AIMA Journal - Edition 113

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CEO Blog

By Jack Inglis, CEO at AIMA

Jack Inglis

2017 was another active and exciting year for AIMA. Last year, which marked the 20th anniversary of our first DDQ, we updated and revamped the DDQ into a more user-friendly, modular feature. We've published our cybersecurity guide and our research team have published reports on small managers, CTAs and our third annual Financing the Economy paper that delves into the private debt market. The release of the Paradise Papers meant our updated offshore guide 'Transparent, Sophisticated, Tax Neutral: The truth about offshore alternative investment funds' - was particularly useful.

Last year also marked another year of continued growth for AIMA. We now represent members across 61 countries, who manage $2 trillion of assets under management. It was a positive year for the industry too, with 2017 representing the best year for managers since 2013, according to HFR, with returns up 8.5%. In particular, equities funds within the industry returned 13.2% for investors, the best performance in four years.

And 2018 has already kicked off with the much anticipated, if not equally dreaded, MiFID2 regulation coming into effect on January 3. Whilst there hasn't been any noticeable fallout thanks to a lot of late nights, there have been a few hiccups. This has been one of the greatest challenges the industry has had to face and for some, there's still some work to be done so our MiFID2 group will now continue its work into 2018 as we support our members to iron out any residual issues around the new regulation. In fact, we recently welcomed AIMA's MiFID2 group to our offices to thank them for their efforts and continued work and there was certainly a sigh of relief and joy.

At the end of this month, we will publish our GDPR Implementation Guide, to help members comply with new data privacy laws that come into force May 25. It's yet another regulation the industry has to cope with and I know from members how taxing and costly complying with existing and new

regulation can be. Still, to help members we have created this guide that summarises the GDPR framework, how it may impact alternative investment managers and provided a check-list of actions firms should complete.

One thing for sure is that the industry will continue to invest in innovation and developing new strategies. There's continued effort to create further initiatives that promote the alignment of interests with investors. These are some of the initial thoughts that have come out of our discussions with industry leaders for our View from the Top paper. The paper, which will be published at the end of the first quarter, will look at how key leaders see the industry developing, as well the opportunities and challenges ahead.

This year we have expanded our US office with a new hire and Michelle Noyes has been promoted to Head of Americas and takes on responsibility for AIMA activity across the US, Canada, Cayman and South America. AIMA is also hiring in Brussels, to staff our joint office with German alternatives trade association BAI. This will not only support our existing work but also help us better safeguard our

members' interests as Brexit negotiations continue. Following the formal setup of the Alternative Credit Council last year, we are now extending our efforts in the APAC region with the creation of a local steering group.

Our annual Global Policy and Regulatory Forum will be in Dublin on 20th March 2018. Main themes will be Brexit, the senior managers' regime and the use of technology with regards to both compliance and supervision. I do hope to see you there.

Hong Kong will host our APAC forum on 1st March, whilst our Australia and Canada forums are set for 12th September and 30th October respectively. These are heavily investor-focused with strong attendance from allocators, so are well worth a visit. As part of our plans, we will facilitate further opportunities for investors to engage with our membership and become members themselves.

As always, I wish you a prosperous 2018. The AIMA team and I look forward to working with you in the year ahead.

Understanding cybersecurity and operational risks of cryptocurrency

By Jay Schulman, Principal; Todd Briggs, Partner; Stan Kot, Partner; Rob Farling, Director at RSM

Todd Briggs

Jay Schulman

Rob Farling

The regulatory environment and the operational and security risks are vitally important when investing in cryptocurrencies

While the price fluctuation for bitcoin, a type of cryptocrrency, garnered significant public interest in 2017, many fundamental questions remain on this subject. Questions such as: What are cryptocurrencies? Why are they so popular? And what are the key risks and challenges of investing in them right now?

What are cryptocurrencies?

Cryptocurrencies are a new asset class that allows one user to transfer a “coin” to another using blockchain technology, which in turn uses both encryption and open distributed ledger technology to facilitate the process. There are more than 1,300 cryptocurrencies currently available; the best known is bitcoin. While these cryptocurrencies are built on the same blockchain protocols, they are not all alike. While Bitcoin is often compared to gold, Ethereum allows for smart contracts. Monero is built on highly anonymized transactions and Civic is designed to provide government identity data.

Cryptocurrencies are becoming increasingly popular with investors as they are highly volatile and in some cases appreciate or depreciate rapidly. For instance, in at the beginning of 2017, bitcoin was trading at about $850 (USD). It then reached an all-time high at almost $20,000 (USD) in the middle of December 2017 and settled at over $13,000 (USD) at year-end.

Most currencies have a limited supply, which is one of the reasons the price has appreciated rapidly.

While a detailed explanation of how blockchain technology works is outside of the scope of this article; the underlying principles include a distributed database that is available to all parties and is not controlled by a single party; peer-to-peer communication instead of information being held

Stan Kot

by a central party; transaction transparency, where transactions that occur in the database are visible to all; and immutability, transactions that are added to the blockchain cannot be altered.

When a cryptocurrency transactions is executed via blockchain technology, the transaction of sending a coin from one person to another is placed in a virtual "block," and that block is then broadcast to participating parties ("miners") on a blockchain network. Miners are paid a reward (akin to a commission) to ensure that the transactions are valid. Once the transactions are validated, the block is added to the "chain," providing a transparent record of the transaction. A transaction is typically completed in 10 to 15 minutes. In this sense, it is more comparable to a banking transaction than a credit card transaction, which takes place in seconds.

A large, complex cryptocurrency ecosystem has erupted, consisting of currencies, exchanges for trading, financial and legal advisors, venture capitalists and hedge funds, market-makers and market researchers, and offline methods for storing the currencies known as "cold storage."

Regulatory status

Bitcoin was designed, and other cryptocurrencies followed, around the idea of an ecosystem where no one entity is in charge. Changing functions in Bitcoin requires consensus among miners to agree rather than a monetary authority to make policy.

Therefore, many would say that these currencies can't be regulated. Certainly, governments try. The most common regulation in this space is entering and existing the marketplace – converting fiat currency (dollars, pounds, euros) to cryptocurrency. Additionally in selling new coins, called Initial Coin Offerings, regulatory authorities can apply standard securities law. For example, throughout 2017 the U.S. Securities and Exchange Commission (SEC) issued various investor alerts, bulletins and a statement on cryptocurrencies and ICOs. Together these documents cement the SEC's intent on applying US federal security laws to cryptocurrency transactions. We expect other international regulatory agencies to follow.

Interestingly, one of the contributing reasons for rapid price fluctuations in this space result from the changes in regulations throughout the world that impact investor's ability to buy and sell cryptocurrencies.

Operational security

With respect to operational security, there are several important issues to consider. First is the immutability factor: transactions in the cryptocurrency space are final and cannot be reversed.

- For example, if you transfer coins to the wrong account, or "wallet," they are gone—you cannot get them back

- If you are running a trading operation and an unscrupulous trader moves coins into his own wallet and not the corporate wallet, there is little you can do to get them back
- If an exchange that you are trading on gets hacked or you lose your username/password, your coins are lost
- If you are storing your coins on a laptop and a hacker breaks in and steals them, they are gone as well

For all these reasons, security in this space is extremely important. Therefore, you must balance the currencies you keep on an exchange, on your local computers and in cold storage.

We suggest investors' consider keeping coins offline, in cold storage especially if you are a buy-and-hold trader. Cold storage typically uses a USB key-like device to store the private keys which allow you to send currency. More active traders, that do not want to miss out on opportunities by keeping their coins in cold storage, must take the necessary precautions.

Webcast

Accounting issues

Just as with regulations, there are few established accounting guidelines for cryptocurrencies. Many regulatory bodies have yet to define what a cryptocurrency is. Is it a financial instrument? Cash equivalent? Intangible asset?

Regarding ICOs, there are questions about how issuers and recipients should treat these transactions for accounting purposes. Are they issuing equity in a company or should it have liability treatment? Or is it a prepaid asset or intangible asset to the recipient and deferred revenue for the issuer? There are no definitive answers yet.

Anti-money laundering issues

Because of its anonymous or pseudonymous nature, cryptocurrencies are a natural place for criminals to launder money. Following local Know Your Customer laws are critical to making sure that your organization isn't facilitating criminal activity. While any transaction can be used to launder money, transactions where a cryptocurrency is used as the source of funds or capital is often a higher risk transaction. Determining how or where a person received their cryptocurrency is much more difficult than with a fiat currency.

Final thoughts

Just as with any new and disruptive technology, the ecosystem around cryptocurrencies is evolving fast. If this is an asset class that your organization is interested in investing in, you shouldn't only be drawn by the appreciation and volatility.

Understanding how these currencies work, what is their purpose and how the ecosystem works around it is important before making an investment.

We will likely see more exchanges fail, currencies collapse and people lose money. That said, this is also still a very big market. We will also see exchanges flourish, currencies appreciate and investors gain.

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Responsible investment in a changing world

By Steven Desmyter, Head of Responsible Investment and Chair of the Responsible Investment Committee at Man Group

Steven Desmyter

Introduction

In recent years, the concept of responsible investment ('RI') has started to gain traction across our industry. But as markets continue to transform – driven by shifting regulation, technological development and the changing needs of institutional investors – how should we think about building responsible strategies for the long term? Institutional investors are increasingly asking this question, faced with a tough challenge in de-coding a varying set of responses from the asset management community. Indeed, despite progress in recent years, there remains little consensus about what responsible investment really means, or what it will take to ensure that these principles remain in focus through time.

This article sets out three elements which we believe are important in responsible investment. First, responsibility around environmental, social and governance ('ESG') factors must be integrated into mainstream investment processes, rather than used to create niche 'ESG-labeled' products. Second, we believe asset managers must be prepared to work flexibly with clients to determine the best ways of implementing RI – in everything from strategy design to the investment process itself. Third, and most important in our view, our industry must reconcile RI considerations with our broader responsibilities to investors – and in doing so, make the case for responsible investment in the context of performance, and even as a potential source of alpha. We believe that these principles can help support the case for responsible investment over the long term, and guide our industry's approach along the way.

RI must be embedded into mainstream investment – niche products hamstring broader progress

In discussions about RI, some commentators point to products and strategies which are explicitly labeled as ESG-focused. The spread of these products might initially seem a positive indicator of progress towards responsibility in the investment industry, but in reality it is more complicated. At worst, it's clear that some of these products are simply marketing gimmicks – exploiting investor interest while maintaining only a casual commitment to RI. Consider the proliferation of fashionable 'clean tech' funds during the financial crisis, for example, several of which later blew up. But at best, these explicitly ESG-focused strategies fail to influence the bigger picture – creating a niche experience for a narrow circle of investors, and limiting the reach of responsible investment principles more broadly. We believe that true progress in responsible investment means adopting these principles across mainstream strategies – so that RI becomes the norm, rather than the exception.

Working flexibly to incorporate RI – from strategy design to the investment process

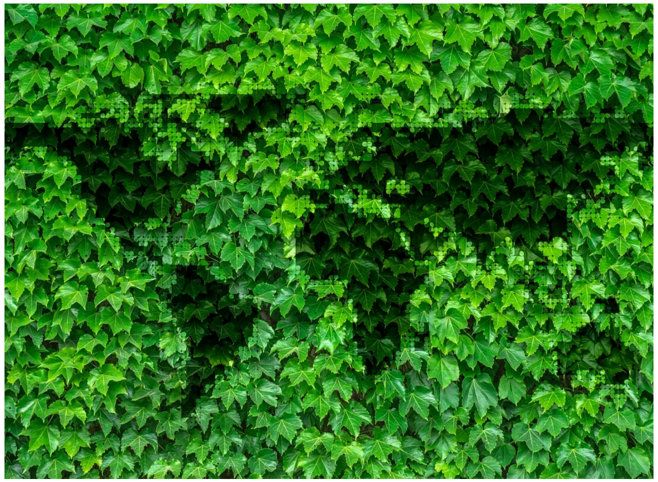
Of course, integrating RI norms across mainstream investment strategies is no easy task – especially given the variance in client perspectives. Real integration requires a high degree of flexibility, not just in terms of how portfolio managers analyse their exposures, but also in how clients access strategies. For example, managed account structures have often been seen as a short-cut for investors to monitor and apply ESG criteria to existing strategies which may not normally incorporate them. This may be the right choice for some investors – but it's unambitious, implicitly accepting that the strategies themselves are not capable of adopting RI themselves. At Man Group, we're working increasingly with clients and investment teams to understand the impact of RI principles on commingled vehicles. In some cases, we are finding that existing strategies can adopt further RI principles without impacting their investment mandate or potential outcome – so we work with fund directors to agree and implement them.

It also takes flexibility to incorporate these norms into the investment process itself, where different strategies will require different approaches. For example, using negative screens to exclude certain exposures, or integrating more comprehensive ESG data within financial analysis, or engaging more actively with underlying companies, or a combination of these – the nature of each investment strategy will determine the best approach. There is no 'correct' way of doing this, but we believe what unites each of them is the need for good data. This can take many forms, and there are already a number of providers working to support investment managers in understanding the non-financial risks around companies. However, there is clearly room for improvement in the transparency of companies on metrics around responsibility, and regulators will have an important role to play over the coming years.

Reconciling RI with fiduciary duty

One of the most common concerns about

incorporating RI principles into investment is its potential impact on performance. After all, investment managers have a fiduciary duty to act in the interests of all clients, in line with their mandated risk and return parameters. Some investors may assume that RI simply restricts a strategy's investable universe, inevitably weakening performance through time and undermining this duty. However, responsible investment is about much more than simply excluding parts of the market – it can also involve looking for 'virtue-signaling', positive characteristics with the potential to support long-term company performance. Research remains in its early stages about the



alpha-generative potential of RI, but we believe that in the coming years, the investment industry will increasingly look towards non-financial factors as a source of potential opportunity, and an additional lens for risk management. Growing amounts of data are helping to make the case for RI as a potential contribution to performance – and bringing a wider and more diverse set of people into the conversation – but beyond this, we believe it is no longer enough to assume that end investors (pension scheme members, for example) are blind to the issues of responsibility and the ethical footprint of their investment mandates. Indeed, we believe that the scope of fiduciary duty in investment is broadening, with many asset owners viewing commitment to RI as an important component.

Moving towards a fully integrated approach to RI

The investment industry still has a way to go in codifying its approach to RI – and we are beginning to see some formalised work here, for example in the industry-standard DDQ published by the UN-supported Principles for Responsible Investment earlier this year. Ultimately, we believe that these issues can be considered as part of every investment strategy – albeit applied in different ways.

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US/GL/R/W

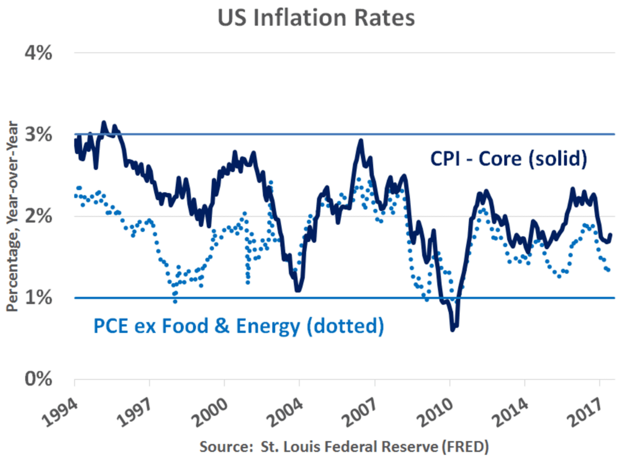
US Rates 2018: All eyes on inflation

By Blu Putnam, Chief Economist and Managing Director, CME Group

Blu Putnam

The big decision for the US Federal Reserve (Fed) in 2018 will be how much to raise short-term rates. With unemployment at low levels, the interest rate decision will more than likely hang on the views of the Federal Open Market Committee (FOMC) members on the future path of inflation, at least in terms of the rhetoric coming from the Fed. US Core inflation has bounced between 1% and 3% since 1994 – 23 years and counting – a very narrow range centered on 2% despite the ups and downs of short-term interest rates and some spectacular bull and bear stock market runs. Currently, the core inflation rate (excludes food and energy) is just under 2%, and even a little lower for the Fed's favorite indicator – the core Personal Consumption Expenditure (PCE) price deflator.

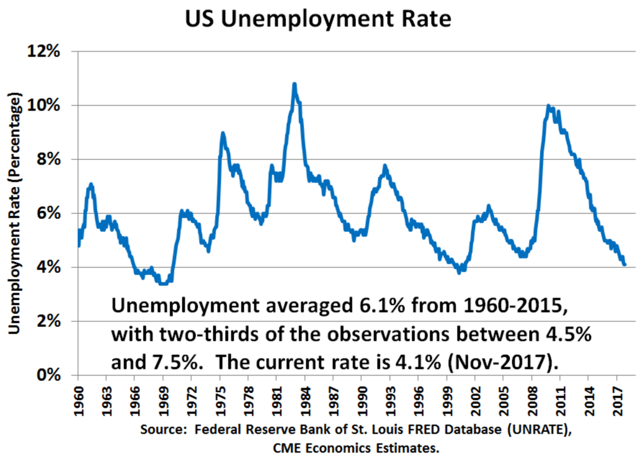
Figure 1



What has mystified many analysts is how the core inflation rate could remain so subdued in the face of exceptionally low unemployment and massive monetary policy accommodation. Essentially, there are two camps, and both have missed their inflation forecasts.

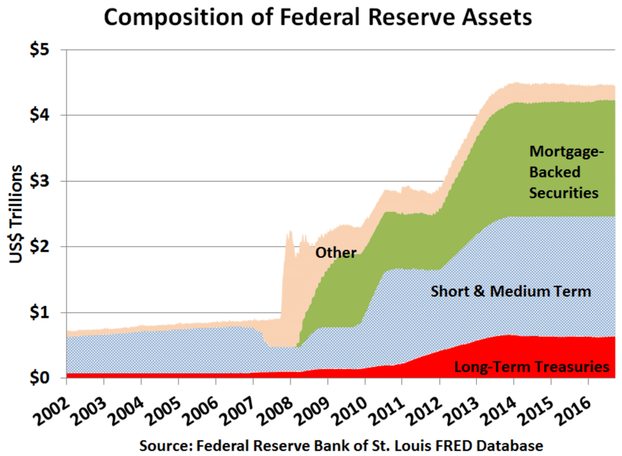
One camp, exemplified by current Fed Chair Janet Yellen, typically forecasts inflation based on labor market conditions. Their view is that tight labor market conditions beget wage inflation which increases consumption demand and leads to more consumer price inflation. This has not happened, at least not yet.

Figure 2



The second camp is represented by more traditional monetarist economists, and they are also mystified about why there has been no pickup in inflation pressures. The traditional monetarists are holding tight to the view, almost a religion amongst many in this camp, that after nine years of negative real short-term rates (i.e., the federal funds rate held below the inflation rate) and massive asset purchases (i.e., Quantitative Easing or QE), that sooner or later the inflation rate will move materially higher, blowing through 2% and heading to 3% and above. This has not happened, at least not yet.

Figure 3



The policy prescriptions from these two camps are different. The "labor markets predict inflation" camp wants to raise the federal funds target range only to what they call a "neutral" monetary policy. "Neutral" is defined by the current and out-going Fed Chair, Janet Yellen, as a range for the federal funds rate that encompasses the persistent core inflation trend, which is currently about 1.75%. This means taking the real or inflation-adjusted federal funds rate to zero from its current negative position. The "neutral" view of monetary policy means only a few more rate hikes in 2018, and then the Fed would go on hold awaiting the inflation data to tell it what to do next.

The policy prescription from the monetarist camp is to get ahead of the coming inflation pressures, even if they have not yet been observed in current or historical data. As exemplified by Fed Governor nominee Marvin Goodfriend, the Fed was too easy for too long and it is past time to move the federal funds rate range to a position modestly above the 2% long-term core inflation target. This is a more hawkish view on rate rises.

While these two camps are focused on inflation, there is another concern – rising debt. Public and private debt is at record levels. There is no doubt that debt powers an economy. Yet, economists are not at all sure at what levels there is too much debt. During the 1980s of the Reagan Administration, the national debt went from around 30% of GDP to over 50% of GDP as taxes were cut and the anticipated revenue increases never arrived. As 2018 commences, the national debt is already over 100% of GDP, and private debt, from housing, autos, and student loans is at all-time records. So, we do not know where the tipping for too much debt is, we just know we are much closer to that tipping point than ever before.

What excessive debt loads do to an economy is to make it much more fragile and sensitive to interest rate increases. After all, higher interest rates mean higher debt service payments, which will take away from consumption expenditures and business investment. So, the "debt" camp worries that raising interest rates in an economy with excessive debt should be done only very cautiously.

