signing the subscription agreement.

## Side Pockets

Typically, the fund's offering document will specify whether the manager has the discretion to invest a maximum percentage of the fund's total assets in illiquid investments. Side pockets can be considered as miniature portfolios of illiquid investments held within a fund's investment portfolio. When the fund manager decides to trade in illiquid investments it is common practice to allocate the particular investment to a separate class within the fund. A new class will be created at the time of the investment and all current investors in the fund will have a pro-rated share of their existing investments transferred into the new class, i.e., a side pocket.

The practical steps are that the administrator will calculate the appropriate redemption amounts for each investor in the existing classes and ultimately subscribe the same amount in the new share class (side pocket class). Redemptions from this new class are not based on an investor's request to redeem but rather based on a liquidation event originating from the investment, for example the investment going public. At the time of the liquidation event, the investor may have the choice to receive the proceeds in cash or have the proceeds re-invested into other classes of the fund.

More recently, side pockets have been used to house instruments that have become illiquid due to market conditions, e.g., many funds of hedge funds have created side pockets to house underlying hedge funds that have suspended NAV calculations or redemptions.

Side pockets are used to prevent investors who redeem early to receive their proceeds in cash while investors who redeem later, receive their proceeds in illiquid securities.

It is best practice if prospective investors are advised of the fund's intention and mechanisms of side pockets. This is usually included in the fund's offering documents but also a communication from the fund manager (possibly sent by the administrator), advising of the creation of a side pocket, will assist in providing transparency to investors.

## Side Letter Agreements

For a multitude of reasons, an investor may wish to invest in a fund but not under the terms that the fund has proposed in the fund offering document. For example, the investor may wish to pay a lower management or incentive fee due to the significant investment they are making into the fund.

To accommodate this request, the fund manager may agree to provide different terms to a specific investor by way of a separate agreement which outlines the revised terms agreed. This agreement is commonly referred to as a side letter agreement.

Side letter agreements are a controversial topic because they can be viewed as going against the golden rule of treating all investors equally all the time. Investors are always interested in the side letter agreements that are made with other investors.

It is best practice to keep side letters to an absolute minimum. Legal counsel and fund directors must review and approve each agreement on behalf of the fund. They must ensure the fund is not disadvantaged or increasing certain risks to the fund or other investors. It is important that the administrator is made aware of all exercised side letter agreements and they should be provided with a copy so they can monitor and address the agreed terms of the agreement.

## Material Terms

According to AIMA's Industry Guidance Note on Side Letters (September 2006), firms will be required to disclose the existence of side letters which contain material terms, and the nature of such terms, where the firm is a party to the side letters or is aware that a fund of which the firm, or an affiliated entity is the investment manager, is a party to them. Firms will not be required to disclose the existence of side letters which contain no material terms.



A material term can be defined as: “Any term the effect of which might reasonably be expected to be to provide an investor with more favourable treatment than other holders of the same class of share or interest which enhances that investor’s ability either (i) to redeem shares or interests of that class or (ii) to make a determination as to whether to redeem shares or interests of that class, and which in either case might, therefore, reasonably be expected to put other holders of shares or interests of that class who are in the same position at a material disadvantage in connection with the exercise of their redemption rights”.

Common examples of terms which are likely to be regarded as material terms would include preferential redemption rights (including an agreement to accept a shorter notice period for redemptions), key-person provisions, redemption gate waivers and portfolio transparency rights. Common examples of non-material terms would include fee rebates and most favoured nation clauses. A term which would otherwise be a material term may not, however, be a material term if it does not, in practice, provide one investor with more favourable treatment. For example, where a side letter contains a term granting a shorter notice period for redemptions, but the fund undertakes to accept an identical notice period in respect of all other investors in the same share class, the term would be cured of its materiality.

Firms should give a brief description of material terms contained in side letters which have been entered into (for example: “we have entered into side letters with investors, which contain material terms which: (a) grant preferential redemption rights; (b) contain a key-person provision; (c) [etc.]”).

Firms are not expected to disclose the number of side letters, the dates on which they were entered into or the parties to them.

Where side letters containing material terms have been entered into with investors whose shareholding or interest, individually or in aggregate, is significant (i.e., in excess of 10%), firms should consider highlighting this fact.

#### Disclosure of Side Letter Agreements

Firms should make disclosure of relevant side letters both to existing and to prospective investors. In the case of existing investors, in particular, firms will need to consider to whom it is appropriate to make the disclosure (for example, the registered holder or, where relevant, the holder’s authorised representative such as its investment manager).

#### Disclosure Method of Side Letter Agreements

Firms are at liberty to select the method by which they make disclosure. It is anticipated that many firms will choose to do so in their monthly, quarterly or half-yearly investor reports/newsletters.

#### One-Off Events

An investor may seek a divergence from the standard terms of the fund’s offering document. This is typically a one-off event, for example, the ability to make an initial investment in the fund that is lower than the minimum initial investment amount to invest in the fund. The fund manager may agree to this divergence from the offering terms of the fund. Any divergence from the terms of the offering document should be documented by way of a director’s resolution. The administrator should assist the manager to ensure the appropriate resolutions are in place and held in the corporate records file of the fund.

## Conversions - Transfer of Records from Prior Administrators

In circumstances where funds change administrators, the regulations may contain no specific guidance as to what compliance checks should be carried out by the new administrator to determine the level of AML compliance for the fund.

It is recommended that the following process be carried out when records are taken over from a prior administrator:

- a. complete inventory of all AML and transaction documentation;
- b. screening of all investors in the fund against the OFAC and Non-Cooperative Countries and Territories (“NCCT”) lists;
- c. follow up with each investor to provide any outstanding documentation which is deemed appropriate;
- d. in circumstances where there is a delay in the transfer of records, a letter of representation should be obtained from the prior administrator to certify that due diligence has been carried out on all investors that are being transferred to the new administrator; and
- e. report to local regulator should material issues be evident.

## EU Savings Directive (“EUSD” hereafter) - Withholding Tax

The EUSD became fully effective on 1 July 2005 as part of a European Commission tax reform package. It was originally designed to implement a uniform information exchange regime across the European Union, with member states agreeing to report, to other member states, the interest on savings paid to citizens of the other member states. Resistance from states with strong bank secrecy traditions has resulted in certain states being permitted to enforce a 15% withholding tax regime (instead of information exchange) up until 2009.

Council Directive 2003/48/EC of 3 June 2003 seeks to ensure that individuals resident in an EU member state who receive interest income from another member state are taxed in the member state in which they are resident for tax purposes. To this end, payments of interest made on or after 1 July 2005 are either (i) reportable by paying agents in the EU to the tax authorities in the paying agents home territory or (ii) subject to withholding tax in those territories which have opted to apply withholding tax rather than report the payment.

Austria, Belgium and Luxembourg opted to apply the withholding tax instead of exchanging information. Some associated and dependent territories, namely, Netherlands Antilles, Jersey, Guernsey, Isle of Man, British Virgin Islands and Turks and Caicos Islands and certain third countries, namely, Andorra, Liechtenstein, Monaco, San Marino and Switzerland, will also apply a withholding tax.

