

Manager Rating

2004-06-30

SG AM Alternative Investments



ASSET MANAGEMENT



RCP & Partners GmbH

Risk rating of asset managers: the investor's measure of trust

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SG AM Alternative Investments

**2 -**
Very good

Manager Rating – Parameters

Date	2004-06-30
Units	Veritas SG Investment Trust GmbH (VSG), SG AM Alternative Investments (SG AM AI), SG Asset Management, Inc. (SG AM Inc)
Asset Classes	Funds of Hedge Funds

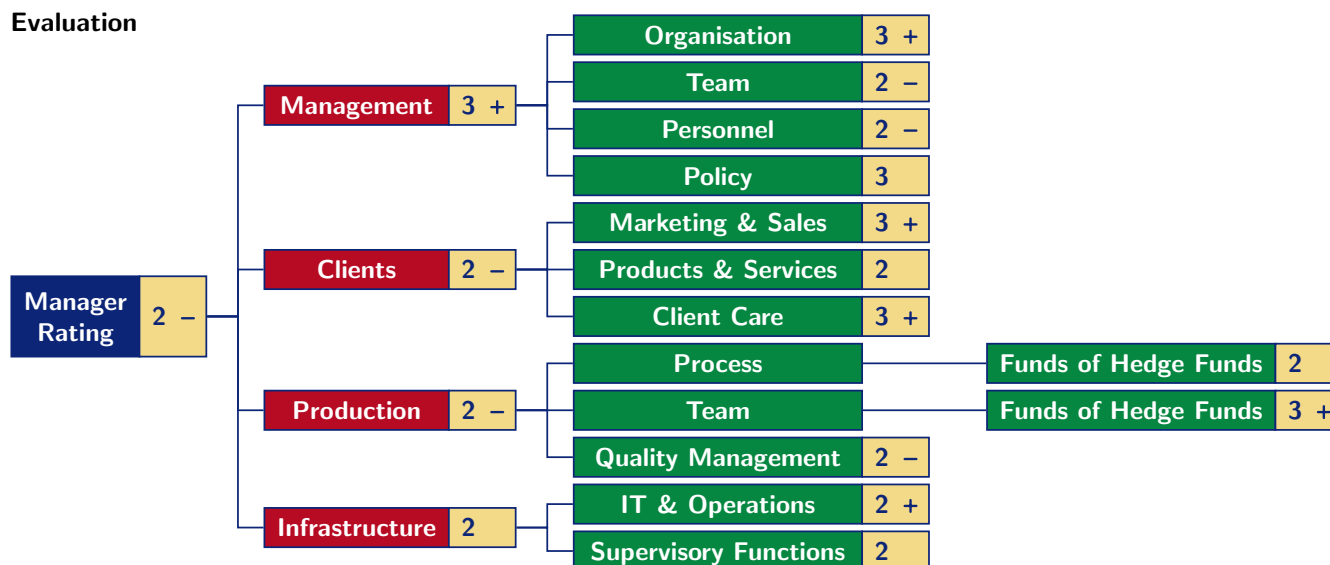
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Manager Rating	
+ 1 -	Excellent
+ 2 -	Very good
+ 3 -	Good
+ 4 -	Satisfactory
+ 5 -	Inadequate
+ 6 -	Weak

Manager Rating – Results

Evaluation



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Introduction

SG AM Alternative Investments (SG AM AI), also referred to here as the *Rated Party* (RP), has undergone for the first time a Manager Rating and received an overall grade of **2- (Very good)**. The present rating evaluates SG AM AI's *Fund of Hedge Funds* (FoHF) capabilities.

Management

Organisation

The RP's parent company, *Société Générale Asset Management S.A.* (SG AM), is a global player in the investment industry and one of the largest European asset managers. The FoHF business was created in 2000 by a team with specific expertise in derivative markets and until last year was supported by a specialised consulting firm. In 2003, the hedge fund product line was merged with other alternative activities to form SG AM AI, a subsidiary of SG AM.

- + The RP can rely heavily on resources (e.g. marketing, reporting, IT, internal audit) from its parent company and focus on its core business.
- + The RP has a strong corporate culture including a leaning toward quantitative methods.
- + The hedge fund product line is highly profitable with strong potential for further growth.
- The strategic goals focus rather on soft than quantifiable objectives.
- Although Chinese walls are formally in place, a few key people have access to some information from all hedge fund areas. However, measures have been taken to keep confidential information separate.

Team

The management team has long-standing management experience, especially in capital markets.

Personnel

The RP's compensation procedures follow a structured process where remuneration is based on compensation studies (of the alternative investment industry) and bonuses are awarded based on annual appraisals.

- + Staff training receives much attention.
- + Portfolio managers are invested in their funds.
- Bonus payments of portfolio managers and executives depend on performance fees only without consideration of risk taken.

Policy

- + There is an internal code of conduct which all staff has to comply with.
- + The RP is a member of the *Association Française de Gestion Financière* (AFG) and complies with the AFG code of conduct.

- There are no independent directors on SG AM AI's supervisory body. Moreover, it includes its CEO and deputy CEO.
- There is no independent compensation or audit committee.

Clients

Marketing & Sales

Marketing is a central function assumed by SG AM. A marketing team within the hedge fund product line co-ordinates between hedge fund production, SG AM Marketing and all relevant distribution channels of *Société Générale Group*.

- + The RP has acquired special know-how in marketing hedge fund products.
- + There are regular management reports regarding sales and marketing activities.
- The RP's marketing team also sells products itself to prospects which are not in the focus of the SG AM salesforce, e.g. to external FoHF managers, interfering with its demanding co-ordination function between sales channels, production process and central functions.

Products & Services

SG AM AI offers a wide range of alternative products, including hedge funds, structured products and private equity. The FoHF product range itself is quite diverse, too. Products can be supplemented by ALM (*Asset-Liability Management*) consulting services, offered by a dedicated team in SG AM.

- + The SG AM *Product Committee* oversees the development of new products, the latter having to follow *Product Creation* procedures.
- + Within the RP, there are designated resources for implementing new products.

Client Care

Client reporting is provided by an independent team within SG AM.

- + Procedures for client reporting have clearly defined deadlines.
- + Proprietary reporting tools and dedicated IT resources allow for customised reporting.

Client relations are managed by the respective sales staff. However, the RP's *Marketing* team assumes a co-ordinating role.

- + Extensive training of sales staff and good knowledge of hedge fund issues.
- Specific CRM procedures and systems are not yet in place but currently under development.

Production

Process

The investment process is clearly structured around its quantitative research on hedge fund behaviour, the underlying model and assumptions. The portfolio managers hold close contact with the hedge fund community, especially in New York. Investment decisions are made by a monthly *Investment Committee* meeting and implemented by the portfolio managers.

- + Investment process follows implications derived from quantitative research.
- + Proprietary, tailor-made tools for strategy allocation and portfolio simulation support decision-making within the investment process.
- + Strict quantitative and qualitative selection criteria supplemented by additional analysis from quantitative research team.
- + Detailed due diligence process including interviews and on-site visits which result in clear investment recommendations.
- Strategic decisions largely based on (hedge fund) market sentiment. Economic and other group or external research are taken into account based on the portfolio manager's individual experience and judgement, rather than by a systematic process.
- Risk management is mainly restricted to mitigating risk by strict selection criteria and thorough understanding of the risks contributed by each hedge fund's investment strategy. However, portfolio managers can insure their portfolio against adverse market conditions by investing into specifically designed SG AM AI hedge funds which have negative correlation to certain market movements.
- The continuing validity of model assumptions is vital for the success of the investment process.
- The RP has taken measures to avoid conflicts of interest. However, there could be clearer separation of functions regarding the two business lines of internal hedge funds and external FoHFs, as far as responsibilities and involvement in investment decision processes are concerned.

There are dedicated resources for FoHF implementation within the Middle Office.

- + Proprietary tool for fund-of-funds administration.
- + Documented and audited procedures available to all staff.
- *Straight-Through Processing* is not in place but under development.

Team

The investment and research teams are well-qualified with the former mainly having expertise in capital markets and

the latter mostly having an academic back-ground.

- + The portfolio management team have built up considerable knowledge of the hedge fund industry.
- + The team have extensive knowledge in respect of derivative instruments.
- Although the team and committee structures allow for substitution and succession, for the time being, the two portfolio managers are critical for the investment process.
- There is some imbalance in respect of professional experience, given that nearly all team members that take investment decisions are former derivative traders.

Quality Management

There are no dedicated quality assurance resources or specific procedures.

- + Performance of FoHFs is followed closely with respect to target return, peer group and indices.
- + Investment risk is monitored by the investment team and independently by a dedicated resource within the SG AM *Risk Control* department.
- Quality of investment decisions is supervised by key personnel within the investment process itself and the CEO rather than having independent checks and balances.

Although investment restrictions are also monitored by the investment team and middle office, systematic control is largely left to the administrator.

- + Breaches of investment restrictions have to be corrected without delay.
- There are no tools supporting the monitoring of investment restrictions and no historic data available.

Performance measurement is carried out by an independent team in SG AM with a number of resources and proprietary tools.

- + Hedge fund composites are certified annually according to AIMR-GIPS.
- + Procedures for AIMR-GIPS-compliance are documented and validated by external auditors.
- Attribution analysis for FoHFs is not yet developed; there is only rudimentary evaluation available.

Infrastructure

IT & Operations

The RP's IT infrastructure and standard applications are provided and supported by SG AM. However, the RP's *Research* department, the *Middle Office* and SG AM's *Performance Measurement and Client Reporting* team have their own resources for developing and maintaining software according to their specific requirements.