The bottom line for Fed interest rate policy in 2018 is that there is likely to be a vigorous debate within the FOMC about future policy. Current Fed Cahir Janet Yellen will not be there to lead the "labor" camp. The new Fed Chair, Jerome Powell, is not an economist, so not tied to either of the "economic" camps. Powel is more of a consensus builder,

although with strong ties to the private equity community and a deep appreciation of the role of debt in the economy.

There are several more Board of Governors seats left to be filled, including that of the vice-chair. As these nominations are made, the character of the FOMC may shift away from economics and toward practical business concerns – meaning high debt loads, but we have to wait and see.

So far, our focus has been on the thinking inside the FOMC that makes the interest rate decisions. But even with Janet Yellen giving up the gavel, the Fed is still going to be heavily data dependent. So, on what economic data should market participants focus? Is it time to watch the inflation data as closely as the employment situation report?

The case for market participants to focus more on inflation data is clear. The unemployment rate is very low and the Fed can check this achievement off its bucket list. Still, the Fed has failed to encourage inflation even with years of extraordinary and unconventional monetary policy. Thus, as future policy becomes more and more dependent on the path of inflation, it makes sense that market participants might focus more inflation data than on the employment data.

There are several challenges to suggest that the inflation data releases will not rival the employment data in importance to market participants, even when the Fed's focus is increasingly on inflation.

First, and as we have already discussed, some FOMC members have a history of looking first at the employment data and then revising perceptions of future inflation based on the tightness (or not) in the labor markets. So, even when the Fed is talking about inflation, many FOMC members are still looking first at the employment data for clues about future inflation.

Then, there is another challenge with inflation data. The Fed's favorite measure of inflation is the core Personal Consumption Expenditure (PCE) price deflator, and that index is released towards the month's end. The headline inflation data, the consumer price index (CPI) is released in mid-month. And, FOMC members often look to hourly wage growth as a precursor to inflation, and that is released with the employment data on the first Friday of each month. The bottom line is that since there are multiple ways of looking at inflation, no one indicator has grabbed the markets attention the way the employment data does, and this is not likely to change.

Which takes us to our last point – namely, what metric do we recommend watching most closely.

The answer is the shape of the yield curve, and not because of inflation concerns, but as the best indicator of future market volatility and probabilities of a recession down the road. Rightly or wrongly, our view remains that Fed really cares much more about the economy than inflation in this environment, and that any shift in economic growth will drive rates. Higher than expected economic growth will lead to faster rate rises, lower than expected economic growth will make for a cautious Fed, and a recession would trigger quick rate cuts.

So, we pay close attention to the spread between the 30-day US Treasury bill rate and the 30-year US Treasury bond yield. When the yield curve has a positive shape – that is, the 30-day rate is well below the 30-year yield, we are not inclined worry about a future recession. As the yield curve flattens, we increasingly expect more equity and bond market volatility and we also start to worry about a recession 12- 24 months down the road.

Finally, we note the obvious, but worth emphasizing. While the Fed controls the short-term federal funds rate, absent QE, the market determines the long-term bond yield. If there is a parallel shift in bond yields upward as the Fed raises short-term rates, the bond market is largely in line with the Fed's thinking and the rate rises are likely to be benign in terms of future economic growth. If the Fed raises short-term rates and long-term bond yields remain stable or even decline – well, then we go on high alert for the potential for economic weakness 12-24 months in the future.

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Disclaimer

Regulatory and investment tax law changes create opportunities for marketing funds to the German institutional market

By Joachim Kayser, Partner at Dechert

Joachim Kayser

Germany is the largest inbound market for alternative and traditional fund investments by institutional investors in the European Union. German insurers, pension funds, pension schemes (Versorgungswerke), corporate investors and family offices are all seeking attractive yields in the current low interest rate environment.

Obstacles to investment by German institutional investors in non-German funds had been created in the past by provisions of German investment tax law and insurance regulatory law. With respect to the latter, German insurers until recently were permitted to purchase only certain assets that met specific eligibility criteria and which could be allocated from certain quota (e.g., a "private equity quota" limited to 15% of total invested assets). From an investment tax perspective, German investors in foreign non-tax transparent funds have to date been subject to a punitive lump-sum taxation; however, a new tax regime will come into force in 2018.

The conditions for investments by German institutional investors have improved significantly, due to: (i) the entry into force (in 2016) of the European Solvency II regime for insurers; and (ii) the upcoming implementation of the German Investment Tax Reform Act (New GITA) with effect from January 1, 2018.

Solvency II - "Look-through" to funds' underlying assets creates broader investment universe for EU insurance investors

As an EU directive, Solvency II generally governs the assets of all insurance companies based in the EU.

Under this regime – roughly comparable to the banking regulation of Basel/CRD IV – insurers are principally free to invest in all types of assets, but need to comply with certain risk management provisions and Solvency Capital Requirements (SCR), based upon predetermined risk classifications and specifics of the relevant assets. The vast majority of EU insurers apply a standard model to calculate the SCR, according to parameters set forth in the Solvency II regulations; only a number of (generally larger) insurance companies provide for an internal calculation model, which must first be approved by the competent national regulatory authority.

A basic principle of Solvency II regarding funds/collective investment undertakings is the "look-through" approach, whereby a risk analysis of a fund is performed by looking through the fund to its underlying assets. The assets held by the fund are classified and allocated to sub-risk modules (e.g., equity risk, spread risk, interest rate risk, property risk) of the market risk module. Based on this classification, the SCR figures are calculated for each asset.

To facilitate this look-through analysis of a fund's assets, insurance investors generally expect the fund manager to provide for periodic, granular, "Solvency II Reporting" – in fact, this is often a prerequisite for an investment. However, fund managers frequently outsource the Solvency II Reporting to specialized service providers (often, the fund's administrator, especially in cases of plain vanilla "long-only" securities funds). However, more complex (e.g., illiquid, private debt or derivative) alternative funds often first require "asset classification" of their underlying investments, in order to enable a proper look-through and ongoing reporting afterwards. Dechert has a team of lawyers able to assist with SCR calculations and Solvency II Reporting.

The look-through and asset qualification is important for the proper calculation of SCR for alternative funds (e.g., debt funds, private equity, infrastructure, hedge funds), traditional funds (e.g., bond funds, listed equity funds) and exchange-traded funds (ETFs).

An asset qualification and subsequent allocation to the relevant sub-risk modules can lead to substantially different SCR figures for different asset categories. Often a proper look-through may lead to significantly lower SCR charges at the investor level (e.g., if a recognised hedging strategy under Solvency II rules is applied or if collateral for a derivative strategy may be taken into account). As an example in the ETF context, the SCR may differ substantially, depending on the method of index

replication (physical or synthetic) and the specific assets held.

The new Solvency II regime generally allows for a much broader investment universe for EU-based insurance companies than was previously the case. However, in order to take advantage of the enhanced distribution opportunities, asset managers need to be able to deliver proper look-through asset classification as well as ongoing Solvency II reporting services.

Reform of German investment tax law - good news for asset managers and German investors

Key provisions

With effect from January 2018, a new German investment tax law will come into force, pursuant to which (among other provisions):

The current (punitive) lump-sum taxation for German investors in non-tax transparent funds will be abolished.
There generally will no longer be a requirement that investment funds subject to the New GITA file an annual German tax return.
Specific partial tax exemptions will be afforded to German taxable investors in investment funds that qualify as so-called Aktienfonds (equity funds); Mischfonds (mixed funds) and Immobilienfonds (real estate funds). These types of funds are described in more detail below.

Categories of covered investment funds

The New GITA applies to all Investmentfonds (investment funds). In general, these funds may be organized in either corporate form (e.g., Irish PLC or ICAV, Luxembourg S.A.) or contractual form (e.g., Luxembourg FCP, Irish unit trust). However, partnership structures cannot qualify as Investmentfonds and will continue to fall under the ordinary income taxation rules.

An Aktienfonds is an investment fund that, according to its contractual terms (Anlagebedingungen), on an ongoing basis invests at least 51% of its value in Kapitalbeteiligungen (generally, equity participations in corporations that are either: listed; or subject to certain minimum taxation of earnings in the country where domiciled). A Mischfonds is an investment fund that, according to its contractual terms, on an ongoing basis invests at least 25% of its value in Kapitalbeteiligungen.An Immobilienfonds is an investment fund that, according to its contractual terms, invests at least 51% of its value in real estate and qualifying real estate companies (Immobiliengesellschaften).

It is important to note that, based on a draft circular of the German Ministry of Finance (BMF), it is possible to set forth, in a legally binding side letter, the investment quota required to qualify as one of the types of funds described above.

Tax treatment

Fund-level

Investment funds are generally treated as non-transparent corporations, which are subject to a reduced flat rate tax on specific German-sourced income (primarily German dividends and German real estate income).

Investor-level

For German taxable investors, distributions received from the fund, as well as gains resulting from the redemption/disposal of fund units, are subject to tax. The former punitive taxation for income received from non-transparent funds is abolished.

With respect to accumulated income, a certain minimum amount (so-called Vorabpauschale), calculated according to a specific formula is, on an annual basis, subject to tax at the investor level. However, this minimum tax applies only if a fund`s distributions in the relevant year are lower than the amount of the Vorabpauschale calculated.

A key benefit for German taxable investors is that the New GITA will introduce significant additional reductions of the investor`s tax base in Aktienfonds, Mischfonds and Immobilienfonds, depending on the fund category and type of investor.

Outlook

Managers have greatly increased chances to attract investments of German – and generally EU – insurers, if they can offer a “Solvency II solution” – including a proper asset classification and granular Solvency II Reporting, a competitive SCR, and an attractive economic yield for the relevant asset class.

From an investment tax perspective, we anticipate that it will be much easier for foreign fund managers to approach German investors, as the new regime: will not impose a punitive lump-sum taxation on non-transparent funds; will implement a simplified tax system for investment funds (without the necessity to file a German tax return); and will create beneficial tax treatment for certain types of funds.

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MiFID2: The journey began on January 3rd

By Mark Croxon, Head of Regulatory and Market Structure Strategy, EMEA at Bloomberg LP

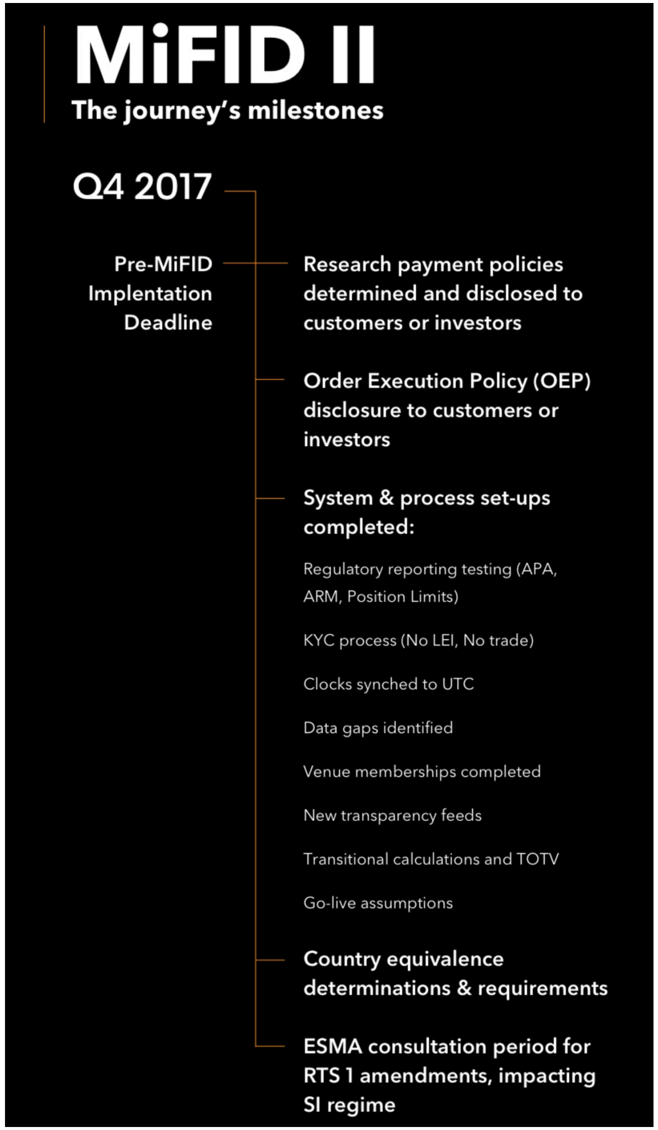
Mark Croxon

By the time this article will be published, MiFID2 will have gone into effect. While most EU and non-EU firms were naturally focused on getting ready to go live, some realized they needed to look beyond 3 January 2018 as well. MiFID2 doesn't occur all at once - regulatory reporting and compliance dates are layered throughout the year.

It is going to be a (long) journey with a lot of twists and turns, new guidance, evolving standards and realizations that people, process and technology may need to be rethought, and perhaps revamped to ensure robustness and data integrity. As Steven Maijoor expressed in Bloomberg Markets magazine: "Once MiFID2 starts, we'll monitor how it is implemented. On a daily basis we'll get Q&As from stakeholders and from national regulators, and on that basis we'll adjust guidelines - as we already are."

To help firms visualize what a MiFID2 calendar may look like for the coming months and year, we have created a chart. This highlights moments at which key information may be provided by the regulators, such as third country equivalence determinations and requirements, expected initial best practice comments or guidance from the National Competent Authorities (NCAs) in Q1, and the release of data for SI determination in August 2018.

In addition, we've noted the checkpoints firms will need to respect with regards to the best execution reporting requirements in RTS 27 and 28, and the research budgeting and valuation obligations for firms who chose to remunerate research providers through RPAs. Some of these "events", such as transaction-trade reporting reconciliations, are not hard-wired into the rules but more a question of interpretation. Firms should consider them as potential best practice suggestions.



Best practices

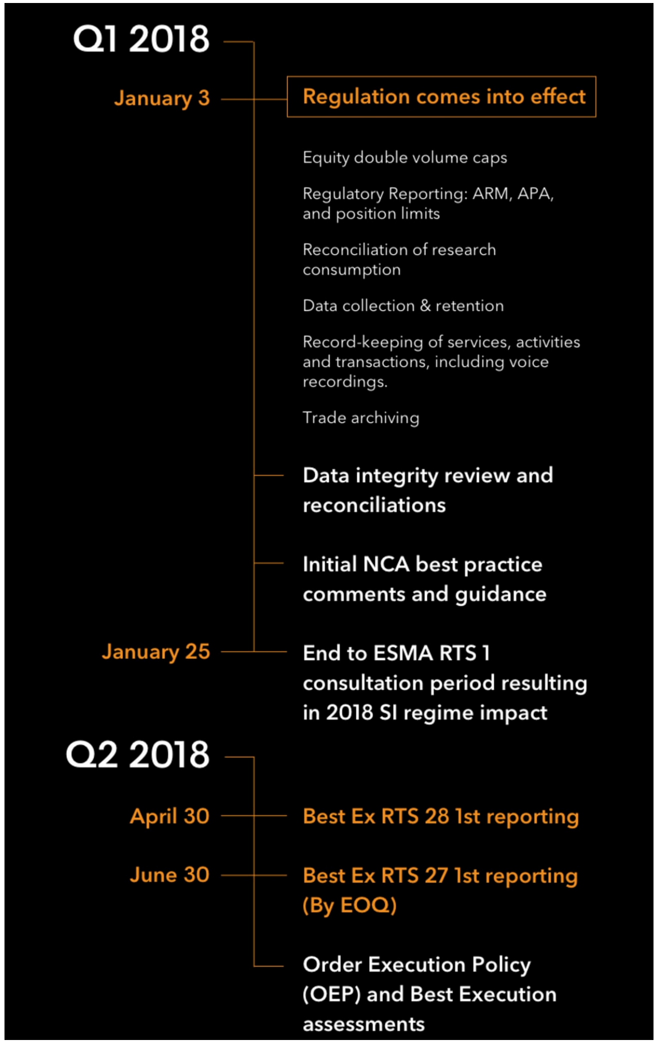
For example, we believe firms should consider performing data integrity exercises during Q1. The main focus in January will be on the three regulatory reporting mandates. In order for national competent authorities to fulfil their statutory investor protection and market abuse prevention obligations, they need accurate information from the transparency reporting (APA), transaction reporting (ARM) and commodity position limit reports. At a basic level this may mean looking at the different data through the post-trade workflows. Broadly speaking, the data used in trade reporting should be the same as the one contained in the transaction reports, used in best execution analysis and stored in immutable format. Is there integrity in the process when a trade is corrected?

From the outset, firms may seek to confirm that transaction reports (and other records) are stored in immutable format. They may choose to reconcile investment generation and execution workflows to their transaction reports and NCA acknowledgement status, to identify potential instances of under and inaccurate reporting. They may also want to consider using their ARM reports to identify instances where they should have submitted a corresponding real-time APA trade report. And, they should verify they are accurately recording time stamps and order and trade execution information for RTS 28 best execution reports that have to be produced in April (and quarterly thereafter).

Speeches from regulators including comments on how systems and the industry are performing, as well as observations of good practice typically accompany regulatory milestones. We should expect these type of "soft guidance" events to be sprinkled throughout January.

Milestones in 2018

For best execution requirements, the UK regulator has indicated that under the MiFID2 regime, an order execution policy (OEP) and a feedback loop are required in order to continually improve execution practices. Due to the wide-ranging market structure changes for equities, bonds and derivatives, firms may want to look at their order



and execution data in February to preliminarily determine if recalibration of trading protocols, strategies, and, if applicable, execution algorithms, is needed.

However, firms may wish to wait until April, when venues and systematic internalisers release their first RTS 27 best execution reports (quarterly thereafter), or June to conduct a more robust analysis. There may simply not be enough statistically significant data to identify trends and make data-driven changes to the order execution process until then.

In early Q2, but potentially near the end of Q1, ESMA is expected to post the first recalibration of bonds and continue to do so quarterly thereon. ESMA will also start to collect trade and volume data from venues in order to create the "official set" of denominators for systematic internaliser determination. In August, ESMA is expected to release their official set of denominators so that firms can determine their status by September.

In Q4, firms will most likely begin business planning for 2019. Although it is mandatory for those who chose to remunerate research providers through RPAs, firms that pay for research out of their P&L will most likely evaluate and set budgets for research to make sure that the value to the fund was commensurate with the cost. Also in Q4, potentially in November but possibly sooner, firms remunerating research through RPAs may start to provide notice for approval from their investors.

December 2018 may also be a busy month. In addition to RTS 27 and 28 best execution reports and evaluation of the best execution data to determine if adjustments need to be made to order execution policies for the coming year, the next leg of transaction (ARM) reporting - securities financing trade reporting (SFTR) - is set to begin.

And, of course, during 2018, we might also have to contend with potential differing member state approaches, the ebb-and-flow of the UK withdrawal from the EU, and a possible application of MiFID2 to collective portfolio management.

For further information, please contact: bbg_mifid@bloomberg.net

Q3 2018

- Systematic Internalisers (SI) report data to ESMA
- August 1 — ESMA releases SI denominators for SI determination
- September 1 — Deadline for SI status declaration
- September 30 — Best Ex RTS 27 2nd reporting period (by EOQ)

Q4 2018

- Research valuation and creation of 2019 budget
- OEP and best execution assessments
- Potential: SFTR reporting begins

Q1 2019

- January 3 — Annual costs and charges calculation period ends for disclosure by April 2019 at the latest
- Thematic reviews from regulators
- Impact from UK EU withdrawal

Preparing to disrupt and grow: Optimistic asset managers see challenges on the path to success

By Alfred Fichera, Global Head, Alternative Investments, KPMG in the US

Alfred Fichera

The casual observer could describe the past few years in terms of unprecedented economic, political, social and technological change, and the alternative investment industry globally has had no safe harbor from this tumult.

Asset managers are navigating profound changes regarding their customers and markets, operations and systems, and their regulatory landscape, driving widespread agreement that they need to be agile – to anticipate and react quickly and well to change – and so must disrupt themselves in order to succeed.

These themes resonated in KPMG's 2017 Global CEO Outlook, which surveyed CEOs from the world's most significant businesses. And for this discussion, we focus on the responses of 85 CEOs of asset management firms, to identify their priorities over the next three years. From these data – and insights gleaned from ongoing conversations with industry executives – it's clear fund managers face common challenges to extract opportunities from these unfolding developments.

Optimism amidst disruption

Looking first at the big picture industry view, we see a high level of optimism, since 71 percent of the asset management CEOs say they expect moderate growth for their company in the next three years and 67 percent feel positive regarding the global economy.

This attitude was pervasive across the gamut of asset management firms. Those surveyed represented firms across the range of asset classes and products, with revenues up to over $10 billion, and included managers based in 10 markets, including Australia, China, Europe, the UK and the US. Conversations with emerging and mid-market managers reinforce that they have similar sentiments and strategic imperatives while their anticipated execution tactics rightly vary for firms' unique situations.

