



## Newsletter - September 2017

### *In this month's newsletter:*

- *HFSB becomes SBAI*
- *Toolbox: Standard Total Expense Ratio (STER) Memo*
- *SBAI in Chicago & Washington DC*
- *Standards Corner: Prevention of insider trading*
- *SBAI at IOSCO Conference*
- *New Working Group – volunteers needed*
- *Upcoming events*
- *Annual Report 2016*

### ***HFSB becomes SBAI***

The Hedge Fund Standards Board (HFSB) announced at its 9th Annual General Assembly hosted in London on 7 September 2017 for its Signatories, Investor Chapter members and Core Supporters that it changed its name to the "Standards Board for Alternative Investments" (SBAI). Here is the link for [the press release](#). The change reflects the significant evolution in the SBAI and the alternative investment industry since the SBAI was formed in 2008. The London event, attended by over 100 guests, was opened Mr. Andrew Bailey, CEO of the UK's Financial Conduct Authority. Other speakers included senior representatives from AlphaGen Capital, Caisse de dépôt et placement du Québec, Church Commissioners for England, Future Fund, Man Group, Nordkinn Asset Management, Utah Retirement System and Varma Mutual Pension Insurance Company.

### ***Toolbox: Standard Total Expense Ratio (STER) Memo***

Following the announcement in the May 2016 SBAI newsletter, a working group (comprising representatives from SBAI manager and investor stakeholders around the globe) explored the issue of fee terms and definitions and developed guidance within the SBAI Toolbox. The working group now has created a Standardised Total Expense Ratio ("STER") that calculates a single, standardised expense ratio to facilitate better understanding, comparison and monitoring of fees and expenses across alternative investment funds. The STER calculation aggregates expenses and management fees charged to, or incurred by, a fund. A unique and important feature of the new STER methodology is that it includes the costs of research bundled with dealing commissions (often referred to as "soft dollar research costs"). Thus, the STER allows the comparison of a fund's structural costs on an "apples to apples" basis (i.e., providing additional transparency to which operating expenses are allocated to the fund or conversely borne by the manager). To make it useful for comparison purposes, STER excludes incentive fees which will fluctuate as a function of performance and trading related costs, as these will vary significantly and will depend on the specific investment strategy. STER is intended to be a ratio that is provided in addition to a fund's existing fee and expense disclosures. In addition to the STER methodology, the memo also includes an overview of regulatory requirements regarding cost and expense disclosure in major jurisdictions.



The SBAI would like to thank the working group participants from Albourne Partners, Caisse de dépôt et placement du Québec, Ionic Capital Management, PAAMCO, The Rock Creek Group, Teacher Retirement System of Texas, Unigestion and Winton Capital for their support.

Please click here to read [the press release](#) and [the full report](#).

### ***SBAI in Chicago & Washington DC***

This month, the SBAI also held its annual institutional investor roundtables in Chicago and Washington DC, bringing investors, managers and regulators together to explore current industry issues.

Topics covered:

- Investor approaches to alternative investment (organisational arrangements, consultant-led versus in-house approach etc.)
- Investor priorities in alternatives in the current market environment (emerging alignment structures, beta-alpha separation, factor analysis)
- Running an investment firm (dealing with pro-cyclicality in capital raising, business development priorities, senior leadership development, tone from the top and importance of "tone from the middle")
- Big data and artificial intelligence in investment management – "hype versus reality"
- Responsible investment (exploration of a pragmatic approach)
- Prevention of insider trading (see separate section below)

Representatives from the Securities and Exchange Commission's Division of Enforcement and the Office of Compliance Inspections and Examinations (OCIE) participated in both events, providing an overview of recent enforcement case studies and current inspection priorities, including in the areas of

- Valuations (deviation of pricing marks for valuation purposes from observable valuations of actual trades by the advisor)
- Insider trading (see SEC press releases [2017-143](#), [2017-146](#))
- Conflicts of interest in side-by-side funds and accounts with similar strategies (allocation of expenses, allocation of investment opportunities/IPOs) [an area that the SBAI extensively covered in the 2015/16 [consultation on conflicts of interest](#)]

Kristin A. Snyder, Co-National Associate Director for the OCIE's Investment Advisor/Investment Company Program said: "The SBAI provides a unique and powerful framework for investors and managers to work



together to improve industry practices and address emerging issues.”

