Guide to Sound Practices for European Hedge Fund Managers



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Foreword to the 2007 edition

The 'Guide to Sound Practices for European Hedge Fund Managers' was first published in 2002. Since then it has been downloaded from the AIMA website alone over 90,000 times. Clearly, the industry was prescient in developing detailed information on this topic for the financial, regulatory, investor and governmental communities.

During the last five years the Hedge Fund industry in Europe has continued to grow at a rapid pace, both in terms of the number of Hedge Fund and Fund of Hedge Funds managers now established and regulated as well as in terms of its total assets under management – a figure which has now surpassed $459 billion.[1]

Globally, the industry has matured and evolved in this time – as to strategies employed, markets accessed, asset types invested in and, indeed, the way in which the industry is regulated.

It is clear, then, that now is an apposite time to give the Guide a thorough overhaul, updating it to take these changes into account. This work has taken several months to complete and many interesting debates have been generated in the process.

Like its predecessor, this Guide provides an overview of the many issues that should be considered by a Hedge Fund manager. However, it is not intended to set out definitive standards or an exhaustive list of requirements that could serve as a benchmark against which conduct should be assessed. There is no substitute for professional advice in managing a Hedge Fund business.

Furthermore this Guide should be read in conjunction with the other AIMA Guides to Sound Practices for:

- Hedge Fund Valuation;
- Offshore Alternative Fund Directors;
- Hedge Fund Administration (produced in conjunction with the Irish Funds Industry Association), and ;
- Business Continuity Management

This Guide is the result of a great deal of time and effort on the part of many generous people – named in Appendix 1 - drawn from all sectors of the industry. The contribution of each is warmly acknowledged.

We are particularly grateful to Goldman Sachs. The original idea for this guide arose at one of their client conferences, and they have once again dedicated significant leadership and resources to this update

We welcome all feedback on our output. Please send any comments to info@aima.org.

Christopher Fawcett
Chairman, The Alternative Investment Management Association Limited (AIMA), 2007
21 May 2007

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[1] Source: EuroHedge Database January 2007

Introduction

AIMA's Guide to Sound Practices for European Hedge Fund Managers is one of a series of AIMA publications (see Appendix 2) which, taken together, set out sound practices for practitioners to follow. These cover not only a range of the most significant industry sectors, but also guide the reader through matters to consider in a number of different locations where Hedge Fund managers operate.

This Guide considers various practical aspects of establishing and managing a Hedge Fund business in Europe and suggests corresponding sound practices. It is intended to be a useful tool for a wide variety of Hedge Fund managers, notwithstanding differences in terms of investment strategies, capital resources or systems capabilities.

Specifically, the Guide covers the following key topics:

i. Creating and Managing a Hedge Fund Business;
ii. Investment Process and Portfolio Risk Management;
iii. Portfolio Administration and Operational Controls;
iv. Raising Capital and Investor Relations; and
v. Hedge Fund Structures and Organisation.

The content and format of each chapter is designed to maximise the Guide's use as a practical and user-friendly tool, rather than a textbook.

Whilst the intention has been to produce a resource for general use, it should not be assumed that one size fits all. The size, nature, jurisdiction of regulation and complexity of a particular Hedge Fund manager's operations and investment strategy may mean that some or all of the sound practices set out in the Guide are in fact inappropriate to the business of that Hedge Fund manager. Accordingly, the sound practices should not be regarded as definitive or "best" practices.

As a general resource, the Guide should not be regarded as a substitute for professional advice, which should still be obtained where appropriate.

Although the issues discussed in this Guide are common to many financial services businesses, the guidance is intended to reflect only the application of sound practice in the areas discussed to a typical Hedge Fund management business. Regulators in different jurisdictions impose more or less stringent requirements in relation to the type of funds, the targeted investors and the nature of financial instruments that may be used by the Hedge Fund manager.

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The Guide does not replace any applicable laws or regulations, which are likely to be more detailed than the sound practices described. To the extent that the Guide refers to legal or regulatory issues, this is based on the UK regime. However many of the principles can be applied in the wider European environment.

In particular, since the first edition of the Guide was published in 2002, a number of significant European Union Directives and Regulations have already come into force or will do so soon. Some of these, including the Markets in Financial Instruments Directive (MiFID) and the Capital Requirements Directive (CRD), will have an impact - in some cases, a potentially major one - on many European Hedge Fund managers and the way in which they structure and conduct their business.

This Guide does not comment specifically on such legislation, nor on its implementation in any given Member State. Those using this Guide should make themselves aware as to which legislative provisions affect them and/or their business and ensure that they comply with these requirements.

AIMA has taken into account in the preparation of this Guide both the Recommendations and Guiding Principles set out in the Report of the Counterparty Risk Management Policy Group II of July 2005 (the Report) and the terms of the Agreement Among the President's Working Group and U.S. Agency Principals in Principles and Guidelines Regarding Private Pools of Capital, published on 22 February 2007 (the Agreement), in particular so far as these relate to risk management, risk monitoring and enhanced transparency in capital market activities.

The Report explicitly recommends that Hedge Funds adopt its Recommendations and Guiding Principles on a voluntary basis and AIMA encourages all Hedge Fund managers to do so. AIMA would expect the majority of financial intermediaries with whom its members work to adopt the Recommendations and Guiding Principles, where they are not already doing so.

The full text of the Report may be found at www.crmpolicygroup.org/docs/CRMPG-II.pdf.

The full text of the Agreement may be found at
http://www.treasury.gov/press/releases/reports/hp272_principles.pdf.

Creating and Managing a Hedge Fund Business



1. Creating and Managing a Hedge Fund Business

The Guide assumes that the establishing of a Hedge Fund business is for the medium and long term and involves creating and managing a viable business. Hedge Fund managers are fiduciaries and must act in the best interests of each of their clients at all times and in compliance with the principles, rules and regulations prevailing in the jurisdictions and on the markets in which they are active.

The principals of the Hedge Fund management business, as the proprietors and/or controllers of a financial services business, are responsible for all aspects of that business and should give due consideration to the business risks involved at the start and throughout the life of the business.

This chapter considers an outline of the requisite management systems and controls internal to a Hedge Fund management business. It does not extend to portfolio management, nor the interfaces with Hedge Funds or managed portfolios, each of which are addressed separately in subsequent chapters. This Guide does not deal with the responsibilities of Directors of the Hedge Funds themselves, which are typically separate from the Hedge Fund manager, and who have distinct and separate fiduciary responsibilities. (Guidance on the duties of the Directors of a Hedge Fund is set out in AIMA's Offshore Alternative Fund Directors' Guide – see Appendix 2.) Although Hedge Fund management businesses are typically small, their influence, through the assets they manage, is significant on the investors in their products, markets and other stakeholders.

For this reason, an attempt is made below to emphasise the importance of strong procedures and controls, segregation of potentially conflicting duties (where possible), the management of business risks and the need for skilled and experienced personnel whether or not on an employed or externally retained basis.

1.1 Creating a Hedge Fund Management Business

Creating a Hedge Fund management business is no different from establishing any other business. Typically, most Hedge Fund management businesses are small, at least at the outset, and are likely to be supported by a number of service providers such as prime brokers, administrators, compliance consultants, systems providers, hedge fund consultants, book-keepers, tax advisers, auditors and lawyers. This can give the management team the ability to use highly specialised and skilled resources without needing to build such support in-house at the outset.

There are a number of considerations which the principals of the Hedge Fund management business need to address when setting up their business. These include:

i. the market opportunity for their products, which often defines the business opportunity;
ii. the investment strategy;
iii. the marketing strategy;
iv. the business strategy and its short, medium and long term goals;
v. the management team and staffing requirements;
vi. the ownership and funding of the entity;
vii. the legal and tax structure of the entity and the fiscal needs, including those of the principals;
viii. regulatory requirements;
ix. the operating infrastructure and systems;
x. service providers;
xi. risks and sensitivities;

xi. margins, financial forecasts, break even analysis, budgets and milestones; and

xii. sources and quality of seed finance and any issues relating to ownership associated with this.

It is important to seek advice from competent and experienced professional advisers in many of these areas to reduce or eliminate the business risks involved in setting up a new business. Many issues will not be unique to a particular Hedge Fund management business and so experienced professional advisers should quickly be able to identify appropriate solutions. For example, the structure and manner of operation of the management business should not only be tax efficient and flexible, but should also be cost effective and easy to implement. The principals will need to consider their personal positions as well as that of the Hedge Fund management business.

Some principals find it useful to address these matters in a business plan. The business plan can then be used to ensure that investments in people, technology and infrastructure are appropriately aligned with each other and with the overall objectives of the business. The plan should reflect realistic growth scenarios and sensitivities should be tested. It should be used to determine the long term capital, working capital and regulatory capital requirements. It should consider the introduction of new partners or principals, realisation strategies and potential exit routes. When a firm is seeking authorisation from a regulator such as the FSA, these documents normally form the basis of its application.

1.2 Managing a Business

Business management involves a set of competencies and responsibilities which are generally distinct from trading or portfolio management. Business management, sales, trading and portfolio management skills are rarely fully developed in any single individual and, if they were, the individual concerned might find himself short of time to exploit them all fully. Decisions, therefore, need to be made about how the business is going to be organised and managed and how the principals are going to divide or delegate their responsibilities.

This chapter restricts itself to discussing some of the business and operational issues – management and controls, finance, compliance and employment related issues – the remainder are dealt with in later chapters of the Guide.

1.3 Management and Controls

Every Hedge Fund management business, whatever its size, should organise its internal affairs in a responsible manner, ensuring it has appropriate systems, procedures and controls designed to mitigate and manage the risks to which the business is subjected. This should be documented but the extent of documentation will vary depending on the complexity of the business operations. The Hedge Fund management business may want (or be required by its local regulator) to document its internal organisation arrangements using an organisation chart to identify those employees involved in each business process as well as the relationships with external providers.

On the assumption that the business has a Chief Executive and a Chief Investment Officer as part of its initial team, they should properly consider the importance of appointing an appropriately qualified individual, typically known as a Chief Operating Officer, as early as possible to deal with operations, risk, finance and compliance issues. The more complex and larger the business, the more likely that these will need to be split. The relevant person should have sufficient authority as they will be instrumental in dealing with a number of counterparties through the start-up phase, designing systems and procedures and ensuring the business is properly structured and financed.

Management should implement a business risk management process to assess all the non - investment risks associated with the business, although the degree of formality of this process will vary widely dependent upon the regulatory environment and the size and complexity of the business. It may, for example, range from an informal process conducted at management meetings to, in the case of a larger firm, a formal, rigorous and fully documented process. The risk management process would typically encompass:

i. the identification of the key risks facing the business, across all areas, including risks such as reliance on key clients or investors, reliance on key staff and access to sufficient capital. The risk analysis should also consider "what if" scenarios for the business and management should anticipate how they might react.

   A formal risk assessment of the business should be carried out no less frequently than on an annual basis and should be approved by senior management. This process should be documented (whether formally or informally). In some jurisdictions, regulators require this risk assessment to be completed and for the Hedge Fund manager formally to consider the regulatory capital implications of the risks that are being taken;
ii. the implementation of controls to mitigate those risks. For each risk, management should determine whether to accept the risk and mitigate it through controls or to avoid it. Controls should be embedded in normal business processes;
iii. the design of a monitoring process to ensure effectiveness of those controls. Management should ensure that any internal or external monitoring exercise includes a review of the key risks;
iv. reporting on both the effectiveness of controls and the changing risk profile of the business; and
v. effective controls to ensure that any significant weaknesses are reported to senior management as soon as they are detected.

If the team have no direct experience of certain aspects within their sphere of control, as a risk management tool the firm may seek to obtain independent advice or a review of the relevant processes.

The key areas which such risk management systems would typically cover include: inter alia, the broad headings of investment (see Chapter 2), finance, compliance, systems, control of outsourcing, tax and personnel.

1.3.1 Outsourcing

Where key functions are outsourced, management must be satisfied as to the competency of the relevant service provider and should have a process in place to monitor and review work performed. The business can outsource functions, **but it cannot outsource its responsibilities.** Such a process may include initial consideration of a number of outsourced service providers against a set of agreed criteria prior to selection and, thereafter, would involve inter alia:

i. an assessment of performance against contractual or agreed service standards normally enshrined in a service level agreement;
ii. periodic performance review meetings; and
iii a comparison of actual performance against agreed benchmarks.

The firm should ensure that it undertakes suitably robust reviews of the third parties to provide itself with the assurance that they are performing the outsourced functions in accordance with their service level agreements.

1.3.2 Segregation of duties and allocation of tasks

One of the strengths of a Hedge Fund management business can be the close involvement of the principals in the day-to-day affairs of the business. Conversely, it can represent a weakness if the Hedge Fund manager is unable to apply the "four eyes" principle to transactions and management controls.

It is good business practice to attempt to segregate, amongst different personnel, duties which may be regarded as incompatible with each other. Examples include initiating and approving investment and cash transactions and monitoring portfolio risk. However, this is often difficult to achieve in Hedge Fund management businesses with a limited number of employees. There are some basic steps which can be taken to help reduce the risks. These include ensuring that key transactions, particularly those related to cash, are approved by two people in appropriate positions of authority and using the control systems and procedures for service providers to verify and oversee transactions. In broad terms, at the very least, there should be a clear distinction between front and back office functions and these should not be conducted by the same people.

