



UK INNOVATION INVESTMENT FUND REQUEST FOR PROPOSALS

Issue Date: 3 August 2009
Due date: 18 September 2009 @ midday.

CAPITAL FOR ENTERPRISE

REQUEST FOR PROPOSALS FOR THE UK INNOVATION INVESTMENT FUND

Purpose of request

On 29 June 2009, the Prime Minister announced the creation of the UK Innovation Investment Fund (“UKIIF” or “the Fund”) to invest in funds that will invest in technology-based businesses with high-growth potential. The Fund will focus on investing in Venture Capital backed technology based small firms, start-ups and spin-outs, in digital and life sciences¹, low carbon², clean technology and advanced manufacturing primarily in the UK.

The Department for Business, Innovation and Skills (“BIS”) will invest £150m in total to cornerstone one or more Fund-of-Funds with the expectation that each first closing will match government investment by at least £1 for £1. Managers proposing a lower proportion of private investment at first close should provide a clear explanation. There is a further expectation that there will be a significantly higher final closing after a maximum period of 18 months.

The Fund(s) of Funds will invest in a small number of specialist UK-focused technology funds that have the expertise to invest directly in companies and a successful track record of having done so.

BIS will be represented in this process by Capital for Enterprise Limited (“CfEL”), the company established by BIS to make, monitor and manage Government’s venture capital fund investments and loan guarantee proposals. CfEL has power of attorney to act for the Secretary of State for Business Innovation & Skills. Further information on CfEL can be found at:

<http://www.capitalforenterprise.gov.uk/>

CfEL is seeking proposals from prospective Managers of the Fund(s) of Funds. The selected Manager or Managers (“Managers”) must be experienced at operating Fund of Funds structures with a proven track record of selecting technology focused Venture Capital funds with a significant UK focus. Managers will be authorised by the Financial Services Authority (FSA) or an equivalent body if registered in a different jurisdiction, and will possess the necessary authorisations to operate in the UK. Managers will be responsible for sourcing the private sector investment for the Fund.

Timetable

CfEL will be operating an open competition to the following timetable, which should result in the appointment of Managers for the Fund(s) of Funds by 11 December 2009:

¹ Life Sciences will include: pharma-biotech, diagnostics, medical devices and other healthcare-related technologies.

² Low carbon is defined as, “Technologies, products and processes which increase or are intended to increase energy efficiency and/or reduce or limit the emission of greenhouse gases (carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulphur hexafluoride) or the use of processes which emit greenhouse gases, including but not limited to sources of renewable energy”

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| • Issue of RFP | 3 August 2009 |
| • Deadline for registering interest | 28 August 2009 |
| • Deadline for submission of proposals | 18 September 2009 |
| • Notification to shortlisted bidders and commencement of formal due diligence | 16 October 2009 |
| • Appointment of selected Manager or Managers | 11 December 2009 |
| • 1 st closing | As soon as possible |

Prospective bidders are invited to direct questions in advance of submitting a Proposal to UKIIF@capitalforenterprise.gov.uk. Questions (posted anonymously) and answers will be available on the CfEL website in order to ensure that all prospective Managers have access to the same information. CfEL will not be able to answer queries by telephone.

Fund of Funds Managers should register their interest in submitting a Proposal by 28 August 2009 by emailing the name of their organisation and contact details to UKIIF@capitalforenterprise.gov.uk.

Delivery of Proposal

Five hard copies of Proposals should be submitted, along with an electronic version; spreadsheets should be Excel compatible. It is expected that Proposals will be between 5 and 10 pages long but appendices may be used if necessary. Managers may be rejected solely on the basis of the Proposal.

All Proposals should be delivered to:

Hard copies:

UK Innovation Investment Fund Proposals
Capital for Enterprise Limited
1 Broadfield Close
Broadfield Business Park
Sheffield S8 0XN

Electronic copies:

UKIIF_bids@capitalforenterprise.gov.uk

Note: Proposals will not be opened until midday on 18 September 2009.

All proposals must be received by midday on 18 September 2009.

Terms and Conditions

CfEL reserves the right to reject any and all proposals with or without cause.

CfEL reserves the right to request clarification of information submitted and to request additional information regarding any or all proposals. Refusal to provide such information upon request may cause the proposal to be rejected. Where no reply to a request for information or for clarification is received within 5 working days, CfEL will consider that the Proposal has been withdrawn.

