

Guidelines on the Valuation of the Assets of Collective Investment Schemes and the Handling of Valuation Errors in the case of open-end Collective Investment Schemes

Checklist for an Internal Directive

26 November 2008

I Basic principles, introduction

Section 24 of the Guidelines on the Valuation of the Assets of Collective Investment Schemes and the Handling of Valuation Errors in the case of open-end Collective Investment Schemes (GL-NAV) issued by the SFA on 20 June 2008 states that the fund management company/SICAV is to issue an internal directive setting down the principles and the operational procedures for valuing the assets of open-ended collective investment schemes. It also states that this directive is to be specifically tailored to the requirements of the fund management company's/SICAV's organizational structure and the range of collective investment schemes offered. This checklist is designed to help fund management companies/SICAVs draw up this directive.

The fund management company/SICAV may at its own discretion use operational handbooks or other documents to regulate individual areas featured in this checklist. However, in so doing it must ensure that all of the points listed under Section 24 GL-NAV are covered, and that there are comprehensive and transparent regulations covering related processes.

This checklist covers only the most important areas. The scope and weighting of the individual provisions must be geared to the size and operational structure of the fund management company/SICAV and the range of collective investment schemes it offers and supplemented as required.

For certain provisions contained in this checklist, the Board of Directors must issue clear guidelines and regulate the decision-making or executive competencies.

II Using the checklist

General information

The checklist is set out as a table. The left-hand column contains the areas that are to be regulated. The center and right-hand columns contain references to the relevant basis and instructions on drawing up the directive.

In certain instances, the checklist suggests that persons be specified. These people should be specified by function rather than by name, e.g. "head of fund accounting" or "holder of position X".

Texts and key words in bold type

In the case of the areas shown in **bold type**, the Board of Directors must issue clear guidelines and regulate the decision-making or executive competencies. Of course, the Board of Directors may also lay down guidelines in respect of other provisions.

Texts and key words in italics

The proposed regulations in *italics* are not related or only partly related to the valuation of the assets of collective investment schemes. To ensure a full description of the functions in question, we recommend that these areas be conclusively regulated in the directive.

Texts and key words in brackets

The texts and key words given in brackets “()” are intended as examples.

Checklist for an Internal Directive - Guidelines on the Valuation of the Assets of Collective Investment Schemes and the Handling of Valuation Errors in the case of open-end Collective Investment Schemes

Regulations

Comments

Organization

1. Involved units and partners

Overview of the key partners and contact persons such as:

- custodian bank
- asset manager
- others

Key information and contact persons are to be given for each partner.

2. Organizational structure

- **Description of the way the persons or organizational unit responsible for valuation are integrated into the organization (organizational charts, job descriptions)** Section 5 GL-NAV
- Head of department responsible; staff, deputies (lists of staff and addresses)
- Responsibility for technical infrastructure and systems; measures to be taken in the case of disruptions and breakdowns; back-up systems (lists of staff and addresses, list of resources)
- Appropriate information for the unit responsible for valuation on agreements concluded with the custodian bank, asset managers and other agents (tasks, competencies, processes)

The independence of the unit responsible for the valuation pursuant to Section 5 must be clearly apparent from the documents.

3. Access to the software used for valuation and booking

- **Persons with authorized access and their deputies**
- **Safekeeping of codes and passwords**
- **Access records (who gained access, time, reason), filing of record logs**

4. Controlling

- **Regulation of the internal controlling system, information on the organizational integration and persons responsible**
- Controls built into operational procedures (compliance with investment guidelines)
- Instructions regarding procedures and reporting when irregularities are identified (investment restrictions exceeded)
- Interfaces to external control bodies
- *Instructions on procedures and reporting in cases where investment restrictions are exceeded as the result of changes in the market*
- *Monitoring corrective measures*
- *Monitoring execution and compliance with agreements concluded with brokers on the recording of transactions*

The tasks and independence of the controlling bodies must be clearly apparent.

The unit responsible for valuation is also to be notified of any deviations identified.

Controls must be coordinated with the custodian bank, e.g. with regard to monitoring compliance with the investment regulations (regulated in the custodian bank agreement).

Operational processes

Flow charts or written descriptions of processes, areas of responsibility (units or persons), external interfaces, reporting flows, procedures in the case of extraordinary events, etc, for individual business transactions

There should be sufficient regulation to ensure that operations run smoothly at all times, and especially in extraordinary situations.

