

EXAMINERS' REPORT

June 2017 examinations

Subject F205 - Investment Fellowship Applications

This exam was in line with previous exams set over the past few years in terms of its overall level of difficulty. There were some opportunities to score marks through fairly straightforward application of bookwork which could have been better capitalized on. The exam included open-ended questions to test the ability of candidates to apply what they have learned to potentially unfamiliar situations. Many candidates understood the scenarios set out in these questions and captured some of the key elements of the solution, but did not develop their discussion of the relevant points to the degree required to meet fellowship standards. The number candidates scoring FC and below again demonstrates the trend in the proportion of students who are inadequately prepared, from both a knowledge and exam skills perspective, for this exam.

QUESTION 1

Generally not well answered. Candidates did not fare as well as expected on bookwork component, and failed to fully capitalise on points available. Part (ii) was particularly poorly answered as many candidates were either unaware of relative returns of asset classes for the period, or did not consider the time period covered in the question. For the subsequent application and higher order questions, candidates generally showed an understanding of the problem presented and valid points were stated however they were not "discussed" in sufficient detail as the question required. In part (iv) where candidates identified the cash flow dynamics of the investment (ie quick payback once units are initially sold and subsequent re-investment of assets) points were awarded for alternative re-investment options and implications relative to liabilities/liquidity needs. These are not all explored in the solution

i.

General comments

- For many years the listed property sector was small and dominated by a few large companies, but has grown significantly and diversification has improved as a result
- More recently an increasingly higher degree of offshore exposure is possible
- Property companies are not necessarily a good diversifier- market beta with equities is demonstrated at times and correlation has been more than 0.7 to bond markets
- Can go active or passively track the index for cost effectiveness (active may be better to control offshore exposure and avoid certain companies if desired)
 - Both are easy to use for modelling (ALM) as data is available

REITs

- company that owns, and usually operates, a portfolio of income producing properties
- JSE listed – used to be PUT's/PLS until 2013
 - JSE has formed an index of REITS
- Strong regulation via JSE rules, CISCA, companies act etc.
- Good for smaller investors because of
 - entry size and
 - governance overlay and inherent expertise,
 - liquidity in DC environment
- Can diversify exposures with REITS and even diversify overseas within REIT or even in invest in a dual listed REIT.
 - But management teams may not have the same expertise in offshore markets
- To maintain REIT status, the company needs to pay out 75% of its earnings as dividends.
- Then does not pay income tax on profits – more tax efficient

Listed property companies

- Some listed property companies are not REITS
- Property development companies do not qualify as REITS (payout too low) but offer potential for higher capital gains (with higher associated risks)
- How liquid are some of the shares?
- Both REITS and listed companies can incorporate gearing internally which will enhance yield as long as gearing is not excessive –introducing/magnifying risks

Unlisted/direct property

- A better overall diversifier when compared with equity
- But end up with more concentrated property portfolio compared to REIT as hard to allocate to different risk sectors vs REITS and listed property
- Only feasible for very large investors
 - Especially difficult for a medium-sized life office

- Expertise required to run, maintain and manage the property compared to REITS/listed – additional explicit costs compared to REIT which should do this on a more cost effective basis
- Lower volatility than listed and other asset classes but synthetic as driven by infrequent valuation and assumption changes
- Difficulty and costs associated with valuation and modelling (e.g. ALM and data availability)
- Possible higher level of real income could be a nice match for liabilities
- Poor liquidity for such a large immovable investment
- Can release embedded value from change of use/structure/tenancy

ii.

- Outperformed other primary asset classes over last 10 and even 20 years significantly
 - Beating inflation by over 10% over both periods
- Volatility has been lower than growth asset classes such as equities
- This is can be as a result of more stable, infrequent pricing of underlying assets
- Sector pricing is driven by :
 - Discount/interest rates - lower discount rates raise valuations, and lower interest rates boost overall economic activity and demand
 - Supply and demand for properties
 - General equity markets attractiveness (index trackers and foreign investors buying these shares)
 - Retail demand – consumers taking on credit and spending at stores
 - Momentum play – there has been significant price momentum particularly from large caps which have sufficient liquidity (a SAPY requirement)
- Performance driven by falling bond yields since 2007 GFC
 - Since properties valued at discount rates set off bond yields
- Investors have also sought the protection of property as an asset class (search for yield – higher/ stable income) and earning a risk premium along the lines of equity
- Economic in SA growth remained fairly robust until more recent years as it seemed SA would avoid the recession following the GFC