## Funds In Scope

- a. Funds established in the EU that are UCITS. UCITS Unit Trusts and UCITS Variable Capital Company (VCC);
- b. funds that have elected to be treated as UCITS for the purposes of this legislation. The effect of such an election is that the fund is treated as an actual paying agent when it pays interest to, or secures interest payments for, a beneficial owner and is therefore subject to the normal reporting arrangements;

- c. funds in dependent territories, such as the Cayman Islands that are deemed to be UCITS equivalent - the simple test here is if the fund were to re-domicile to Ireland, would it qualify as a UCITS? Dependent territories include Cayman, B.V.I., and Dutch Antilles but not third countries such as Switzerland, USA, Bermuda and Bahamas. For the Cayman Islands, it would appear that only Section 5 Funds (under the Mutual Funds Law 2003) qualify under the EUSD; and
- d. for funds domiciled on the third countries schedule (including Switzerland, USA., Bermuda and Bahamas) the 40% and 15% rules mentioned under the next section would apply. For US Limited Partnership/Limited Liability Corporations, the shareholder services department would have to monitor investments from non-US individuals to see if such transactions are reportable under the directive.

#### Funds Out of Scope

- a) Cayman Funds that are not UCITS equivalent are not within the scope of bilateral agreements. Cayman legislation only applies to UCITS type funds, so a Cayman Fund registered under Section 4(3) of the Mutual Fund Law (2003 revision) is outside the scope of the Directive. It is believed that the “home rule” principle will apply, in that if the Cayman authorities rule a fund out of scope, then this will be accepted by the Irish authorities;
- b) close-ended funds are not UCITS equivalent, nor are professional and qualifying investor funds; so do not come under the EUSD;
- c) non-distributing hedge funds that invest 40% or less in debt claims are excluded from the directive; and
- d) a member state has the option of excluding from the definition of savings income any income earned on investments in debt claims not exceeding 15% of the fund’s assets where the fund is established in its home territory.

Administrators should keep a register of all funds ruled in and out of scope, together with the reasons why a fund may have been ruled out of scope, and this list should be reviewed at least annually.

## APPENDIX 3 Performance Fee Equalisation

There are multiple performance fee methods in issue in the unitised hedge fund industry. There are two broad methods:

- a. equalised; and
- b. non-equalised.

Equalised fees generally follow two main methods:

- a. share series; and
- b. equalisation credit.

Non-equalised fees utilise unlimited variations.

Within limited partnerships, there are multiple possibilities, particularly where a partner has invested more than once. At a high level, partnership performance fee calculations broadly follow a similar structure to share series accounting.

This section does not seek to be prescriptive and nothing in the attached should be viewed as a recommendation. However, this section does attempt to provide a high level overview of the broad themes and concepts surrounding performance fee structuring.

### Table of Definitions

Term	Description
Performance fee	A performance or incentive fee is a fee paid to the investment manager, based on some level of investment performance. This is usually a set percentage of the increase in the value of the fund or increase above an agreed benchmark.
Gross asset value (or gross NAV)	NAV before accrual of performance fee.
Net asset value (or Net NAV)	NAV after accrual of performance fee.
Taxlot	This is essentially an individual shareholding. If an investor subscribes for 100 shares in January and 200 shares in February, while their total shareholding is 300, they have two distinct taxlots. This concept is important as each taxlot may have different performance fee information attached to it.
Crystallisation period	The period over which the fund will assess the performance to determine whether a performance fee should be paid. This is generally annually or quarterly, but can be monthly or any other frequency. The next crystallisation date represents the date on which performance fees, if any, become payable.
High water mark	The NAV at which the most recent performance fee became payable, or the launch price of the fund. The high water mark is reset each time performance fees are crystallised. See section below on high water mark for examples.

### High Water Mark (“HWM” hereafter)

The calculation and resetting of the HWM is best shown by example:

Fund A	Criteria
Performance Fee	20%
HWM	Yes
Hurdle	No
Crystallisation Frequency	Quarterly

	GAV	NAV	HWM	Incentive Fee Per Share
31 January	100	100	100	0
28 February	95	95	100	0
31 March	105	104	100	1
1 April	104	104	104	0
30 April	102	102	104	0
31 May	110	108.8	104	1.2
30 June	114	112	104	2.0
1 July	112	112	112	0

In this example, the HWM is reset on the crystallisation of performance fees at 31 March to the NAV value (104) on that date. Therefore, any trades processed on 1 April until the end of the next crystallisation period (30 June) will carry a fund HWM of 104. On the crystallisation of performance fees on 30 June, the fund HWM is reset for the next period to 112.

Please note that if the NAV on 30 June had been below 104, the HWM would not have been reset downward (i.e., it would have remained at 104). Performance fees would not be payable at fund level until the NAV exceeds 104. This concept is referred to as “loss carry forward” (i.e., the fund must recoup any losses before a performance fee can begin to accrue).

For the purposes of most methods of performance fee equalisation, it is necessary to maintain both a fund HWM and taxlot HWM. If an investor subscribed for 1,000 shares at GAV 110 on 31 May, then their taxlot HWM would be 110 while the fund HWM was 104. Both fund and taxlot HWM would be reset to 112 after crystallisation on 30 June. Maintaining a record of fund and taxlot HWMs will ensure that this investor pays the correct amount of performance fee on their investment using one of the performance fee equalisation methodologies set out below.

### Hurdles

A hurdle represents the minimum performance required to be achieved before a performance fee can be charged.

#### Example 1: No Hurdle

31 Dec 2006	Gross asset value per share	1,000
31 Dec 2007	Gross asset value per share	1,500
	Increase in gross asset value	500
	Performance fee (20%)	100
31 Dec 2007	Net asset value	1,400

A hurdle can be fixed or variable.

### Example 2: 10% Fixed Hurdle

31 Dec 2006	Gross asset value per share (HWM)	1,000
31 Dec 2007	Gross asset value per share	1,500
	HWM plus Hurdle	1,100
	Increase in GAV over HWM plus hurdle	400
	Performance fee (20%)	80
31 Dec 2007	Net asset value	1,420

In the second example, the performance fee is calculated on the increase in GAV over the hurdle adjusted HWM. Some funds may pay a performance fee on the entire increase in the GAV in the period, provided that the hurdle rate is exceeded. If this was the case in example 2, a performance fee of 100 would be payable.

### Day Count

Hurdles may be calculated based on different day counts. For example, in a monthly fund, a 6% fixed hurdle on a 30/360 day count would result in a hurdle of 0.5% per month. If the day count was actual/365, then the rate for January would be 0.509589%.

### Compounded Hurdle Rates

A hurdle rate may compound from period to period. For example, a 6% hurdle on a 30/360 basis would equate to 0.5% in January, compounding to 0.5025% in February etc.

### Variable Hurdles

This hurdle type is based on a rate of return that varies over time, e.g., like a published interest rate such as 1 month LIBOR or an index S&P500. Different calculations may also be required, e.g., if 1 month LIBOR for January is 5.75% and changes to 6% for February, both months can be calculated independently or, alternatively, January's hurdle recalculated based on February's revised rate.

Index based hurdles may also result in the possibility of applying a negative hurdle rate.

