



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

Regulatory timeline



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.

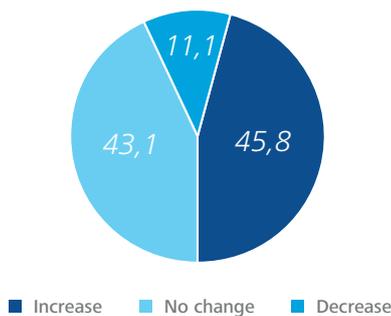
Addressing risk management issues:

- 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

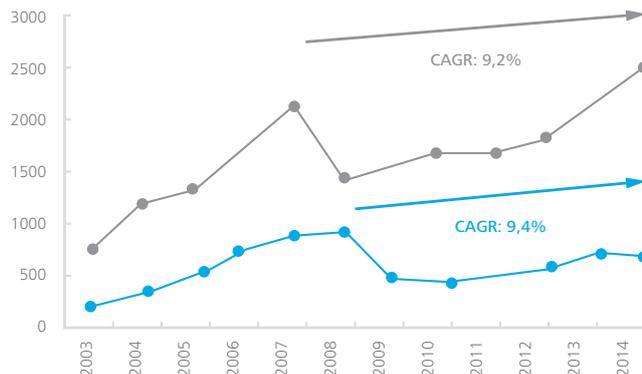
Leading to opportunities:

- 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

Investors' views on development of global Real Estate portfolio (in % or respondents)



AUM in the Hedge Fund industry (in \$ bln) and Global PE capital raised (in \$ bln)



Sources: INREV Investment Intentions Survey 2015; Bain & Company's Global Private Equity Report 2015

Turning requirements into value creation

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)



