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**SEC No.: 801-77045**

**CRD No.: 165155**

**Brochure / Form ADV 2A**

## **1 – INTRODUCTION**

City Financial Investment Company Limited ("City Financial" or the "Firm") is authorised and regulated by the UK Financial Services Authority ("FSA") and is registered with the U.S. Securities and Exchange Commission ("SEC"). This brochure provides information about the qualifications and business practices of City Financial. Any questions about the contents of this brochure should be addressed to City Financial at: Tel: +44 20 7451 9600 or email: [enquiries@cityfinancial.co.uk](mailto:enquiries@cityfinancial.co.uk).

The information in this brochure has not been approved or verified by the SEC or any state or foreign securities authority. Registration does not imply that City Financial, or its associates, have attained a certain level of skill or training. This brochure provides information for our U.S. clients. Most provisions of the U.S. Investment Advisers Act of 1940 (the "Advisers Act") and of this brochure do not apply to our non-U.S. clients.

More information about City Financial can be gained by visiting the SEC's Investment Adviser Public Disclosure ("IAPD"). The IAPD web address is: [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## **2 – MATERIAL CHANGES**

In October 2012, further to the original document submitted with City Financial's initial filing, the Firm became Investment Manager to a number of investment vehicles, expanding the scope of the product offerings to include unregulated pooled investment vehicles and managed accounts.

The following funds were added to the Form ADV 2A:

Akamatsu Fund, Akamatsu Bonsai Fund, Cumulus Energy Fund, Cumulus Fahrenheit Fund, Wiltshire Credit Opportunities Fund, CF Eden UK select Opportunities Fund and the Kewell Managed Account.

This also required additional information to be set out in Section 5, Fees and Compensation.

In October 2012, CFIC Cayman Limited, an investment advisory company owned by City Financial, took over the investment management of a fund which, in turn, delegated the function of Sub-Investment Manager to City Financial.

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#### **4 – ADVISORY BUSINESS**

City Financial is a privately owned company registered in the United Kingdom. The majority shareholders comprise City Financial's board, with the largest positions ultimately owned by City Financial's Chairman and CEO.

Since establishing its core fund range in 2006, City Financial has grown its assets under management to around US\$900 million of net assets managed across a diverse range of investment strategies. More information is available in City Financial's Form ADV Part 1 and on the Firm's website.

Rob Hain, formerly CEO of Invesco Perpetual and Andrew Williams, former Head of Distribution at the same firm, acquired City Financial in 2006 and created a new business offering a highly differentiated client proposition for investors.

City Financial is the Authorised Corporate Director (ACD) and Investment Manager (IM) of a number of funds and managed accounts. The funds cover a range of asset classes, strategies and risk categories. For the funds for which City Financial serves as ACD, the Firm is accountable on a regulatory basis for all aspects of those funds and to oversee all delegated functions of the fund management process.

Some funds have representatives from City Financial (executives or portfolio managers) on the Board of the fund. As City Financial is a service provider to and earning fees from the funds, this conflict of interests represents a potential risk because these individuals are not independent. However, the majority of the directors on the fund Boards are independent, and representatives from the Firm do not vote on issues where they are conflicted.

Portfolio managers will generally invest in the funds that they manage. In theory, this represents a conflict of interest and influence the way that they manage the fund's portfolio; however, external investors would typically view this as an alignment of interests, demonstrating that the portfolio managers were prepared to risk their own capital alongside that of the other investors. In any case, the way that portfolio managers carry out the strategy and keep within the investment restrictions of the fund is monitored by City Financial's compliance department and is under the ultimate supervision of the directors of the fund.

The funds themselves are classified by the United Kingdom Financial Services Authority as:

- Undertakings for Collective Investment in Transferable Securities (UCITS) Open Ended Investment Companies (OEICs),
- Undertakings for Collective Investment in Transferable Securities (UCITS) Unit Trusts (UTs),
- Non-UCITs Retail Schemes (NURS) Open Ended Investment Companies (OEICs), or,
- Unregulated Pooled Investment Vehicles (Unregulated Collective Investment Schemes or UCIS) and Managed Accounts.

The aim of City Financial is to grow assets under management both organically, through healthy fund performance, and through strategic acquisitions of pools of assets or companies. City Financial acquired the Foresters assets in October 2006 and then the Neptune MultiManager business was acquired in October 2007. In December 2010 City Financial acquired the rights to the pH Investment

Portfolio from Unizone Financial Solutions Limited. In September 2012 City Financial secured the Octopus Investment Fund range from Capita Financial Management Limited, as well as three pools of assets from PCE Investors Limited. In October 2012 City Financial acquired the wealth management division of Eden Financial. The purchase of fund management businesses allows City Financial to create value from cost and revenue synergies and capital market trends.

City Financial operates a robust, client focused business infrastructure, delivering an alignment of interests between investor and fund manager through firmly embedded transparent systems of risk management, reporting and compliance, all providing an independent second layer of oversight over the portfolio management process. City Financial maintains a culture of continuous improvement, role specialisation and the use of cutting-edge technology.

City Financial manages funds through a partnership ethos whereby portfolio managers have the required independence to encourage creative investment ideas, whilst benefiting from economies of scale, strong central business leadership and operational excellence. City Financial believes the resulting business model is conducive to developing high performing strategies, since operational risk is mitigated and complete investment focus from the portfolio managers is assured. City Financial also participates in the marketing of the funds.

The unregulated pooled investment vehicles and managed accounts offer alternative investment strategies within what the Firm is dedicated to maintaining as an environment of institutional reliability to the benefit of both manager and investor, through a number of funds managed by experienced investment professionals. Investors may subscribe to funds dealing in varying asset classes, geographies and strategies, with the objective of producing risk-adjusted returns with minimal correlation to equity and fixed income markets. City Financial provides advisory services exclusively to pooled investment vehicles and managed accounts that largely follow the same strategy.