### Incentive Period Compounding

Where incentive period compounding applies, the fund HWM would reset to the higher of the current fund HWM plus hurdle and the current fund NAV per share at the time of crystallisation. For example, where 6% fixed hurdle applied to HWM of 100 to give period end fund HWM plus hurdle of 106, if the NAV at period end was 103, the HWM carried into the next period would be 106. In this instance, underperformance (performance below hurdle rate) in one year is "carried forward" and made up in the following year(s) before an incentive fee is accrued (referred to as hurdle loss carry forward).

In this example, where incentive period compounding does not apply, the fund HWM would reset to NAV (103).

### Equalisation Methodologies

The three most common methods of equalising performance fees in use today are:

- a. Equalisation credit/depreciation deposit method ("depreciation deposit" hereafter);
- b. Equalisation credit/contingent liquidation method ("contingent liquidation" hereafter); and
- c. Series of shares method ("series" hereafter).

The principal difference between depreciation deposit and contingent liquidation methods is the treatment of subscriptions invested where the NAV is less than the fund HWM at subscription date. If the NAV is greater than the fund HWM at the subscription date, in both cases, an equalisation credit is created.

### Equalisation Credit Overview

When a shareholder subscribes at a price that exceeds the current fund HWM, this investment (taxlot) will be subject to a performance fee that exceeds what should be paid so an equalisation credit amount is granted. For example, subscribing for 1,000 shares at a GAV USD 105, with a fund HWM of USD 100 and 20% performance fee will result in an equalisation credit balance of USD 1,000 (or USD 1 per share).

This balance may be adjusted as follows:

- a) if the taxlot is still held at the end of the period, and the GAV exceeds the fund HWM, additional shares are issued to the investor to the value of the credit; or
- b) if the taxlot is redeemed, the equalisation credit balance is rebated in the form of an additional cash payment.

### Depreciation Deposit Overview

Where an investor subscribes at a price under the fund's HWM, this methodology effectively represents an incentive fee pre-payment. For example, if an investor invests at a NAV of USD 90 when the fund HWM was USD 100, an additional performance fee (20%) of USD 2 per share is payable (to ensure the investor does not get a "free ride"). With the depreciation deposit method, the execution price for the subscription would be USD 92 and the calculated amount of performance fee due of USD 2 should be segregated from the rest of the fund's assets and invested in safe interest-bearing instruments.

In the example, if the investor subscribed for 1,000 shares, the cost of this investment would be USD 92,000 - with USD 90,000 invested in the fund and USD 2,000 set aside as a depreciation deposit amount (fund liability). This depreciation deposit will either be paid out to the investment manager on the crystallisation of performance fees (in full, if the NAV on crystallisation date > fund HWM of 100) or paid back to the investor (in full, if the investor redeems at a price < 90 or partly, if he or she redeems at a price >90 and <100).

The advantage of the depreciation deposit approach is its transparency. The pre-payment of any additional incentive fee is effectively set aside.

The disadvantages are firstly, that not the entire subscription amount is invested in the fund, which potentially lowers overall returns and, secondly, mathematically it is very difficult to apply a hurdle rate using this methodology.

### Contingent Liquidation Overview

Where an investor subscribes at a price under the fund's HWM, using this methodology, the full subscription amount will be invested in the fund, e.g., 1,000 shares at a NAV of USD 90 with a fund HWM of 100 will cost the investor USD 90,000. With the depreciation deposit method above, the investor must also prepay the additional incentive fee leaving a total investment cost of USD 92,000. This is not the case with contingent liquidation.

The additional incentive fee payable (to equalise the holding and avoid a free ride) is recouped by either:

- a. if the taxlot is still held at the end of the performance period, then the shareholder is subjected to a forced redemption of sufficient shares to raise the appropriate amount of cash required to pay the additional incentive fee to the advisor; or

- b. if the taxlot is redeemed, by withholding part of the proceeds of the redemption to pay the extra incentive fee due to the advisor.

The principal advantages of this methodology are firstly, that the full subscription proceeds are invested in the fund and, secondly, it facilitates the use of hurdles with all of its complexities. The main disadvantage is that investors' share balances are often reduced by the forced redemptions at performance fee crystallisation time. This may be difficult for the investor to comprehend.

### Series of Shares Overview

For funds using the series method, a new series of shares is issued for each dealing day, usually at a fixed price per share, e.g., USD 100. Investors may only subscribe into this new series on one particular dealing date. Each new series is priced separately (GAV/NAV) and a performance fee is calculated at the series level, based on the total shares in the series multiplied by the incentive fee per share.

As each investor effectively subscribed at the series HWM, no equalisation credits or deficits are ever calculated at individual shareholder/taxlot level. Therefore, the total performance fee due to the investment manager is simply the sum of all the amounts calculated at series level.

When the performance fee is crystallised for each series, all performing series may be rolled into (consolidated with) a roll up (lead) series. This is normally processed automatically by the transfer agency system via a series of 100% switch transactions. By rolling multiple series into a single series, this cuts down on the administration required in the next period as only existing series need to be valued.

#### Example:

Fund A is a monthly valuation fund, with annual performance fee (20%) crystallisation and annual roll up. Fund A January series is issued at USD 100 per share. A total of 5,000 shares are subscribed. It is designated the "roll up" series.

Fund A February series is issued at USD 100 per share. A total of 2,000 shares are subscribed. Fund A March series is issued etc.

On 31 December, performance fees are crystallised. For each series with a GAV > 100 (issue price), performance fees are payable. Therefore, if Fund A January series GAV = 105 with performance fee of 20%, the performance fee payable in relation to the January series is USD 5,000. The February series is valued at GAV 103 and total performance fee payable of USD 1,200.

All performing series are then rolled into the roll up (January) series as each of these performing series have effectively been equalised and can be processed as a single series going forward.

The principal advantage of the series method is that there is no requirement to maintain equalisation credit and deficit balances at taxlot level, with the potential to create equalisation credit purchases and incentive fee liquidations or depreciation deposit transactions.

The main disadvantages of the series method are the administration and reporting of series. New series need to be set up and valued each period, with possible roll up. From a reporting perspective, it can be confusing for an investor to receive statements displaying shares in different series, which may subsequently switch into other series, all within the one fund/share class.



## APPENDIX 4 Funds of Hedge Funds

Although this guide deals primarily with the function of the administration of the fund it is worth pointing out the additional custody function that the administrator is likely to carry out (often through a subsidiary company) in the case of funds of hedge funds.

Many administrators/custodians will, on request from the client, arrange for the purchase, sale and transfer of underlying hedge funds by the fund being administered. This will involve completing the subscription form or redemption form or transfer form, transmitting this to the underlying administrator by the cut-off time and arranging for the payment, where necessary, to be made by the settlement date. The administrator/custodian will keep a record of all positions held and reconcile these against monthly statements received from the administrators of the underlying hedge funds. It is important that a separate trading agreement is put in place and strong operational procedures are agreed upon with the client to ensure that the administrator/custodian adequately minimises the risk of errors being made with regard to these transactions and indemnifies itself, where necessary, from errors made by the client. Given the nature of these transactions, market risk exposure can be very large as they are generally only traded once a month.

