Risk management for alternative investment funds
Deloitte: Your partner of choice
Converging regulatory and market trends call for enhanced risk management

Following the 2008 financial crisis, regulators across the globe have increased their focus on the alternative investment fund industry, an industry which until recently was less regulated.

This has triggered the introduction of measures such as the Alternative Investment Fund Managers Directive (AIFMD) and other strong requirements pertaining to governance and risk management.

In particular, risk management is one of the two core functions of investment management under AIFMD, with the Directive stringently regulating risk governance in Alternative Investment Fund Managers (AIFM) and how risk management processes are designed and operated.

Further, the increased demand from regulators for additional reporting and greater transparency in disclosing the risk profile of Alternative Investment Funds (AIF) calls for enhanced ability to provide meaningful and useful risk reporting in an automated way and at a reasonable cost.

At the same time, alternative asset classes such as private equity, real estate, infrastructure funds or hedge funds have become popular for institutional investors seeking higher yield in an environment of persisting low or negative interest rates. In that context, risk management considerations are of crucial importance and play an important role during due diligence processes.

All stakeholders across the value chain, thus, have to adapt to this new environment and either dedicate internal resources or seek an external provider to assist with their risk management needs.

Past philosophies and processes might no longer comply with current requirements. In this context, the way professionals look at these issues has to be rethought.

Deloitte Luxembourg is your partner of choice for risk management activities across all asset classes
2002-2007: Boom in alternative investments
Low interest rate environment coupled with investors looking for higher yields while taking on more risk led to the largest leveraged buy-out transactions in history… countered by loose credit standards, covenant light transactions, “pay in kind” instruments, and increasing leverage.

2007-2008: Credit crunch
Shut down of high yield markets and access to financing for alternative investments led to losses because of plummeting values of investments affecting funds, originating banks and the final investors. This revealed issues in alternative investment fund risk management, weaknesses in due diligence procedures and a general lack of transparency in the industry.
In particular, incorrect pricing of risk was among the most important lessons learned and was especially prominent within the alternative investment industry given the historical lack of focus on risk management activities.

2008 onwards: New opportunities for the industry
From 2008 onwards, tightening regulation of alternative investment sector addresses risk management issues… and creates additional opportunities for the industry.

Addressing risk management issues:
- Improved due diligence procedures
- Independent risk management function to ensure that all risks are accounted for and priced correctly
- Closer board scrutiny of risk management activities
- Better reporting and transparency

Leading to opportunities:
- Attractiveness of alternative asset classes in a long lasting low interest rate environment
- Enhanced investor confidence in investing in alternative assets as a result of better disclosure and risk management

RISK MANAGEMENT IS EVERYONE’S BUSINESS IN TODAY’S ENVIRONMENT

DIRECTORS
Your requirements
- Responsible for proper risk management systems
- Ensure oversight of the risk function
- Ensure existence and respect of escalation measures
- Ensure safeguards against conflict of interests
- Set up an independent risk management function

SENIOR MANAGEMENT
Your requirements
- Design risk management frameworks and systems
- Define the risk profiles of all AIFs
- Develop a risk and liquidity management policy
- Implement a systematic due diligence processes for delegated tasks (e.g., valuation) and investments

PERMANENT RISK FUNCTION
Your requirements
- Implement and maintain risk management policy
- Monitor compliance with risk profiles and associated limits (internal and regulatory)
- Conduct risk analysis and stress tests programs
- Report to governing body about risk profile
- Periodic review of the valuation process

OUR SERVICE OFFERING TO HELP YOU IN FULFILLING YOUR DUTIES
- Design or review of your risk governance arrangements
- Risk management framework documentation (incl. related policies and procedures)
- Design and implementation of internal processes to accurately capture, manage and quantify risks specific to the AIFM, including non-financial risks (operational, strategic, etc.)
- Outsourcing risk assessment (third party outsourcing arrangements and internal control procedures)
- Continuous learning facilities and risk dash-boarding capabilities for governing bodies
- Provide independent assurance on efficiency of the control environment (through internal audit services or control assurance reports)
NEED FOR SOUND RISK MANAGEMENT EXISTS AT VARIOUS LEVELS IN THE INVESTMENT STRUCTURE