Where it is not possible for the firm to apply the "four-eyes" principle, it should consider alternative methods of obtaining this assurance, for example, by the use of specialist external consultants.

1.4 Finance

1.4.1 Systems and Accounting Records

Firms should ensure that they have appropriate systems and procedures capable of:

i. developing relevant budgets;

ii. monitoring their financial resources position;

iii. producing timely and accurate management accounting and financial information; and

iv. providing necessary regulatory and statutory financial reports in the format that the jurisdiction requires.

In the case of (i), budgets should be prepared annually and updated where significant changes occur in underlying assumptions. They should include monthly income, expenditure, cash and (if relevant) regulatory capital forecasts.

Procedures in respect of the processes adopted for each of (i) to (iv) above should be documented and retained.

Client reporting which may, within smaller firms, reside within the finance function, is outside the scope of this Chapter, but the importance of accurate, timely and fairly presented client reports cannot be overemphasised.

1.4.2 Regulatory Financial Resources

Management should have the appropriate knowledge and skills to monitor the financial resources position of the business and to complete relevant regulatory financial filings. Financial regulations in the UK and many Continental European jurisdictions often dictate the manner of computing financial resources for these purposes. Where relevant, a Hedge Fund manager should be capitalised so as to meet the minimum regulatory capital requirements with some contingency (most managers will have an excess of at least 10 – 20% over the amount that they are required to hold) to take account of future changes and unexpected developments.

In some jurisdictions, regulators also require regular financial information on the Hedge Fund manager and the Hedge Fund manager's group, including group capital adequacy returns.

1.5 Compliance

Typically, a Hedge Fund manager will need to have its business authorised or licensed by a local regulatory body. This can be a time-consuming and complex process; obtaining and retaining the correct authorisations for the business the Hedge Fund manager intends to operate is essential. Unless the Hedge Fund manager has the required in-house experience, professional advice should be sought to guide the manager through the initial registration process. However, if the firm decides to go down this route then it needs to ensure that it is fully conversant with the information included in its documents because, as part of the application process, individuals in the firm may be questioned by the regulator.

The Hedge Fund manager should also ensure that if any new business activity is planned, the compliance and internal resource requirements are understood and are in place prior to commencing such business.

A Hedge Fund manager should ensure they take reasonable steps to understand the regulatory environment within which it operates and the specific rules applicable to its business. The Hedge Fund manager should develop procedures to comply with these rules. The manager should additionally ensure that all staff are fully aware of the procedures and rules applicable to their particular area of work.

This can be achieved by adopting a written Compliance Manual setting out policies on key areas such as investment and trading policies, code of ethics on personal dealing, market abuse (including insider dealing), conflicts of interest and the use of dealing commission in the UK to pay for research services. When new policies are implemented, the Manual should be updated accordingly. A copy of the Manual should be given to every member of staff. Some firms may decide to supplement the Compliance Manual with written procedures for specified processes. The Compliance Manual should be reviewed and maintained as a 'living' document and updated to reflect both changes that occur at the firm and any changes to applicable laws or regulations.

1.5.1 Compliance Function

The Hedge Fund manager should appoint a senior individual to take responsibility for compliance oversight. The Hedge Fund manager should ensure that this individual has sufficient time to dedicate to the task and that recurring tasks, such as record keeping and compliance monitoring, are completed on a timely basis. He or she should be vested with the necessary authority to enforce compliance with relevant rules and internal procedures.

It is unusual, in smaller management companies, for the compliance officer to be full time or have a total knowledge of all rules and regulations and, where this is the case, the manager should consider having an arrangement with appropriate professional advisers for further advice and guidance. The compliance officer and chief executive must be involved in key compliance issues and should ensure that they provide an appropriate compliance culture in the business.

In some jurisdictions, compliance consultants assist the compliance officer to maintain the compliance infrastructure of the Hedge Fund manager. The compliance officer remains responsible for the compliance arrangements of the business.

It is worth repeating that, where a function is outsourced, the responsibility remains with the firm.

1.5.2 Compliance Monitoring

The Hedge Fund manager should implement arrangements for the regular monitoring of business risks and for adherence to all compliance requirements. The frequency and scope of monitoring should be determined by the size and complexity of the business, targeting compliance work on those areas of highest risk. Invariably, this will result in most work focussed on the investment process and related risks. Typically, a Hedge Fund manager would conduct a formal monitoring exercise on at least an annual basis which may be split into monthly or quarterly elements. The results of monitoring should be documented and communicated to management. Procedures should be in place to ensure that where weaknesses have been identified, these are promptly resolved, as well as processes to ensure that changes in regulation are assessed and properly implemented.

1.5.3 Relationship with Regulator

Where a Hedge Fund management business is regulated, managers should seek to retain an open and co-operative dialogue with their regulator either directly or through a trade association such as AIMA.

1.6 Employees

Typically, Hedge Fund managers employ small teams of specialised professionals who are highly committed and who are known to each other. Nonetheless, management should be committed to ensuring that employees:

i. have the requisite level of knowledge and experience for the tasks they are undertaking;
ii. are and remain competent for the work they undertake; and
iii. are appropriately supervised and that their competence is regularly reviewed.

Senior management should be aware of the dependence which can be placed upon key individuals in a small team and seek to mitigate the risks involved if one of these key individuals leaves (or is otherwise not available to) the Hedge Fund manager. Where possible, the Hedge Fund manager should seek to have alternates in place for all significant roles. Managers should give consideration to purchasing professional indemnity and directors' and officers' liability insurance.

1.6.1 Recruitment

In order to ensure the suitability of new employees, the manager should have in place appropriate recruitment procedures. Typically, such procedures would include: an analysis of the specific role (job description), interviewing against that job description and undertaking appropriate due diligence checks on new employees. Such due diligence checks are likely to include seeking formal references. The recruitment procedures should also comply with relevant employment law, such as equal opportunity and/or anti-discrimination legislation. Written terms of employment should, if possible, be in place by the time an employee takes up appointment. Employment may also need to be conditional upon regulatory approvals. The fundamental determinant in selecting an individual for any particular role should be the competence of the individual to carry out that role.

Some Hedge Fund managers find it helpful to develop a staff handbook setting out employment policies, terms and conditions.

1.6.2 Training

All employees should undergo both induction training and continuous professional development (much of which may be informal in nature). Such training should be designed to introduce the employee to the key business systems, procedures and compliance requirements and to ensure that employees remain up to date with the market, product developments and with changes in rules, laws and regulations.

In some jurisdictions, training is required for all relevant employees in respect of anti-money laundering and counter terrorist finance. It is important that Hedge Fund management businesses meet their legal obligations and maintain evidence of the completion of required training.

Hedge Fund managers should remain alert to the need for continued training and development of employees, particularly in rapidly changing investment environments or in cases where employees are changing or undertaking new roles.

Before an individual trades a new instrument, the firm should ensure that the individual has been assessed as being suitably competent, and that the firm has incorporated processes and procedures to assess and control the risks associated with the instrument.

Investment Process and Portfolio Risk Management

2. Investment Process and Portfolio Risk Management

This Chapter describes sound practices relating to the creation of an investment process, investment dealing and portfolio risk management. Some of these practices may be very intuitive for individual managers and small teams, but it is important to recognise that investment processes evolve over time and that, as a Hedge Fund manager grows and staff change, clear communication about the investment process both to staff involved in its implementation and to investors will help to avoid misunderstandings and reduce the potential legal risk and the risk of errors.

The implementation of these processes will also depend on the portfolio size, complexity of instruments traded and strategy of the portfolio and should be tailored to individual Hedge Fund managers and the style of investment undertaken.

2.1 Investment Process

2.1.1 Investment Strategy

The investment strategy to be applied by the Hedge Fund manager must be clearly documented and understood by those executing it. The investment strategy should also be disclosed to investors; such disclosure usually appears in the Hedge Fund's offering document and should contain an explanation of how funds are to be invested, what factors will influence investment performance and what risks are associated with a particular investment strategy. The Hedge Fund manager must be cognisant of these matters and communicate them effectively internally.

The Hedge Fund manager should:

i. set out the investment objectives of the strategy;
ii. identify any constraints the strategy imposes, e.g. types of products traded, size, amount of leverage, geographical and market limitations, position and risk limits;
iii. identify the main risks and evaluate how such risks should be managed (i.e. avoidance, hedging or the decision to accept that risk);
iv. comply with any applicable investment, legal, fiscal or regulatory constraints, including local market regulations and identify how such constraints affect the execution of the investment strategy;
v. have due regard to the offering document issued in connection with the relevant Hedge Fund and meet the legal and/or regulatory requirements imposed by the Hedge Fund itself because of its home or listing jurisdiction;
vi. ensure that any additional restrictions arising out of marketing material are monitored;
vii. communicate material changes to the investment strategy on a timely basis; and
viii. ensure that the investment strategy is documented and kept up to date.

2.1.2 Managing the Investment Process

A Hedge Fund manager should have a defined investment decision-making process. There are a number of reasons for this:

i. it provides an important control function with respect to the management of the investments;
ii. it provides investors with an understanding of how the investments are managed; and
iii. applicable regulations may require a Hedge Fund manager adequately to control the investment process.

Hedge Fund managers are often small organisations engaged in dynamic and opportunistic markets. Accordingly, the Hedge Fund manager's investment process should impose an investment management discipline, but should also be flexible enough to reflect the resources of the Hedge Fund manager and the markets in which it is operating.

Any explanation of the investment process to investors or potential investors should accurately represent what happens in practice and be broadly adhered to thereafter.

A Hedge Fund manager's investment process should:

i. define, at a high level, the steps to be undertaken before an investment decision is taken;
ii. identify any investment restrictions such as investment type, position size, concentration limits, short/long balance, amount of leverage, geographical, market, regulatory constraints and risk limits;
iii. consider whether an investment decision would result in a conflict of interest and, if so, how such a conflict may be appropriately managed;
iv. ensure that any investment decisions made comply with the provisions of applicable regulation relating to market abuse or insider trading;
v. identify who has actual authority to make investment decisions and any limits on such authority;
vi. identify who has responsibility for overseeing the investment decision process and monitoring investment decisions against any internally or externally defined limits;
vii. identify who has authority to place orders in the market;
viii. design procedures and define responsibilities for identifying and ensuring compliance with local market regulations; and
ix. document all of the above.

The process should be reviewed and updated regularly. Employees of the Hedge Fund manager should also understand the investment process and their role in it.

2.1.3 Risk Parameters

Hedge Fund managers should assess and evaluate their appetite for risk with respect to the given investment strategy. Furthermore, the Hedge Fund manager should ensure that it makes investment decisions within the parameters of the Hedge Fund's mandate. Setting risk parameters helps both those implementing the strategy to benchmark the risks of the investment strategy as well as to inform investors as to how the Hedge Fund manager is going to manage these risks. Individual Hedge Fund managers may have many different views on the risks involved in their investment strategies as well as the best metrics and methodology employed to monitor these risks. Risk parameters also add clarity to the investment process and strategy.

The Hedge Fund manager should routinely re-evaluate and re-assess its risk parameters within the terms of the portfolio or Hedge Fund mandate. The mandate will ordinarily take the form of an Investment Management Agreement (IMA).

2.1.4 Best Execution

The principle of best execution may be defined differently under a number of regulatory regimes and Hedge Fund managers should ensure they understand the implications of, and comply with, the regulations applicable to it. Achieving best execution may not always be appropriate trade by trade, having regard to a particular investment strategy.

In certain jurisdictions, a Hedge Fund manager may be allowed formally to contract out of providing best execution, which can reduce the regulatory burden, even if the manager tries to achieve best execution in practice. The implementation of the Markets in Financial Instruments Directive (MiFID), however, will significantly limit a Hedge Fund manager's ability to contract out of its best execution obligations – the Hedge Fund manager should take professional advice on this point as appropriate.

The Hedge Fund manager should have a written policy, which should include a process regularly to review trading activity, including counterparties, in order to monitor that it is achieving its best execution objectives and complying with relevant regulatory requirements.

2.1.5 Trade Allocation

Hedge Fund managers often operate a number of different investment vehicles, share classes, trading strategies and managed accounts. The fair allocation of trades amongst portfolios should be an overriding principle of business both at the time of trade and at regular valuation points. It is an important control against a number of potential abuses such as front running and placing the Hedge Fund manager in a position of a potential conflict of interest. Procedures to demonstrate that the principles of fair and prompt allocation are enforced should include:

i. the adoption of an allocation policy which should be consistently applied, unless unusual circumstances arise (e.g. if it would be uneconomical to allocate a very small investment to a particular account);
ii. recording the intended basis of allocation of all proposed transactions prior to the transaction taking place (i.e. prior to execution);
iii. prompt allocation of all transactions after execution, usually on the trade date;
iv. ensuring that no allocation is made to the account of the manager or a staff member, unless it can clearly be demonstrated that this is in accordance with the intended basis of allocation, and that all clients have received their full allocation; and
v. documenting the reason for any reallocation from one account to another. Typically this would only be permitted where the original allocation can be shown to have been made in error.
vi. the Hedge Fund manager should have a process to review trade allocations for consistency and to achieve its objective of fair allocation.

2.1.6 Investment in Non-Listed Instruments

The increasing use of non-listed instruments, the challenges of valuation and liquidity and the complexity of OTC derivative contracts present considerable challenges and risks to Hedge Fund managers.