The intention of this document is that it applies equally to funds of hedge funds as with other hedge fund types but, there are specific considerations. In this case, the fund of hedge funds is an investor into hedge funds and will be subject to equalisation adjustments. These balances and adjustments will need to be reflected accurately in the books of the funds of hedge funds. Equally, many of the other considerations in this document as they relate to investor processing and transactions, will now apply to the funds of hedge funds, and the administrator/custodian as its delegate.

Many funds of hedge funds strike their NAVs before final prices for target hedge funds are available, and complete the funds of hedge funds valuation using estimated prices or returns. It is recommended that provisions for the use of estimates are detailed in the pricing policy document.

The administrator may, from time to time, be requested to provide, on behalf of their clients, certain information regarding their processes, e.g., pricing policies and procedures to potential investors. This is particularly commonplace where a fund of hedge funds is carrying out due diligence on a hedge fund and may seek to visit the HFA to assist in that due diligence process.

AIMA's Guide to Sound Practices for Hedge Fund Valuation Executive Summary can be downloaded [here](#) free of charge. The following are key excerpts from the document.

### Executive Summary

Drawing on feedback after its initial survey of valuation issues in the industry, AIMA has brought together a broad working party of experts, representing all stakeholders in the valuation process, to explore the issues raised in more detail. The working party has sought to streamline AIMA's original 20 Recommendations in order to reflect more detailed representations from stakeholders and to take full account of ongoing developments in the industry, such as the increasing use of side pockets.

The hedge fund industry is global and ever-evolving, embracing a wide range of instrument types and market conventions. A "one size fits all" approach to the valuation of hedge funds would therefore be unwise and unworkable. AIMA's revised 15 Recommendations are not intended to represent a comprehensive or prescriptive set of rules, and may not be optimal or appropriate for all industry participants. Rather, they are intended as principles-based guidelines for valuation sound practices in the areas of governance, transparency, procedures and methodology (there is inevitably some overlap across these headings).

In its 2005 survey of valuation issues, AIMA highlighted the fact that the Governing Body of a Fund has ultimate legal responsibility for the valuation of the Fund's portfolio. In practice, the Governing Body will delegate the responsibility for the production of the Fund's Net Asset Value (NAV) to another party. Throughout this study we refer to this party as the Valuation Service Provider. The Valuation Service Provider will typically be the Fund's Administrator. The triangular relationship of Governing Body, Valuation Service Provider and Investment Manager will vary from situation to situation, but its dynamics shape the management of the equilibrium between independence and competence which is at the heart of the hedge fund valuation process.

The working party's main conclusions may be summarised as follows:

#### Governance

- All hedge funds should have in place a detailed Valuation Policy Document, approved by the Governing Body after consultation with other stakeholders.
- Conflicts of interest in the valuation process are usually best managed by the appointment of an independent and competent Valuation Service Provider.
- If the Investment Manager is responsible for valuation and/or governance, robust controls over conflicts of interest should be established.

#### Transparency

- Investors have the right to expect disclosure of any material involvement by the Investment Manager in the production of a Fund's formal NAV.

#### Procedures, Processes and Systems

- The parties controlling a Fund's valuation process should be segregated from the parties involved in the Fund's investment process.
- Procedures should be capable of practical implementation and consistent application by the Valuation Service Provider.

## Sources, Models and Methodology

- Wherever possible multiple price sources should be used to verify the valuation of each position in a Fund's portfolio.
- The use of broker quotations and pricing models for formal valuation purposes should be sufficiently tested and controlled.
- Any decision to allow the side-pocketing of illiquid/hard-to-value positions should be taken only after careful consideration by a Fund's Governing Body, who should then ensure that side-pocket policies are properly communicated and consistently applied.

## AIMA's 15 Recommendations for Hedge Fund Valuation

### Recommendations on Governance

1. In advance of the Fund's launch a summary of practical, workable pricing valuation practices, procedures and controls should be enshrined in a Valuation Policy Document and approved by the Fund's Governing Body, after consultation with relevant stakeholders. The Valuation Policy Document should be reviewed on a regular basis by the Governing Body.
2. The Valuation Policy Document should explicitly clarify the role of each party in the valuation process, should identify price sources for each instrument type and should include a practical escalation or resolution procedure for the management of exceptions.
3. The Governing Body of the Fund should ensure adequate segregation of duties in the NAV determination process, which may be achieved by delegating the calculation, determination and production of the NAV to a suitably independent, competent and experienced Valuation Service Provider. If the Investment Manager is responsible for determining the NAV, and/or acts as the Fund's Governing Body, robust controls over conflicts of interest should be established.
4. Oversight of the entire valuation process and, in particular, resolution of pricing issues associated with hard-to-price illiquid positions and exotic instruments remains the ultimate responsibility of the Fund's Governing Body.

### Recommendations on Transparency

5. The Fund's Offering Document should explicitly name the party to whom responsibility for the calculation, determination and production of NAV has been delegated.
6. There should be adequate disclosure of any material involvement by the Investment Manager in the pricing of underlying portfolio positions.
7. NAV reports should be addressed directly to investors by the Administrator, where an Administrator is used, and any NAVs produced by the Investment Manager should be qualified as such.

## Recommendations on Procedures, Processes and Systems

8. The procedures enshrined in the Fund's Valuation Policy Document should be designed to ensure that the parties controlling the Fund's valuation process are segregated from the parties involved in the Fund's investment process.
9. The industry recognises that in certain instances the Investment Manager has the best insight with respect to the valuation of particular instruments. Wherever prices are provided or sourced by the Investment Manager, the Valuation Service Provider should be furnished with sufficient supporting information by the Investment Manager.
10. Procedures described in the Valuation Policy Document of the Fund must be capable of practical implementation by the Valuation Service Provider.
11. The Valuation Service Provider should use reasonable endeavours to apply any pricing policy consistently. Deviations from the policy should be approved by the Governing Body in advance of any NAV being released.

## Recommendations on Sources, Models and Methodology

12. Wherever possible the valuation of each position in the Fund's portfolio should be checked against a primary and secondary price source. The Valuation Policy Document should outline the hierarchy of sources to be used for each security type and the tolerance levels for variances between the sources.
13. If the Governing Body approves the use of broker quotations for the valuation of certain instruments, these quotations should wherever possible be multiple, sourced consistently and accessed by the Valuation Service Provider independently without intervention by the Investment Manager.
14. Any decision to use a pricing model should be approved by the Governing Body and should be properly justified by appropriate testing. If an Investment Manager's pricing models are used they should be independently tested and verified.
15. Any decision to allow the side-pocketing of illiquid/hard-to-value positions should be taken only after careful consideration by a Fund's Governing Body. If the Governing Body approves such a decision it should ensure that side-pocket policies are clearly communicated to all investors. The criteria for side-pocketing individual positions should be as consistent as possible.



- ≈ the independent pricing expert,
- ≈ the appointment of a “competent person”
- ≈ the valuation agent
- ≈ the custodian/trustee
- ≈ the auditor
- ≈ the regulator

It is advisable for each fund to consider and approve the definition of the roles and responsibilities of each of the above as it applies to that fund.