#### **Investor Benefits**

- City Financial provides access to a broad range of high quality strategies within a control environment,
- Independent compliance and risk management departments add security,
- Operational risk is addressed through an established, specialised infrastructure, and
- A focus on technology provides enhanced transparency via independent risk and performance reporting.

#### **Manager Benefits**

- Portfolio managers access economies of scale without relinquishing equity or investment control,
- Funds benefit from an infrastructure of institutional quality, and
- City Financial's experienced management and operational support removes the opportunity cost of back and middle office management.

## 5 – FEES AND COMPENSATION

City Financial provides services as an Authorised Corporate Director (ACD) and/or Investment Manager of the funds, for which it generally charges each of the funds a management fee (“Management Fee”) based on the fund’s net assets. The Management Fee will usually range from 1% to 2% of assets under management on an annualized basis, depending on the terms of the particular fund, and is normally payable monthly in arrears.

In the case of City Financial serving as ACD, the specific manner in which fees are charged by the Firm is established in the prospectus of each fund. In that document, what fees are payable to City Financial and what other expenses may or may not be payable by the fund is clearly explained. For example, funds may incur certain charges imposed by custodians, brokers, directors, auditors etc, and other fees and taxes on brokerage accounts and securities transactions – none of which will be receivable by City Financial.

In the case of City Financial serving as Investment Manager, the specific manner in which fees are charged by City Financial is established in each fund's Investment Management Agreement (or Sub-Investment Management Agreement, or Advisory Agreement, as the case may be), and is detailed in the fund's private placement memorandum. Fees are exclusive of brokerage commissions, transaction fees and other related costs and expenses which shall be incurred by the fund. Funds may incur certain charges imposed by custodians, brokers, directors, auditors etc, and other fees and taxes on brokerage accounts and securities transactions - none of which will be receivable by City Financial.

City Financial may enter into rebate or trail agreements with platforms or advisors who refer prospective investors to a City Financial fund. Such parties may have a conflict of interests in advising prospective investors whether to purchase or redeem their shares or interests in a fund due to the fees paid to them by City Financial and this arrangement will be adjusted in line with UK fund governance requirements issued by the Financial Services Authority.

City Financial may enter into fee sharing arrangements with third party marketers who refer prospective investors to a fund managed by City Financial. Such marketers may be paid a portion of the fees earned by City Financial from the assets relating to the referred investor, subject to negotiation. Such third party marketers may have a conflict of interests in advising prospective investors whether to purchase or redeem their shares or interests in a fund, due to the fees paid to those marketers by City Financial. The use of third party marketers may lead to their suggesting unsuitable investors as prospective shareholders in the funds. However, the third-party fund Administrators act independently in being responsible for vetting all prospective investors (as part of their KYC and AML procedures) before they are accepted as shareholders in the funds.

## 6 – PERFORMANCE-BASED FEES

City Financial will charge a number of funds an incentive fee or performance allocation (the “Performance Fee”). The Performance Fees range from 10% to 20% of profits made and can be charged monthly, quarterly or annually in arrears. These fees are usually subject to a high water mark and, in some cases, to a hurdle rate.

While the Firm believes that performance-based fee arrangements align its interests with the interests of clients who are subject to these fees, performance-based compensation may create an incentive for the Firm to make investments that are riskier or more speculative than would be the case in the absence of the performance-based compensation. In addition, the performance on which performance-based compensation is calculated will include unrealized appreciation and depreciation of investments that may not ultimately be realized. Performance fee arrangements may also create an incentive to favour higher fee paying accounts over other accounts, including accounts that are charged no performance-based fees, in the allocation of investment opportunities. City Financial has adopted policies and procedures that seek to mitigate any such conflicts presented by performance-based fee arrangement and to ensure that all clients are treated fairly.

## 7 – TYPES OF CLIENTS

City Financial’s clients are restricted to the funds for which it acts as Authorised Corporate Director or Investment Manager, and in each case City Financial will specifically agree with the fund concerned that it will treat it as a professional client.

In one case, City Financial acts as both the ACD and the Investment Manager of that fund, essentially appointing itself as the Investment Manager. However, this conflict of interests is fully disclosed in the prospectus of that fund.

As City Financial’s clients are the funds for which it provides services, on City Financial’s Form ADV 1 all clients are described as “Other pooled investment vehicles (eg hedge funds)”, but it is possible that the actual mix of types of clients may change over time, based upon market conditions, business plans and other factors. Assets are only accepted by City Financial after appropriate due diligence has been successfully completed in line with regulations.

As at 31<sup>st</sup> December 2012, funds managed by City Financial include the following:

<b>Fund Name Domicile / Structure</b>	<b>Investment Focus &amp; Strategy</b>	<b>City Financial Role</b>
CFIC Octopus UK Micro Cap Growth Fund UK Master/Feeder	UK equity fund with a focus on small cap stocks	Authorised Corporate Director

City Financial UK Equity Fund  UK Master/Feeder	Absolute return long/short UK equity fund	Authorised Corporate Director and Investment Manager
City Financial Asian Absolute Growth Fund  Cayman Single Company	Fund of Asian Hedge Funds to create exposure to secular Asian growth primarily through long/short equity funds	Investment Manager
City Financial UK Equity Income Fund UK Master/Feeder	UK equity fund with a focus on large cap stocks with strong dividends	Authorised Corporate Director
City Financial Strategic Global Bond Fund  UK Master/Feeder	Global corporate and sovereign debt fund driven by movements in interest and/or exchange rates	Authorised Corporate Director
City Financial Strategic Gilt Fund UK Master/Feeder	The Fund invests in UK Government Gilts only	Authorised Corporate Director
City Financial Dynamic Fund  UK Master/Feeder	Global long-term capital return multi-manager fund	Authorised Corporate Director
City Financial Diversified Fund UK Master/Feeder	Global total return multi-manager fund holding a diversified portfolio of asset classes	Authorised Corporate Director
City Financial MultiManager Growth Fund  UK Master/Feeder	Global capital return multi-manager fund	Authorised Corporate Director