FUND
Your requirements

• Define risk indicators
• Set-up quantitative and qualitative risk limits (concentration, leverage, etc.)
• Manage and oversee liquidity
• Disclose risk information in financial reports
• Report to regulators

STRUCTURING
Your requirements

• Manage and oversee liquidity
• Assess and monitor credit risk
• Identify and mitigate risks relating to jurisdiction, taxes, regulatory or legal matters

UNDERLYING ASSETS
Your requirements

• Conduct stress tests at investment level, i.e. the impact on valuation of adverse changes in parameters
• Risk model validation
• Back test the assumptions of the model
• Assumptions back tests

OUR SERVICE OFFERING TO HELP YOU IN FULFILLING YOUR DUTIES

• Independent risk model validation
• Quantitative risk analysis for investment funds (market risk, value at risk (VaR), leverage, liquidity risk, credit risk, default risk, counterparty risk, back tests and stress-tests reports)
• Outsourced regulatory reporting solutions
• Independent review of valuations
• Stress tests report

Deloitte provides tailor-made solutions to stakeholders across the value chain
Added value throughout the entire cycle

**01  FUND SET-UP**
- Define fund strategy and main features
- Organize key processes

**02  OPPORTUNITIES SCREENING**
- Selection of best investment opportunities

**AIFM’s goals**

**KEY TASKS OF THE RISK MANAGER**

**Deloitte support**

- AIFMD gap analysis
- Organization of risk governance and reporting lines
- Writing/review of risk management policies and procedures
- Fund risk profiling assistance
- Risk system selection support

- Review of asset eligibility against investment criteria and compliance with risk profile
- Due diligence support

**VALUE ADDED THROUGHOUT THE**
03 ACQUISITION

Ensure fair pricing of the investment and accounting of all risks

Go/no-go advice
Asset risk profiling
Mitigating structuring risks

- Underlying assets risk profiling assistance
- Identification of quantitative and qualitative risk factors
- Review of structuring risk (legal/tax financing)

04 ONGOING MANAGEMENT

Monitor and maximize investment value in accordance with the risk profiles
Escalate and report risk issues to all the relevant stakeholders

Risk monitoring
Liquidity management
Stress tests
Reporting

- Development of risk measurement techniques
- Outsourcing of risk factors calculation
- Outsourcing of risk dashboard for management
- Outsourcing of risk reporting for investors and regulators
- Design of liquidity, funding and cash flows monitoring
- Design of stress tests

05 EXIT

Maximize investment value and process efficiency upon disposal

Risk monitoring
Liquidity management
Back tests

- Liquidity management and appropriate exit risk mitigating techniques
- Review of exit scenarios
- Design of back tests program

ENTIRE INVESTMENT LIFECYCLE
A wide coverage across asset classes

We cover a wide range of asset classes and our goal is to become your preferred risk management support service provider, irrespective of the alternative asset class under consideration.

**All types of strategies:**
- Private equity across business stages
- Real estate including all type of properties and infrastructure projects across the globe
- Hedge funds with the most complex investments
- Fund of funds

**All types of vehicles:**
- Regulated and unregulated structures
- SIF, SICAR, Part 2 funds
- Holdings and SPVs
- Securitisation vehicles, etc.

**Geographies**
- Access to valuation professionals across the globe through the Deloitte network

**Industries**
- Financial services
- Retail, wholesale & distribution
- Tourism hospitality & leisure
- Insurance
- Public sector
- Media
- Global energy & resources

**Strategies**
- Aerospace & defence
- Automotive industry
- Telecommunications
- Consumer products
- Real Estate
- Manufacturing
- Global shipping & ports
- Infrastructure

**Instruments**
- Equity investments
- Debt and hybrid instruments
- Complex derivatives, exotic options, rights
- Structured products
- Asset backed securities, etc.
Deloitte offers a broad range of services that help you to comply with risk management requirements for alternative investments and also to exploit the opportunities they create.
Deloitte member firms work with organizations to develop sustainable governance, compliance, and risk management programs by helping them identify, remediate, monitor, exploit, and manage enterprise risks. Deloitte’s “Governance, Regulatory & Risk (GR&R)” also assists in the implementation of technology solutions that enable organizations to meet compliance requirements and to identify new and emerging risks and opportunities.

