

The Alternative Investment Standards – Operational Due Diligence



1. The Alternative Investment Standards – Operational Due Diligence

Operational Due Diligence can be one of the toughest parts of investor due diligence for small and emerging managers. Whilst there is an understanding of proportionality (for example, considering size) there is still an expectation of robust governance, procedures, and controls. The Standards cover a vast spectrum of governance topics including valuation, operational risk, outsourcing, fund governance and shareholder conduct.

The SBAI's Alternative Investment Standards ("Standards") have been developed over-time through extensive consultation with asset managers and allocators. The Standards address key issues relating to alternative investment practices covering the areas of, disclosure, valuation, risk management, fund governance and shareholders' conduct. This document contains the Standards related to Operational Due Diligence and any relevant appendices.

Note that the below are a sub-set of the full standards that are relevant to this area. A copy of the full standards that signatories are required to adopt on a comply or explain basis can be found [here](#).

The Standards are complemented by the SBAI Toolbox ("Toolbox"). The Toolbox contains transparency tools and guidance memos; however, are not part of the standards that signatories sign up to upon joining the SBAI. These Toolbox memos are designed to provide further insight into areas including providing investors with questions to ask during investor due diligence meetings.

The following Toolbox Memos may provide additional insight into meeting these Standards:

Transparency Tools

- [Administrator Transparency Report](#)
- [Standardised Trial Data Licence](#)
- [Standardised Board Agenda](#)
- [Standard Total Expense Ratio](#)

Toolbox Guidance and Best Practice Memos

- [Cyber Security](#)
- [Cash Handling and Cyber Security](#)
- [Conflicts of Interest in Parallel Funds](#)
- [Co-Investments](#)
- [Alternative Credit – Fund Structuring](#)
- [Alternative Credit – Valuation](#)
- [Alternative Credit – Conflicts of Interest](#)
- [ILS - Valuation](#)

2. Introducing the Standards

The Standards encompass a wide array of functions and the standards detailed below represent those that are most applicable to Operational Due Diligence (ODD). Other parts of the Standards will be included in the companion documents covering Investment Due Diligence (IDD) and Risk Management (Risk):

	ODD	IDD	Risk
Disclosure to Investors and Counterparties [1] to [4]	✓	✓	
Valuation [5] to [8]	✓		
Risk Framework [9] to [10]			✓
Portfolio Risk [11] to [16]		✓	✓
Operational Risk [17] to [18]	✓		
Outsourcing Risk [19] to [20]	✓		
Fund Governance [21] to [22]	✓		
Prevention of Market Abuse [23] to [24]	✓		
Proxy Voting [25] to [26]	✓		
Disclosure of Derivative Positions [27]	✓		
Borrowing Stock to Vote [28]	✓		
Appendix A – Examples for Leverage		✓	
Appendix B – Examples of Functions Covered by SLAs	✓		
Appendix C – Examples of Compliance for Market Abuse	✓		
Appendix D – Examples to determine Similarity	✓		

2.1 How to read the Standards:

The Standards are set out in a consistent format in blue shaded boxes throughout this document. The formatting of the text within the boxes is differentiated to reflect the following elements:

- The Standards (**in bold**)
- Additional guidance and examples which are intended to assist and illustrate how compliance might be achieved (in normal text)
- Explanations and comments (*in italic*).
- A fund manager means an alternative investment manager that became a signatory to the Standards

Illustration

- **The Standard is set out in bold text**

- Lists of relevant sub-items which form part of the Standard are set out in bold text.

Guidance on the Standard (and references to useful additional guidance, e.g., materials published by AIMA and IOSCO) and examples of how the Standard might be complied with are set out in normal text.

Additional explanation and commentary to enhance understanding is set out in italics.

2.2 Other Considerations when Reading the Standards

When reading these standards asset managers should ensure to consider the following points:

- Some Standards may not be applicable for segregated accounts or fund of funds.
- Where the power to comply with a Standard sits with the fund governing body, the standard requires that a manager do what they reasonably can to ensure compliance.
- Marketing materials can be taken to mean all documents disclosed to investors including the Offering Memorandum and disclosures are not required in each document separately.

Further Details on the above are contained in the [full Standards document](#)

3. The Alternative Investment Standards

Note that the standards and appendices below do not necessarily flow in sequential order as they have retained the numbering from the main Standards document¹.

A. Disclosure to Investors and Counterparties

Appropriate disclosure to investors is crucial in enabling well informed investment decisions. Also, counterparties require adequate information to satisfy their risk assessment and regulatory requirements and make well informed lending decisions.

[Commercial Terms Disclosure – Standards and Guidance \[2\]²](#)

2.1. The commercial terms applicable to the relevant interests being offered in a particular fund should be disclosed in the fund’s offering documents in sufficient detail and with sufficient prominence (taking into account the identity and sophistication of potential investors).³

The SBAI envisages that in most circumstances such disclosure would, amongst other things, include:

- Fees and expenses:
 - Fair disclosure of the methodology used to calculate performance fees,
 - Details of any other remuneration received by the manager in connection with its management of the fund (this will be relevant, for example, where a fund is a “feeder” fund into another fund managed by the same manager),
 - The basis of calculation for any base management fee and details of the nature of any expenses which may be payable or reimbursed by the fund to the manager,
 - To the extent possible, the amount of, and/or method of calculating, the periodic fees payable to the fund’s other service providers,
 - To the extent known, a description of other material fees, costs, and charges which will be payable by the fund,

¹ <https://www.sbai.org/standards/>

² Managers may require further guidance, as set out by GIPS on disclosure of fees and cost (section F), www.gipsstandards.org

³ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

- if applicable, the fact that the fees and expenses payable to service providers may change.
- Termination rights:
 - details of the circumstances in which the fund is entitled to terminate the manager’s appointment and the terms (e.g., in relation to termination fees) of such termination.
- Exit terms (in the case of open-ended funds):
 - The period of notice investors are required to give to redeem their investment in the fund,
 - The circumstances in which redemption requests can be revoked (e.g., redemption requests may be irrevocable except with consent of the fund governing body),
 - Details of any redemption penalties (including, if relevant, any fee or penalty applicable where redemption requests are revoked),
 - Details of any “lock-up” periods during which the investor will be unable to redeem its investment in the fund and any limits on the extent of redemptions on any redemption date (i.e., redemption "gates"), and
 - An indication of circumstances in which normal redemption mechanics might not apply or may be suspended, if any – these could include, amongst other things:
 - A significant reduction in the liquidity of the fund's underlying assets, and
 - Distress of one or more of the fund's counterparties (including its prime broker(s)) leading to uncertainty as to the value of OTC contracts or access to / ownership of re-hypothecated assets.
 - Details of any other measures which may be considered by the fund governing body in circumstances where normal redemption mechanics might not apply or may be suspended – for example:
 - Fund level gating, investor level gating, lockups, suspension of redemptions, penalties for revoking redemption requests (*to the extent that the fund’s constitutional documents/offering documents do not already provide for such mechanisms*)
 - Side pocketing
 - Restructuring the fund to incentivise investors to accept, or switch to an alternative share class offering reduced liquidity (for example, in exchange for lower fees)
 - If relevant, an indication of any circumstances in which any changes to redemption terms may be made without shareholder consent,
 - Whether measures to enhance liquidity at the fund level may be considered when redemptions are suspended/restricted (e.g., facilitating transfers of shares/units in the fund subject to ensuring that investors satisfy investor eligibility requirements).