- + SG AM provides IT infrastructure and sets IT standards within the group.

- + Back-up procedures include real-time mirroring of data on back-up server with immediate recovery.
- + Disaster recovery centres are available; contingency plans have been tested successfully.

Supervisory Functions

The independent *Risk Control* function, monitoring both investment and operational risk of the RP, is integrated within SG AM's *Risk Control & Compliance* department, which also houses the *Group Compliance* and *Internal Control* teams. The risk methodology of SG AM is based on a general stress test approach which is applied to FoHFs as well as to any other product.

- + Mitigation of operational risk through audit missions

and validation of new products as well as disaster recovery plans.

- + Clear understanding of operational risk, although not yet extensively measured.
- + Monthly risk reporting including follow-up of audit issues.
- + No soft-dollar or kick-back agreements.
- + No personal trading by executives allowed; far-reaching restrictions for investment professionals.
- + Detailed compliance manual available on the intranet.
- + All audit missions are conducted without previous announcement.



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ASSET MANAGEMENT

**2 –
Sehr gut**

Manager Rating – Parameter

Datum	30.06.2004
Einheiten	Veritas SG Investment Trust GmbH (VSG), SG AM Alternative Investments (SG AM AI), SG Asset Management, Inc. (SG AM Inc)
Assetklassen	Funds of Hedge Funds

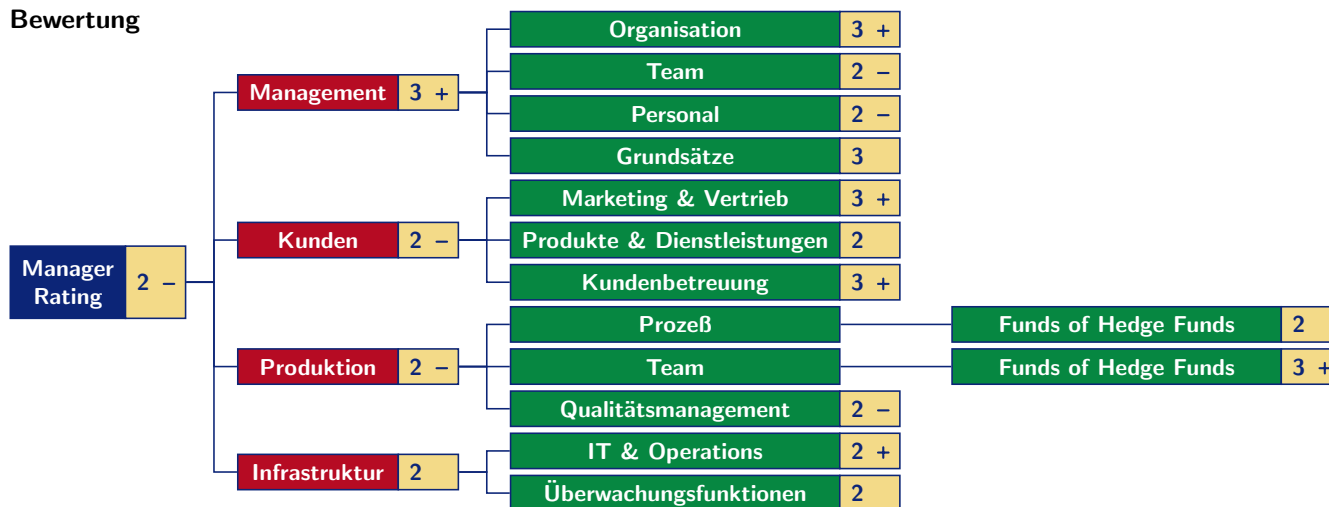
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Manager Rating	
+ 1 -	Exzellent
+ 2 -	Sehr gut
+ 3 -	Gut
+ 4 -	Befriedigend
+ 5 -	Mangelhaft
+ 6 -	Ungenügend

Manager Rating – Ergebnisse

Bewertung



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Einleitung

SGAM *Alternative Investments* (SG AM AI), im folgenden auch als *Rated Party* (RP) bezeichnet, hat sich zum ersten Mal einem Manager Rating durch RCP unterzogen. Die Gesellschaft schnitt insgesamt mit der Note **2- (Sehr gut)** ab. Das vorliegende Rating bewertet den Bereich *Funds of Hedge Funds* (FoHF) der SG AM AI.

Management

Organisation

Die Muttergesellschaft der RP, *Société Générale Asset Management S.A.* (SG AM), ist einer der globalen Player in der Investmentindustrie und einer der größten Asset Manager in Europa. Das FoHF-Geschäft wurde im Jahr 2000 durch ein Team aufgebaut, das besondere Expertise in Derivatemärkten hat. Bis in das letzte Jahr hinein wurde dieser Aufbau durch eine spezialisierte Beratungsfirma unterstützt. Im Jahr 2003 wurde die Produktlinie Hedge Funds mit den sonstigen Aktivitäten im Bereich alternativer Investments in der SG AM AI, einer Tochtergesellschaft der SG AM, zusammengeführt.

- + Die RP kann in starkem Maße auf die Ressourcen der Muttergesellschaft (z. B. Marketing, Reporting, IT, Revision) zurückgreifen und sich auf ihr Kerngeschäft konzentrieren.
- + Die RP verfügt über eine ausgeprägte Unternehmenskultur, die eine Neigung zum Einsatz von quantitativen Methoden einschließt.
- + Die Produktlinie Hedge Funds ist hochprofitabel mit großem Potential für weiteres Wachstum.
- Die strategischen Ziele beruhen eher auf weichen als auf quantifizierbaren Zielsetzungen.
- Obwohl formal *Chinese Walls* errichtet sind, haben einige wenige Schlüsselpersonen Zugang zu manchen Informationen aus allen Hedge-Fund-Bereichen. Allerdings wurden Maßnahmen getroffen, um vertrauliche Informationen getrennt zu halten.

Team

Das Management Team verfügt über langjährige Managementenerfahrung, insbesondere im Bereich Kapitalmärkte.

Personal

Die Festlegung von Gehältern basiert auf einem klar strukturierten Prozeß. Die Gehaltsstruktur orientiert sich dabei an Vergütungsstudien (insbesondere im Bereich Alternative Investments). Boni werden aufgrund jährlicher Beurteilungen gewährt.

- + Der Ausbildung von Mitarbeitern wird ein hoher Stellenwert beigemessen.
- + Die Portfoliomanager haben in ihre eigenen Fonds investiert.

- Die Bonusvergütung der Portfoliomanager und der Entscheidungsträger orientiert sich alleine an den vereinbarten Performance Fees ohne Berücksichtigung von Risiken.

Grundsätze

- + Alle Mitarbeiter müssen einen Katalog interner Verhaltensregeln beachten.
- + Die RP ist Mitglied der *Association Française de Gestion Financière* (AFG) und beachtet die Wohlverhaltensregeln der AFG.
- Im Aufsichtsrat der SG AM AI sind keine unabhängigen Mitglieder vertreten. Sowohl der CEO als auch sein Stellvertreter sind Mitglieder des Aufsichtsrats.
- Es existieren keine unabhängigen Komitees für Vergütung oder Revision.

Kunden

Marketing & Vertrieb

Die Marketingfunktion wird zentral von der SG AM wahrgenommen. Ein Marketing-Team im Hedge-Fund-Bereich übernimmt die Koordination zwischen der Hedge-Fund-Produktion, dem Marketing in der SG AM sowie allen relevanten Vertriebskanälen der *Société Générale Group*.

- + Die RP hat sich spezielles Know-How beim Marketing von Hedge-Fund-Produkten angeeignet.
- + Management-Reports über die Vertriebs- und Marketingaktivitäten werden regelmäßig erstellt.
- Das Marketing-Team vertreibt selbst auch Produkte an solche Kunden, die nicht im Fokus des SG-Vertriebs stehen, z. B. an externe FoHF Manager. Dies kollidiert mit der anspruchsvollen Aufgabe der Koordination zwischen Vertriebskanälen, Produktionsprozeß und zentralen Funktionen.

Produkte & Dienstleistungen

SG AM AI bietet eine breite Palette alternativer Investmentprodukte an. Dazu gehören Hedge Funds, strukturierte Produkte sowie Private Equity. Die FoHF-Produktpalette ist breit angelegt und kann um ALM-Beratungsdienstleistungen (*Asset-Liability Management*) ergänzt werden, die von einem eigenen Team der SG AM erbracht werden.

- + Das SG AM *Product Committee* überwacht die Entwicklung von neuen Produkten, die in Übereinstimmung mit Prozeduren für diesen Bereich erfolgen muß.
- + Innerhalb der RP werden Ressourcen eigens für die Implementierung neuer Produkte vorgehalten.

Kundenbetreuung

Das Kundenreporting wird von einem eigenständigen Team in der SG AM erstellt.

- + Für die Bereitstellung der Kundenreports gibt es klare zeitliche Vorgaben.
- + Selbstentwickelte Reportingtools sowie die eigenen IT-Ressourcen erlauben ein individualisiertes Reporting.

Die Kunden werden durch die jeweils zuständigen Mitarbeiter im Vertrieb betreut. Allerdings übernimmt das *Marketing*-Team der RP eine Koordinationsfunktion.

- + Die Mitarbeiter im Vertrieb werden einer intensiven Schulung unterzogen und verfügen über gute Kenntnisse im Bereich Hedge Funds.
- Spezifische CRM-Prozeduren oder -Systeme sind noch nicht eingeführt, werden allerdings zur Zeit entwickelt.

