

DRAFT NOTICE * OF 2014

Under sections 42, 89, 90(2) and (4) and 114(4)(b) of the Collective Investment Schemes Control Act, 2002, (Act No. 45 of 2002), I, Dube P Tshidi, Registrar of Collective Investment Schemes, hereby determine the matters contained in the Schedule.

DP TSHIDI

REGISTRAR OF COLLECTIVE INVESTMENT SCHEMES

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PART 4: Transitional arrangements

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SCHEDULE

PART 1: INTRODUCTION

1. Definitions

In this Schedule, “**the Act**” means the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002), and any word or expression to which a meaning has been assigned in the Act, bears that meaning so assigned to it and unless the context otherwise indicate-

“**authorised user**” means an authorised user as defined in section 1 of the Financial Markets Act;

“**bank**” means a bank as defined in the Banks Act 1990 (Act No. 94 of 1990), or a mutual bank as defined in the Mutual Banks Act, 1993 (Act No. 124 of 1993), or a co-operative bank as defined in the Co-operative Banks Act, 2007 (Act No. 40 of 2007);

“**clearing house**” means a clearing house as defined in section 1 of the Financial Markets Act;

“**counterparty**” means a juristic person on whom the hedge fund is dependent to realise, collect or settle the value of securities;

“**counterparty exposure**” means a value that best reflects the hedge fund’s effective exposure to a relevant counterparty and accurately reflects the economic loss that the hedge fund is exposed to if the counterparty defaults on its obligations;

“**derivative instrument**” or “**derivatives**” means a derivative instrument as defined in the Financial Markets Act;

“**equity member**” means an authorised user as defined in the Financial Markets Act who has been admitted as an equity member under the exchange rules defined in that Act;

“embedded derivative” means a derivative where -

- (a) the host contract’s cash flows are altered;
- (b) the cash flows simulate those of a derivative;
- (c) the instrument’s economic characteristics and risks behave the same as a derivative and are dissimilar from the host contract; and
- (d) the derivative has an impact on the pricing of the host contract;

“FAIS Act” means the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002);

“Financial Markets Act” means the Financial Markets Act, 2012 (Act No. 19 of 2012);

“Fit and Proper Requirements” means the Determination of fit and proper requirements and conditions for managers of collective investment schemes determined under section 42 of the Act;

“FSP” means a financial services provider authorised under the FAIS Act;

“fund administrator” means a person, who administers the accounting, reconciliation, investor liability, valuation and pricing for a hedge fund;

“gross exposure” means the aggregate of the absolute value of the exposures of all the long and short financial instruments in the portfolio;

“hedge fund” means a collective investment scheme which uses any strategy or takes any position which could result in the portfolio incurring losses greater than its aggregate market value at any point in time, and which strategies or positions include but are not limited to—

- (a) leverage; or
- (b) net short positions;

“hedge fund FSP” means an authorised hedge fund FSP as defined in the Code of Conduct for Discretionary Financial Services Providers published in Notice 79 of 8 August 2003 under the FAIS Act;

“leverage” means the use of financial instruments, including derivative instruments, short positions and borrowed capital to increase the exposure beyond the capital employed to an investment;

“prime broker” means a person offering prime brokerage services, such as lending money, acting as counterparty to finance or execute transactions in financial instruments, lending securities for the purpose of short selling, clearing and settlement of trades, operational support facilities and customised technology;

“qualified investor” means any person, who has a minimum investment amount of R1 million available for investment, and who-

- (a) has demonstrable knowledge and experience in financial and business matters which would enable the investor to assess the merits and risks of a hedge fund investment; or
- (b) has appointed an FSP who has demonstrable knowledge and experience to advise the investor regarding the merits and risks of a hedge fund investment;

“qualified investor hedge fund” means a hedge fund in which only qualified investors may invest;

“retail investor hedge fund” means a hedge fund in which any investor may invest;

“securities” means securities as defined in section 1 of the Financial Markets Act, 2012 (Act No. 24 of 2012); and

“short selling” means the sale of securities that the seller does not own, or a sale that is completed by the delivery of a security borrowed by, or for the account of the seller.

2. Objects

This Notice aims to-

- (a) provide for the protection of investors in hedge funds;
- (b) assist in the monitoring and management of systemic risk;
- (c) promote the integrity of the hedge fund industry;
- (d) enhance transparency in the hedge fund industry; and
- (e) promote financial market development.

PART 2: GENERAL PROVISIONS APPLICABLE TO ALL HEDGE FUNDS

3. Compliance function

A manager must establish a permanent and effective compliance function irrespective of the size and complexity of its business to ensure daily compliance with the Act and this Notice, provided that the manager does not have to establish an independent compliance function where such a requirement would be disproportionate having regard to the size of the manager or the nature, scale and complexity of its business, in which case the risk manager referred to in paragraph 39(4) may perform compliance functions.

4. Conflict of interest

(1) The manager must establish a conflict of interest policy to identify, manage and disclose any actual or potential conflict of interest between the manager's interests and the interests of the investors.

(2) A manager must adopt procedures and measures to ensure that persons engaged in the different business activities that could involve conflict of interest carry out these activities independently, appropriate to the size and activities of the fund.

5. Leverage

A manager may not use assets which are not included in the portfolio as margin against leverage provided in that portfolio.

6. Fund administrator

(1) A manager must conduct proper due diligence in selecting a fund administrator.

(2) A manager must ensure that its fund administrator -

- (a) is domiciled in the Republic;
- (b) is an authorised FSP; and
- (c) has adequate internal controls and systems to ensure proper administration of the fund.

7. Prime Broker

(1) A manager may appoint a prime broker, which must be-

- (a) an equity member; or
- (b) a bank.

(2) A manager must act with due skill, care and diligence when appointing a prime broker, and only appoint a prime broker that -

- (a) is subject to ongoing supervision;
- (b) is financially sound; and
- (c) has the necessary organisational structure appropriate for the services to be provided to the manager or the fund

(3) A manager must ensure that it is conversant with all counterparty and prime broker legal agreements, including re-hypothecation arrangements.

(4) A manager must conduct appropriate stress- testing to assess the risk of failure or credit downgrade of a prime broker or counterparty and the impact of such failure or downgrading on financing and collateral requirements.