The valuation issues are considered elsewhere in this Guide, but there are also significant risks associated with non-listed instruments which can result in sudden and significant losses. If Hedge Fund managers intend to invest in such instruments they should:

i. inform investors of their intentions, typically in a Hedge Fund's marketing material and/or in the offering document ensuring that all necessary legal documentation is clear that the Hedge Fund may enter into such contracts and transactions;

ii. possess the necessary expertise and experience to properly understand the factors which will change the risk profile or pricing of the instruments;

iii. ensure there are rigorous controls over entering into, documenting and collateralising the instruments;

iv. fully understand the impact of any warranties and liabilities contained in the documentation, and have a process to monitor and record these where applicable;

v. ensure they understand any legal documentation governing or defining the nature of the instruments and the terms of their clearance, settlement and close out before signing the documents. If managers do not have access to adequate in-house resources, reference should be made to expert legal advisers; and

vi. consider using independent price providers.

2.1.7 Codes of Market Conduct

Hedge Fund managers should conduct themselves in a manner which a reasonable market participant would deem prudent, honest and reputable.

Different jurisdictions will have different laws and regulations relevant to the market conduct of Hedge Fund managers, although within the European Economic Area Hedge Fund managers will be commonly subject to local law and regulation implementing the provisions of the Market Abuse Directive. Hedge Fund managers should ensure that they understand the implications of such regulation. Many of these laws and regulations may be complex and their application may be obscure. Managers should seek advice from relevant professionals where they are uncertain about their application.

2.1.8 Inducements and Soft Commissions

Inducements and soft commission can be offered to Hedge Fund managers from a variety of sources. Care should be taken to ensure that inducements do not create unacceptable conflicts of interest or influence the Hedge Fund manager to put its own interests before those of its clients or to act otherwise than in the best interest of its clients.

The practice of using dealing commissions (soft commissions or soft dollars) to pay for certain investment services is permitted by some regulators subject to a number of rules. Hedge Fund managers seeking to pay for investment-related services in this way should ensure that the service itself is a documented legitimate softing service of which clients have been made aware.

Any other forms of inducement, given to or received by Hedge Fund managers or their employees, should be monitored to ensure they are appropriate in the circumstances and not likely to unduly influence the judgment of the recipient.

2.1.9 Conflicts of Interest

The Hedge Fund manager should be aware that potential conflicts of interest might exist or develop from many sources, including formal or informal discussions, activities in the market and other business activities. Where they do exist or develop, the Hedge Fund manager should ensure it has policies and procedures in place for identifying such potential conflicts of interest. Any such potential or actual conflicts of interest should be kept under regular review by the senior management of the Hedge Fund manager and by those people responsible for the compliance function.

The Hedge Fund manager should ensure such conflicts are either appropriately managed or eliminated and, to the extent not eliminated, disclosed to the relevant parties. The Hedge Fund manager should also ensure that adequate steps are taken to control internal communication of information about potential or actual conflicts of interest in, order for such conflicts of interest to be dealt with appropriately; this may include, where appropriate, the creation of "Chinese walls" and the use of restricted lists.

2.1.10 Personal Account Dealing

The Hedge Fund manager should adopt a personal account dealing policy that ensures that conflicts of interest between staff and clients are effectively managed. The easiest way to avoid conflicts of interest is for a Hedge Fund manager to prohibit personnel from trading on their own account in securities which they analyse or in which they invest for clients. Indeed there are perceived benefits for all if staff are encouraged to invest instead in the client Hedge Funds themselves thereby aligning their interests with those of their investors. However this may not be appropriate in all circumstances. Providing adequate controls exist, personal account dealing may be permitted.

For all personal account dealing the Hedge Fund manager should have:

i. written policies and procedures communicated to and accepted in writing by all employees;
ii. clearance and hard copy confirmation records of relevant transactions; and
iii. monitoring and analysis of all personal dealings by a person competent to ensure proper management of the potential conflicts involved.

2.2 Portfolio Risk Management

Risk management is an important part of portfolio management and should be used to help reduce the likelihood of capital loss and failure. In some cases, Hedge Fund managers may not have a full time risk manager but they should ensure that they have a process in place for managing the level of risk in the portfolio.

2.2.1 Defined Process

There should be a defined risk management process in place, which is both realistic and is regularly used by the Hedge Fund manager to enhance performance in addition to monitoring and managing risk.

Hedge Fund managers should identify and understand the sources of risks inherent in their investment styles or processes. As far as is possible these risks should be translated into relevant, measurable risk factors. Typically, a risk measure should estimate the impact of an event on the portfolio and the probability of this event occurring. Hedge Fund managers should consider including risk factors such as market risk, credit risk, liquidity risk, concentration, and counterparty risk. When considering risk, Hedge Fund managers should take into account the interaction between different types of risk;

Hedge Fund managers should define their attitude towards risk by documenting investment restrictions. Where appropriate, quantitative risk measures should also be provided; and

Hedge Fund managers should monitor risk on a regular basis. The investment decision makers should be informed on a timely basis about the current level of risk in the portfolio.

A risk management process should deal with both normal and exceptional conditions.

2.2.2 Frequency of Review

Hedge Fund managers should adapt the frequency of their risk monitoring to the needs of the portfolio. Monitoring would typically be continuous and should formally occur in writing at appropriate regular intervals.

Hedge Fund managers should reconsider the overall risk management process from time to time to make sure that it remains suitable for the investment strategy and current portfolio. If risk systems such as risk models are in use, they should be flexible enough to allow modifications. A review of the process should typically be performed at least once a year and more frequently during exceptional conditions or before structural changes to the portfolio.

Hedge Fund managers should carry out appropriate stress tests on their portfolios. The scenarios modelled should cover the most significant factors that could impact the portfolio and should evolve over time.

Portfolio stress tests should be conducted as frequently as the Hedge Fund manager believes is required. A comprehensive stress test should normally be completed at least once a year.

2.2.3 Independence of Review

Hedge Fund managers should ensure the integrity of the risk monitoring function. Where practical the manager should aim to segregate the risk monitoring function from the investment management function with different people responsible for each.

Where practical, independent personnel should periodically review the application and robustness of the risk management process, including the use of any risk models where used, and ensure that controls and limits are being adhered to.

The risk manager should have clear and robust reporting lines to senior management which will facilitate escalation of positions or trades which present risk in excess of pre-agreed parameters.

2.2.4 Market Risk

Market risk includes all kinds of asset and liability price risk: price changes, liquidity, volatility, non-linearity and correlation, foreign exchange, political and credit risk. Hedge Fund managers should:

i. seek to identify each major category of market risk and regularly attempt to measure and manage these risks both individually and together;

ii. be aware that there are many methodologies for measuring market risks and that these methodologies may produce widely different results; and

iii. seek to manage the risk exposures of the portfolio within pre-defined internal and/or external guidelines. Excesses should be identified and corrected as soon as possible either through hedging or position reduction.

2.2.5 Leverage

Many Hedge Fund managers use leverage which can magnify the impact of the investment risks in the portfolio. Hedge Fund managers should be conscious of the impact of leverage, in all its forms, on the overall risk of a portfolio.

Hedge Fund managers should define the way they measure leverage, which should be monitored regularly. Careful consideration should be given to define and calculate the impact of all instrument types on leverage calculations. In many cases, daily monitoring will be appropriate.

The maximum amount of leverage which can be employed may be constrained by such things as contractual terms and the suppliers of finance. Managers should ensure leverage remains within any such constraints. The maximum level of intended leverage should be disclosed to investors.

2.2.6 Liquidity

The liquidity of both individual positions and the overall portfolio should be actively monitored, particularly focusing on average daily trading volume and the concentration of positions within the portfolio.

It is important, if there are significant investor flows (i.e. subscriptions or redemptions), that the investor liquidity profile of the Hedge Fund is monitored and communicated on a timely basis to those taking investment decisions to ensure that new capital is appropriately invested and positions are liquidated in order to allow investors to redeem from the Hedge Fund in accordance with the agreed contractual terms.

Market liquidity (i.e. capacity to trade assets) is usually an important risk factor and, therefore, the following should be measured and monitored:

i. funding liquidity (i.e. available sources of finance to fund positions and redemptions) is a significant risk, highly correlated with other risks. The portfolio's cash requirements should be monitored against available sources of finance. Usually, prime brokers are the major providers of financing and their financing policies should be understood and monitored both in normal conditions and periods of stress; and
ii. position, portfolio, market and funding liquidity should be managed by having proper monitoring procedures. These procedures should be fully documented to deal with normal conditions as well as periods of stress.

2.2.7 Counterparty Exposures

Often the vast majority of trades entered into by Hedge Fund managers will be delivery versus payment transactions, which involve less counterparty exposures. There are, however, other types of transactions and periods of sudden stress where counterparty exposure can become significant. Creditworthiness or solvency of a counterparty can become a risk particularly when there are significant unexpected changes. Because this risk is usually not hedged, managers should be aware that this may become a source of risk.

The Hedge Fund manager should have defined procedures for establishing relationships with new counterparties, undertaking a high level review of the quality of the counterparty, credit reviews and for maintaining the necessary documentation. Prime brokers and swap counterparties should be considered as significant counterparties.

Portfolio Administration and Operational Controls



3. Portfolio Administration and Operational Controls

This chapter identifies sound practices for trade recording, trade settlement, movements of cash, pricing of portfolios, net asset valuations, client reporting, and maintaining appropriate information systems. Hedge Fund managers often operate separate managed accounts as well as Hedge Funds and the processes and controls for both should be consistent.

Almost all Hedge Funds with a European-based manager have an independent administrator, as do many managed accounts. This provides an element of independent expertise in the net asset value calculation process. For many portfolios, a prime broker is also an important service provider to provide effective clearance and settlement as well as position and portfolio reporting. Day to day, the Hedge Fund manager is responsible for liaising with and monitoring information flow between itself, the administrator and the prime broker. The appointment and ongoing management of the service providers establishes the high level internal control framework for the Fund.

Given the activities of such third parties, this chapter also covers the management of external service providers.

3.1 Fund Pre-Launch

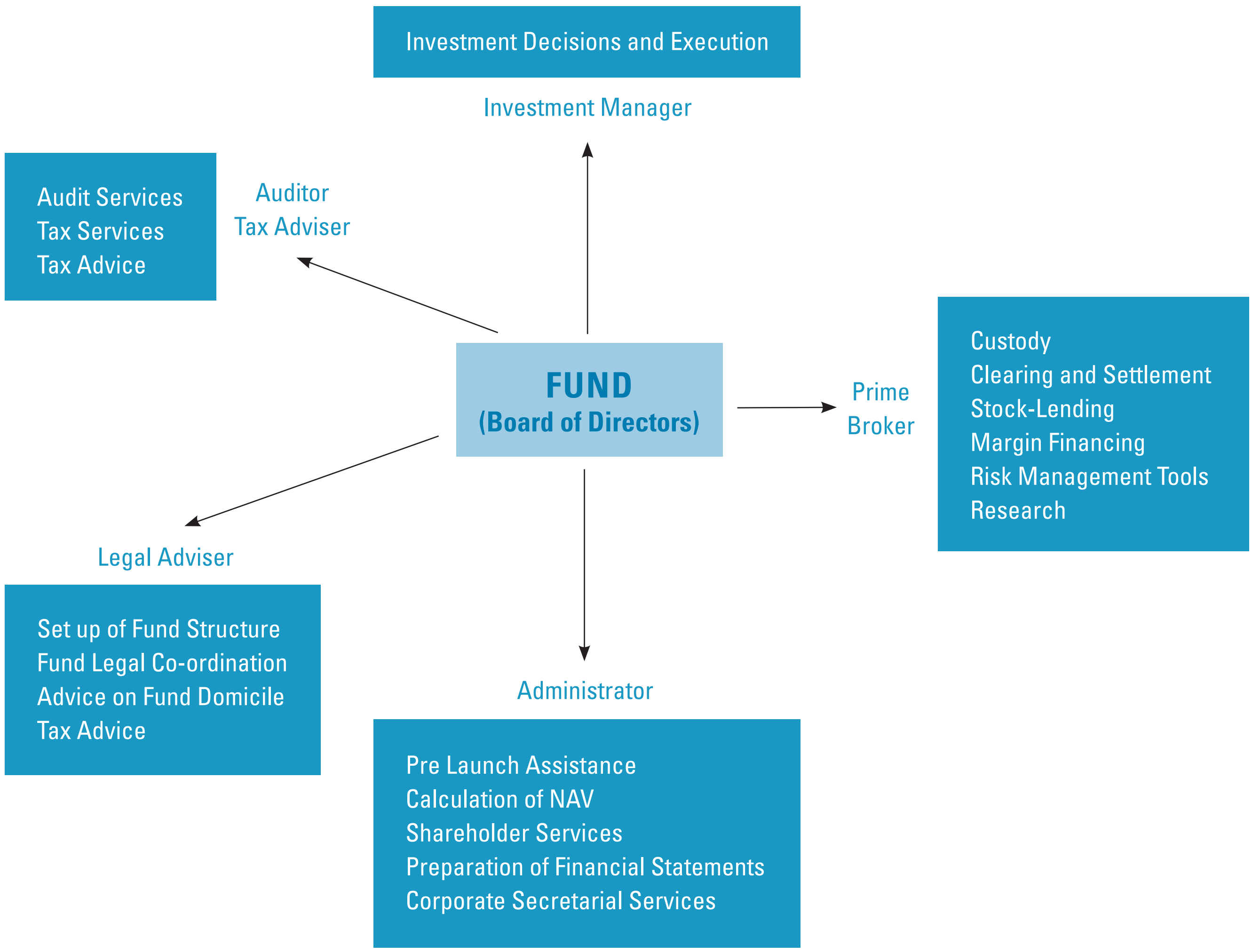
Before the launch of any Fund and the appointment of any service providers, it is important that the particular needs of the Fund and its structure are identified. The Hedge Fund manager should be satisfied that the service providers have the requisite level of expertise and technology to deliver the services required to support the investment strategy and investor base effectively. Particular considerations should include:

i. the size and expected growth of funds under management;
ii. the complexity of the instruments to be traded;
iii. the structural complexity of the fund, e.g. side pockets, the number of share classes, foreign exchange hedging etc;
iv. the number of locations; and
v. the number and type of investors.

