hedge fund standards board

Bringing managers and investors together to set standards for the hedge fund industry

Newsletter – September 2016

In this month's newsletter:

- *New stakeholders*
- *HFSB Annual General Assembly*
- *HFSB on the East Coast and in the Midwest*
- *Upcoming HFSB events*
- *HFSB responds to FSB consultation*
- *HFSB at IOSCO AMCC Regulatory Training Seminar*

New Stakeholders

The HFSB is delighted to welcome new additions to its family:

Signatories

- TB Alternatives Assets (Hong Kong)

Investor Chapter Members

- Alaska Permanent Fund Corporation (USA)
- CB PermaTrust Asset Management (China)

HFSB Annual General Assembly

The HFSB held its Annual General Assembly in London on 8 September. The event brought together industry leaders both from the hedge fund and Institutional investor communities with such high profile speakers as Paul Marshall of Marshall Wace, Leda Braga of Systematica Investments, Scott Davies of CDAM, Poul Winslow of Canada Pension Plan Investment Board (CPPIB), Mario Therrien of Caisse de Dépôt et placement du Québec, Kathryn Graham of Universities Superannuation Scheme and Simon Ruddick of Albourne.

The Investor panel focused on the importance of alignment of interest, concerns about the "alpha share" (how alpha is divided between the manager and the investors) in light of the current low interest / low return environment. The panellists also discussed the issues of Investment risk management. Specifically:

- Whether there is a "risk" of risk management becoming "over institutionalised", introducing too much risk aversion into an individual manager's approach. One investor highlighted that in the context of a much broader pension portfolio, there is no harm in having a more volatile fund (as long as this results in higher returns).
- Whether computers are better able to navigate the current erratic markets than humans by eliminating cognitive and emotional biases (see short overview of behavioural biases and "How Biases Affect Investor Behaviour".

- The panel also highlighted that signing up to the standards facilitates investor due diligence and helps investors make a strong case for their hedge fund programmes and investments with individual managers vis-à-vis their own boards and investment committees.
- The manager panel explored the implications of Brexit for the hedge fund industry – most speakers felt relatively relaxed about the implications and were confident that European markets would continue to be accessible. A survey of the audience indicated that most attendees felt that Brexit does not make a big difference, and, in any event, it is too early to tell the impact on the industry.
- The managers also discussed smart beta/factor based investing, and questions around whether "factor-based investment" is starting to get crowded and the related possible impact on markets.
- Finally the managers explored competition from bank products (e.g., Total Return Swaps) and some of the key distinctions (in terms of investor protection): fund managers act as fiduciaries for the investor, while banks are counterparties in such arrangements.

The event was hosted by Herbert Smith Freehills, and the HFSB would like to thank them for their tremendous support.

HFSB on the East Coast and in the Midwest

This month the HFSB continued its Institutional Investor Roundtable series in the US with two events: in Chicago (27 Sep) and Washington D.C (29 Sep).

The Chicago Roundtable brought together leading investors and HFSB signatories. Speakers included representatives from Florida State Board of Administration (SBAFLA), Canada Pension Plan Investment Board (CPPIB), School Employees Retirement System of Ohio (OHSERS), GCM Grosvenor, Alyeska Investment Group, IONIC Capital Management and Magnetar Financial.
The key issues covered:

- The investors provided an overview of their investment programmes, the role of hedge funds and current investment priorities/opportunities. They explored how to achieve better alignment of interest, and exchanged views on the "alpha share", factor-based investing and the role of smaller managers in portfolios.
- The manager panel explored different approaches to addressing changing investor preferences (including customisation of mandates, bespoke fee structures, etc. and how potential conflicts can be addressed) versus a simpler (and less complex) "one product" approach, factor investing and "crowding as a risk factor", and measures firms have undertaken to improve cyber security.

Ash Williams, Executive Director and CIO of SBAFLA, who was one of the panellists, said: "Hedge funds can be a valuable mechanism to reduce risk in pension portfolios and can help improve information ratios and returns in the long term. However, it is important that the industry continues to work towards better alignment with its investors and continuously improves practices, and the HFSB is a great platform through which we can engage and collaborate with the industry."

The HFSB would like to thank the panellists for the contribution to the discussions, and GCM Grosvenor for hosting the event.

The **Washington D.C. Roundtable** was opened by Marc Wyatt, Director of the Office of Compliance Inspections and Examinations at the U.S. Securities and Exchange Commission. He focused on the following areas:

- Risk-based approach to examinations, taking factors such as "changes in AUM", "aberration of performance" and "changes of key personnel" into account
- How the SEC prepares for exams, and how managers should engage with the SEC
- How the National Exams Analytics Tool (NEAT) is used to inform examiners' inquiries into issues like insider trading and other anomalies in trading data.

The panel discussions included speakers from Cystic Fibrosis Foundation, Howard Hughes Medical Institute, Lockheed Martin Investment Management, Rock Creek Group, FORT, MKP Capital Management and Old Mutual Global Investors, covering a wide range of topics, including factor-based investing, alignment of interest, dynamics in the liquid alts space, standardisation of risk reporting and risk monitoring. One of the institutional investor panellists noted that it is important for managers to understand their role in their investors' overall portfolios, and that any individual manager's strategy shift could derail an investor's carefully crafted risk and asset allocation if the shift is not coordinated with the investor.