Produktion

Prozeß

Der Investmentprozeß baut klar auf dem quantitativen Research über Verhaltensmuster im Bereich Hedge Funds sowie dem zugrundeliegenden Modell und dessen Annahmen auf. Die Portfoliomanager stehen in engem Kontakt mit der Hedge-Fund-Branche, insbesondere in New York. Die Investmententscheidungen werden vom monatlich tagenden *Investment Committee* getroffen. Die Umsetzung erfolgt durch die Portfoliomanager.

- + Der Investmentprozeß folgt Implikationen, die aus quantitativem Research abgeleitet wurden.
- + Die Entscheidungen im Investmentprozeß werden durch selbstentwickelte und maßgeschneiderte Tools für Strategieallokation und Portfoliosimulation unterstützt.
- + Es existieren klare quantitative und qualitative Selektionskriterien, die durch Analysen des quantitativen Research-Teams ergänzt werden.
- + Der Due-Diligence-Prozeß ist sehr tiefgehend und umfaßt Interviews und Besuche vor Ort. Die Due Diligence resultiert in klaren Investmentempfehlungen.
- Strategische Entscheidungen basieren zum großen Teil auf (Hedge Fund) Markteinschätzungen. Volkswirtschaftliches und sonstiges Research aus dem Konzern bzw. aus anderen Quellen wird von den Portfoliomanagern berücksichtigt. Allerdings hängen die Schlußfolgerungen eher von der individuellen Erfahrung und Einschätzung ab, als daß ein systematischer Prozeß zugrundeliegt.
- Risikomanagement ist zum großen Teil darauf beschränkt, Risiken durch die strengen Auswahlkriterien und das Verständnis des Risikobeitrags der Investmentstrategie jedes einzelnen Hedge-Fund-Managers zu reduzieren. Allerdings können die Portfoliomanager ihre Portfolios auch gegen ungünstige Marktentwicklungen absichern. Dazu können sie in Hedge Funds der SG AM AI investieren, die ihrer Konstruktion zufolge eine negative Korrelation zu bestimmten Marktbewegungen haben.

- Der Erfolg des Investmentprozesses ist in starkem Maße von der fortwährenden Gültigkeit der Modellannahmen abhängig.
- Die RP hat Maßnahmen getroffen, um Interessenkonflikte zu vermeiden. Allerdings könnte die Funktionstrennung zwischen den beiden Geschäftsbereichen der internen Hedge Funds und der externen FoHFs hinsichtlich der Verantwortlichkeiten und der Einflußnahme auf den Investmentprozeß klarer sein.

Für die Implementierung von FoHFs sind klare Zuständigkeiten und entsprechende Ressourcen innerhalb des *Middle Office* vorhanden.

- + Für die FoHF-Administration existiert ein selbstentwickeltes Tool.
- + Klar dokumentierte und geprüfte Prozesse, die allen Mitarbeitern zur Verfügung stehen.
- *Straight-Through Processing* ist bisher nicht umgesetzt, befindet sich jedoch in der Entwicklung.

Team

Die Mitarbeiter im Investment- und Research-Team sind sehr gut qualifiziert. Erstere verfügen vor allem über langjährige Erfahrung an den Kapitalmärkten. Letztere haben überwiegend akademische Erfahrungen.

- + Das Portfoliomanagement-Team hat ein beträchtliches Know-How über die Hedge-Fund-Industrie aufgebaut.
- + Das Team hat weitreichende Expertise im Hinblick auf derivative Instrumente.
- Obwohl die Team- und Komitee-Strukturen ausreichend Spielraum für Vertretung und Nachfolge lassen, sind die beiden Portfoliomanager derzeit noch wesentlich für den Investmentprozeß.
- Ein gewisses Ungleichgewicht besteht im Hinblick auf die Berufserfahrung, da fast alle Mitglieder des Teams, das Investmententscheidungen trifft, ehemalige Derivatehändler sind.

Qualitätsmanagement

Es werden keine eigenen Ressourcen oder spezielle Prozeduren für die Qualitätssicherung vorgehalten.

- + Die Performance der FoHFs wird ständig im Hinblick auf Rendite-Ziele, Peer Groups und Indizes verfolgt.
- + Das Investmentrisiko wird durch das Investmentteam und zusätzlich unabhängig davon durch die Abteilung *Risk Control* der SG AM überwacht.
- Die Qualitätskontrolle der Investmententscheidungen erfolgt nicht unabhängig, sondern wird durch für den Investmentprozeß zentrale Personen selbst sowie den CEO überwacht.

Das Investmentteam sowie die Mitarbeiter im *Middle Office* überwachen zwar die Investmentrestriktionen, die systematische Kontrolle wird jedoch weitgehend dem Administrator überlassen.

- + Jede Verletzung von Investmentrestriktionen muß ohne Verzögerung korrigiert werden.
- Es existieren keine Tools, welche die Überwachung von Investmentrestriktionen unterstützen; historische Daten sind nicht verfügbar.

Die Performance-Messung wird von einem eigenen Team in der SG AM mit zahlreichen Ressourcen und selbstentwickelten Tools durchgeführt.

- + Hedge Fund Composites werden jährlich gemäß AIMR-GIPS zertifiziert.
- + Die Prozeduren für die Einhaltung von AIMR-GIPS sind dokumentiert und werden durch externe Prüfer validiert.
- Eine Attributionsanalyse für FoHFs existiert noch nicht; bislang ist eine Auswertung nur in Ansätzen verfügbar.

Infrastruktur

IT & Operations

Die IT-Infrastruktur und die Standardanwendungen der RP werden von der SG AM bereitgestellt und unterstützt. Allerdings verfügt die RP auch über eigene Ressourcen in den Bereichen *Research* und *Middle Office* sowie im Bereich *Performance Measurement & Client Reporting* der SG AM, um Software entsprechend ihrer eigenen Anforderungen zu entwickeln und zu pflegen.

- + SG AM stellt die IT-Infrastruktur zur Verfügung und setzt IT-Standards innerhalb der gesamten Gruppe.
- + Back-up-Prozeduren umfassen die Real-Time-Spiegelung von Daten auf Back-up-Servern mit sofortiger Wiederherstellung.

- + Notfalleinrichtungen sind verfügbar; die Notfallpläne wurden erfolgreich getestet.

Überwachungsfunktionen

Die unabhängige Stelle *Risk Control* überwacht sowohl Investment- wie auch operationale Risiken und ist im Bereich *Risk Control & Compliance* der SG AM integriert. Dieser Bereich beinhaltet auch die Teams *Group Compliance* und *Internal Control*. Die Risikomethodik der SG AM basiert auf einem allgemeinen Streß-Test-Ansatz, der sowohl auf FoHFs als auch auf alle anderen Produkte angewendet wird.

- + Operationale Risiken werden durch Revisionsprüfungen, die Validierung neuer Produkte sowie Notfallpläne reduziert.
- + Die RP hat ein klares Verständnis operationaler Risiken, gleichwohl werden diese bisher noch nicht umfassen gemessen.
- + Das Risikoreporting erfolgt monatlich und beinhaltet offene Revisionspunkte.
- + Es gibt keine Vereinbarungen über Soft-Dollars oder Kick-backs.
- + Der Geschäftsleitung sind eigene Wertpapiertransaktionen ganz untersagt, Investment Professionals unterliegen weitreichenden Restriktionen.
- + Ein detailliertes Compliance-Handbuch steht den Mitarbeitern im Intranet zur Verfügung.
- + Sämtliche Revisionsprüfungen werden ohne vorherige Ankündigung durchgeführt.

Rated Party

Units

This rating concerns the independent legal entities:

- ✗ **SGAM Alternative Investments** (abbreviation: SG AM AI), located in Paris, as well as
- ✗ **SG Asset Management, Inc.** (abbreviation: SG AM Inc), located in New York, and
- ✗ **Veritas SG Investment Trust GmbH** (abbreviation: VSG), a full *Kapitalanlagegesellschaft* according to German law, located in Frankfurt am Main.

All entities are subsidiaries of *Société Générale Asset Management S.A.* (abbreviation: SG AM), headquartered in Paris, which, in turn, is part of the *Société Générale Group* (abbreviation: SG Group).

Client Groups

This rating does not focus on a particular client group as the processes under consideration do not vary with the product's tranches for different client groups.

Asset Classes

For the purposes of this rating, the asset class

- ✗ **Funds of Hedge Funds** (FoHF)

has been subject to analysis and evaluation.

Effective Date

Unless stated otherwise, all data contained in the present report refer to **2004-04-30**.

Table 1: Companies

Company	SG AM AI — SG AM Alternative Investments, Product Line FoHF — Funds of Hedge Funds	SG AM Inc — SG Asset Management, Inc., Product Line FoHF — Funds of Hedge Funds	VSG — Veritas SG Investment Trust GmbH
Address	2, Place de la Coupole	1221 Avenue of the Americas, 12th Floor New York, New York 10020, USA	Bettinastraße 62
Phone	F-92400 Courbevoie +33-1-5637-8000	+1-212-278-53-70	D-60325 Frankfurt am Main +49-69-975743-22
Internet	www.sgam.com	www.sgam.com	www.veritassg.de
Founded	1997 ¹ /2003	1998 ²	1991
Employees	48	10	46
AUM (EUR m)	1007	—	843 ³
Portfolios	9	9	17
Services	Management of Funds of Hedge Funds	Advisory for Funds of Hedge Funds	Portfolio Management (equities, fixed income, balanced, money market) and distribution of SG AM Group products

¹as SG SAM ²as SG Cowen AM ³as of 2004-05-31

Management

Organisation

Group Structure

Société Générale S.A. (SG) was founded in Paris in 1864. Today it employs more than 88 000 staff in 80 countries and is one of the largest European banks. Its asset management activities were launched in 1964 and at the end of 1996 transferred to a fully-owned subsidiary, *Société Générale Asset Management S.A.* (SG AM). Since then SG AM has acquired *Trust Company of the West* (TCW), a large independent fund manager in the USA, and SG Yamaichi AM in Japan and Singapore and created SG AM UK. Recently, SG AM has been expanding in Japan, China and South Korea through acquisitions, joint ventures and partnerships. More information on *Société Générale S.A.* and SG AM are available at www.socgen.com and www.sgam.com, respectively.