2.2. Changes to the fees and expenses payable by the fund to the manager or parties related to the manager, or the redemption rights available to investors which the fund governing body considers to be materially adverse to investors should not be effected without either (a) obtaining investor consent in accordance with the provisions relating to shareholder voting/consent/approvals contained in the fund’s constitution or offering documents, or (b)

providing advance notice sufficient for investors to redeem prior to the effective date of the changes without penalty.⁴

2.3. A fund manager should disclose the existence of side letters which contain a "material terms"⁵, and the nature of such terms. A fund manager is not required to disclose the existence of side letters which contain no material terms.

2.4. Upon request, a fund manager should disclose:

- (a) Existence of funds, accounts or vehicles managed by it using the same or similar⁶ investment strategy,⁷**
- (b) Any material adverse effects which the existence of such other funds, accounts or vehicles may have on investors in the fund,**
- (c) The aggregate value of asset managed by the manager using the same or similar⁶ investment strategy,**
- (d) The aggregate size of employee or partner interests in the investment strategy,⁸**
- (e) The existence of any other funds or accounts managed by it which follow the same or similar⁶ investment strategy to the fund and which are available for investment only by partners or employees (or their connected persons) of the fund manager,^{7, 9} and**
- (f) In the case of (e) above, the size of such funds and accounts.**

Please see below an example of non-binding guidance to determine "similarity".

2.5. The fees and expenses (including but not limited to management and performance fees) charged to the fund should be disclosed in the fund's audited financial statements.⁴ This includes explanations in the annual report which allow investors to compare, readily, the fees and expenses charged with the description of such fees and expenses set out in the fund's offering documents where this is not obvious from the disclosure in the financial statements.

⁴ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

⁵ "Any term the effect of which might be reasonably expected to provide the investor with more favourable treatment than other holders of the same class of shares or interests which enhance that investor's ability either (i) to redeem shares or interests of that class or (ii) to determine as to whether to redeem shares or interests of that class, and which in either case might be reasonably expected to put other holders of shares or interests of that class who are in the same position at a material disadvantage based on the exercise of their redemption rights."
(https://katten.com/files/19837_the_fsa_hedge_funds_and_side_letters.pdf)

⁶ Similar strategies should be interpreted to include funds, accounts or vehicles managed by an investment management team or individual within the fund manager and which trade substantially in parallel, in whole or in part with the fund. Substantially similar trading patterns over time, rather than overlapping positions by themselves, is the key indicator (i.e., overlapping positions by themselves do not define similarity).

⁷ For the avoidance of doubt, the Standard requires fund managers to disclose that they manage other funds, accounts, or vehicles, but does not require disclosure of specific details of such funds, accounts, or vehicles.

⁸ For the avoidance of doubt, the Standard requires disclosure of aggregate partner/employee investment in the respective strategy, not a person-by-person break-down.

⁹ For the avoidance of doubt, a feeder fund, accessible only to partners or employees (or their connected persons) which only invests into a master fund accessible to external investors through a different feeder does not fall under this disclosure.

For example, the categories and captions in the fund’s financial statements might correspond to those used in the fund’s offering documents so that they can be easily compared.

Managers might also consider disclosure of a total expense ratio (TER) or gross vs. net return for the period under review.

2.6. On the establishment of a fund, a fund manager should liaise with the fund’s administrator to ensure that the methodology for calculating fees payable to the manager (and in particular performance fees) is agreed in advance. Such methodology should be accurately described in the fund’s offering documents.⁴

Further guidance on this topic can be found in the SBAI’s Toolbox Memo on Conflicts of Interest in Parallel Funds¹⁰.

Example of non-binding guidance to determine “similarity”.

- 1) The Portfolio Manager or investment team, the investment mandate (i.e., equity, fixed income, macro) and the strategy or style (i.e., market neutral, relative value, trend following) will all need to be the same.
- 2) Additionally, the “similar” fund or separately managed account will have to have an 80% overlap in the following 4 areas (an example follows each item):
 - a) **Asset classes traded** (i.e., mortgages, equity, credit, FX) - If the fund is 100% equities, then other funds/sleeves must have at least 80% in equities to be classified as similar.
 - b) **Target risk and return** - Funds must have similar risk-return targets (measured by Sharpe or Information Ratio) to be classified as similar. Thus, if the fund targets a Sharpe ratio of 1, then “similar” funds must target a Sharpe between 0.8 and 1.2 (+/- 20% band).
 - c) **Time horizon of positions** - If the average holding period for the fund is 3 months, then the holding period for the similar fund needs to be between 2.4 to 3.6 months (+/- 20% band).
 - d) **Average liquidity of positions** - If the average liquidity profile of the fund is 10 days, then the similar fund needs to have an average liquidity profile between 8 to 12 days to be classified as similar (+/- 20% band).
- 3) A multi-strategy fund would have to have 80% overlap of allocations among sub-strategies, and the sub-strategies would have to be substantially similar (80%), as in item 2 above.

Disclosure to Lenders/Prime Brokers/Dealers - Standards and Guidance [4]

4.1. A fund manager should, subject to obtaining the consent of the fund’s governing body, provide, or do what it reasonably can to enable and encourage the fund's administrator to provide, any agreed information reports to the fund's counterparties in a timely manner.

¹⁰ <https://www.sbai.org/wp-content/uploads/2016/04/Toolbox-Memo-Case-Study-Conflicts-of-interest-between-parallel-funds-6-March-2020.pdf>

B. Valuation [5]-[8]

While valuation is generally expressed as a single number it is important to recognise that the single number is merely the expression of a range of potential outcomes that derive from the valuation process. It follows that investors need to be informed about the valuation process and have confidence in its breadth and robustness. The following areas are of particular relevance in this context:

- Segregation of functions in valuation
- Approach to handling and valuing of hard-to-value assets
- Investor disclosure of the governance arrangements and hard-to-value assets

Further guidance on Valuation in Alternative Credit¹¹ and Insurance Linked Strategies¹² can be found in the SBAI Toolbox.

Segregation of Functions in Valuation – Governance Standards and Guidance [5]

5.1 Valuation arrangements aimed at addressing and mitigating conflicts of interest in relation to asset valuation should be put in place.¹³

The SBAI believes that the most satisfactory way to achieve this is the appointment of an independent and competent third-party valuation service provider.¹³

The SBAI acknowledges, however, that in some cases it will not be possible in practice to achieve both independence and the required level of competence by appointing a third-party valuation service provider, in which case the involvement of the fund manager in the asset valuation process will, to a greater or lesser extent, be unavoidable.