The HFSB would like to thank the speakers for their sharing their thoughts on the above topics and Akin Gump Strauss Hauer & Feld for hosting the event at their Washington DC Offices.

Upcoming HFSB Events

- **17 Oct, Singapore:** Sovereign Wealth Funds Roundtable, with speakers from GIC, Fullerton and Future Fund
- **19 Oct, Hong Kong:** Joint seminar with CAIA and Jones Day on cyber security
- **10 Nov, Montreal:** Institutional Investor Roundtable with leading Canadian pension funds
- **23 Nov, Shanghai**: Joint event with the Lujiazui Financial Centre

HFSB responds to FSB Consultation

The HFSB responded to the recently published Consultative Document by the Financial Stability Board "Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities".

- The Hedge Fund Standards address many of the concerns raised in this Consultative Document, including the issues of liquidity management, stress-testing, handling of redemptions in situations of liquidity distress, fund governance and counterparty reporting (Standards 9-20)
- The HFSB supports the regulatory efforts to gain better understanding of asset management activities / capital markets globally and believes that regulators should make use of the existing data and work towards a more consistent global approach, particularly with respect to data collection and reporting

- Before developing a "system-wide" stress-testing framework and in order to produce more meaningful insights, the HFSB believes that the FSB's approach should take into account other participants in the capital markets, not just asset managers (who account for ~30% of activity)
- The HFSB's response provides a framework for assessing the different leverage measures discussed in the Consultative Document, analysing the informative value and limitations of each measure, based on such criteria as "suitability for (risk) comparison purposes" and "ability to aggregate leverage across funds". The HFSB highlights that there is likely to be no singular "right" leverage measure that answers all questions, and in fact, different leverage measurement approaches may be suitable for different investment strategies. The HFSB also highlights the risk of narrowly focussing on singular "risk" measures. Risk management is one of the key areas of the Hedge Fund Standards, but the HFSB always has been careful not to prescribe a singular approach to measuring and managing risk, acknowledging the diversity of the hedge fund sector and preventing the creation of a "risk management monoculture". A key challenge for regulators today is to create regulatory frameworks that encourage better "risk management" while preventing the type of homogeneous behaviours that can result from a prescriptive regulatory approach.

Please click here to see the HFSB response.

HFSB at IOSCO AMCC Regulatory Training Seminar

Cyber Security remains a key priority for securities regulators around the globe. Thomas Deinet, HFSB Executive Director, provided an overview of the main results of the HFSB's activities in this area at the IOSCO AMCC Regulatory Training Seminar hosted by the National Futures Association (NFA) in Chicago, specifically:

- key lessons learned from the HFSB cyber-attack simulation exercises
- how cyber risks in asset management differ from other areas of finance
- understanding attack paths and mitigants, and
- assessing different mitigants from a cost/benefit perspective.

Over 100 representatives from securities regulators around the globe participated in the event.

The HFSB's activities in this area complement regulatory efforts to address cyber security risk by providing practical guidance and raising awareness. The HFSB also supports the 2016 AMCC Cybersecurity Survey. The results will be presented later this year. A summary of the results of the 2015 AMCC Cybersecurity Benchmarking Survey is available here.

The HFSB's next initiative in this area will be a Cyber Security Seminar to be hosted in Hong Kong on 19 October in collaboration with CAIA and Jones Day.

Appendix

Alaska Permanent Fund Corporation

The Alaska Permanent Fund is an investment fund created through a Constitutional Amendment approved by Alaskans in 1976 as a way to save a portion of Alaska's resource wealth for the needs of future generations. In 1980, the Alaska State Legislature created the Alaska Permanent Fund Corporation (APFC) to manage and invest the assets of the Permanent Fund. APFC has worked diligently to maximize the value of the Fund through a diverse portfolio of assets, including U.S. and non-U.S. fixed income securities, equities and real estate, as well as infrastructure, absolute return and private equity investments. The Fund has grown from the first deposit of oil revenues totaling $743,000 to a value of over $54bn today.

TB Alternatives Assets Limited

TB Alternative Assets Limited is one of the group companies of Trustbridge Partners ("TBP"). TBP is a China-focused investment firm and founded in 2006. TBP primarily focuses on investing in private and publicly-listed Chinese companies and companies with substantial operation in China. The firm employs over 30 investment professionals (public and private) and has offices in Shanghai, Hong Kong, and Boston. The firm's investment philosophy is driven by a fundamental understanding of long-term trends in society, consumer behavior, and technology. It concentrates on the TMT, consumer, and healthcare sectors.

CB Permatrust Asset Management Ltd

CB Permatrust is a Shanghai based asset management firm specialized in fund of hedge funds in China. Through research-based asset allocation and carefully conducted manager selection, it aims to provide institutional investors and HNWIs with professionally constructed portfolios of China hedge managers.

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