Bringing managers and investors together to set standards for the alternative investment industry

Newsletter – May 2019

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New Stakeholders

The Standards Board is delighted to welcome new additions to the SBAI family.

Core Supporters

- BlackRock (USA)
- HPS Investment Partners (USA)
- PIMCO (USA)

Investor Chapter

- CdR Capital (Switzerland)
- Ontario Teachers' Pension Plan (Canada)
- State of Wisconsin Investment Board (USA)

Signatories

- Graham Capital (USA)
- HPS Investment Partners (USA)
- Martlet Asset Management (USA)

SBAI Annual North American Stakeholder Forum

The SBAI Annual North American Stakeholder Forum in New York City attracted over 200 guests this year, representing SBAI Signatories, Investor Chapter Members, Core Supporters and other leading fund managers and institutional investors. The Forum focused on three main topics:

- Industry Leader's Perspective: Evolving Asset Management
- Shaping Corporate Culture: How it Works in Practice
- Redefining Partnerships between Asset Owners & Managers

The speakers included senior executives from Angelo Gordon, Bank of America, BlackRock, CQS, Canada Pension Plan Investment Board, Caisse de dépôt et placement du Québec, Citadel, Future Fund, Man Group, New Holland Capital, Oz Management, Reservoir Capital, State of Wisconsin Investment Board and Wellington.

The **Leaders' Panel** explored key aspects of managing an asset management firm and how to build a firm that has staying power in what continues to be an evolving and dynamic market environment.

- **Generating Alpha:** The world is becoming more efficient every day, and alpha becomes harder to mine: size as a competitive advantage to build infrastructure/technology, attract talent to expand capabilities, innovate and diversify the business
- **Balancing Cost-Drivers & Investing in Growth:** Focus on long-term strategy rather than chasing short term trends/product opportunities
- **Does Firm Ownership Structure Matter?** Focus should be on maximising performance for clients. It should not be on accumulating assets, managing to a stock price, catering to partners/owners and other distractions
- **Leadership & Succession:** Importance of distributing ownership and creating a culture that fosters growth and upward mobility

The **Shaping Corporate Culture Panel** focused on how company culture impacts performance, what tools employers should use to foster the right culture and investors' perspective on assessing culture of fund managers.

Key observations:

- "Why does it matter? Because it can make or break a company"
- "Successful cultures exhibit humbleness and reflect a great closeness to/alignment with customers"
- "Individuals and corporate culture as first lines of defence"
- "Importance of creating an atmosphere of inclusiveness to foster collaboration"
- "Overcoming group think by assigning devil's advocate in allocation discussions"
- "Overcoming diversity challenge by looking outside the usual recruiting paths" (same schools, conventional backgrounds, etc.)

Assessing culture in manager due diligence:

- Mosaic of observations, including consistency of message and follow-through ("walk the talk"), employee turnover and what's being done to retain talent, staff behaviour in casual settings, assessing people one to two levels down, diversity of thought, succession planning

- Cross checks with other investors/network, background checks with previous employers/colleagues, including firm and individual behaviour during downturns or periods of firm distress
- Distraction risk of Founders by outside interests
- Objective is not to assess "good" versus "bad" culture, but to identify warning signs/red flags which could impact the longevity of the organisation

The **"Redefining Partnerships between Asset Owners & Managers"** panel focused on how the interface between investors and managers is evolving and how investors should evaluate and benchmark strategic relationships.

- **Strategic partnerships** go beyond "fees", "lockups", "co-investments" and other tactical issues: can include consulting (technology, trade execution, emerging markets), two-way idea sharing/generation, use of investor balance sheet, long term capacity access; usually require patience and take time to develop
- **Key observations for investors**: Clarity of what investor can bring to the table (e.g., balance sheet), establishing firm-wide commitment to work together, strong governance frameworks and KPIs to assess separately fund performance and true value of other relationship benefits
- **Key observation for managers:** "be prepared for 90+% of ideas not materialising, manage succession challenge (i.e., "owners" of strategic relationship at manager and/or investor move on), ability to terminate partnership if there is no "meeting of minds"
- **Role for smaller managers:** differentiated view, rich content and direct access to portfolio manager
- **Investors look beyond managers and banks:** emerging partnerships with peers, industrial conglomerates, families (e.g., corporate succession/ownership planning)

The Standards Board would like to thank its speakers for their invaluable contribution to these important discussions. A special thank you goes to Bank of America Merrill Lynch for hosting this Forum.

