



# Financial Supervision Commission

P.O. Box 58, Finch Hill House, Bucks Road, Douglas, Isle of Man, IM99 IDT

## Guidance Note

### Funds - Valuation & Fee Charging

The global credit crisis that impacted financial markets during the latter half of 2008 and onwards into 2009 inevitably spilled over into the funds industry.

This placed pressure spots on funds as managers and funds struggled to raise fresh capital against redemption requests.

The Commission is conscious that this coupled with market dislocation and volatility, in turn led to restraints being placed upon existing leverage.

With regard to funds that invested in 'alternative asset' classes be it other funds or esoteric non-mainstream investments the ultimately illiquid nature of these created further issues.

This resulted in the potential for liquid elements of a funds portfolio being used to satisfy redemptions, leaving remaining investors exposed to an increasingly illiquid investment that potentially is not reflective of the intended investment strategy.

To mitigate or address these issues funds have adopted several policies:-

- Creation of side-pockets;
- Imposition of redemption gates;
- Re-structuring;
- Payment deferrals; and
- Fund suspensions.

### **Investor Communication**

This has clearly led to investor concerns with regard to liquidity issues and transparency; specifically disclosure on leverage information, frequency of reports including accounts, and open communication rather than generic 'market status' newsletters.

The Commission is cognisant that a number of funds are or have been suspended or were in suspension for considerable time. The Commission is also aware that some funds/boards have utilised a historic or underlying historic NAV for fee accruals.

The Commission believes that this methodology is potentially flawed and that fees may be being taken on a valuation that is, (significantly), higher than the assets are actually worth or may realise.

Directors should be aware of the Commission's Guidance Note on the Responsibilities and Duties of Directors under the Laws of the Isle of Man<sup>1</sup>.

<sup>1</sup><http://www.gov.im/lib/docs/fsc/handbooks/guides/Banking/responsibilitiesanddutiesofdirec.pdf>



The Commission would expect Funds/Directors to have considered options such as conservative valuation of investments; zero valuation of investments; consideration of introducing hair cuts on fees or changing charging to a 'time spent' basis.

At all times funds/directors must ensure that investors receive clear, accurate and non-misleading information.

The Commission will be reviewing the charging basis applied to suspended funds specifically that the basis of fees taken from such funds is equitable. It is important that the fund/its board can demonstrate the rationale/justification for the fee calculation.

The Commission's expectation is that Part 6 (Conduct of Business) of the Financial Services Rule Book 2009 is followed to the highest standard.

#### **Summary**

When reviewing the methodology applied to fee calculation of suspended funds it is expected that the fund/board can demonstrate beyond the fact that the offering document or constitutional documents permit the same but has also considered whether it is the right way or if there a better way and what alternative was considered in shareholder/investor interests.

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