City Financial MultiManager Income Fund  UK Master/Feeder	Global income-producing multi manager fund	Authorised Corporate Director
Akamatsu Fund *  Cayman Single Company	Japanese equity long/short fund focusing on small/medium cap stocks	Investment Manager
Akamatsu Bonsai Fund  Cayman Single Company	Japanese equity long only fund focusing on micro-cap stocks	Investment Manager
Cumulus Energy Fund *  Cayman Master/Feeder	European energy fund specialising in near-term power and gas futures contracts based on weather impact	Investment Manager
Cumulus Fahrenheit Fund *  Cayman Single Company	Weather derivatives fund trading front month temperature futures on the CME	Investment Manager
Wiltshire Credit Opportunities Fund  Cayman Master/Feeder	European credit event-driven fund investing in mispriced sub-investment grade corporate debt.	Investment Manager
CF Eden UK Select Opportunities Fund UK Master/Feeder	UK equity long only fund	Investment Manager
Kewell Managed Account  Panama	Targeting a gross return in excess of 4.5% per annum through investments in global credit markets	Investment Manager

\*Each of the funds asterisked has one or more managed accounts that largely follow the same strategy.



The prospectus and offering document of each fund contain a more detailed description of its investment strategy, liquidity terms etc. Normal notice period for subscriptions and redemptions may be waived, leading to the potential risk that one investor could be favoured over the others. However, fund directors are careful to ensure that investors have not delayed their investment decision until after fund performance data is published, and the fund Administrator will not process subscriptions or redemptions outside the normal notice periods unless they are in receipt of a formal waiver document provided by the directors of the fund.

The NAV of a fund may be suspended, leading to investors being prevented from redeeming, and there is a risk that the Investment Manager will benefit from assets not being reduced and fee levels being maintained. However, only the Board of the fund can agree to a suspension, and they would only do this in order to safeguard the interests of all investors.

Side letters have been agreed with early and/or significant investors in certain funds. In these circumstances, there is a risk that some investors may be favoured over the others. However, any potentially material terms (which would, for example, give an investor an enhanced ability to decide on whether or not to increase or reduce its investment in the fund) are either built into the prospectus so that all investors benefit, or are specifically disclosed to all investors.

## **8 – METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS**

City Financial uses a very wide range of sources of information and types of analysis, from purely quantitative methods using only price data to highly qualitative methods using independent analytical work or direct research on the companies or instruments being assessed.

Sources of information include:

- Broker and investment bank research
- Market data from vendors such as Reuters, Bloomberg and DataStream
- Other independent research houses, and
- Internal analysis and data gathering

Strategies include (but is not limited to):

- Stock picking strategies (with both long and short positions)
- Themed investment (eg weather driven), and
- Fixed income strategies

More detail is provided in the promotional material of the individual fund, which can be provided on request.

The Firm will generally invest for its clients in listed securities and listed derivatives and, to a lesser degree, in unlisted securities and over-the-counter derivatives. Investments in securities may be in both mature and emerging markets, including but not limited to: sovereign and corporate debt, hybrid securities, convertible bonds, long-dated subordinated debt, preference shares, exchange-listed securities, foreign issuers, warrants and commercial paper. Multi-manager funds and funds of hedge funds will invest in UCIS.

Subject to the investment restrictions and other parameters set out in each fund's prospectus/private placement memorandum, City Financial makes use of certain investment techniques. These can include:

**Short Selling** – for certain accounts, City Financial is permitted, subject to the rules of the local regulator and/or exchange, to sell securities short, in the expectation of covering the short sale with securities acquired in the open market at a price lower than that received from the short sale. The possible losses from short selling are unlimited. This differs from the possible losses that could be incurred from taking long positions in securities, which are limited to the total amount invested. In addition, short selling can cause downward price pressure on a stock and could therefore pose a potential conflict of interest if some client accounts were selling short the same security other client accounts hold long (and vice versa).

One fund may be short in a stock in which another fund has a long position. Although this would appear to be a conflict of interests for City Financial, the portfolio of each fund is actually managed separately, using the strategy and limited by the investment restrictions as set out in each fund's prospectus, and the portfolio's adherence to this is monitored daily by the Firm.

**Use of Leverage** – In managing certain accounts, City Financial may also use leverage, such as investing monies borrowed on margin or taking positions in certain types of derivatives that involve leverage. The Firm may also invest client accounts in certain ETFs (exchange-traded funds) that provide leveraged exposure to their underlying indexes. Use of leverage can cause portfolio values to rise and fall faster than if leverage were not used. Use of leverage also involves the risk that securities in an account will have to be liquidated in order to meet margin calls or maintain sufficient asset coverage, at a time when it may not be desirable or advantageous to sell.

**Concentrated or Non-Diversified Positions** - Investments in accounts managed by City Financial may be concentrated in certain industries, sectors or markets. Investments may also be focused on the securities of a particular issuer such that the account is relatively non-diversified. Concentration and non-diversification pose increased risk of loss to the extent that the account is more susceptible to adverse events affecting the industry or issuer on which the account is focused.

**Options Trading** - The purchase or sale of an option involves the payment or receipt of a premium by the investor and the corresponding right or obligation either to purchase or sell the underlying security, commodity or other instrument for a specific price at a certain time or during a certain period. Purchasing options involves the risk that the underlying instrument will not change price in the manner expected, so that the investor loses its premium. Selling options involves potentially greater risk because the investor is exposed to the extent of the actual price movement in the underlying security rather than only the premium payment received (which could result in a potentially unlimited loss). Over-the-counter options also involve counterparty solvency risk.