- Lots of building and development demand (both commercial and residential, as well as world cup related) in major centres
- A greater number of listings, liquidity improvements and accessibility with REITS has increased demand in the sector

iii

- It is viewed as a distinct asset class with different drivers of returns by many managers
- Often seen as separate asset class when constructing balanced strategies (so excluded from equity building block here) and this equity carve-out can form the basis for a manager's stand-alone equity portfolio
- Specialist skills are often required for this sector – tend to be held by specialist property managers
- Although it has grown significantly in the last few years it was previously a small component of the ALSI and small relative to the size of largest asset managers – so did not represent a big “off-benchmark” risk by excluding this from portfolios
- Many may have seen it as overvalued in last 10 years. Would for example not necessarily have been held by managers following a value philosophy
- Large managers would prefer to take positions in largest liquid property shares – bidding these prices up to unattractive levels
- Manager mandates (or client IPS) may specifically exclude property shares

iv.

Nature and term of liabilities

- Longer term liability for annuity book – term of annuity can be as long as 30-40 years or even longer for dependents. Long term, perpetual nature of investment would be a good match for term.

- Annuity book has a mix of real and nominal liabilities - guaranteed annuities may be level or have fixed increases, with profit annuities will be real as policyholders anticipate increases in line with policyholders expectations (to maintain income purchasing power over longer term)
- Property is generally considered a real asset class so matches by nature, but this investment would not form as close a match for the liabilities as compared to bonds or ILB.
- While profits can be made on initial sale, units may be priced attractively to attract retirees. A large proportion of the overall long term returns could be made on re-sales– this could lead to a long lead time until significant positive returns, and an escalating return profile.
- In this case one of the primary risks associated with the investment proposal could be longevity risk – since re-sales will be delayed if occupants live longer than expected. This introduces a significant correlation risk with annuity book if mortality assumptions too light – when pricing/valuing both the investment and their book of business.
- Liquidity may be needed to pay pensions: Unit itself pays no income in the meantime – no regular income to meet liabilities.
 - However capital is not “tied up” for significant periods as units are sold at the start so invested capital is returned for liquidity and/or re-investment in other projects or asset classes.
- Uncertainty re timing to pay out on deaths (in which case an asset – the unit – is re-acquired by the fund for resale).
- Capital requirements to cover reserves and contingencies.

Existing Portfolio

- What does the existing portfolio backing these liabilities look like - does the investment enhance the overall risk-return profile of the portfolio?
 - Is it possible to model using ALM – may be difficult to set assumptions?
- What is the size of the book – can it accommodate the size of the proposed investment without introducing concentration risk?
 - Medium sized Life Company suggests this should not be a problem

Valuation

- How would you value this?
 - Would be difficult to value - need applicable mortality assumptions as well as assumptions for residential property price growth
 - Need to allow for expenses (maintenance, marketing, regional taxes, refurbishment etc) to extent not allowed for in levies
 - Then apply a DCF approach
- No historic returns or similar projects to compare with or measure against

Possible market appeal

- Pricing of units must be attractive to retirees - what are the demographics in the area- number of elderly, income levels etc?
- Should be attractive to retirees as they get money out at end- to meet bequest motive or to fund assisted care.
- Highly popular market but purchases depends on people's ability to sell existing homes – in a depressed property market this may be difficult.
- Location - is facility near to shops, hospitals, recreational facilities?
- Do they provide a frail care facility? This introduces additional costs (which could be passed on) and expertise yet a facility may not be attractive without this option?
- Will residents be allowed to sell back to the developer before death? What are the terms and conditions associated with this option?

Further considerations

- Development time to sales – how long is the lead time from breaking ground until the first sales come in?
 - Unless existing complexes are wholly bought out and converted – which may not be practical.
- How will day-to-day maintenance be funded? Assume residents pay levies toward taxes and maintenance.
 - Have such expenses been adequately assessed?