"71% of asset managers are confident in their company growth prospects in the next 3 years"

Alert to shifting risks

Although most asset management CEOs exhibit bullishness for the near future, they also voice prudent caution and planning for potential uncertainty over the next 36 months. For instance,

71 percent are now spending more time on scenario planning due to an uncertain geopolitical climate.

As a result, among fund operators surveyed by KPMG, the top industry risks are strategic, regulatory and operational. And in response, they are prioritizing client-related initiatives to improve their speed to market, technology (including disruptive technologies and data-driven capabilities), branding and marketing and strengthening their internal culture.

These findings align with recurring comments from our clients who describe their concerns about meeting evolving customer demands, navigating product polarization, and accelerating regulatory change. Managers are conveying the pressure they feel to attract and retain customers by identifying the critical moments in the customer experience, improving the returns they deliver and creating distinct value for their clients.

This theme is especially relevant to alternative investment managers who see global investors' rising appetite for non-traditional strategies that can deliver enhanced, risk-adjusted returns. The challenge for alternative asset managers is to differentiate themselves with robust operating processes, and greater customization and innovation of product offerings in a way that minimizes costs and enables scale.

In addition, these fund managers describe their unease with the growing regulatory complexity they face, weighing heavily upon their business models, costs and growth plans. Indeed, while regulatory liberalization is unearthing new opportunities for some, many jurisdictions are intensifying their scrutiny of firm conduct, including internal culture, pricing and client disclosure, in addition to governance and risk management practices.

Asset Managers' 3-year top strategic priorities

1. Greater speed to market
2. Implementing disruptive technology

#3 Becoming more data-driven

#3 Stronger marketing, branding and communications

#3 Articulating vision, culture and purpose

Source: 2017 CEO Outlook, KPMG International

Investing for long-term growth

In light of these risks and related priorities, the CEOs articulated a longer-term mindset, with a focus on investing today for growth and transformation. Seventy-five percent of the CEOs say their organizations have successfully balanced long-term growth plans with short-term financial goals. Interestingly, the same percentage indicate they place greater importance on trust, values and culture in order to sustain their long-term growth.

Executives listed their top four investment priorities as improving bottom-line growth, business transformation, increasing productivity, and improving customer engagement.

We see these themes playing out in various forms with our clients who typically are heavily focused on reducing costs and improving efficiency due to rising compliance expenses from new regulations, increased expense to recruit and retain necessary talent, and the significant outlays required to replace legacy systems with next generation technology.

Focus on customer-oriented transformation

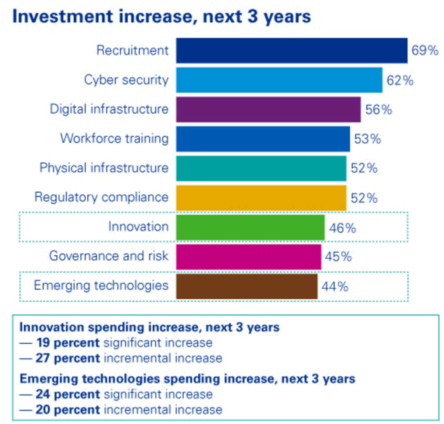
It's important to highlight that asset managers are not solely concentrated on cost reduction and risk mitigation. Fifty-two percent of the responding fund managers say they are pursuing customer-focused transformation as a route to growth, and two-thirds say they have a growing responsibility to represent the best interests of their customers. Our industry is under pressure to attract and retain customers, with firms trying to find some bit of competitive advantage by being able to identify the critical moments that matter to the customer. The funds that get this customer experience right will have great success.

Source: 2017 CEO Outlook, KPMG International

Embracing disruption, but unclear path

With such optimism among asset managers, it's no surprise that the CEOs say they are embracing disruption. In fact, 71 percent say that rather than waiting to be disrupted by competitors, they are actively disrupting their sector. And, 65 percent boldly affirm that they see technological disruption as more of an opportunity than a threat.

That said, the KPMG study found a clear disconnect between stated ambitions and action among asset managers. While 46 percent say they will increase their investment in innovation over the next three years, only 19 percent expect that investment to be significant. Similarly, while 44 percent plan to invest in emerging technology, just 24 percent define that spending as significant. The survey data also showed that actual investments in the past 12 months lagged behind the CEOs' stated investment goals.



Source: 2017 CEO Outlook, KPMG International

Even in the acknowledged, high-risk realm of cyber security, planned investment levels may not be sufficient to address evolving challenges over the next 3 years, since 4 in 10 firms will be making no

new investment in this critical area.

This reticence among CEOs to make tangible new investment may be linked to a variety of factors. When asked what is the single biggest barrier to implementing new technologies, 24 percent state lack of internal skills or knowledge, 22 percent say complexity of implementation, 14 percent cite risk and security concerns, and 13 percent blame legacy systems.

A roadmap to disrupt and grow

It's evident that while asset managers are attuned to the wall of new customer-, technology- and regulatory-related hurdles on the horizon, they feel ready to confront the challenges and take bold steps to disrupt themselves, so they can both lead the pack and achieve sustainable growth.

To do so, alternative investment managers may need to strengthen their brand positioning and internal cultures to focus crisply on value delivery for customers, and develop concrete plans to apply innovation and emerging technologies to tame the mounting customer demands, regulatory expectations and operating costs.

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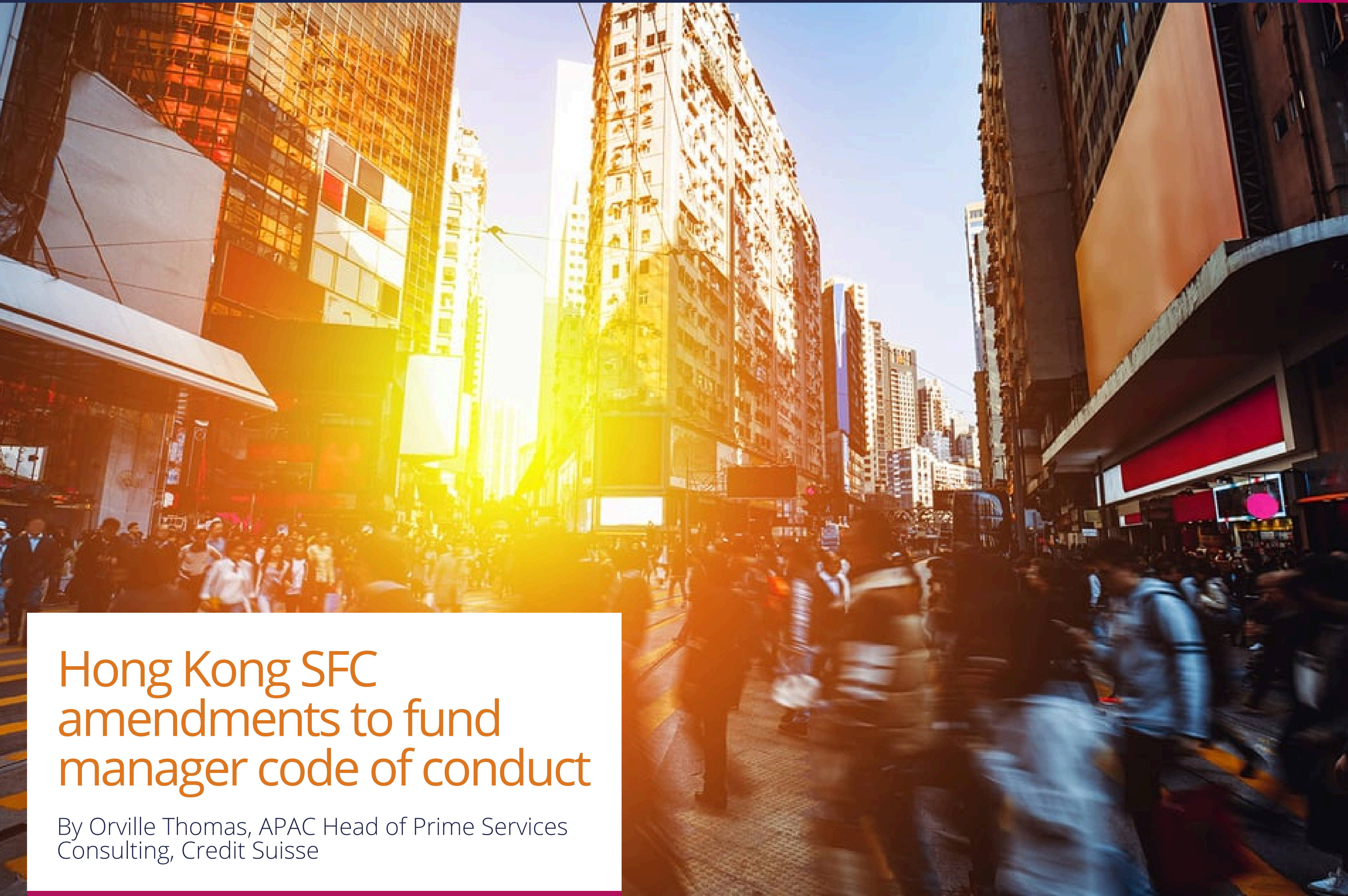


Hong Kong SFC amendments to fund manager code of conduct

By Orville Thomas, APAC Head of Prime Services Consulting, Credit Suisse

Orville Thomas

On Thursday 16 November 2017, the Hong Kong Securities and Futures Commission (SFC) released its Consultation Conclusions on Proposals to Enhance Asset Management Regulation and Point-of-Sale Transparency and Further Consultation on Proposed Disclosure Requirements Applicable to Discretionary Accounts. Of significance to Hong Kong fund managers are the forthcoming changes to the Fund Manager Code of Conduct (FMCC). (Full text of the 16 November SFC Announcement)

The SFC noted that the enhancements to the FMCC are intended to reflect the latest international benchmarks concerning the conduct of fund managers issued by the International Organization of Securities Commissions (IOSCO) and the Financial Stability Board (FSB), and other international expectations which are intended to ensure that Hong Kong has a robust regulatory regime that is in line with international regulatory developments. (Full text of the SFC Consultation Conclusions)

The changes to the FMCC will be applicable to those managers that are regarded as having responsibility for the overall operation of a fund. Based on comments received during the consultation period, the SFC has agreed to remove any reference to the concept of a manager having "de facto control" of a fund, bringing the FMCC more closely in line with the cited IOSCO principles. The SFC also noted that although a fund may have a "governing body" such a board of directors, and the manager may thus not formally be responsible for day-to-day decision making at the fund, said manager may still, in substance, be responsible for the overall operation of the fund, and will therefore be subject to the enhanced FMCC. The SFC has also clarified that where representatives of a fund manager or its subsidiaries constitute the majority of the board of directors of a fund, then the manager may be considered to be responsible for the overall operation of the fund.

We would ask you to note the following enhancements to the FMCC in particular:

Securities Lending & Repos

- Managers should have a collateral valuation and management policy in place and set minimum valuation and margin requirements.
- Managers should set a policy which outlines acceptable collateral and the methodology used to calculate haircuts.
- Managers should have in place a cash collateral reinvestment policy to ensure

sufficient liquidity, with transparent pricing and low risk, in order to meet reasonably foreseeable recalls of cash collateral.
- Managers should disclose a summary of the securities lending, repo and reverse repo transactions policy to fund investors, but need not make such disclosure in the fund's offering documents.

Custody

- Managers are required to exercise due skill, care and diligence in the selection, arranging for the appointment, and ongoing monitoring of a fund's custodian, irrespective of the fact that the manager does not formally appoint the custodian.
- Managers should ensure that a formal custody agreement is entered into with the custodian.
- Managers should ensure that the custody arrangements and any material risks associated are disclosed to fund investors.

Liquidity Risk Management

- Managers should establish, implement and maintain appropriate and effective liquidity management policies and procedures to monitor the liquidity of the fund, taking into account the investment strategy, liquidity profile, underlying assets and obligations, and redemption policy of the fund.
- Managers should regularly conduct liquidity assessments and stress tests.
- Managers should disclose liquidity risks, management policies and any tools or exceptional measures that could affect redemption rights in the fund's offering documents, or otherwise make such information freely available to fund investors.
- A manager will not be deemed to be responsible for the overall operation of a fund simply by virtue of its responsibility in managing liquidity risk.

Disclosure of Leverage

Managers must disclose to investors (i) the expected maximum level of leverage it may employ on behalf of the fund, and (ii) the basis of calculation of leverage.
The SFC does not prescribe a methodology for calculating leverage, but states that managers should ensure that the disclosure is arrived at based on a reasonable and prudent calculation methodology.

The amendments to the FMCC will become

effective on 17 November 2018 which represents 12 months from the date of official publication of the revised FMCC.

Singapore MAS issues Liquidity Risk Management Consultation Paper (Full text of the MAS Consultation Paper)

On Thursday 26 October, the Monetary Authority of Singapore (MAS) issued Consultation Paper P019-2017 entitled Liquidity Risk Management (LRM) Framework for Fund Management Companies (FMC). The consultation paper sets forth proposed guidelines designed to create a framework of sound practices in liquidity risk management of collective investment schemes, to address the risks to investors from potential liquidity mismatches between the collective investment scheme's portfolio liquidity and redemption terms. Similar to the corresponding enhancements to the Hong Kong FMCC, the proposed guidelines take into account the international recommendations promulgated by the FSB and IOSCO. The MAS proposes to apply these guidelines to licensed FMCs and registered FMCs which are responsible for the portfolio management of open-ended collective investment schemes.

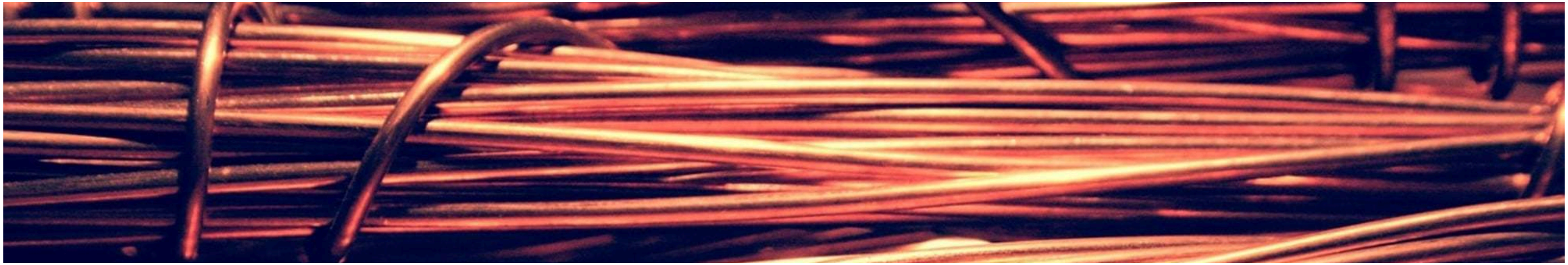
The guidelines cover 4 key areas:

Governance

The board of directors and senior management of the FMC should ensure that the FMC has a liquidity risk management function that is subject to effective oversight.
There should be clear accountability in an FMC for implementing the LRM framework, and monitoring and managing the liquidity risk.

Initial design of product

- FMCs should ensure that their subscription and redemption terms are commensurate with the fund's investment strategy and liquidity profile.
- FMC's should understand investors' historical and expected redemption patterns and include these in the liquidity assessment of the fund.
- FMCs should consider the suitability of any liquidity management tools, and ensure that they are used only where fair treatment to investors is not compromised.
- Offering documentation should contain clear disclosure of any liquidity management tools and how these may impact investor redemption rights.



Ongoing liquidity risk management

- FMCs should monitor trends in the fund's investor profile and concentration and redemption patterns, and regularly assess the liquidity profile of the fund's assets and liabilities.
- FMCs should establish appropriate internal thresholds for the fund's liquidity which are proportionate to the redemption obligations and liabilities.
- Any decision to suspend redemptions must be reviewed and approved by the senior management and/or board of directors of the FMC, and be notified to the MAS immediately.

Stress testing

- FMCs should regularly conduct stress testing, and review and revise assumptions underlying the stress scenarios.
- If an FMC elects not to conduct stress testing, it should document its rationale, and such decision should be reviewed and approved by the senior management and/or board of directors of the FMC.

The MAS intends to issue the final guidelines in Q1 2018, and expects to provide a transitional three month period for FMCs to adopt and implement the guidelines as appropriate.

In the case of both the HK FMCC and the Singapore LRM Framework, these changes largely represent a codification of existing practice. Nonetheless, managers should be sure to fully apprise themselves of the applicable requirements in their entirety, and determine what corresponding changes may be necessary to their fund documentation and internal policies and procedures.

Please do not hesitate to reach out to a member of the Prime Services Consulting Group or your Credit Suisse representative should you have any immediate questions or concerns.

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Distributing foreign investment funds in Switzerland

By Matteo Risoldi, Chief Operating Officer and Joana de Burgo, Compliance Officer at Oligo Swiss Fund Services

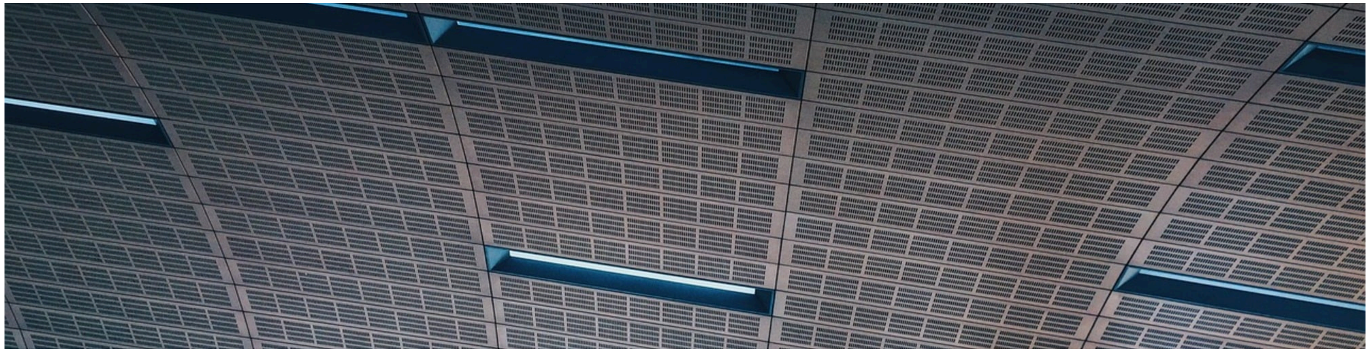
Matteo Risoldi

Switzerland, an attractive market for foreign funds

Switzerland is a politically stable and neutral country. Two-thirds of Swiss adults have assets above USD 100k. There are 594 thousand USD millionaires and an estimated 4000 ultra-high-net-worth individuals (over USD50m) as of the end of 2017.[1] Seed capital from insurances, banks and foundations is also present in sizeable amounts. The Swiss fund market is the fifth-largest in Europe, with assets totalling CHF1073bn in October 2017, up CHF155bn since the previous year.[2]

Joana de Burgo

These facts make the Swiss market an attractive location for selling investment funds. When looking at the number of funds authorised for public distribution in Switzerland, foreign funds outnumber Swiss funds by almost five to one (7401 vs. 1551). Luxembourg and Ireland are the most represented domiciles for foreign funds, with over 6500 funds combined.[3]



The Swiss fund distribution regulatory framework

Switzerland is not part of the European Union and is not subject to the AIFMD rules. The distribution of foreign funds in Switzerland is regulated by a specific set of rules, where the function of the Swiss representative is central.

For the Swiss Financial Market Supervisory Authority (FINMA), any activity that promotes a fund is considered distribution, even a simple email or a phone call.

The current revision of the Collective Investment

Schemes Act (CISA) came into full force on 1 March 2015. Among the key changes that were introduced, the Swiss investor base was segmented in three groups:

- Regulated qualified investors, i.e. banks, insurance companies and fund managers managing more than CHF100m in Switzerland
- Non-regulated qualified investors, e.g. pension funds, independent asset managers, HNWIs and family offices
- Non-qualified, or retail, investors

A foreign fund distributing or intending to distribute to retail or to non-regulated qualified investors in Switzerland is required to appoint a Swiss representative and a Swiss paying agent.

While this obligation is waived in the case of reverse solicitation, it is considerably difficult to make sure that a contact with an investor actually fulfils the very strict requirements for the definition of reverse solicitation, i.e. without any form of prior solicitation by the fund manager. For this reason, it is largely considered to be safer to appoint a representative and paying agent.

Once a foreign fund manager takes the decision to approach the Swiss market, the first step is generally to secure the services of a Swiss representative. The representative will initially discuss with the fund manager about the Swiss regulation in general and about the aspects which are specific to the type of the fund. A list of Swiss paying agents will also be provided for the client to choose from. Services and pricing models for Swiss representation can vary, although the general trend is that prices have been dropping since 2015.

After the initial contact, an onboarding process follows which typically takes a few weeks, during which the representative executes due diligence work on the fund, a representation contract is established, and the fund's legal and marketing documents are amended for distribution in Switzerland.