The types of risk considered by City Financial are:

### **Market Risk**

Market risk is the exposure of the fund to movements in net asset value as a result of changes in factors that affect the price of the underlying assets in the fund. While investors should expect market risk that occurs as a result of applying the fund's investment policy to meet its investment objectives, the deployment of derivatives will bring different parameters into the market risk equation. For example, the value of an option will not necessarily move on a one for one basis with the underlying security but with the delta of the option. In addition, other external factors that may

not affect the underlying security will have a bearing on the value of the derivative such as interest rates, volatility, time to maturity and dividend yield.

### **Valuation Risk**

Most portfolio positions are in instruments which are either themselves quoted on a recognised investment exchange or are derivatives of such instruments, and are therefore easily valued by the independent third-party fund Administrator appointed by the Board of the fund through pricing sources such as Bloomberg etc. OTC instruments will be the subject of contracts with market counterparties, and the value of those instruments will be supported by corroborating documentation from those counterparties. However, there may be positions which the Administrator has difficulty obtaining valuations and the Board of the fund may ask the portfolio manager for advice. In these cases, the manager may influence pricing, and this conflict of interests may result in the potential risk that fees earned by City Financial may be inflated by the over-valuation of assets. However, under the pricing policies approved by the Board, the ultimate decision rests with the Board, who may also take advice from the fund's auditors.

For City Financial's UK retail funds, Fund Managers must mark to market positions on a daily basis and demonstrate that they can obtain a price from the derivative provider as at each valuation point and at any other time that it is required. The Compliance Team will independently verify the price of each derivative used. The Fund Managers also provide the Compliance Team with a weekly sign off report. The pricing of more complex derivatives will be reviewed by the Risk Management Committee and properly documented - especially if a third party is involved - to ensure that this independent price can be maintained throughout the life of the derivative.

### **Counterparty/Credit Risk**

The Fund's counterparty risk can be broken down into two elements:

- i) the credit risk of the counterparty (i.e. the counterparty to a financial instrument such as a derivative contract will fail to discharge an obligation or commitment that it has entered into with the fund), and
- ii) the requirements on maximum counterparty exposure as laid down in the fund prospectus and, where relevant, the FSA's COLL rules.

With regard to the latter, care needs to be taken when dealing with derivative counterparties that the correct legal counterparty is identified, as some investment banks deal via legal entities specifically set up to deal in derivatives and these may fall under the 5% limit for an eligible institution rather than the 10% limit for an approved bank.

The credit strength of each entity should also be assessed. This will typically be expressed as a rating from an agency such as Standard & Poor's, Moody's or Fitch. The Firm may determine a minimum rating requirement for the counterparty. Should the counterparty fall below a certain level then the derivative can be closed out or suitable collateral demanded from the counterparty to increase the comfort to the fund.

Consideration should also be taken of other assets held by the fund that expose it to non-derivative exposure, to take into account the overall exposure limits to counterparties.

The counterparty assessment should also take into consideration any substantial delays in settling collateral or derivative trades and timely submission of documentation as this increases the

potential credit risk on the counterparty (see specific risks covered elsewhere) should one of these risks be realised.

### **Key Man Risk**

With regard to City Financial's UK retail funds, this is the risk that the parties undertaking elements of the derivative process do not understand the type of derivatives that the fund is entering into as well as how to properly execute and monitor them within the FSA COLL rules. This specifically refers to the Fund Manager and the derivatives counterparty who will be the initial parties to the derivative contract. Where City Financial is the ACD, it should ensure that these parties can demonstrate the appropriate level of expertise and competence in executing the trades and that the due diligence undertaken is documented. This area is becoming increasingly important as funds are being set up by non traditional fund managers who might be structured product producers, distributors or alternative Fund Managers who either (i) do not have the appropriate FSA regulatory permission to run a fund and rely on a third party Fund Manager to successfully implement the investment process or, (ii) do have the appropriate regulatory requirements but do not understand the FSA COLL rules.

### **Conflicts of Interest**

Many investment banks are setting up funds as sponsor to allow them to generate additional business through dealing in derivatives with those funds. It is important that the parties can demonstrate that there is a proper arms length dealing process between the Fund Manager and the investment bank/derivative provider. This can either be as a separate legal entity or that they can demonstrate appropriate independence from each other in terms of dealing facilities (i.e. something similar to Chinese walls or the ability to be able to freely deal with other external counterparties). In all cases the Fund Manager should be able to demonstrate best execution as appropriately defined. For simple short term derivatives such as exchange traded or currency forward contracts this might be based on price alone. For more complex derivatives other factors such as counterparty risk will play a part.

### **Documentation Risk**

This is the risk that the documentation of the derivative contract does not match what the Fund thought it had entered into. In terms of funds governed by the FSA COLL rules, there is another dimension in that the documentation must also ensure that the terms of the derivative do not breach those rules or allow for the derivative to be unwound if a breach does occur. These risks can be minimised through the use of best practice standards.

Document risk is monitored by the Compliance Team, with the assistance of, where appropriate, external counsel. City Financial 's policy is to have general derivative documentation signed and in place prior to the Fund Manager entering into any derivative contract on behalf of the fund. For UK retail funds, the documentation should also be agreed by the Fund's Depositary. This includes over the counter agreements such as ISDAs, collateral arrangements and any documentation covering the use of exchange traded derivatives. Non industry standard documentation should be avoided or approved by a suitably qualified external lawyer. This will ensure that the requirements of the FSA COLL rule book are met through the inclusion of specific language to cover these points

Certain points in particular need to be addressed, specifically:

- **Counterparty Exposure**

Specific wording to ensure that exposure to the counterparty can be kept within the FSA COLL requirements. Where closing out the position is not practical then alternative arrangements such as suitable collateral requirements or partial cash settlement can be considered.