The award of any mandate from CfEL as a result of this Request for Proposals process will be subject to the prompt and satisfactory agreement of legal terms. Applicants will also be expected to provide a timetable for meeting any other obligations, such as the raising of further investment, and the award and continuation of a mandate will be conditional on meeting that timetable.

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The legal agreement resulting from acceptance of a Proposal shall be in a form supplied or approved by CfEL and shall reflect the specifications in this RFP.

Neither HM Government nor CfEL shall be responsible for any costs incurred by applicants in preparing, submitting or presenting their response to the RFP.

All information provided by Managers will be treated as commercially confidential. Except where required by law or where the consent of the applicant has been obtained, such information will not be disclosed to third parties other than those involved in assessing or advising on UKIIF or in other aspects of the management or evaluation of UKIIF. The Government will retain Proposals after a mandate has been awarded, for example to support any evaluation of the UKIIF selection process. This may involve passing certain details to carefully selected external researchers, who would be bound by strict confidentiality provisions.

Process

Proposals are invited from any Manager which considers that its organisation can meet the mandatory criteria for the Fund of Funds and which is able to fulfil the investment mandate outlined in the Requirements section.

Proposals

Managers will have until midday on 18 September 2009 to submit their proposal.

The information at Appendix 1 is the minimum that CfEL will require from Managers in order to assess their Proposals. Managers should provide contact details for relevant personnel who will be available to answer questions and provide clarification on materials submitted.

It is expected that Proposals will be between 5 and 10 pages long but appendices may be used if necessary. Managers may be rejected solely on the basis of the information contained in the Proposal.

Prospective bidders are invited to direct questions in advance of submitting a Proposal to UKIIF@capitalforenterprise.gov.uk. Questions (posted anonymously) and answers will be available on the CfEL website in order to ensure that all prospective Managers have access to the same information. CfEL will not be able to answer queries by telephone.

CfEL will not meet with Managers prior to the deadline for the submission of Proposals. Prior to shortlisting, CfEL may require to meet Managers. However, CfEL may reject Proposals solely on the basis of materials provided in the Proposal.

Shortlisting

It is expected that CfEL will inform Managers who have been shortlisted by 16 October 2009. The receipt of such notification should not be interpreted as confirmation that HM Government will invest in the Manager's fund. CfEL intends to operate a competitive shortlist.

Managers who have not been shortlisted will also be notified. CfEL will not provide feedback on such Proposals.

CfEL reserves the right not to make any appointment should the quality of Proposals not meet the requirements of HM Government.

The shortlist will be drawn up by CfEL on the basis of the Selection Criteria below. During the shortlisting process, CfEL may contact Managers in order to request further clarification of information provided in the Proposal.

Formal due diligence

Shortlisted bidders will be required to provide documentary evidence which validates the information provided in their Proposal. CfEL will review this information and any other information as part of a detailed due diligence process.

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By submitting a proposal Managers will be agreeing to CfEL undertaking such background checks as it deems reasonable. This will include referencing with prospective, existing and past investors, the managers of funds in which the Manager has invested, and other third parties. CfEL will also carry out checks with the managers of funds identified by the Manager as being suitable for investment by the Fund.

Award of mandate

Following satisfactory conclusion of the due diligence process, CfEL will issue notice of its intention to invest in the Manager's fund – subject to various conditions being met such as a successful fundraising and the prompt and satisfactory completion of legal documents. The Requirements section below gives further details of the fundraising expectations of the government.

Shortlisted bidders who are not awarded a mandate will be notified.

Requirements

Overall objective

The purpose of the Fund is to:

- Support technology businesses in strategically important UK sectors, including digital and life sciences, low carbon, clean technology and advanced manufacturing (at least £25m to be committed to investment in each of the life sciences³ and low carbon⁴ sectors);
- Attract private sector investment to support technology companies and address longstanding structural issues;
- Stimulate the venture capital and syndication markets in the UK at a time when they are most vulnerable;
- Provide a cost effective mechanism that provides a market return to private sector investors and to HM Government;

Managers should state clearly how they intend to achieve these objectives. In particular, Managers should state how:

- Private capital will be raised and from whom;
- UK focus will be achieved;
- Investment will be allocated so that it will impact on businesses at various stages of development, from seed to later stage;
- Investment will be allocated so that it will impact on businesses operating in a range of technology sectors;
- The investment policy of the funds in which the Manager invests will be influenced to ensure that these objectives are met and so that the fund invests in line with Government objectives.