Distribution to non-qualified investors (Retail distribution)

Distribution to retail investors is subject to a further authorisation by FINMA. Obtaining authorisation for retail distribution involves providing a set of required documents and translating legal material in a Swiss official language (German, French or Italian) if necessary. The representative leads the fund throughout this process to bring it to a good end.

FINMA has cooperation and information exchange agreements with the supervisory authorities in 17 countries.[4] Funds domiciled in these countries are eligible to apply for authorisation. Since December 2016, Hong Kong joined the list. It is worth noting that UCITS funds have a fast-track approval for retail distribution.

Funds authorised for retail distribution are allowed to market in the big Swiss distribution platforms, including the ones from well-established banks, thus accessing a broader scope of potential investors.

Choosing a Swiss representative

There are currently about 15 independent firms offering representation services for foreign funds in Switzerland. They fall into two groups:

- Firms that are licensed to represent funds distributed to qualified investors only;
- Firms that are licensed to represent funds distributed to all types of investors, including retail investors.

A fund wishing to be distributed in Switzerland should carefully consider which investor segments to address, and choose a Swiss representative with the appropriate licence.

Representatives that are licensed to represent funds for distribution to retail investors will have a deep knowledge and experience about how to proceed in the best possible way, including providing resources such as professional translation services and direct communication channels with FINMA and with the big distribution platforms.

The Swiss representative, a long-term partner for foreign funds

The role of the Swiss representative, as established in the CISA, is to ensure that the funds' distribution activities comply with the Swiss law.

While it is a legal obligation to appoint a Swiss representative for distribution in Switzerland, some representatives evolved their services very quickly beyond those of a simple legal representative. In addition to the legal and procedural expertise, a Swiss representative can provide guidance and help with the fund's distribution in Switzerland.

Today, Swiss representatives can:

- Help building relations between their client funds and Swiss-based distributors and investors;
- Organise cap intro events and conferences to help funds meet investors;
- Act as a global distributor to organise

retrocessions for placement agents in Switzerland;
- Assist the fund with cross-border registration in multiple countries within and beyond Europe;
- Publish fund information and documents on electronic platforms dedicated to Swiss investors;
- In some cases, act as a point of contact between potential investors and the fund.

This makes the Swiss representative an ongoing point of reference, source of business, and long-term partner for a fund’s distribution activity in Switzerland.

In summary

Switzerland is a large and attractive market for foreign investment funds with very specific, yet easy to fulfil, requirements for distribution. The main points to retain are:

- Addressing a Swiss investor in any way (except for regulated qualified investors) is distribution, and requires appointing a Swiss representative and a Swiss paying agent;
- There is a large market for retail distribution;
- Ucits funds as well as funds from agreed countries can apply for retail distribution authorisation;
- The Swiss representative is the main hub through which a fund can fulfil its regulatory obligations in Switzerland;
- The relation between the fund and the Swiss representative is an active one, with an ongoing exchange of useful contacts and information.

For any question concerning funds representation and distribution in Switzerland, please feel free to contact Oligo Swiss Fund Services (a regulated Swiss representative for funds addressed to both qualified and retail Swiss investors) at info@oligofunds.ch.

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Footnotes:

[1] Credit Suisse Research Institute, Global Wealth Report 2016

[2] Swiss Fund Data – Swiss Fund Market Statistics, 31 October 2017

[3] SFAMA, annual report 2016

[4] FINMA agreements in accordance with Art. 120 para. 2 let. e CISA, December 2nd 2016

Risk factor analysis and passive investment: The implications for both managers and investors

By Bill Saltus, Director, Business Consulting, Wells Fargo Prime Services

William Saltus

For more than forty years, investment managers have sought to deconstruct their portfolios' risks and returns into a set of common factors. More recently, in the first quarter of 2016, the factor movement was reinvigorated when the price of West Texas Intermediate crude oil dropped over 50% from the prior summer to below $30 per barrel[1]. Based on our conversations during that timeframe, we found that some hedge fund managers' portfolios were moving lower in tandem to this "oil factor" – even if their holdings didn't include energy stocks. This left investors asking portfolio managers for the correlations within their portfolios to oil and other factors. Current market events, combined with the proliferation of passive products based on factor indexes, brought to the forefront the increasing importance of investment managers understanding how the investor community may be viewing their overall exposures from a risk factors perspective.

This shift in perspective may have contributed to passive products growing to $12 trillion[2], fueled in part by investors who seem to be replacing beta-hugging asset managers with cheaper mutual funds or exchange-traded funds (ETFs). With this backdrop in mind, it has become more important than ever for active asset managers to understand whether the sources of their returns are idiosyncratic or factor-based. This may be achievable with the assistance of a variety of software providers, who can compare the return streams of a manager's portfolio to those of published factors. The closer the manager's returns mirror those of various factors, the easier it may be for an investor to achieve the same results by buying low-priced factor index-based ETFs. Providers such as Vanguard, BlackRock, and State Street, who dominate the market with an 82% share,[3] will license indexes from well-known providers, including Standard & Poor's or MSCI, and then will manufacture passive product based on these indexes. "There are now $213 billion in assets benchmarked to our factor indexes," indicates Peter Zangari, Global Head of Research

and Product Development at MSCI, a leading research-based index and analytics provider.

MSCI provides standard factor classification and analytics tools that help investors capture exposures to different equity risk premia across a stable of factors including value, size, momentum, quality, yield, and volatility.[4] Based on ideas put forth in a paper by Eugene Fama and Kenneth French of the University of Chicago Booth School of Business in 1992[5], which explored how three factors (market risk, company size, and book-to-market equity) contribute to equity risk and return, the modern application of a broader array of factors can be achieved through tools from other firms as well, including BlackRock Solutions' Aladdin, Kiski's Jasmine, Bloomberg's PORT, and Axioma's Risk. These tools calculate how each stock is exposed to a number of factors. Using data on individual stock returns, the return attributed to each factor can then be calculated using regression techniques. With information on the holdings of a portfolio, one can calculate the portfolio's exposure to each factor. Combining the portfolio factor exposures with the factor returns from the regression then enables one to determine the contribution each factor made to the portfolio return. The stocks with the highest scores, or exposures, on a given factor, such as dividend yield could also be assembled into an index or basket. The factor exposure and return of this index could be compared to any other portfolio or fund that described its strategy as seeking high dividend paying stocks, for example.

Though the development of these techniques began in academia, the adoption of risk factor analysis began with pensions. Fredrik Martinsson, Chief Investment Officer of Kiski Group and former CIO of Investments at ATP, the Danish Labour Market Supplementary Pension Fund, developed and implemented ATP's proprietary Alternative Risk Premia program.[6] He notes that "while the pension industry is in a current state of 'factor mania', it is important to segment the world in a way that makes sense." He continues, "It is not a 'more-is-better' approach with factors, but rather it is a question of 'which ones are more valuable'". Once the most useful factors have been determined, it becomes a question of what the institutional investor should do about these exposures. Armed with this information, the investment committee of a pension or another institutional investor will look to act in a handful of ways. If there is a trading desk within the pension, they may trade around those factor exposures in order to hedge unintended risks. Since only the largest investors will have internal capabilities, most others will look to hedge these risks through either manager selection, passive index exposures, or a combination of both. Furthermore, they may look to replace existing active managers with either a custom solution or a basket of index exposures if, as stated earlier, they believe their portfolio managers are simply charging active management fees for various forms of beta.

“Investors want to ensure that they’re not paying alpha rates for factor-related beta,” states Charles Millard, Head of Institutional Relationships at Kiski Group, and former Director of the U.S. Pension Benefit Guaranty Corp. under President George W. Bush. Once a manager understands their exposures, they may want to augment a factor, or offset an unintended exposure. Using one of the aforementioned risk factor analysis tools, they can optimize their portfolio by performing “what-if” scenario analysis, bringing their exposures closer to the desired level. “Clients will come in to us with a list of names, and we’ll look to execute that as a custom basket off of our delta one trading desk,” explains Lance Meyerowich, Managing Director at Wells Fargo Securities. In so doing, hedge fund managers can leverage their brokerage relationships for tailored investment baskets that help them complete their desired portfolio exposure targets.

Given this evolving investment landscape, hedge fund managers are arguably better positioned than traditional asset managers. With access to and knowledge of these advanced hedging techniques, hedge funds may be able to provide a higher value – and potentially charge higher fees for true alpha generation – to their institutional investor clients, who are increasingly conscious of over-paying for beta. And when considering the abundance of cheap beta that can be had through a variety of passively-managed ETFs, the institutional investor has more options than ever before in terms of portfolio allocation. A better understanding of this factor-based investing landscape will arm both the manager and the investor with the knowledge necessary to navigate the way forward.

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Footnotes:

[1] http://www.macrotrends.net/1369/crude-oi...
[2] BCG Global Asset Management 2017 Report: The Innovator’s Advantage (p. 10)
[3] https://www.forbes.com/sites/greatspecul...
[4] https://www.msci.com/documents/10199/71b...
[5] https://faculty.fuqua.duke.edu/~charvey/...
[6] https://www.kiskigroup.com/bios

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Are you leaving money on the table? A cross-border tax recovery guide for hedge funds

By Brian Sapadin, Executive Director of Hedge Fund Services at GlobeTax

Brian Sapadin

Why are my international dividends being over-withheld and what remedies do I have to secure my entitlements?

Funds receiving dividends from international investments are often subject to withholding by the government of the issuer's jurisdiction. The same income may also be subject to home country tax. To mitigate this double taxation, pairs of countries have entered into double taxation treaties or enacted laws providing investors the opportunity to recover all or part of the foreign tax withheld.

Some markets offer a relief at source process (where treaty rates can be obtained on pay-date). This is the best situation for investors. However, participation in relief at source is dependent on several factors including market availability and custodial support. While global custodians support a relief at source process to varying degrees, prime brokers, for the most part, do not. When relief at source is unavailable, investors seeking entitlements must rely on standard long-form procedures. Since standard refund filing requirements are increasingly complex, funds should be aware of a number of factors. The following is meant to educate hedge funds about the tax recovery process, guiding an informed course of action.

What is involved in lodging a standard (long-form) reclaim?

You must first determine how the process works in a particular market. Each jurisdiction operates with its own unique processes and requirements. Do forms need to be completed in native language, or is English an option? Does a claim go directly to a tax authority? Which counterparties need to be involved? Do you have to navigate through the web of custodians, withholding agents, depositaries, and depositories to lodge a claim? Once these questions are answered, error-free claim applications must be accompanied by all required documents and lodged within the statute of

limitations. Entitlements must be precisely calculated, taking into account prevailing statutory rates, treaty rates, and beneficial owner types for each income event.

In the event of an audit, claimants must be ready to support information requests from tax authorities. Most are routine and can be easily managed, if you are prepared. The importance of audit support can't be overstated.

How much am I entitled to recover?

For taxable entities, recoveries range from 4% of the gross dividend (e.g. Poland, Spain) to 20% of the gross dividend (e.g. Ireland, Switzerland). Tax-exempt entities can often reclaim the entire withholding (e.g. 35% in Switzerland, 30% in Belgium, Finland, and Sweden, 26.375% in Germany, and 25% in Canada). Transparent funds (such as partnerships) can often reclaim at a "blended" rate based on the tax-status of the underlying investors.

Potential Recoveries: Sample Markets

	Statutory Rates (%)	Reclaim Rates- U.S. Funds (%)	Reclaim Rates- Luxembourg Funds (%)	Reclaim Rates- Irish Funds (%)
elgium	30	15	N/A	15
anada	25	10	N/A	10
rance	30	15	N/A	15
ermany	26.375	11.375	11.375	11.375
eland	20	20	20	N/A
pain	19	4	4	4
weden	30	15	N/A	15
witzerland	35	20	N/A	20

** All rates subject to change*

** Reclaim rates above are based on taxable entities*

How long does the recovery process take?

The average recovery time for most markets is around 12 months, though the range varies from as short as 3 months to as long as 24 months.

How quickly must I act?

Claims must be lodged within the published statute of limitations or the investor forfeits the entitlement. Statutes of limitations vary by market, but range from 2 years to 7 years. As a result of the statutes, investors engaging in tax reclamation for the first time often receive a windfall for the initial filing based on prior years' excess withholdings that are still available for recovery.

What are the disclosure requirements?

While each market has its own rules and nuances, most jurisdictions now require disclosure of investors within transparent entities to ensure treaty benefits are being granted appropriately. Tax authorities often require funds to submit lists of their underlying investors or certificates of residency for those investors. While the latter requirement is more onerous, funds can usually reclaim the pro rata portion of the entitlements for investors for whom they can produce proper documentation, so it is typically not an all-or-nothing scenario.

In certain markets, a greater portion of the withholding can be recovered if investors are pensions or other tax-exempt entities. 'Funds of one' for large tax-exempt investors have a distinct advantage in this context.

Are Depositary Receipts and Global Shares also eligible for reclamation?

Yes. Depositary Receipts (DRs) and Global Shares also present a reclaim opportunity for investors. Some investors are unaware that they have an entitlement because they did not buy the shares in their home market. However, investors who hold these securities have the same issue of withholding at source and the same burden to file a tax reclaim application to recover the excess withholding. To recover these funds, investors must file reclaims through the institution that issued the DRs, who then files a claim with the foreign tax authority.

Are there reclaim opportunities for offshore funds (Cayman, BVI, Bermuda, etc.)?

While it is easier for fund managers to access treaty benefits for onshore funds and feeders, there are opportunities for offshore vehicles as well.

1. Control Provision Claims for Offshore Corporations:

In certain markets, opportunities exist to lodge claims based on specific control provisions within the treaty or local law in the jurisdiction of investment. Disclosure and documentation requirements vary by jurisdiction.

2. Accessing Treaty Benefits through Cayman LLCs:

Traditionally, many U.S. tax-exempt entities invest through an offshore feeder-- most commonly a Cayman limited company. While providing protection from unrelated business taxable income (UBTI), these vehicles subject investors to 30% back-up withholding on all U.S.-sourced income, as well as full withholding rates on dividend payments from other markets.

Last year, the Cayman Islands introduced a new vehicle: the Cayman Limited Liability Company. Although US withholding tax still applies, the structure allows for fund managers to reclaim over-withheld foreign tax on behalf of U.S. tax exempts and other eligible investors (in certain markets), while allowing U.S. tax exempts to remain shielded from UBTI.

3. Accessing Legal Entitlements through EU Discrimination Claims:

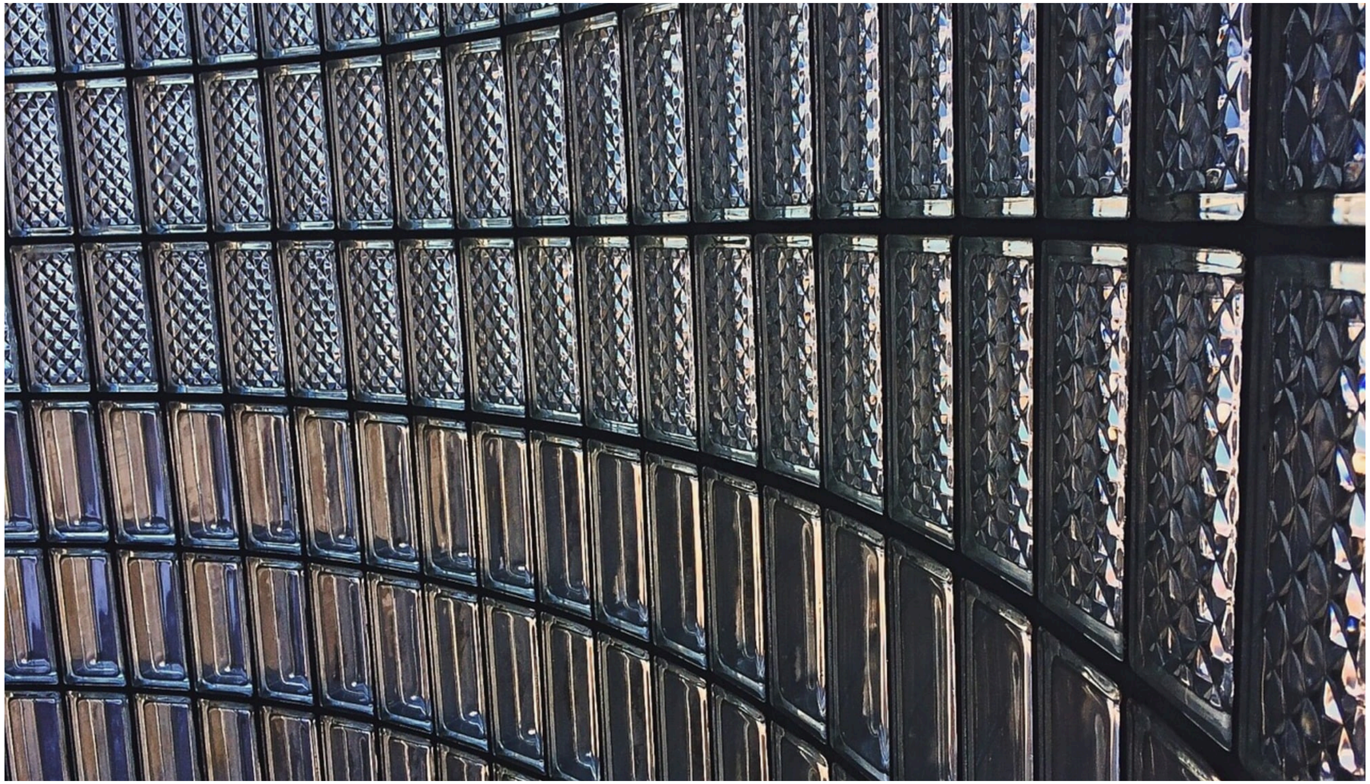
Eligible fund structures can explore new opportunities in Europe thanks to decisions by the

European Court of Justice (ECJ). Cases like FIM Santander and DFA Emerging Markets, among others, have paved the way for non-EU funds to qualify for more favorable tax rates in European Union member countries. In these rulings, the court has found that the 'free-movement of capital' provisions in the Treaty on the Functioning of the European Union entitles foreign funds to the same treatment as similarly-structured resident funds; to suffer worse outcomes would constitute discrimination.

While ultimate results are still uncertain, U.S. RICs and Cayman/BVI-domiciled corporations can take advantage of the new legal landscape by filing discrimination-based claims with foreign tax authorities. Fund structures must be compared, evidence gathered, and legal briefs presented to local authorities. Upon receiving the evidence, the applicable authority will determine whether the fund in question is sufficiently similar to those granted refunds in prior ECJ rulings.

How can I develop a tax recovery strategy?

Tax reclamation is a powerful tool for enhancing portfolio performance and meeting industry best practices. Because most funds do not have the in-house capabilities to successfully reclaim over-withheld tax on their own, those seeking to pursue entitlements should consider a specialized tax recovery firm.



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EU citizen rights post-Brexit: An end to uncertainty?

By James Perrott, Head of immigration team at Macfarlanes LLP

James Perrott

Since the result of the EU referendum was announced on 24 June 2016, one of the biggest concerns for EU citizens currently living in the UK, and businesses who employ them, is what their status will be post-Brexit. The UK Government has consistently stated that it wishes to safeguard the rights of those EU citizens who are currently in the UK and wish to remain after the UK's withdrawal from the EU. However, this has always been subject to the UK being able to negotiate similar safeguards for British citizens living in the EU.

The economic reasons for granting EU citizens who are currently in the UK the right to remain post-Brexit are almost beyond debate. There are currently almost 3.5 million non-EEA nationals in the UK; around 2.4 million of them in work. If all these workers were suddenly required to leave the UK, the effect on the UK economy would be cataclysmic.

In terms of the financial services industry, according to the Office for National Statistics, it is one of the biggest employers of EU nationals in the UK. The financial and business services sector is the second biggest employer of EU nationals in the UK, second only to the wholesale and retail trade, hotels and restaurants sector, with over 380,000 EU nationals working in the industry. Half of them are working in London making the financial and business services sector the largest employer of EU nationals in the capital.

Consequently, from the very beginning of the Brexit negotiations, the financial services industry has been particularly concerned about whether EU workers working in the sector, particularly those who are highly skilled, will be able to remain in the UK once it leaves the EU.

On 8 December 2017, the UK and the EU finally reached an agreement on the rights of EU citizens post-Brexit.

EU citizens' rights post-Brexit

In summary, the following agreement was reached for EU citizens and their family members who wish to remain in the UK post-Brexit:

- Those who arrive in the UK by 29 March 2019 and have been continuously and lawfully living in the UK for five years or more will be able to apply for 'settled status', which will enable them to reside in the UK indefinitely. This means that they will be free to reside in the UK, able to access public funds and services and eventually apply for British citizenship.
- People who arrive by 29 March 2019 but who will not have completed the five year qualifying period for settled status by the time the UK departs the EU, will be able to apply for a temporary residence permit which will enable them to remain in the UK until they have reached the five year threshold for applying for settled status.
- Family members who are living with, or join, EU

citizens in the UK before 29 March 2019 will also be able to apply for settled status after five years in the UK.