- **Closing Positions**

The derivative counterparty must agree that it will unwind the derivative position at the prevailing market price at any time that is required. This might be as a result of when (a) the derivative position no longer meets the investment objectives of the company, (b) cannot be considered to be appropriately covered, (c) liquidity is required to meet redemptions, or (d) counterparty exposure is exceeded. For certain funds due consideration should also be given to the minimum size of partial unwinds of derivative positions to ensure that the fund does not deviate away from its stated investment objectives through holding an inappropriate amount of derivative position as investors subscribe for more or divest units in the fund.

- **Pricing**

The documentation must state that the counterparty will supply a price for the derivative as of the dealing time on each dealing date of the fund and a price at any other time that it might so be requested. The basis for the price should be specified and this may relate to the unit pricing of the specific fund e.g. bid/offer for two way pricing or mid market for single priced funds. The source of the third party independent pricing or at least the requirement for the counterparty to provide a third party source should also be documented.

- **Minimising Contagion Risk**

Traditionally, sub funds of an umbrella company were at risk from contagion - that is, if one fund were to have liabilities exceeding its assets then those liabilities could be divided amongst the unit holders of other sub funds. However, as required by the protected cell regime, each sub fund going forward will be treated as a separate entity and the liabilities of one sub fund will no longer be discharged out of the assets of another. Liabilities that are not attributable to one fund in particular will be allocated between sub funds in a manner which treats shareholders fairly.

- **Collateral**

As part of this documentation the parties should also consider whether a Credit Support Annex or Deed should be put in place. This is particularly relevant where it is anticipated that the fund's exposure to the counterparty is likely to breach the FSA COLL counterparty concentration rules or where the quality of the derivative counterparty will require it.

- **Storage of Documents**

Original documents are retained on site in the offices of City Financial. Copies of documents are circulated to the other counterparties e.g. the Depositary.

## **Operational Risk**

For specific structured product payoffs, the operational risk is the implementation of that derivative contract - i.e. that the parties deliver documents, settle in a timely manner, and place collateral when called for. The non delivery of these operational requirements can be an early signal of a wider problem such as credit risk or misunderstanding of what is required that could enhance the other risks outlined above and can lead to further breaches of the FSA COLL rules, where applicable, and potential losses to investors.

Operational requirements are detailed in the operations manual of each Fund. The aim of the operations manual is to ensure that the smooth operation of each Fund is not reliant on key individuals who may not always be at the organisation. The operations manual outlines the correct procedures should be put in place by each Fund. This shows the various parties what is expected of

them during certain events (e.g. the unwinding of a derivative, or the calling for more collateral) and how they should implement it. Operational manuals will vary in content according to the complexity of the underlying schemes, however at the very least they will include a complete list of contacts at City Financial, the Fund Manager, the Depositary and any third party such as a derivative counterparty or collateral provider. There is also a trigger process operated by the Fund Managers.

### **Basis Risk**

This risk is important for the Risk Management Process (RMP) where a fund is relying on assets that do not or may not in the future exactly match the derivative exposure it is taking on (e.g. writing a call option on the FTSE 100 index while holding the underlying stocks to cover the position). The danger is that the composition of stocks diverges away from the index as a result of a re-composition or rebalancing of the index. The potential impact is that it moves the fund away from a non-sophisticated derivatives requirement to a sophisticated one and may also be a breach of the investment policy of the fund.

City Financial is mindful of this risk and it has been discussed with the Fund Managers.

### **Liquidity Risk**

Liquidity risk arises when the Fund Manager is unable to trade an asset because nobody in the market wants to enter into the trade. Liquidity risk becomes particularly important when the fund holds or is about to an asset, since it may affect their future trading ability.

Liquidity risk also arises when the Fund Manager is unable to meet the requirement to provide liquidity for withdrawals, and to meet the fund's liabilities to deliver assets or cash under derivative contracts. The Risk Management Committee monitors this risk to ensure that the former is not unduly affected by the latter. This may also have an impact on the temporary borrowing requirements of the fund that need to be monitored to ensure that limits are not breached.

In order to control liquidity risk, City Financial and the Fund Managers employ cash monitoring procedures. The Compliance Team review the daily NAV received from the Administrators and they also receive large deal notifications.

### **Cash Flow Risk**

The Fund Manager's remit is to manage the investment of the monies flowing into the fund but must also be mindful of the requirement to provide liquidity for withdrawals and to meet the fund's liabilities to deliver assets or cash under derivative contracts. The Risk Management Committee should ensure that the former is not unduly affected by the latter. This may also have an impact on the temporary borrowing requirements of the fund that need to be monitored to ensure that limits are not breached.

### **Regulatory Risk**

This is the risk that the fund, or parties to the fund, falls foul of the regulations laid down by the FSA and the SEC. Following the proper procedures, documenting the RMP and monitoring activities will assist in minimising this risk. In addition, whenever any derivative contract is entered into, it is important to be mindful of potential future changes to the FSA COLL rules and their impact when these conflict with the terms of the derivative contracts.

### **Reputational Risk**

Reputational risk can occur by association even if a party has followed all the rules and regulations. The rigorous compliance of the standards set out by the documented risk management process will assist in minimising any reputational risk.

## **9 – DISCIPLINARY INFORMATION**

As an SEC-registered company, City Financial is required to disclose all material facts regarding any legal or disciplinary events that would be material to an evaluation of the Firm or the integrity of its management. No events have transpired applicable to this Item.

The Firm strives to maintain the highest level of business standards as evidenced by its employee handbook and compliance manual as well as by the importance which its officers attach to professional standards.