### **3. FUND'S ACCOUNTING STANDARDS AND DETAIL OF APPLICABLE GUIDANCE**

- 3.1. Generally, there is a three way choice for a fund - IFRS, US GAAP or Irish/UK GAAP. Other GAAPs are permissible subject to compliance with any stock exchange or regulatory requirements. IFRS, US GAAP and Irish/UK GAAP are identical as to the requirement to fair value all investments held. There are some differences on bid/offer for IFRS/Irish/UK GAAP versus US GAAP (see appendix 7).
- 3.2. The policy document should consider specifying which accounting standards the fund is adopting along with the key accounting policies in relation to the valuation, recognition and derecognition of investments. A summary of the key aspects of IFRS and Irish/UK GAAP are included appendix 7.
- 3.3. The pricing policy should outline the valuation methods to be used as per the offering memorandum - e.g., last traded price, bid, mid or offer. Consideration should be given to the principal/most advantageous market, the time of day for pricing and the source and time of FX rates to be used, if applicable. If the policy deviates from the requirements of the adopted accounting standards the pricing policy document is a good place to address this.

### **4. FUND'S VALUATION GUIDELINES PER THE OM/PPM**

- 4.1. Valuation guidelines per the OM/PPM may cover the following items:
  - (i) value of securities listed or traded on a stock exchange - last traded/mid/bid-offer, which market to use if traded on more than one, e.g., principal market. (Should include consideration of downgraded securities if applicable);
  - (ii) value of securities not listed and not traded on any stock exchange or regulated market. Basis of valuation - e.g., probable realisation value; who determines, e.g., investment manager, directors, or other competent person; who approves; discuss use of valuations made by investment manager;
  - (iii) exchange traded derivatives;
  - (iv) over the counter derivatives;
  - (v) collective investment schemes;
  - (vi) cash and other liquid assets;
  - (vii) accrued expenses and liabilities;
  - (viii) foreign currency translation to base currency;
  - (ix) directors ability to override valuations that they feel do not represent fair value;

- (x) administrators use of certain valuation sources; and
  - (xi) calculation of NAV for different share classes.
- 4.2. The pricing policy should be consistent with the pricing methodology in the OM. Generally, the pricing policy supplements the pricing methodology in the OM.
- 4.3. There should be adequate risk disclosure in the fund's OM to enable the reader to appreciate the risks involved from a valuation perspective (e.g., likelihood of illiquidity, single sources, stale pricing, model valuation, etc.). There should also be adequate disclosure of the investment manager's role and potential conflicts of interest with respect to valuation.
- 4.4. Those charged with governance of the pricing process should sign the pricing policy document.

## **5. PRICING POLICY OBJECTIVES AND SCOPE**

- 5.1. The aim of a pricing policy is to provide a framework within which securities and derivatives traded by a fund can be valued. It is preferable to have a pricing policy in place and tested prior to the launch of operations of a fund so that any issues/inconsistencies can be identified and resolved prior to commencement of operations.
- 5.2. It is intended to give reassurance to directors that pricing is carried out on a consistent basis and to ensure clarity, for all parties involved, of the pricing procedures in place. A pricing policy should also detail the circumstances under which the directors/valuation committee should be consulted on pricing.
- 5.3. The pricing policy should clearly state that valuation of the investment portfolio ultimately is the responsibility of the board of directors (or equivalent body charged with governance, e.g., general partner or manager) of a fund.
- 5.4. The board may choose to delegate the calculation of the valuation and this should be specified in the policy. Acceptance of day-to-day responsibility for calculation of valuation by another third party should be documented in the policy, as applicable. Effective delegation requires monitoring and oversight and this should be implemented in the policy. A well constructed pricing policy is an important element of ensuring such an oversight function. Ultimate responsibility for fair valuation will always lie with the board (or those charged with governance).
- 5.5. It should be noted that for all investments, fair value is the market value. While valuation for listed investments is relatively straightforward, for unlisted positions the pricing policy may have regard to the guidelines issued by the Alternative Investment Management Association (AIMA), the International Organisation of Securities Commissions (IOSCO) and the International Private Equity and Venture Capital Association (IVCA), prevailing accounting standards and also complying with the terms of the OM.
- 5.6. The pricing policy should also consider stating that, in the case of complex or hard to price instruments, data may be required from independent sources in order to determine fair value. A matrix of independent sources should be set out in the pricing policy document, in the interests of consistency.
- 5.7. It may also occur that a single price source for a security either exists or is available/accessible. Good practice would be to report this to the valuation committee/board and where indicative prices have been used, that these have been reasonably challenged by the investment manager. The pricing policy should consider detailing the universe of such prices and the HFA should report on the single price source to the board of directors.

- 5.8. Should the unique valuation of a security be considered material (to be predefined in the pricing policy document), then consideration should be given to consultation with the board of directors as to the fair valuation of that security.
- 5.9. A pricing policy would require a review process for individual values generated to ensure their appropriateness. This review process should be conducted by appropriately experienced and knowledgeable persons. Some specific cases will reveal a greater risk of inappropriate pricing, which include:
- (i) prices only available from a single counterparty or broker source;
  - (ii) illiquidity of exchange prices;
  - (iii) valuations influenced by the investment manager;
  - (iv) validating prices by comparison of realised prices against recent carrying values;
  - (v) testing for stale prices or implied parameters (e.g., spreads, volatilities); and
  - (vi) testing for market trading activity.
- 5.10. Ultimately, a pricing policy is a valuation framework and does not detail the price to be applied in every possible situation. The final judgment rests with the board of directors.

## **6. LAST DATE OF APPROVAL OF PRICING POLICY DOCUMENT**

[ ]

## **7. FREQUENCY OF REVIEW AND POTENTIAL REVISION OF PRICING POLICY DOCUMENT**

- 7.1. The pricing policy document should consider outlining the frequency of review of the policy, and the frequency of its revision and re-approval by the board of directors.

Discussion: To be meaningful and relevant, the pricing policy document should be frequently reviewed and updated if necessary. This ongoing review should be performed by the administrator and the investment manager with oversight by the board. This is to reflect changes in the types of instruments being traded, or when better information becomes available on the method to use in valuing certain positions. The frequency determined will depend on the likelihood of the investment manager introducing new investment types, valuation methods being improved or the introduction of new accounting standards such as FAS 157 under US GAAP. Generally, a minimum would be to require a review annually, or upon investment into a new instrument type that is not already dealt with in the current policy document. Upon revision, the pricing policy document can be presented to the board of directors and approved for adoption.

- 7.2. A pricing policy should consider including a valuation methodology specific to each instrument in an asset class.
- 7.3. In the event that new products are to be added to the portfolio of the fund, then the pricing policy in respect of these should be added. The revised document may then be approved by the board of directors/or the general partner.

## **8. SEGREGATION OF DUTIES**

The pricing policy, usually, would address how segregation of duties is to be achieved - e.g., through the use of a third party administrator or adequate Chinese walls if in-house. Such Chinese walls could be outlined in the pricing policy document.



### Discussion:

Both the AIMA recommendations and the IOSCO principles refer to the preference for a party independent of those with a vested interest in the valuation to be responsible for determination of such valuation, to the fullest extent possible. This is to avoid a conflict of interest in determining a valuation that is fair and representative, rather than inflated to generate additional fees or misrepresent performance results. Generally, an external, third party should produce the valuation and this is subject to review and approval. There may be situations where the investment manager's involvement in valuation is necessary and useful. If there are conflicts of interest in the valuation process (e.g., the investment manager involved in valuing illiquid positions), the policy usually states what those conflicts are and how they are addressed/mitigated. Often, the investment manager will have a separate pricing team or a valuation committee which contributes to the segregation of duties or oversight of such conflicted situations.