- Reputational risk – scope to increase levies for cash-strapped retirees
- Who is the developer? How many projects or developments have done – track record, experience and reputation?
- Competition in the area – are other developers planning similar projects?
- What will your stake in the overall venture be?
 - Who are the co-investors (if any)?
- Difficulty associated with exiting the investment – the Life Office will not easily find another buyer if it wishes to exit the investment
- ESG considerations – how does this investment align with the Office’s ESG investment policy

QUESTION 2

For part (i) it was surprising that some candidates did not attempt to (or did so incorrectly) convert the returns into a single currency for their discussion. Easy marks for a simple application question were missed. In part (i) & (ii) few criticized the use of standard deviation as a risk measure for an investment with such a binary outcome as a cat bond, and failed to discuss the difficulties associated with this type of distribution when considering returns over the given measurement period.

In parts (iii) candidates were familiar with the generic bookwork related to manager selection but could have scored higher marks by focusing on the cat bond specific issues and how these related to the consideration of the manager.

i.

- The cat bond index has in fact generated the highest return if one adjusts the returns in the table into one currency.
- The rand depreciated by roughly 7% pa over the 10 year period.
- This means that the JSE ALSI returned just 3.3% in US\$ over the period (vs the 8.3% from cat bonds).
- In addition when one considers the risk-adjusted return (return divided by standard deviation) cat bonds seem to have offered the highest risk-adjusted return of all the asset classes.
- However one should interrogate the appropriateness of the definition of risk. Standard deviation is arguably not an appropriate measure considering the substantial tail risk posed by cat bonds.
- The time period of measurement is perhaps too short to fully recognise the risk of cat bonds.
 - The frequency of catastrophe event is too low for any meaningful parameters to be estimated from a period of only 10 years.
- It is possible that this time period saw an unusually low level of catastrophes hence limited capital loss.
- In a short period the number of events will be low, but the effect on the return is radical – good return if no event, no return if events occur. So it only takes a few events to dramatically change the historical returns.
- The comparison of cat bond returns to equity returns is somewhat skewed by the starting point(i.e. 31Dec 2006). This starting point is close to the pre-financial crisis peak in equity

markets, so the 10 year performance will look weak compared with if one used the beginning of 2009 as starting point.

- Global bond returns in rand terms outperformed SA equity and bonds over the time period. This was due in part to the action of developed market central banks pushing rates to historical lows using quantitative easing.
- Many developed market bond yields are at historically low levels which implies that future returns are likely to be lower than experienced in the recent past.
- Comparison should also be made on a net of fees basis as costs may impact net returns significantly for cat bonds.

ii.

- The low correlation between cat bonds and other asset classes should enhance the risk/return profile of fund.
- How would the cat bonds be accommodated within the fund's strategic asset allocation?
 - Hard to justify as a substitute for other bonds (vanilla or ILBs) since the return signature is very different.
 - If as a separate asset class providing access to a unique risk premium, the ability to model the optimal exposure will be hampered by the peculiar statistical distribution of returns and lack of sufficient relevant data points.
 - Would have to build a qualitative case based on testing that the risk premium is remunerative and sustainable over time.
 - Trends in frequency of events resulting from changes to global weather patterns may erode faith in the logic of these investments over time.
 - However, the diversification must be demonstrated to be real; multiple-weather events could be related to each other even if they occur across the world (e.g. as a result of El Nino).
- Cat bonds provide access to an asset class not commonly found in SA pension funds. This enhances diversification.
- However this will introduce peer performance risk which is a reality for SA DC pension funds.

- Pension fund liabilities are real in nature and long term. A diversified portfolio of cat bonds would be expected to provide a real return over time, making the asset class a good match for pension liabilities.
 - Although over time cat bonds have outperformed inflation the asset class is too young to conclude that this will persist in perpetuity.
 - An individual cat bond is usually priced to offer a wide spread over short term fixed interest securities of similar duration. This should exceed inflation over the term of the bond.
 - By design, there is no guarantee that the principal will be protected in nominal terms, never mind in real terms.
 - Cat bonds are short term instruments (3-5 years in duration) so not a good match from a term perspective.
- Cat bond market is likely small in SA so it may be difficult to buy a sufficient position size in the fund if you wanted to invest in local cat bonds rather than offshore.
- Liquidity is probably limited. How established is the secondary market for the cat bonds?
 - Are the bonds listed on an exchange?
 - Lack of liquidity may mean the fund attempting to buy/sell a cat bond position influence market prices negatively.
- If the fund desires additional exposure it may have to investigate the option of foreign cat bonds.
 - However this introduces currency risk and is a mismatch for the rand denominated liabilities of the fund member.
- This will also necessitate having to make use of the fund's 25% international allowance.
- Does Regulation 28 permit investment in such instruments and if so what is the limit?
- Does the fund's IPS permit investment in unlisted securities and cat bonds in general?
- How will the fund price the bonds at inception and over time?
- How would the fund know which cat bonds to invest in and what is fair value for each individual bond?
- How will counterparty risk be considered and priced?
- Expertise will be needed. Do these skills exist in SA and what would it cost the fund?
- An option is to invest in external (3rd party) cat bond fund.