Organisational Structure

SG AM's hedge fund activities were launched in 2000 and in 2003 joined with other alternative products (structured products, private equity, and later real estate) to form *SG AM Alternative Investments* (SG AM AI). At the end of 2003 SG AM AI had almost EUR 19bn in *Assets under Management* of which EUR 2.6bn were managed in hedge fund products.

SG AM AI is organised by (alternative) product lines with separate and distinct operational support, see also figure 2 on page 15. The portfolio management of external *Funds of Hedge Funds* is located in New York as part of *SG Asset Management, Inc.* (SG AM Inc) but is functionally managed by the global head of hedge funds, Arié Assayag.

SG AM AI is supported by its parent company in respect of the following functions or activities:

- ✗ marketing
- ✗ performance measurement
- ✗ client reporting
- ✗ risk control
- ✗ audit
- ✗ legal affairs

Veritas SG Investment Trust GmbH (VSG), founded in 1991, is a *Kapitalanlagegesellschaft* according to German law and majority-owned by SG AM, see figure 1 on page 14. VSG manages itself a number of mutual funds and German Spezialfonds with approximately EUR 843m of *Assets under Management* at the end of May 2004, relying on its own client account administration and fund accounting infrastructure. VSG also distributes SG AM funds and supports SG AM AI in its distribution of hedge fund products in Germany.

Co-operations

During the start-up of the hedge fund activities SG AM was supported by *Alpha Investment Managers, Inc.*, USA. The co-operation expired in 2003.

Financials

Although audited financial statements for SG AM AI were not yet available due to the recent creation of SG AM AI, the information provided shows that the hedge fund product line has been profitable. Profits and losses are consolidated with SG Group.

Competitive Position

SG AM AI positions itself as a global alternative asset manager with a complete range of alternative products which feature diversification, absolute returns and non-correlation with traditional asset classes. The client groups targeted are institutions, high-net-worth individuals as well as retail clients. The main markets in Europe are France, the UK, Germany, Italy and Spain. In Asia the regional focus is on Japan, South-East Asia and Australia.

As comprehensive market statistics are not available for the alternative segment, SG AM AI compares itself constantly with a chosen peer group.

Strategy

SG AM AI wants to be a leading actor in the alternative asset management industry. To meet its business goals it focuses on an increased global coverage by expanding its presence in Europe and abroad and offering all product lines to interested clients. While it seeks to achieve financial stability through complementary businesses in a diversified portfolio of products, the individual product lines enjoy a high degree of entrepreneurial freedom.

To meet the strategic goals and to support growth, SG AM AI made an effort to hire well-experienced staff, mostly with backgrounds in the capital markets or the asset management industry.

Team

Education & Experience

For new staff joining the management team SG AM AI has clear and focused requirements regarding education and experience.

Stability

The management team for external *Funds of Hedge Funds* has been unchanged since the launch of SG AM's hedge fund activities.

Personnel

Remuneration

Salary ranges are established across SG AM based on comparative compensation studies, including dedicated research on the alternative asset management industry. Compared with the industry, the bonus element of SG AM AI's compensation has stronger emphasis whereas the fixed part is slightly below average.

The distribution of bonuses and the review of salaries follows an annual performance appraisal procedure as established within SG AM. The size of the bonus pool is determined by gross operating income. Bonuses for senior management, portfolio managers and senior research professionals are based on performance fees only. The distribution depends both on individual fund performance and the performance fees generated by the entire team.

Training

SG AM AI expects senior recruits to have extensive professional experience in similar tasks. Junior positions are filled with graduates who are then trained internally.

SG AM encourages their employees to obtain professional qualification such as *Chartered Financial Analysts* (CFA), offering financial support and time-off for study and exam preparation.

Corporate Culture

Internal information is available on SG AM's intranet. Important decisions are communicated to the employees through an internal newsletter. There are also staff meetings organised three times a year.

Table 2: Personnel Hedge Funds

Year	SG AM AI/SG AM		in		out		SG AM Inc	
2003	41	(13.9%)	6	1	10	(150.0%)	6	0
2002	36	(63.6%)	15	1	4	(33.3%)	1	0
2001	22	(83.3%)	10	0	3	(0.0%)	1	1
2000	12				3			

All data as of year-end

Policy

Corporate Governance

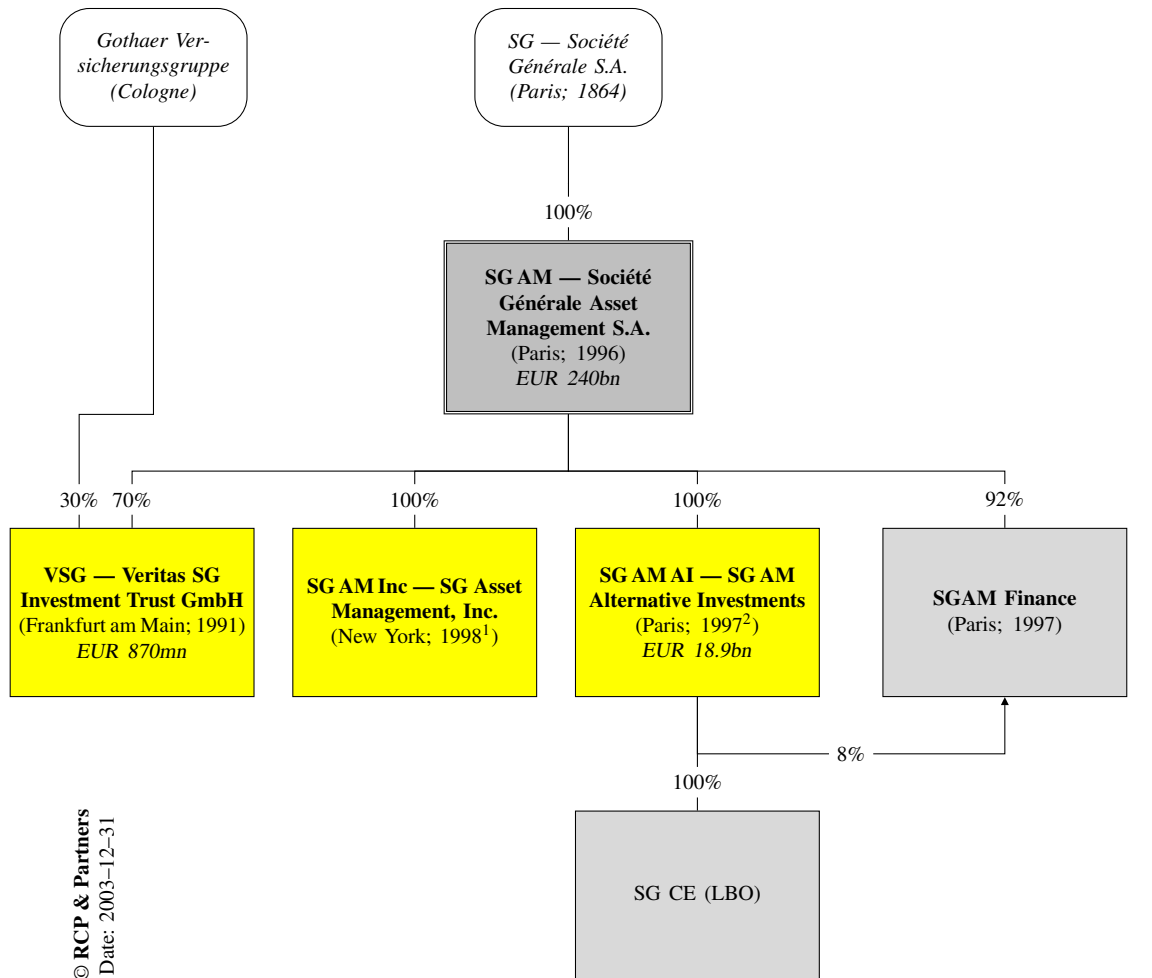
Senior managers of SG AM as well as its own CEO and deputy CEO are on the SG AM AI supervisory board. There are no independent directors. The board meets twice a year, discussing past and future activities, budget issues and adequacy of resources.

The four product lines of SG AM AI, the CEO and the deputy CEO are represented on its executive committee which meets at least weekly to discuss day-to-day activities.

Rules of Conduct

All employees of SG AM and SG AM Inc work to a code of conduct which is available on the intranet and handed out to new employees. Violations of the code of conduct are sanctioned. SG AM and SG AM Inc comply with the AFG (*Association Française de Gestion Financière*) code of conduct.