- After 29 March 2019, close family members (defined as spouses, civil partners and unmarried partners, dependent children and grandchildren, and dependent parents and grandparents) will be able to join EU citizens who arrive in the UK before 29 March 2019, provided the relationship existed on 29 March 2019 and continues to exist when they wish to come to the UK.

EU nationals with settled status and temporary residence permits will continue to have the same access as they currently do to healthcare, pensions and other benefits. Those with a temporary residence permit will effectively be able to continue to exercise EU free movement rights in the UK post-Brexit provided they continue to hold that document.

The UK has stated that it expects also to extend this offer to resident nationals of Norway, Iceland and Lichtenstein (who are part of the EEA) and Switzerland (which is not part of the EU or the EEA).

Temporary residence permits / settled status

The UK intends for there to be a grace period after the UK formally leaves the EU during which EU nationals and their family members will apply for temporary residence permits or settled status. The length of this grace period is yet to be formally agreed with the EU but the UK is currently stating that it will last for two years. During this period, although EU nationals will technically be subject to UK immigration law, they will automatically be granted "deemed leave" on 29 March 2019 and this status will enable them to continue to live, work and study in the UK as if they were continuing to exercise free movement rights in the UK.

The UK Government is likely to start accepting applications for settled status and temporary residence permits towards the end of 2018. It is aiming to develop a straightforward, on-line application system. The Immigration Minister has stated that the application form will have a maximum of eight questions, the cost of the application will be up to £72 and a decision should be made within two weeks. In order to facilitate the process, the Home Office will work with other government departments, such as HMRC, to verify the identity of applicants and to obtain existing government data. This should minimise the amount of documents the applicants will be required to submit.

Furthermore, the criteria for qualifying for settled status will effectively be the same as for obtaining permanent residence under EU law, which are that the EU national must have been continuously resident in the UK exercising an EU Treaty Right, such as employment, self-employment, study, self-sufficiency or as a job seeker, for five years. However, the UK Government has stated that it will take a more pragmatic approach to dealing with applications. For example, normally EU nationals who have been studying or self-sufficient in the UK for five years will only be deemed to hold permanent residence if they have held comprehensive sickness insurance for that period. The UK Government has stated that this requirement will not apply to settled status applications. It has also said that, for those who are in employment or self-employment, it will not apply the requirement that the work must be genuine and effective and not marginal or supplementary. In other words, it will not be assessing if the work involves so little time and money that it is unrelated to the lifestyle of the worker.

This approach is to be welcomed as there are many EU nationals who have been in the UK for over five years who do not meet these requirements, who therefore are not deemed to hold permanent residence in the UK, even though they have never sought assistance from the state.

Documents certifying permanent residence

Under EU law, EU nationals who are deemed to hold permanent residence may apply for a Document Certifying Permanent Residence (DCPR) in order to evidence this status, although this is not mandatory. The UK Government has stated that these documents will cease to be valid when the UK leaves the EU.

However, the UK Government has confirmed that those who hold a DCPR will be able to use a simplified procedure to exchange this for a new settled status document free of charge.

Processing of applications

The UK Government is very aware of the logistical challenges it faces in issuing temporary resident permits and settled status documents to the 3 million EU nationals who are currently in the UK by the end of March 2021. As well as developing a new on-line system, the UK Government is also looking to more than double the number of personnel at the Home Office who process immigration applications.

An end to uncertainty?

Undoubtedly, a huge sense of relief has been felt by EU citizens who wish to remain in the UK post-Brexit, and those who employ them, that the UK and the EU have finally reached an agreement on EU citizens' rights. The agreement represents a middle ground between the two negotiating positions and has enabled both sides to say that they have reached a "good deal".

There is clearly still a lot of work to be done by the UK Government in defining in more detail the criteria for obtaining a temporary residence permit and settled status and in putting in place procedures which will enable it to process the large numbers of applications involved before the end of the grace period.

Furthermore, the UK Government has yet to publish any proposals for what the UK immigration requirements will be for those EU citizens who arrive in the UK after 29 March 2019 and wish to remain in the UK after the end of the grace period. The current UK economic migration system only effectively provides routes of entry to highly skilled migrants but, given the number of EU citizens working in medium and low skilled occupations, it will be vital that the system is adapted to enable employers to recruit non-UK nationals to fill vacancies at those skill levels as there are unlikely to be sufficient local workers to satisfy the demand.

Many EU citizens who have already completed five years of continuous residence in the UK may still wish to obtain a DCPR, given that the UK Government has stated that it will be possible to exchange this for a settled status document using a simplified procedure. The UK Government has already streamlined the procedure and documentation required for these applications which means that they are currently being processed in around two months. EU nationals may also keep their original passports throughout the consideration process, thereby retaining their ability to travel overseas. It is also worth noting that EU nationals must first obtain a DCPR before they may be eligible to apply for British citizenship.

Many employers are providing assistance to their EU work force in preparing these applications and it will certainly be important for employers to encourage their EU staff to apply for temporary residence permits or settled status as soon as possible once the Home Office starts accepting these applications. This will hopefully ensure that they receive their documents substantially before the end of the grace period and avoid the inevitable last minute rush.

Consequently, although the agreement reached on 8 December represents a huge step forward in clarifying EU citizens rights post-Brexit, there is still a long way to go before EU citizens, and the UK businesses who employ them, know precisely on what basis EU citizens will be able to live and work in the UK in the future.

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MiFID2 and trade reporting: Get ready for big changes

By Kirston Winters, MD & Co-Head of Product Management for MarkitSERV and Brie Lam, Director, Regulatory & Compliance Services, IHS Markit

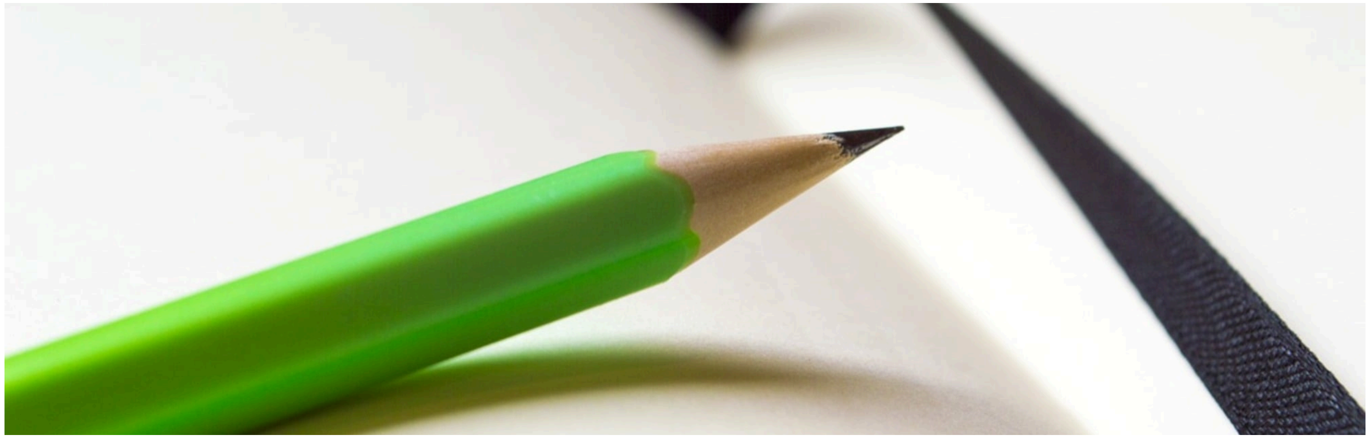
MiFID came into effect in 2007 – under the current regime, buyside firms are typically not required to publish trades and real-time public reporting (“trade reporting”) is handled by trading venues and dealers.

However, in January 2018, MiFID2 rules will shift the responsibility for trade reporting to the buyside for certain products and in certain situations.

The trade reporting rules are complex and, as the implementation of MiFID2 approaches, asset managers are justifiably confused and concerned – and if they’re not, they should be.

The new challenge for asset managers stems from a creation unique to MiFID: the systematic internaliser (SI). Under MiFID, an SI is defined as an “investment firm which, on an organised, frequent, systematic and substantial basis, deals on its own account by executing client orders outside [a trading venue].” In layman’s terms, it’s any firm that matches and fills a significant number of client orders internally.

But wait, there’s more: MiFID2 changes how SIs are



designated. A firm could be an SI in hundreds of instruments and not in hundreds of others. For off-venue trades, where both parties are EU firms, if just one party to a trade is an SI, it is responsible for trade reporting. If neither party to the trade is (or both are) an SI, then the seller is responsible for trade reporting.

The rub is keeping track of it all and reporting within minutes if it’s your obligation.

Trade reporting mandate

As mandated by MiFID2, for every transaction subject to “traded on a trading venue” (ToTV), whether traded on-venue or off-venue within the EU, trade reporting must be conducted as close to real-time as possible; the trade must be reported by just one of the parties involved, whether it is the trading venue itself, an SI or an investment firm. ESMA defines the time window within which to report as one minute post-trade for equities and equity-like instruments, and 15 minutes for other instruments (reducing to five minutes after three years). Depending on the instrument, up to 33 data fields are required to be reported by the Approved Publication Arrangement (APA).

Failure to report is not an option, but neither is duplicative reporting by both parties to a transaction. How do firms know who has the obligation to report if they don't know if their counterparty is an SI in that instrument?

Redefining systematic internalisers

Under the original MiFID, the SI regime was limited to equities transactions, but MiFID2 expands coverage to include virtually all instruments. The most drastic change in the regime, however, is that quantitative thresholds for the determination of SI status have been defined at the sub-asset class level. Under MiFIR, Regulation No. 600/2014 drafted to accompany MiFID2, the SI thresholds are defined as a percentage of total trading activity in the EU, with ESMA publishing the aggregated instrument volumes quarterly. A firm exceeding the thresholds for a product is an SI for that product and is obligated to adhere to all regulatory requirements that accompany that status.

This means a firm can be deemed an SI for USD-EUR cross currency swaps (2-3 years), but a non-SI for JPY-USD cross currency swaps (2-3 years) and a non-SI in USD-EUR cross currency swaps (3-4 years). Thus, each firm will need to assess their SI status at granular levels across all asset classes.

Furthermore, the SI status of a firm is dynamic and they must reassess based on updated thresholds and volumes published by ESMA, even firms that don't breach the thresholds in a certain product can still opt to be an SI.

So, what does all this really mean?

In a traditional off-venue sellside versus buyside transaction, one might expect the dealer to report; however, if the dealer is not an SI in a particular instrument and the buyside counterpart is the seller then it becomes the obligation of the buyside to report the trade within the 15-minute window. Being able to meet that obligation implies that the buyside has the operational and technological processes in place to transmit requisite data to an APA, including all mandatory reportable attributes for that trade.

Trading only with SI firms in an attempt to avoid reporting requirements is unlikely to be allowed as that will not satisfy the best execution requirements under MiFID2.

The chart below illustrates how the obligation to report trades is determined.

Chart: Whose obligation is it to perform the Trade Reporting?

Transaction	Is the Trade Executed on a Trading Venue?	Is Dealer an SI for the Instrument Transacted?	Trade Reporting Time Limit	Which Party is Responsible for the Trade Reporting to an APA?
Investment Manager XYZ sells a futures/forward contract on 10-Year German Bunds to Dealer ABC* *Both are MiFID investment firms	Yes	Not applicable	**Within 15 minutes**	Scenario 1: The Trading Venue reports under its obligation as a trading venue
	No	Yes		Scenario 2: Dealer ABC reports, as it is the Systematic Internaliser's obligation
	No	No		Scenario 3: Investment Manager XYZ reports, as it is the seller's obligation when the buyer is a not a Systematic Internaliser for the instrument transacted

Communication of SI Status to the Buyside

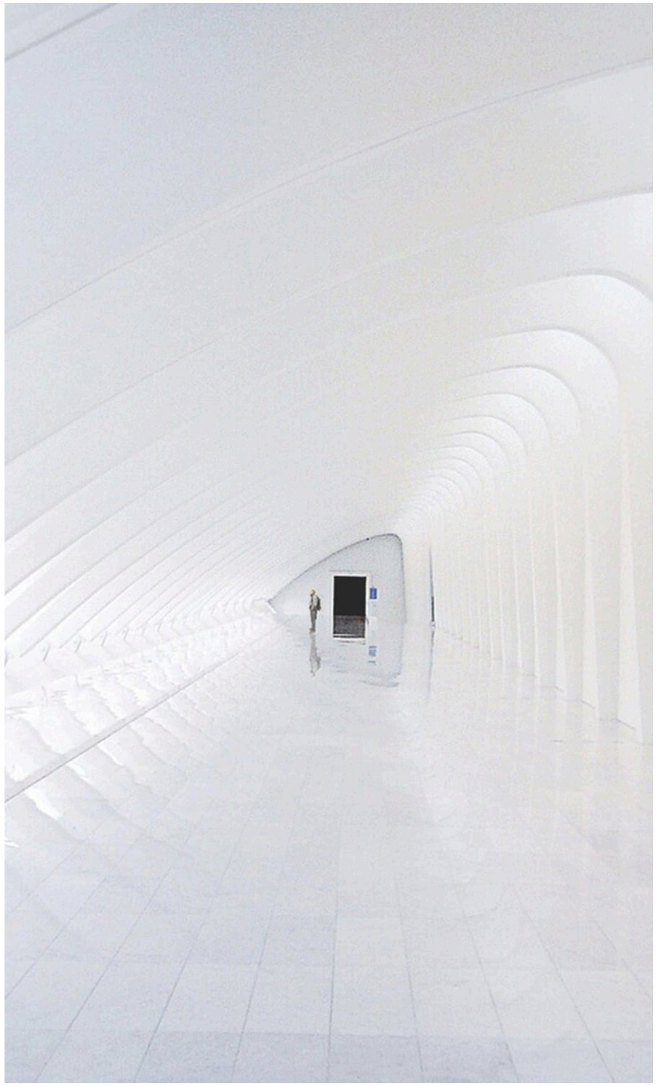
If an asset manager (non-SI) is obliged to report when selling to another non-SI, they will need to know whether their counterparty is an SI for every off-venue trade. ESMA will publish a firm's status as an SI – but it does not plan to publish information at the instrument level. So you will know whether your counterparty is designated as an SI in something, if it listed on the ESMA register but not whether it is an SI for the instrument you just traded. This adds another significant layer of operational complexity for the buyside: every minute of every day, the firm will need to know whether it is the party obligated to report trades to an APA.

That's a lot of extra work.

The good news: IHS Markit can provide granular-level SI status information on counterparties and help automate part of the reporting process. Just like it does for so much other information governing the relationship between dealers and asset managers, the Counterparty Manager platform can serve as a central hub for dealers to store data on which instruments they are designated as SIs and permission their clients to access it in order to help them understand their reporting obligations.

Concluding Thoughts

MiFID2 places significant burden on buyside firms to understand the SI status of all their counterparties at a granular instrument level, and to be able to report trades to an APA in a timely manner when — and only when — obligated to do so. With the compliance date approaching, the time is now for asset managers to ensure they are prepared to determine their counterparty's SI status by instrument and to plan how they will access an APA, via vendor solution or internal build.



A look at VAT on research after MIFID II

By Marie Barber, Managing Director, Tax Consulting and Ryan Kulczycki Vice President, Compliance and Regulatory Consulting at Duff & Phelps

What is this article about?

MIFID II has arrived this January, carrying with it the policy aim of increasing transparency and reducing conflicts of interest around inducements. In implementing this policy MIFID II changes the way investment research is supplied. This has the knock on effect of changing the nature of VAT treatment of investment research. For some investment managers this may result in a higher level of VAT taxation. We explore some of the key questions about how VAT will work now.

What was the VAT position?

VAT is based around the concept of supplies of good or services. Where a combination of services that are inseparable are supplied together, the whole service takes on the characteristics of the primary service. Where the services are separately supplied, the VAT treatment must be separately considered for each.

Previously research supplied by brokers together with execution services was treated as one inseparable supply. The research took on the characteristics of the primary part of the supply that was VAT exempt execution services, which maderesearch provided as part of that inseparable supply also exempt.

What has changed?

From 3 January 2018 when MiFID II became live, research and execution can no longer be provided as one single supply of services and instead research must be priced separately to execution services.

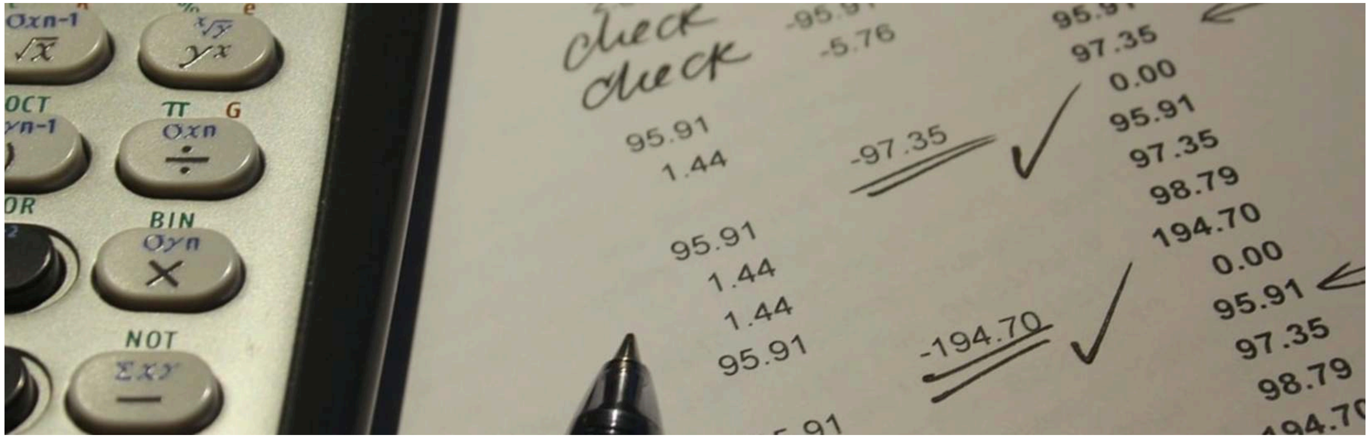
Each supply has its own VAT treatment with execution generally being exempt from VAT (meaning the broker will not apply VAT to execution fees) and research being a standard rated VAT supply with VAT applied at 20 percent. The impact of receiving research on which VAT has been applied depends on the manager’s position with respect to recovering VAT.

How does VAT exemption and VAT recovery work?

Exemption is a tricky word in VAT, common sense would imply it means that no VAT is charged, but this is not the full story.

There are 4 main ways a transaction can occur with no VAT being applied:

1. It is an exempt service - which is a limited set of specific services;
2. It is outside the scope of VAT because there is no supply of goods or services;
3. It is outside the scope of VAT because the place of supply is in another country; or



4. It is zero rated, i.e. VAT is applied but at 0%

Situations 1 and 2 do not result in a taxable supply, whereas 3 and 4 usually do. This is important because **a firm that makes taxable supplies to others through its sales, can recover VAT incurred on its purchases**. If a firm makes exempt supplies there is no taxable supply to others, that means there is no recovery of VAT on purchases, therefore being VAT exempt is not always favourable as it stops recovery of VAT on purchases.

Am I making taxable supplies?

Investment management in general is a taxable, standard rated supply for VAT purposes, with the significant exception of investment management provided to Special Investment Funds ('SIF's).

What about Special Investment Funds?

This is where it gets tricky. One specific type of investment management is exempt for VAT purposes, that is a supply to a Special Investment Fund ("SIF"). As a result, the VAT paid by an investment manager on the services it has received to enable it to provide services to a SIF is not recoverable. Furthermore, this exemption reaches back down the chain of services to any services directly attributable to management of a SIF.

One important point to note here is that tax authorities take a wider view of what counts as "investment management " than a body like the FCA. Two notable legal cases, (ECJ C-169/04 and C-275/11) have analysed the scope of management such that it is possible some research may conceptually count as management for tax purposes.

What is a SIF?

One would hope you could look at the definition in the legislation, unfortunately we again need to go to the case law. Legal cases (like ECJ C-363/05 and C-464/12), have widened the scope of the SIF definition from its original definition of a fund marketed to UK retail investors to include UCITS funds, certain types of pension funds and more.

Will I be charged VAT on research?

If the research purchased is directly attributable to the management of a SIF then the supply of research purchased is exempt and no VAT should be added by the research provider.