5.2. Where a fund manager determines the value of any of the fund's assets (whether by performing valuations in-house or providing final prices to a valuation service provider), it should operate a valuation function which is segregated from the portfolio management function and should explain its approach to investors. If a smaller or start-up manager considers it impractical to do so, it should disclose this in its marketing documents. This should also be disclosed in the fund's offering documents.¹³

It is envisaged that this will, amongst other things, entail:

- Ensuring that the relevant employees operate independently of the portfolio management team and that potential conflicts of interest are minimised,
- Ensuring that the remuneration of the valuation team is not directly linked to fund performance,

¹¹ <https://www.sbai.org/wp-content/uploads/2020/05/SBAI-Alternative-Credit-Valuations-Memo-20-May-2020.pdf>

¹² <https://www.sbai.org/wp-content/uploads/2019/05/SBAI-Valuation-of-Insurance-Linked-Funds-7-May-2019.pdf>

¹³ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

- In instances where the portfolio management team has necessary expertise and understanding, ensure that information provided by that team in connection with the valuation process is properly documented and recorded, and
- Assisting fund governing bodies to satisfy themselves regularly that in-house valuations are handled appropriately.

Ways to achieve this might include:

- Ensuring that valuation staff provide periodically a report on the valuation process to the fund governing body,
- The formation of a designated “valuation committee” (no member of which is involved in investment decisions),¹⁸ and
- Employing the services of an appropriate external party to evaluate the effectiveness and robustness of the valuation procedures in place and report to the fund governing body (or its valuation committee).

Fund managers also could refer to The SBAI Toolbox Memos on Valuation for Alternative Credit¹⁴ and Insurance Linked Strategies¹⁵, as well as publications by standard setters and regulators, including IOSCO’s Principles for the Valuation of Collective Investment Schemes (2013)¹⁶ and IOSCO’s Principles for the Valuation of Hedge Funds (2007)¹⁷ for further guidance in this area.

Segregation of Functions in Valuation – Disclosure Standards and Guidance [6]

6.1. A document (a “Valuation Policy Document”) covering all material aspects of the valuation process and valuation procedures and controls in respect of the fund should be prepared.¹⁸ The Valuation Policy Document (which it is acknowledged will contain information which is proprietary to the fund manager) should be reviewed regularly by the fund manager, in consultation with the fund governing body, and be made available to investors upon request on a confidential basis.

The SBAI envisages that in most circumstances the Valuation Policy Document will describe:

- The responsibilities of each of the parties involved in the valuation process,
- The processes and procedures in place that are designed to ensure that conflicts of interest are managed effectively,
- The relevant material provisions of any service level agreements (SLAs) entered into with third parties responsible for or involved in the valuation process (excluding details of commercial aspects of any such SLAs), and

¹⁴ <https://www.sbai.org/wp-content/uploads/2020/05/SBAI-Alternative-Credit-Valuations-Memo-20-May-2020.pdf>

¹⁵ <https://www.sbai.org/wp-content/uploads/2019/05/SBAI-Valuation-of-Insurance-Linked-Funds-7-May-2019.pdf>

¹⁶ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD413.pdf>

¹⁷ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD240.pdf>

¹⁸ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

- The controls and monitoring processes in place that are designed to ensure that the performance of any third party to whom the valuation function is outsourced is satisfactory.

6.2. Where a fund manager is involved in the valuation process, it should disclose in its own marketing materials any actual or likely material involvement of the portfolio management team in the valuation process. Such disclosure should also be included in the fund’s offering documents.¹⁹ Investors should then be informed, for example via manager newsletters, of any material changes to such level of involvement.

This could be satisfied by disclosing an estimate of the percentage of the fund’s assets which have been, or are expected to be, valued with some input from the portfolio management team or a description of components of the portfolio for which the portfolio management team usually makes a contribution to the valuation process.

Hard-to-Value Assets – Governance [7] + [8]

Hard-to-Value Assets – Governance Standards and Guidance [7]

7.1. Where a fund manager performs in-house valuations of hard-to-value assets or is otherwise involved in providing final prices to the valuation service provider, valuation procedures for such assets which are aimed at ensuring a consistent approach to determining fair value should be adopted and such procedures should be set out in the Valuation Policy Document.²⁰

The SBAI envisages that such procedures would in most circumstances include:

- Details of a hierarchy of pricing sources and models to be used for each asset type in a fund’s portfolio (where relevant),
- If using broker quotes:
 - Making reasonable efforts to identify and draw upon multiple (typically 2-3) price sources (where available),
 - Specifying the acceptable tolerance ranges when multiple pricing sources are used and the approach to handling “outliers”,
 - Ensuring consistency and avoiding “cherry picking” of favourable price sources by using the same brokers at each valuation point, and
 - Where the fund manager arranges the provision of broker prices (as opposed to the administrator or other third-party valuation service provider), the fund manager should instruct brokers to send the prices directly to the administrator (or other third-party valuation service provider).

¹⁹ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

²⁰ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

- If using pricing models, a process specified in the Valuation Policy Document for²¹:
 - Approving pricing models including back-testing, documentation and approval by the fund governing body or its valuation committee,
 - Monitoring and verification against observed market prices, and
 - Governing manual overrides of the model inputs or results, including approval, documentation and reporting to the fund governing body or its valuation committee.

7.2. If using side pockets, a fund manager should ensure that the fund governing body has been consulted on, and consented to, the circumstances in which side-pockets may be used. Furthermore;²²

- **The types of asset eligible for side pocketing should be described in the Valuation Policy Document and the side pocketing process should be disclosed in the fund's offering documents.**
- **Side-pocketing should occur either on or about the time the relevant asset is purchased or on or about the point at which the relevant asset becomes hard-to-value. The initial valuation of an asset on entering a side-pocket should be at cost²³, the last available market price (as appropriate) or a lower number or nil.**
- **Where a limit to the total amount of assets which may be included in side-pockets is disclosed in the fund's offering documents, such limit should not be breached.**
- **Management fees, for the side pocketed assets, if charged, should be calculated on no more than the lower of cost (or last available market price in the case of a previously liquid asset) or fair value.**
- **Any performance fees should accrue for the duration of the existence of the side pocket and should be paid only at the point at which the asset is finally disposed of or a liquid market price is available.**

Fund managers could also refer to the SBAI Toolbox Memos on Valuation for Alternative Credit²⁴ and Insurance Linked Strategies²⁵, as well as publications by industry associations and regulators for further guidance on the valuation of hard-to-value assets.

Hard-to-Value Assets – Disclosure Standards and Guidance [8]

²¹ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

²² See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

²³ May be subject to regional accounting standards.