## **10 – OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

City Financial's business is providing a regulatory environment and investment management services, and it is not engaged in any other business endeavour.

City Financial is the owner of another investment advisor, CFIC Cayman Limited. CFIC Cayman Limited acts as the investment manager of one of the funds listed above, in which case City Financial will act as the sub-investment manager, with all powers of discretionary management fully delegated to City Financial. CFIC Cayman Limited is also the owner of the management shares of one fund and, in another fund, the nominee holder of "refund shares", representing a portion of performance fees earned by City Financial but held back from payment for two subsequent quarters in case performance falls below the high water mark.

Some supervised persons may have other external activities and business interests. This conflict of interests has the potential risk that these individuals may not provide the necessary time and attention to the regulated business of the Firm. City Financial has a policy where all such activities and interests must be disclosed and reported regularly to the Firm's compliance department who will ensure that these activities are peripheral and take a minimal amount of the individual's time. Strict confidentiality clauses signed by all individuals should ensure that there is no risk that information obtained from their work for the Firm is used in other capacities.

It is, however, understood that where portfolio management teams are seconded to City Financial in order to manage the portfolio of the funds, those secondees will be members of one or more Joint Venture partner entities, and this is seen as an inherent part of the Firm's operating structure.

## **11 – CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL ACCOUNT TRADING**

City Financial does not at this time invest its own capital or share in transactions.

Employees of City Financial may, from time to time, buy or sell securities for themselves. Personal account trading by City Financial personnel may only be undertaken in line with City Financial's Personal Account Dealing policy, which is contained in the Firm's Compliance Manual and also further developed in a Code of Ethics ("Code") adopted by City Financial.

Generally, the Code sets general standards of conduct for City Financial's personnel and imposes specific requirements aimed at preventing, detecting and correcting fraudulent activity, market abuse or activities that would pose a conflict of interest in connection with personal securities transactions. The Code prohibits personnel from engaging in conduct commonly known as "insider trading" and restricts their giving and receiving of gifts and their ability to accept certain positions with external organisations. The Code also restricts personal securities transactions by various means, such as a requirement for pre-trade compliance clearance and a prohibition on any trading ahead of the fund for which the individual is acting as portfolio manager.

In order to monitor compliance by City Financial's personnel with the Code and applicable law, each officer and employee is required to provide City Financial with duplicate copies of their personal account trading contract notes which are reviewed by the Firm's Compliance department. In addition, each officer and employee is required to sign a statement to acknowledge that they have read and understood and will abide by the terms of the Compliance Manual, including the sections on insider trading and money-laundering, which are also set out in the Code.

Individuals associated with City Financial may buy or sell securities for their personal accounts, even if they are identical to those traded in the portfolio of client funds. However, it is the express policy of City Financial that no person employed by City Financial shall place his or her own interests ahead of those of a client.

This is only a summary of City Financial's Code of Ethics. The entire Code will be made available to clients upon request. City Financial maintains a log of material conflicts and the means to address/resolve them, which are reviewed on a regular basis.



## **12 – BROKERAGE PRACTICES**

### **A. Brokerage Partners and Best Execution**

Portfolio investments may normally be purchased through brokers on securities exchanges or directly from the issuer or from an underwriter or market maker for the investments. Securities transactions will be executed by brokers or counterparties selected by City Financial or its appointed Investment Managers in its sole discretion. In placing portfolio transactions and negotiating commission rates, where applicable, City Financial will seek to obtain the best execution for the funds, taking into account the following factors: the ability to effect prompt and reliable executions at favourable prices (including the applicable dealer spread or commission, if any); the operational efficiency with which transactions are effected, taking into account the size of order and difficulty of execution; the financial strength, integrity, reputation in the industry, infrastructure and stability of the broker; the firm's risk in positioning a block of securities and committing its capital; efficiency of error resolution; the quality, comprehensiveness and frequency of available research services considered to be of value; and the competitiveness of commission rates in comparison with other brokers satisfying City Financial's selection criteria.

City Financial or its delegated Investment Managers places orders for execution in accordance with its best execution policy, procedures and criteria (see below). The Firm's brokerage policy seeks to achieve the most favourable net results for clients on each transaction. City Financial believes that the key components to achieve the most favourable net results are transaction specific and dependent upon the broker's ability to accommodate special transaction needs. Trades may involve specialized services on the part of the broker-dealer involved and entail higher commissions than would be the case with other trades requiring more routine services, and therefore may not always be executed at the lowest available price or commission.

City Financial uses the following factors when selecting and evaluating brokers and counterparties: financial standing, regulatory status and best execution policy. The Firm requires evidence that they are regulated by their national regulator, confirmation that they will classify City Financial as a professional client, a copy of their best execution and conflict of interest policies, and a copy of their latest audited financial statements.

In certain cases, a fund may trade with another. This conflict of interests has a potential risk that one fund may be favoured at the expense of another. However, this is normally done as part of a routine rebalancing exercise, eg at the beginning of the month to reflect changes in the AUM of the relevant funds as a result of subscriptions/redemptions. Generally, these trades are carried out using the previous day's closing prices, either through the prime broker outside market trading hours (in order to minimise transaction charges), for the benefit of the funds concerned. In any case, no direct crosses are carried out between funds unless specifically approved by the Boards of those funds.

### **B. Soft dollars**

City Financial may pay a broker a commission in excess of that which another broker may have charged for effecting that transaction, in recognition of the value of the research and/or brokerage services provided by that broker. This is commonly referred to as "soft dollars" and is the subject of Commission Sharing Agreements between City Financial and certain brokers for trades carried out for specific funds, subject to a strict policy in line with FSA and SEC rules (see below) that ensures such commissions are used solely for the enhancement of investment research to the benefit of those funds.