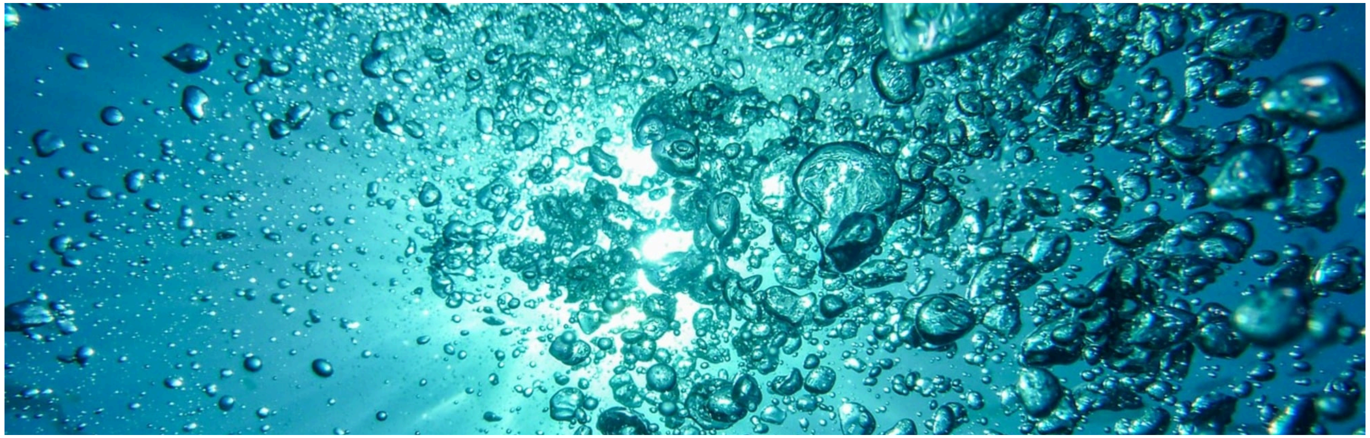
If the research purchased is not directly attributable to the management of a SIF then the supply of research will be taxable. If the research provider is based in the UK VAT will be added at 20%.

If the research provider is based overseas the standard VAT rules on place of supply of services apply. The research will have no VAT added to it by the provider, but you will need to apply the reverse charge mechanism. Reverse charge makes you account for the VAT that would have been added if the services were supplied in the UK, by accounting for a notional sale and purchase.

Will I be able to recover the VAT I am charged on research?

If you only make taxable supplies you will be able to recover any VAT you are charged on the research, the reverse charge on overseas research purchases will not have economic cost.

If you make exempt supplies you will not be able to recover any VAT you are charged on the research, the reverse charge on overseas research purchases will be a cash cost.



If you make a mix of exempt and taxable supplies the normal partial exemption rules will apply.

If you are not VAT registered then you will not be able reclaim VAT, but be aware that the notional sale that reverse charge purchases trigger, count towards the VAT registration threshold.

What about CSAs and RPAs?

Commission sharing agreements ('CSA's) were a common way of paying for research by diverting part of a brokers commission towards a research provider. CSAs that take a charge proportional to the volume of trades are no longer allowed under MIFID II. They have been replaced by Research Payment Accounts ('RPA's) one form of which allows collection of an amount alongside a commission that is not volume linked and has additional administrative requirements.

VAT applies to the supply of services, the supply is distinct from the payment of a service. In most cases the person who receives the supply also pays. Only the person who received the services can recover any VAT added therefore any situation where the person receiving the service is not paying for it, like an old CSA or a new RPA that is modelled as tripartite agreement needs careful VAT consideration.

Another form of RPA has a direct budgeted charge to clients from the manager, careful consideration of the contract under which that charge is made needs to be undertaken to determine if it qualifies as a supply of services with associated VAT liability.

What has HMRC changed?

Nothing in the VAT rules has changed. HMRC have made no amendments to the VAT regulations which derive from EU based legislation. The application of VAT derives from the general VAT rules applied to the change in treatment under MIFID II to not regard research and execution as inseparable

Notwithstanding that HMRC haven't explicitly acted to raise the taxation burden it has risen none the less and the Office for Budget Responsibility claims this will raise GBP40 million a year for the Treasury. This is largely out of HRMC's control as, BREXIT notwithstanding, the concepts applied follow from the EU VAT directive.

What's the problem?

An investment manager that does both of these:

1. makes partially or fully exempt sales; and
2. purchases research not directly attributable to management of a SIF with VAT added to it (notional or actual);

will have irrecoverable VAT on that research which effectively makes that research purchase up to 20% more expensive.

What action do you need to take as a manager?

As an investment manager you should assess:

- if you are managing a SIF are you being charged the right VAT on directly attributable purchases;
- who research is supplied to (as opposed to who is paying), as only the recipient of supply has a right to reclaim the VAT on the purchase;
- in your RPA agreements, if you are using them, make sure you can identify where the supply of services exist and the VAT liability of that supply;
- if you are applying the reverse charge mechanism correctly; and
- if you are reclaiming VAT appropriately?

MiFID II came into force on 3 January 2018 and we expect that you have already had conversations with your suppliers about the research they are providing, who it is being provided to and how it will be charged. You should make sure that your accountants and those preparing your VAT returns are fully aware of these conversations.

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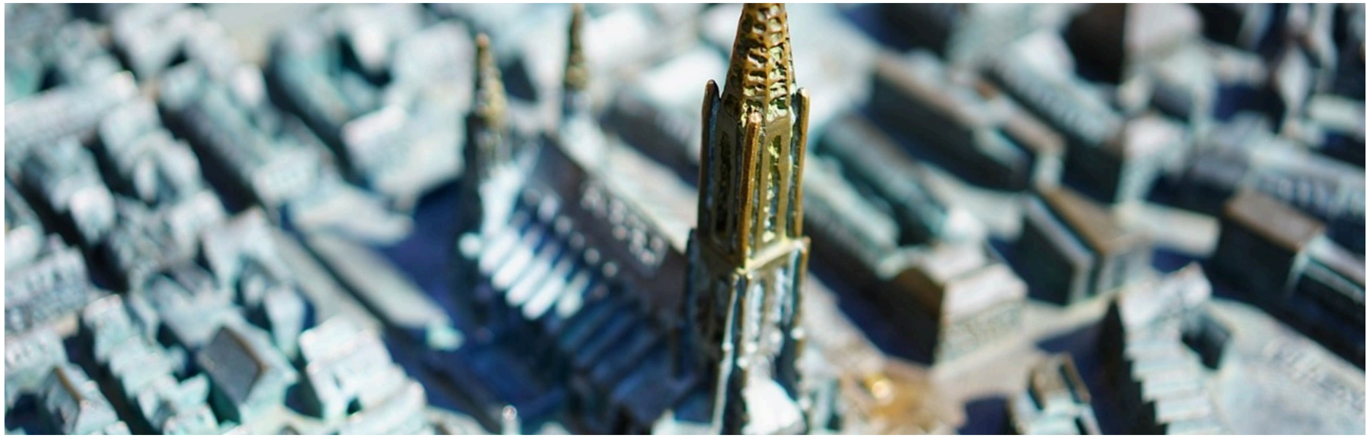
2017 in review – An independent depositary's perspective

By Bill Prew, CEO, INDOS Financial Limited

Bill Prew



The depositary model, introduced in 2014 for many funds under the EU's Alternative Investment Fund Managers Directive (AIFMD), is now firmly enshrined within the industry. The appointment of a depositary was not initially met with support among the alternative investment fund manager (AIFM) community, but many now recognise the value in the extra level of oversight being undertaken.

Equally, institutional clients, some of whom have lost money in the past through operational failings and frauds in the industry, have continued to welcome the additional protections which depositaries bring.

As 2017 ends, independent depositary INDOS Financial looks at some of the major trends and developments that have impacted the depositary business over the preceding year, and explores what 2018 may hold.

The Independent Depositary Model Grows

As an independent depositary, INDOS has experienced solid growth in 2017 driven by several factors. Having seen fund launch activity fizzle out in the aftermath of Brexit and the uncertainty that followed, 2017 has seen a pick-up in start-ups coming to market. Whether this is a sign of renewed confidence in the fund management industry is unknown, but it represents a noticeable turnaround and it is a welcome boost. However, this must be tempered as several AIFMs have closed due to a combination of challenges with asset raising, rising costs, regulation, and market conditions.

Increased non-EU/ third country manager interest in soliciting money via NPPR (National Private Placement Regimes) in some EU markets has also increased demand for depositary services. This is partly because AIFMD equivalence discussions with third countries have stalled since Brexit prompting some non-EU managers to raise capital via the NPPR route, instead of holding out for passporting rights. While the registration process in some countries such as Germany and Denmark can be time consuming, several INDOS clients in the US and Asia have been rewarded for their efforts raising significant sums of institutional money.

At the same time, fund managers with existing depositary arrangements have continued to re-evaluate their provider relationships. This has arisen due to conflict of interest concerns at managers who are increasingly sceptical about whether depositaries affiliated with fund administrators, which represents most firms in the industry, can carry out their roles and duties without bias, unintentional or not. As such, some managers are questioning whether affiliated depositaries can offer the same value as an independent firm.

The decision to switch depositary providers is also a consequence of managers seeking improved service delivery. Several managers have reported that engagement by depositaries has been piecemeal, while others complain of basic fund administration errors being overlooked or not flagged for further scrutiny.

Institutional investor due diligence teams are also becoming more vigilant and focussing on the role of the depositary. Managers that have taken a “tick the box” approach to the depositary requirement are facing increasing questions. Given the swing in the balance of power from manager to investor over recent years, firms need to have a well thought out strategy to address these investor concerns.

Along with investors, fund directors are more active and vocal than they were a decade ago, with many now undertaking thorough assessments on service provider performance. Directors are comparing the service quality they receive from different depositaries across their funds. Given their fiduciary responsibilities, directors want to see depositaries offer real value and demonstrate they can be trusted to bring issues to their attention.

Directors are therefore taking more interest in what the depositary is doing and challenging the manager on their selections, resulting in an upswing in fund houses changing providers at the behest of their boards. Independent depositaries, which regularly engage with board directors, alert them to fund-level problems and exhibit sound judgement will be the chief beneficiaries.

This increased focus on depositaries has also partly been prompted by regulation. As far back as 2013, the Financial Conduct Authority (FCA) conducted reviews into asset managers’ outsourcing arrangements and specific attention was paid to how firms were effectively overseeing third party relationships. Following this year’s FCA Asset Management Market Study (AMMS), managers are now facing scrutiny from the regulator about how they deliver value for money across the value chain including fund service providers, while senior managers will also become subject to greater accountability through the Senior Managers & Certification Regime (SMCR) later in 2018.

Depositaries – like other fund service providers – are also being asked to show that they have effective controls to manage IT and cyber security risks in addition to evidencing that their processes and controls more broadly are subject to independent review. Surprisingly, few depositaries undertake SOC 1/ ISAE3402 controls assurance reviews but are coming under pressure to do so.

Considerations for 2018

Fund managers are clearly facing some challenging regulatory headwinds going into 2018. On January 3, 2018, the Markets in Financial Instruments Directive II (MiFID II) will impose a range of new obligations on fund managers, with provisions around product governance, transaction reporting, bans on inducements and restrictions on using commissions to buy sell-side research.

Managers will then have to prepare for the General Data Protection Regulation (GDPR) which comes into effect in May 2018, and will require firms to ensure robust and thorough safeguards around how client and other personal data is used and stored. Both MiFID II and GDPR are significant pieces of regulation which require a lot of resources and focus from fund managers. Once managers have attained MiFID II and GDPR compliance, they will begin re-evaluating their depositary relationships and consider a change in provider.

AIFMD originally included a requirement that it must be reviewed by the European Commission by

22 July 2017. The European Commission has now started this review. Its purpose is to ascertain whether AIFMD's initial objectives have been met, but also to qualify its impact on the alternatives industry and its institutional client base.

There are several areas that the alternatives industry would like to see reviewed and improved namely the introduction of more meaningful AIFMD leverage measures, more standardisation of cross-border marketing, and simplification of the Annex IV reporting requirements among others. The current depositary-lite model will continue to apply, despite initial expectations that it would be phased out from mid-2018.

The impact of Brexit on AIFMD and the depositary requirements is the biggest elephant in the room. The UK regulator has given no indication that it intends to roll back on AIFMD. The depositary is viewed by the regulator as a cornerstone of good fund governance. It is also supported by the investor community and taking away these protections would be a regressive step, potentially harming the UK's reputation as a well-regulated international market and undermining its long-term ambitions to obtain equivalence with the EU.

Irrespective of what Brexit looks like, INDOS Financial believes the depositary requirement is here to stay.

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Co-Investment

By James Oussedik, Partner and Robert Nield, Associate at Sidley Austin

James Oussedik

Robert Nield

Co-investment opportunities were traditionally only rarely offered by fund managers to their investor clients. Indeed, many managers of buyout funds historically considered it preferable to participate in acquisitions of portfolio companies alongside funds managed by other firms, rather than offer the right to do so to investors in their conventional blind-pool funds. Chief among the reasons for this was the perceived lack of willingness or ability of many fund allocators to adapt to the fast-paced and complex nature of making direct co-investments.

Over the last decade, however, as investors have become increasingly sophisticated, managers and investors alike have sought to gain from the mutual benefits that participating in co-investment opportunities can yield. This article seeks to further explain the basis for this trend and to discuss certain transactional considerations which regularly apply to the structuring and consummation of investment opportunities.

From the perspective of the fund manager, there are three main drivers which encourage the offering of co-investment opportunities to investors:

1. **Relationship-building and fundraising:** by participating alongside one another in direct co-investments, a manager and an investor gain an insight into their respective cultures, strategies and policies, aiding the development of a strong, long-term working relationship.

This is of heightened importance to fund managers as the fundraising landscape has become increasingly competitive. Indeed, it is not uncommon, particularly for less mature managers, for a co-investment structure and programme to be established and implemented even before the manager's main fund has been launched. In this regard, the potential of co-investment opportunities stimulates the wider capital raising process. This could be of additional benefit to new fund managers seeking to demonstrate track record in order to attract further commitments to their main fund vehicle.

2. **Fee maintenance**: while the ability to offer investors an attractive level of fees in respect of co-investments has enabled fund managers to use co-investment opportunities as part of a competitive package of fund terms, it has also allowed them to maintain relatively consistent management and incentive fees in respect of

commitments to their main fund vehicles. This is, on the whole, a satisfactory scenario for many fund managers, some of whom even offer co-investment opportunities to investors on a fee-free basis.

3. **Deal access:** main fund vehicles are often constrained by restrictions as to the concentration of investments which they are permitted to make. In circumstances where a fund manager identifies an attractive investment opportunity, it is often the case that proceeding to consummate the investment would only be possible with the participation of the relevant co-investors (where sub-participating is indeed feasible – for certain types of credit and direct lending investments this is difficult).

When acting upon co-investment opportunities, fund managers and directors are required to take important decisions regarding allocations, conflicts of interest, fees, costs and expenses and investment structuring:

(a) *Allocations of co-investment opportunities:* many fund managers have sophisticated policies regarding the allocation of co-investment opportunities among their constituencies of co-investors. While each co-investor may well seek to negotiate a position of priority as regards access to such opportunities, a prudent manager will often have at its disposal an overriding list of case-by-case considerations which it may take into account when allocating opportunities. It is highly likely that a factor on such list will be the speed at which each co-investor can act upon a co-investment opportunity given the often-condensed timeline for closing.

(b) *Conflicts of interest:* for the first investment to be made by a co-investment programme, it may be possible for a portion of the asset to be held, initially and on a temporary basis, by the manager's main fund vehicle pending the establishment of the relevant co-investment vehicle(s) – at which point the relevant portion will be transferred to the co-investment vehicle. This could, however, give rise to conflicts of interest issues relating to the transaction between the two vehicles. For example, such a transaction between related parties would often need to be conducted on an arm's length basis (with all deal expenses allocated in an appropriate manner), disclosed to any investor committees and even blessed by the relevant regulatory body in the case of certain regulated vehicles such as the Irish ICAV.

(c) *Fees, costs and expenses:* it is crucial that fund managers adequately disclose how all fees, costs and expenses relating to co-investments are to be treated. For example, it is necessary for the manager and the constituency of co-investors to agree how abort costs will be allocated among the parties in the event that a co-investment is not consummated. In addition, as regards any potential transaction fees that a fund manager may receive as lead arranging party in respect of a co-investment, it is vital that the manager includes in the relevant fund documents detailed disclosure as to how these fees will be dealt with, particularly if it is the intention of the manager to retain such amounts.

(d) *Structuring:* the fund manager will also, often in consultation with its co-investors, define and implement an appropriate structure for its programme of co-investments. The decision-making process as regards the structuring of co-investments is commonly, as for many other types of investments, underpinned by a combination of legal, tax, regulatory and operational considerations. Separate co-investment vehicles may be formed to accommodate a single investor or multiple investors. Given that the same considerations often apply to the co-investment vehicle(s) as the main fund vehicle, it is not surprising that all vehicles are often domiciled in the same jurisdiction.

In terms of specific vehicles, managers of buyout funds have recently favoured Cayman Islands limited partnerships (with under-the-fund structuring tailored to suit each underlying asset) and managers of credit funds have commonly favoured Irish "section 110" companies or Luxembourg SARLs, which are capable of benefiting from the range of Irish or Luxembourg (as the case may be) tax treaties commonly providing for reduced or nil withholding tax. Where a co-investment vehicle, such as an Irish "section 110" company, is investing in credit instruments such as non-performing loans, it would be standard practice for investors to fund such investments by way of debt (for instance a profit participating note) rather than equity.

As many co-investment vehicles are established to acquire, or hold interests, in a number of discreet assets, it can be the case that such vehicles are treated as investing rather than trading from a tax perspective. If so, certain of the common tax issues relating to the location of investment decisions, and related permanent establishment risks, fall away.

Whilst the limited purpose of many co-investment vehicles can often be helpful, it can also give rise to other challenges. For example, the development of the OECD initiative on Base Erosion and Profit Shifting, in particular Action 6 (focused on the perceived abuse of double tax treaties), will often require careful consideration when determining how the co-investment vehicle will hold underlying assets. Due to the manner in which Action 6 will likely be applied, through the "principal purpose test", additional care will often be required to ensure that the co-investment vehicle remains entitled to benefit from the provisions of applicable double tax treaties.

For investors, there are also several compelling factors which have underpinned sustained increases in the popularity of co-investments:

1. **Enhanced returns:** the lower fees which are generally charged by fund managers in respect of co-investments result in better returns for investors. Moreover, capital committed to co-investment opportunities tends to be invested in a single tranche at closing, which serves to mitigate the J-curve effect which investors regularly witness in respect of their blind pool fund investments.
2. **Control and experience:** many investors will seek to negotiate consultation or veto rights into their co-investment programme. This,

coupled with the fact that co-investors will be involved in the due diligence and negotiation phases of any transactions which do proceed (and, ultimately certain governance rights at target level), entails that participation in co-investments allows allocators to exert increased control over the design and construction of their investment portfolio. Such participation also aids the development of an investor's market experience given the enhanced risk and complexity associated with direct co-investment transactions.

In conclusion, investors making allocations across the full spectrum of asset classes are requesting access to co-investment opportunities as a matter of course – and this is set to continue. However, managers of funds in areas which are less developed as regards co-investments need to be cautious and thoughtful as to the implications of implementing programmes of co-investment on their main fund vehicles and on investor relations, as well as to the challenges posed by allocating and structuring co-investment deals.

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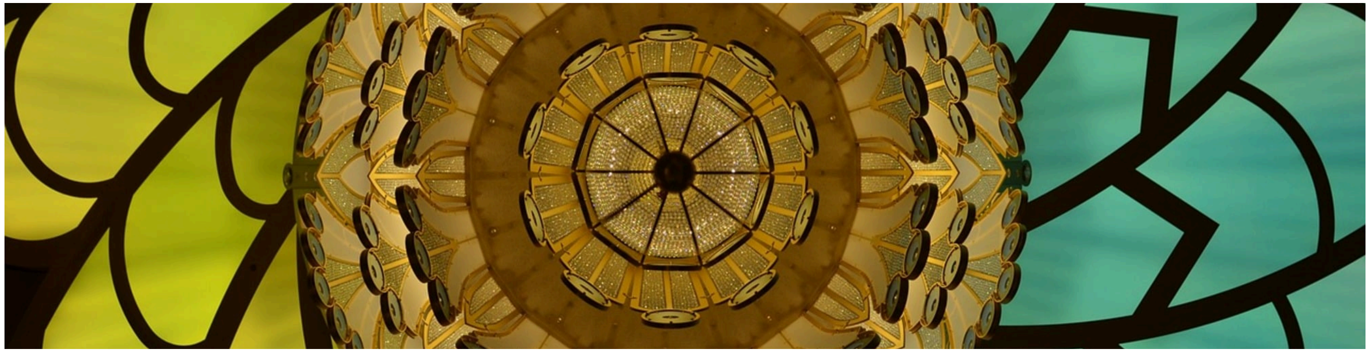

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Disclaimer

Bitcoin: A compelling alternative asset class

By Jack Tatar, Advisor, 3iQ

Jack Tatar

It seems as though everyone is talking about bitcoin these days.