²⁴ <https://www.sbai.org/wp-content/uploads/2020/05/SBAI-Alternative-Credit-Valuations-Memo-20-May-2020.pdf>

²⁵ <https://www.sbai.org/wp-content/uploads/2019/05/SBAI-Valuation-of-Insurance-Linked-Funds-7-May-2019.pdf>

- 8.1. The percentage of the fund's portfolio that falls into each of the three “levels” prescribed by ASC 820²⁶ or IFRS 7, or equivalent account standards or recognised definitions (and, where meaningful and applicable, the extent to which internal pricing models or assumptions are used to value certain components of the fund’s portfolio invested in hard-to-value assets) should be periodically disclosed (e.g., via newsletters).**
- 8.2. Notification of any material increase (as determined by the fund governing body) in the percentage of a fund's portfolio invested in hard-to-value assets should be disclosed to investors in a timely manner, e.g., via the manager's newsletters.**
- 8.3. The value of side pockets should be reported periodically in the fund’s audited annual accounts in accordance with applicable accounting standards.²⁷**
- 8.4. A fund manager conducting valuations in-house should discuss with the fund governing body any material issues in relation to the valuation of hard-to-value assets (e.g., unavailability of a sufficient number of pricing sources or dispersion of broker quotes beyond tolerance levels). Such material issues in relation to the valuation of hard-to-value assets should be disclosed to investors.¹³**

Operational Risk [17] + [18]

Overview of areas covered:

- People and Governance [17a], Trading and Execution [17b], Fraud and Financial Crime Prevention [17c], Disaster Recovery [17d], Model Risks [17e], IT Security [17f], Legal and Regulatory Risk [17g], Personal Account Dealing [17h], Trade Allocation [17g] and Conflicts of Interest [17j]

People and Governance - Governance Standards and Guidance [17a]

- 17a.1 In areas where potential conflicts of interest could arise (valuation, risk management, compliance), a fund manager should clearly divide these activities from the portfolio management function with separate reporting lines into the manager's chief executive officer or chief investment officer or similar. If a smaller or start-up manager considers it impractical to do so, it should disclose this in its marketing documents and such potential conflicts of interest should also be disclosed in the fund's offering documents.²⁸**
- 17a.2 A fund manager's staff remuneration should not set false incentives (e.g., by linking the compensation of the valuation team directly to fund performance).**
- 17a.3 A fund manager should ensure that material aspects of its operational procedures are adequately documented, and training is provided to staff. This should include, amongst other things, areas such as compliance procedures, back-up/disaster recovery procedures,**

²⁶ Formerly FAS 157

²⁷ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

²⁸ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

and client confidentiality. A fund manager should also periodically test its compliance procedures or have them audited by an external party.

17a.4 One or more third parties, independent of the manager, should be appointed to be responsible for the safekeeping of the property of the fund.²⁹

- The SBAI acknowledges that in the case of master feeder structures, it will not be appropriate for the feeder fund, which will normally hold shares/interests in the master fund and some cash, to appoint a third party responsible for safekeeping its assets. In such circumstances, appropriate due diligence should be conducted on the master fund and the arrangements in place for the safekeeping of its assets.
- The SBAI acknowledges that prime brokers may take charges and/or security interests over the assets of a fund or may hold fund assets as collateral.

17a.5 A third party, independent of the manager, with responsibility for fund administration (including calculation of the NAV and the maintenance of the accounting records of the fund) should be appointed in order to ensure the segregation of functions and the avoidance of conflicts of interest in relation to the provision of fund administration services.

- The SBAI acknowledges, however, that in some cases, it will not be possible in practice to achieve both independence and the required level of competence and service quality by appointing a third-party provider.
 - In such instances the manager should ensure that the internal function in charge of the calculation of the NAV and the maintenance of the accounting records are kept segregated from the portfolio management and trading divisions. Such function should be properly resourced and carried out by staff who have appropriate expertise. This function should report to senior management of the firm.
 - The internal function in charge of the calculation of the NAV and the maintenance of the accounting records of the funds should be audited annually by an independent auditor.

Issues in relation to the valuation process are covered separately and included in Standards 5 and 6.

Issues in relation to due diligence of third-party service providers are also covered separately and included in Standard 19.

17a.6 The nature, structure and governance of these arrangements should be disclosed.

Issues in relation to disclosure of third-party service providers such as administrators are also covered included in Standard 20.

Operational Risk – Trading and Execution - Standards and Guidance [17b]

17b.1 To prevent trading and execution failures, a fund manager should put effective trading and counterparty procedures in place.

²⁹ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

This might include the following aspects:

- Entering into master agreements with trading counterparties,
- Agreeing well defined termination and collateral policies,
- Tracking changes in key provisions of any agreements with trading counterparties, and
- A robust trade confirmation and reconciliation process including, amongst other things:
 - Sufficient back and middle-office capacity to handle trading volumes,
 - Daily confirmation of trades and positions,
 - Use of electronic matching and confirmation systems (depending on the scale of the manager - smaller managers and managers with low trading volumes may rely to a larger extent on manual handling),
 - Timely reconciliation of complex over-the-counter trades and loans, and
 - Monitoring of corporate action events (e.g., voting, splits, spin-offs) on long and short equity derivative instruments and applying the events to fund accounts.

Operational Risk – Fraud and Financial Crime Prevention - Standards and Guidance [17c]

17c.1 A fund manager should be confident that it understands the applicable laws and regulations in the markets in which it deals and has effective systems and controls in place to enable it to identify, assess, monitor, and manage the risk that the fund manager might be used to further financial crimes.

This may apply to areas such as:

- Anti-money laundering procedures (although typically the fund's administrator will be responsible for compliance), and
- Procedures to prevent market abuse offences (see also Standard [23] (*Prevention of market abuse*)).

17c.2 A fund manager should appoint a compliance officer who is independent of the portfolio management function to oversee all issues relating to regulatory compliance and market and professional conduct. If a smaller or start-up manager considers it impractical to do so, this should be disclosed in the fund's offering documents.³⁰ The compliance officer should report regularly to the manager's chief executive officer or management committee or equivalent. A fund manager should provide to the fund governing body a report on regulatory compliance prepared by the compliance officer on a regular basis.

17c.3 Where client money is held by the manager, the fund manager should put in place strict internal controls to prevent misappropriation of such money (e.g., co-signing policies).

Further guidance on this topic can be found in the SBAI's Governance Toolbox in the Cash Handling and Cyber Security Memo³¹.

³⁰ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

³¹ <https://www.sbai.org/wp-content/uploads/2016/04/Toolbox-Memo-Cash-Handling-Cyber-Security-Final.pdf>

17d.1 A fund manager should put in place measures designed to ensure that the provision of fund management services to the fund will remain possible in the event of a disaster. The level of tolerance should be agreed by the executive committee of the fund manager and, where relevant, be notified to the fund governing body.

Depending on the scale of the fund manager’s business, this could include:

- A communication plan to contact important parties (such as senior management, prime broker, administrator, and regulator),
- Contingency plans (including a succession plan to address key man risk, fall back communications router and capabilities),
- Offsite data back-up facilities,
- Back-up office space/infrastructure (applicable to larger fund managers), and
- Regular testing of procedures/processes.

17e.1 As part of its operational risk management procedures, a fund manager should assess any exposure to model risk annually or as dictated by events and where model risk is perceived to be material to the performance of the manager, should implement appropriate procedures to ensure that material model risks are identified and mitigated where possible.