8. Counterparties

A hedge fund may only invest in derivative instruments where the counterparty is-

- (a) the South African Government;
- (b) a bank;
- (c) a long-term insurer registered or deemed to be registered as a long-term insurer under the Long-term Insurance Act, 1998 (Act No. 52 of 1998);

- (d) a short-term insurer registered or deemed to be registered as a short-term insurer under the Short-term Insurance Act, 1998 (Act No. 53 of 1998);
- (e) a clearing house; or
- (f) an authorised user.

9. Remuneration policy

A manager must have a remuneration and reward policy that ensures-

- (a) the interest of the investors are aligned with that of the manager; and
- (b) sound and prudent risk management and risk-taking which is consistent with the relevant risk profile of the fund.

10. Risk management, risk management policy and risk manager

(1) A manager must establish, maintain, enforce and document risk management policies, including operational risk management, appropriate to the nature, scale and complexity of its business, which must provide for-

- (a) the measures, techniques and procedures employed to measure and manage risks, including risk measurement techniques to carry out stress tests, back tests and scenario analysis appropriate to the manager's fund strategy;
- (b) prompt steps and corrective actions, where stress tests and scenario analysis reveal particular vulnerability to a given set of circumstances;
- (c) the frequency with which stress tests and scenario analysis should be conducted depending on the nature of the fund, the investment strategy, liquidity profile, type of investor and repurchase policy of the fund.
- (d) the safeguards for independent performance of the risk management function, including details of the allocation of responsibilities within the fund for risk management and operating procedures;
- (e) risk management to be performed on a daily basis;
- (f) appropriate internal control mechanisms to avoid or mitigate operational failures, including professional liability risks.

(2) A manager must review the risk management policy when necessary but at least annually.

(3) A manager must be in line with the risk profile of the retail fund.

(4) A manager must appoint a risk manager separate from its investment management function and fund administration function, who must have a primary role in-

- (a) determining the risk policy of the fund;
- (b) active risk measuring;
- (c) risk monitoring and reporting; and
- (d) ensuring, on a daily basis, that the risk limits comply with the fund's risk profile.

11. Execution

A manager must ensure the best execution of transactions reasonably available at all times.

12. Short selling

A manager may engage in physical short selling; naked short selling and synthetic instruments creating short positions is not allowed.

13. Borrowing

A manager is permitted to borrow and secure such borrowing utilising the assets of the portfolio, provided that such activities are permitted by the portfolio's constituting document.

PART 3: QUALIFIED INVESTOR HEDGE FUND

14. Definitions

For purposes of this Part, a "**QI fund**" means a qualified investor hedge fund;
and

"**manager**" means a manager of a QI fund.

15. Registration

(1) A manager must be registered under this Part to administer a QI fund.

(2) An applicant for registration under this Part-

- (a) must be a company, a trust contemplated in the Trust Property Control Act, 1988 (Act No. 57 of 1988) or a partnership;
 - (b) must have the capital and reserves as determined in section 88(1)(a) of the Act available for employment in its QI fund;
 - (c) must have a governing body responsible and accountable for the management of the QI fund, which body must-
 - (i) comprise of at least 50% independent officers, whether directors, trustees, or partners; where an independent officer has the meaning ascribed to an independent director in King III: Report on Corporate Governance for South Africa 2009;
 - (ii) comply with the Fit and Proper requirements;
 - (iii) have appropriate professional expertise and knowledge of the assets in which the QI fund is invested;
 - (iv) have written processes and procedures in place to-
 - (aa) ensure a high standard of diligence in the selection and monitoring of investments;
 - (bb) ensure that investment decisions are carried out in compliance with the investment strategy and, where applicable, risk limits of the QI fund;
 - (cc) ensure that the QI fund is managed efficiently and in a manner that prevents undue costs being charged to the fund and its investors;
 - (dd) provide for due diligence procedures where appropriate; and
 - (ee) approve all policies prescribed in this Notice;
 - (v) maintain investment management decision-making functions, including, at least, risk and portfolio management;
 - (d) appoint-
 - (i) a trustee as contemplated in section 69 of the Act to perform the functions set out in section 70(1) to (3) of the Act, or
 - (ii) an independent fund administrator to perform the functions set out in section 70(1) to (3) of the Act.
- (3) An applicant for registration as a manager of a QI fund must lodge an application for registration with the registrar on the application form determined under section 42 of the Act, and the application must include -

- (a) the prescribed fee;
- (b) the name of the QI fund
- (c) the name of the QI fund's hedge fund FSP and a copy of its FSP licence;
- (d) the founding documents of the QI fund;
- (e) a copy of the portfolio mandate and investment limits, including the leverage limit and redemption policy of the QI fund;
- (f) a copy of the investment policy indicating the investment strategies, including the types of underlying funds, if it invests in other funds;
- (g) audit certificate confirming minimum capital and reserves;
- (h) where applicable, declaration by the applicant and auditor confirming that all investors in the fund are qualified investors;
- (i) the risk management and valuation policy of the QI fund;
- (j) the name and details of the auditor of the QI fund
- (k) where applicable, the name and details of
 - (i) the custodian;
 - (ii) the fund administrator; and
 - (iii) the prime broker and other counterparties;of the QI fund
- (l) where applicable, a business plan for the QI fund; and
- (m) the remuneration policy and practices of the manager.

16. Principles for administration of a QI fund

A manager-

- (a) may only invite or permit qualified investors to invest in a QI fund, and must take reasonable steps to verify that all investors in the QI fund are qualified investors;
- (b) must ensure that the assets of the QI fund are managed by a hedge fund FSP;
- (c) must employ a structure that limits the liability of an investor to give effect to the principle that an investor may not lose more than his or her capital investment amount;
- (d) must ensure that the principle of segregation of investors assets is adhered to by its custodian or the nominee of its prime broker approved in terms of section 76(1)(a) of the Financial Markets Act;

- (e) may include assets in the QI Fund as set out in its founding documents, provided that the following are adhered to-
 - (i) the asset must listed and dealt with on an exchange or on a market that is regulated, operates regularly, recognised and open to the public;
 - (ii) a structured product must be based on permitted assets and securities prescribed in terms of this Notice for retail funds;
 - (iii) instruments based on the value of commodities listed on an exchange may not allow for physical delivery of the commodity;
 - (iv) instrument must be subject to reliable valuation and must negotiable and transferable; and
 - (v) the liquidity of instruments must not compromise the liquidity terms of the QI fund.