Once the administrator, prime broker and other providers (if appropriate) are identified, there should be careful negotiation of their contracts together with appropriate professional advisers, to ensure that they reflect the particular requirements of the Fund. In practice, the Hedge Fund manager will often be negotiating these on behalf of the Fund and should be able to understand the key provisions of such contracts. Appropriate due diligence should be undertaken by the Hedge Fund manager to confirm that the requisite services can be delivered and service standards should also be agreed. These contracts should be approved and signed by the Hedge Fund's board of directors.

3.1.1 Types of Organisations that have Relationships with the Fund

The typical Hedge Fund will have the following contractual relationships:



3.2 Middle Office

Many of the procedures detailed in this chapter fall under the general term of "middle office". There is no clear industry definition of middle office, although functions which are all related to the process and control of operations can typically include trade settlement, position reconciliation's, producing daily NAV calculations etc. These functions can be undertaken internally by the Hedge Fund manager, or externally delegated to the administrator and/or prime broker, or by specialised platforms.

3.3 Trade Procedures

The Hedge Fund manager may outsource some (or even all) of these processes. If this is the case, it is important for the manager to verify that the outsourcing provider has appropriate procedures in place, and to manage the outsourcing provider to ensure that all such processes and procedures are properly undertaken.

The Hedge Fund manager should also ensure that contracts with service providers are as clear and practical as possible, especially in relation to liabilities.

3.3.1 Trade Capture

Hedge Fund managers should record detailed information on all trades executed on its own systems as well as ensuring they are sent to the Hedge Fund's prime broker or settlement agent and administrator promptly. Once an order has been placed and the trade has been executed, the Hedge Fund manager should record all the details of the trade on its own systems. With electronic trading systems, this can be done through an order management system that interfaces directly with the manager's own portfolio management system. Alternatively, a system generated or manual dealing ticket can be entered directly into a portfolio management system.

Details which should be recorded include:

i. the security traded;
ii. the identifier (e.g. SEDOL);
iii. the counterparty with whom the trade was executed;
iv. the time of the instructions for the trade;
v. the time of the trade;
vi. the type of trade, i.e. buy, sell, short, cover;
vii. the form of the transaction such as ordinary, CFD, swap, forward etc;
viii. the quantity of units traded;
ix. the price;
x. the trade and settlement date;
xi. the commission rates and any other charges such as stamp duties;
xii. details of how the trade will be allocated; and
xiii. sufficient information to provide a clear audit trail for the transaction.

If the trade is to be allocated over different accounts, the method to be used should be recorded and be consistent with the Hedge Fund manager's stated policy.

Trades that relate to currency hedging for non base currency share classes should be clearly marked by the Hedge Fund manager so that the administrator can account for them in the correct manner.

Details of the trade should be passed to the relevant prime broker and to the administrator. In most cases this will be done electronically, thereby reducing the risk of error in re-keying any information and increasing operational efficiency. This should include, where appropriate, how the trade is allocated to different accounts.

The Hedge Fund manager should maintain records so that all trades and trade details can be accounted for. The records should be sufficiently detailed and be kept for the appropriate period as required by the local regulator and, in any event, at least until after the relevant Hedge Fund's audit has been completed.

3.3.2 Trade Matching

All trades should be confirmed with the counterparty. It is sound practice to confirm the trade details with the counterparty on trade date as a standard control. This provides more time to deal with any problems, such as failed settlement and the resulting incorrect risk measurement of the portfolio.

The Hedge Fund manager should have appropriate procedures in place to monitor trade confirmation information to ensure that all trades are promptly confirmed and matched with counterparties. A daily record showing details of unmatched trades should be produced. The Hedge Fund manager should have clear procedures in place to address unmatched trades, and should record how unmatched trades are being resolved on a daily basis.

The actual process of counterparty confirmation and trade matching can be undertaken by the Hedge Fund manager, or may be outsourced to a middle office service provider. Where this is the case, the Hedge Fund manager should have in place the appropriate oversight and monitoring procedures to ensure that all trades are being promptly matched. These should include receiving daily records of any unmatched trades and actions required, including amending the portfolio information where necessary.

For many Hedge Funds, trades will often involve OTC contracts. It is likely that additional documentation will be required before the trade is entered into. In the case of legal documentation (e.g. trading agreements such as the International Swaps and Derivatives Association's Master Agreement, an 'ISDA'), the Hedge Fund manager should ensure that there is sufficient expertise (e.g. external lawyers, accountants) available to be able to advise on the legal and commercial ramifications prior to entering into the documentation. It is important that the key features of the OTC contracts are clear and properly understood including those related to the provision of collateral and termination events. Similarly, Hedge Fund managers should ensure that counterparties and relevant service providers are fully informed when trades involve novation or assignment to a third party.

3.3.3 Trade Settlement

All trades should be settled in accordance with the agreed trade terms. Wherever possible, standard settlement instructions sent out by the Hedge Fund manager should be used to reduce the risk of incorrect details on any payment.

Settlement will be undertaken once a trade has been confirmed with counterparties and matched. The settlement agent (often the prime broker) will liaise directly with the counterparty or its custodian to make or receive payment. The settlement process will often be automated.

OTC trading will also involve the payment of collateral and margin to counterparties. Issues surrounding such payments are dealt with below.

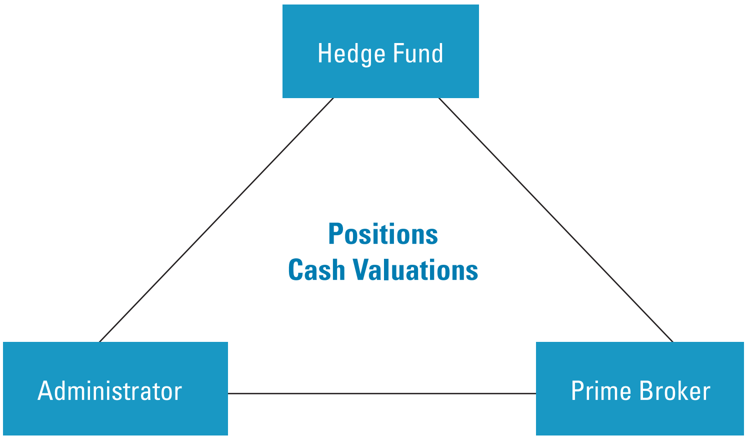
When a trade fails (i.e. is not matched when settlement is due), there should be procedures in place to ensure that the Hedge Fund manager is promptly informed by the custodian and/or executing broker and that records are updated to reflect the situation. Impact on the NAV should be immediately evaluated, and the directors of the Hedge Fund should consider what measures are appropriate in order to protect the existing investors (see also AIMA's Offshore Alternative Fund Directors' Guide).

3.3.4 Trade Errors

The Hedge Fund manager should have in place a policy and procedures to identify and address trade and other errors. An 'incident' report should be written up and reviewed by senior management of the Hedge Fund manager.

3.4 Reconciliation Procedures

The reconciliation of stock and trading cash positions is a critical component of the control framework. The Hedge Fund should have controls in place to cover broker account approval and opening, regular reconciliation of stock positions between the Hedge Fund manager, administrator, prime broker and other brokers, and clear escalation procedures to identify and resolve reconciliation differences promptly.



There should be an appropriate segregation of duties between the individual who undertakes the reconciliation and the individual who makes the trade.

3.4.1 Position Reconciliations

The Hedge Fund manager should ensure that the holdings used in trading portfolios are consistent with the underlying records held by the administrator, prime broker and (where relevant) the counterparty/custodian for OTC contracts.

The Hedge Fund manager should reconcile its own recorded stock positions against the records (including corporate actions) held by the administrator and the prime broker/custodian. This should be undertaken on a regular basis as determined by the trading activities of the Hedge Fund. Ideally, a reconciliation between the Hedge Fund and the prime broker should be undertaken daily for most Hedge Funds, but may be less often (weekly or sometimes monthly) by the administrator. The flow of information between the parties should preferably be automated. Reconciliation reports should clearly show the ageing of all differences between the records held by different parties.

When designing the information flow to the administrator, the Hedge Fund manager should ensure that detailed transaction information is available in order to enable timely investigation and resolution of position differences ("breaks").

There should be clear escalation procedures between the Hedge Fund manager and service provider to identify and resolve differences in a timely manner, with recommended actions depending upon both the materiality and age of the differences. Valuations should not be issued to investors until all material differences are resolved.

The reconciliations should include OTC contracts. These may be undertaken directly between the Hedge Fund manager and the counterparty, or through the prime broker / custodian. The reporting, escalation and resolution procedures should be consistent with trades on a recognised exchange or other liquid market.

3.4.2 Trading Cash Reconciliations

Cash (including collateral accounts) held by prime brokers and counterparties should be reconciled using the same standard procedures as position reconciliations. It is sound practice to do this on a daily basis.

3.5 Portfolio Valuations

3.5.1 Pricing Policy

There should be clear policies and procedures in place for valuing the underlying positions within the Hedge Fund and for calculating the Fund's Net Asset Value (NAV). The directors of the Hedge Fund have ultimate responsibility for the valuation but generally delegate the activity to a combination of the Hedge Fund manager and the administrator.

The AIMA "Guide to Sound Practices for Hedge Fund Valuations" (March 2007) is available to give detailed guidance in this area including 15 overall recommendations set out below:

"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 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 productions 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

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-pockets policies are clearly communicated to all investors. The criteria for side-pocketing should be consistent as possible."

3.5.2 Control of Management, Performance and Administration Fees and Other Accruals

The policy and methodology for the calculation of performance, management and administration fees should be documented in the offering document. The calculation procedures will typically be undertaken by the administrator on behalf of the Hedge Fund, who also will calculate and report on the Fund NAV. The Hedge Fund manager must ensure that the administrator has the capability to fulfil the calculation requirements for complex performance fee structures.

Investors expect the administrator to act as an independent check for the proper accrual of non transaction related expenses such as audit fees, directors' expenses, legal fees or any other significant costs.

The Hedge Fund manager should have procedures and systems (independent of the administrator) in place to check all fee calculations and to enable the Hedge Fund manager to include realistic fee accruals into any intra-month net asset value reporting to investors. As these will impact the Hedge Fund price, the directors, trustee or general partner of the Hedge Fund will be responsible for ensuring that there are sufficient controls in place to independently verify such calculations.

The Hedge Fund manager should also keep under review any other accrued income or costs, such as dividends payable, interest receivable or interest payable and be involved in the review and monitoring of non transaction related expenses such as audit fees, directors' expenses or any other significant costs although ultimately these expenses are for the approval of the directors.

3.5.3 Monitoring Investment Restrictions

Investment restrictions are intended to provide limits on a Hedge Fund manager's investment activity and, as such, to provide investors with an assurance as to the level of risk inherent in the manager's investment strategy. Hedge Fund managers must continually monitor the adherence to those restrictions.

Investment restrictions should be clearly stated in a Fund's offering document. References to investment restrictions in other marketing material generated must be consistent with the prospectus.

The restrictions should be sensible and realistic with respect to the relevant investment strategy and should comply with any regulatory or listing requirements. Hedge Fund managers may set tighter restrictions in-house in order to have an early warning as to when the external restrictions are being approached.

The restrictions should be regularly monitored by the Hedge Fund manager. These are easier to monitor when the firm has automated procedures and restrictions can be built into its systems.

The restrictions should be monitored on a timely basis to ensure that they are not breached at trade entry but, if this happens, the issues should be identified and resolved promptly.

Clear procedures should be documented to resolve any investment restriction breaches should they occur, including communication lines as appropriate.

3.6 Reporting

Hedge Fund managers should provide adequate disclosure of information to investors on a consistent, regular and timely basis. Typical of the reports which the Hedge Fund manager will provide to investors are:

i. annual accounts;
ii. monthly or quarterly statements; and
iii. monthly or quarterly newsletters.

Performance estimates may also be provided (with suitable warnings).