- This brings an additional layer of fees – specialised manager may demand very high level of fees.
- How would you measure the performance of an external manager?
- Would trustees fully understand the risks involved? Instruments are not standardised. Each individual bond has a unique risk exposure and technicalities (what exact event triggers a loss/reduction in capital) that need to be understood.
 - Reputational risk: if the bonds suffer capital losses as a result of a catastrophe, could the trustees be accused of recklessness by fund members despite good intentions.
- Whichever vehicle is used, the fund must quantify the maximum extent of losses possible and probability of various levels of loss and must be comfortable that it is comfortable to absorb those losses should they materialise.

iii.

The firm

- Is the firm a dedicated cat bond manager or a division of a larger asset manager?
 - Larger manager will have important support functions – governance, risk management, IT, infrastructure that could be non-core distraction for a dedicated smaller manager
- How long has the firm been in existence and managing cat bonds?
 - This speaks to experience, investment focus and expertise on the one hand...
 - ... and infrastructure, operational readiness
- What is the scale of the operation: i.e. what is the size of the fund under management?
 - What minimum size is needed for business to be viable?
 - What maximum size of AUM at which process/strategy no longer delivers expected returns?
- Have there been significant fund inflows/outflows over the past few years and why?
- Organisational structure: research analysts, portfolio management, marketing, client servicing, corporate governance, compliance etc.

People

- Need to identify the key individuals who have the required qualifications and experience to effectively manage a portfolio of cat bonds
- How many years have they managed relevant cat bond portfolios? How many years would be acceptable given this is a “young” asset class?
- Quality of the firm’s leadership
- Staff turnover: how many of the key individuals have joined/left the firm over the last 5-10 years?
- How does the firm attract and retain top talent – particularly in a niche area?
- How are investment staff remunerated?
- Is there alignment of interests between managers and clients?

Philosophy

- Firm should have a clearly defined investment philosophy
 - That has stood the test of time and does not change with the seasons
 - And is understood and embodied by all staff at the firm

Process

- Need to understand the managers investment process
- How does an individual cat bond get selected to be part of the portfolio?
- Does the manager have requisite models and data required for this unique asset class?
- Usually trustees look for a process that has stood the “test of time” – this is not possible with an asset class that has not existed for long
- What is the investment universe of cat bonds?
- What is the manager’s competitive advantage – do they have unique access to deal flow?
- Is the process repeatable or scaleable? .For small asset classes the managers success may not be replicable for larger AUM
- Do staff have the necessary resources to effectively carry out their jobs?
- Risk management process – again standard off-the-shelf tools may not be relevant
 - How does the manager manage the fat tailed risk associated with cat bonds?

- How does he understand the correlations between individual cat bond and hence the risk impact of adding a further bond to a portfolio?
- What are the processes with regard to dealing and settlement?

Performance

- Past performance assessment and measure must be taken with care – risk adjusted measures not as simple as usual measures not relevant
- Also not a very large peer group with which to compare returns
- What is an appropriate benchmark? Scarcity of indices may make setting a benchmark difficult and hence has implications for performance fee arrangements
 - Are there local (SA) cat bond indices? If not what does the manager compare his/her performance to?
- Performance attribution analysis concepts cannot be translated to this asset class further limiting the value of performance measurement

Costs

- Fees – what is the industry norm for these funds (if such exists). A premium could be charged for scarcity of skills
 - Performance fees structure (high water marks etc.) are they appropriate?

Other considerations

- Is the portfolio to be a local or offshore portfolio? Consider whether the requisite skills are available in SA – it seems the asset class is better established in developed markets and trustees may consider appointing a manager not domiciled in SA This introduces further logistical, legal, compliance and procedural complexities

QUESTION 3

Candidates answered the first part well and were either familiar with the issues or were able to apply logical thought when answering the question. Part (iii) comprised bookwork with a degree of application and this was adequately handled.

