Newsletter
July 2014

Dear All,

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

New Signatories

We are delighted to welcome a new addition to the HFSB Signatory family:

- **Old Mutual Investment Management Ltd (UK)**

HFSB joins IOSCO

As reported in our recent Press release, the HFSB became an affiliate member of the International Organization of Securities Commission (IOSCO).

To read the Press release in full, please click here.

In July Thomas Deinet attended the IOSCO Board meeting with financial markets stakeholders held in Madrid.

Upcoming Events

23 September 2014, Annual North American Stakeholder and Institutional Investor Roundtable, New York (for HFSB stakeholders only).

The detailed programme will be sent to the HFSB stakeholders later next month.

Standards Corner: Role of Credit Ratings in Risk Management

The financial crisis has put credit rating agencies (CRA) under regulatory scrutiny, as over-reliance on external ratings by some market participants has given rise to concerns about herding and cliff effects.

In banking regulation, rating thresholds had been hard-wired into laws, regulation and market practice. In the insurance and pension sectors, regulation explicitly (or implicitly, through capital weightings) determine the investment universe, with sometimes strong reliance on credit ratings. In asset management, investment mandates may contain hard-wired external rating thresholds. The IOSCO is currently consulting on "Good Practices on Reducing Reliance on CRAs in Asset Management" to develop a set of good practices to reduce over-reliance on external credit ratings.

The Hedge Fund Standards contain a dedicated section on Risk Management, focussing on governance, risk framework, control processes, and disclosure (Std. 9-20), addressing many of the regulatory concerns.

- The approach involves reviewing and testing of the risk measurement framework (Std. 11.4**), i.e. managers should review their approach to using / relying on CRA assessments in their internal risk management approach.**
- As part of the manager's scenario analysis/stress testing framework (Std. 13.2 + 13.3), **managers can model the impact of rating downgrades (and potential abrupt market fluctuations).**

- Assessing and managing the counterparty risk of trading counterparties (incl. the setting of risk limits) is an important pillar of risk management in many hedge funds, **and managers should review their approach from time to time.** (Std. 14.2).

Institutional Investors may also wish to review the extent of hard-wiring and reliance on CRA assessments in their overall portfolios. The HFSB will explore this topic in more detail with managers and investors at its future Institutional Investor Roundtable events.

Commentary:

Risk management regulations, including the "hard-wiring" of external ratings, while well-intended, has led to more homogeneous behaviour of market participants and exacerbated the market distress during the crisis.

Risk management is one of the key areas of the Hedge Fund Standards, but the HFSB has been careful not to prescribe a singular approach to measuring and managing risk (e.g. by overly relying on singular metrics such as VAR, leverage, etc.), 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. The Hedge Fund Standards provide just the answer to this challenge.

APPENDIX

Old Mutual Investment Management Limited	Old Mutual Investment Management Limited ("OMIML") has its Headquarters in London and is 100% owned by Old Mutual plc, a FTSE 100 Listed Company. Old Mutual has been managing Hedge Funds since December 2001. OMIML manages three liquid equity hedge fund strategies each of which has structurally low Beta exposure and low correlation to Equities. Two of the strategies are quantitative: a Global Statistical Arbitrage Strategy and a Global Equity Market Neutral strategy and one is a discretionary UK Mid & Small Cap Equity Long/Short strategy. Old Mutual also manages three "Liquid Alternative" UCITS funds. AUM in the combined Alternatives strategies exceeded $2.4 Billion as at June 30 2014.