

Circular No. CMI 02/2008  
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28 July 2008

[To holders of a Capital Markets Services License for fund management and exempt fund managers under paragraph 5(1)(d) of the Second Schedule to the Securities and Futures (Licensing and Conduct of Business) Regulations]

Dear Sir/Madam

### **SURVEY AND THEMATIC INSPECTION OF HEDGE FUND MANAGERS**

MAS carried out a written survey on the business activities of hedge fund managers in March 2007. The survey was to help provide MAS with a better understanding of the hedge fund industry in Singapore. MAS also conducted a thematic inspection of hedge fund managers in the second half of 2007.

2. The insights gained from the survey complement our observations from the inspection of the controls and business practices of hedge fund managers. Although the thematic inspection was targeted at hedge fund managers, the findings and recommendations in this letter are applicable to other types of fund managers.

3. Most hedge fund managers we inspected had appointed independent third parties for asset pricing and valuation. We also noted that they disclosed to their investors information on the funds managed. These include the funds' investment objectives and strategies, the use of leverage, and the risks involved in the strategies and leverage employed by the managers. We encourage all fund managers to adopt industry best practices in the areas of valuation and investor disclosure.

4. At a number of the managers inspected, we observed that there was no proper segregation of duties between the risk management function and front office functions of portfolio management and trading. We also found instances where the compliance arrangements were not independent from the back office functions of operations and finance. Such practices undermine the effectiveness of the oversight function. Where segregation of duties is impractical for smaller outfits, fund managers should institute appropriate measures to mitigate any potential or perceived conflicts of interest

5. We also noted deficiencies in the compliance monitoring arrangements of several hedge fund managers, where there were no structured compliance monitoring procedures in place. While fund managers may engage external service providers to review and advise them on their compliance needs, it is

important that they recognize that the responsibility for compliance ultimately lies with the fund manager's board and senior management.

6. Several fund managers inspected did not have a formalized framework for the setting and monitoring of risk limits. It is vital that fund managers establish a formalized risk management framework, suited to the size and scale of operations, to be able to effectively identify, manage and monitor risks. In addition, many of the managers inspected did not put in place written policies and procedures. Having formal policies and procedures enhance management oversight over the firm's operations, and provide clarity to employees on their responsibilities and the limits within which they can act.

7. MAS expects the board and senior management of all licensed and exempt fund managers to maintain adequate oversight of their firm's business activities. The board and senior management are responsible for implementing processes and controls to effectively manage the firm's risks, to ensure compliance with all applicable rules and regulations, as well as to deal with its customers and counterparties in a fair and transparent manner.

8. MAS welcomes industry initiatives to foster high standards of professionalism and promote good practices in the fund management industry. Past examples include the guiding principles issued by the International Organisation of Securities Commissions ["IOSCO"] and Alternative Investment Management Association ["AIMA"] on valuation of hedge funds<sup>1</sup>. MAS notes the more recent initiatives by the UK-based Hedge Fund Working Group and the US President's Working Group in establishing best practice standards<sup>2</sup> for the hedge fund industry. We urge all fund managers operating in Singapore to actively keep up-to-date with developments in industry best practices and adopt them in a manner appropriate to the nature, size and scale of their operations.

Yours faithfully

(Sent via MASNET/email)

LAM SAN LING  
EXECUTIVE DIRECTOR  
CAPITAL MARKETS INTERMEDIARIES DEPARTMENT

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<sup>1</sup> These reports are available on the IOSCO's website at [www.iosco.org](http://www.iosco.org) and the AIMA's website at [www.aima.org](http://www.aima.org) respectively.

<sup>2</sup> These reports are available on the Hedge Fund Standard Board's website at [www.hfsb.org](http://www.hfsb.org) and the Asset Manager's Committee's website at [www.amaicmte.org](http://www.amaicmte.org) respectively.