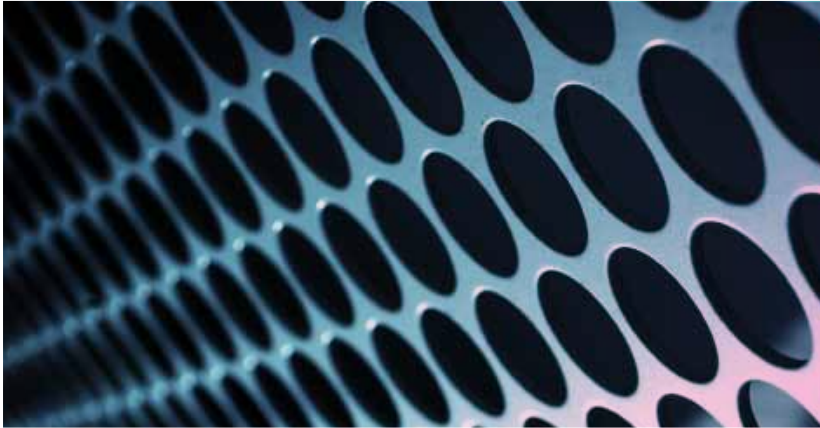


Operational Risk Due Diligence



“Increasingly, the process of investor due diligence is becoming a pivotal stage in the investment process.”

“When the tide goes out you find out who is swimming naked” Warren Buffet

In these uncertain times overshadowed, as they are, by the credit crunch and images of the wretched icons of it such as Bernie Madoff, investor confidence has taken a battering. In this fragile environment alternative investment investors are seeking a greater degree of comfort and transparency about the potential operational risk managers' face, not only before they invest but also for the duration of their investment.

To help you address this challenge, we at MMS Regulatory Solutions (“MMS RSL”) have devised an operational due diligence process that can provide the touchstones of transparency and assurance sought by today’s investors.

→ Scope

The Basel Committee defines operational risk along the following lines:

“The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.”

The FSA definition goes one step further by including legal risk and over the past year numerous reviews conducted by the regulator have sought to address apparent weaknesses exposed by recent events. However, the challenges faced by potential investors are perhaps more immediate and vital. Increasingly, the process of investor due diligence is becoming a pivotal stage in the investment process.

→ Investors need confidence

In essence, investors seek to be reassured that their investments will be:

- > Secure
- > Managed by reputable managers
- > Invested according to their risk appetite and the fund's stated objectives and constraints
- > Managed within a robust legal, regulatory, operational and financial control framework


- > Administered by established and respected third party service providers
- > Valued independently and according to prevailing standards
- > Regular audits by reputable auditors
- > Treated fairly in relation to co-investors and other clients of the manager
- > Subject to regular, accurate and independent reporting on fund performance and investment risks
- > Transparent; i.e. that they are informed about significant developments impacting their participation in the fund

→ Process

The MMS RSL due diligence process is designed to analyse and comment on key operational risk indicators present in the entity or group subject to review. This is achieved by cross-referencing findings from a combination of investigations involving:

- > Key personnel interviews
- > Background checks on principals and key staff
- > Test checks and reconciliation of asset balances and valuations.
- > On-site visits and questionnaires directed to third party service providers

Continued...



“MMS RSL will produce a detailed report outlining the key operational risks indicators and controls identified to provide sufficient transparency for potential investors.”

Continued...

- > Detailed review of key legal documents to confirm their existence and adequacy including commenting on key clauses, deficiencies and risks (such as re-hypothecation of assets)
- > Reviews of financial, legal and regulatory filings

MMS RSL will produce a detailed report outlining the key operational risks indicators and controls identified to provide sufficient transparency for potential investors.

MMS RSL will request that firms report changes in key operational indicators and can also perform periodic follow-up visits to reconfirm all key operational risk indicators remain effective.

→ The MMS RSL skill set

MMS RSL staffs possess a unique combination of skills including: internal audit, operational risk, accounting, legal, regulatory and alternative investment business experience sufficient to build an operational risk profile based on the key operational risk indicators. This, in turn, can help you help to assure both investors and the regulator.

→ Recent FSA prosecutions

Aside from the jaw dropping scale of the Madoff fraud, recent history is littered with examples of operational control failures at both large and small firms:

- > FSA bans hedge funds manager and fines him £140k for 'mismatching' - February 2010
- > FSA fines Standard Life for £2.45mn for serious systems and controls failures – January 2010
- > FSA starts criminal proceedings against former iSOFT directors for conspiring to make misleading statements – January 2010
- > Toronto Dominion fined £7mn for repeated systems and controls failings – December 2009
- > FSA fines Nomura £1.75mn for inadequate systems and controls – November 2009
- > FSA fines UBS £8mn for failing to prevent employees carrying out unauthorised transactions with customer money – November 2009
- > FSA fines Seymour Pierce £154k for failing to prevent employee fraud – October 2009
- > HSBC firms fined over £3mn for information security failings – June 2009

→ Next steps

If you wish to discuss this process and its potential in more detail please get in touch. MMS Regulatory Solutions can help you to assess and fortify your operational framework in order to withstand the important challenges presented by the new paradigm of investor due diligence.

It's our business to protect your business

We strive to provide all of our clients with the service they require in a flexible but structured way. At MMS Regulatory Solutions – one of the UK's leading compliance consultancies – we want you to relax knowing that your business is protected. If you wish to know more, please do not hesitate to get in touch.

Call us on **020 7065 5200**, email info@mms-rsl.com or visit our website at www.mms-rsl.com