This use of commissions or soft dollars to pay for certain research products or services is within the safe harbor created by Section 28(e) of the U.S. Securities Exchange Act of 1934 and COBS 11.6 of the FSA Handbook. Products or services received from brokers as a result of clients' transactions may be used by a fund's portfolio managers in servicing other accounts. In the past year, we have used soft dollars to purchase: broker, investment bank and third-party research that addressed both economic trends and analyses specific markets, sectors and issuers.

In selecting a broker providing research or brokerage services to execute client transactions, City Financial will make a good faith determination that the amount of the commission charged is reasonable in relation to the value of the research and brokerage services received, viewed either in terms of the specific transaction or the Firm's overall responsibility to the accounts over which it exercises investment discretion. City Financial may choose on a case-by-case basis to place a trade with a particular broker when, for example, a research analyst at that broker has provided valuable perspective or advice regarding a specific company or security or its trading market. In order to have continued access to that type of perspective and advice, the Firm may develop relationships with brokers who have research and analytical expertise relevant to the needs of City Financial and its clients.

### **C. Aggregate Trade Allocations**

A fund may share part of all of its strategy with another fund or managed account. This conflict of interests has a potential risk that one fund may be favoured at the expense of another re trade allocation. Because of this, City Financial has a clear allocation policy, with trades apportioned based on pre-agreed splits (normally *pari passu* with the AUM of the funds).

City Financial will execute transactions on an aggregated basis when it believes this will allow it to obtain best execution and negotiate more favourable commission rates or other transaction costs that might have otherwise been paid had such orders been placed independently. When orders are aggregated, all of the Firm's clients will be treated in a fair and equitable manner, and the prices obtained may be averaged so that all clients involved in the transaction pay or receive the same average price. This may result in one fund obtaining on some occasions a more favourable transaction price and on others a less favourable transaction price than had that fund's order been effected separately.

City Financial will not aggregate orders unless aggregation is consistent with the Firm's duty to obtain best execution. No account will be favoured over any other client; however, a variety of factors will determine whether or not a particular fund may or may not be included in a particular aggregated transaction. These factors include, but are not limited to: investment objectives and strategies, position weightings, cash availability and risk tolerance. Because of these factors, there may be differences in portfolio allocations from a strict *pro rata* basis even between client accounts following the same strategy.

When City Financial determines that order aggregation is in the best interest of its clients, the following guidelines generally are followed for all portfolios which are participating in the execution under the same trading circumstances (e.g., price limits and time of entry). Aggregated orders filled in their entirety or partially will be allocated within strategy among the participating accounts *pro-rata* by account market value. In the event of a *de minimis* allocation for a partial allocation, the trader has the authority to determine an appropriate allocation methodology.

## **D. Trading Errors**

Consistent with City Financial's fiduciary duties, the Firm's policy is to exercise care in making and implementing investment decisions for client accounts. To the extent trading errors occur, the Firm seeks to ensure that clients' best interests are served. City Financial's policy is to resolve all trade errors within a reasonable time while ensuring the client is not disadvantaged, consistent with the orderly disposition (and/or acquisition) of the securities in question. Actual losses suffered by a client account as a result of a trade error caused by City Financial will be reimbursed by City Financial; however, as a general matter, City Financial does not compensate its client funds for lost investment opportunities (e.g., failure to take advantage of investment or market improvements).

## **13 – REVIEW OF ACCOUNTS (CLIENT FUND PORTFOLIOS)**

### **A. Frequency of Reviews**

All accounts managed by City Financial are reviewed, generally on a daily basis, by the respective portfolio managers and risk management and compliance staff of City Financial and operations staff of EDD Fund Services LP (EDD) to whom City Financial outsources core operational functions for a number of funds. (EDD has been working with hedge funds since 1998 and has 4 experienced employees in London, plus 12 employees in the USA.)

EDD reconciles all positions and transactions and helps to ensure consistency with City Financial's investment processes and conformity with client objectives and guidelines. Reviews may include an evaluation of account performance relative to certain agreed benchmarks or objectives, while others may include an analysis of current positions and/or asset mix. Account reviews may result in adjustments to a client's portfolio. City Financial and/or EDD liaise directly with the funds' third-party Administrators to ensure that each side's books and records agree or can easily be reconciled.

City Financial's Portfolio Managers review each client account continuously to determine, among other things, whether it is appropriately positioned and whether investment objectives and policies are being followed.

Further oversight is provided daily by City Financial's Compliance department to monitor each portfolio against that fund's investment restrictions laid out in the private placement memorandum, other factors mentioned in the fund's promotional material, and the rules of the relevant exchange and regulator for each of the markets traded.

In addition, City Financial's Risk Management Committee monitors the investment strategy risk and the market risk per fund, as well as the counterparty risk and the operational risk per fund and for the entire Firm. Issues, including regulatory breaches, are escalated to the portfolio management team of the fund concerned, City Financial's Risk Management Committee, and the Board of the Fund, as well as being reported where appropriate to the relevant regulator and/or exchange.

### **B. Written Reports**

For a number of funds, the underlying investors in those funds typically receive on a monthly basis:

- i) statements from the fund's Administrator, which include, among other things, the change in value of their accounts since the last reports that were provided, and

- ii) communications from City Financial in the form of a shareholder newsletter, explaining recent trading activity and the outlook for the fund based on the current state of the markets.

Investors also typically receive on an annual basis audited financial statements from the fund Administrator, as well as certain tax information for preparation of their respective tax returns, including a Schedule K-1 or PFIC for United States persons.

Customised reports may be provided to certain investors on request on a case-by-case basis.

#### **14 – CLIENT REFERRALS AND OTHER COMPENSATION**

City Financial has not entered into contractual arrangements with firms that may solicit clients for us. However, in some cases firms may market City Financial's client funds to prospective underlying investors and receive a fee as a proportion of amounts invested as a result of their efforts.