17. Prudential requirements

- (1) A manager must at all times maintain liquid assets equal to or greater than 13/52 weeks of annual expenditure.
- (2) A manager must maintain in force-
 - (a) suitable guarantees of a minimum amount of R5 million; or
 - (b) suitable professional indemnity cover of a minimum amount of R5 million.
- (3) A manager must have procedures in place to ensure-
 - (a) ongoing monitoring of the total value of the assets under management; and
 - (b) adjustments to the amount of coverage for professional liability risks following any significant change in assets under management.
- (4) A manager must implement and maintain a repurchase policy, which policy must provide for-
 - (a) a level of liquidity for the QI fund that would enable the manager to repurchase participatory interests within 91 days after receipt of an investor instruction to repurchase;
 - (b) the circumstances under which the manager may suspend repurchase of participatory interests, provided that -
 - (i) suspension may only be applied in exceptional circumstances and when in the interests of investors;

- (ii) suspension must be in accordance with the provisions of the Notice of Suspension of Repurchase of Participatory Interests by Manager of Collective Investment Scheme In Securities prescribed by the registrar under section 114(3)(f) of the Act;¹ and
- (iii) the registrar must immediately be informed of any suspension arrangement.

18. Leverage

- (1) A manager must set a maximum level of leverage for each underlying portfolio of the QI fund, and inform the registrar of the limit.
- (2) A manager may not change the maximum limit set in accordance with subparagraph (1) without approval of the investors and the registrar.

19. Valuation

- (a) A manager must establish, maintain, enforce and document policies and procedures for the valuation of the assets held or employed in each portfolio, explaining the methodology used for valuing all the different types of assets held by or employed by the QI fund.
- (b) A manager must ensure that the valuation methodology is consistently applied according to the policies and procedures.
- (c) The policies and procedures must –
 - (a) be reviewed periodically to ensure continued appropriateness;
 - (b) provide for the obligations, roles and responsibilities of all parties involved in the valuation process, including the fund administrators;
 - (c) ensure that an appropriate level of independent review is undertaken for each valuation and in particular any valuation that is influenced by the manager or the hedge fund FSP;
 - (d) describe the process for handling and documenting instances where the manager has disagreed with the valuations, including providing for the review of price overrides by an independent party;

¹ Currently Notice 573 of 28 February 2003.

- (e) provide for initial and independent due diligence investigations of any third parties that are appointed to perform valuation services;
- (f) ensure that the arrangements for the valuation of the portfolio are transparent to investors;
- (g) ensure that valuations are performed at least monthly or equal to the repurchase period of the QI fund, whichever is more frequent; and
- (h) when using models for valuations, ensure-
 - (i) that the model is included in the QI fund's valuation policy;
 - (ii) that the valuation procedures and policies indicate the main features of the model; and
 - (iii) that the model is subject to independent validation, by a person who-
 - (aa) was not involved in the process of developing the model; and
 - (bb) has adequate competence and experience in the valuation of assets using such models.

20. Liquidity risk management

(1) A manager must have an appropriate framework to measure and manage the liquidity risk of the QI fund against its repurchase obligations.

(2) A manager must ensure that investors are able to repurchase their investments in accordance with the QI fund's repurchase policy, which must include conditions for repurchase in both normal and exceptional circumstances, and in a manner consistent with the fair treatment of all investors.

(3) A manager must implement a liquidity stress-testing policy providing for-

- (a) increased investor repurchases;
- (b) shortage of liquidity of the underlying assets of the fund; and
- (c) an analysis of the period of time required to meet repurchase requests in the simulated stress scenarios.

21. Disclosure and reporting to investors

(1) A manager must disclose to a potential investor before investment-

- (a) the name of the fund and of the manager stated clearly and unambiguously;
- (b) a description of the investment strategy and objectives of the fund and all associated risks;
- (c) whether the fund invests in underlying funds;
- (d) a description of the types of assets in which the QI fund may invest;
- (e) any applicable investment restrictions of the portfolio;
- (f) the circumstances in which the QI fund may use leverage, the types and sources of leverage permitted and the associated risks, any restrictions on the use of leverage and any collateral and asset reuse arrangements, and the maximum level of leverage which the QI fund is entitled to employ;
- (g) a description of the procedures by which the QI fund may change its investment strategy or investment policy, or both;
- (h) the identity of the QI fund's custodian, governing body, auditor and any other service provider and a description of their duties;
- (i) in respect of the prime broker and other counterparties, a description of any material arrangements of the manager with a prime broker and the other counterparties, including-
 - (i) the manner in which conflicts of interest in relation thereto are managed;
 - (ii) any provision in the contract with the custodian on the possibility of transfer and re-use of fund assets; and
 - (iii) counterparty credit exposure to the prime broker;
- (j) a description of any delegated administration function and of any safe-keeping function delegated by the custodian, identification of the delegated person and any conflicts of interest that may arise from such delegations;
- (k) a description of the QI fund's asset valuation and pricing methodologies;
- (l) a description of the QI fund's liquidity risk management, including the repurchase rights both in normal and in exceptional circumstances;
- (m) any gating, side pocket or repurchase restrictions that may exist in the QI fund and how those restrictions may be triggered;
- (n) any special repurchase arrangement rights of some investors;

- (o) a description of all fees, charges and expenses and the maximum amount thereof which are borne directly by investors;
- (p) a description of all charges paid by the QI fund;
- (q) a description of how the manager ensures fair treatment of investors and, whenever an investor obtains preferential treatment or has the right to obtain preferential treatment, including ring-fencing arrangements, a description of that preferential treatment, the type of investors who obtain such preferential treatment and, where relevant, those investors' legal or economic relation with the manager or the QI fund;
- (r) the latest annual report referred to in section 90 of the Act;
- (s) the procedure and conditions for the issue and sale of participatory interests;
- (t) the latest net asset value of the QI fund and the latest price of the participatory interests of the fund;
- (u) where available, the historical performance of the QI fund after deducting fees; and
- (v) a description of how and when the quarterly reporting under subparagraph 2 will be provided.