The following suggests the key objectives that disclosure to investors should aim to achieve:

i. information provided to investors should be prepared on a consistent basis and be presented in a clear manner. Where significant assumptions have been used in preparing the information, these should be clearly explained and consistently applied;
ii. as far as possible, Hedge Fund managers should advise investors before they invest of the form, content and timing of regular information that will be communicated to them;
iii. the Hedge Fund manager should aim to complete this communication promptly after the net asset value is finalised each month/quarter;
iv. a summary of portfolio information should be provided to investors on a periodic basis and should allow investors to determine, in summary form, how the assets of the Hedge Fund are invested. As a principle, the same level of information should be available to all investors;
v. investment performance information (and other risk analytics as appropriate) should be made available to investors to allow investors to understand how a Hedge Fund has performed. The Hedge Fund manager will be crucial to preparing this information, although the administrator may help facilitate the provision of such information to the investors in the Fund; and

vi. prompt disclosures of unusual and/or non standard matters should be made to investors. These may include significant changes in how a Hedge Fund is managed, side letter arrangements, changes to key investment personnel and any major changes in the infrastructure of the Hedge Fund manager and/or service providers to the Fund.

3.7 Non-Trading Transactions

The controls relating to non-trading transactions and management of the Hedge Fund's non-trading bank accounts are important aspects of the management of the Hedge Fund.

The basic principles of the controls required for these transactions are consistent with those associated with trade processing. However, the detailed controls will be different as they need to cover subscription receipts, redemption payments, transfers, expenses payments and other items to third parties. The key areas of control are account opening, transaction authorisation, account reconciliation and investor transactions.

3.7.1 Bank Account Opening

The directors of the Fund itself should approve the opening of a new bank account for the Hedge Fund. The approval should be formally documented (e.g. in board minutes). If the directors have delegated authority to the Hedge Fund manager, the manager should formally notify the directors of the Hedge Fund of any new accounts.

The bank account opening documentation should include an authorised signatory list and appropriate limits on those authorisations and on the types of payment that may be made from the bank account (the mandate).

The administrator will be responsible for issuing payment instructions and, as such, will be an authorised signatory and should provide up to date signatory lists. Significant third party payments should require signatories independent of the Hedge Fund manager.

3.7.2 Non-Trading Transaction Authorisation

All transactions should be authorised in accordance with the bank mandate.

The administrator should retain details of all Fund payments as a key record of bank transactions.

Wherever possible, standard settlement instructions should be used to reduce the risk of incorrect details on any payment.

At each month end, the prime broker will post income and expense items to the prime brokerage account. These items will cover, amongst others, interest receivable and payable, stock loan fees and the financing cost of synthetic positions held. The Hedge Fund manager should have adequate systems to check the accuracy of these postings.

3.7.3 Bank Account Reconciliation

The Hedge Fund's administrator and the Hedge Fund manager should reconcile details of the Hedge Fund's bank accounts on a regular, perhaps daily, basis.

All reconciling items should be recorded and aged. Clear procedures should exist to resolve reconciliation differences, including escalation procedures for long outstanding and/or difficult items.

Valuations should not be issued unless all bank accounts have been satisfactorily reconciled.

3.7.4 Investor transactions

The administrator will typically operate a bank account in the name of the Hedge Fund, which is used for the receipt of subscriptions and payment of redemptions. Where applicable, money may instead be paid into or withdrawn from a segregated client account at the administrator prior to any transfer to or from the prime broker.

The Hedge Fund manager should obtain records of net subscriptions and redemptions provided by the administrator. This will enable the Hedge Fund manager to monitor and manage the Fund's cash flow requirements.

The Hedge Fund manager should also familiarise itself with the extent, if any, to which it may rely upon the administrator's anti-money laundering procedures, and ensure that, between itself, the administrator and any other service providers, there are adequate procedures in place to complete client identification checks.

3.8 Managing Service Providers

Service providers' roles, responsibilities and liabilities should be clearly documented and their performance should be periodically reviewed and documented by the Hedge Fund manager on behalf of the directors of the Hedge Fund.

The directors of the Hedge Fund or the Hedge Fund manager on their behalf should have regular contact with the service providers to establish good relationships, monitor and review information flows, deal with issues as they arise and continue to look for ways that the service providers can add value.

There should be clear escalation procedures to cover the raising and resolving of serious failures in the delivery of service to the Hedge Fund by third party providers.

3.8.1 Prime Brokers

It is important that the Hedge Fund manager and the director of the Hedge Fund understand the role of the prime broker. Key aspects to understand include the cost, financing and securities lending structure, as well as all material provisions of the prime brokerage documentation such as margin calls, synthetic products trading, segregation of assets, events of default etc.

The prime broker's functions are likely to include:

i. clearing and settlement;
ii. custody;
iii. brokerage;
iv. margin financing (i.e. providing leverage);
v. reporting; and
vi. stock lending.

It is important for the Hedge Fund manager, when recommending a prime broker to a Fund, to consider not only the services which the prime broker will provide but also how it will deliver them. Most processes relating to the delivery of information to the Hedge Fund manager and administrator should be automated.

Generally, the following factors should be considered in evaluating a prime broker and its documentation:

i. interest rate and fee structure;
ii. the prime broker's familiarity with, and appropriate internal resources to service, the investment strategy;
iii. the ability of the prime broker to provide stock loans to cover short positions;
iv. the amount of leverage the prime broker is prepared to provide and the basis on which this is provided (e.g. the use of a risk-based system);
v. extent of segregation and ownership of assets;
vi. the exposure to the credit of the prime broker; and
vii. the value added services provided.

The relationship between the Fund and the prime broker should be set out in a Prime Brokerage Agreement signed by both parties. The Hedge Fund manager should ensure that there are regular meetings between the Hedge Fund manager and the prime broker to discuss the delivery of key outputs set out in the Prime Brokerage Agreement.

The Hedge Fund manager should expect to receive electronically, at a minimum, daily portfolio, margin and cash reporting. It should review this information on a daily basis and raise any errors or differences with the prime broker.

The Hedge Fund manager should seek confirmation from the prime broker that information furnished to its credit desk by the Hedge Fund manager will not be shared with any trading personnel without the Hedge Fund manager's consent.

Where the Hedge Fund has several prime brokers, the Hedge Fund manager should put in place operational and risk management processes to handle the additional complexity of dealing with multiple parties.

3.8.2 Administrators

In addition to the Hedge Fund manager, the administrator is often the investors' main contact.
The administrator's functions are likely to include:

i. co-ordinating opening bank accounts for the Fund;
ii. receiving and processing subscriptions and redemption requests;
iii. producing and reporting net asset value calculations;
iv. independent pricing and reconciliation of the portfolio;
v. calculating and paying management and performance fees;
vi. acting as company secretary;
vii. preparing annual and interim accounts;
viii. maintaining the shareholder register;
ix. arranging payment of dividends (if necessary) and redemption proceeds;
x. co-ordinating communications with investors;
xi. implementing anti-money laundering procedures; and
xii. dealing with the accounting complexities of the Fund's structure, e.g. side pockets.

The Hedge Fund manager should undertake a significant due diligence process when recommending an administrator. The type of questions that should be considered are set out in the AIMA illustrative questionnaire for due diligence of Hedge Fund administrators by managers.

The due diligence should at a minimum include details of the administrator, including:

i. ownership;
ii. client base;
iii. size;
iv. structure;
v. key management staff;
vi. turnover of staff;
vii. experience;
viii. expertise;
ix. processes; and
x. services offered.

The relationship between the Hedge Fund and the administrator should be set out in a signed contract, where appropriate supplemented by an SLA signed by both parties. There should be regular communication and occasional meetings between the Hedge Fund manager and the administrator to discuss the delivery of key outputs set out in the contract and/or SLA. These will include regular reconciliation of trades undertaken by the Fund with the records of the administrator and the prime broker, monitoring and reviewing the net asset value calculation and other services, such as anti-money laundering procedures, which may be performed by the administrator.

3.8.3 Executing Brokers

A Hedge Fund manager may trade with multiple executing brokers and use the prime broker as the settlement agent for the trades. It may also use multiple prime brokers. In such situations, whilst many of the issues already referred to are equally applicable, the importance of the capture of the trade data by the administrator, cash management and the reconciliation processes involving the Hedge Fund manager are heightened due to the increased number of parties involved.

The Hedge Fund manager should always know the executing broker and the prime broker handling each specific trade. It is also important that the appropriate 'give up' agreements are in place in order for cash movement between authorised brokers to take place.

The directors of the Hedge Fund itself may wish to approve the opening of executing broker accounts. In any event, the approval for opening and maintaining broker accounts should be formally documented. The directors may delegate the authority to open executing broker accounts to the Hedge Fund manager. In this situation, the directors should be regularly informed as to the full list of executing broker accounts opened.

3.8.4 Auditors

Most Hedge Funds are required to appoint auditors to audit the annual accounts of the Fund. Typically, the administrator is responsible for maintaining the accounting records of the Fund and the preparation of draft accounts for audit. The Fund's auditor will work closely with the administrator to complete the audit work;

where the administrator operates in a different jurisdiction from the Fund, the auditor will need to co-ordinate audit work performed in one office with audit sign-off in another office (where the law requires local sign-off in the jurisdiction of the Fund).

The relationship between the Hedge Fund and the auditor is set out in an audit engagement letter. In order to achieve an efficient and timely audit, it is important that there is a timetable with clearly defined responsibilities agreed by the administrator, the Hedge Fund manager, the prime broker and the auditor.

The directors of the Hedge Fund should monitor the relationship with the auditor and oversee the annual audit process. The directors should consider and agree with the auditor the annual audit plan and the extent of direct contact the directors require with the auditor. It should ensure that the auditor is a member of a recognised professional body and that the audit is carried out on a timely basis. There should be a clear process in place so that any issues resulting from the audit can be brought to the attention of the directors of the Fund.

The auditor may be engaged by the Hedge Fund to provide other services including tax advice and reporting. The terms of any additional services should be covered by a separate agreed engagement letter.

The Hedge Fund manager is likely to require its own auditor, which may or may not be the same firm as the auditor of the Fund; this is a matter of individual preference, as there are no rules or clearly established practices for this situation.

3.8.5 Professional Advisers

Professional advisers provide comfort to the directors of a Fund, the Hedge Fund manager, investors and regulators that the Fund is being operated in a proper manner.

Lawyers and/or accountants will be instructed in the set up process to advise on structuring the Hedge Fund, to produce the Fund documentation, review service provider agreements and advise on other issues. Increasingly, smaller firms are using specialist compliance consulting firms for advice. The Hedge Fund manager must ensure that the professional advisers appointed have the appropriate experience, knowledge and expertise to undertake their assigned tasks to the standard required by the directors of the Fund.

3.8.6 Other Support Functions

The Hedge Fund manager is likely to outsource certain other business operations such as payroll processing, risk analytics/performance, bookkeeping and IT support. In all cases the directors of the Hedge Fund should undertake sufficient due diligence to ensure that the suppliers have the required level of expertise and experience to carry out the roles to the required level. Where appropriate there should be a formal SLA with clear details of how performance against requirements is to be measured. There should be regular reviews of service against the SLA.

3.9 Information Systems and Business Continuity

3.9.1 Information Systems

There should be high standards of security and integrity over the computer systems that are used by the Hedge Fund manager. Such systems are likely to include:

i. order management systems;
ii. trade capture systems;
iii. portfolio management systems;
iv. risk management system;
v. research systems;
vi. accounting systems; and
vii. client information.

The systems used will vary between Hedge Fund managers depending on the size, investment strategy and volume of transactions being managed; the Hedge Fund manager should determine the most appropriate systems required to manage the business. Systems may be developed in house or the Hedge Fund manager may use external systems. In both cases, the Hedge Fund manager should ensure that systems are developed, implemented and maintained in a controlled manner. The existence of the different systems in use and their interaction between them should be clearly documented.

Inevitably, the operations of the Hedge Fund manager will be heavily dependent on the proper functioning of the systems and spreadsheets and on the integrity of the information produced by those systems. It is preferable for there to be automated links between the Hedge Fund manager, the prime broker and the administrator.

Where the Hedge Fund manager is to place critical reliance on the contents of a spreadsheet, the data should be adequately backed up and appropriate arrangements should be in place as to who may have access to them.

Systems infrastructure may be located in-house or outsourced to third party suppliers and, therefore, there will be differences in control procedures.

However, the key controls that should be addressed are:

i. core computer systems should be physically secure to prevent unauthorised access to the data processing area;
ii. the physical area where core computer systems are located should have adequate clean/redundant power, UPS protection, cooling and fire/water suppression systems to ensure best operating infrastructure;
iii. electronic access to the systems should be controlled and limited to authorised personnel. Access to different levels of the data processing systems should be protected by the use of readily and frequently changed passwords and other arrangements. These systems should be programmed to prevent and detect unauthorised access and any attempted breaches of security should be logged and appropriately followed up. IT security procedures should be regularly reviewed and updated;
iv. a two stage authorisation of input and release should exist on any payment system. Passwords on all systems should adhere to adequate standards in length, mixture of characters, frequency of change, last passwords used etc. A system access request procedure should be in place to document and record the request and processing of a user access change;

v. network file servers and computers should be protected by virus protection software and this virus protection software must always apply the latest version of the antivirus file to remain protected against constantly evolving threats. The internal network should be protected by a firewall and perimeter network to protect against unauthorised access from external networks, including the internet. The firewall should be regularly tested to ensure that it provides sufficient protection. There should be clear procedures in place when individuals are allowed to access the firm's systems remotely;

vi. the systems should provide a complete and accurate trail of transactions processed and appropriate procedures should exist for backup, archiving and safe storage retention and retrieval of computer records. This would include daily, weekly and monthly backups of the system and off site storage of backup tapes; and

vii. amendments to systems should be properly authorised, tested and documented. This will enable modifications to the systems to be implemented in a controlled manner. Often this process may be outsourced to a specialist firm and it is important that such a firm has the requisite skills to modify the systems.