Fund structure

Proposals are invited to invest either the whole of or a proportion of the Government's investment. CfEL will select a manager or managers who offer the best overall value for money for the Government. Funds will be required to meet the specific criteria listed and Managers will need to provide CfEL with confidence that they will be able to raise the level of private sector investment required within the proposed timescale.

³ Life Sciences includes Pharma-biotech, diagnostics, medical devices and other healthcare-related technologies.

⁴ Low carbon is defined as, "Technologies, products and processes which increase or are intended to increase energy efficiency and/or reduce or limit the emission of greenhouse gases (carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulphur hexafluoride) or the use of processes which emit greenhouse gases, including but not limited to sources of renewable energy"

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Specific Requirements

Minimum size for UKIIF

The Government is looking to make a significant impact through its investment into the UKIIF. Managers should propose a fund size that is significant enough for them to make underlying investments that will, in turn, be significant enough to ensure that the investment policy of the underlying funds is compatible with UKIIF's objectives.

The Government expects that it will invest in one, or two, or three UKIIF Funds of Funds, depending on the scope of proposals received.

Private sector participation

The Government is seeking to maximise the level of private investment that is attracted to the UKIIF programme. In selecting which proposals to support, CfEL will consider a higher proportion of private sector funding as a positive factor.

Managers should propose a level of funding for a first close, which should be as soon as possible. Proposals should set out when bidders believe this could be. Managers should be confident that they can raise the level of private sector funding they propose as failing to deliver this level within the agreed timescale is likely to result in the mandate being withdrawn. The private funding for the first close should ideally match the commitment sought from Government by at least £1 for £1.

Managers should also give an indication of the amount of funding that could be achieved on second and subsequent closings. The final closing shall be no later than 18 months after first closing.

There is no restriction on the source of private funding. It is acceptable for investment to come from overseas investors. The Manager will be expected to carry out all the necessary money laundering and other checks.

Managers, in order to maximise the level of private funding raised, may provide for investors to specify a preference within the Fund of Funds for their investment to be allocated to certain sectors. Where Managers think this beneficial they should propose specific mechanisms to allow it.

The Government has committed that private and public funding will be invested on a pari-passu basis. Proposals that seek, in any way, to provide private investors with advantageous terms will not be accepted.

Investment in UK businesses

The UKIIF will be able to invest in underlying funds that operate across a wider geography than the UK. However, the Government is keen to maximise the impact of this fund on UK businesses and so CfEL will favour proposals from Managers able to demonstrate greater levels of investment into UK based businesses.

Sector and Stage coverage

The UKIIF is intended to support businesses at various stages of development and across a broad definition of technology. The Government is aware that VC funds have tended to move towards making later stage investments but is keen that this Fund has an impact at all stages. The

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Government also wants to ensure that the funding is not overly focussed on any particular sector. Proposals must describe how the Manager can ensure that underlying funds meet this requirement.

Within the above the Government is not placing any restriction on the domicile of the UKIIF Manager or the managers of any of the underlying funds. However, Proposals will need to demonstrate that these managers have the experience and capacity to make and monitor investments within the UK and a demonstrable track record of having done so successfully in the past.

Investing into closed funds

In order to allow for flexible investment where it is most needed, the Government will allow investment into underlying funds that might not otherwise be fundraising. This can be through the purchase of secondary positions (from previous LPs who cannot meet commitments) or as an investment of fresh capital on appropriate terms. Managers who want to use this flexibility must demonstrate, within their proposals, that they will have, and follow, policies and procedures that protect the value for money of the Government's investment.

It is unlikely that investment will be allowed in circumstances where the Manager has or manages a previous investment within the underlying 'closed' fund, unless there is significant third party investment occurring at the same time and on the same terms.

An alternative mechanism for supporting portfolio companies of existing funds might be a co-investment pool within the Fund of Funds or an allocation to a manager with a remit to invest in the portfolio companies of other existing funds independently or alongside those funds or alongside other third party investors.