(2) A manager must disclose to the investor quarterly-

- (a) the sources of leverage, including the type, the amount and the providers of leverage;
- (b) the maximum level of leverage permitted under the fund mandate and the maximum level of leverage applied during the reporting period, and the level of leverage as at the quarter-end;
- (c) the extent to which assets are encumbered or re-hypothecated;
- (d) the methodology for conducting stress-testing;
- (e) a report on the QI fund's exposures to counterparties;
- (f) latest total expense ratio applicable to the fund; and
- (g) any changes to the liquidity risk profile of the QI fund.

22. Annual report

(1) A manager must, in respect of the QI fund, prepare an annual report for each financial year no later than ninety days following the year-end of such financial year, which report must comprise-

financial statements in terms of section 90(1)

- (b) details of any activities that had a material impact on the business of the manager, the fund, and the portfolios during the financial year
 - (c) any material changes in the information listed in paragraph 14(3) during the financial year covered by the report.
- (b) The annual report must be provided to investors on request.

23. Reporting to the registrar

(1) A manager must within 30 days after the end of each calendar quarter, furnish to the registrar, in respect of each fund that it manages, electronically or otherwise —

- (a) a full list of all gross and net assets in the QI fund reflecting the independent market value of each asset included in that fund, and the value of each of those assets expressed—
 - (i) as a percentage of the total value of assets in the fund concerned;
 - (ii) as a percentage of the total amount of assets of that class issued by the entity in which the investment is held, and indicating which of such assets are illiquid;
- (b) a report containing details of—
 - (i) all long and short positions in the fund;
 - (ii) the maximum level of leverage permitted under the fund mandate and the maximum level of leverage applied during the reporting period, and the level of leverage as at the quarter-end;
 - (iii) the method of calculation of leverage and showing how leverage limits have been complied with;
 - (iv) the sources of leverage, including the type, the amount and the providers of leverage;
 - (v) level of collateralisation and the re-hypothecation of assets;
 - (vi) level of exposure to each counterparty;
 - (vii) the capability of the internal control systems for derivatives;
 - (viii) new investors; and
 - (ix) the current risk profile of the fund and the risk management systems employed by the manager to manage risks, including

market, liquidity, counterparty, derivatives, operational and other risks;

(c) a detailed list of all the funds that the manager administers.

(2) A manager must—

(a) not later than 90 days after the close of its financial year, send to the registrar a copy of the QI fund's duly audited financial statements and the annual report referred to in paragraph 21(2); and

(b) on or before a date specified by the registrar, lodge with the registrar such further information and explanations as the registrar may request.

(3) A manager must inform the registrar immediately of any change in the liquidity risk profile of the fund.

PART 4: RETAIL HEDGE FUND

24. Definitions

For purposes of this Part, a “**retail fund**” means a retail investor hedge fund; and “**manager**” means a manager of a retail fund.

25. Registration

(1) A manager of a retail fund must be registered under this Part to administer a retail fund.

(2) An applicant for registration under this Part, must

(a) be a company;

(b) have the capital and reserves as determined in section 88 of the Act available for employment in its retail fund;

(c) appoint a trustee in terms of section 69 of the Act;

(d) conform to the fit and proper requirements prescribed by the registrar;

(e) ensure a high standard of diligence in the selection and monitoring of investments;

(f) ensure that investment decisions are carried out in compliance with the investment strategy and, where applicable, risk limits of the fund;

(g) have appropriate professional expertise and knowledge of the assets in which the retail fund is invested;

- (h) retain investment management decision-making functions, including, at least, risk and portfolio management;
- (i) establish appropriate procedures to ensure that the fund is managed efficiently and in a manner to prevent undue costs being charged to the fund and its investors;
- (j) establish and implement written policies and procedures on due diligence procedures where appropriate.

(3) An applicant for registration as a manager of a retail fund must lodge an application with the registrar on the application form determined under section 42 of the Act , and the application must include-

- (a) the name of the retail fund;
- (b) the prescribed fee;
- (c) the name of the proposed prime broker, if applicable;
- (d) the name and details of the fund administrator; and
- (e) the names of derivatives counterparties.

26. Trustee

(1) A manager must appoint a trustee, meeting the requirements set out in section 69 of the Act, for the retail fund.

(2) A trustee appointed under subparagraph (2) must comply with the duties of a trustee set out in section 70 of the Act.

27. Custody of assets

(a) A manager must ensure that the principle of segregation of fund assets, including collateral assets, is adhered to by-

- (a) its trustee appointed under paragraph 18; or
- (b) a nominee of its prime broker approved in terms of section 76(1)(a) of the Financial Markets Act.

(b) A custodian may only be appointed under subparagraph (1), if such custodian -

- (a) meets the requirements set out in section 69 of the Act; and
- (b) is a participant as defined in section 1 of the Financial Markets Act.

(3) The duties of the custodian appointed under subparagraph (1) include-

- (a) holding and safeguarding of assets on a segregated basis;
- (b) securities settlement;
- (c) income collection;
- (d) corporate action processing; and
- (e) cash management.

28. Valuation and pricing

(1) A manager must establish, maintain, enforce and document policies and procedures for the valuation of the assets held or employed in each portfolio, explaining the methodology used for valuing all the different types of assets held by or employed by the retail fund.

(2) A manager must ensure that the valuation methodology is consistently applied according to the policies and procedures, which must –

- (a) be reviewed periodically to ensure continued appropriateness;
- (b) provide for the obligations, roles and responsibilities of all parties involved in the valuation process, including fund administrators;
- (c) ensure that daily valuation is conducted, and that a requirement to provide daily valuation is included in the founding document;
- (d) provide for pricing that is at least equal to the repurchase period;
- (e) provide for all listed investments being priced according to market prices as contemplated in section 44 of the Act, marking to market, and the unlisted investments being priced according to a methodology approved by the trustee and undertaken by a party approved by the trustee;
- (f) ensure that an appropriate level of independent review is undertaken for each valuation and in particular any valuation that is influenced by the manager or the hedge fund FSP;
- (g) describe the process for handling and documenting instances where the manager has disagreed with the valuations, providing for the review of price overrides by an independent party;
- (h) provide for initial and independent due diligence investigations of third parties that are appointed to perform valuation services;
- (i) ensure that the arrangements for the valuation of the portfolio are transparent to investors.