Excessive entertainment of members of City Financial by suppliers or counterparties may influence decisions to use, or increase the use of, those entities. City Financial has strict policies on bribery and on gifts and entertainment which should prevent the risk of this occurring.

#### **15 – CUSTODY (AND CLIENT ASSETS)**

City Financial does not hold client assets – it does not maintain physical possession of the monies or securities of any fund, and in no case may City Financial access client assets or securities.

Instead, City Financial, when it is the ACD of a fund, enters into agreements with the fund Depository for the latter to provide, among other things, custodial services to the fund. Where City Financial is the Investment Manager, the funds themselves contract directly with prime brokerage firms and/or commercial banks to serve as custodians of client assets.

All client funds receive statements of account holdings from their custodian not less than quarterly, and in most cases monthly. Additionally, City Financial will provide client funds with account balances and activity details upon request.

#### **16 – INVESTMENT DISCRETION**

As a discretionary investment manager, City Financial has complete discretion over the investments it makes on behalf of its clients, subject to the stated guidelines and investment restrictions set forth in the investment management agreement or similar agreement relating to the relevant fund. Compliance with these guidelines and restrictions is monitored by the Firm's Compliance department and City Financial's Risk Management Committee, who will report any breaches to the portfolio managers and where appropriate to the Board of the fund concerned. Subject to a client's specified investment objectives and guidelines, City Financial determines which securities are bought or sold, the total amount of securities to be bought or sold, the broker or dealer through which the securities are to be bought or sold and the commission rates to be paid, all without further consultation with the client. In exercising its investment discretion, City Financial is guided by the investment policies and guidelines that are established at the inception of the adviser-client relationship in the investment management agreement (and as amended from time to time). The guidelines cover matters such as the types and amounts of securities that will comprise the

portfolio. In certain circumstances, some clients may also restrict certain securities from being purchased for their account.

## **17 – VOTING CLIENT SECURITIES (PROXY VOTING FOR CLIENT FUNDS)**

City Financial's policy on proxy voting is to base voting on the investment objectives and approach of its client funds, as interpreted by the portfolio managers, as the strategy of some funds may be more interventionist than others. Where City Financial is asked to carry out proxy voting under its own policies and procedures, the Firm take steps to ensure that proxy voting is carried out relating to securities held in client accounts. If City Financial votes on this basis, it would do so in the best interest of its clients. As an alternative to giving City Financial discretion to vote proxies, client funds may provide their own written proxy voting guidelines or their own policies, procedures or directions regarding proxy voting. Such guidelines or directions must be in writing and delivered to City Financial sufficiently in advance to allow the Firm to vote as directed.

## **18 – FINANCIAL INFORMATION**

City Financial does not have any adverse financial information to disclose. The management of City Financial believes that the Firm is financially sound, and ensures that at all times it meets the regulatory capital requirements of the FSA.

## **APPENDIX A. DIRECTORS BUSINESS BACKGROUND**

### **Andrew Williams, Chief Executive**

Andrew Williams is Chief Executive of City Financial. He was previously Head of Distribution at Invesco UK Limited (see above) during which time the Invesco Perpetual family of funds became the second most popular in the UK domestic savings market and the best-selling family in the Invesco group. Before coming to the UK, Andrew had a variety of roles in Invesco's Canadian AIM Trimark business and was responsible for the team managing the integration of AIM and Trimark. Andrew holds the CFA designation, has an MBA from the Rotman School of Management and a degree in Economics and Chinese from the University of Toronto. He lives in London.

### **Robert C. Hain, Chairman**

Robert Hain is Chairman of City Financial Investment Company Limited. He was previously Chief Executive Officer of Invesco UK Limited, one of the largest asset managers in the UK, trading as "Invesco Perpetual" in the UK and "Invesco" in Ireland. Before coming to the UK, Robert was CEO of Invesco's Canadian AIM Trimark business which became one of the best-selling fund families in Canada and acquired the Trimark Financial Corporation for US\$1.8 billion. Prior to his being recruited by Invesco, Robert's career included four years with Investors Group, part of the Power Corporation of Canada. Most of his earlier career was spent with Royal Trustco (now the Royal Bank of Canada) in global private banking. Robert is a graduate of the Universities of Toronto and Oxford. He lives in London.

### **Jack Hollihan: Non-Executive Director**

Jack Hollihan is a Non-Executive Director of City Financial. Jack is the Chairman of Litchfield Capital Holdings, a director of Armour Residential REIT and, until its sale to Gramercy Capital, a trustee of American Financial Realty Trust. Previously, he was Head of European Industry Investment Banking for Banc of America Securities, and Head of Global Project Finance and European Utilities and Energy Investment Banking for Morgan Stanley International. Jack practised law before entering the financial services business with Lazards.

### **Michael Stein**

Michael is an Executive Director of City Financial. Michael is the founder, Chairman and CEO of The MPI group, a property development and investment group with a strong track record in incubating, investing in and managing successful companies. An experienced entrepreneur, Michael is a founder of several successful businesses including CAP REIT, Canada's first apartment REIT, and continues to serve as its Chairman. Michael has an MBA from Columbia University, New York and graduated with a B.Sc. in Civil Engineering from the Israel Institute of Technology.

### **David R Beatty**

David Beatty, OBE, is an Executive Director of City Financial. Professor Beatty is an experienced global businessman with extensive Board experience. He is the current Chairman of Inmet Mining Corporation and a Director of several multi-national corporations. He was the managing director of the Canadian Coalition for Good Governance, an organisation that represents 50 pension funds, mutual funds and money managers with over US\$1 trillion in assets under management. Professor Beatty is also the Conway Director of the Clarkson Centre for Business Ethics and Board Effectiveness at the Rotman School of Management at the University of Toronto.