## 9. ROLES AND RESPONSIBILITIES

- 9.1. A pricing policy is a valuation framework and does not detail the price to be applied in every possible situation. Ultimately, the final judgment rests with the directors and, depending on the regulatory environment, the trustee and/or custodian.
- 9.2. The pricing policy can recognise that, in certain instances, the investment manager has the best insight with respect to the valuation of particular instruments and, often, it is appropriate to consult with the investment manager.
- 9.3. Wherever prices are provided or sourced by the investment manager, the pricing policy, usually, will seek to ensure that the administrator is furnished with sufficient independent supporting information by the investment manager.
- 9.4. A pricing policy will also seek to disclose any material involvement by the investment manager in the pricing of underlying portfolio positions and ascertain that the parties involved in the valuation process have an appropriate level of experience, competence and that an appropriate degree of independence exists within the valuation process.
- 9.5. A valuation committee may be appointed and considered appropriate by the board depending on the complexity/illiquidity of the portfolio's underlying investment positions, the level of segregation of duties in determining the NAV and the involvement of the investment manager in valuation. It is generally acknowledged as good practice to have such a committee. The pricing policy usually outlines the method for liaison of those performing the valuation with the client valuation committee, if applicable, to review valuation policy and procedures and oversee the application of those policies and procedures on a regular basis. The fund usually will need to document the role, composition, mandate and operation of the valuation committee. Sound practice is to have the valuation committee chaired by an independent director, but to include a representative from the investment manager and the administrator also. Escalation procedures to bring items to the valuation committee's attention and also for the valuation committee to report to the board are usually clearly documented. The valuation committee generally meets frequently (e.g., quarterly) or as deemed necessary. Clear and regular reporting to the valuation committee enables them to fulfil their role and this is usually documented in the pricing policy.

Depending on the complexity of the portfolio, consideration should be given to the composition of the valuation committee. Such a committee/team usually comprises investment manager representatives, investment operations representatives from the investment management team, the third party calculation agent/administrator, etc.

- 9.6. In the least transparent areas of valuation, such as private equity, positions are to be held at fair value in accordance with industry guidelines, such as the EVCA (European

Private Equity Venture Capital Association) and predominant accounting guidelines. In some instances, the pricing policy may approve the use of a valuation from an appropriately qualified party, which will be approved by the board of directors.

- 9.7. Valuation should be further reviewed by the valuation committee at points where the administrator is informed of any trading activity that indicates the real fair value is either above or below the holding value used in the NAV, above a predetermined threshold/materiality level. The ratified valuation is then usually approved by the board of directors, subject to the terms of the OM.
- 9.8 In outlining roles and responsibilities, the policy should consider detailing the limitations of liability clauses of the various parties involved in the valuation process.

## 10. VALUATION SOURCES

10.1. Wherever possible, the valuation of each position in the fund’s portfolio is usually checked against a primary and secondary price source. A pricing policy will outline that hierarchy of sources to be used for each security type and the most appropriate tolerance levels for variances between the sources, by asset class and instrument. In determining the most effective tolerance to be applied, the volatility of the instrument type should be considered.

10.2. A pricing policy could contain a matrix clearly illustrating the instrument, valuation methodology and pricing hierarchy. A non-prescriptive sample is detailed below:

Asset Type	Pricing Detail	Primary Pricing Source	Secondary Pricing Source	Tertiary Pricing Source
Cash				
Repurchase Agreements				
FX Spot				
FX Forward				
Long Dated FX Forwards				
Exchange Traded Futures				
OTC Equity Options				
Listed/Quoted Securities: Equities, CFDs, Bonds, Warrants				
Convertible Bonds				
Single Name Credit Default Swaps				
Credit Default Swap Options				
Listed Equity Indices				
Volatility and Variance Swaps				
Interest Rate Swaps				
Cross-Currency Interest Rate Swaps				
Interest Rate Swaptions				
Bank Loans				
ASCOTS				
Cash Collateralised Debt Obligations, Bond Obligations and Loan Obligations				
Synthetic Collateralised Debt Obligations				
Loan Credit Index Swaps				
Credit Index Swap Options				
Credit Index Tranches				
Credit Index Tranche Options				
Loan CDS				
Warrants on Illiquid Equities				

Illiquid Listed Warranties				
Private Equity				
PIPES				
Other				

Other considerations the pricing policy might include are:

- (vii) outline the controls over the selection of valuation inputs, sources, models and methodologies;
  - (viii) split between exchange traded and non-exchange traded sources;
  - (ix) for exchange traded - detail the range of sources for each valuation method. The sources should be multiple, if possible, independently obtained, specify the time of day and principal market/exchange, time of day and source for FX rate if appropriate, etc. If there is an industry standard/market convention this could be applied to groups of similar securities with the same characteristics. Define tolerance levels, and procedures to be taken if deviations move outside the tolerance levels (escalation procedure);
  - (x) for non-exchange traded - outline the third party broker sources (multiple if possible), and document the reason for ranking or choosing a particular broker over another. The policy should state what steps should be taken in the event of there being only one price source. Examples of proposed actions could include seeking to model value or have some form/mechanism of benchmarking the broker quote for reasonableness. If a position is model valued seek a broker source to validate the model price, if possible. Document the approach if averaging or using a matrix. Define outliers and tolerance levels for using a matrix/averaging. Outline the procedures if outside the tolerance level (escalation procedure). Outline reconciliation procedures where two sources differ in excess of the tolerance level, including how it should be resolved; and
  - (xi) model values - use industry standard model where possible. If not possible, have the model back tested and stress tested and outline the policy and sources for obtaining inputs which should be verified by an appropriately knowledgeable person prior to use. Ensure there is segregation of duties if “black boxes” (complex models) are used. The person generating the model value must not have incentive/interest in biased valuations. If it is not possible to achieve absolute segregation, a documented and transparent approach should be employed.
- 10.3. Due to the complexity of some derivative products, there may be instances when the most reliable price source is a validation model supplied by the investment manager or a quote from a counterparty that the fund will ultimately close out the position with.
- 10.4. Any manager-developed models should be pre-approved or benchmarked to industry standard models by an appropriately qualified expert who is independent of the manager and administrator. The approval of this model should be documented in the fund’s valuation policy document.
- 10.5. Models should be consistently applied, with changes being made only upon significant market events or back testing evidencing a reason for an adjustment (e.g., a security being removed from a comparable index due to its acquisition or bankruptcy). This may require input from the investment manager due to the unique knowledge that the investment manager possesses in relation to the model and its associated inputs.
- 10.6. Model adjustments of prices are designed to produce the best approximations of fair value between valuation events which crystallise a valuation in a traditional manner.