As I write this, the price of bitcoin has just risen above $15,000, and it's now a daily topic of discussion on 24-hour finance channels and nightly news. It's only a matter of time before it's listed on the bottom of TV screens alongside the current equity market averages and commodity prices.

To put its current price in perspective, back in January of 2017, it was trading at $1,000 a bitcoin. Clearly, anyone who put money into it back then would now have huge profits. But the question for many investors and investment managers is - is it an investment? Perhaps the first question should be - what the heck is bitcoin?

What is Bitcoin?

The creation of Bitcoin grew out of the financial crisis of 2008. It was created by an anonymous entity known as Satoshi Nakamoto. Six and a half weeks after mid-September, 2008 when Lehman Brothers declared bankruptcy and Merrill Lynch was sold to Bank of America to save it, Satoshi released the Bitcoin white paper. This document outlined a new method for electronic transactions and is the genesis for every single blockchain implementation deployed. Satoshi wrote, "We have proposed a system for electronic transactions without relying on trust."

Although Satoshi released the white paper first to outline the creation, the coding of the bitcoin software had been completed. Soon the software was loaded onto computers and Bitcoin's blockchain was implemented. Bitcoin's blockchain can be thought of as a digital ledger that keeps track of user balances via debits and credits. On each computer running the Bitcoin software around the world sits the entire record of all transactions conducted on the Bitcoin blockchain as a distributed, immutable and permanent record.

Bitcoin is the reward for the verification of transactions, which is a "competitive" exercise utilizing a "proof of work" protocol (consistently working computer power is required to compete). This is an overly simple explanation for the process

but the key to recognize is that the public eco-system of the bitcoin blockchain is maintained by this process and its open nature allows for anyone (with computing power) to join the blockchain.

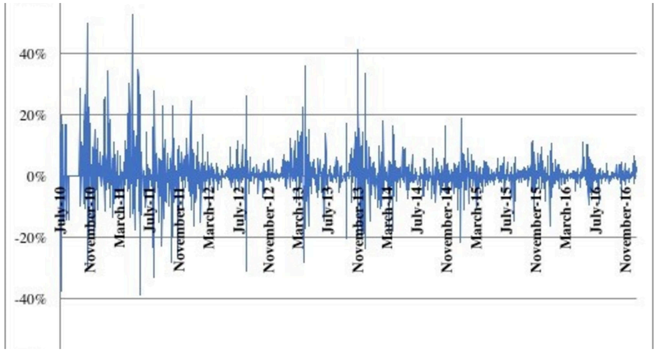
The process of gaining bitcoin through the public blockchain is known as “mining,” and there will be a total of 21 million bitcoin by the year 2024 created through this mining process. There are currently over 16 million bitcoin in circulation. This “set” total of bitcoin creates a “disinflationary” asset, as compared to gold, which has a rising supply and no end amount in sight (thus, an “inflationary” asset). I bring up gold in this comparison because it’s often compared to bitcoin in discussions extolling bitcoin as an asset and even an investment. So, should we consider bitcoin an asset and even an investment?

Bitcoin as an asset

Bitcoin is currently traded on numerous exchanges throughout the world on a 24-hour basis. Anyone can trade fiat currency for bitcoin through exchanges such as Coinbase (NYSE is an investor). At any time, traders can recognize a price for bitcoin and many other cryptoassets, including ether (ethereum) and litecoin. Currently there are over 800 cryptoassets trading on exchanges around the world. Along with bitcoin, many of these assets exhibit volatility and significant returns for those brave enough to invest in them.

Over the past few months, bitcoin has been on a wild price ride, but let’s take a look at its volatility historically and even compare it to current assets that make up holdings in investor’s portfolios. Below is a chart from the book, ‘Cryptoassets” that shows that bitcoin’s volatility has been significantly decreasing since the collapse of Mt. Gox (the initial bitcoin exchange that was opened in 2010 and subsequently hacked in 2013 with many bitcoins lost).

Chart 1

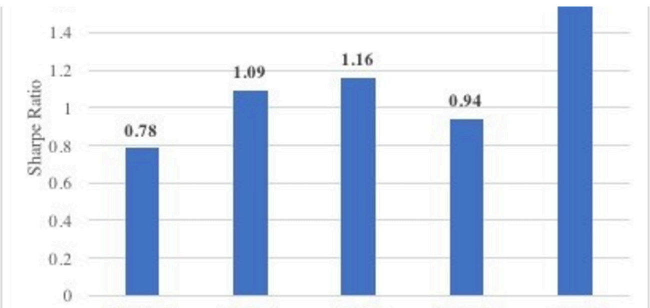


Although there’s been a decrease in volatility over time, it’s true that bitcoin exhibits a significant level of volatility. However, the same can be said for some of the most widely held stocks by investors – the FANG stocks. So how does the volatility of bitcoin stack up against the volatility of those stocks?

In the time-period from Facebook’s IPO to January 3, 2017, the volatility levels were: Facebook 2.5%; Amazon 1.9%; Netflix 3.4%, Google 1.5%, and bitcoin was 4.6%. Although bitcoin exhibited higher volatility than each of the FANG stocks, it’s not as drastic as one may think. All five of these assets have seen significant absolute returns over the last few years, and although returns and volatility are important, those of us who study assets recognize that putting the two together provides us with the Sharpe ratio, which helps to calibrate the returns for the risk taken. The higher the Sharpe ratio, the more the asset is compensating investors for the risk.

Evaluating the Sharpe ratio for bitcoin and these assets over this same time-period show that not only did bitcoin exhibit the highest volatility and highest returns over this time, but it also had the highest Sharpe ratio of these assets by a significant level. Bitcoin compensated investors twice as well for the risk they took with Facebook, and 40 percent better than Netflix.

Chart 2



As investors and investment managers, there's always need to implement effective risk/reward holdings into our portfolios. Utilizing the Sharpe ratio helps to identify those assets that can provide significant returns while balancing the risk profiles of our funds and investors. The significant returns exhibited by bitcoin over the last couple of years are "nudging" investors of all levels to explore bitcoin and other cryptoassets as assets within their investment portfolios. As responsible investment professionals, it becomes vital for us to consider how these assets should be appropriately recommended and positioned for investors.

Bitcoin as an alternative asset

In 2013 as a columnist writing on retirement for Marketwatch.com, I began a series of articles (https://www.bitcoinandbeyond.com/single... about my interest in pursuing bitcoin as a holding for my investment portfolio, specifically into the alternative asset allocation of my portfolio. After the financial crisis of 2008, we saw financial service firms incorporate alternative assets into their asset allocation for clients.

Morgan Stanley and Merrill Lynch soon produced asset allocation models for both high net worth and traditional investors that provided recommendations for around 20% of a portfolio to be positioned into alternative assets. The primary reason was to address the correlation between assets in a portfolio to protect investors from down markets significantly impacting multiple assets, as happened in 2008 when both equities and fixed income both had drastic drops. Since that time, the growth of the ETF model and the inclusion of gold, energy resources, and real estate into these holdings provided an easy way for all investors to gain access to alternatives in their portfolio.

So, could bitcoin fit the model of being an alternative asset? One of the major functions of an alternative asset is to provide a level of non-correlation to other assets, which would then provide a lower level of risk in a portfolio.

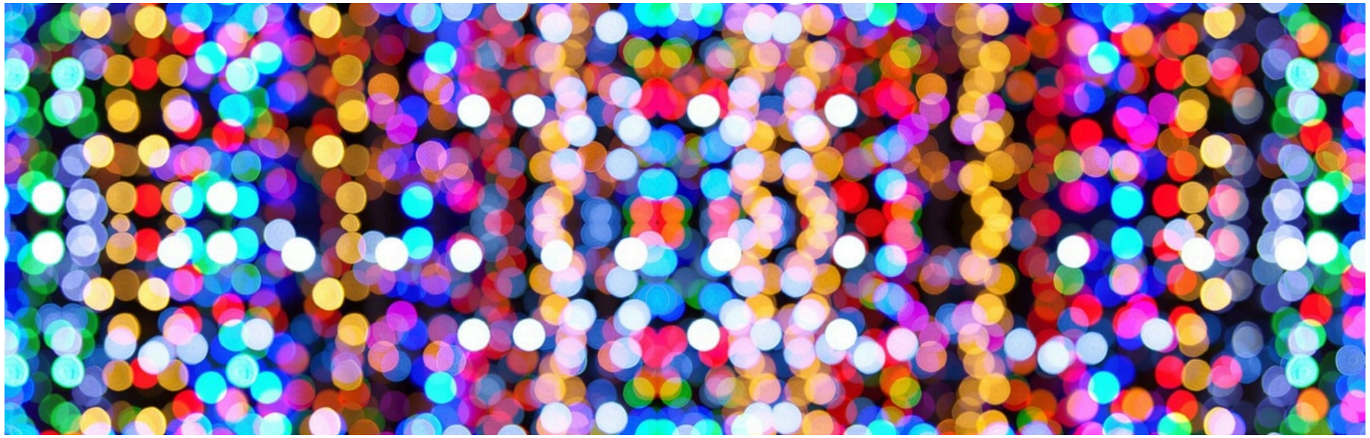
Looking at the period-of-time from January 2011 to January 2017, we find that bitcoin's average 30-day rolling correlation with other assets was -.04 for the S&P 500, .02 for gold, -0.2 with oil and zero correlation with U.S real estate and U.S. bonds. According to Burton Malkiel in his classic book, "A

Random Walk Down Wall Street," the closer an asset is zero correlated to other asset results in "considerable risk reduction" for a portfolio.

Having an open mind towards Bitcoin

Bitcoin has moved from being something that's discussed between geeks to front page material for financial publications and the mass media. As it permeates the public discourse, clients are bringing it up to their advisors, and investment managers are frantically searching for knowledge on the topic. We're now seeing people with knowledge of the topic being given a chance to report to the public on it. They extol the opportunities that exist for bitcoin and other cryptoassets to not only disrupt current financial systems, but also make money for those investors who are willing to do their due diligence and recognize how it may fit into their asset allocation models.

Dismissing bitcoin and ignoring the entire cryptoassets space is something that an investor and investment manager does at their own peril. For every Jamie Dimon who seeks to protect the



financial status quo with uneducated remarks and dismissals of bitcoin as a fraud, there are those visionaries in the investment space like Fidelity, who now include bitcoin balances as part of a client's net worth.

Since I began my bitcoin journey in 2013, I've heard the same old tired calls from banks, investment firms and advisors dismissing it as a fraud and a fad, and it's not fair to investors. I believe that it fits an alternative asset sleeve for investors and for the investment manager who's willing to come to bitcoin with an open mind, do your due diligence, and understand the risks involved, you may come to the same conclusion.

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Held to account – The competitive impact of enhanced senior management responsibilities in global financial services

By Ben Blackett-Ord, Chief Executive at Bovill

Ben Blackett-Ord

Ever since Nick Leeson brought down Barings Bank in 1995, regulators in the UK have been struggling to put in place an appropriate regime for holding senior managers to account. The UK's first attempt, the Approved Persons Regime, which lasted ten years, was found wanting in the light of the financial crisis. Warren Buffett once said: "Only when the tide goes out do you discover who has been swimming naked". The financial crisis exposed some shocking behaviour, from reckless decision making to outright illegality. The reputation of financial services nosedived as case after case of systemic failings was uncovered, all arguably caused by a lack of accountability of those at the top. The UK regulator's response has been the Senior Managers and Certification Regime, which has been heralded as a gold standard. Only time will tell whether it can deliver what it aims to achieve.

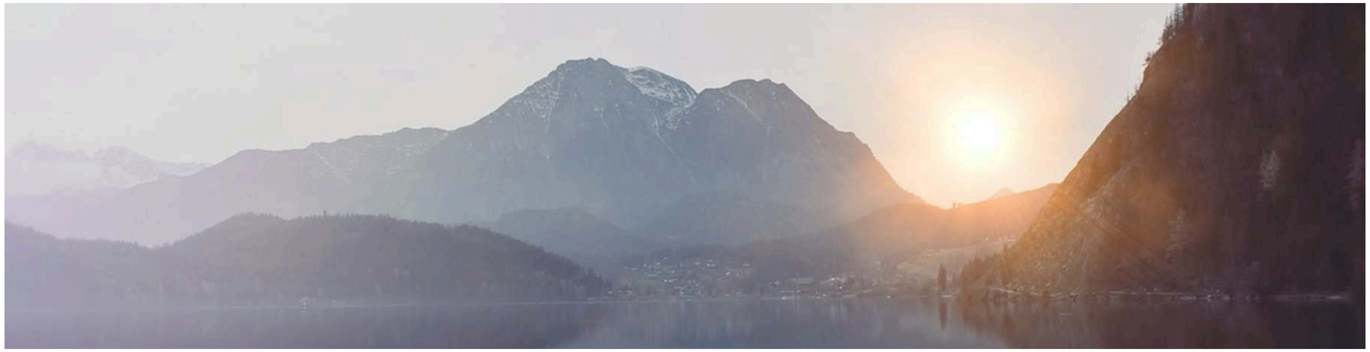
Fast forward a decade from the start of the financial crisis, and a shift in regulatory focus from the institution to the individual is apparent. Scrutiny on the responsibilities and accountability of senior management within financial services is increasing across the globe, with particular parallels between what is happening in the UK and Asia. 89% of senior managers and compliance officers we spoke to worldwide for our new report agreed that scrutiny has increased since the financial crisis. Encouragingly though, we've also found that the new rules are largely accepted, rather than challenged, driven by a belief that senior management accountability is good for business. In particular, there is a feeling that the increased scrutiny has improved governance and attitudes towards setting culture.

To understand the impact of the rules around senior management responsibilities, we conducted online research and in-depth qualitative interviews with Executive Directors, Senior Management and Heads of Compliance. This spanned the four countries under our spotlight: the UK, Singapore, Hong Kong and the US.

Senior management embrace the scrutiny

Nearly all the senior managers surveyed felt regulatory scrutiny on them had increased. Their awareness of the rules is extremely high. 88% of participants told us they are "aware" or "very aware" of the rules around senior management

responsibilities in their primary jurisdiction. It is also encouraging that 50% believe the level of regulatory scrutiny is about right. Another one in ten feel it is actually too low. There is a sizable portion - just over one in four - who think the level of scrutiny is too high, but on the whole this represents a positive reaction to the steps taken by regulators over the last decade.



Business leaders feel that the increased scrutiny on senior management has positive implications for corporate governance, setting a precedent for principled behaviour and an ethical culture within the workplace.

An example of this is the changing relationship between Compliance Officers and leadership teams, which according to business leaders has vastly improved. Jonathan Polin at Sanlam UK told us that "the compliance framework and leadership is kept much closer than it has been in the past. Not only do we need to have it as part of a cultural change for the industry, but we need to show the audit trail in our discussions that we are reviewing all the aspects the regulator would require us to do." Across many jurisdictions, Compliance Officers are often required to take part in Board meetings. According to one interviewee this is particularly the case in the US, although it is worth noting that mutual fund Compliance Officers in the US report to the Board, not to management.

In the UK, under MiFID, Compliance Officers are required to report to the management body, on at least an annual basis, on the implementation and effectiveness of the overall control environment for investment services and activities, on the risks that have been identified. The compliance function must also report on an ad-hoc basis directly to the management body where it detects a significant risk of failure by the firm to comply with its obligations under MiFID.

In our report, 'Held to Account', we explore the approach being taken by regulators across the world's four leading financial jurisdictions - the UK, US, Hong Kong and Singapore. We examine the similarities and differences between the regimes, the reactions of those subject to the regimes, and highlight the following potential unintended consequences of the increased emphasis on senior management:

1. There is emerging evidence that, if left unchecked, a brain drain away from the top echelons of financial services will develop. Alongside the increased scrutiny, there is the potential for mistakes and errors to stay with individuals for the duration of their career. This fear of being punished could put future

management candidates off taking senior roles within financial services firms.

2. Chief Compliance Officers are not typically risk takers, but the best Chief Executives do tend to push boundaries. Without the right balance of personalities at the top of an organisation, firms could struggle to compete and may suffer as a result.
3. While this study does not specifically examine the approaches being taken to senior management responsibilities in all EU member states, it is worth noting the UK regime is home grown and goes way beyond the requirements of any EU directive or regulation. This is particularly relevant in the context of the UK's competitive position arising from its planned departure from the EU. Will the UK regime be seen as a standard to be admired and emulated - or a step too far?
4. Differences between the approaches adopted by various regulators could significantly increase the burden on individuals charged with global responsibilities. A reluctance by individuals to be subject to more than one regulatory regime could drive businesses to manage their affairs more along jurisdictional lines rather than product or service lines. This may not be in the interests of those that they serve.

Business leaders accept that increasing levels of personal responsibility has been the right thing to do. But our research has exposed some potential side effects which, if left unchecked, could have significant consequences for firms to operate effectively and successfully. Because of the role financial services play in the wider economy, these risks could have broader impact.

There is no silver bullet solution to address these issues. But there are steps which senior management and regulators can consider to stop them overshadowing the many positive aspects of greater personal responsibility and accountability.

Plan now for tomorrow's senior managers

Our research found evidence that some of tomorrow's senior individuals will decide against taking senior roles, put off by the level of accountability on their shoulders. Businesses can start to mitigate this risk now by preparing for the issues that will likely make the next generation of leaders think twice. Effective succession planning for particular roles will be critical, but another consideration is investing in training and education for junior and middle managers. Demystifying some of the responsibilities that come with senior roles may reduce the proportion who think such jobs are not worth the potential risks.

Bring compliance and Boards closer together

Our research shows that the relationship between Boards and compliance has never been more

important. A consideration for all firms is to bring compliance heads in to Board meetings, or go further and make the role a Board appointment. This will give the CCO insight into the way senior teams discuss and decide on critical issues which has to be good for effective governance. Ultimately, it should help compliance departments produce better management briefings that do more than simply provide the facts on updates from the regulator, and answer the question senior management want answered above all others: 'what does this mean for me?'.

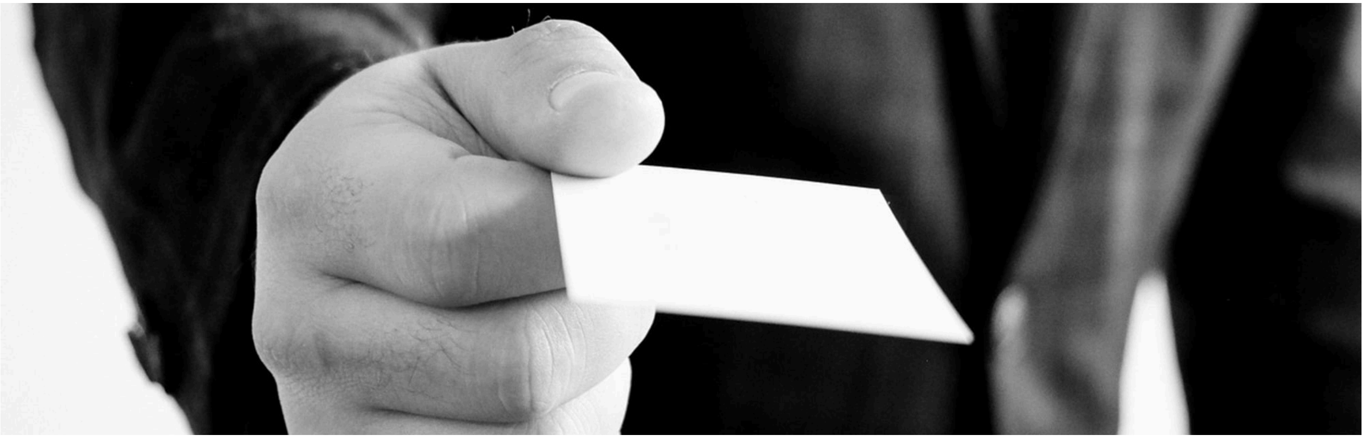
Use regimes as a calling card for businesses who see well established rules as a draw

Our research has found that for a significant cohort of business leaders, clearly defined and well-established rules around senior management responsibilities enhance a location's attractiveness as a place to do business. Regulators should consider ways in which promoting their regimes can be apositive factor in attracting firms and investors to their jurisdiction, in order to reduce the risk that the perceived strength of the regime is a deterrent.

Nobody wants to see a repeat of the behaviours that led to the biggest global economic downturn since the Great Depression. So it is reassuring to see that leaders accept and understand why scrutiny of their responsibility and accountability is higher than ever. We must also be alert to unintended consequences that could put people off taking senior roles in future, or damage competition. The long-term impact on global financial services could be profound if we are not.

To read our full report 'Held to Account' click and download it here.

