



AIMA APAC Webinar: When Hedge Meets Private Part Deux – Recent Developments, Trends and Best Practices in Side Pockets

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Speakers:

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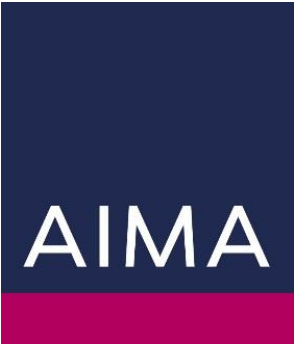
Howard Ching, Director, KPMG Singapore

Moderator: Kher Sheng Lee, Managing Director, Co-Head of APAC and Deputy Global Head of Government Affairs, AIMA

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Recap of Part I - Fundamentals

Recap of Part I – Fundamentals

Liquidity management tool to segregate illiquid / hard to value assets from the main liquid portfolio

Not subject to general redemption requests until realisation of the side-pocket portfolio

Created generally by means of creation of a new side-pocket share class or a separate vehicle

Fees and expenses are accounted for separately

Recap of Part I – Fundamentals (continued)

Benefits



Access to investment opportunities such as pre-IPO investments



Liquidity management



Equitable to investors and address the issue of valuation uncertainty and fees



Prevent the “loss spiral” when the investments are realised under the timing of crisis



Drawbacks

(To investors) Additional hurdles in redemptions



Side-pockets can be costly to setup



Potential abuse by investment managers

Recent Developments & Trends



Governance



Valuation



Disclosure



Fees and Costs



Exit Strategies

Contact

The AIMA logo consists of the letters "AIMA" in a dark blue, sans-serif font, positioned above a solid magenta horizontal bar.

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Additional Materials (Appendix)

- The fund governing body should weigh up the advantages and disadvantages of side-pockets in the context of the fund and may wish to consult the investment manager and valuation service provider.
- The Fund Governing body should require the investment manager to justify any side-pocket request and to aim for consistency as much as possible in its criteria of side-pocketing (factors to consider: materiality of the position, fair value measurements available, the likely time horizon to realisation of investment and nature of exit strategies)
- Care needs to be taken to ensure side-pocket is not being used to serve investment manager's interest or to disadvantage investors

Disclosure (PPM)

- Policies and procedures in relation to creation and operation of side-pockets
- Distinction to be made between side-pockets created due to crisis/specific need, or side-pockets created in the normal course of business as part of the Fund's overall strategy
- Opt in/opt outs, fee charging arrangements, threshold/cap of net assets allowed in side-pockets
- Detailed disclosure of policies relating to side-pockets (which should be linked to how investors' continued holding of side-pocketed assets, both from a liquidity and fees perspective, is treated) and/or run-off classes, if either or both are allowed as per the terms of the offering document

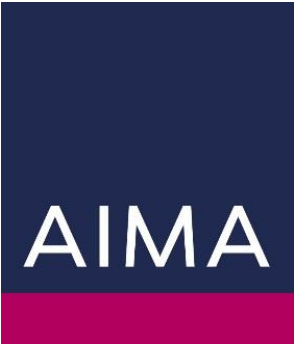
Disclosure (continued)



- Clear reporting to investors of the assets which have been side-pocketed and how they have been valued
- Compensation that is properly matched to the risks and potential conflicts attributable to holding investments in a side-pocket

- Fair value measurement under IFRS/ USGAAP (Principle: comparability of return among funds and consistency)
- Frequency: correspond to the timing of financial reports to investors (at least annual, generally quarterly)
- Significant changes in FV of investments needs to be communicated on a timely basis
- The fund governing body remains primarily responsible in all pricing decisions but may delegate the valuation activity to an independent valuation expert
- Valuation experts: have all supports in valuation inputs and models
- The governing body needs to be satisfied about the competence and experience of the valuation expert
- Other parties involved in valuation may include investment manager, directors of the IM or valuation committee, prime brokers

Valuation policy document



A valuation policy document should include the followings if applicable:

- Guidance on how frequent the side-pocket position be formally valued (by an independent expert or otherwise), framed in the context of frequency of NAV calculations
- The process around side-pocketing and the movement of investment into or out of the side pocket.
- Impact on the valuation basis to be applied and the assignment of a level in the fair value hierarchy (generally level 3) of the side-pocketed assets
- Considerations in relation to the use of independent valuation experts

- Disclosure in respective sections in the financial statements: (fees and expenses, share capital, fair value of investments)
- Fees and expenses: how fees are calculated and accounted for for side pocket shares
- Share capital: terms of the side-pocket shares created, and respective conversion/realisation process
- Fair value of investments: fair value hierarchy, valuation process of the side-pocket investments, significant management judgments involved in fair valuation, unobservable inputs involved in fair valuation

Reference materials

AIMA

AIMA Guide to Sound Practices for the Valuation of Investments

Download [here](#)

