AIST Operational Due Diligence Guidance Note

Frequently Asked Questions from Investment Managers

1. **What are AIST members expecting to see in the report?**

   The Operational Due Diligence report will review all operational aspects of an investment manager's processes.

   The report is expected to review people, culture, the risk management framework and processes to ensure the investment manager has the operational capabilities to perform the functions to which it was appointed.

   In particular, the report is expected to identify any operational risk that the RSE may assume when outsourcing the investment management role.

   Suggested operational aspects of an investment manager's business to be reviewed are highlighted in the AIST Guidance Note, based on the APRA Insights No1 publication of Feb 2014.

   Note: the Guidance Note should not be considered exhaustive, and specific features of any review may depend on asset class, geographical location, size and other factors specific to the investment manager.

2. **What feedback do AIST members have on the reports that have been received so far? Please elaborate with respect to the assurance vs advisory approach and any potential gaps between what AIST wants to see and the current suggested reporting formats.**

   It is still early in the process of the collation of reports. However, AIST members are agreed that there is to be a strong "advisory" element to any ODD report which should provide insight to the investment manager's capability of fulfilling its operational obligations and that this is in line with the practices of major ODD providers. ODD reviews should also include third party descriptions and observations of key processes and systems with relevant evidencing and testing.

   It is also expected that an ODD report will give an opinion on the ability of the fund manager's operational processes to meet future obligations and targets outlined in an IMA or relevant Trust documentation. Such opinion is expected to be based on an analysis of data used to verify systems and processes, desktop analysis and an onsite visitation program. A common theme regarding reports is that the team conducting ODD reviews has a good knowledge of investment markets and a working knowledge of investment processes, trading, settlements, reporting etc.

3. **What will AIST members do with the report?**

   Member RSEs will have individual approaches to each report received depending on internal resources, size and complexity of the investment manager and asset class under review.

   Trustees recognise that they bear ultimate accountability for all outsourcing decisions and all Trustees must be satisfied that the risks of doing so are identified, reported and managed appropriately.

Each report will be analysed and matched with the RSE's Risk Management Framework (RMF). Any risks not considered in the RMF will be assessed and acted on accordingly.

AIST is encouraging members to work with investment managers to minimize duplication and use whatever report a manager produces.

Prudential standards create a positive and enforceable obligation of the RSE Trustee to demonstrate compliance with prudential requirements and be satisfied that expected processes and risk management are in place. Therefore it is incumbent on the Trustee to demonstrate:

- Due Diligence policies and processes;
- Expectations with respect to the operational processes of investment managers; and
- Evidence for all appointments, and ongoing monitoring, of the required Operational Due Diligence and how the overall assessment was made.

4. How frequently should these reports be issued? And how will interim reports be handled?

To satisfy the prudential obligations of RSEs, an annual report should be produced.

It is expected that a full (in depth) report be issued by the investment manager at least every three years, complemented with an annual "light touch" review.

In the event of significant issues or changes arising in the business of the investment manager, additional work may be required in the interim.

5. What investment strategies should be covered by the report?

All investment strategies relating to a specific asset class are expected to be reviewed.

Multiple mandates from a single manager will give rise to reports cascading down to each specific strategy as a subsection of a report covering the "headline" issues relevant to the manager at the business level. The manner in which such reports are delivered may depend on negotiation between the investment manager and provider.

To avoid repetition it is not expected that issues regarding the overriding business will be reviewed multiple times in the instance of a manager running multiple strategies.

6. How should investment managers handle the differences that might emerge between the products that external providers might deliver? Including how to handle concerns from service providers regarding their in-house approach being different from the AIST guidance note (eg issues of IP)?

The overarching expectation is that there is a strong "advisory" element to the ODD report.

With that said, investment managers may seek guidance from their clients regarding the most appropriate report and provider. The Guidance Note is intended to be a guide only.

While funds would seek comparability of reports (coverage; depth; etc) across providers, there needs to be some allowance for inevitable differences between providers. Variation of approaches may occur depending on style, experience and skill.

7. **What do AIST members expect where there are multiple mandates with a single manger, both onshore and offshore?**

   See Q.5

8. **Does the AIST see the development of an industry consistent ODD questionnaire as being useful?**

   AIST sees an industry consistent ODD questionnaire as a positive factor assisting with the collation of quantitative data necessary as a prerequisite for a review.

   Accordingly, AIST supports the implementation of a questionnaire that is also supported by investment managers, ODD providers and super funds.

   It is viewed as an enhancement that will assist in standardizing reports to make them comparable, reduce inconsistencies and ease the workload of investment managers.

   An ODD questionnaire is seen as an aid to an ODD review, not a complete review in itself.

9. **How often will AIST be reviewing the Guidance Note framework/policy?**

   The AIST Guidance Note is considered to be a "live" document and will be under continual review as the ODD process evolves and risk profiles alter in line with market evolution.

   The result of an initial review of the Guidance Note will be published by end March 2018, and subsequent structured reviews will be undertaken.

10. **Can a trustee rely on this report by itself? If not, what else will be required?**

    Trustees understand that they are ultimately responsible for all outsourcing, and must come to their own view about the completeness and adequacy of the report.

    At times, if an issue is raised, a Trustee may explore that aspect of a manager's business in detail to ensure the issue can be managed, or indeed resolved. Additional work may be required depending on the issue, the asset class, the strategy and the internal resources available to the RSE.

11. **What should investment managers expect regarding the timeline of implementation of these reports?**

    AIST is encouraging its members to ask investment managers for ODD reports in a timely manner. The timing of implementation is at the discretion of each RSE, although it is expected that initial reports will be completed within the next 12 months.

12. **Has APRA formed a view on this approach? If so, what is it? Is APRA concerned about the conflict of the manager paying a third party for a report?**

    APRA has an open line of communication with the AIST Working Group (and FSC) throughout the development of this model, and is encouraging RSEs to consider the Guidance Note in their response to the ODD requirements.

    The focus of APRA's is on improving the quality of operational due diligence, efficiency in carrying it out and reducing costs within the superannuation industry. AIST believes the proposed model is consistent with these goals.

13. **Will there be a description of the process the external ODD provider undertook to complete their review?**

    Yes. ODD providers are expected to outline the processes undertaken in reaching their conclusions in the final ODD report.

14. **What constitutes "independent" at paragraph 3 under the heading *Investment Manager Operational Due Diligence Review Process* on page 1 of the AIST Guidance Note?**

    The intention is for an opinion to be provided by an appropriately experienced, independent third party who is contracted by the Investment manager under a standard commercial agreement.