

Newsletter
November 2014

Dear All,

Below is our November report on the developments at the HFSB.

HFSB presents the Hedge Fund Standards in Japanese in Tokyo

The HFSB presented the Japanese translation of the Hedge Fund Standards at its first Institutional Investor Roundtable in Tokyo co-hosted by Morgan Lewis.

Chris Wells, Partner of Morgan Lewis and the co-host of the HFSB event in Tokyo, said:

“We are delighted that the HFSB is engaging with the Japanese alternative investment community and raising awareness about the role of the Standards in improving practices in this industry.”

Dame Amelia Fawcett, Chairman of the HFSB, said:

“The Standards have been used widely in Europe, North America and Asia ex-Japan, and we believe they will make a similar contribution to the Japanese market. We look forward to involving the Japanese regulators, officials and market participants in the ongoing HFSB global dialogue on a wide variety of market issues.”

The [Japanese translation](#) of the Standards is now available on our website. Please click here to read the [Press Release](#).

This month the HFSB Team also met with the regulators and the investor community in Hong Kong, Beijing, Seoul and Tokyo as part of the HFSB Asian campaign to engage with the investor community in Asia and the Far East.

Upcoming events

- 10 December 2014, Helsinki, Finland: **HFSB Nordic Institutional Investor Roundtable**, hosted by Varma Mutual Pension Insurance Company
- 14 January 2015, Dallas, Texas: [Governance Solutions for Limited Partnership Structures](#), in collaboration with the Texas Hedge Fund Association

HFSB Survey

As you remember from our last newsletter, the HFSB has started a series of short surveys on standard-related issues. We intend to use these surveys in the months ahead to leverage the expertise and experience of our stakeholders and market participants. To remind you that the first survey is on management of conflicts of interest. The Standards and existing regulation address many concerns, but conflicts can manifest themselves in different ways across companies.



If you have not participated in the first survey, please [click here](#). Participants will receive the detailed survey results.

HFSB Institutional Investor Roundtable in Geneva

This month the HFSB held its third Swiss Institutional Investor Roundtable in Geneva which was co-hosted by Mirabaud Asset Management, an Investor Chapter member. The participants discussed investor due diligence case studies, investor risk aggregation and outsourcing arrangements by managers.

The HFSB would like to thank Mirabaud Asset Management, Unigestion, Albourne, PAAMCO and KromRiver Trading for their presentations and insightful comments.

HFSB at the International Forum of Sovereign Wealth Funds (IFSWF) in Doha

Earlier this month the HFSB was invited to speak on a panel at the [International Forum of Sovereign Wealth Funds](#) (IFSWF) conference in Doha. The key questions discussed included:

- the international role of SWF as long-term investors
- responsible investment and how sovereign wealth funds apply the Santiago Principles¹, and
- the role of investors in driving better standards.

HFSB Executive Director Thomas Deinet also highlighted the important role of hedge funds in the capital markets and how the HFSB provides a platform for investors and managers to collaborate to improve their market place.

Standards Corner

Investor due diligence of outsourcing arrangements

The hedge fund industry traditionally is based on a strongly unbundled business model, with managers focussing on what they are best at – managing the portfolio – and third party providers offering services such as administration, valuation, IT etc. The involvement of third parties /independent oversight in many of these areas can contribute to the structural strength of the business but also can be a source of risk, if not properly monitored and managed.

In recent years growing investor expectations and regulatory requirements have led to increasing the operating cost for the industry and creating bigger entry barriers for newly established hedge fund managers. Outsourcing of costly operational functions can be a way to address this challenge by introducing a more “variable” cost structure for some activities, such as finance/accounting, HR, marketing, middle/back office operations and parts of compliance.

The topic of outsourcing was explored in more detail at the **HFSB Swiss Institutional Investor Roundtable in Geneva** held this month. Specifically, the participants looked into how investor operational due diligence needs to take account of the impact of outsourced functions and what managers should be aware of when certain functions are outsourced:

Investor due diligence implications:

- *Testing of the manager’s understanding of the outsourcing arrangements*
- *Operational due diligence of the service provider*

Considerations for managers:

- *Retaining knowledge of the outsourced activity/ideally creating multiple links within the organisation to prevent knowledge loss*
- *Understanding legal ramifications and applicable standards and regulations*

¹ The “[Santiago Principles](#)” are a set of voluntary guidelines for the operation of Sovereign Wealth Funds established in 2008.

- *Conducting ex ante selection due diligence and ongoing review of service provider (including documentation)*
- *Defining performance metrics (e.g. scorecard, SLAs)*
- *Disclosing to investors the monitoring procedures in relation to third party service providers (Standard 20, Outsourcing risk)*
- *Communicating outsourcing approach to investors and regulators*
- *Outsourcing changes to employee job roles – prepare employees (communication, training)*
- *Outsourcing also changes the role of the COO (make deals, manage relationships, ‘change management’)*

It is important to highlight that some services are provided directly to the fund (e.g. fund administration), and it is the fund directors who oversee these appointments. However, the manager should monitor regularly the performance of such service providers and then report any issues to the fund directors. The [HFSB Standardised Board Agenda](#) provides an overview on the reports the fund directors receive directly from service providers and the manager (i.e. sections 5. Administrator Report, 6. Third Party Service Provider Report, 8. Auditor’s Report (annually)). The [Hedge Fund Standards 19 and 20](#) cover the governance of outsourcing relationships and the relevant investor disclosures in more detail.

The HFSB will continue to explore this topic at its Institutional Investor Roundtable in Helsinki on 10 December 2014.