Such procedures might include:

- Evaluation of model risk in the model selection process,
- Frequent review of models, including parameterisation, calibration, assumptions, and data integrity,
- Stress testing of assumptions,
- Sign-off and documentation of management overrides (overrides can become necessary when models produce unreasonable results so that human intervention becomes necessary, but such overrides need to be governed carefully),
- Documentation of models to avoid key man risk, and
- Security of algorithm and source code (back-up).

Further guidance on this topic can be found in the SBAI’s Alternative Risk Premia Toolbox in the Back-testing Memo³².

³² <https://www.sbai.org/wp-content/uploads/2020/07/Toolbox-Memo-Backtesting-15-July-2020.pdf>

17f.1 A fund manager should ensure security and integrity of systems and data.

Depending on the scale of the manager, this could include system testing, offsite IT and data back-up, disaster recovery procedures and supervision of contract IT resources.

Operational Risk – Legal and Regulatory Risk - Standards and Guidance [17g]

17g.1 A fund manager should ensure that it understands local conduct of business rules and regulations which apply in the jurisdictions in which it operates (including any rules governing the passporting of regulatory authorisations from one jurisdiction to another). A fund manager should also ensure that it understands laws and regulations relevant to the securities in which it trades (e.g., shareholding disclosure requirements and foreign ownership rules).

Operational Risk – Personal Account Dealing [17h]

17h.1 A fund manager should adopt a personal account dealing policy for its staff, ensure awareness of this, test compliance from time to time (e.g. comparing broker statements against trades for which permission has been granted), and where a manager is not regulated, make a summary of the policy available to investors upon request.

Operational Risk – Trade Allocation policy [17i]

17i.1 A fund manager should put in place a trade allocation policy.

17i.2 Upon request, a manager should disclose the trade allocation policy to investors on a confidential basis.

Further guidance on this topic can be found in the SBAI's Governance Toolbox in the Conflicts of Interest in Parallel Funds Memo³³.

Operational risk – arrangements to address conflicts of interest [17j]

17j.1 A manager should ensure that it has internal arrangements to manage and mitigate conflicts of interest, and this should include documented compliance policies and procedures (e.g., conflicts of interest policy). Conflicts of interest should be recorded and reported to senior management on a periodic basis (e.g., monthly or quarterly) or, in the case of conflicts requiring the approval of senior management, escalated as soon as

³³ <https://www.sbai.org/wp-content/uploads/2016/04/Toolbox-Memo-Case-Study-Conflicts-of-interest-between-parallel-funds-6-March-2020.pdf>

reasonably practical. Where applicable, conflicts of interest should be reported to the fund governing body.

Examples may include, but are not limited to:

- a) Cross trades,
- b) Fair allocation of trades / opportunities across different funds or accounts,
- c) Employee/partners funds,
- d) Funds that in turn invest in other internal/external funds with incremental fees,
- e) Internal resource allocation across different funds/client accounts,
- f) Personal Account dealing policies,
- g) Allocation of expenses,
- h) Use of affiliated service providers,
- i) Lack of independent valuation,
- j) Differential terms or fees,
- k) Use of soft dollars/dealing commissions,
- l) Other business interests of investment manager employees,
- m) Gifts and entertainment,
- n) Suspension and/or gating of redemptions.

Operational Risk - Disclosure Standards and Guidance [18]

18.1 To enable investors and creditors to be confident that operational risks are managed satisfactorily, a fund manager should make available a summary of its procedures and controls applying to the management of operational risk to investors and creditors undertaking due diligence.

Additional disclosures might include:

- **The manager's "soft-dollar" policy or "use of dealing commissions" policy and practices.**

Outsourcing Risk [19] + [20]

The alternative investment industry is traditionally based on a strongly unbundled business model, with managers focusing on what they are best at – managing the portfolio – while third parties provide other services such as administration, valuation, custody, and prime brokerage.

All of these services are vital to the success of funds. Ensuring that the selection and monitoring of third-party service providers are properly managed, is therefore of great importance to investors.

Outsourcing Risk - Governance Standards and Guidance [19]

Third party services are normally provided under a contract between the fund and the entity providing the service.

19.1 A fund manager should ensure that careful due diligence on third party service providers is conducted before recommending them to the fund governing body.

This could include using Due Diligence Questionnaires or evaluating “reports on controls” from an independent reporting accountant issued by the respective third-party service provider.³⁴

19.2 Third party service providers should be regularly reviewed.³⁵

Valuation and administration

19.3 Where appropriate, a service level agreement (“SLA”) should be put in place with relevant service providers (commonly, this will be attached as a schedule to the agreement between the fund and the relevant service provider).³⁶

An SLA would normally be expected to:

- Set out in precise detail the services to be provided by the relevant service provider along with deadlines for completion of the services,
- Make clear accountability and responsibility for the orderly operation of all administration or other functions performed by the relevant service provider on behalf of investors, and
- Include "Key Performance Indicators" to provide fund managers and fund governing bodies with a means of measuring whether the objectives set out in the SLA are met by the relevant service provider.

Further examples of the contents of SLAs are provided in Appendix B.

19.4 The services provided by the relevant service provider should be reviewed and monitored against contractual or other agreed standards.³⁷

19.5 The manager should report to the fund governing body any material concerns it may have in relation to the quality of such services.

Prime brokers

19.6 A fund manager of a large fund should carefully consider whether it is appropriate for the fund to appoint more than one prime broker (taking into account in particular the potential advantages of diversification of funding and other services).

The SBAI is aware that there is a spectrum of criteria to consider when choosing a prime broker, including efficiency and operational risk considerations.

In carrying out due diligence on a prime broker, a fund manager should consider the potential prime broker’s credit rating, policy on re-hypothecation and general ability to fulfil all process functions accurately and efficiently.

³⁴ Reports on controls under the ISAE 3402 (international), SAE16 (US), AAF 01/06 (UK) or other standards include a report from an independent service auditor.

³⁵ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

³⁶ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

³⁷ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

Auditors

19.7 Reputable auditors should be appointed to audit the financial statements of the fund.³⁸

Outsourcing Risk - Disclosure Standards and Guidance [20]

20.1 A fund manager should disclose the names of its principal third party service providers in its due diligence documents or upon request.

20.2 A fund manager should, to the extent it is able or permitted to do so, provide information on the fund's committed funding or financing arrangements with prime brokers/lenders to investors in its due diligence documents or upon request.

20.3 A fund manager should disclose the nature of any special commercial terms with its third-party service providers which result in potential conflicts of interest (e.g., in-house brokerage or rebates).

20.4 A fund manager to the extent applicable should disclose the monitoring procedures in relation to its third-party service providers in its due diligence documents or upon request.

D. Fund Governance [21] + [22]

Potential conflicts of interest can arise between fund managers, the funds which they manage and investors in those funds. To mitigate these potential conflicts, appropriate governance mechanisms and oversight are required.