29. Liquidity and repurchases

(1) A retail fund may borrow up to ten percent of the value of the fund for liquidity purposes.

(2) A manager may not encumber any assets of the fund for reasons other than as provided for in the Act.

(3) A manager must implement and maintain a repurchase policy, which policy must provide for

- (a) a level of liquidity for the retail fund that would enable the manager to repurchase participatory interests within 30 days of receipt of an investor instruction to repurchase;
- (b) the circumstances under which the manager may suspend repurchase of participatory interests, provided that -
 - (i) suspension may only be applied in exceptional circumstances and when in the interests of investors;
 - (ii) suspension must be in accordance with the Notice of Suspension of Repurchase of Participatory Interests by Manager of Collective Investment Scheme In Securities prescribed by the registrar under section 114(3)(f) of the Act; and
 - (iii) the registrar must immediately be informed of any suspension.

(4) Where the inclusion of a derivative results in an immediate or future commitment for the fund, the following liquidity requirements applies-

- (a) for a derivative that may require settlement in cash, the portfolio must at all times hold sufficient assets in liquid form to effect the required settlement; and
- (b) for a derivative that requires physical settlement, the portfolio must hold the physical asset or hold sufficient assets in liquid form to cover the value of the underlying physical asset, on condition that the underlying physical asset is liquid.

30. Fees

(1) A manager must specify in its deed the maximum level of all fees charged by the manager to the retail fund.

(2) A manager must give investors reasonable notice, but not less than three months, of any increase in the fees referred to in subparagraph (1).

31. Counterparty exposure

(1) A manager must limit the exposure of a retail fund to 30 percent of the net asset value of the portfolio per one counterparty, other than a bank, in relation to over-the-counter derivatives, where the total value of the exposure is calculated utilising the verifiable mark to market value of the derivative including any over-collateralised amount.

(2) A manager may net over-the-counter derivatives positions with the same counterparty and in the same portfolio, provided that the fund is able to legally enforce netting arrangements with that counterparty.

(3) When calculating counterparty exposure, a fund must take into account-

- (a) any initial or variation margin posted to a counterparty under exchange traded derivatives or cleared derivatives that are not posted to the clearing house but held by the counterparty; and
- (b) any net exposure to a counterparty generated through a securities lending or repurchase agreement and exposures created through the reinvestment of collateral.

32. Collateral

(1) A retail fund may-

- (a) post collateral to its counterparties; or
- (b) receive collateral to manage its credit exposure to a counterparty or where counterparty limits have been breached.

(2) A manager must ensure that collateral arrangements satisfy the following rules and principles-

- (a) Legal Agreements: Collateral arrangements must be governed by appropriate international collateral agreements;
- (b) Liquidity: Collateral must be sufficiently liquid to ensure that it can be sold quickly in a default event at a price that is close to its pre-sale valuation;
- (c) Valuations: Collateral must be capable of being valued on at least a daily basis and must be marked to market daily taking into account any haircuts on non-cash collateral;

- (d) Issuer credit quality: Creditworthiness of the issuer of the collateral must be taken into account and relevant haircuts must be applied to take into account issuer default risk;
- (e) Legal rights: a retail fund must ensure that the collateral obligation is legally enforceable and that the collateral will be available to the fund without recourse to the counterparty, in the event of a default by the counterparty;
- (f) Concentration risks: A retail fund must take into account the concentration risks to a single issuer;
- (g) Relatedness: the fund must not accept securities of the counterparty as collateral;
- (h) Cash collateral: the retail fund must appropriately manage the reinvestment risk of cash collateral.

33. Permitted assets and securities

(1) A retail fund may invest into the following asset classes, provided they meet the principles set out in subparagraph (2) and subject to the exposure limits set out in Schedule A-

- (a) securities, and money market instruments, which are-
 - (i) listed on an exchange; provided that any instrument that bases its value on a commodity does not establish a contract for physical delivery of any commodity; or
 - (ii) dealt with on a market which is regulated, operates regularly, is recognised and open to the public;
- (b) over-the-counter derivatives, subject to paragraphs 24 and 26;
- (c) participatory interests in registered collective investment schemes;
- (d) financial indices, subject to paragraph 25 and 26.

(2) The following principles must be adhered to-

- (a) The potential loss on the investment must be limited to the amount paid to acquire it (e.g. one cannot lose more money than one has invested).
- (b) The liquidity of the instruments or securities must not compromise the ability of the hedge fund to meet its repurchase obligations.
- (c) A reliable valuation for the investment must exist.
- (d) Appropriate information on the investment must be available.

- (e) The instrument must be negotiable.
- (f) The acquisition of the investment must be consistent with the investment policy of the hedge fund.

34. Non- permitted asset classes

A manager may not include in a retail fund, investments in-

- (a) commodities where physical delivery of the commodities is possible;
- (b) immovable property; and
- (c) private equity.

35. Derivatives

(1) When a manager of a retail hedge fund includes derivatives in a portfolio, the manager must-

- (a) ensure that its total exposure relating to derivative instruments does not exceed the total net asset value of its portfolio, provided that when a transferable security or money market instrument contains an embedded derivative, the exposure created by that derivative must be taken into account when exposure is calculated;
- (b) be satisfied that the counterparty will value the over-the counter derivative with reasonable accuracy and on a reliable basis;
- (c) ensure that the derivative can be sold, liquidated or closed by an offsetting transaction at fair value at any time at the retail hedge fund's initiative;
- (d) ensure that the fund administrator has the ability to value the derivatives instruments independently;
- (e) ensure that the underlying assets of the derivative are taken into consideration in determining the resulting position exposure;
- (f) take into account the position exposure referred to in subparagraph (e) in calculating the issuer concentration;
- (g) not permit the position exposure to the underlying assets of derivatives (including embedded derivatives in transferable securities, money market instruments or investment funds) when combined with positions resulting from direct investments, to exceed the investment limits or counterparty limits;

(h) ensure that the derivative does not result in the delivery of a security that is not permitted under this Notice.