Part (iv) was the poorest-answered question of the paper. Candidates spent too much time covering generic points (Reg 28, fees etc.) rather than applying knowledge to the specifics of the question ie practicalities/difficulties related to such an ETF as described in the question. This could indicate time management or fatigue (this being the last question) or a lack of confidence in their understanding the investment strategy described in the question.

i.

Advantages

- Forces saving for retirement instead of spending (especially on short term debt) and creates further awareness of the need to save. The default, to date, has usually been for retirement monies to be paid out - often just because people are not aware that there is an alternative.
- Could be beneficial for individual in terms of tax - withdrawal benefits are taxed quite heavily.
- Could obtain much needed retirement advice that wouldn't otherwise be accessed.
- Secondary benefit for the economy as savings increase and a reduced burden on the state in retirement years.
- Could increase employee retention as company is seen to take better care of employees.
- Could increase term for which monies are held in fund, increasing the attraction of long term alternative/real investments that have been historically less attractive to DC.
- Larger preservation funds offer institutional fees rather than retail fees which could mean a substantial saving in overall fees for members.

Disadvantages

- Cost of the IFA will most probably be transferred onto the fund/members. IFA would either charge members a fee directly (fixed or based on size of assets) or charge the fund a fee of Rx per member per month. The latter being more likely.
 - For members who already have private IFA it will be a wasted expense.

- Low income earners may need the money immediately, especially if retrenched/forced to resign, for example through disability.
- Does not cater to members who have their own independent saving plans for the assets – eg investing for a child’s education.
- Possible only one portfolio or limited investment options are used for the preservation fund – one size fits all approach for simplicity. Thus lack of flexibility obtainable outside the fund.

ii.

Liability

- The liability will differ in that a target NRR objective may not be pursued and measured under the preservation fund.
- Members may be more likely to withdraw a portion of their benefits (under the new framework) from the preservation fund as they do not need to leave their job to access the assets. Uncertainty re withdrawal rates.
 - This could mean the turnover in a preservation fund could be larger, and liquidity needs will be higher.
- The membership could be slightly older than the retirement fund as they have already worked for a while before resigning which triggers the transfer to the preservation fund. This may limit the withdrawals as per the point above, and members might be slightly more risk averse/focused on capital preservation.
 - or may have accumulated other wealth so could have a higher risk appetite
 - Can equally argue membership may be younger as younger workforce is more mobile

Considerations

- Is the retirement fund offered by the company a pension or a provident fund as the preservation fund will have to be the same in order for members to be able to transfer to it without tax penalties?

- What does the current retirement fund investment strategy/portfolio look like? For example if only a single Trustee selected investment portfolio is offered it wouldn't make sense to offer member choice on the preservation fund.
- Only Regulation 28 compliant portfolios can be considered.
- Does the fund have the internal expertise to launch an in-house preservation fund? Can they cope with the admin burden – especially over the long term?
- Finding members to pay out a benefit possibly long after they have left the company can be problematic.
- What will the cost be to launch an internal fund compared to outsourcing it? Since it is a large retirement fund, the preservation fund will most likely also grow large very quickly. The salaries of dedicated personnel need to be taken into consideration as well as the time needed from the Board of Trustees.
- Less alignment of interests between HR, trustees and members who are no longer involved with the company could influence care taken with default selections.

iii.

(a)

Full replication

- Full replication: Investing in the full underlying index in exact proportions
- Full replication could be achieved by investing in each hedge fund
 - Full replication can also be achieved by a look-through to the underlying holding of each hedge fund
- Doing either of these across so many hedge funds each with a range of strategies and positions would be totally impractical
 - given the need to disinvest/invest cashflows and liquidity constraints
- Hedge fund managers do not all disclose this information, and if they do it will reflect historic positions
- Mismatch risk – between the ETF which could be trading daily and the underlying hedge funds which probably only trade monthly.

Partial replication: Selecting specific funds and/or strategies which represent the index for investment rather than investing in the entire index

- For example top x% of underlying invested in physically and the rest is sampled, or
- Could pick one fund which follows each strategy and replicate this – reducing the number of positions and amount of work necessary
- But similar arguments as above would apply as issues around availability of look-through would still apply

Synthetic replication

- Synthetic replication: The performances of the hedge funds are replicated by investing in indices/single stocks or using derivatives.
 - would be best option in this case
 - If such derivatives are available

(b)

- Using historic data from indices available on the major asset classes (e.g. broad equities markets, equity market sectors and categories, money market instruments and bonds) and economic factors...
- ...run a factor based model using this data which replicates the published HFID returns as closely as possible and which are applicable to these market exposures
- Use results of the model to determine weightings of these market factors and hence construct a portfolio using a range of liquid securities and derivatives based on these factors or indices
- Would need to consider how robust the replication model should be – e.g. would parameters be expected to be constant through different market conditions
- Make sure the model is not “over fitted” by selecting best fit factors – rather use factors that make intuitive sense.

iv.