An important issue to consider on establishing a fund, therefore, is the mechanism for addressing and containing such potential conflicts of interest. This issue may not have been accorded great importance when the alternative investment industry was in its infancy; perhaps reflecting the fact that the relationships between managers and their relatively few private investors were more informal or that managers themselves may have been the main investors. As such, these relationships were essentially based on mutual knowledge and trust at that time. As the industry has grown, however, the investor base has broadened with more and more institutional investors (insurance companies, pension funds, endowments and so on) and funds of funds starting to invest in alternative investment funds. The SBAI considers that this change in the investor base requires a reinforcement of oversight processes.

Of course, not all alternative investment funds are the same and so practices in any particular case may need to reflect the investor base, the size and age of a fund and other relevant factors. The legal structure will also need to be taken into account, with the governance mechanism applicable in the case of a fund structured as a company, for example, differing from that applicable in the case of a limited partnership or unit trust. This indicates a "spectrum" of acceptable governance approaches.

Conceptually, the SBAI believes that in most cases the preferred model involves establishing a fund governing body comprising a majority of independent directors, who are suitably qualified and

³⁸ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

experienced such that they are comfortable holding the manager to account for its performance and conduct. The SBAI recognises, however, that, amongst other things, the nature of the investor base, market practice in certain jurisdictions, the legal structure of the fund and the availability of individuals to serve on fund governing bodies will in some cases legitimately result in alternative governance mechanisms being adopted.

Where the preferred model outlined above is not adopted (for whatever reason), the SBAI believes that it is appropriate to consider whether the fund's constitution or offering documents should provide for certain decisions or actions (for example, material changes to fees, investment strategy, etc.) to be made or taken only with investor consent (obtained in accordance with the provisions relating to investor voting/consent/approvals contained in the fund's constitutional documentation or offering documents) or, if applicable, where advance notice has been given sufficient for investors to redeem their investments before such decisions or actions take effect.

Of course, the SBAI acknowledges that irrespective of the chosen governance approach, in practical terms, investors usually choose a manager to invest with rather than appointing a fund governing body with a mandate to select an appropriate manager.

Further Guidance can be found in the SBAI's Governance Toolbox on running a Fund Board meeting and a standardised Board Agenda³⁹.

Fund Governance - Standards and Guidance [21]

21.1 Prior to the establishment of a fund, a fund manager should assess where the fund governance structure should lie on the “spectrum” (see above). In light of that assessment, the manager should be proactive in seeking to ensure that a fund governance structure which is suitable and robust to oversee and handle potential conflicts of interest is put in place at the outset.

In determining the fund governance structure which is suitable in the case of any particular fund, the SBAI believes that managers will wish to consider:

- The range of relevant skills and experience of the members of the fund governing body and the extent to which the fund governing body is able adequately to supervise, and hold to account, the fund manager, and
- The extent to which the fund governing body is able to operate independently of the fund manager.

21.2 Where a majority of the individual members of the fund governing body are not independent of the manager or where there is no fund governing body, certain key actions such as (a) material adverse changes to: the fees and expenses payable by the fund to the manager or the redemption rights available to investors, or (b) material changes to the fund's stated investment strategy or legal structure should (unless required by law or regulation) only be taken with investor consent (obtained in accordance with the provisions relating to investor voting/consent/approval contained in the fund's constitution or offering documents) or if advance notice is provided sufficient for investors to redeem before such actions take effect.

³⁹ <https://www.sbai.org/wp-content/uploads/2016/04/Standardised-Board-Agenda-6-November-2019.pdf>

For the purposes of this Standard, the SBAI would not consider a member of a fund governing body to be independent if he or she is a director, employee, partner, or officer of the fund's manager or of any member of the manager's group with the following exceptions:

The SBAI acknowledges that in certain structures, an entity within a manager's group may act as the governing body to certain funds managed (e.g., as a general partner to a limited partnership fund). Where an individual acts as a director of such an entity and, but for this, would be considered independent of the manager, then, such an individual may still be viewed as independent for the purposes of this Standard.

21.3 Members of the fund governing body should have suitable experience and integrity in order to discharge effectively their role with the appropriate level of independence.⁴⁰

21.4 The composition of the fund governing body and the governance processes in place should be monitored and, if necessary, adjusted throughout the life of the fund to ensure that they remain effective and appropriate in light of, amongst other things, changes in the nature of the fund and its investors.⁴¹

21.5 The fund governing body should meet regularly and conduct such meetings in a manner which safeguards the intended legal, regulatory and tax status of the fund. Such meetings should be appropriately documented.⁴²

- In normal circumstances the SBAI would expect fund governing bodies to meet at least quarterly.

21.6 Careful consideration should be given to the extent to which the adoption by the fund governing body of all or parts of established codes of corporate governance or other director guidance is appropriate.⁴⁴ Fund governing bodies should be adequately resourced in order to comply with any such corporate governance code or director guidance.⁴³ This includes ensuring that the fund governing body has adequate resources to comply with any such corporate governance code or director guidance.

Whilst the SBAI recognises that managers cannot legally require independent boards to adopt good practice principles for their governance, they should nevertheless use their influence to encourage adoption and compliance. Naturally, the SBAI is also aware that the Standards in no way override legal, technical, contractual and tax realities.

As guidance to managers when considering which corporate governance code or director guidance are appropriate for fund governing bodies to adopt, the SBAI has set out below a selection of those principles contained in the corporate governance codes and director guidance published by AIC and AIMA which it considers to be of greatest importance⁴⁴. The SBAI recognises, however, that not all of these principles will be applicable to all types of alternative investment funds:

⁴⁰ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

⁴¹ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

⁴² See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

⁴³ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

⁴⁴ AIC: Association of Investment Companies: The AIC Code of Corporate Governance, <https://www.theaic.co.uk/sites/default/files/documents/AIC2019AICCodeofCorporateGovernanceFeb19.pdf>;

- Directors’ potential conflicts of interest should be disclosed fully to the fund’s investors (through the fund’s offering documents) and the board as a whole (at the first available meeting),
- Fund boards should have sufficient collective expertise, availability and be otherwise qualified to understand the investment policy and strategies of the fund and the attendant risks (AIC 6). Expertise should include areas, such as investment management, regulatory issues, accounting, administration, and technical understanding of the fund’s strategies,
- The board should put in place a policy on tenure of directors and disclose it in the fund’s offering documents and its annual report (AIC 4),
- Directors’ remuneration should reflect their duties and responsibilities, and the value of their time spent (AIC 8),
- Regular face to face board meetings should be held, preferably quarterly. Typical board agendas may include approval of accounts, investment performance review, review of any relevant regulatory breaches and review of the performance of third-party service providers, such as the administrator and prime broker(s), review of the manager’s risk management procedures,
- There should be regular review of adherence by the manager to investment policy and investment restrictions, review and approval of side letters, compliance and valuation functions and regular review of business continuity,
- The manager, external valuation agent and administrator should be required to report regularly to the fund directors regarding performance, subscriptions, redemptions and adherence to investment policy and restrictions and applicable anti-money laundering requirements (including direct reporting from the compliance officer and any in-house valuation function),
- The fund directors should be made aware of their personal responsibility for the issuance and legality of side letters or discretionary waivers (AIMA 6.9 and 6.11), and
- The directors should consider whether the fund should take out D&O insurance proportional to any liabilities relating to the directors’ role with respect to the fund.