5. Issue and redemption of units

- Procedures for reporting to the unit responsible for valuation (deadlines, content,

Ensure that the unit responsible for valua-

responsibility) with regard to:

- deadlines for submitting orders
- unit subscriptions
- unit redemptions
- cancellation of orders

- Procedures in the case of reports that are submitted late or are incomplete

6. Deferment of redemption payments / suspension of the issue of units

- **Set thresholds for the portion of the assets that cannot be valued which will trigger the instigation of appropriate measures**
- **Demarcation of decision-making powers with regard to instigating measures, in particular the suspension of the calculation of the NAV; the persons responsible are to be specified**
- Internal/external reporting procedures relating to the suspension of the calculation of the NAV, list of persons/bodies to be informed (supervisory authority, custodian bank, auditor, distributors, investors); the persons responsible for providing this information are to be specified
- Responsibility for monitoring the collective investment scheme after calculation of the NAV has been suspended
- **Decision-making powers with regard to recommencing the calculation of the NAV**

Section 13 et seq. GL-NAV

§17.3 and §17.4 of the model regulations

tion receives relevant and timely information on the issue and redemption of units.

Define possible escalation scenarios, e.g.:

- Threshold 1: report to superior
- Threshold 2: strict monitoring of subscriptions and redemptions of units; distributors to be contacted
- Threshold 3: application for the calculation of the NAV to be suspended

Possibly specific regulations for individual collective investment schemes.

7. Postponement of payments in the case of large-scale redemptions

- **Threshold limits for “large-scale” redemptions**
- **Decision-making powers with regard to instigating measures, in particular the postponement of redemption payments; the persons responsible are to be specified**
- *Internal/external reporting procedures relating to the postponement of redemption payments, list of persons/bodies to be informed (supervisory authority, custodian bank, auditor, distributors, investors); the persons responsible for provid-*

Quantitative or qualitative definition (e.g. when transactions necessary to adjust the portfolio are restricted by the liquidity of the investment market in question); in the case of investments with limited tradability, documents with information on liquidity - e.g. average daily turnover - are to be kept

10. Distribution of income

- Procedures for reporting to the unit responsible for valuation (deadlines, content, responsibility) with regard to: Section 9
GL-NAV
 - details on distributions
- **Setting distributions of income / distribution policy**
- *Reports to the custodian bank, paying agent, etc.*

11. Ongoing, regular reports to the authorities

- *The persons/units responsible for reporting are to be specified*
- *Internal distribution list for reports*

Valuation of the assets of the collective investment scheme

12. “Forward pricing” method

- The assets of the collective investment scheme are valued at market prices paid after the cut-off time Section 11
GL-NAV

Any regulations in deviation from the above (e.g. historic pricing) are only permitted in the case of open-end collective investment schemes whose portfolios have an actual overall duration of up to 12 months.

In setting the cut-off time, the fund management company/SICAV takes into account the trading hours on the exchanges on which the open-end collective investment scheme's investments are traded.

13.	<u>Main markets and price sources</u>	<ul style="list-style-type: none"> • The exchanges relevant for the valuation (for each country, asset class, etc.) • The sources from which prices are obtained are to be specified (Reuters, Telekurs, etc.) 	Sections 1, 2 and 6 GL-NAV	Price information must be obtained from external sources, but may be obtained via the custodian bank's internal information systems.
14.	<u>Plausibility checks of prices used for valuation</u>	<ul style="list-style-type: none"> • Plausibility check procedures • Plausibility criteria (tolerance limits in percent for day-on-day deviations, tolerance limits in terms of time for unchanged prices, tolerable age of prices) • Procedures in cases where tolerance limits or "age limits" are exceeded (e.g. checking prices using special sources which are to be specified) 	Section 8 GL-NAV	Once set, the tolerance thresholds and age limits for prices are to be reviewed annually.
15.	<u>Deviations from external price sources used as standard</u>	<ul style="list-style-type: none"> • Methods, powers and responsibilities • Possible deviations • Alternative measures • Record logs (content, recipients, archive) 	Section 3 GL-NAV	If trading on an exchange closes in the morning or early afternoon Swiss time, the fund management company/SICAV may use prices that are already known at the cut-off time for accepting orders for the valuation. If the investments of an open-end collective investment scheme valued in this manner exceed 25% of its assets, the fund management company/SICAV must adjust the valuation in line with the developments known in the meantime which could have a relevant impact on the net asset value.