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

Regulators

AIFM

Investors

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

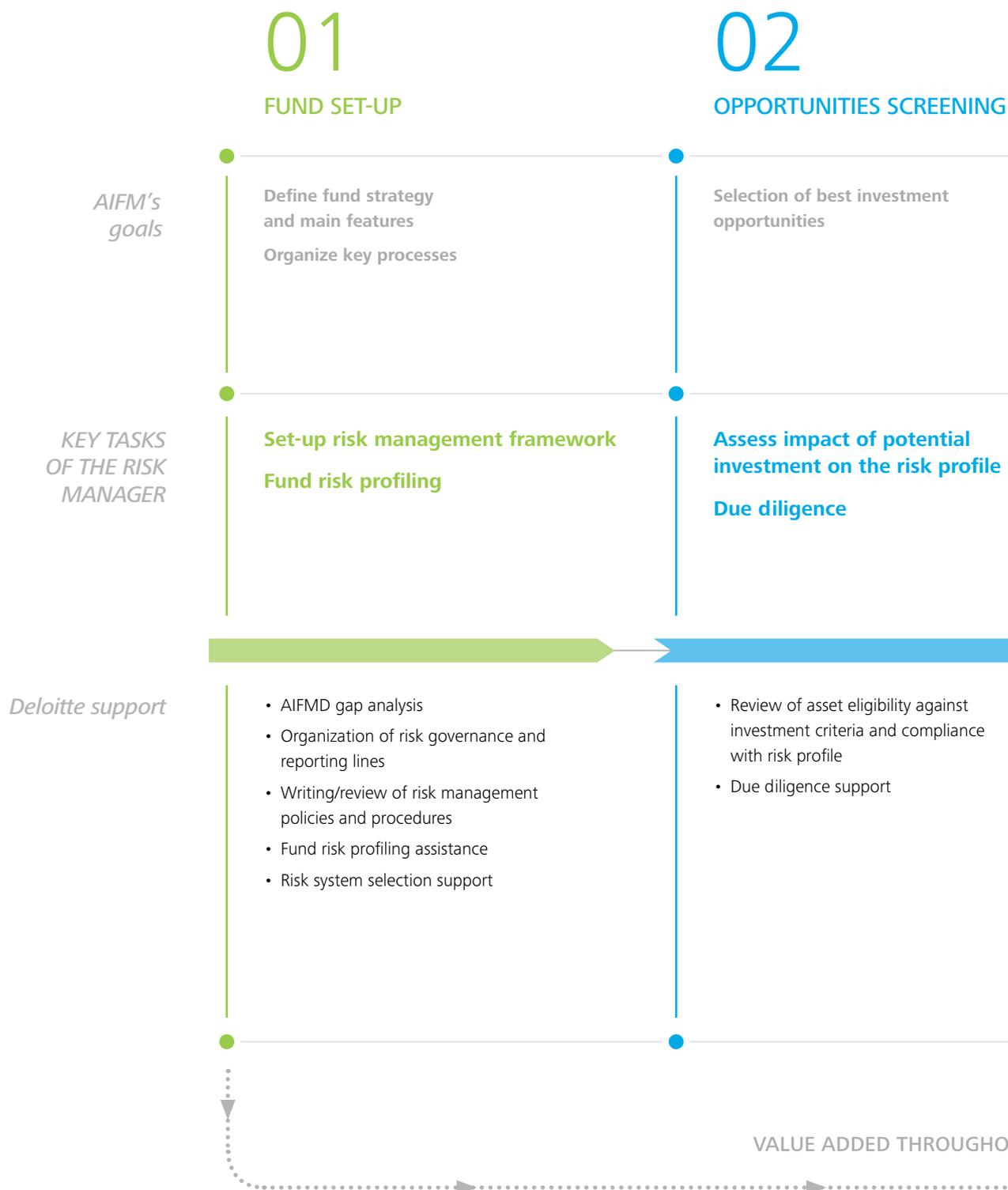
OUR SERVICE OFFERING TO HELP YOU IN FULFILLING YOUR DUTIES

- 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



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)

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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

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EXIT

Maximize investment value and process efficiency upon disposal

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.



Geographies

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

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



Our Risk Services offering at a glance

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

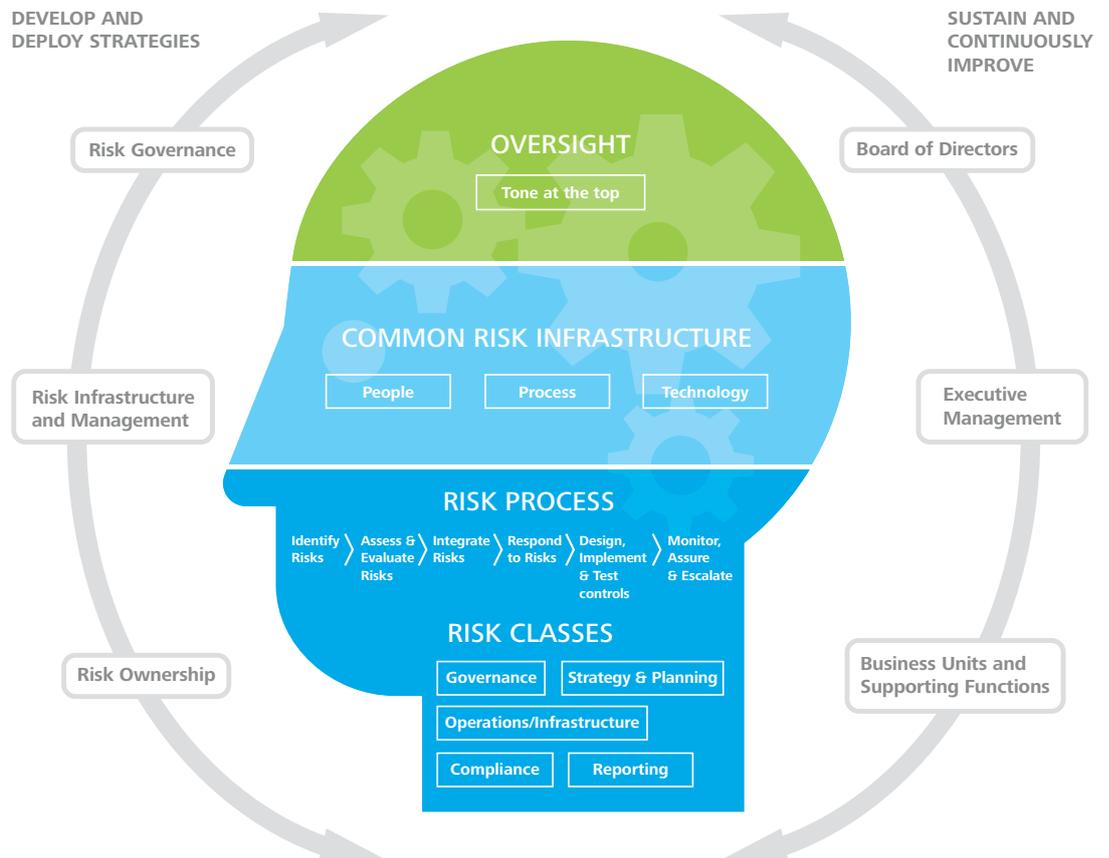
in developing a strategic approach to managing risk that simultaneously addresses management expectations and provides solutions for both risk management and regulatory compliance.

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's risk intelligence



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

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