The SBAI would like to thank the speakers from Alyeska Investment Group, Citadel, Exelon Corporation, HealthCor Management, Magnetar Financial, Maryland State Retirement and Pension System, Municipal Employees’ Retirement System of Michigan, National Futures Association, Orchard Global Asset Management, Pennsylvania Public School Employees’ Retirement System, The Rock Creek Group, Tipper X, the SEC and Varma Mutual Pension Insurance Company for their contributions. **A special thank you goes to Citadel for hosting the Chicago event and to Orchard Global Asset Management for hosting the Washington, DC event.**

### ***Standards Corner: Prevention of Insider Trading***

The SBAI roundtable in Washington included a practitioner panel which focused on **prevention of insider trading**, specifically :

- *Lessons from recent enforcement cases in the US:* strong policies and procedures must be applied to expert networks and political consultants; prosecutors are expanding their efforts beyond securities fraud, including to wire fraud, stealing property from US government and failure to supervise. Cases are won on poorly drafted e-mails - beware of poor “optics.”
- *Measures to prevent market abuse:* escalation procedures where analysts are trained always to bring issues to compliance (which should be an open door --when in doubt, consult!) and use of restricted lists and watch lists programmed into order management systems. Frequent training from the beginning of hiring and throughout employment is key to fostering the right culture.
- *Indicators that can help compliance detect illegal behaviour:* notable "red flags" include trade surveillance examining profitable trades, email “hot words” searches, random sampling of e-mail and vetting of research vendors and brokers.

An important contributor to the discussion was [Tom Hardin \(Tipper X Advisors\)](#), who was charged for insider trading and then became the FBI’s most productive cooperating witness in Operation Perfect Hedge (this led to 80 guilty pleas). Mr Hardin explored how firms can improve corporate ethics and provided insights into specific behavioural aspects, including rationalisations and psychological traps that push traders and analysts to cross the line:

- false consensus effect (“everyone is doing it”)
- belittlement (“it’s an immaterial trade”)
- small steps
- misconceptions about the damage (it’s *not* a victimless crime)



- faceless victims

The Shareholder Conduct section of the Alternative Investment Standards (Standard 23) covers prevention of market abuse, including examples for compliance procedures that can help firms identify and prevent breaches of market abuse laws.

### ***SBAI at IOSCO Conference***

The SBAI participated in the Affiliate Members Consultative Committee (AMCC) Mid-Year Meeting and 10th IOSCO AMCC Regulatory Staff Training Seminar hosted in Mumbai. SBAI Executive Director, Thomas Deinet, touched upon the SBAI's activities in two important areas:

- **Cyber security:** overview of the findings of the SBAI cyber-attack simulation table-top exercises, review of anatomy of breaches, assessment of recent high profile cyber-attacks (such as Equifax and Deloitte) and how basic cyber security measures could have prevented these attacks.
- **Financial stability (in support of IOSCO Committee 5):** Overview of Open Protocol risk reporting, perspective on different leverage measures and their limitations, understanding interplay of "leverage" with specific risk factors and the development of a "financial stability dashboard" (using existing data reported to regulators by investment managers) to understand different risk transmission channels.

### ***New Working Group – volunteers needed***

There has been a growing interest in recent years in factor-based investing/dynamic beta/alternative beta. The SBAI will be forming a new working group to explore this area as well as assess if/where standards and/or guidance can help address potential issues in areas such as governance, disclosure, etc. Stakeholders interested in joining the working group are invited to contact us at [info@sbai.org](mailto:info@sbai.org).

### ***Upcoming events***

- **16 October, Los Angeles: SBAI Institutional Investor Roundtable**

The event will bring together leading industry participants. Speakers include senior representatives from Caisse de dépôt et placement du Québec, Carlson Capital, Pepperdine University, Teacher Retirement System of Texas, University of Southern California and Victorian Funds Management Corporation.

- **28 November, Montreal: SBAI Institutional Investor Roundtable**



The event will bring together international industry participants. Details to be published soon.

- **14 December, Shanghai: SBAI Institutional Investor Roundtable**

The event will bring together international industry participants. Details to be published soon.

The full event schedule is available [here](#).

### ***Annual Report 2016***

The SBAI published its annual report. Please click here to read [the report](#).



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