21.7 Regular reports on compliance with laws and regulations (in particular those relating to anti-money laundering) applicable to activities which are performed by the administrator on behalf of the fund should be obtained by the fund governing body from the fund’s administrator.⁴⁵

⁴⁵ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

22.1 Details of the fund governance structure which is put in place should be disclosed in the fund's offering documents.⁴⁶

This could include elements such as:

- Biographies of each director setting out details of his/her experience relevant to performing the role of a member of the fund governing body,
- An indication as to whether each member of the fund governing body is independent of the fund manager, and
- Details of any corporate governance code or director guidance with which the fund governing body has agreed to comply.

22.2 The existence of any class of shares which are held only by the manager (or an entity connected with the manager) and which carry voting rights affecting any aspect of decision-making in respect of the fund should be disclosed in the fund's offering documents.⁴⁷

Such classes of shares are often known as "founder" or "management" shares and carry rights to, amongst other things, vote (to the exclusion of any other shareholders) on the appointment or removal of directors and/or the termination of the investment management agreement between the fund and its manager.

E. Shareholder conduct, including activism [23] - [28]

This section focuses on fostering behaviours which contribute to market integrity and shareholder engagement. The following areas are covered:

- Prevention of Market Abuse [23] + [24], Proxy Voting [25] + [26], Disclosure of Derivative Positions [28], and Borrowing Stock (to vote) [27]

[Prevention of Market Abuse – Governance Standards and Guidance \[23\]](#)

23.1 A fund manager should ensure that it has internal compliance arrangements which are designed to identify, detect, and prevent breaches of market abuse laws and regulations.

A sound approach might include the following components:

- A dedicated compliance officer who is not involved in the investment management process,
- A written compliance document describing all relevant compliance procedures,
- Documentation of all compliance incidents by the compliance officer in accordance with, where relevant, applicable regulatory requirements,
- Training/education of investment management and other staff to ensure that the relevant laws and regulations, the relevant compliance procedures and what constitutes inside information are all understood and adhered to,
- The provision of regular compliance reports to the fund governing body,

⁴⁶ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

⁴⁷ See introduction, chapter 1.3: The fund versus the manager (in the full standards document).

- Seeking legal and regulatory guidance to ensure that compliance arrangements are designed to prevent regulatory breaches, and
- Open relations with its regulator.

The table below provides some examples of procedures which may support the application of good practices.

Examples of compliance procedures designed to identify, detect, and prevent market abuse

Abuse	Procedure
Insider dealing	<ul style="list-style-type: none"> ▪ Notification to the compliance officer if an employee believes he/she has received inside information. ▪ Compliance officer to determine whether information is material and non-public. ▪ If information is material and non-public, the securities of the issuer concerned should be placed on the restricted list (in which case such stocks cannot be traded) or on a grey list (non-disclosed restricted list, which prevents such information from being shared with the entire firm such that it might allow personnel to second guess why something was restricted). ▪ Securities (shares, bonds, etc.) of companies on the restricted list in which the entire firm would be excluded from dealing (e.g., restricted in the order management system). ▪ Where practicable, use of Chinese walls to prevent, for example, individual portfolio managers who are members of a creditors' committee of a distressed or bankrupt company (and who therefore have access to confidential information) from also trading such company's debt or equity. ▪ In instances where inside information is known to employees who have no active involvement in the investment management function, documentation of details of this knowledge should be placed on a separate (non-publicised) register.
Dissemination of inside information	<ul style="list-style-type: none"> ▪ Managers should have policies to restrict dissemination of material non-public information including, for example, the manager's own intention actively to engage with a company (e.g., by advocating/suggesting a corporate restructuring).
Non-disclosure of shareholdings when disclosure thresholds have been exceeded	<ul style="list-style-type: none"> ▪ Managers should document arrangements with other parties (e.g., other managers) together with which it has adopted a "lasting common policy towards the management of the issuer in question". ▪ Relevant disclosures should take place if disclosure thresholds are exceeded, accounting for collective share ownership of all parties involved.
Prevention of market manipulation	<ul style="list-style-type: none"> ▪ Public relations policies regarding public statements of intent to seek to ensure that no false or misleading impressions are given to the market.

Prevention of Market Abuse – Disclosure Standards and Guidance [24]

24.1 A fund manager shall have a policy to prevent market abuse. For managers that are not regulated, a summary of the policy should be made available to investors upon request.

Examples of potential inside information

- Knowledge of another fund manager's intention to engage in activist behaviour (which is not publicly disclosed).
- Inside information obtained by a manager while serving on a creditor committee in a bankruptcy work-out situation.
- Information on upcoming securities offerings, which have not yet been publicly announced by the issuer.

Proxy Voting – Governance Standards and Guidance [25]

25.1 A fund manager should have a proxy voting policy which allows investors to evaluate the general approach the manager takes towards proxy voting. A summary thereof should be made available to investee companies on request.

The SBAI envisages that a voting policy might include the following elements:

- Guidelines as to the process to be followed to decide how to exercise voting rights, including responsibility to vote and mechanisms to resolve potential conflicts of interest,
- A mechanism to review proposals that are not considered to be in the best overall interests of a company in which the fund is invested,
- A process for deciding when and how to communicate with an investee company's management or board of directors and other shareholders, and
- A process for determining whether to join the efforts of other concerned investors, with due regard to compliance procedures to prevent market abuse (see Guidance in Standard [24] (*Prevention of market abuse*)).

It is acknowledged that prime brokers will often not undertake to notify funds or their managers of corporate events. The proxy voting policy may well state, therefore, that the manager's ability to follow such policy will depend on its being aware of the opportunity to vote.

The SBAI acknowledges that it may not be part of a manager's strategy to vote all proxies (e.g., "black box" traders⁴⁸) and a manager might, for cost benefit considerations, adopt a systematic approach, for example never voting except in exceptional circumstances rather than evaluating each proxy situation. In such circumstances, this should be explained to investors in accordance with the comply or explain regime.

Proxy Voting – Disclosure Standards and Guidance [26]

26.1 A fund manager's proxy voting policy should be made available to investors upon request. A fund manager should also document cases where the voting policy has not been followed and report accordingly to the fund governing body.

⁴⁸ Black box trader: computerised, automated trading system, which generates buy and sell signals based on proprietary algorithms, often executing a larger number of trades.

Disclosure of Derivative Positions [27]

Derivatives such as Contracts for Difference ("CFDs") allow investors to obtain economic exposure to stocks. There are many reasons for seeking exposure via derivatives rather than buying the stock directly, including market access, stamp tax and funding/leverage⁴⁹. These derivatives do not normally fall under the same disclosure requirements (in the UK, for example, under the FSA's Disclosure and Transparency Rules⁵⁰) as shares owned outright.⁵¹

Disclosure of Derivative Positions

The SBAI acknowledges that companies have a right to know who owns them or who has an ability to easily obtain significant voting power.