- 10.7. In any instances where the investment manager utilises a pricing model in order to determine a price, then there should be a sense check on the model output. This should be conducted through the administrator who should undertake to have the model and outputs reviewed. Examples of an administrator review may include:
- (i) sources should be used consistently, valuation point to valuation point. Consider outlining a mechanism for approval/changing sources (to avoid shopping for the best price). The pricing policy should outline the frequency of an output review (back testing of results to prices achieved on sale/close out, etc.);
  - (ii) fair value - usually, it is best to have a process/standard template to document the considerations and logic in determining fair value. Reference to the valuation method (cost approach, market approach, income approach such as discounted cash flow (DCF)) being used and consider all factors such as economic environment, performance of actual versus budget, FX rate exposure impact on valuation, etc. The same logical approach can be used month on month. There should be regular reviews for recent transactions in the investment (purchase/sale of debt/equity) etc.;
  - (iii) third party valuations - procedures around selection, appointment, when to use, what parameters, any input from the investment manager; and
  - (iv) where the price cannot be independently verified by, or through, a third party, the administrator, generally, will seek approval from the board of directors or board delegated valuation committee to use the price.
- 10.8. Procedures around the investment manager overrides: whether they should be allowed; if yes, then in what circumstances?; they must be reviewed/benchmarked; must be consistent with the OM (likely to require consent of the directors, and custodian where applicable).
- 10.9. Policy should be established for the handling and documenting of price overrides, including the review of price overrides by an investment manager or fund accountant, if permitted.
- 10.10. In certain exceptional circumstances, the value of a financial instrument determined in accordance with the fund's policies and procedures may not be appropriate. The investment manager, administrator or complex pricing team may therefore propose an override to that value and use another. This is likely to require the approval of the directors, on a case by case basis, and regard must be given to the OM.
- 10.11. Procedures for price overrides will include a requirement for reporting to the relevant party, as soon as practicable, supporting the case for the proposed override. A price override, usually, will not be utilised until a review has taken place.

## 11. DISCUSSION OF KEY TERMS

### 11.1. Illiquidity

A position can be illiquid if there is no active market in terms of volumes to buy and sell the position. A position might also be considered illiquid if the size of the position held by the fund relative to the average daily traded volumes is large, or alternatively relative to the total number of shares in issue. In this situation there is a view that if the fund tried to sell its entire holding that it would effectively move the market price and not be able to realise all of its position at that price. However, if there is some trading on the markets, even if the amounts are small, the accounting standards do consider the market to be active and mandate the use of the market price.

### 11.2. Stale prices

There is no commonly accepted definition of stale but the SEC states that if a position has not traded for an entire trading day then fair valuation procedures should be adopted. A stale price is a price for a position which has not traded on the day of valuation, and therefore it is old or relates to trading on a day prior to the date of valuation. It can be used as a proxy for the valuation. Documentation should be maintained of the factors considered in accepting the use of the stale price as a proxy for fair value, the time frame over which the position price has been stale and why it is deemed appropriate for the purposes of the NAV calculation.

### 11.3. No Prices

Valuation is both an art and a science, and when there are no prices on the valuation date then all available sources of information should be gathered, considered and a judgement made for the purposes of determining fair valuation. This should all be documented to outline the rationale and logic in determining the fair valuation. Consideration should be given to any recent market transactions for identical or similar positions, if a model valuation can be used, a discounted cash flow or other valuation method can be used; if there is consensus data or an index that helps to determine an approximation, and consideration of cost and how long it is since it was purchased. In such a situation, there is no right answer so a fund needs to make a reasonable effort to document all available information and the thought processes involved. Benchmarking previous estimates to valuation realised can help to further identify methods to improve the estimation process.

No change in price reports can provide good information on stale/illiquid positions. The pricing policy can deal with responsibilities for the production and review of such reports, how they should be reported, to whom and with what frequency.

Material change in price reports can indicate a possible error in the valuation/price and, again, the pricing policy should outline the responsibilities for its production and review, how and to whom they are reported and with what frequency.

### 11.4. Reporting to the Valuation Committee and/or the Board

Those charged with governance (be that the general partner, managing member or board of directors) are charged with the ultimate responsibility for fair valuation. This actual calculation of the valuation is usually delegated on a day-to-day basis to the valuation agent (administrator). In order to adequately fulfil the delegation of valuation there has to be oversight and review. This can be made effective through proper reporting to the board on valuations. Suggestions would be to include a report by the valuation agent on a quarterly basis on valuation; whether there were any fair valued positions; what % of NAV they comprised; confirmation of compliance with the pricing policy; a report of any stale prices; single source prices; illiquid positions or side pockets and support for the valuations used in the absence of a quoted price, etc. Also, a list of any positions valued at cost and the reason for valuing them at cost is useful. Those charged with governance may also request a discussion with the investment manager on any involvement in valuation, including investment manager overrides. They may also consider the appointment of a valuation committee to oversee the valuation process where expertise is required.

There may be instances where immediate/exceptional reporting to the valuation committee or board is mandated and the pricing policy can outline when, and in what situations, this may be appropriate. It can also outline the mechanism for such reporting.

#### 11.5. Materiality to the Fund

Materiality represents a threshold level used to determine whether errors or differences identified require further investigation, or ultimately adjustment/restatement of the reported NAV and compensation to investors. Materiality is also a concept used by auditors to determine whether a change to the information presented in the financial statements might reasonably affect the economic decisions of the users of financial statements. Materiality is generally expressed as a percentage of the NAV of the fund. There is no single percentage threshold that quantifies materiality for all funds. Some regulators specify materiality for regulated funds. They specify materiality in the context of NAV varying from 25 basis points to 75 basis points, typically. Different materiality levels may be used in assessing the valuation of different types of securities. Materiality levels should be set out in the pricing policy document for each type of security held at a level requiring further investigation, generally expressed as a percentage of the valuation. For OTC positions, the threshold/materiality levels should also be considered and specified and they may differ from those set for exchange traded positions as, by their nature, they are more subjective. The process for investigating differences, escalation procedures and timescales for resolution should be documented in the pricing policy document. Materiality at the fund level, expressed in basis points, should also be set out in the pricing policy document. There may be different materiality levels specified for adjusting the NAV and for providing compensation.

#### 11.6. Tolerance Levels for Escalation Procedures

Multiple sources of pricing information may be available. The pricing policy will specify a primary source and a secondary source, at minimum, whenever possible. Prices from secondary source(s) should be compared to the primary source and the difference expressed as a percentage of the primary price. The difference should also be applied to the holding and expressed as a number of basis points of NAV. Differences above a certain level (the tolerance level) require further investigation (escalation procedures). Percentage tolerance levels will vary for different securities but should be specified in the pricing policy document. Basis point tolerance levels will usually be fixed for all securities and should also be specified in the pricing policy document. Escalation procedures may include some or all of the following procedures: obtaining a third source; review of all information available and investigation by a more senior member of management within the pricing team; review and investigation by the investment manager; referral to a pricing committee comprising senior management; and referral to the board of directors (or a sub-committee). Specific escalation procedures to be used for the fund should be documented. These procedures will generally be organised in a hierarchy. The procedure for determining whether to refer a difference to the next level of the hierarchy should be documented.

#### 11.7. Documentation/Audit Trail

Where price differences are identified between a primary and secondary source that exceed the tolerance level, it is likely that these securities will also be identified by the auditors as requiring investigation. To avoid undue cost and delay in completing the audit, it is important that escalation procedures and the evidence upon which the pricing decision is made are documented and accessible. Documentation should include a list of securities reviewed by each level of escalation procedures, and at each level: sources of information considered; prices provided by each source; copy documentation from brokers where broker prices are obtained; decision as to which price to use or to escalate further and the basis for conclusion.