SBAI Emerging Manager Session

The Standards Board held its second Emerging Manager Information Session in New York earlier this month. The first one was held in Dallas in March. Senior representatives of Albourne, Ionic Capital Management, Man Group, Ontario Teachers' Pension Plan, RockCreek and Teacher Retirement System of Texas shared their views with a group of New York-based emerging managers on the benefits of becoming involved in the SBAI.

Key takeaways:

- Investor recognition of adoption of the Standards

- Alternative Investment Standards and SBAI resources provide emerging managers with a roadmap to institutionalisation
- The core principle is "comply ***or*** explain"--every manager is different, and every investor wants different things, but the Standards help everyone focus on what's important, by helping to simplify compliance and ODD
- Strength lies in facilitating collaboration between managers and investors on industry practices and standards; ongoing dialogue about best practice with industry and regulators, but *not* lobbying group or trade body
- Investor perspectives:
    - "It's not enough to be a great trader, but start-up managers need to have the mindset to run a business to qualify for investment"
    - "Start-ups need to demonstrate they have a roadmap to build a robust business; the Standards provide the blueprint"
    - "We want to spent valuable time on the 10% where managers are unique and differ, not on the basics of operational due diligence"

The Standards Board will continue its Emerging Manager Series in other cities.

SBAI ILS Working Group: Publication of ILS Fund Valuation Memo

Earlier this month, the Standards Board published guidance (one of its series of Toolbox memos) to investors conducting due diligence on valuation arrangements of Insurance-Linked Funds.

Following the insurance losses from catastrophic events worldwide in 2017 and 2018, the valuation of funds investing in (re)insurance-linked securities ("ILS Funds") has become an area of heightened scrutiny by investors. This new Toolbox memo provides detailed guidance to managers and investors on what constitutes a robust valuation framework consistent with the SBAI Alternative Investment Standards, including governance arrangements, processes for hard-to-value assets and investor disclosures. It also identifies particular aspects of the process that relate to ILS Funds, including processes for capturing material information about catastrophe events, use of modelling, income recognition and loss estimation procedures. The memo also suggests questions that investors might wish to ask when assessing a manager's approach to valuation.

The document, developed by a working group of institutional investors, investment managers and investment consultants, is the first in a series of Toolbox Memos on ILS Funds to be published by the SBAI.

Eveline Takken-Somers, Senior Investment Manager at PGGM, a Dutch pension fund service provider, and a member of the working group, said: "Good standards are critical from an investor's perspective, and we encourage ILS Fund managers to sign up to the Alternative

Investment Standards. Robust valuation procedures are of particular importance: they help to address conflicts of interest between different investors and the manager, and they facilitate the fair comparison of performance between managers."

The Standards Board would like to take this opportunity to acknowledge and thank the tremendous efforts of the ILS Working Group members, including Jennifer Lau and Helen Rexwinkel (Aberdeen Standard Investments), Michael Hamer and Jack Davis (Albourne Partners), Aleksander Weiler, CFA (CPP Investment Board), Mike France (Elementum Advisors), Craig Dandurand (Future Fund), Richard Lowther, Matthew Swan and Adriaan Van Der Merwe (Hiscox Re Insurance Linked Strategies), Tim Shreeve (Nephila Capital), Eveline Taken-Somers (PGGM), Juan Prado (PIMCO), Kataryna Diesen and Kai Rimpi (Varma).

To read the Press Release in full, please click here. The ILS Fund Valuation Memo is available here.

Publication of SBAI Cyber Security Memo: Guidance for Small and Medium-sized Managers

Also this month, the Standards Board published a new Cyber Security Memo which focuses on small and medium-sized alternative investment managers. The new memo, which also is part of the SBAI's Toolbox, helps firms shape their cyber security strategies and related risk oversight arrangements. The new Memo provides a series of practical tools managers can consider, including:

- A cyber defence framework
- A basic cyber hygiene implementation (the "SBAI Basic Approach")
- Due diligence of managed IT service providers
- An overview of regulatory expectations
- Examples of contractual requirements for technology service providers
- Summary of cyber security testing options

The memo follows on from the series of table-top cyber-attack simulation exercises the SBAI held with its Signatories and Investor Chapter Members and the first Cyber Security Memo published in 2015.

To read the press release in full, please click here. The cyber security memo is available here.