Figure 1: Group Structure (SG AM AI)



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Date: 2003-12-31

- Shareholder
- Group
- Investment company
- Other company

Specified are headquarters, year of foundation, and assets under management;
effective date: 2004-04-30
¹ as SG Cowen AM
² as SG SAM

Figure 2: Organisational Structure (SG AM AI)

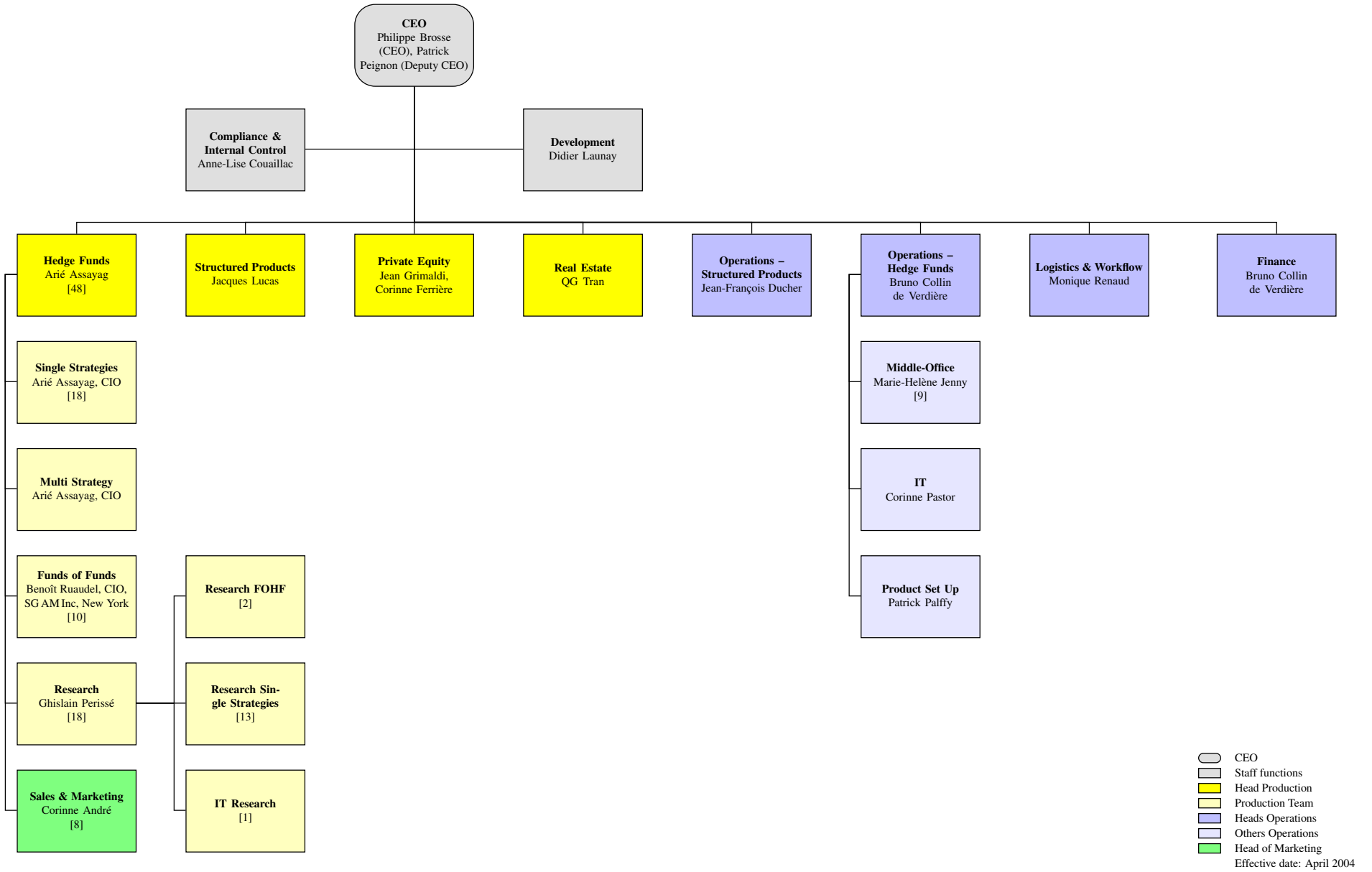
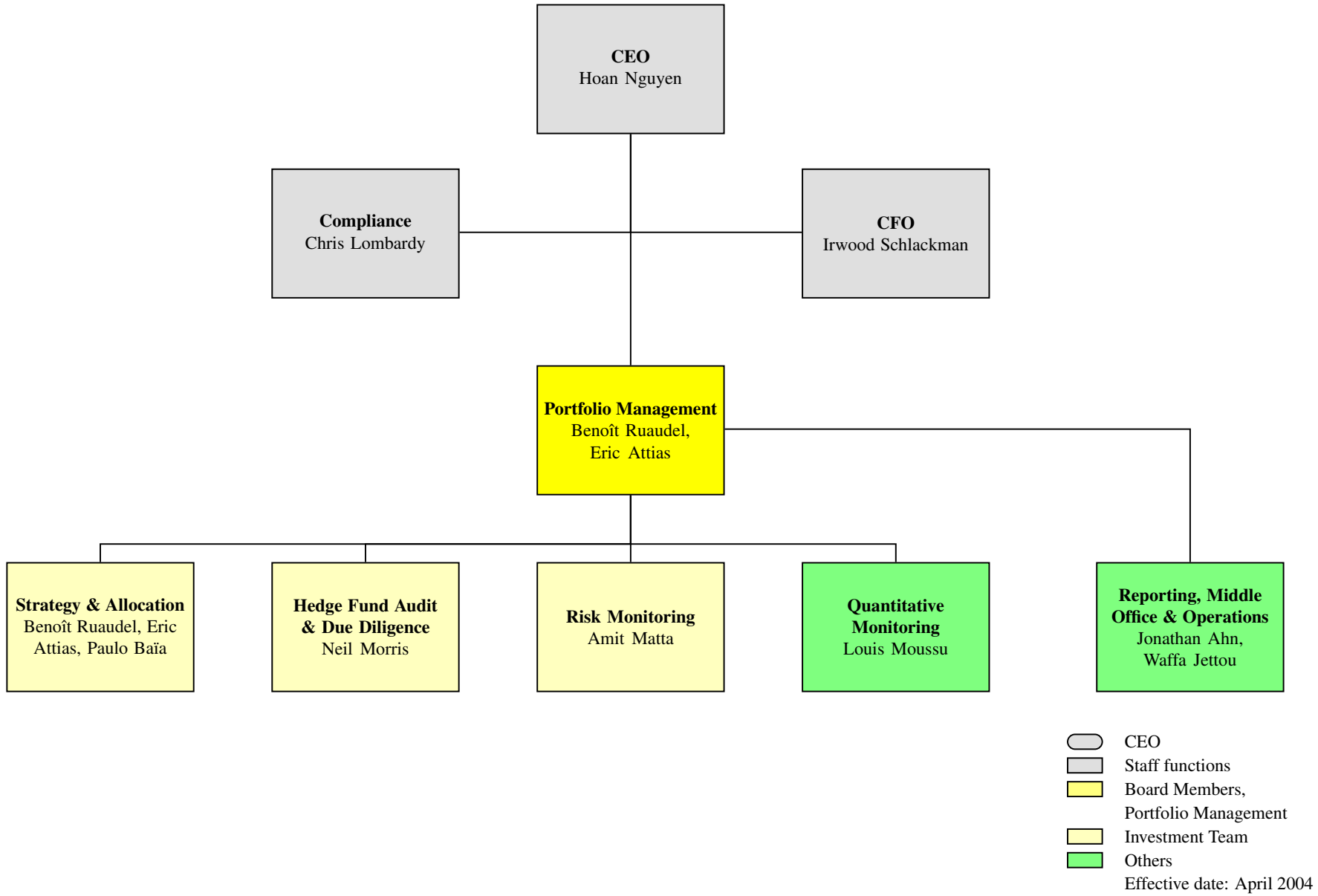


Figure 3: Organisational Structure (SG AM Inc)



Clients

As of 2003–12–31, SG AM AI managed a total of EUR 18.96bn in assets, EUR 2.6bn of which in hedge fund products including EUR 1.0bn in 9 *Funds of Hedge Funds* (FoHFs). French retail clients contributed 16% and European (mainly French) institutional investors 39% of FoHF assets, respectively. Private clients from a number of European countries make up 14% of the investments, compared with 22% from Asian private clients.

Marketing & Sales

Marketing

SG AM has dedicated marketing teams for retail and institutional clients. On the institutional side there are specific teams for investment process marketing and consultant relations. On the retail side marketing includes a product development function. For the organisation of this department see figure 4 on the following page.

Marketing has particular importance for the hedge fund business, in that it often has to perform an educational role for the many clients new to this asset class, enhancing their understanding and improving transparency regarding the investment process and control of risk. SG AM AI can draw on all of these resources and guides them in respect of alternative investments and FoHFs in particular. The Hedge Fund product line has a separate marketing function, see figure 2 on page 15 and figure 4 on the following page, to coordinate between the investment professionals and the marketing and sales teams in their respective units.

In its marketing strategy, SG AM AI focuses on communicating products and services, describing their competitive edge, risk/reward profile, fees etc. Its branding strategy capitalises on its parent company as, for instance, all product names incorporate the acronym SG AM.

The processes in the marketing area are formalised and documented. They are supported by software tools including a contact database for consultants and an RfP/Marketing database.

Sales

SG AM AI utilises two distribution channels. On the one side there are SG Group entities such as the global SG AM sales force, for instance VSG in Germany, where 6 staff are involved in marketing FoHFs. But there is also direct distribution by the SG AM AI *Marketing* team targeting FoHF managers and specialised third party distributors as well as corporates, and family offices in some countries.

The distribution channels are supported by 5 staff within the *Marketing* team of SG AM AI's hedge fund product line, see figure 2 on page 15.