#### 11.8. Timescales for Determination

The fund may have committed to certain timescales by which NAV information will be published and available to investors. Funds of hedge funds investors comprise a significant proportion of subscriptions to hedge funds and these investors generally require pricing information monthly. There can be a trade off between the speed of valuation and the level of accuracy. For many funds, it is common to provide NAV estimates prior to indicating a final NAV. For difficult to value securities, the more time that goes by the more pricing information is likely to be available. The fund should document whether it will provide estimated NAVs, and the timescale within which it will normally provide estimates and final NAVs. Procedures for delays in NAV, notification to investors (and stock exchanges, if applicable) and suspension of trading should also be documented.

#### 11.9. Timescales for Escalation Procedures/Review and Approval

Escalation procedures, particularly at higher levels, can be time consuming. Without agreed timescales, such valuations can be unnecessarily drawn out. In addition, because escalation procedures may ultimately need to go through a series of levels, it is important not to be unduly delayed at any one level. Sufficient time, however, must be left to allow for proper consideration. Where review depends on certain individuals, procedures for alternates to perform the procedures in their absence should be documented. Adequate time should be allowed for all relevant information to be considered.

## APPENDIX 7 IFRS and Irish/UK GAAP- Impact on Valuation

Fair value is defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

IAS 39/FRS 26 defines 4 categories of financial instruments:

- a. financial assets and liabilities at fair value through profit or loss (FVTPL);
- b. held to maturity investments;
- c. loans and receivables; and
- d. available for sale financial assets.

Held to maturity investments and loans and receivables are carried at amortised cost, while all other financial instruments are valued at fair value. An exemption from fair value exists for investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured. This might happen where the range of possible fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed. Such investments should be measured at cost.

### Forced Transactions or Distressed Sales

A significantly lower than normal volume of transactions does not necessarily provide sufficient evidence that there is not an active market and that the observed transactions are forced transactions or distressed sales. An imbalance between supply and demand (for example fewer buyers than sellers thereby driving prices down) is not the same as a forced transaction or distressed sale. If transactions are occurring between willing buyers and sellers in a manner that is usual and customary for transactions involving such instruments, then these are not forced transactions or distressed sales. Persuasive evidence is required to establish that an observable transaction is a forced or distressed sale. Forced transactions or distressed sales may occur in an involuntary liquidation.

### Active Market

In an active market where there are regularly occurring market transactions and quoted prices are available, these must be used.

### Bid/Ask Pricing

The appropriate quoted market price for an asset held is usually the current bid price and for a liability held is the ask price. Funds which are valued using closing trade prices or mid market prices will accordingly be required to perform a valuation for reporting purposes at the year end using bid and ask prices. This bid/ask valuation should be used as the value of assets and liabilities in the financial statements and a reconciliation may then be provided to another valuation basis, e.g., mid/closing/last traded as per the offering memorandum or prospectus.

### Valuation Techniques

These should be used to determine fair value in an inactive market. Such techniques include discounted cash flow analysis. When discounting cash flow, discount rates equal to the prevailing rates of return for financial instruments having substantially the same terms and characteristics (including credit quality, maturity date, currency, period for which rate is fixed) should be used. Accordingly, different investments will be discounted using different discount rates. Short term receivables and payables with no stated interest rate may be measured at the original invoice rate if the effect of discounting is immaterial.



## Calibration

IAS 39.AG76 requires any valuation technique to be calibrated periodically against market transactions in the same instrument or available observable market data for similar instruments. Any market transactions in similar instruments cannot be simply ignored but must be considered.

## US GAAP - Impact on Valuation

Fair value is defined in FAS 157 as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”. The standard explains that market participants should not include related parties.

FAS 157 became effective for accounting periods beginning after 15 November 2007, and earlier application was encouraged. This standard is aimed at consolidating and enhancing the guidance currently provided throughout US GAAP.

FAS 157 establishes a hierarchy for determining fair value based on inputs, being the assumptions that market participants would use to price the asset or liability. Observable inputs are based on market data obtained from sources independent of the reporting entity. Valuation techniques should maximise the use of observable inputs and minimise the use of unobservable inputs. Three levels of inputs are identified by the standard. The fund must divide its assets measured at fair value into these three categories and disclose them accordingly in the financial statements. The three levels are:

- a. level 1 inputs are quoted prices in active markets;
- b. level 2 inputs are observable inputs other than quoted prices; and
- c. level 3 inputs are unobservable inputs that reflect the fund’s own assumptions about the assumptions that market participants would use and are developed based on the best information available in the circumstances.

In situations where there is little or no market activity, fair value may be based on unobservable inputs. In such circumstances, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity must not ignore information about market participant assumptions that is reasonably available without undue cost and effort.

Blockage factors, which are where the quoted price is adjusted because of the size of the position relative to trading volume, cannot be used in calculating fair value at level 1.

Bid/ask pricing is not required - mid-market pricing may be used. Quoted prices should be obtained from the principal market for the asset or liability, or in the absence of a principal market from the most advantageous market for the asset or liability. The principal market is the market with the greatest volume and level of activity for the particular asset or liability.

Occasionally, the method of valuation determined by the fund (as outlined in its OM) may differ from the GAAP calculation of valuation (e.g., under IFRS requiring the use of bid/ask pricing, whereas many funds adopt last traded or mid prices). When this occurs, there will be a difference between the NAV calculated per the OM (the “trading NAV”) and the NAV calculated in accordance with the accounting standards (“the GAAP NAV”).

Management may decide that it wishes to disclose this divergence in the financial statements, if it is material. Therefore the financial statements may be prepared according to the valuation per the OM, determining the trading NAV and then showing a reconciling figure in the financial statements (on the balance sheet, the profit and loss account and the statement of changes in net assets, as well as a footnote to clearly explain the reconciling item). This then meets the requirements to show GAAP compliant financial statements but also explains to investors why their trading NAV is different.

## APPENDIX 8      About the Associations

### About AIMA

As the only truly representative global hedge fund association, AIMA, the Alternative Investment Management Association, has more than 1,100 corporate members worldwide, based in over 40 countries. Members include leading hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms and fund administrators. They all benefit from AIMA's active influence in policy development, its leadership in industry initiatives, including education and sound practice manuals and its excellent reputation with regulators worldwide.

AIMA is a dynamic organisation that reflects its members' interests and provides them with a vibrant global network. AIMA is committed to developing industry skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) - the industry's first and only specialised educational standard for alternative investment specialists. For further information, please visit AIMA's website, [www.aima.org](http://www.aima.org).

### About IFIA

The Irish Funds Industry Association (IFIA) is the representative body of the international investment funds community in Ireland, representing the custodian banks, administrators, managers, transfer agents and professional advisory firms involved in the international fund services industry in Ireland. Its 80 members and 20 associate members are responsible for in excess of 10,000 funds with a net asset value of over Euro 1.5 trillion. The objective of the IFIA is to support and complement the development of the international funds industry in Ireland, ensuring it continues to be a location of choice for the domiciling and servicing of investment funds.