Size of investment into underlying funds

The Government is seeking to maximise the impact of its funding and in some cases this might be through the Fund of Funds taking a majority share in an underlying fund. There will be no restriction on the proportion of an underlying fund that is made up by the UKIIF.

Similarly, there is no restriction on the proportion of the UKIIF that can be invested into any single fund.

Proposals should set out the intended target funds and CfEL will be looking for an appropriate spread of investments for the size of the proposed fund and in the light of the need for the UKIIF as a whole to meet the need for a spread of investment sizes and sectors, taking into account prudent portfolio and risk management.

Legal structure

The Government expects to invest through a UK Limited Partnership.

The Fund of Funds should have an initial 10 year life with Investors having the option to extend as necessary. Proposals should set out a reasonable investment period, taking into account the Government's desire to generate a significant yet appropriate level of activity in the short term (i.e. next two years).

Selection Criteria

Mandatory criteria

Any prospective manager must:

- Be authorised to raise and operate a Fund of Funds within the UK;
- Have previous experience of successfully managing similar Fund of Funds, or generalist Funds of Funds with a significant exposure to UK technology investments
- In the opinion of CfEL:
 - o Have systems and procedures in place for identifying, making and managing fund investments which are robust and appropriately documented
 - o Have industry-standard back office systems capable of generating reports and other information regarding investments that HMG is likely to require from time to time
 - o Have the experience and expertise needed to source the level of private capital proposed
 - o Not be likely to cause embarrassment to HMG

Other criteria

In assessing Proposals, CfEL will also have regard to the following broad parameters:

The management team

The UKIIF must be managed by a competent and stable management team. CfEL will be looking for teams that are able to demonstrate having worked together effectively and the capacity to execute the mandate for the full life of the fund. In addition to the track record and background information requested, CfEL will also place high reliance on satisfactory face-to-face and other dealings with management teams.

Track record

CfEL will assess the overall returns generated for investors in any funds currently or previously managed by the Manager. The Manager's return expectations for the Fund must be credible given this track record. Consideration will be given to the following:

- IRR and cash multiples generated on previous funds
- IRR and cash multiple performance of those parts of Funds of Funds that are comparable to the UKIIF mandate
- The number of funds currently and previously managed
- The size of the funds currently and previously managed
- The performance of the funds currently under management
- Overlap of the investment mandate proposed with the objectives of the UKIIF

Fundraising capability

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In assessing whether Managers can deliver the level of private sector funding suggested, CfEL will consider:

- The mechanisms in place to raise funds from private sector sources
- The sources and amount of funding secured for previous funds and how this compared with original targets
- The timetable for previous fundraisings
- Availability of funding for UKIIF from Manager's existing investment programmes and mandates

With respect to UKIIF, CfEL will favour proposals that provide comfort that the funding targets will be met. Proposals that contain indicative letters of commitment or other letters of support will be at an advantage. CfEL expect to be able to contact prospective investors and so the names and contact details of investors should be provided in the Proposal.

Return expectations

The Government is seeking to invest on terms and with a return that would also be attractive to private investors. The fund should therefore be targeting a commercial return. The proposal should set out the Manager's expected/target returns and the justification for this.

Fees and Charges

CfEL will be looking to secure value for money which may not necessarily be the Manager who offers the lowest level of fees. However, other things being equal, lower fees and charges will be considered a positive factor.

Proposals should contain details of all fees and charges, including and especially where the Managers consider these should be external to the management fee.

Incentive structures/ Carried interest

Carried interest and similar performance related schemes will help to align the interests of managers and investors and will be considered favourably. Proposals should contain details of any carried interest or similar incentive schemes.

The Government will not accept a 'deal by deal' or 'fund by fund' carried interest scheme and will be looking for a hurdle rate that provides a meaningful incentive. Other things being equal, Proposals with a lower carried interest share and higher hurdle will be preferred.

Investment strategy

Proposals should describe the target underlying funds along with any strategy to ensure that the UKIIF invests across the range of investment stages and sectors described in the Requirements section. They should also set out any previous relationship the Manager has with those underlying funds.