3.9.2 Business Continuity

The Hedge Fund manager should develop a business continuity plan (BCP) to cater for a disaster. The AIMA Guide to Sound Practices for Business Continuity Management for Hedge Fund Managers (June 2006) provides detailed information on how this should be prepared and maintained, although the focus is on smaller managers (fewer than 50 employees). The high level process steps to follow are below:

At a high level, the Hedge Fund manager should ensure that the BCP is owned by a senior business manager (i.e. not just technology), that the plan has been written with input from all senior and key personnel across the business, and that the most critical business activities have been identified and appropriate actions identified to maintain operations.

The BCP, including a full systems test, should be tested, preferably without warning, at least once per year. In addition, the Hedge Fund manager should also understand and be satisfied that service providers have sufficient business continuity plans to support the Hedge Fund if there is an emergency.

Raising Capital and Investor Relations

4. Raising Capital and Investor Relations

4.1 Raising Capital

Raising adequate capital and attracting suitable investors is often one of the key determinants of the success of a Hedge Fund management business. When promoting their services and marketing the Hedge Funds whose investments they manage, Hedge Fund managers need to consider a variety of complex issues, including:

i. regulations on promotion and marketing;
ii. preparing marketing materials;
iii. targeting and attracting appropriate investors;
iv. addressing taxation issues for the targeted investors;
v. use of third party marketers;
vi. anti-money laundering regulations;
vii. special agreements with investors ("side letters"); and
viii. on-going investor communications.

These issues are discussed in more detail in this Chapter.

4.1.1 Regulations on Promotion and Marketing

Hedge Fund managers must be conscious of the regulatory restrictions that apply to promoting their services and marketing the Hedge Funds whose investments they manage. Hedge Fund managers will need to have regard to the regulations of the jurisdictions in which they operate as well as those in which target investors are located and possibly other jurisdictions as well, including the jurisdiction in which the Hedge Fund is established and/or any stock exchanges on which its shares are listed. Breach of these regulations can lead to severe consequences, including investor suits, fines, rescission rights and criminal sanctions, as well as reputational damage.

Limitations on types of investors and/or additional disclosure requirements may apply. These may include:

i. promotion by the Hedge Fund manager - a Hedge Fund manager may require authorisation by the regulatory authority in the jurisdiction(s) in which it is established and in which it operates. In some cases, the Hedge Fund manager may be able to "passport" in to another jurisdiction based on its regulatory authorisation in its home jurisdiction. The local regulations may restrict the manner in which the Hedge Fund manager may promote its services, including restrictions on the type of investors that may be contacted, the type of communications that may be made (including, for example, presentation of past performance or "track record") and legends that must appear in marketing materials. Use of publicly available media, such as the Internet, to promote the Hedge Fund manager's services/Hedge Funds may be subject to restriction and/or lead to restrictions in the use of otherwise available private placement exemptions;
ii. private and restricted offerings - in most jurisdictions, Hedge Funds may generally be offered on a private basis only. For example, the offering may be limited to a specified number of potential investors and/or to investors who meet certain threshold eligibility qualifications. The eligibility requirements may be based, among other things, on the target investor's net assets or income, their own regulatory or professional investor status or their investment being at or above a certain amount; and
iii. the complexity of applicable restrictions and the gravity of the consequences of their breach mean that it is essential that a Hedge Fund manager should consult a professional adviser familiar with applicable laws, regulations and market practice before undertaking any marketing. As these restrictions can

seriously impact fund raising and as the nature of the target investors may influence the structure and domicile of a Hedge Fund, this analysis should be undertaken early in the process of establishing a new Hedge Fund manager or Hedge Fund.

4.1.2 Preparing Marketing Materials

The Hedge Fund manager should take adequate time and care to prepare suitable marketing materials. This might include but is not limited to:

i. an investor presentation;
ii. a due diligence questionnaire. AIMA provides its members and institutional investors with a series of due diligence questionnaires, which are extensively used by the industry; and
iii. copies of the appropriate Fund offering documents.

An Investor presentation might include:

i. an overview of the Hedge Fund manager and its staff;
ii. a description of the investment process and the nature and style of investments made;
iii. an overview of how portfolios are constructed, what risks are taken and how these are managed;
iv. where appropriate, historical performance statistics. These should be prepared in a clear and consistent manner. Any methodology and assumptions used should be clearly stated;
v. terms of the Hedge Fund;
vi. key service providers; and
vii. appropriate regulatory notices and legal disclaimers.

Before being used, marketing materials should be approved by the Hedge Fund manager's compliance function having, where necessary, taken appropriate legal or regulatory advice. It is essential that all marketing materials are consistent with the Hedge Fund offering documents. Additional legal restrictions may apply to the distribution of marketing materials and it is important to keep track of those who have received such materials. Documents should include appropriate disclaimers.

4.1.3 Targeting and Attracting Investors

A balanced investor base may help to reduce shareholder turnover and volatility, thereby bringing benefits to all investors.

A Hedge Fund manager should prepare a marketing plan to help focus on the type and scale of investors that it will seek to attract. This plan can also act as a key input when assessing the viability of a new venture and allow the Hedge Fund manager to reach a more objective judgement on potential investor requests for different terms and conditions. In establishing a Hedge Fund, consideration should be given to the structural preferences that the target investors may have (see Chapter 5 – Hedge Fund Structure and Organisation).

There are various distribution channels available for a Hedge Fund manager to promote a Hedge Fund. Introductions by the prime broker may be part of the process of sourcing investment, and these may be utilised alongside other methods to source investors. If such a third party is used, the Hedge Fund manager should fully understand the scope of the services offered.

During the process of attracting investors, the Hedge Fund manager should seek to gain a good understanding of the potential investors and their businesses, including understanding their source of funds, investment process, appetite for risk, typical holding periods, reporting expectations and key senior personnel involved in the investment decision making process.

4.1.4 Use of Third Party Marketers

Some Hedge Fund managers may decide to use third party marketers to help them raise capital or retain investors. When engaging third party marketers, the Hedge Fund manager should consider a number of business issues, including the suitability of the marketers properly to represent the Hedge Fund manager or product being marketed and the standing and reputation of the marketers.

It is recommended that a legal agreement is drawn up when engaging third party marketers, which covers at a minimum:

i. the products to be marketed;
ii. the services to be provided and any appropriate service standards or benchmarks required;
iii. references to the appropriate legal and regulatory arrangements covering the activity and the clear assignment of responsibilities to ensure these are understood and can be met;
iv. the process and steps to approve and distribute marketing materials;
v. the financial arrangements agreed between the parties;
vi. the length of the agreement and termination provisions; and
vii. the governing law of the agreement.

Hedge Fund managers should periodically review the levels of service being provided by the third party marketers and take appropriate action where the expected service levels or objectives are not being achieved or require adjustment.

4.1.5 Anti-Money Laundering Regulations

It is important that all those involved in promoting/distributing a Hedge Fund understand their role in preventing money laundering.

The Hedge Fund manager should ensure that a senior individual is responsible for its anti-money laundering compliance and that all employees are kept up to date with developments in this area. The Hedge Fund manager should also ensure that appropriate procedures and controls are in place to ensure that the relevant rules and requirements are considered particularly when marketing to potential investors. The Hedge Fund manager and administrator have separate responsibilities in relation to money laundering although their duties may often overlap.

AIMA is preparing a matrix of anti-money laundering customer identification requirements in a number of the principal hedge fund jurisdictions. The matrix, which will be published later in 2007, will be available to AIMA members within the Regulation & Taxation Resource on the AIMA website (www.aima.org).

4.1.6 Special Agreements with Investors ("Side Letters")

Individual investors may seek to maximise disclosures and/or negotiate preferential terms for their investment and/or obtain comfort that a Hedge Fund is structured or run in such a way to protect an investor's regulatory or tax status. In such circumstances, the Hedge Fund and its manager should continue to attempt to treat all investors as equally as possible and continue to respect all legal and regulatory requirements. Agreeing to special terms may have significant legal consequences with long-term implications for both the Hedge Fund and the Hedge Fund manager. In addition, special terms agreed with early investors in a Hedge Fund can, as a business matter, hamper the Hedge Fund as it expands. Hedge Fund managers should also consider carefully any conflicts of interest they create by agreeing to special terms and any legal and regulatory requirements to disclose the existence and content of special agreements and side letters. Legal advice should be sought before agreeing to any such special conditions and side letters.

Hedge Fund managers should not themselves purport to bind the Hedge Fund where they have no legal authority to do so. Regulatory and/or taxation consequences may also arise from such behaviour.

Following discussions with the Financial Services Authority in the UK, AIMA has published an Industry Guidance Note ("the Note") and Supplement on the use and disclosure of side letters. Side letters which contain a "material term" should be disclosed to investors and potential investors by the Hedge Fund manager on a regular basis, for example through the manager's monthly newsletter (although the means of disclosure is a choice for the manager to make). A definition of "material term" is contained in the Note but, in essence, a material term is one which enhances an investor's ability to redeem (or make a determination as to whether or not to redeem) his shares or interest.

The provisions set out in the Note are specific to the regulatory situation in the UK, but have wider relevance as a general statement of sound practice for the disclosure of side letters. The Note may be found on the AIMA website (http://www.aima.org/uploads/IndustryGuidanceNoteSideLettersPublic.pdf).

Alternative arrangements may also be made for investors to invest through managed accounts. Again, the Hedge Fund manager should consider carefully both its ability to meet any special requirements and terms and the impact that any such arrangements may have on other clients and or investors.

4.2 On-going Investor Communications

A key to efficient investor communications is to maintain a current and accurate investor database linking investors with details of shareholdings and ensuring relevant contact details.

4.2.1 Information Provided to Investors

Hedge Fund managers should provide adequate disclosure of information to investors on a consistent and timely basis. The following suggests the key objectives that disclosure to investors should aim to achieve:

i. information provided to investors should be prepared on a consistent basis and be presented in a clear manner. Where significant assumptions have been used in preparing the information, these should be clearly explained and consistently applied;
ii. as far as possible Hedge Fund managers should advise investors before they invest of the form, content and timing of the regular information that will be communicated to them;
iii. sufficient information should be provided to investors on a periodic basis to allow them to determine, in summary form, how the Hedge Fund is invested;
iv. performance and risk information should be made available to investors to allow them to understand how a portfolio has performed. The Hedge Fund manager may be crucial to preparing this information. The administrator may help facilitate the provision of this information to investors in a Hedge Fund;

v. Hedge Fund managers should ensure they have adequate internal procedures in place to verify information and calculations included in information sent to investors, including verification of performance and NAV figures with internal systems and/or the administrator as appropriate. Appropriate records of such information should be kept;

vi. exceptional disclosures should be made to investors if there have been significant changes in how a portfolio is managed, changes to key investment personnel and any major changes in the infrastructure of the Hedge Fund manager and or service providers to the Hedge Fund; and

vii information provided to some investors should, ideally, be available on request to all investors. Investors should be notified of the possibility of obtaining this additional information.

4.2.2 Timely Disclosure of Information

Disclosure to investors should be made as soon as reasonably practicable, bearing in mind the need to protect all investors' interests and any applicable legal or regulatory constraints. Often, the Hedge Fund will be subject to regulatory requirements that mandate the production of accounts or other information, an independent audit, and their filing with relevant regulatory authorities within a certain time period. The Hedge Fund manager should be aware of these requirements and may wish to monitor compliance with them, though it has no legal obligation to do so.

i. regular communication to investors should take place and a Hedge Fund manager should aim to complete this communication promptly after the net asset value is finalised each month;

ii. the Hedge Fund manager or administrator should maintain an up to date investor contact database to facilitate the effective and timely distribution of important information; and

iii. if a Hedge Fund manager has important disclosures to make and wishes to do so by telephone or in person, the manager should aim to organise itself in such a way as to endeavour to complete all investor contact as soon and as simultaneously as practicable.

The Hedge Fund manager, as far as practical, should aim to disclose information about material items and changes to all investors who will be affected by such items and changes. Such disclosure should be made to all investors at the same time as far as possible.

The Hedge Fund manager should seek not to differentiate communications to investors, either in terms of the nature, content, manner or timing of disclosures, except as justified by the different relevance of the communication to the investors.

Investors should be able to direct questions to a small number of key personnel at the Hedge Fund manager and expect a timely response to questions irrespective of the size of their investment. A Hedge Fund manager should devote adequate resources to responding to investor queries (made either directly or through the administrator).

Hedge Fund Structure and Organisation

5. Hedge Fund Structure and Organisation

Whilst the foregoing chapters have focused largely on sound practices in connection with Hedge Fund managers, this chapter summarises various sound practices with respect to Hedge Funds.

Investment vehicles managed by European Hedge Fund managers can take the form of a number of structures, not all of which are technically classified as "funds". The type of structure the investment vehicle will take is dependent, amongst other things, on the jurisdiction within which the vehicle is formed and the local legislative treatment of the vehicle.

It should be noted that, because Hedge Funds take many different forms and structures and vary substantially with respect to type and complexity of investment strategy and instruments traded, some of the sound practices outlined in this chapter may include items more relevant to some Hedge Funds than to others.