However, the voluntary adoption of enhanced disclosure requirements by fund managers (or any other particular sector of the market) would cause distortions in the marketplace because they would not apply to all market participants but only to fund managers.

Borrowing Stock to Vote [28]

Borrowing Stock to Vote – Governance Standards and Guidance [28]

28.1 A fund manager should not borrow stock in order to vote.

The SBAI acknowledges that there might be specific situations where it should be acceptable to vote on borrowed stock, e.g., when a fund is invested in shares (and the trade has settled), but the shares have not transferred into their name.

4. Appendices

Appendix B: Examples of Functions often covered by Service Level Agreements (SLA)

Net Asset Value and Share Price calculation	<ul style="list-style-type: none">• Timing of NAV release (including estimated NAVs)• Process for NAV sign-off (roles and responsibilities)• NAV and other reporting requirements• Valuation policy (particular reference to hard-to-value instruments and use of estimates)• Process for ensuring completeness and existence of positions (reconciliations of cash and positions, trade confirmations etc)• Sign off and notification of share price to external parties• Errors policy in place
Shareholder Services	<ul style="list-style-type: none">• Subscriptions/Redemptions & Transfers<ul style="list-style-type: none">○ Accurate receipt of application/redemption instructions from investors in line with fund prospectus○ Timely provision of subscription note/contract notes to investors○ Reconciliation of cash transferred to/from the subscription/redemption account to/from the custody/trading accounts on a monthly basis

⁴⁹ When buying stock, the investor will have to pay the market value of the holding. In the case of a derivative, the investor might only be exposed to the changes in value of the underlying stock, but with no need to fund the position at the outset and save for the posting of margin.

⁵⁰ Disclosure and Transparency Rules, e.g., requiring disclosure of share ownership if certain thresholds are exceeded.

⁵¹ NB: There is a disclosure obligation if under the terms of the derivative the fund can require physical delivery of the underlying securities.

	<ul style="list-style-type: none"> ○ Timely payment of redemption monies in line with local regulatory requirements and fund prospectus ● End Investor Servicing <ul style="list-style-type: none"> ○ Timely provision of investor statements containing holdings, latest NAV per share and market value of holding ○ Timely responses to investor/manager queries ○ Timely and accurate notification and process of corporate action ○ Money laundering – Ensure there are policies and procedures that meet or exceed requirements imposed by the anti-money laundering (AML) regulations set by their local regulator ○ Application of AML/know-your-customer (KYC) requirements in line with jurisdictional and prospectus requirements ○ Monitoring and reporting of suspicious activity ● Regulatory Filings <ul style="list-style-type: none"> ○ Completion and submission of statutory/listing filings as required (in conjunction with Corporate Secretary) ● Monitoring <ul style="list-style-type: none"> ○ Employment retirement income security act (ERISA) and other investor tax requirements
Transaction Processing	<ul style="list-style-type: none"> ● Ability to handle Security and FX trades ● Ability to handle corporate actions ● Definitions of accounting policies for interest and income accruals ● Charges and expenses including performance fees ● Subscriptions, redemptions and transfers – trade orders, order confirmation, trade confirmation ● Cash management – cash balance review, cash movements ● Reconciliations – when performed and detail of reconciliation ● Monthly custodian reporting – reporting contents, for example, settled positions, latest prices, market value
Compliance	<ul style="list-style-type: none"> ● Pricing control ● Error and breach reporting
Accounting and Financial	<ul style="list-style-type: none"> ● Accounting standards used ● Filing or accounts
Corporate Secetrarial	<ul style="list-style-type: none"> ● Maintenance of all statutory books and records ● Provision of registered office facilities ● Organisation of opening of subscription, holding, redemption, brokerage accounts as well as trading and any other bank accounts as required ● Annual Reports and organisation of annual meetings and emergency general meetings ● Arrangement execution of legal documents by fund directors ● Submission of required information to relevant regulatory body

Appendix C: Examples of Compliance Procedures Designed to Identify, Detect and Prevent Market Abuse

Abuse	Procedure
Insider dealing	<p>Notification to the compliance officer if an employee believes he/she has received inside information.</p> <p>Compliance officer to determine whether information is material and non-public.</p> <p>If information is material and non-public, the securities of the issuer concerned should be placed on the restricted list (in which case such stocks cannot be traded) or on a grey list (non-disclosed</p>

	<p>restricted list, which prevents such information from being shared with the entire firm such that it might allow personnel to second guess why something was restricted).</p> <p>Securities (shares, bonds, etc) of companies on the restricted list in which the entire firm would be excluded from dealing (e.g. restricted in the order management system).</p> <p>Where practicable, use of Chinese walls to prevent, for example, individual portfolio managers who are members of a creditors’ committee of a distressed or bankrupt company (and who therefore have access to confidential information) from also trading such company’s debt or equity.</p> <p>In instances where inside information is known to employees who have no active involvement in the investment management function, documentation of details of this knowledge should be placed on a separate (non-publicised) register.</p>
Dissemination of inside information	Managers should have policies to restrict dissemination of material non-public information including, for example, the manager’s own intention actively to engage with a company (e.g. by advocating/suggesting a corporate restructuring).
Non-disclosure of shareholdings when disclosure thresholds have been exceeded	<p>Managers should document arrangements with other parties (e.g. other managers) together with which it has adopted a “lasting common policy towards the management of the issuer in question”.</p> <p>Relevant disclosures should take place if disclosure thresholds are exceeded, accounting for collective share ownership of all parties involved.</p>
Prevention of market manipulation	Public relations policies regarding public statements of intent to seek to ensure that no false or misleading impressions are given to the market.

Appendix D: Examples of Non-Binding Guidance to Determine “Similarity”

1)	The Portfolio Manager or investment team, the investment mandate (i.e., equity, fixed income, macro) and the strategy or style (i.e., market neutral, relative value, trend following) will all need to be the same.
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2)	<p>Additionally, the “similar” fund or separately managed account will have to have an 80% overlap in the following 4 areas (an example follows each item):</p> <p>a) Asset classes traded (i.e., mortgages, equity, credit, FX) - If the fund is 100% equities, then other funds/sleeves must have at least 80% in equities to be classified as similar.</p> <p>b) Target risk and return - Funds must have similar risk-return targets (measured by Sharpe or Information Ratio) to be classified as similar. Thus, if the fund targets a Sharpe ratio of 1, then “similar” funds must target a Sharpe between 0.8 and 1.2 (+/-20% band).</p> <p>c) Time horizon of positions - If the average holding period for the fund is 3 months, then the holding period for the similar fund needs to be between 2.4 to 3.6 months (+/- 20% band).</p> <p>d) Average liquidity of positions - If the average liquidity profile of the fund is 10 days, then the similar fund needs to have an average liquidity profile between 8 to 12 days to be classified as similar (+/- 20% band).</p>
3)	<p>A multi-strategy fund would have to have 80% overlap of allocations among sub-strategies, and the sub-strategies would have to be substantially similar (80%), as in item 2 above.</p>