(2) A manager must ensure that it-

(a) is at all times capable of meeting its payment and delivery obligations for cash settled derivatives by holding liquid assets which are sufficient to cover the exposure; and

(b) establishes and maintains risk management processes which monitor derivative transactions so that they are adequately covered in accordance with these requirements.

36. Financial indices

(1) To be eligible for inclusion in a retail fund, a financial index must be-

(a) sufficiently diversified;

(b) an adequate benchmark of the market to which it refers;

(c) published in an appropriate manner and be readily accessible; and

(d) compiled and calculated independently from the manager, the fund and the issuer of the instrument.

(2) Indices may, based on the eligibility criteria set out in subparagraph (1), consist of amongst others, commodity, metal, real estate and private equity indices.

37. Exposure limits

A manager must include securities and assets in a portfolio in accordance with the limits set out in Schedule A to this Notice.

38. Leverage

(1) For purposes of this paragraph,

“commitment approach” means an approach that considers the market value of the assets underlying the derivative and takes an aggregate view of the absolute value of the underlying exposure; and

“value-at-risk” means a measure of the maximum expected loss at a given confidence level over a specific time period;

(2) A manager may create leverage in a portfolio by borrowing funds or by engaging in derivative transactions with counterparties.

(3) A manager may calculate the portfolio's total exposure and leverage by-

- (a) the value-at-risk approach; or
- (b) the commitment approach.

(4) A manager using the commitment approach must ensure that a portfolio's gross exposure to the market does not exceed 200% of the total net asset value of its portfolio.

(5) (a) When calculating the exposure using the value-at-risk approach, all the positions of the portfolio must be considered.

(b) A manager must always set the maximum value-at-risk limit according to a fund's defined risk profile.

(c) A manager is responsible for deciding which value-at-risk approach is the most appropriate methodology given a fund's risk profile and investment strategy and the manager's decision and its underlying assumptions must be fully documented.

(d) A manager must be able to demonstrate that the value-at-risk approach it uses for a fund is appropriate for that fund and there must be consistency in the choice of the type of value-at-risk used.

(e) A manager must ensure that the value-at-risk model-

(i) is appropriate for the retail fund and takes into account the investment strategy being pursued and the types and complexity of the financial instruments used;

(ii) takes into account the general market risks;

(iii) is supported by appropriate back-testing and stress-testing of the portfolio that allows for, inter alia a comparison to expected loss, and where-

(aa) a one day change in portfolio value exceeds the related one day value-at-risk measure, the model must be adjusted; and

(bb) the event described in subparagraph (aa) occurs more than four times in the most recent 250 business days, the manager must immediately report this to the registrar, who may take measures and apply stricter criteria for the use of value-at-risk.

(6) (a) When using the commitment approach, all derivatives must be converted into the market value of an equivalent position in the underlying asset of the derivative contract.

(b) Where the commitment approach is used for the calculation of total exposure, a manager must apply this approach to all derivative positions, whether used as part of the fund's general investment policy, for purposes of risk reduction or for the purposes of efficient portfolio management.

(c) When calculating the total exposure using the commitment approach, a manager may consider hedging and netting arrangements for the same asset class provided they fulfil the criteria relating to the commitment approach, and that investment strategies that aim to generate returns are not regarded as hedging arrangements.

(d) Hedging arrangements must -

- (i) ensure that there is a verifiable reduction of risk;
- (ii) relate to the same asset class;
- (iii) be efficient in stressed market conditions

(e) Netting arrangements -

- (i) may only include those derivative trades which offset the risks linked to other trades on the same underlying asset, leaving no material residual risk;
- (ii) must be effected within specific maturity segments in respect of interest rate instruments.

Minimum transparency and disclosure requirements

39. Reporting to investors

(1) A manager must disclose to a potential investor before investment-

- (a) the name of the retail fund and of the manager clearly and unambiguously stated;
- (b) the date of establishment of the fund;
- (c) list of all portfolios;
- (d) names of the members of the Board of the manager;
- (e) the legal structure of the fund;
- (f) accounting and distribution dates of each portfolio;

- (g) a description of the investment strategy and objectives of the fund and all associated risks;
- (h) whether the fund invests in underlying funds;
- (i) a description of the types of assets in which the fund may invest;
- (j) any applicable investment restrictions of the portfolio,
- (k) the circumstances in which the fund may use leverage, the types and sources of leverage permitted and the associated risks, any restrictions on the use of leverage and any collateral and asset reuse arrangements, and the maximum level of leverage which the fund is entitled to employ on behalf of the fund;
- (l) a description of the procedures by which the fund may change its investment strategy or investment policy, or both;
- (m) the identity of the fund's trustee, custodian, auditor and any other service providers and a description of their duties and the investors' rights;
- (n) in respect of the prime broker and other counterparties, a description of any material arrangements of the manager with its prime brokers and such counterparties, including-
 - (i) the manner conflicts of interest in relation thereto are managed;
 - (ii) a provision in the contract with the custodian on the possibility of transfer and re-use of fund assets; and
 - (iii) counterparty credit exposure to the prime broker;
- (o) a description of any delegated administration function and of any safe-keeping function delegated by the custodian, the identification of the delegated person and any conflicts of interest that may arise from such delegations;
- (p) a description of the fund's asset valuation and pricing methodologies, including the methods used for valuing hard to value assets;
- (q) a description of the fund's liquidity risk management, including the redemption rights both in ordinary and in exceptional circumstances;
- (r) a description of all fees, charges and expenses and the maximum amount thereof which are borne directly by investors;
- (s) a description of all charges paid by the portfolio;
- (t) a description of how the manager ensures fair treatment of investors and, whenever an investor obtains preferential treatment or has the right

to obtain preferential treatment, including ring-fencing arrangements, a description of that preferential treatment, the type of investors who obtain such preferential treatment and, where relevant, those investors' legal or economic links with the manager or the fund;

- (u) the latest annual report referred to in section 90 of the Act;
- (v) the procedure and conditions for the creation, issue and sale of participatory interests;
- (w) the latest net asset value of the fund and the latest price of the participatory interests of the fund;
- (x) the method used to determine the creation, issue and sale prices and the repurchase and calculation prices of participatory interests, particularly-
 - (i) the method and frequency of the calculation of the net asset value; and
 - (ii) information concerning the charges relating to the sale or issue and repurchase of the participatory agreements;
- (y) where available, the historical performance of the fund, after deducting fees;
- (w) a description of how and when the quarterly reporting required under subparagraph 2 will be done; and
- (x) how risk reporting will be done.