A number of different considerations need to be taken into account in determining the most appropriate structure for a Hedge Fund. Foremost among these will be the needs and preferences of the anticipated core investors. It cannot be overstated how important it is to identify at the structuring stage who the targeted investors will be in terms of their domicile, taxable status, base currency, and appetite for potentially complex fund structures. It will also be necessary to ensure that the structure deals with any adverse tax issues which might arise from the proposed investment strategy as well as balancing any particular tax planning that the Hedge Fund manager may desire to put in place for its own benefit. Careful analysis in the initial structuring of a Hedge Fund can help avoid adverse consequences, delay and additional expense at a later stage.

5.1 Structure of the Hedge Fund

The structure of a proposed Hedge Fund should be considered in consultation with professional advisers and adapted to the distribution objectives, i.e. targeted investors and their geographical location.

Investors are likely to have certain expectations and preferences before they invest in a Hedge Fund, including:

i. that the Hedge Fund is established in a jurisdiction that is familiar and acceptable to them and is tax beneficial or neutral;
ii. that the Hedge Fund is established in a particular form (e.g., company, limited partnership, unit trust or civil law equivalents). There may be jurisdictional issues to consider;
iii. that advice has been sought from a professional adviser on the structure's tax consequences for the Hedge Fund and the investors;
iv. the extent and frequency of reporting (financials and/or investor updates from the Hedge Fund manager);
v. the frequency of, and any limitations on, dealing (subscriptions, redemptions, minimum investment amount, lock up periods and gates);
vi. the level of management fees, performance fees and any initial charges or early redemption fees;
vii. the investment strategy, investment objective, anticipated leverage, risk profile and investment restrictions;
viii. whether or not the Hedge Fund is listed;
ix. whether or not the Hedge Fund has different currency share classes; and
x. the quality of the Hedge Fund's service providers (administrator, lawyers, auditors etc).

In structuring a Hedge Fund, consideration should also be given to retaining enough flexibility to accommodate any contemplated expansion in the type of investors being targeted.

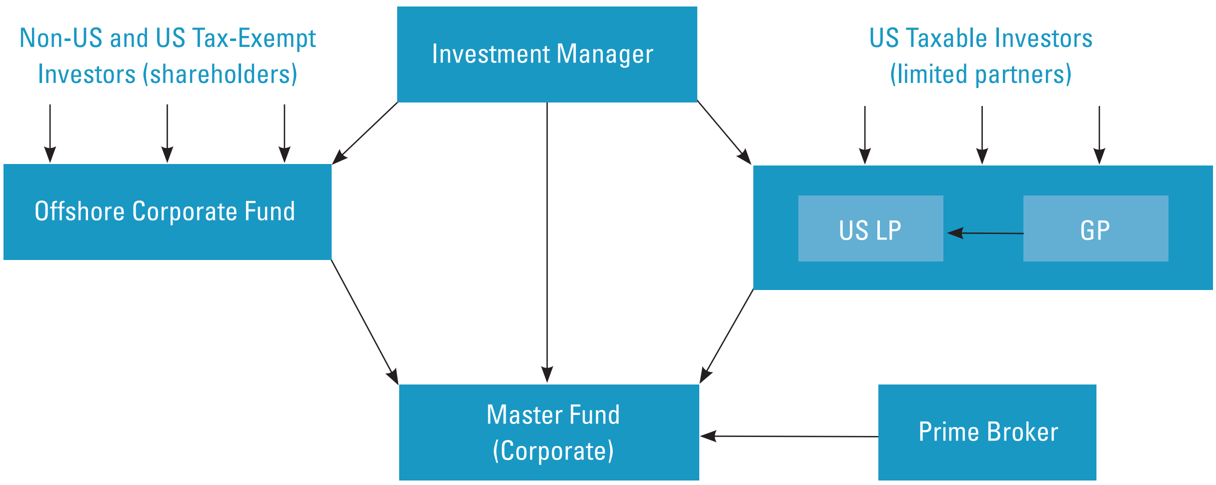
5.1.1 Legal Structure of a Hedge Fund

A Hedge Fund will almost always be a separate legal entity from the Hedge Fund manager. Hedge Funds may be structured in a variety of forms, including: limited companies, limited partnerships and unit trusts (or their equivalents in civil law jurisdictions).

Where different structures are required to accommodate different types of investors, then these can often be run in parallel. Each fund would be separate and have its own investment portfolio. Investments would then be allocated across the funds, (which might not always be possible or practical). The portfolios may require to be rebalanced as investors enter or exit individual funds. Accordingly, where it is desired to accommodate as many investors as possible but without giving rise to allocation and rebalancing issues, a "Master-Feeder" structure might be used.

In master-feeder structures, different investor entry points are available to meet different investor needs with, generally, all investment assets held in a "master fund", thus effectively pooling the assets. The portfolio is held and traded at the level of the master fund with the returns of the master fund being reflected in the net asset value of the feeder fund(s).

Master-feeder funds can take a variety of forms, but an example is illustrated below. In the illustrated example, there is a corporate feeder for non-US and US tax-exempt investors and a limited partnership feeder for US taxable investors (including funds of funds of US taxable investors). Both of these funds feed into the master fund which is typically a structure designed to be tax transparent from a US perspective. Where a corporate fund is used, this can be achieved by "checking the box" so as to elect to be treated as a partnership (and, thus, tax transparent) for U.S tax purposes (though this may not be possible in all situations). Feeder funds can be added or removed at any time and this makes the structure very flexible.



Investors may wish to use a Managed Account ("MAC") to invest in a Hedge Fund manager's strategy instead of investing in the Hedge Fund whose investments it manages. In practice, however, this will be at the Hedge Fund manager's discretion and is likely to be restricted to investors investing significant assets with the manager. A MAC is an investment vehicle that will be set up to mirror closely the trading activity of a Hedge Fund. A MAC will normally be structured by the investor and his lawyers and usually takes the form of a corporate entity. The aim of a MAC is to provide the investor with exposure to the manager's strategy without investing directly in the Hedge Fund.

The advantages of a MAC for an investor include:

i. the investor sets the gearing of the MAC (which may differ from that of the main fund);
ii. the investor gains enhanced transparency on the portfolio;
iii. the investor sets liquidity and tailored investment guidelines; and
iv. different commercial and legal terms in relation to strategies the manager is trading in its Hedge Funds.

A MAC also gives the investor control over service provider selection which is a key risk management tool.

A MAC will generally be traded pari passu to the Hedge Fund although the investor may, for a variety of reasons, request the manager to exclude specific types of trades or designated counterparties from the MAC e.g. by imposing an ethical investing requirement.

5.1.2 Hedge Fund domicile

Hedge Funds may be established in any jurisdiction that has suitable legal provision for the formation of the proposed investment vehicle and its business. The domicile ultimately selected for the Hedge Fund should be determined by weighing several factors.

It should be noted that these factors are not independent of each other – the domicile will be determined by the factors that combine to produce the most beneficial result, and may include:

i. the level of regulation (including investor protection) and taxation imposed, the time required to gain local regulatory approval and the flexibility of local regulation to the ongoing business operations of the Hedge Fund, including adequately robust local anti-money laundering provisions;
ii. formation costs and ongoing expenses (e.g., annual registration costs);
iii. service provider requirements and the availability and quality of local service providers (e.g. auditor, administrator, domiciliary agent, prime broker) where 'local content' rules prevail, such as the requirement to have a separate custodian and prime broker;
iv. jurisdiction of targeted investors and their familiarity with and preferences concerning the Hedge Fund's domicile;
v. any difficulties arising from the remoteness of the proposed jurisdiction (e.g. time zone differences), particularly where local service providers are required; and
vi. the potential for funds domiciled in certain jurisdictions to be registered in other jurisdictions.

Jurisdictions vary as to the extent of their receptivity to Hedge Fund structures, although differences vary dynamically over time as jurisdictions compete with each other for Hedge Fund business. In addition, the location of the Hedge Fund manager may have an impact on any regulation applicable to the Hedge Fund. Appropriate experts should be consulted with a view to determining the Hedge Fund's domicile.

5.1.3 Taxation Considerations

A Hedge Fund should be structured and maintained so as to preserve or improve upon its tax neutrality. Different structures may have different advantages for different investors. There are too many possible permutations to provide anything other than general guidance in this document. Expert legal and tax advice should be taken at the outset to ensure that neither the activities of a Hedge Fund nor its structure of relationships (including its directors, service providers, and its Hedge Fund manager) prejudice its tax status. For example, for a UK-based Hedge Fund manager, this would include ensuring that the manager should satisfy the requirements of the Investment Manager Exemption.

The tax issues that should be considered in establishing and operating a Hedge Fund will depend on the jurisdictions in which the Fund operates and the jurisdictions in which the activities of the Hedge Fund's directors, service providers and its manager are undertaken. The following list of potential tax considerations for a Fund, the Hedge Fund manager and the investors is not exhaustive and is merely intended to provide a general idea of the issues that may need to be considered.

Consideration should be given to:

i. the types of tax efficient vehicles available in the preferred jurisdiction(s);
ii. the direct taxation rates that will apply to a Fund and to what income, profits or capital they will apply;
iii. the requirements for maintaining the tax residence of a Fund in the chosen jurisdiction;
iv. whether the chosen jurisdiction provides access to double tax treaties;
v. the rates of transaction taxes or other indirect taxes payable on a Fund's investment transactions;
vi. the withholding tax requirements on dividend or interest payments made by a Fund or on realisation of an interest in the Fund;
vii. any taxation requirements for the types of investors to which a Fund will be marketed e.g. whether a master/feeder structure would increase the marketability of a Fund; and
viii. the tax information requirements of the investors for tax reporting purposes.

The Hedge Fund manager should consider:

i. the direct tax rates applying to the manager and to what extent they may apply to income and/or profits;
ii. whether activities undertaken by the manager on behalf of a Fund could create a taxable presence outside the Fund's jurisdiction or residence;
iii. the personal tax requirements of the key individuals; and
iv. any net VAT costs of the manager.

Investors should consider:

i. he taxation rules applying to income arising from investments in a fund/feeder funds and the tax treatment on realisation of the investment, including whether the rules differ depending on the percentage of ownership held in a Fund;
ii. any anti-avoidance tax legislation applying to the investment in a Fund, such as tax rules applying to passive income, controlled foreign companies or other offshore fund provisions;
iii. any transfer taxes payable on the purchase and sale of investments in a Fund; and
iv. the tax information required from a Fund in order to meet tax reporting requirements.

A master-feeder structure is generally used to deal with specific taxation requirements of the investors.

There may be tax benefits for a master fund to make its investments through subsidiary entities. For example, this may provide access to double tax treaty benefits. The structuring of investments may be considered after the initial Hedge Fund structure is established.

5.1.4 Listing

A Hedge Fund should obtain professional advice to determine whether and, if so when, it should seek to list some, or all, of its shares on a recognised stock exchange. Whilst the purpose of listing would not generally be to create an active secondary market (liquidity is generally provided by a Hedge Fund itself through the redemption facility), it could serve several useful purposes, including:

i. opening a Hedge Fund to investors that are restricted from investing in unlisted securities; and/or
ii. opening a Hedge Fund to investors that require an additional level of comfort that the Hedge Fund is subject to more stringent regulations and requirements than it would otherwise be in its domicile.

However, advice should be obtained on the additional costs associated with the listing, continuing obligations and any additional investment restrictions. In particular, listing after launch may require the preparation of additional audited financial information.

5.1.5 Multiple Classes, Ring-Fencing and Other Structural Issues

If a Hedge Fund will be trading identifiably distinct strategies, in the form of a multi-strategy fund, consideration should be given to the establishment of separate sub-funds through which each strategy is traded. Certain jurisdictions permit the creation of sub-funds that are legally segregated, whereby the losses of one sub-fund should not affect the assets of another. If the nature of a Hedge Fund's trading makes such "contagion" a significant concern, e.g. highly leveraged versions of a share class, then consideration could also be given to forming subsidiary companies of the Hedge Fund through which trading would be done in order to "ring fence" the liabilities associated with such trading in the applicable subsidiary.

A Hedge Fund may offer different share classes, such as currency classes or classes reflecting different fees or liquidity. An umbrella fund may be used when different strategies/portfolios are to be offered or where a fund is a multi-manager fund. Rather than create a separate fund for each strategy/portfolio manager, strategies/portfolios may be offered under one "umbrella". An umbrella fund may be established using a single company that issues a different class of share for each portfolio to be managed under the umbrella. This structure may give rise to concerns about cross liability - where the liabilities of one sub-fund exceed its assets, the assets of the other sub-funds, which are part of the same legal entity, may be required to meet the liabilities of the failed sub-fund. In addition, losses occurring in one portfolio may exceed profits in other portfolios and, as a consequence, the ability of the fund to meet redemptions or distributions may be restricted. In some jurisdictions, it may be possible to limit this risk by using a segregated portfolio or protected cell company. Alternatively, trading subsidiaries may be used to "ring fence" the liabilities.

Where a Hedge Fund invests in illiquid or hard to value assets, these may be "side pocketed". Such assets will be reflected by a separate class of shares and only those who were investors at the time an asset was put into the side pocket will participate in gains or losses arising there from. Shares in a side pocket are not normally redeemable at the option of the holder but will be redeemed or exchanged upon realisation of the relevant asset(s). Performance fees are normally only paid on realisation. Careful consideration needs to be given to the likely investment portfolio and whether a side pocket may be attractive. It is necessary to understand issues arising in respect of side pockets in advance and professional advisers should be engaged where required.