The Standards Board will hold its **next cyber security event in London on 28 June 2019** to explore:

- How basic "cyber hygiene expectations" have evolved

- Due diligence of outsourced service providers (including software as a service and cloud services)
- What cyber security testing is needed (as a function of a firm's cyber maturity)
- Examples of simple table-top exercises for small-medium sized firms

New Working Group: Developing a Standard Investor Profile Template

The Standards Board is pleased to announce that it is forming a new working group to develop a Standard Investor Profile template. The subscription, Know-Your-Customer (KYC) and anti-money laundering (AML) processes require investors to provide certain information to managers and their administrators. Much of the information required is consistent across most jurisdictions; however, the way this information is collected differs from fund to fund. By creating a single, widely accepted Standard Investor Profile (SIP) template, the administrative workload for investors (who are otherwise required to analyse and fill a myriad of different documents) can be reduced. This template also standardises data processing and prevents errors and inconsistencies between documents.

The Working Group will review a sample of subscription documents and develop a standardised data structure, taking into consideration common jurisdictional and legal requirements. Please contact us at info@sbai.org, if you are interested in participating. Please note that the size of the Working Group is limited.

SBAI at NorthPeak-PRI Roundtable Helsinki

SBAI participated in the NorthPeak-PRI roundtable in Helsinki to explore the current state of ESG implementation in alternative strategies, including challenges and the important role of fund governance. Key topics raised:

Understanding ESG implementation:

- No singular "right" ESG framework—a great deal depends on a particular investor's preferences (weighting of factors)
- Low correlation between different ESG scoring systems highlights need for investors to critically evaluate validity of scoring models
- Manager perspective: importance of understanding which ESG measures help versus hurt returns
- ESG performance analysis: difficult to separate "ESG" factors from other factors in attribution analysis
- Relevance of ESG varies by strategy, usually more relevant in equities / strategies with longer holding periods than in macro investing (potentially focus on country level risk assessment/governance); lacking clarity of application in "commodities"

- Question raised as to why some investors have difficulties shorting names with low ESG ratings (or firms on the exclusion list) if it enhances returns

Fund and firm governance:

- Governance and operational risks are not rewarded through excess returns
- Fund Director due diligence: relevant skill, trustworthiness, not overstretched (in terms of number and complexity of Board commitments), independence ("how reliant is the Director on a single manager in terms of income?")
- Approaches to strengthen governance in "partnership structures": enshrine stronger protections in PPM, hardwiring decision-making to Master Fund (which has an independent Fund Board)

Toolbox: Open Protocol Update

Following the publication of the latest Open Protocol template, we would like to explain the main differences between the 2016 Open Protocol template and manual and the 2018 versions. The first change was the update of the GICS sector breakdown, and the second change was that all exposure templates now report number of (long and short) issuers rather than positions.

The 2016 Open Protocol template requires that number of long and short issuers should only be reported for the Credit (x Convertible Bonds) and the Convertible Bond Exposure template. In the 2018 template, the change was made across all exposure templates to include issuers in place of positions for Equity Exposure, Sovereign & Interest Rate Exposure, Credit (x Convertible Bonds) Exposure, Convertible Bonds Exposure, Currency Exposure and Real Assets & Commodities Exposure. There is guidance in the recently updated Open Protocol Manual outlining this change under General Point 8. If you have any concerns or queries about this change, please email info@sbai.org. Please also visit the FAQ webpage.

Upcoming Events

- 28 June 2019, London: SBAI Cyber Security Workshop
- 16 September 2019, Singapore: SBAI Institutional Investor Roundtable
- 26 September 2019, London: SBAI Annual General Assembly
- 15 October 2019, Chicago: SBAI Culture & Diversity in Asset Management Roundtable
- 21 October 2019, Philadelphia: SBAI Institutional Investor Roundtable (at Albourne Annual Conference)
- 19 November 2019, Washington D.C.: SBAI Institutional Investor Roundtable

- 20 November 2019, Toronto: SBAI Culture & Diversity in Asset Management Roundtable
- 21 November 2019, Montreal: SBAI Institutional Investor Roundtable
- December 2019, New York: SBAI Institutional Investor Roundtable
- 5 December 2019, Shanghai: SBAI Institutional Investor Roundtable

The full event schedule is available here.

APPENDIX

BlackRock

BlackRock is a premier provider of global investment management services. As of 31 March 2019, BlackRock manages $6.52 trillion across equity, fixed income, alternatives, multi-asset, and cash management strategies for institutional and retail clients. In Alternatives, BlackRock manages $152bn with specialized capabilities across real estate, private equity, direct hedge funds, fund of hedge funds, infrastructure and renewable power.

BlackRock was founded in New York City in 1988 by eight partners, five of whom remain active in the firm today. They instilled in the firm: a determination to put client needs and interests first; a dedication to data-driven investing; a passion for understanding and managing risk; and a culture that championed technology and innovation. By listening to clients and understanding their unmet needs, the firm innovated in the areas of closed-end funds, trusts, defined contribution plans and more.