Consideration will also be given to:

- The speed with which Managers will be able to make these investments

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- The ability of the Managers to ensure that the investment strategy of UKIIF will be adhered to within the underlying funds
- Proposals to access those quality management teams that have recently raised funds and who are not expected to raise new funds for several years to come

Monitoring and engagement

The Government will make a substantial commitment to any Fund of Funds and will need to ensure its investment will, and will continue to be, properly monitored and managed. In addition to providing details on formal reporting, Managers will be expected to set out how they will additionally engage with CfEL to provide information, intelligence and assurance on the allocation, monitoring and ongoing management and performance of the portfolio of funds. This might include, for example, arranging for CfEL to observe due diligence or allocation meetings, and investor meetings of portfolio funds. Additional or alternative proposals from prospective Managers would be welcomed, but any such proposals should pay due regard to the need to avoid any potential liability attaching to the Secretary of State.

APPENDIX 1

Checklist of Information Required from Managers

This section sets out the minimum information which will be required by CfEL in assessing Proposals.

About the management company

Please include the following information:

- Name of the legal entity and type of organisation (e.g. partnership, limited company)
- Administrative details (Company / Partnership registration number, registered address, etc)
- Date of formation
- Ownership details including names and contact details for significant owners and a schedule of any changes in ownership or ownership structure over the past 10 years
- Names and addresses of directors
- Organisation chart detailing responsibilities of executives
- Latest available accounts
- Details of insurance policies in place and whether any claims have been made on such policies within the last 5 years
- Documentation as to litigation involving any executive officers or Directors (bankruptcy, crimes, securities, taxation)
- Documentation regarding any material litigation or disputes (pending and within last 5 years)
- Details of professional advisers
- All relevant permissions from relevant regulatory bodies
- A high level business plan outlining the strategic aims of the business and other products / funds under consideration
- Details of the remuneration strategy of the business, including how the fees and any carried interest proposed for managing the Fund would accrue and vest to members of the management team

About the Fund

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Fund structure

- Details of the fund structure
- The total anticipated size of the fund, including the total amount of funding required from HM Government and the total amount of funding expected to be committed to the fund by private investors and when this would be in place by
- The arrangements in place for distributing / monetising non-cash assets at the end of the fund's life

Investment strategy

- Managers will need to specify which elements of the strategy are to be written in to the partnership agreement. Applicants should note that, in assessing Proposals, CfEL will have regard only to those elements that can be written into the legal agreements. As a minimum, Managers will need to provide the following details:
 - o A description of how the overall objectives of the fund will be met including the requirement for a UK focus
 - o Target number and value of fund investments in each year of the fund
 - o The overall approach that will be adopted to building a portfolio of funds including the mix of new and existing funds to be invested in, target sectors and stages of investment. Managers should provide details of funds they have identified which may be suitable for investment by the Fund and provide contact details where possible
 - o How the manager will ensure that the investment policy of the underlying funds align with that of the fund of funds
 - o How the Manager proposes to abide by any allocations for specific sectors and stages of investment
 - o Target investment size for underlying funds
- An assessment of the specific risks associated with the proposed strategy (i.e. ignoring general venture capital market risks)

Fund operation

- Managers should describe the operation of the Fund of Funds including details of:
 - o The Managers' investment processes and fund selection procedures
 - o The criteria by which funds are assessed including both qualitative and quantitative analysis undertaken as part of the due diligence
 - o The remit and membership of any Investment Committee
 - o Arrangements in place for identifying and managing conflicts of interest
 - o Any other bodies to be incorporated within the constitution of the fund such as an Advisory Panel or Investors' Committee
 - o The proposed level of active portfolio management and how this might enhance the performance of funds invested in
 - o Drawdown arrangements, including the notice periods that will apply to the private investors and the measures to be put in place to ensure that drawdown commitments are met
 - o Distribution arrangements and timings

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- Arrangements in place for back office operations including reporting and details of reporting requirements to be placed on underlying funds
- Reporting to fund-of-funds investors

Managers should also outline how they would engage with CfEL.