Products & Services

Product Range

SG AM AI offers a wide range of alternative investment products, including investments in hedge funds, structured products, private equity and real estate. Within the hedge fund product line, single hedge funds, overlay strategies and internal FoHFs are offered, supplemented by 9 external FoHFs. The external FoHF products range from diversified funds to region-specific and strategy- or sector-focused varieties, catering for a wide spectrum of investment interests. The original offer was the SGAM ADF fund created in October 2000.

The FoHF products have clear targets regarding absolute return, investment horizon, volatility and drawdown. The management fees are currently between 1.2% and 2.5% with additional performance fees of 15% on the annual positive return for most products.

SG AM AI can offer strategic asset allocation services to clients and prospects via a dedicated SG AM team.

Product Development

Product development within SG AM AI is not performed by a separate unit but by senior professionals.

Client Care

Reporting

Reports are considered to be a communication tool with clients, providing reliable and consistent information on a regular basis. Reporting is provided by a dedicated 15-strong team, see figure 4 on the following page, using proprietary software developed by dedicated IT resources. Reports are translated into various languages and can be customised according to client's requests.

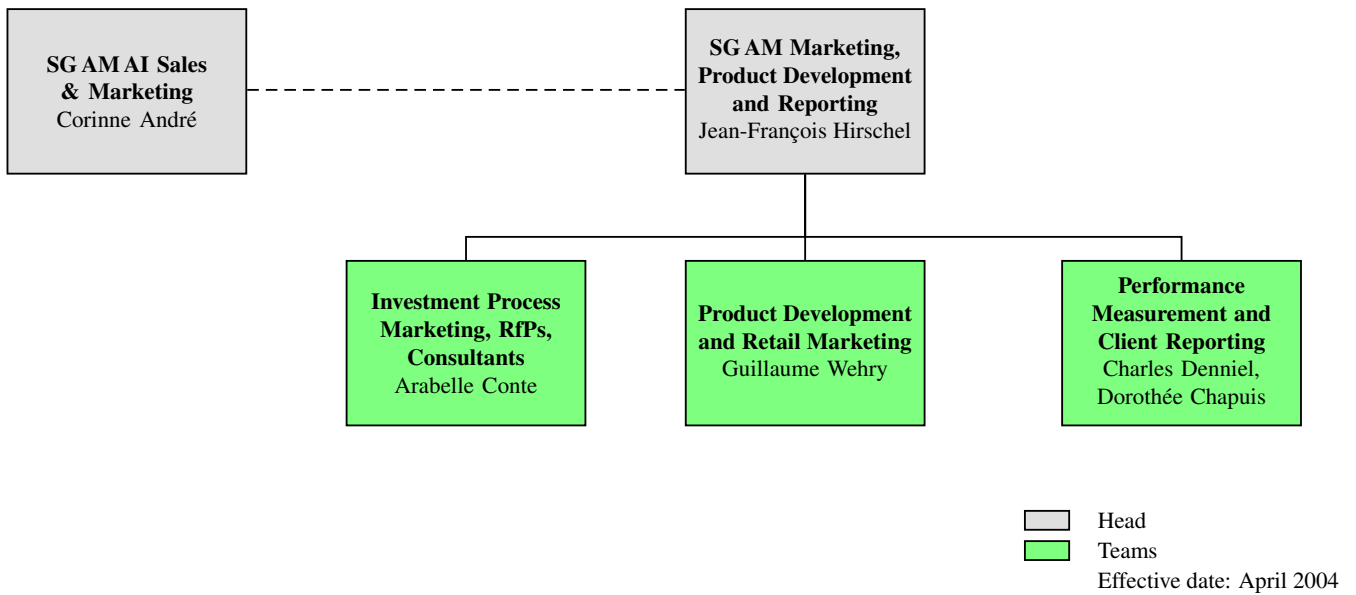
Procedures for creating reports are documented in detail. Reports are validated by fund managers before release.

Client Relationship Management

Client relationships are taken care of by the SG AM AI *Sales & Marketing* team supported by the Sales teams. For the German market, VSG performs the task with 6 of its employees.

There are internal education and training sessions to improve team knowledge regarding FoHFs with the aim of improving quality of client meetings and services. A client database is used to maintain contact information.

Figure 4: Organisation (Marketing, Product Development and Client Reporting)



Production

Process

Funds of Hedge Funds

SG AM AI offers a range of *Funds of Hedge Funds* (FoHFs) investing in external hedge funds. SG AM AI also offers single hedge funds and overlay strategies as well as multi strategy products.

Investment Process

Tasks & Organisation The tasks within the investment process are handled by the investment team at SG AM Inc in New York, see figure 3 on page 16, with the support of quantitative research analysts at SG AM AI's *Research* department, see also figure 2 on page 15. The investment process is supervised by and all investment decisions are taken in the *Investment Committee*. The *Investment Committee* is supervised by Benoît Ruauzel, Eric Attias, portfolio managers, Arié Assayag, head of hedge funds and Philippe Brosse, CEO of SG AM AI. Day-to-day decisions are taken by the two portfolio managers guided by recommendations of the Investment Committee.

Resources & Tools The investment process employs various proprietary software tools, ranging from a hedge fund database to tools for strategy allocation, sensitivity analysis and portfolio simulation. The tools are developed and maintained by the research department.

Stability The investment process has been applied since 2000 without significant changes.

Philosophy Key to the investment philosophy is a blend of quantitative and qualitative approaches where research analysts constantly interact with investment professionals who keep close contact with the hedge fund community. The underlying hedge funds have to satisfy a range of quality criteria to be considered for investment. On the other hand, access to the best hedge fund managers is vital for successful FoHF management.

Modus Operandi The investment process is a combination of top-down and bottom-up approaches. The allocation between broad hedge fund categories and their sub-strategies is performed top-down, starting from the optimal solution of a quantitative model. Individual hedge funds are selected for inclusion in the portfolio by various stages of quantitative and qualitative analysis.

Strategic Decision-making SG AM AI divides hedge fund strategies into three categories:

✗ equity hedge (long and short equity oriented investing)

✗ global macro/CTA (long and short positions throughout the asset class spectrum)

✗ relative value (benefit from trading anomalies)

Each of these strategies has corresponding sub-strategies. The strategies – as defined – each have a characteristic behaviour relative to market conditions which is very similar to certain options. The objective is to diversify among those strategies to achieve absolute returns in all market conditions.

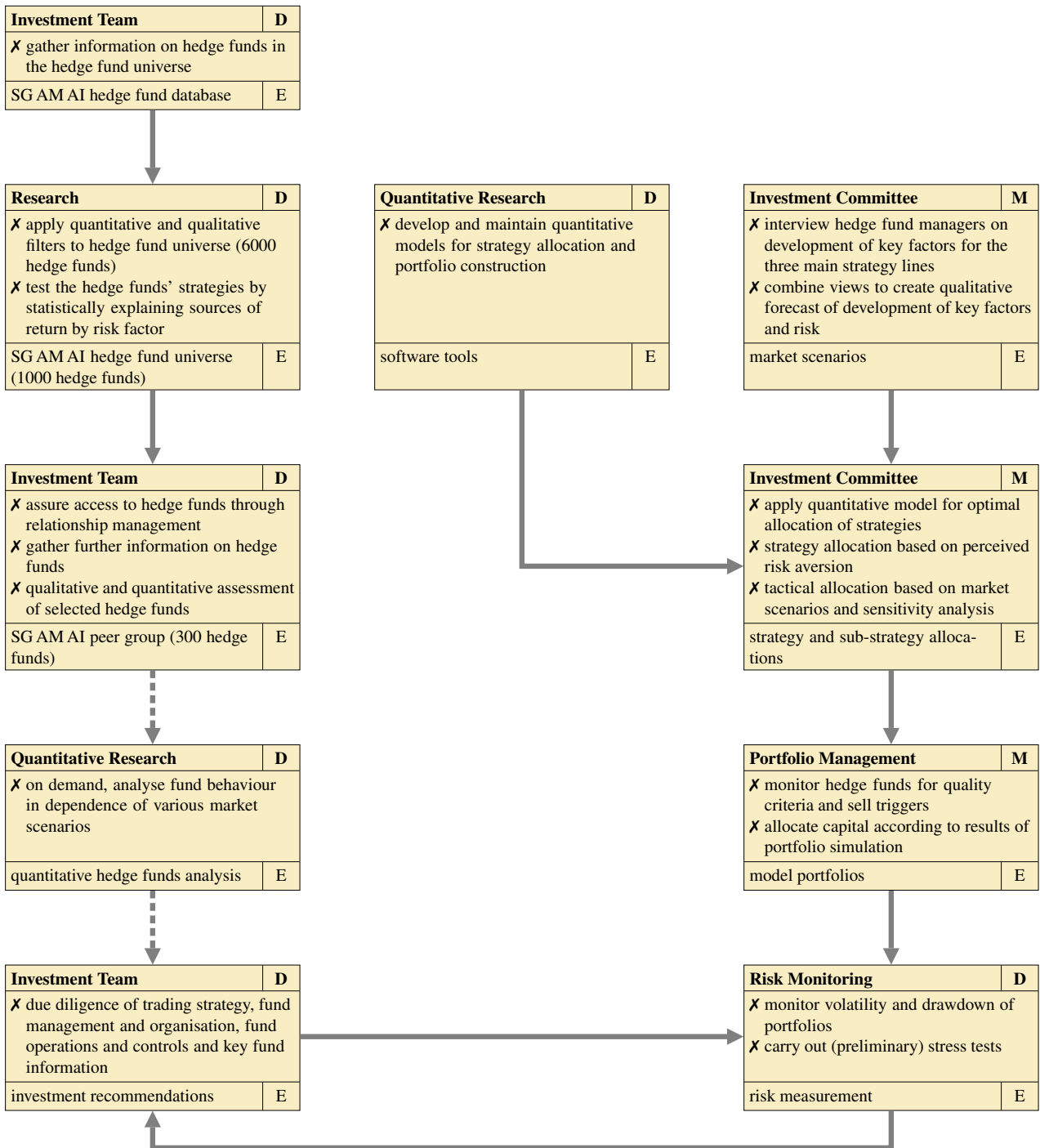
The optimal allocation between the three broad strategies is calculated using a proprietary quantitative model which does not rely on distribution assumptions but on utility functions and the notion of risk aversion. The allocation model calculates optimal allocations as a function of risk aversion, providing directional guidance to the change in strategy allocation. The *Investment Committee* assemble qualitative market scenarios based on interviews with hedge fund managers and their own market expertise. The actual strategy allocation is decided upon by the *Investment Committee* based on the indicated changes in strategy allocation and the market scenarios, and is subject to further constraints such as the availability and liquidity of suitable investment opportunities.