16. Valuation of assets in cases where external sources do not provide sufficient data
- Methods, possibly varying depending on the origin of the position
 - Updating of securities valued using alternative methods
- Section 7
GL-NAV
- Possibly specify a special “valuation group”.
17. Money market instruments
- Instruments with an original term to maturity or interest rate adjustment period of up to 12 months are valued at cost, with straight-line deferment of the difference vis-à-vis the redemption price until maturity
 - In the event of more marked changes in the market environment or the credit rating of the investments, the above valuation is to be adjusted accordingly
 - **The threshold values for more marked changes in the market environment or a change in the credit rating are to be specified**
18. Validation of net asset values calculated
- **Timeframes (frequency) and, where applicable, other parameters for the matching of holdings with the custodian bank**
 - Responsibility for validation
 - Plausibility criteria (e.g. tolerance limits in percent for day-on-day deviations, tolerance limits in percent for changes in the net asset value compared with changes in the relevant benchmark)
 - Procedures in cases where tolerance limits are exceeded (checking net asset values calculated on the previous day)
- Section 10
GL-NAV
- The tolerance limits are to be reviewed annually.

Procedures in the case of valuation errors

19. Thresholds for determining the significance of an error

- **Thresholds for other funds for alternative investments** Section 18
 - **Progressive thresholds for internal measures (e.g. report to executive management if the error reaches 50% of the threshold pursuant to Section 18 GL-NAV)** GL-NAV
 - **Specific definition of recurring errors, errors that remain undetected for longer periods of time and errors in excess of a certain volume** Section 19
GL-NAV
- Thresholds for all collective investment schemes managed are to be defined in an overview and reviewed regularly.
- Decision-making powers with regard to setting the thresholds are to be regulated.

20. Error reports

- Responsibility for compiling error reports Section 17
- Minimum contents of the error report (date error was identified, cause and extent of the error, first-time or repeat occurrence, measures taken to avoid a repetition) GL-NAV
- Circulation and archiving of error reports

21. Measures (conditional decisions)

- Review of the operational organization and processes (identification of weaknesses and gaps in the controlling system) Sections 17, 19 and 20
- Organizational and/or personnel instructions to avoid a repetition of valuation errors GL-NAV
- Triggering of cancellations
- Clear regulation of the internal reporting procedures and the performance of duties to disclose information to third parties, specifically the supervisory authorities, auditors, custodian bank, distributors and investors
- Responsibilities with regard to instigating and carrying out measures and for reporting
- Report on the execution of the measures taken (content, circulation, archiving); responsibility for controlling compliance and expedience (monitoring success)

CONTENTS

Guidelines on the Valuation of the Assets of Collective Investment Schemes and the Handling of Valuation Errors in the case of open-end Collective Investment Schemes - Checklist for an Internal Directive	1
I Basic principles, introduction.....	2
II Using the checklist.....	2
General information	2
Texts and key words in bold type.....	3
Texts and key words in italics	3
Texts and key words in brackets.....	3
Checklist for an Internal Directive - Guidelines on the Valuation of the Assets of Collective Investment Schemes and the Handling of Valuation Errors in the case of open-end Collective Investment Schemes	4
Organization	4
1. Involved units and partners	4
2. Organizational structure	4
3. Access to the software used for valuation and booking.....	5
4. Controlling.....	5
Operational processes.....	5
5. Issue and redemption of units	5
6. Deferment of redemption payments / suspension of the issue of units	6
7. <i>Postponement of payments in the case of large-scale redemptions</i>	6
8. Investing the collective investment scheme's assets; transactions involving the collective investment scheme's assets	7
9. Liabilities of the collective investment scheme	7
10. Distribution of income	8
11. <i>Ongoing, regular reports to the authorities</i>	8
Valuation of the assets of the collective investment scheme	8
12. "Forward pricing" method.....	8
13. Main markets and price sources	9
14. Plausibility checks of prices used for valuation.....	9
15. Deviations from external price sources used as standard	9
16. Valuation of assets in cases where external sources do not provide sufficient data.....	10
17. Money market instruments.....	10
18. Validation of net asset values calculated.....	10
Procedures in the case of valuation errors.....	11

19.	Thresholds for determining the significance of an error	11
20.	Error reports.....	11
21.	Measures (conditional decisions)	11