As the firm diversified, the concept of "One BlackRock" was developed and became a core principle. BlackRock established a coordinated platform rather than autonomous business units. Managing investment platforms in concert, BlackRock has put in place a business model in which it seeks to leverage the entire firm's resources and products for the benefit of clients.

CdR Capital

Founded in 2012, the CdR group and its affiliates manage and advise approx. $2.2bn of assets across traditional and alternative investment strategies for institutional investors, private clients and families. CdR Capital SA (based in Geneva) is the Head Office for the Independent Private Wealth arm of the firm which develops discretionary and advisory solutions for clients with a bias towards Alternative Investments. CdR fosters a collegial and open culture partnered with deep alternatives experience. Clients have direct access to business-owners and portfolio teams to optimise for solutions. CdR and its affiliates currently have offices in Geneva, Dubai, Miami, São Paulo and London.

Graham Capital Founded by Kenneth G. Tropin in 1994, Graham Capital is an alternative investment manager with approximately $14.1 billion in AUM and a diverse roster of global institutional and private client investors. The firm emphasizes directional trading across liquid global markets, and Graham's strategies tend have low correlation to traditional and other alternative investments. Graham has three main pillars of its business, comprised of systematic trend-following, quantitative macro, and discretionary macro trading strategies. Graham has an established, long-term track record, a rigorous and comprehensive risk management process, a substantial investment in operational infrastructure, and significant proprietary capital to attract and retain talented investment professionals and develop new investment strategies.

HPS Investment Partners HPS Investment Partners is a leading global investment firm that seeks to provide creative capital solutions and generate attractive risk-adjusted returns for its clients. The firm manages various strategies across the capital structure that include syndicated leveraged loans and high yield bonds to privately negotiated senior secured debt and mezzanine investments, asset-based leasing and private equity. The scale and breadth of its platform offers the flexibility to invest in companies large and small, through standard or customized solutions.

HPS was founded in 2007, to focus on credit and longer-dated less liquid investment opportunities. It was originally formed as a division of Highbridge Capital Management within J.P. Morgan Asset Management and known as Highbridge Principal Strategies. The firm is led by five principals: Scott Kapnick, Scot French, Michael Patterson, Purnima Puri and Faith Rosenfeld. As of April 2019, HPS has over $48 billion of assets under management.

Ontario Teachers' Pension Plan The Ontario Teachers' Pension Plan (Ontario Teachers') is Canada's largest single-profession pension plan, with $191.1 billion in net assets at December 31, 2018. It holds a diverse global portfolio of assets, approximately 80% of which is managed in-house, and has earned an annual total-fund net return of 9.7% since the plan's founding in 1990. Ontario Teachers' is an independent organization headquartered in Toronto. Its Asia-Pacific region office is located in Hong Kong and its Europe, Middle East & Africa region office is in London. The defined-benefit plan, which was fully funded as at December 31, 2018, invests and administers the pensions of the province of Ontario's 327,000 active and retired teachers.

PIMCO

PIMCO is a global investment management firm and one of the world's premier fixed income and credit managers. For 45+ years, PIMCO has established a reputation of innovation and expertise and evolved in its partnership with clients across assets classes and environments.

With over a decade of alternatives experience, PIMCO has developed a robust $35 billion alternatives platform. PIMCO's macroeconomic insights and investment discipline combine with alternatives talent, resources and sourcing capabilities to offer a diverse set of approaches in private strategies, hedge funds, insurance-linked securities and quantitative investing.

Since its founding in Newport Beach, California, in 1971, PIMCO has grown into a team of professionals across 17 offices globally.

State of Wisconsin Investment Board

With more than $110bn in total assets, the State of Wisconsin Investment Board (SWIB) is an independent state agency responsible for managing assets of the Wisconsin Retirement System (WRS), the State Investment Fund. SWIB manages 57 percent of the assets internally. The WRS is the eighth largest public pension plan in the United States and 25th largest public or private pension fund in the world. The WRS is one of the only fully funded public pensions, placing it in an elite class of the country's best funded public employee retirement systems. With assets of more than $100bn, the WRS comprises 91 percent of SWIB's assets under management. Investment performance generally accounts for about 75 percent of WRS income and 25 percent comes from employer and employee contributions. SWIB's investment strategy considers the unique design of the WRS among public pension plans because members share in the investment risk and annuitants do not have automatic cost of living adjustments. It is designed to weather a variety of economic environments. This helps keep annuities and contribution rates stable.