Additionally, GR&R supports the coordination and utilization of people, processes, and technology to improve effectiveness and help manage costs.

We work with organizations to implement risk appetite frameworks, optimise monitoring capabilities and establish risk related governance structures across the enterprise. Within the context of new and emerging regulations, Deloitte professionals can assist in developing a strategic approach to managing risk that simultaneously addresses management expectations and provides solutions for both risk management and regulatory compliance.

Our risk management experts come from different backgrounds and offer a well-balanced mix of former private equity, real estate or hedge funds professionals and consultants. They are highly qualified and hold globally recognized certifications as FRM, CFA or ERP.

Deloitte member firms have over 17,000 enterprise risk professionals of which more than 120 are located in Luxembourg, helping clients from around the globe protect and create value.

Our professionals are always abreast of changes in regulatory, tax and accounting requirements using Deloitte’s global accounting, advisory and tax practices.
Deloitte is regularly recognized by industry analysts as a market leader in the Alternative Investment consulting industry thanks to the depth and breadth of its capabilities.
Contacts

Governance, Risk & Compliance

Laurent Berliner
Partner - EMEA Financial Services Industry - Enterprise Risk Services Leader
+352 451 452 328
lberliner@deloitte.lu

Jean-Philippe Peters
Partner - Governance, Risk & Compliance
+352 451 452 276
jpeters@deloitte.lu

Jérôme Sosnowski
Director - Governance, Risk & Compliance
+352 451 454 353
jsosnowski@deloitte.lu

Strategy Regulatory & Corporate Finance

Pierre Masset
Partner - Corporate Finance Leader
+352 451 452 756
pmasset@deloitte.lu

Joachim Heukmes
Director - Corporate Finance
+352 451 452 037
jheukmes@deloitte.lu

Francesco Piantoni
Director - Strategy, Regulatory & Corporate Finance
+352 451 453 371
fpiantoni@deloitte.lu

Capital Markets

Xavier Zaegel
Partner - Capital Markets
+352 451 452 748
xzaegel@deloitte.lu

Sylvain Crépin
Director - Capital Markets
+352 451 454 054
screpin@deloitte.lu

AIFMD

Benjamin Collette
Partner - EMEA AIFMD Leader
+352 451 452 809
bcollette@deloitte.lu

Private Equity & Real Estate

Benjamin Lam
Partner - Private Equity & Real Estate Leader
+352 451 452 429
blam@deloitte.lu

Investment Funds & Hedge Funds

Johnny Yip
Partner - Investment Funds & Hedge Funds Leader
+352 451 452 489
jyiplanyan@deloitte.lu

Deloitte Luxembourg
560, rue de Neudorf
L-2220 Luxembourg
Grand Duchy of Luxembourg

Tel: +352 451 451
Fax: +352 451 452 401
www.deloitte.lu

Deloitte is a multidisciplinary service organisation which is subject to certain regulatory and professional restrictions on the types of services we can provide to our clients, particularly where an audit relationship exists, as independence issues and other conflicts of interest may arise. Any services we commit to deliver to you will comply fully with applicable restrictions.

Due to the constant changes and amendments to Luxembourg legislation, Deloitte cannot assume any liability for the content of this leaflet. It shall only serve as general information and shall not replace the need to consult your Deloitte adviser.

About Deloitte Touche Tohmatsu Limited:
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte provides audit, consulting, financial advisory, risk management, tax and related services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries and territories, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte’s more than 220,000 professionals are committed to making an impact that matters.

© 2016. For information, contact Deloitte Touche Tohmatsu Limited
Designed and produced by MarCom at Deloitte Luxembourg