



The Open Protocol Consultation to ESMA and SEC

ESMA: Possible implementing measures of the Alternative Investment Fund Managers Directive. Specific Reference to Annex V: Pro-forma for AIFM Reporting for Competent Authorities (Article 24)

SEC: Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF

Introduction

We fully support the collection of trading, funding, and counterparty information from Alternative Investment Fund Managers (AIFM) by the world's leading financial authorities.

If such initiatives are appropriately formulated, orchestrated and converge with the industry's own requirements, then there is enormous scope for a very tangible win-win-win. Conversely, however, entrenching discrepancies at this stage would be a damaging step back, rather than a step forward.

The authorities have a legitimate interest in understanding the aggregate exposures arising from the Alternatives Investment (AI) Industry as they look for sources of systemic risk. They also wish to minimize the risk of fraudulent practices. Investors have the exact same desire to understand aggregate exposures within their portfolios and to avoid fraudulent funds. Harnessing this alignment both empowers investors and minimizes costs to the AIFM. Ignoring investor preferences and needs is to actively disadvantage them as AIFM will be obliged to prioritize their regulatory obligations.

The reporting solution preferred by investors is The Open Protocol (please see attached), which coincides with the preference of the industry as a whole. This is not accidental. The Open Protocol was forged by the collaborative efforts of hands-on practitioners drawn from investors, AIFM and service providers. The Open Protocol is a fully-worked, technically detailed, blue print for reporting. It is, effectively, an exact response to the challenge set by the IOSCO technical committee on 25/02/2010.

The "unison" solution would be for the world's authorities to adopt The Open Protocol.

The "harmony" solution would be for the world's authorities to allow the definitions laid-out in The Open Protocol to be used when AIFM's fill in regional reporting variants.

A "discordant" outcome will naturally result if each jurisdiction attempts to solve the challenge of reporting in isolation.

The rest of this document focuses on the benefits of a solution that bridges jurisdictions, as well as the public and private sectors. By contradistinction, it would be a painful irony if questions that target an understanding of systemic risk were not eventually asked in a systematic way.



First key benefit: A unified data structure facilitates aggregation

A simple example of the disutility of a splintered approach to reporting is the regional focus of each regulatory initiative.

Without an overriding definition of the regions to establish consistency, the proliferation of regional-focused templates fatally compromises data structure. The more practical solution is clearly for all regulators to collect all information on the same basis. Any given regulator would then still have the option to drill down on a specific region.

A second example is reporting currency.

The easiest solution here would be for AIFMs to report in a single currency and for each authority to then convert into their local currency at spot. If this is unacceptable, there need to be very exact and explicit rules for the AIFM to follow when it comes to currency conversion for regulatory reporting, or else the overall data collected will be randomized.

The authorities need to approach this by working back from how they will end up having to use the data gathered. Be it proactively, or reactively, it is certain that the world's authorities will eventually need to aggregate the data that they receive. Data structure inconsistencies at this stage are bound to create difficulties in the future.

Investors always need to understand and integrate market risks on a global basis, so The Open Protocol is an exact example of the kind of unified data structure that is required.

Second key benefit: greater breadth of data collected

Proposed regulatory reporting formats to date have focused on the “usual suspects” of systemic risk, such as the financial sector.

The Open protocol collects broader data. This might prove valuable if the next crisis turns out to be materially different from past crises. It would be hard and expensive for the authorities and AIFM to have to continually reconfigure reporting requirements. Changes in data structure also compromise the utility of historic data.

The Open Protocol is a more complete solution.

Third key benefit: harnessing the “group intelligence” of the world's investors

If regulators and investors receive the same well-structured data then the confidence in that data should increase.

Investors should be comforted by the penalties for inaccurate reporting. Regulators should also be comforted by knowing that investors are reviewing the data searching for concentrations of risk and



signs of implausibility. In such a scenario, the world's great investors would effectively be amplifying the resources at the disposal of the authorities.

However, poorly structured “regulatory” data might well ‘crowd out’ well-structured investor-friendly data. If such “regulatory” data proved to be less coherent, less consistent, harder to harness and harder to interpret then there would be less point in investors studying it. Most ironically, an unmonitored submission might even provide an ‘alibi’ for a mis-intentioned AIFM

When it comes to the monitoring of both market and operational risk, the authorities should look upon investors as allies. However, this means listening, and responding, to their needs.