Sources of private capital

- Managers should include the following information in their Proposals and be prepared to supply further supporting evidence if required:
 - **For any fund of funds currently or previously managed by the Manager:**
 - Details of investors with contact names and telephone numbers where possible
 - Details of targets for fund sizes and timing vs actual funds raised and dates closed
 - **For the proposed fund:**
 - The target level of private capital and the mechanisms in place to source it
 - Details of the target investors, together with contact information
 - Any provision made for investors to specify a preference within the Fund of Funds for their investment to be allocated to certain sectors
 - The timeframe for preparing a prospectus and raising the money and whether there would be more than one closing for the fund
 - Where more than one closing is envisaged, applicants should describe any mechanisms in place to give comfort that this level of funding will be raised.
- Managers should provide formal consent for CfEL to contact both existing and prospective investors;

Fee structures

Managers should set out:

- The level, structure and timing of management fees and other remuneration to the fund manager. Where carried interest is to accrue to the Manager of the fund, the basis of calculation, including the hurdle return for investors, and a detailed vesting schedule should be set out;
- Details of any other charges or fees. Applicants are asked to explain whether these fees or charges accrue to the fund, investors or to the fund manager;

Financial projections and budgets

- Outline financial projections for the fund management company covering the fund life. These projections should demonstrate that the fund manager will be generating income that is sufficient to cover the costs of managing the fund, but is not excessive
- Full financial projections for the fund of funds itself, including the financial returns that are expected to accrue to investors. This should include a sensitivity analysis that shows how returns vary on a range of different assumptions about underlying investment and fund performance.

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Applicants should note that more detailed spreadsheets underpinning the financial projections, in a format capable of being read by Microsoft Excel, will be required from short listed applicants.

About the management team

'Key personnel' includes each individual whose experience and expertise are to be taken into account by CFEL when assessing a proposal.

In addition to investment principals, this may include staff with responsibility for reporting, accounting and compliance. For each of these individuals, the following should be included:

- Their name, full address, contact details, full curriculum vitae
- Details of relevant authorisation(s) held, including a copy of the current Statement of Permitted Business or equivalent.
- Details of existing commitments on their time (including any other funds under management) that will impact on their ability to dedicate their time to this fund. Where existing commitments are to be handed over to others within the team, arrangements in place for this transition should be described;
- Details of their proposed role, responsibilities and terms of employment, including how much of their time will be devoted to management of the fund;
- The length of time for which they have:
 - Worked for the management company;
 - Worked with the other members of the team; and
 - Worked in the private equity industry
- Details of their relevant skills, expertise and previous experience including:
 - Details of other fund of funds, venture funds or other equity investment activities in which they are currently or have previously been engaged, or are likely to be engaged during the lifetime of the fund.
 - Details of any directorships held currently or within the past seven years;
 - Whether they are an undischarged bankrupt, have ever been declared bankrupt or are currently the subject of bankruptcy proceedings; are or have ever been a director of an insolvent company; or have an unspent criminal conviction (other than for minor traffic offences). If the answer to any of these questions is 'yes', this will not exclude them from the application process. However, full details should be provided: applications will be dismissed if CfEL's due diligence reveals that information has been withheld;
 - Details of any cases of non-compliance by any of the 'key personnel' identified by regulatory authorities or their agents during the course of an audit or other review of compliance procedures; and

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- Written/signed consent for background checks, including checks of bankruptcy, financial or criminal records, to be undertaken;
- Employment contracts and, where applicable, severance agreements for each of the Key Personnel;
- Details of any investment positions which remain to be filled;
- The name and full contact details of at least 3 referees for each of the Key Personnel.

Track record

Details of current and previous funds under management should be provided, including the investment policy, size of each fund, the number of funds, and performance of each fund.

As part of this, Managers should provide a **full** analysis of all fund investments made. The following information should be provided for the management team as a whole for its Fund of Funds investment track record. Where applicants consider it relevant, applicants may also provide this information for individuals within the team.

Fund invested in	Vintage Year	Location ¹	Sectors	Stages	Type of investments ₂	Performance ₃

1. Where the fund invests/invested, e.g. UK-only, Europe, Europe and US, etc;
2. New or existing funds including details of any secondary purchases;
3. Performance information should be comprehensive and include:
 - Distributed Value / Total investments;
 - Total value of the portfolio / Total investments;
 - Gross IRR at the fund of funds level, i.e. after all fees and charges on the underlying funds invested in but before fees and charges for the fund of funds
 - Net IRR for the portfolio for investors in the fund of funds;
 - Proportion of UK early stage/technology components of these funds and their performance (IRR and cash multiples).

The basis of any valuation should be described.