(2) A manager must quarterly publish on its website a general investor report that details-

- (a) the sources of leverage, including the type, the amount and the providers of leverage;
- (b) the maximum level of leverage permitted under the fund mandate and the maximum level of leverage applied during the reporting period, and the level of leverage as at the quarter-end;
- (c) the extent to which assets are encumbered or re-hypothecated;
- (d) the methodology for conducting stress-testing;
- (e) total expense ratio applicable to the fund;
- (f) a report on the fund's exposures to counterparties; and
- (g) any changes to the liquidity risk profile of the fund.

(3) A manager must disclose quarterly to an investor by way of an investor statement, the following minimum information—

- (a) the series or class of assets invested in;
- (b) the net asset value and participatory interest price multiplied by the number of notional participatory interests held in fund;
- (c) equalisation credit (where applicable);
- (d) monthly return;
- (e) transactions processed;
- (f) subscriptions (new investments) and number of participatory interests;
- (g) redemptions & number of participatory interests;
- (h) breakdown of net profit/loss for the period;
- (i) realised gain or loss;
- (j) unrealised gain/loss;
- (k) dividends and dividend expenses;
- (l) interest earned and interest incurred;
- (m) management fees;
- (n) performance fee / incentive fee;
- (o) trading expenses;
- (p) other expenses in aggregate, including-
 - (i) accounting fee;
 - (ii) administration fee;
 - (iii) audit fee;
 - (iv) bank charges;
 - (v) custodian fee;
 - (vi) scrip borrowing fee; and
 - (vii) transaction fee.

40. Annual report

- (1) A manager must, in respect for each of the retail funds it manages, prepare an annual report for each financial year no later than ninety days following the year-end of such financial year, which report must comprise-the
- (a) financial statements in terms of section 90(1) of the Act;
 - (b) details of any activities that had a material impact on the business of the manager, the fund, and the portfolios during the financial year
 - (c) any material changes in the information listed in paragraph 24(3) during the financial year covered by the report

- (2) The annual report must be provided to investors on request.

41. Reporting to the registrar

(1) A manager must within 30 days after the end of each calendar quarter, furnish to the registrar, in respect of each fund that it manages, electronically or otherwise —

- (a) a full list of all gross and net assets in the fund reflecting the market value of each asset included in that fund, and the value of each of those assets expressed—
 - (i) as a percentage of the total value of assets in the fund concerned;
 - (ii) as a percentage of the total amount of assets of that class issued by the concern in which the investment is held, and indicating which of such assets are illiquid;
- (b) a report containing details of—
 - (i) all long and short positions in the fund;
 - (ii) in respect of leveraging,
 - (aa) the method of calculation;
 - (bb) the sources of leverage, including the type, the amount and the providers of leverage;
 - (cc) the maximum level of leverage (including disclosure of long and short positions of the fund) permitted under the fund mandate and the maximum level of leverage applied during the reporting period, and the level of leverage as at the quarter-end;
 - (iii) level of collateralisation and the re-use of assets;
 - (iv) level of exposure to each counterparties;
 - (v) capable of internal control systems for derivatives; and
 - (vi) the current risk profile of the fund and the risk management systems employed by the manager to manage the market risk, liquidity risk, counterparty risk, derivative risks and other risks including operational risk;
- (c) a detailed list of all the funds that the manager administers.
 - (2) A manager must—

- (a) not later than 90 days after the close of its financial year, provide the registrar with a copy of each fund's annual report referred to in paragraph 40; and
- (b) on or before a date specified by the registrar, lodge with the registrar such further information and explanations in connection with the financial and other statements referred to as the registrar may request.

42. Monthly reporting to the registrar

In respect of each portfolio, a manager must, on a monthly basis, furnish the registrar electronically or otherwise, with —

- (a) a full list of all gross and net assets in the portfolio, the market value of each asset included in that portfolio, and the value of each of those assets expressed—
 - (i) as a percentage of the total value of assets in the portfolio concerned;
 - (ii) as a percentage of the total amount of assets of that class issued by the entity in which the investment is held, and indicating which of such assets are illiquid;
- (b) a report containing details of—
 - (i) all long and short positions in the fund;
 - (ii) the maximum level of leverage permitted under the fund mandate and the maximum level of leverage applied during the reporting period;
 - (iii) each credit counterparty and the respective exposure to the counterparties; and
 - (iv) capability of the internal systems of control for derivatives.

43. Transitional arrangements

(Will be determined at promulgation stage)

SCHEDULE A**EXPOSURE LIMITS FOR PERMITTED ASSETS****For Equity Instruments (including OTCs)**

Description	RETAIL FUNDS
Exposure limits	<ul style="list-style-type: none"> • 10% per security or 25% per security as long as the aggregate of positions above 10% is limited to 40% of fund. • Aggregate (transferable equity securities, money market instruments, or deposits) counterparty exposure \leq 25% • max 20% in aggregate in instruments based on the value of gold, other metals, and commodities if the instruments are listed on an exchange (in accordance with Board Notice 80) and as long as physical delivery of the underlying is not directly contracted for. • max 20% in unlisted transferable equity securities as long as these securities are negotiable, can be independently valued, and do not compromise the ability of the fund to meet its liquidity terms. • max 10% in any other securities or assets

For Interest Rate Instruments

DESCRIPTION	RETAIL FUNDS
Permitted securities	<p>The following are permitted as interest rate securities:</p> <ul style="list-style-type: none"> • Bonds, debentures • Notes (unsecured/secured/with or without other option rights) • Islamic bonds/instruments • Repurchase transactions • Listed futures • Listed options/warrants/index certificates • Unlisted forex swaps (spot/ forward) • Unlisted interest rate swaps • Unlisted Forward Rate Agreements • Unlisted interest rate options (including but not limited to swaptions, caps, floors, caplets and floorlets) • Instruments based on assets/baskets returns • ETFs/Notes based on other permitted interest rate securities • Trade Bill, trade note • Treasury Bill • Promissory note

