



RCP & Partners GmbH

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

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 |

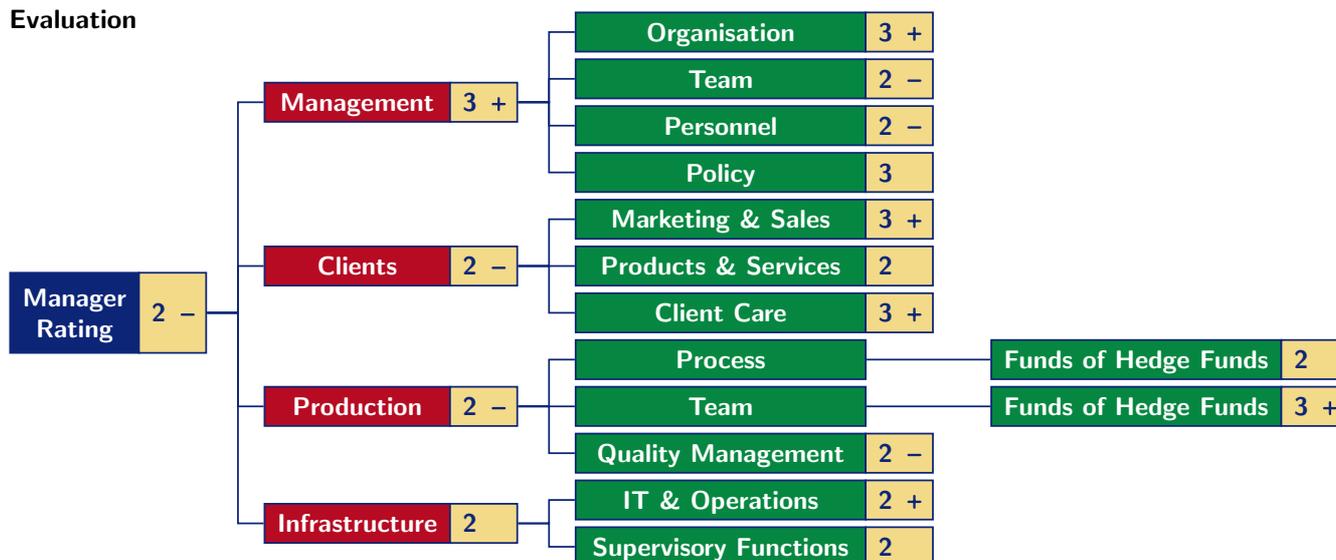
Contact

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|-------------|---|
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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.