5.1.6 Offering Documents and Material Contracts

The directors of a Hedge Fund should approve a final version of the prospectus, offering memorandum or other offering document and constitutional documents such as Memorandum and Articles of Association or Limited Partnership Agreement and all material contracts to be entered into by the Hedge Fund, in a formal meeting prior to the commencement of the offer of interests.

Material contracts would typically initially include:

i. Administration Agreement with the Hedge Fund's administrator and a Registrar Agreement where these functions have been separated;
ii. Prime Brokerage Agreement with the Hedge Fund's prime broker, and Custodian Agreement where the custodian is a separate entity;
iii. Limited Partnership Agreement (if applicable);
iv. Investment Management Agreement with the Hedge Fund manager; and
v. Control Agreement for Master-Feeder Funds (if applicable).

A Hedge Fund's offering document should provide disclosure to potential investors which is sufficient to allow them to make an informed investment decision, including material risks, potential conflicts of interest for both the Hedge Fund manager and service providers and directors, material aspects of the valuation methodology, liquidity, the investment objective, strategy and restrictions, service providers and directors. Marketing and reporting material should be in line with this information and the alignment regularly checked.

Supplemental disclosures should be made in respect of material changes in any of the above (which may require pre-approval) although some listing jurisdictions, in the absence of exceptional circumstances, will not permit material changes to the investment objective or strategy within three years.

The directors of the Hedge Fund should affirmatively take responsibility for the statements in the offering document. The directors should closely review the offering document and, as appropriate, consult with the Hedge Fund manager, administrator, prime broker, lawyers and auditors, and ensure that there isadequate disclosure.

5.1.7 Appropriate Professional Advice

In evaluating its organisational structure, the advice of lawyers and accountants with experience in the tax and financial services regulations relevant to Hedge Funds, the jurisdiction and rules applicable to the Hedge Fund manager and their investments should be sought.

5.1.8 Directors

Other than Hedge Funds organised as unit trusts/FCPs, Hedge Funds are controlled by directors either of the Hedge Fund itself, if organised as a company, or of the Hedge Fund's corporate general partner, if organised as a limited partnership. Directors should consist of natural persons rather than corporate entities. The directors should have relevant standing and experience to allow them to discharge their fiduciary and other duties. The directors should be prepared to act in the interest of the investors and to disclose any potential conflicts of interest that may prevent this. For a fuller description of the role and duties of directors of an offshore alternative fund, see AIMA's Offshore Alternative Fund Directors' Guide.

Hedge Funds organised as unit trusts are controlled by a trustee. Generally, the responsibilities outlined in this chapter for directors will fall on the trustee of such Hedge Funds.

i. Taxation consequences of Board Composition and Meetings

When selecting directors, consideration should be given and appropriate professional advice sought as to the taxation consequences to the Hedge Fund resulting from the residence and domicile of each of the directors and the location of directors' meetings.

ii. Substantive Board Meetings

Directors should meet at appropriate intervals in minuted board meetings in a location which does not itself give rise to tax or regulatory issues for the Hedge Fund.

Formal agendas and board reports should be prepared in advance and the Hedge Fund manager should report on the Hedge Fund's strategy, performance and compliance with its investment objective. The directors should also periodically be presented with reports on the performance of all of the Hedge Fund's counterparties and service providers. Audited financial statements should be approved on an annual basis.

5.2 Independent Service Providers

A Hedge Fund should appoint relevant reputable and experienced service providers. A Hedge Fund's service providers and their proposed contracts with the Hedge Fund should be reviewed and approved by the directors prior to commencement of the offer of interests and reviewed at appropriate periods. In addition, once these service providers have been appointed, the Hedge Fund should make appropriate and timely use of its service providers' resources and expertise.

In addition to the Hedge Fund manager, among the service providers and advisers that the Hedge Fund should consider appointing and monitoring, once appointed, are an administrator, (or registrar and valuation agent in instances where these functions have been separated), prime broker (where appropriate to its business), custodian (where separately required by the law of its domicile), listing sponsor (if there is a listing), auditor and lawyers.

Appropriate due diligence (which may include face-to-face meetings with, and office visits to, the service provider) including the taking up of references should be carried out, generally by the Hedge Fund manager or its professional advisers on the Hedge Fund's behalf, prior to starting the business relationship.

It is important at the beginning of each relationship with a service provider that the Hedge Fund's requirements are identified and formally documented in an appropriate legal agreement.

Once service providers have been retained, the directors should take reasonable steps to ensure that they formally monitor the performance of each service provider by the use of key performance indicators. This monitoring may be best achieved by delegating investigation of, and reports on, the service providers to the Hedge Fund manager who will be well placed to gauge the quality of the service delivery. The standard of performance should periodically be reported in writing to the Hedge Fund's directors. However, the role of the Hedge Fund manager should not be to supplant the overall control of the directors of the Hedge Fund and the Hedge Fund manager itself should be subject to performance review by the Fund's directors.

5.2.1 Hedge Fund Manager

The role of the Hedge Fund manager is to manage the assets of the Hedge Fund. The Hedge Fund's Investment Management Agreement (IMA) specifically sets out the investment restrictions and investment policies of the Hedge Fund (by cross-reference, if appropriate, to the Hedge Fund's offering document), as well as the fees to be paid to the Hedge Fund manager. Whilst the Hedge Fund manager may monitor the other service providers of the Hedge Fund under delegation from the Fund's directors, the Hedge Fund manager should act as a service provider to the Hedge Fund only. This may be particularly important from a tax perspective. It is important to maintain independence between the Hedge Fund and the Hedge Fund manager.

There should be clear written escalation procedures between the Hedge Fund manager and the directors of the Hedge Fund to identify and resolve differences in a timely manner, with recommended actions where appropriate, depending on the materiality of the difference.

The Hedge Fund manager may also act as the sales distributor of the Hedge Fund, in which case these responsibilities may either be captured under the IMA or covered in a separate Distribution Agreement.

The directors of the Hedge Fund should expect to review a written investment report from the Hedge Fund manager at least quarterly and should consider whether it wishes to have a mechanism whereby the Hedge Fund manager's appointment is periodically reviewed and confirmed. If the Hedge Fund manager also acts as the distributor for the Fund, then a periodic written sales and marketing report should be provided to the directors.

5.2.2 Hedge Fund Administrator

The administrator of the Hedge Fund usually has two primary inter-related roles - fund accounting and transfer agency - although sometimes these are sub-divided between separate specialist providers. The administrator may also provide corporate secretarial services to the Hedge Fund.

The Hedge Fund should select an administrator that has the experience and resources to provide satisfactory services to the Hedge Fund. Specifically, the administrator should have experience in accounting for the instruments and products traded by Hedge Funds with similar investment strategies.

Investors will expect to be able to establish contact with the Hedge Fund through the administrator. The directors should bear this investor relationship role in mind when appointing the Hedge Fund's administrator.

The administrator is likely (especially in a European context) to undertake anti-money laundering checks on behalf of the Hedge Fund – see also section 3.8.2.

The directors of the Hedge Fund should satisfy themselves that the administrator is capable of pricing the assets of the Fund independently and in accordance with a written asset pricing policy, the terms of which have previously been agreed between the directors and the administrator.

The directors of the Fund should expect to review a written administration report from the administrator at least quarterly (or at every board meeting) and should consider whether it wishes to have a mechanism whereby the administrator's appointment is periodically reviewed and confirmed.

5.2.3 Prime Broker(s) and Custodian(s)

The prime broker may perform several roles for the Hedge Fund depending on the latter's requirements. These contracted services may include: margin lending, financing, securities' lending, custody, clearing and settlement. It is increasingly common for larger or more complex Hedge Funds to have relationships with more than one prime broker.

The relationship between the Hedge Fund and its prime broker(s) is governed by the Prime Brokerage Agreement (PBA) which is typically a highly complex and technical document that should be reviewed by a lawyer familiar with these arrangements. The directors should ensure that they and the Hedge Fund manager fully understand and disclose to investors the prime brokerage arrangements and the protections/risks inherent in them.

An independent custodian may be required in some jurisdictions, in which case advice should be sought on the ability of the custodian to appoint the prime broker as a sub-custodian.

The directors of the Hedge Fund should expect to review periodically the charges paid to the prime broker and should ask the Hedge Fund manager to comment on the quality of the service being provided. It may also wish to consider whether to implement a procedure whereby the prime broker's appointment is periodically reviewed and confirmed.

In addition to acting as prime broker, the prime brokerage provider may also have normal brokerage and securities trading relationships with a Hedge Fund. These relationships will typically be managed by divisions within the prime brokerage firm that are separate and distinct from the prime brokerage divisions and may be governed by agreements which are separate from the prime brokerage agreement.

5.2.4 Auditors

The role of the auditor is to provide an independent opinion, generally annually, on the financial statements of the Hedge Fund in accordance with appropriate auditing standards.

The Hedge Fund should retain an appropriately qualified external auditor that has experience of Hedge Funds generally and is familiar with the specific types of trading and instruments contemplated by the Hedge Fund manager. The directors of the Hedge Fund should satisfy themselves that the auditors are sufficiently independent.

The duty of the auditor is, typically, to express an opinion on the financial statements as a whole. The precise form of such an opinion will vary by jurisdiction but will normally state that the financial statements present fairly the Hedge Fund's income, expenses, losses and gains (usually set out in an income statement) and the Fund's financial condition (including the Fund's net asset value). The financial statements will normally include accounting policies and footnotes which will form an integral part of such statements and fall within the ambit of the auditor's examination and opinion. In addition, the auditors may report to management on weaknesses in internal controls and suggestions for improvements which come to their attention as part of the audit.

The terms of the auditor's appointment are generally set out in an audit engagement letter. Recently, in response to claims for negligence in the wake of certain high-profile hedge fund failures or frauds, auditors have introduced liability caps into their engagement letters (particularly for Cayman Islands funds).

5.2.5 Lawyers

A Hedge Fund should appoint legal counsel with appropriate expertise in appropriate jurisdictions, including where the Hedge Fund is domiciled and where the Hedge Fund manager is located and operates.

Appendix

Appendix 1 – Working Group

Co-ordinator: Segun Aganga, Goldman Sachs International (Prime Brokerage)
Legal Review: Iain Cullen, Simmons & Simmons

Managers

1.	Adelphi Capital Limited (UK)	Nick Tyler
2.	ADI Alternative Investments SA	Alain Reinhold
3.	Centaurus Capital Limited	Paul Leary
4.	F&C Management Limited	Lisa Hall
5.	Financial Risk Management Limited	Paul Parkins-Godwin
6.	Kairos Investment Management Spa	Raymond Bugeja
7.	Lansdowne Partners Ltd	Yok Wah Tai
8.	Man Investments	Greg O'Connor
9.	Newsmith Asset Management LLP	Lucy Elwes
10.	Polygon Investment Management Limited	Phil Bland
11.	Schroders Plc	Andrew Baker
12.	The Children's Investment Fund Management (UK) LLP	Catherine O'Reilly

Accountants

15.	Ernst and Young LLP	Ratan Engineer
16.	KPMG LLP	Tom Brown
17.	KPMG LLP	Neil Connor
20.	PricewaterhouseCoopers	Graham Phillips

Administrators

21.	Citco Fund Services (Dublin) Limited	Kieran Conroy
22.	Fortis Prime Fund Solutions	Philip Craig

Compliance Consultants

23.	IMS Consulting Limited	Stephen Burke
24.	Regulatory Solutions Limited	Alan Leale-Green

Lawyers

25.	D. Harris & Co International	Daniel Harris
26.	Dechert LLP	Peter Astleford
27.	Schulte Roth & Zabel International LLP	Christopher Hilditch
28.	Simmons & Simmons	Iain Cullen

Prime Brokers

29.	Goldman Sachs International	William Douglas
30.	Goldman Sachs International	Graham Jung
31.	Morgan Stanley & Co International Limited	Sonia Bhasin
32.	Morgan Stanley & Co International Limited	Guy Clayton
33.	Morgan Stanley & Co International Limited	Jack Tracy

Investor

34.	Fauchier Partners LLP	Christopher Fawcett

Industry Association

35.	The Alternative Investment Management Association Limited (AIMA)	Florence Lombard
36.	The Alternative Investment Management Association Limited (AIMA)	Matthew Jones

Appendix 2 – Other AIMA Publications

AIMA's Guides to Sound Practices

- Hedge Fund Valuation (March 2007)
- Hedge Fund Managers
  - Asian Hedge Fund Managers (December 2004)
  - Canadian Hedge Fund Managers (March 2004)
- Hedge Fund Administrators (September 2004 – to be reviewed in 2007)
- Offshore Alternative Fund Directors' Guide (June 2005 – to be revewed in 2007)
- Business Continuity Management for Hedge Fund Managers (June 2006)

Industry Guidance

- Industry Guidance Note on Side Letters (September 2006, updated November 2006)

Independent Research

- 'A Guide to Fund of Hedge Funds Management and Investment', edited by CRMA (AIMA 2002)
- 'Market Neutral and Hedged Strategies', HFR, Inc. (AIMA, updated 2002)
- 'Benefits of Managed Futures', Schneeweis (AIMA, 2002)

AIMA Journal

- Published quarterly, the AIMA Journal contains purely non-commercial information and education written by industry practitioners – plus new member listings.

See the AIMA website (www.aima.org) for further details.