	<ul style="list-style-type: none"> • Parastatal bill • Negotiable certificate of deposit • Land Bank bill • Asset with a branch of a foreign bank • Banker's acceptance • Bridging bond • Commercial paper • Deposit
Exposure limits	<p>A manager may include the following interest rate securities whether listed on an exchange or not, in a portfolio in the following manner:</p> <ol style="list-style-type: none"> 1) any money market instrument and repurchase transaction provided that the market value of such interest rate securities does not exceed the percentage/s, as specified in Table 1 below, with netting of credit / issuer / borrower / counterparty risk applied 2) bonds, debentures, debenture stock and debenture bonds, notes, whether or not they have inherent option rights or are convertible, provided that the market value of such interest rate securities does not exceed the percentage/s, as specified in Table 2 below , with netting of credit / issuer / borrower / counterparty risk. 3) Credit derivatives, provided that the market value of such interest rate securities does not exceed the percentage/s on a look-through bases, as specified in Table 2 below, with netting of credit / issuer / borrower / counterparty risk <ul style="list-style-type: none"> • Interest rate derivatives may be used provided that overall portfolio global exposure is within one of the chosen Global exposure limits. • Market risk: A manager may select one of the Global Exposure limits as specified in Table 3 below. The fund has to stipulate upfront in the mandate documentation which approach it will employ to measure Market Risk. If a manager selects the relative VaR method, the chosen benchmark has to be stipulated upfront in the mandate documentation. • Netting to be applied under Commitment approach: A hedge fund using the commitment approach must ensure that its total global exposure does not

exceed its net asset value. The hedge fund may not, therefore, be leveraged in excess of 100% of its NAV. The following steps must be taken by a manager when calculating global exposure using the commitment approach:

a. Calculate the commitment of each individual derivative (as well as any embedded derivatives and leverage linked to EPM techniques).

b. Identify netting and hedging arrangements. For each netting or hedging arrangement, calculate a net commitment as follows :

- Gross commitment is equal to the sum of the commitments of the individual financial derivative instruments (including embedded derivatives) after derivative netting;

- If the netting or hedging arrangement involves security positions, the market value of security positions can be used to offset gross commitment;

- The absolute value of the resulting calculation is equal to net commitment.

c. Global exposure is then equal to the sum of:

- The absolute value of the commitment of each individual derivative not involved in netting or hedging arrangements; and

- The absolute value of each net commitment after the netting or hedging arrangements as described above; and

- The sum of the absolute values of the commitment linked to EPM techniques

3. The calculation of gross and net commitment must be based on an exact conversion of the financial derivative position into the market value of an equivalent position in the underlying asset of that derivative.

4. The commitment calculation of each financial derivative position should be converted to the base currency of the hedge fund using the spot rate.

5. Where any currency derivative has 2 legs that are not in the base currency of the fund, both legs must be taken into account in the commitment calculation

- OTC counterparty exposure in the case of derivatives that involves collateral movements requires an ISDA & CSA. Counterparty exposure on interest rate derivatives is measured as the Net Present Value of the derivative (e.g. on, but not limited to, interest rate swaps, forward rate agreements, swaptions, caps and floors).

Table 1: Money market instruments, repurchase transactions, bonds, debentures, debenture stock and debenture bonds, notes, credit derivatives

Item	Categories of Securities	Limits being the maximum percentage of the aggregate market value of the portfolio	
		Per issuer/guarantor as applicable	In aggregate for all issuers/guarantors as applicable
1	Non-equity securities issued or guaranteed by:		200%
	1.1 the government of the Republic of South Africa;	200%	200%
	1.2 any foreign government which has been assigned a foreign currency sovereign rating not lower than that of the Republic of South Africa;	100%	100%
	1.3 the South African Reserve Bank.	100%	100%
2	Non-equity securities issued or guaranteed by a local or foreign bank and repurchase transactions entered into with a local or foreign bank which forms part of a group (in terms of international accounting standards) of which the holding company is listed on an exchange:		100%
	2.1 with a market capitalisation for the listed group holding company of more than R 20 billion;	30%	100%
	2.2 with a market capitalisation for the listed group holding company of between R 2 billion and R 20 billion.	20%	100%
3	Non-equity securities issued or guaranteed by:		100%
	3.1 a public entity under the Public Finance Management Act, 1999 (Act No.1 of 1999); and	10%	100%
	3.2 any local or foreign entity which is listed on an exchange, including foreign companies, foreign public entities, foreign local authorities and foreign development institutions	10%	100%
4	Non-equity securities issued or guaranteed by entities not described above where such security is:		25%
	4.1 listed and traded on an exchange	5%	25%
	4.2 not listed on an exchange, including, participatory interests in participation bonds	5%	10%

Table 2 : Market risk and gross exposure limits

Item	Gross exposure measure	
1	Commitment approach limitation	200% of the

			aggregate market value of the portfolio
2		VaR approach	
	2.1	Relative VaR	2x Benchmark VaR
	2.2	Absolute VaR	"VAR must be calculated on a daily basis to determine with a 99% confidence level that a total loss over the following month will not exceed 20%.

Table 3:

DESCRIPTION	RETAIL FUND
Permitted investment	A retail fund may invest in other retail funds and collective investment schemes in securities but may not invest in any QI funds, apart from assets in liquid form, whether listed on an exchange or not.
Exposure Limits	Where a hedge fund invests in other portfolios, (a) investment in any one portfolio may not exceed seventy five percent of the market value of the fund (b) it may invest in participatory interests issued by a fund of funds only if that fund of funds is domiciled and regulated outside the Republic and where the fund of funds is not invested in another fund of funds or feeder fund. (c) it may invest in participatory interests issued by a feeder fund only if the feeder fund holds assets outside the Republic of at least eighty five percent of the value of the feeder fund
Due Diligence	A due diligence should be conducted before and during the period of the investment, in respect of underlying hedge funds that the fund wished to invest in.