Table 3: Profile (Funds of Hedge Funds)

CIO	Arié Assayag (since 1999)
Team Leader	Benoît Ruauzel (since 2000)
Investment Professionals	5
Portfolios	9
AUM (EUR m)	1007
Philosophy	✗ blend of top-down and bottom-up approaches with interaction between quantitative analysts and qualitative portfolio managers
Investment horizon	3–5 years
Objectives ¹ :	Performance: ✗ LIBOR + 600 bp Risk: ✗ volatility 4% ✗ drawdown < 1.5% Portfolio turnover: ✗ 40% p.a.
Hedging/derivatives	✗ currency swaps only
Leveraging	on average 120%
Documentation	marketing presentation

¹ for SGAM ADF product

Figure 5: Process (Funds of Hedge Funds)



Legend:

Team/Meeting	*
X Tasks	
Output	**

* Frequency: D = daily, W = weekly, M = monthly, Q = quarterly, Y = yearly
 ** Media: E = electronic, T = telephone, O = oral, P = paper

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Tactical Decision-making The allocation of sub-strategies within one of the three broad strategies is based on the above-mentioned market scenarios and follows along the same lines as the strategic allocation. The sensitivity of sub-strategies to (historical) market scenarios can be validated with the aid of a software tool.

Portfolio Construction After deciding upon the strategic and tactical allocations, the change in portfolio composition is simulated with regard to performance, volatility and draw-down. The capital is then allocated to selected funds based on the outcome of this analysis.

FoHF portfolios consist of around 30 hedge funds. All invested funds are constantly monitored and subjected to the same criteria as all other funds. There is a strict sell-discipline where the violation of any of those criteria can trigger the exit from a hedge fund.

Security Selection The universe of around 6000 hedge funds is filtered using quantitative (return, volatility and drawdown, Sharpe ratio, three-year track record, minimum of USD 100m under management) and qualitative (dedicated to emerging markets or mortgage-backed securities, high or increasing leverage according to strategy) criteria which leave approximately 1000 hedge funds to be validated.

Hedge funds managers perceived to be interesting are interviewed by the FoHF portfolio managers and, if considered for investment, are subjected to a preliminary due diligence. Around 300 funds actually pass this assessment (various basic quality criteria, investment style, transparency, liquidity, capacity). As their (sub-)strategies are considered for allocation, they are subjected to an in-depth due diligence process seeking to:

- ✗ understand trading strategy and key risks taken
- ✗ know fund management and organisation
- ✗ understand fund operations and controls
- ✗ verify key fund information

The due diligence process is questionnaire-based but supplemented by extensive interviews with the portfolio managers and on-site visits by the investment team analysing risk management procedures and infrastructure, among other matters.

Currency allocation There is no currency allocation within the investment process. The individual funds have share classes in different currencies (USD, EUR, YEN, GBP) which are systematically hedged with currency swaps.

Leverage The degree of investment of FoHF portfolios is on average 100% for most funds; specific products have a higher leverage by design. Under normal circumstances the leverage is stable but constantly monitored through stress tests.

Investment Guidelines For each portfolio there are guidelines regarding ranges for

- ✗ the number of funds
- ✗ the allocation to a single fund
- ✗ the number of strategies
- ✗ the allocation to a single strategy

Risk Management The principal means of controlling risk within the investment process is the careful hedge fund selection process, assuring quality and understanding investment strategies and the associated risks.

The volatility of portfolios is monitored on a daily basis. Stress tests are carried out to measure and control overall portfolio risk. The stress tests are independently calculated and monitored by the *Risk Control* department, see figure 6 on page 25.

Exceptional Situations In case of exceptional events, the investment team communicates internally and with clients via a *Communication Brief*, analysing the impact on the portfolios and strategies they are composed of.

Table 4: Analytical approaches (Funds of Hedge Funds)

<i>Method</i>	<i>Significance</i>
Qualitative analysis	1
Quantitative analysis	2
Macro-economics	3
Micro-economics	3
Cycle analysis	3
Analysis of financial statements	3
Visits to issuers	1
Discussions with issuers	1
Rating	2
Factors, ratios	2
Price forecasts	2
Relative value	2
Regression analysis	3
Non-linear models	3
Portfolio optimisation	1
Artificial intelligence	5
Scenario playing	2
Chart analysis	2
Technical indicators	3
Others	5

Significance: 1 = high importance, 5 = no importance

Research The quantitative research team works in close co-operation with the investment professionals. The team provides tools for supporting the investment process and conducts research to improve the underlying methods. In particular, it maintains and supports the proprietary software

tools TANIS and ANKHAMON. TANIS is a database of all portfolios and investee hedge funds, as well as containing data and analytical tools. ANKHAMON provides a number of decision-making tools, in particular the allocation model and the sensitivity analysis. Other tools are to be included in the ANKHAMON package.

Of the 18-strong team, five members are dedicated to FoHF. There is also contribution from an external consultant, a professor teaching at various academic institutions.

All information on hedge funds is gathered by the investment team. The information is then entered in TANIS and the research team performs on request various stages of quantitative screening on the data (performance versus peer group, sensitivity of market parameters, analysis of return sources).

The research team also provides the tools to optimise the strategy allocations as a function of risk aversion perceived by the Investment Committee.

The results are continuously incorporated in TANIS and available to all participants in the investment process.

Settlement

The *Middle Office* team consists of eight employees, two of them dedicated to FoHFs. SG AM AI uses a proprietary system, FOLIA, for FoHF administration.

The *Middle Office* team receives all subscription and redemption orders from the transfer agent and the new portfolio structure from the portfolio management team and enters them in FOLIA. The trade blotters created from the data are then forwarded to the external parties involved in the settlement process: depository bank, transfer agent and fund administrator, all of which are part of SG Group except for one provider based in the USA.

The *Middle Office* team follows these orders on a day-to-day basis and reconciles the positions. They also validate the NAV calculation provided by the fund administrator.

All procedures are documented and audited.

Team

Funds of Hedge Funds

Education & Experience

For new staff joining the investment team SG AM AI has clear and focused requirements regarding education and experience. All investment professionals have relevant education and experience.

Stability

The investment team for external FoHFs has been stable since the launch of SG AM's hedge fund activities in 2000 with the addition of a second portfolio manager in 2002. In 2003, the investment team was enlarged by one person responsible for *Risk Monitoring* and *Strategy & Allocation*. In 2004, a further person was added holding responsibility for *Structural Due Diligence*.

All investment decisions are taken by the *Investment Committee*, thereby avoiding dependence on a single decision-maker who may be absent on occasion.

Quality Management

Quality Assurance

Quality assurance within SG AM AI consists of controlling the implementation of all processes related to FoHF products. This responsibility is assumed by the respective functional heads. To do so, there is a strong emphasis on team work and procedures which have to be followed strictly but also on the sustainability of the processes. The investment process is supervised by the Investment Committee and the reliability of information is improved through dedicated tools.

Investment Process

Performance Estimated performance is available weekly and stored in TANIS. The performance is then analysed against hedge fund and market indices. At the strategy and sub-strategy level the actual allocation is evaluated against the optimal allocation as calculated by the model.

Risk The risk of the portfolios is measured by stress tests, calculated and monitored by the *Risk Management* department. FoHFs do not have a stress test limit, but the result serves as a risk indicator. For portfolio construction, the portfolio managers take preliminary stress test calculations into account.

The market risk of portfolios is measured by analysing their sensitivity to what is considered the main market drivers such as equity indices, interest rates, exchange rates, credit spread and volatility. The analysis is based on the relevant risk factors for each (sub-)strategy.

Degree of Investment The target investment exposure is monitored by the *Risk Management* department on a monthly basis. Under normal circumstances the investment exposure is 100%, except for products which are specifically designed to have a certain leverage.

Investment Horizon The recommended investment horizon is three to five years. However, as the objective is to achieve an absolute return, strategy allocation and investment in individual hedge funds are revised on a shorter time scale.

Portfolio Turnover On average, the portfolio turnover is 40% per year.

Portfolio Characteristics The portfolio characteristics are monitored by the Investment Committee.

Processes The investment process is continually supervised by the portfolio management team.

Research Quantitative research is constantly supervised by the head of the research department.

Settlement Settlement is continuously supervised by the *Middle Office* team.