Fund related issues

- What are the regulatory constraints as far as investing in this fund? How would it be classified for Reg 28 - Assume a look-through will be applied and hedge fund regulatory limits are to be adhered to
 - These are 10% in hedge funds with a maximum of 5% in one hfof and 2.5% in one hedge fund
- Does the fund's own IPS cover investments of this nature and what constraints are in the IPS?
- Additional administration might be required in terms of compliance, reporting auditing etc.
- The complexity of the product – will trustees be able to deal with this?
 - will it be too time consuming to explain to members?
- Peer risk is introduced – other retirement funds will likely not be invested in the hedge fund ETF. This is a very new innovative product – are they sure they want to be the first ones in?
- Will the Trustees/members be able to understand that their hedge fund exposure might not be 100% replicable, even over a prolonged period?
- Is the risk-return profile and diversification benefit of the proposed hedge fund ETF attractive enough, given the complexity and small allocation allowed?
 - This might make up such a small portion of the total investment (given Reg 28 constraints) that Trustees have to consider whether they want to put the effort in for the small potential gain
 - Diversification benefits are expected but how great is this benefit given Reg 28 constraints? Again back tested data can be used
- How often will you measure performance of the ETF? – sufficient time needs to be given to this investment to determine whether diversification/additional returns can be achieved over the long term.
- Against which benchmark? The HFID or an alternative CPI+ type benchmark commonly used by hedge funds
- It is anticipated that this ETF should provide better liquidity than investing directly in a hedge fund

Product specific issues

- This is a newly launched product which introduces significant risk – what evidence do we have that the strategy works? No track record is available
 - Although this is new to SA has the methodology been successfully applied overseas?
- How well will the ETF fund be able to replicate the returns:
 - The index is constructed on a backward-looking basis. Returns published will be in arrears thus the hedge fund etf model will always be lagging
 - The factor-based method, while practical, could result in large tracking errors
 - Are there sufficient instrument/indices/derivatives available in the market to track the returns?
- Certain biases may present themselves over time in the construction process, particularly relating to the changes of factors to be used and the timing thereof. Replicating using a factor based approach would incorporate these biases. – how are these to be handled?
- How often the underlying is rebalanced? If done too often, trading cost is high. If done not often enough, returns will lag
- What tracking error can be expected or is acceptable? Given the nature of the product it could be quite high
- Has the model been extensively back tested – how rigorous was the testing?
- Who is responsible for running and updating the model – does the firm have the requisite skills and backup plan?
- The construction of the ETF will require use of derivatives which introduces further risks and issues:
 - Exchange traded derivatives offer best liquidity and would be preferable
 - What derivatives can be used? Would expect for something this sophisticated that OTC derivatives would be necessary
 - Is there a limit on the derivative positions taken – particularly wrt OTC derivatives and counterparty risk?
 - Is compliance against internal controls independently tested on a daily/hourly basis?
 - Cost of derivatives used – these can be quite costly particularly under certain market conditions. This would broaden the tracking error.

- Does the underlying strategy wrt derivatives align with the risk policy of the fund in terms of their IPS and other regulation (e.g. no speculation, cannot lose more than you invest)?

The index

- The index it will track is newly published. How much historical data is available and is it reliable?
- Who is constructing and maintaining the index – a reputable provider with requisite experience?
- The index may be the benchmark for the portfolio so will need to be independently constructed and audited.
- How will the hedge funds to be included in the index be selected? Who will have the authority to change this criteria? How often are the hedge funds included to be reviewed?
- What events/factors will trigger a hedge fund to be dropped? Will the dropped fund's performance be excluded since inception or at the time the event occurs?

Other considerations

- Are there other investors in the product already? What size of AUM is currently under management and what degree of client diversification can be expected?
- Has the manager invested any of their capital in the product?
- What will the cost of the product be and how will the manager be remunerated? Would expect the fee structure to be more closely aligned to traditional investments rather than the hedge fund model.