Fourth key benefit: eventual coherence and effectiveness of policy responses

There wouldn't be much point in the authorities collecting such data if there wasn't the possibility of their one day acting on it. At that time, it will be absolutely essential that the world's providers of risk capital have faith that the correct information has been collected and interpreted. Anything short of this will lead to an exodus of risk capital that will substantially magnify the kind of crisis that such data collection was intended to help mitigate. This could prove to be a deeply painful example of unintended consequences.

By definition, paying very close attention to the concern of investors now is the only way to prevent those very same concerns coming back to materially jeopardize the effectiveness of future policy responses.

Fifth key benefit: minimizing cost

Proliferating and diverging regulatory reporting requirements can only translate into costs. If they meant safer financial markets and a safer industry then these might be costs worth paying. However, for the reasons outlined above, we consider the exact opposite to be true.

More positively, there is a very real possibility that the authorities can serve as a profoundly effective catalyst for a much needed rationalization of how AIFM communicate their market risk exposure to their investors. In time, this could actually reduce costs for the industry. There is already substantial industry-based momentum behind the Open Protocol initiative. Whether it be the ‘unison’ or ‘harmony’ solutions referred to above, any overlap of methodologies with regulatory initiatives would ensure that The Open Protocol moves to the top of the AIFM to do list.

The Open Protocol: Summary

Provenance

The Open Protocol, as the name suggests, is completely open and has zero commercial agenda. Nobody owns the copyright of the protocol and is freely available for download from the website (www.theopenprotocol.org). The protocol was developed by the working group after several meetings and lengthy discussions. Industry bodies and regulators were invited to observe all the discussions with a view to ensure that the protocol is unbiased, objective and independent. The Working group also held a 6 week public consultation exercise which helped to make the protocol inclusive and promote awareness.

The Open Protocol is basically a taxonomy or language; it is not a data hub or utility. It looks to define consistent practices, not best practices and where available it incorporates existing standards and protocols.

Working Group

The Open Protocol was developed by an independent working group of 16 members representing different participants in the AI industry. Members included:

Investors:	BT Pension Scheme Management Limited Investcorp Investment Advisers Ltd Utah Retirement Systems Weyerhaeuser Asset Management LLC
AIFM:	Brevan Howard Lansdowne Partners Limited Och-Ziff Capital Management Group LLC The D.E. Shaw Group
Investment Banks:	Credit Suisse Group AG Goldman Sachs Group Inc. Morgan Stanley UBS AG
Administrators	CITCO International Fund Services - a State Street Company
Consultant	Albourne Partners (Co Chair)
Media	Thomson Reuters (Co Chair).

Component Parts

The Open Protocol comprises 3 documents.

- 1) **Template:** The Open Protocol is based on a holistic approach to understanding risk. The greatest risk in "risk" comes from assigning too much significance to any one measure of it. Therefore the template provides an exhaustive list of all the information that an AIFM should provide in Human eye friendly format.



The level of granularity of the information can be controlled by the managers by using the pre defined “Grade System”. There are three grade levels.

- 2) **Manual:** Defines the methodology for calculating various metrics in the template. It provides the details which are essential to ensure consistent reporting and covers all the grades. The working group has always strived to define the most objective method with a view to creating an unbiased output.
- 3) **XML schema:** Standard electronic template which can be easily read and analysed by a computer. It would help in seamless transmission of information and avoid manual entry errors.

Investor Support

The following major institutional investors have allowed us to reference their general support of the Open Protocol initiative and its associated efforts to harmonize and influence regulatory reporting around the world

- New Zealand Superannuation Fund
- Alcatel-Lucent
- Atlantic Trust Company
- British Airways Pension Investment Management Ltd
- Canadian Medical Protective Association
- Carleton College
- Cargill Inc. and Associated Companies Master Pension Trust (including Foundation)
- Georgia Tech Foundation, Inc.
- Oxford University Endowment
- Rice University
- Stanhope Pension Trust Limited
- Telstra Super Pty Ltd
- University of Pittsburgh
- University of Southern California
- University of Toronto Asset Management
- Utah Retirement System
- Virginia Tech Foundation
- Weyerhaeuser Asset Management
- Coal Pension Trustee Investment

Attachments:

1. Open Protocol Manual I (PDF)
2. Open Protocol Template I (Excel)
3. Open Protocol Schema I (XML)