Investment Controlling

Investment Guidelines Regulatory investment restrictions are taken into account by *Risk Monitoring* while constructing the portfolio. Compliance with these investment restrictions is monitored on a monthly basis by the respective custodian of the fund. Any breach is reported to the portfolio management team and the *Risk Management* team. SG AM AI's compliance officer would also receive such a breach report. An escalation procedure is defined if breaches are not corrected in due course.

In case clients give specific investment guidelines, compliance is ensured by *Compliance* and *Risk Management*.

Currency Exposure All FoHF investments are in USD (or hedged if necessary). For non-USD share classes the currency risk is fully hedged with currency swaps.

Performance Measurement

Organisation Performance measurement is conducted by a separate, dedicated team, see figure 4 on page 18.

Modus Operandi The performance of funds is evaluated as often as daily for monitoring purposes, through an *Instant Valuation* process. The latter is based on performance information obtained from regular communication with hedge fund managers.

SG AM uses proprietary software, SIPRA, for monthly performance measurement. Performance is initially calculated based on estimated NAVs until audited numbers become available (25 days after end of month).

PPS Certification The performance presentation of SG AM has complied with AIMR-PPS or GIPS since 1999, the certified track record starts at 1994-01-01.

For FoHFs, performance presentation is GIPS-compliant as certified by an external auditor. The track record starts at inception of a FoHF.

Infrastructure

IT & Operations

IT Organisation

Within SG AM AI, two teams are involved with IT issues regarding hedge funds. Firstly, there is a 3-strong IT team in the *Operations* department dedicated to the hedge fund middle office and supported by external consultants. Secondly, the *Research* team is involved in developing and maintaining specific software for the investment process.

There is regular reporting on project progress and quarterly reporting on software architecture as well as an annual budget report.

IT Infrastructure

Hardware The IT infrastructure is in general operated and supported by SG AM. SG AM AI only runs two servers with specific applications which have to match the software provider's requirements.

Within SG AM, internal procedures for purchasing hardware are defined to ensure compatibility with the existing architecture.

Software SG AM's workstations run standard software and operating systems. Specific applications within SG AM AI are either browser-based or are client/server applications accessed with a modification-proof client installed on each workstation.

Apart from the specific SG AM AI applications TANIS and AKHAMON, SG AM AI uses a number of software tools developed in-house. For FoHFs, an application for the administration of funds of funds, FOLIA, is employed.

Back-up Procedures & Disaster Recovery

Back-ups are stored daily on tape and in real-time on servers in the disaster recovery data centre. In the case of FoHFs, specific data is stored on a redundant server which allows for instantaneous recovery in the event of breakdown in the main system. As the applications in New York are browser-based, the investment team is largely covered by the Paris disaster recovery plans.

In a separate location, emergency offices are available, both for SG AM AI and SG AM Inc. The disaster recovery plans were successfully tested at the beginning of this year.

Security

SG Group Security Instructions require two levels of firewall. Furthermore, different types of access (Internet, subsidiaries, market data, mobile users, etc.) are separated by demilitarised zones. Internally, servers are protected by access controls and switch ports use physical addresses to prevent unknown hardware from accessing the network through existing connections.

SG AM employs three different anti-virus systems for Internet proxy, mail server and workstations, all of them updated automatically and in real-time.

Mobile users have access to the internal network through a VPN connection. In addition, hard disks of notebook computers are encrypted.

Supervisory Functions

Risk Management

In general, risk management is understood to cover different kinds of risks such as market risk, operational risk, reputation risk, credit risk and counterparty risk. For operational risk, there is a standard SG Group-wide definition in accordance with Basel II constraints as far as they are available. Measurement of operational risk is largely confined to risk assessment missions and the reporting of incidents. Measures to mitigate operational risk are taken, e.g. in respect of system risk (disaster recovery plans) or client risk (money laundering prevention).

Tasks & Organisation There are several parties involved in risk management. The SG AM Inc investment team evaluates *a priori* the impact of each investment by means of a stress test. On a monthly basis, the investment risk is evaluated by the risk managers in the *Risk Control* team, see figure 6 on the next page, again using stress tests. For Operational Risk there is a dedicated person in the *Operations* department of SG AM AI. Operational Risk is also monitored by the *Risk Control* team.

Modus Operandi Risk Management within SG AM starts by identifying in co-operation with local staff and first-level risk managers the risk checks which should be carried out in each entity. These checks are regularly performed by first-level risk managers, their results being consolidated in a monthly report communicated to senior management of the respective entity and to the risk management department. The monthly reports of each entity are consolidated to a global report on SG AM group level which includes validations of risk checks as well as results of specific risk assessment missions, both conducted by second-level risk managers.

Compliance

Within SG AM, *Compliance* is a central function with the *Risk Control & Compliance* department, see figure 6 on the following page, supported by dedicated compliance officers in each legal entity such as SG AM Inc or SG AM AI.

The compliance rules are focused on client interests and market integrity. All staff are trained on compliance issues at entry to the firm and have to certify that they read and understood these rules and also that they are in compliance with their requirements.

Most personnel can only invest in a very limited range of securities such as mutual funds. All personal transactions have to be disclosed at least annually to the compliance officer.

The compliance manual contains detailed guidelines in respect of insider trading and Chinese walls. Conflicts of interests are clearly defined and best execution is part of the requirements. Listed securities can only be traded with affiliates if authorised by the client in writing. There are no kick-backs or soft-dollar agreements, the latter being prohibited within SG AM.

Annually, a compliance report is issued to the head of SG AM AI containing the findings of the compliance officers, risk managers and auditors.

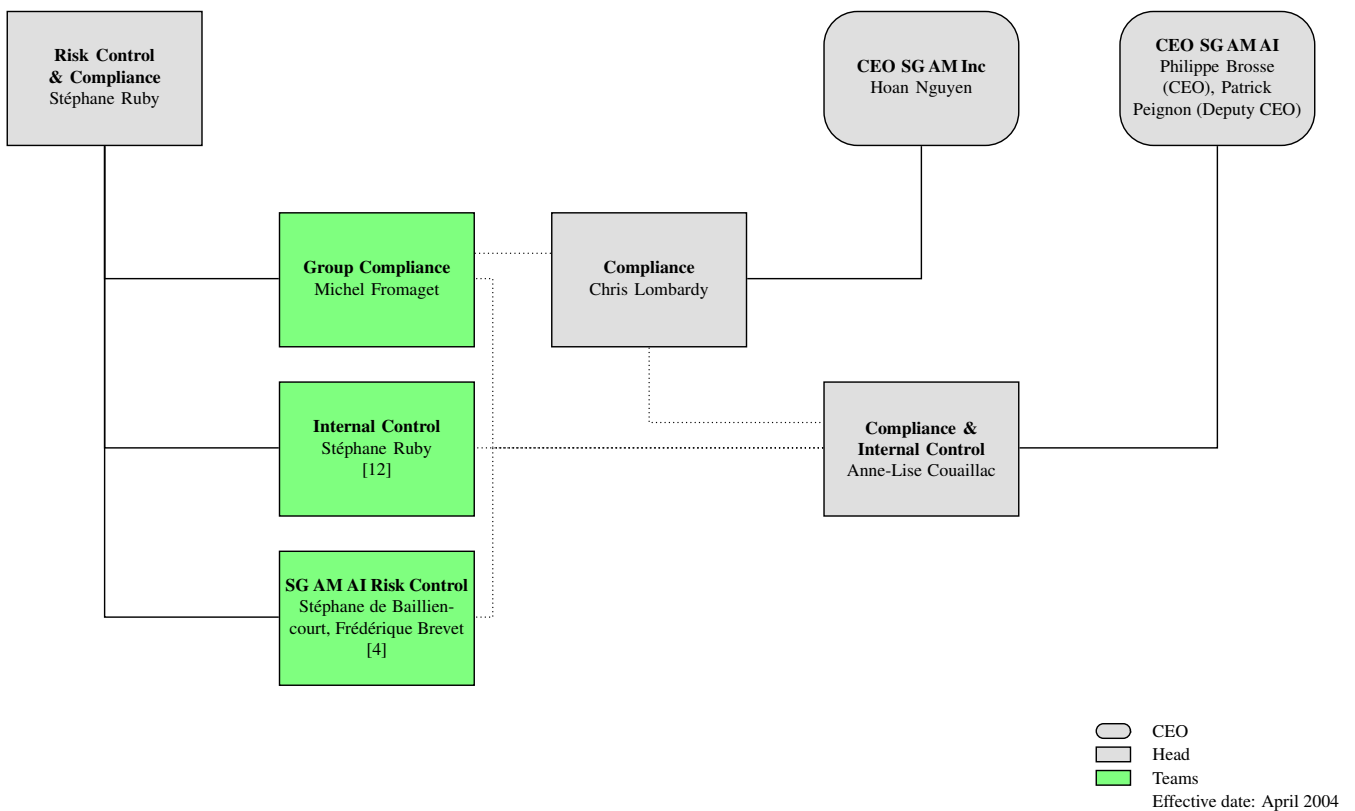
Audits

The audit function is centralised in the 12-strong *Internal Control* team, part of the SG AM Risk Control & Compliance department, see figure 6. Within SG AM AI, two employees of the *Compliance & Internal Control* team are involved.

The SG AM approach to audit is organisation-oriented and risk-based. The scope is comparatively broad, ranging from control of the adequacy of operations to the structure of portfolios regarding regulatory and client restrictions. The risk related to the activities is identified and followed.

The audit methodology is based on a repository of procedures and documents which are revised against the current processes and organisation. Audit reports contain an assessment of the organisation, the level of risk management and recommendations to strengthen both. The implementation of recommendations is followed-up on a monthly basis.

Figure 6: Organisation (Risk Control & Compliance)



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