For further information, please contact: enquiries@bovill.com



What a long strange trip it's been...on ALIS

By Michael Oliver Weinberg, Chief Investment Officer, MOV37 and Protege Partners

Michael Weinberg

We have titled this paper with an ode to a compilation album by a band that was founded in Palo Alto and developed a counter-culture. Though the title espouses a new state of mind, it is investment, not consumption driven, as this is 2017 and not 1965.

There is a book written by John Markoff entitled What the Dormouse Said, and those with a penchant for '60s music may recall this is a line from a Jefferson Airplane song based on Lewis Carroll's classic book, Alice's Adventures in Wonderland. For those not familiar with Markoff's book, a primary point is that today's personal computer is largely a derivative of Stanford and its/the counter-culture. It was this counter-culture that revolutionized society in ways that no one then could dream of ex-ante, and are only obvious now, ex-post. In line with these themes, in our website, www.mov37.com, we include allusions to Carroll's book through the titles of our "ALIS Through the Looking Glass" and "ALIS Down the Rabbit Hole" sections.

"ALIS" is an acronym we have created for "Autonomous Learning Investment Strategies", which we believe are an emerging "third wave" of investment managers, the first and second being fundamental discretionary and quantitative investing, respectively. ALIS are smaller managers taking of advantage of recent advances in artificial intelligence and machine learning, combined with an explosion in data availability and inexpensive cloud computing, to generate alpha at a fraction of the cost of traditional managers. (For a fuller explanation of ALIS managers, we recommend reading the canonical paper on them by Jeffrey Tarrant, entitled "The Intelligent Investor in an Era of Autonomous Learning", available on our website.)

Just as the Grateful Dead developed a counter-culture, ALIS managers are also. Whereas the first wave of investing was comprised of MBAs, the third wave is comprised of PhDs. Though some ALIS managers are based in New York and London, as the MBAs and Wall Street or The City are, many are based in Palo Alto and San Francisco, homes of the original counter-culture and Silicon Valley. The counter-culture of the '60s often sprouted from the world's leading universities, which is where ALIS managers also are germinating.

Reverting to the title of this essay, we have spent the last couple of years traversing the globe, far beyond New York and London, including Israel, Asia, Canada, Silicon Valley, university towns, The South (in the US) and suburbs in our quest to locate the world's best ALIS managers, and it has been a long, strange trip. We have found 200 managers that portend to be ALIS managers. For context, this compares to one of the world's preeminent hedge fund databases that has only identified a fraction of that.

In George Orwell's Animal Farm he states that all animals are equal but some are more equal than others. Similarly, our take on ALIS managers is that they all are equal but some are more equal than others. In the land of ALIS there is a wide spread between the best and the worst, and most managers are far from average.

We shall now share with the reader some of our adventures researching ALIS managers around the world, organized into sections on the genres of ALIS managers we would and would not invest in. To do this, instead of obscuring and altering certain details so that it's not overtly apparent which managers we are referring to, we will simply speak very generally, just as Barton Biggs did in his book about first wave investing, Hedgehogging.

<u>Which ALIS managers are better? Which ones to avoid?</u>

Genre 1 - Acronym Soup

The best optimize machine learning techniques and focus on depth rather than superficial coverage.

The best ALIS managers understand exactly why

they use a particular machine learning technique. They don't just use off-the-shelf code – they custom-tailor it to exactly suit their needs.

The worst fall into Acronym Soup.

Though we have named the third wave with our own acronym, ALIS, we sensibly took a pause. There is a genre of ALIS managers that over-compensates for a lack of substance by asserting they use every acronym of machine learning, in what we refer to as Acronym Soup.

A typical due diligence meeting with these transgressors might go something like this. MOV37 team: "What type of machine learning techniques do you employ?" Alphabet Soup ALIS managers: "We use SVM, PCA, NN, NLP and KNN" (referring to Support Vector Machines, Principal Component Analysis, Neural Networks, Natural Language Programming or Neural Linguistic Programming and K-Nearest Neighbor, which are detailed on our website).

There are some top ALIS managers who do employ many of these techniques together, however, in our experience to date, the top decile of ALIS managers generally are most proficient in one of them, which is dominant in their strategy. In addition, these techniques are typically not being used through off-the-shelf code, but are custom-tailored by the managers. There typically is an inverse correlation between the number of ALIS techniques employed and the quality of the machine learning, and fund.

For fun, to violate our aforementioned acronym stinginess, we will extemporaneously create a new one, MLP. Henceforth, an MLP is a Machine Learning Panacea. Unlike a Black Swan, it doesn't exist. Different machine learning techniques are ideal for solving different classification challenges.

Genre 2 - To PhD or Not To PhD.

The best are highly educated.

As a member of a Shakespeare Club, we love to pay tribute to the bard. We therefore title this genre with a bastardized take on “to be, or not to be”. One of our fundamental ALIS premises is that an ALIS manager only needs one or two PhDs, not a hundred or multiple hundred, as some of the world's best second wave quantitative, or computational finance managers employ.

However, while ALIS managers don’t need a large quantity of PhDs, quality is critical. ALIS leverages the strength of man plus machine, which will outperform either man or machine individually.

Generally the world's top-decile ALIS managers have PhDs from the world's best schools, though not necessarily Ivy League, but often technical. The degrees may be in statistics, particle physics, epidemiology, machine learning and robotics to name a few.

Though we have identified one ALIS manager without a PhD, he is exceptional, went to a top school, studied computer science, was a gamer and hacker (though in a benign way) at an early age, and effectively educated himself in many of the machine learning techniques and technical trading of the markets. This manager is exceptional. The rest of the top decile ALIS managers generally have 1 or 2 PhDs.

The worst have less education and experience.

We did a meeting with an ALIS manager who discussed his PhD. However, upon closer examination, we found that the manager hadn't completed his dissertation and therefore didn't have one. This manager’s non-PhD was from a school in a state with a nice landscape, but that was about it.

Though as previously stated, we prefer (and generally require) PhDs to MBAs for ALIS managers, there is one crucial caveat. An ALIS manager with a PhD who doesn't understand investing is an automatic pass. As one of the world's great investors we worked for once said, "If I could short that fund I would." And that applies to some ALIS managers.

For example, we met an impressive ALIS PhD with strong machine learning. However, there were two primary and irreconcilable problems with the fund. The first was the fund naked shorted options. That is a strategy we learned early on in our careers to avoid at all costs due to the left-tail risk. The second issue is the Prime Brokers convinced the manager to turn liquid large capitalization securities into illiquid swaps. Perhaps this is revenge of the MBAs. In any case, it is an example, where the man in the man plus machine formula must at heart be a strong investor and understand markets and investing. Merely having a PhD is not enough.

And sometimes there may be plenty of PhDs, years of research and inordinate amounts of money invested, but nothing to show for it. Because Silicon Valley has revolutionized and disrupted many industries ranging from the taxi business to advertising, there often is a view that Wall Street or investing is no different. But it is, at least in our opinion.

For example, we have seen ALIS managers in the unsecured lending space with (and without) PhDs who have come up with models that were effectively short a put, and worse, levered them up only to lose large amounts when the loans stopped performing. More troubling are managers in this space making loans with no credit, distressed or work-out experience. We believe that these are likely to lose large amounts of principal in the next economic downturn.

Genre 3 - Back-test Heaven

The best know that history doesn't always repeat itself.

The top-decile managers that we have identified all have actual track records, ranging from a year to a few years. The actual returns are impressive, not only in terms of level of return, but also due to the quality of the returns. They are low beta, high alpha, uncorrelated to indices and are generated by idiosyncratic sources. These return streams are not predicated on easily and inexpensively replicable factors. They also are not long-only or long-biased. With top decile ALIS managers, one is paying for alpha, not beta.

Moreover, because ALIS managers are typically small and emerging managers with low cost structures, they are amenable to investor friendly and aligned fees. Some top decile ones have adopted the 1/10/20 fee schedule that we, Jeffrey Tarrant, Adil Abdulali and I, espoused in a Pensions & Investments article entitled "A Perfect Solution."

The worst live in the past, in back-test land.

The bottom decile of managers usually have phenomenal back-tests, hypothetical or pro forma returns, but no actual returns. They are "heavenly" theoretical return series that were over-fit, and when actual dollars are deployed they become hellish.

There would have to be quite an extraordinary circumstance for us to invest in an ALIS manager that does not have an actual track record. For example, as multiple members of the MOV37 team were investors in Renaissance Medallion, in our opinion one of the world's best funds, if Jim Simons were to start an ALIS fund, we would be more than happy to consider an exception.

However, all too often with ALIS managers, they may not fall in the two aforementioned categories, but they ascend to back-test heaven. There is no dearth of articles on the flaws with back-tests, and the typical commensurate over-fitting, so we will not spend much time on that other than to say, machine learning can inherently lend itself to over-fitting if not used properly.

What we often see with ALIS managers is a back-test that generates, to quote an '80s icon, Crazy Eddie, “Insane” returns, often 20-30% per annum, or Sharpe ratios in the mid-single digits, or higher! Then at some point the managers scrape up enough capital or intestinal fortitude to actually launch the fund. That's when they go from Back-test Heaven to Actual Hell.

We met with one of these managers that crossed the chasm. Interestingly the fund went from the aforementioned heavenly back-test return rate to a mid-single digit actual return rate. Moreover, the Sharpe ratio fell off a cliff as function of the quality of returns having gone from a few mildly poor periods, to many very bad periods.

Along these lines, there is another ALIS manager that we think very highly of but came from a long-only background, lacked short data and consequently had a back-test with a broad index hedge, rather than security specific shorts. We helped the manager source short data, and explained that after a track had developed with security specific shorts, we are happy to revisit.

Genre 4 - The Disreputable

The best have integrity.

We have thoroughly vetted our ALIS managers. They are who they say they are, situated where they say they are, doing what they say they do. They have been forthcoming with the techniques they use without revealing the details of their secret sauce. They are willing to be transparent with trades, because it is next to impossible to reverse engineer an ALIS strategy.

The worst are frankly disreputable.

Though fortunately only a tiny minority of funds in the ALIS universe, we have come across a few which we refer to as the disreputable. We have not spent the time to confirm or disaffirm their disreputable status, because for our purposes, all we know is that they are bad enough to not warrant further due diligence.

One such manager asked us, "How much and how quickly we could invest?" Our response was a highly respectable institutional amount within the next 6-12 months. After the manager had only run a small amount at the aforementioned “insane” rates of return, they went on to tell us, "That the amount you suggested may be insufficient for them to warrant expending their limited time and resources on our due diligence process." They also went on to ask, "Could we not invest more quickly?"

Another manager told us they learned from some of the world's top investment managers, including ones we knew. It turns out they never worked for those same managers. Instead, they were at a service provider who worked for those managers, and said they learned from seeing the positions and trades. By that token, anyone who studies 13Fs can learn from the world's best managers.

We once set up a dial-in conference line for ourselves and an ALIS manager in another country. We asked them, "Do you have an office and are you all there now?" because it wasn't clear that they did. They then went on to say, "Yes and we are there now." However, because we had the dial-in number, we could see that there was not one dial-in from their side, but rather there were multiple. So even if they did have an office, they prevaricated in terms of where they were at the time of the call.

Yet another ALIS manager we know, who fits into multiple genres, including Acronym Soup, Back-test Heaven and disreputable, both in one-on-one meetings and publicly to the media brags about their systems picking up on insider trading patterns. At least they are making it easy for the Securities Exchange Commission, SEC, to find them.

In summary, we have spent the past two years on this proverbial long, strange trip.   It has been extremely rewarding separating out the wheat from the chafe, or bifurcating the top decile manages from the ones in the four worst genres. Though we have over-simplified much of it here for the sake of brevity, the research process was long, arduous and complicated. In many instances it took multiple meetings and much analysis to truly differentiate these managers. We look forward to spending the next few years continuing our long strange trip sleuthing out the world's best ALIS managers.   Having come so far on this trip, we are certain ALIS will revolutionize investment management as the counter-culture did approximately a half a century ago.

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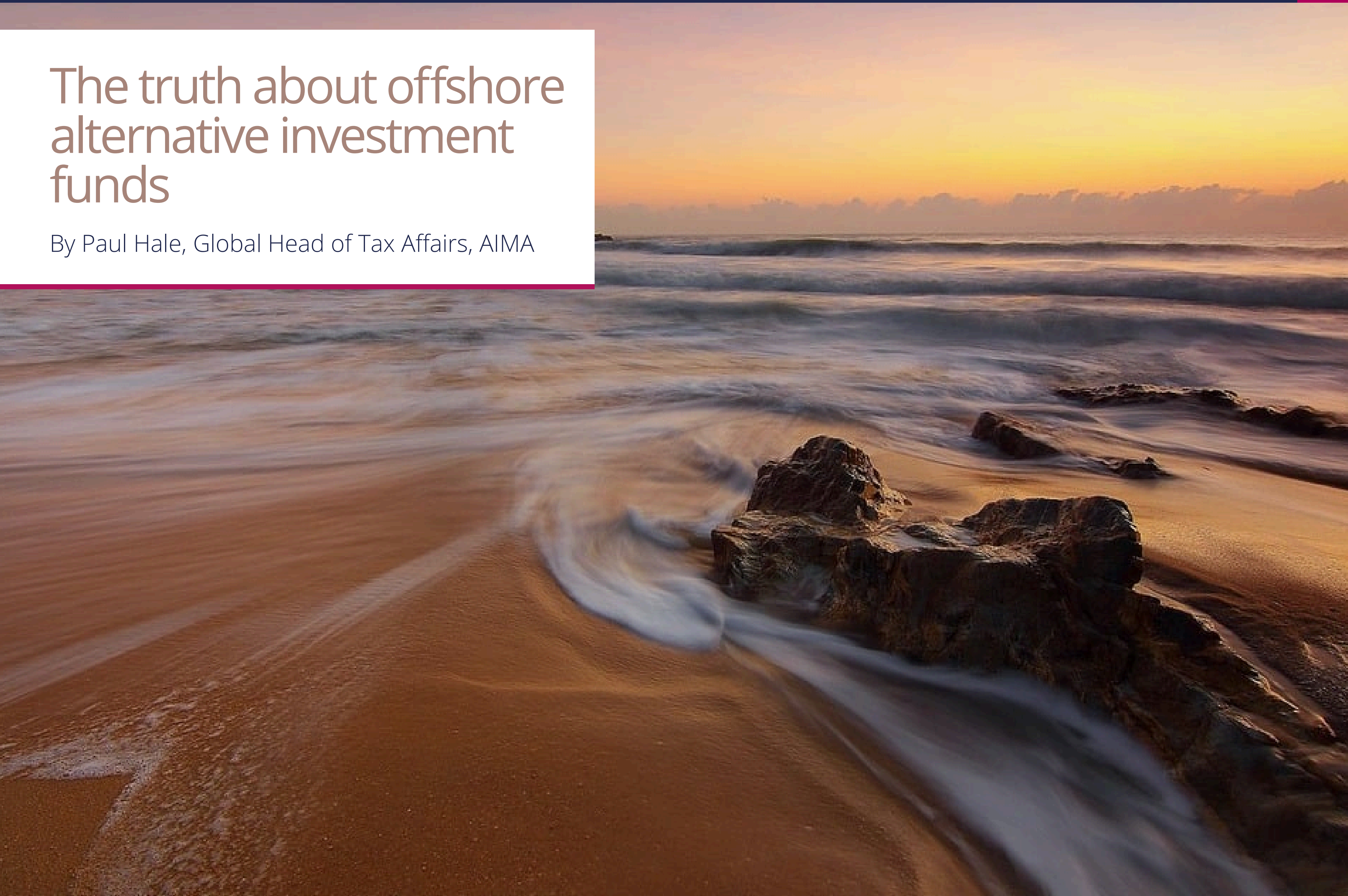
The truth about offshore alternative investment funds

By Paul Hale, Global Head of Tax Affairs, AIMA



Paul Hale

There are often fundamental misunderstandings when it comes to hedge funds and taxation. Here are some of the basics on the subject:

- **Investing in an offshore alternative investment fund does not confer a tax advantage** over investing in an onshore fund, because investment funds (and "collective investment schemes" in general) are tax neutral, whether registered offshore or onshore. That means that investors in the funds remain liable to tax on their gains but the fund itself does not incur tax which would be an additional cost to the investors. Tax neutrality thus is not unique to the offshore world. All developed economies with funds industries, such as the US, France, Germany and the UK, have tax neutral fund structures in their regulatory and tax regimes. The reason hedge funds, private credit funds and private equity funds tend to be set up in offshore jurisdictions such as the Cayman Islands is that the regulatory regimes of those financial centres permit much more flexibility over the investing and risk-management tools the funds may use as well as being more suited to an international institutional investor base.

- **The identity of investors in offshore alternative investment funds may be private, but it is not secret**. Under the Common Reporting Standard (CRS), a set of global tax transparency rules that were drawn up by the OECD and have been implemented by more than 90 countries, including all the main offshore alternative investment fund jurisdictions, the identities and financial details of beneficial owners (such as investors in offshore alternative investment funds) are shared with tax authorities in the investors' home countries. These reports are sent automatically - there are no legal hoops for tax authorities to jump through first. The offshore alternative investment fund jurisdictions also have or are establishing registries of beneficial ownership from which details can be provided to official agencies on request. The information is treated as private and confidential by tax and law enforcement agencies, meaning the data may not enter the public domain without good reason. The wider public interest is served by official agencies having access to the data.

- Offshore alternative investment funds are set up in offshore jurisdictions such as the Cayman Islands, Bermuda, the British Virgin Islands, Jersey and Guernsey, many of which have regulatory and supervisory regimes that have been comprehensively and positively assessed by the European Securities Markets Authority from the point of view of investor protection and systemic risk monitoring. All of the mentioned jurisdictions have implemented global anti-money laundering standards, comply with US and **global tax information exchange rules and meet global transparency standards.**

- Money invested in offshore alternative investment funds is not kept in a bank account offshore but is **invested in financial markets around the world**. This activity helps to provide additional sources of financing to businesses and infrastructure projects in developing and developed economies, creating significant jobs and generating tax revenues around the world.

- The majority of investment into hedge funds is made by **institutional investors such as pension funds, insurance companies and charitable institutions**. Such investors require high standards of corporate governance, in addition to compliance with the regulatory regimes in the jurisdictions they operate and are established in.

Further reading: Transparent, Sophisticated, Tax Neutral: The truth about offshore alternative investment funds can be view

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Singapore's alternative investment industry is alive and kicking

By Kher Sheng Lee, Managing Director, Co-Head of APAC and Deputy Global Head of Government Affairs, AIMA, and Michael Bugel, Managing Director, Co-Head of APAC, AIMA

Kher Sheng Lee

Michael Bugel

Singapore's alternative investment fund industry continues to evolve and grow amid on-going regulatory change, constructive government support and increased allocations from sophisticated local and international investors.

The hedge fund sector grew by 16% last year to S$138 billion in assets under management (AUM), according to the Monetary Authority of Singapore's recently published asset management survey. This makes hedge funds the second-largest alts sector in the city today after private equity, which grew 14% to S$152 billion in assets. Significantly, the MAS survey also highlighted that investor allocations to alternatives funds – much of it sourced from international investors - are growing more rapidly than those to long-only funds.

Institutions such as pensions and sovereign wealth funds continue to look to the sector as a provider of diversification and downside protection. Private wealth managers and private banks also are seeking to diversify their investments and are increasingly looking at hedge funds as well as real estate and other alternative investments.

Singapore continues to be a leader in alternative investment vehicles that exploit the intersection between technology and investment management. In particular, managed futures funds, which deploy complex mathematical models and considerable computational power, continue to be popular in Singapore, while fintech is thriving, thanks in no small part to the government's far-sighted support.

Private credit is a growing space with many opportunities and rising investor demand. Constructive activism is on the rise, bringing improvements to corporate governance and performance. Standards and practices for a range of issues, from cyber security to record-keeping, have matured. Investor relations operations are becoming ever more professionalised and sophisticated. A growing number of firms are building successful brands and engaging with the media.

The city's regulatory environment is also evolving. The MAS, one of the region's most forward-looking bodies, has ambitious plans to turn the city into a fund domiciliation centre from 2018 to compete with jurisdictions like the Cayman Islands and Ireland, a move that could help to bring more alternative investment fund assets onshore and stimulate additional demand for Singaporean businesses that provide services to fund managers such as fund administrators and law firms.

Building on this momentum is the encouraging performance of Singapore-based fund managers. In the first nine months of this year, for example, Singapore's roughly 180 hedge fund firms produced average returns of 13.7%, according to Preqin (a global hedge fund data provider with a research presence in the city). That is more than five percentage points better than the global average (8.2%).

Many of these successful firms are small businesses, managing less than US$500 million in assets and on average employing fewer than 10 staff. That they are building sustainable businesses is a tribute to their operational efficiency as well as their smart investment decisions. That is because the sector in Singapore, as elsewhere around the world, continues to adjust to a number of headwinds, including barriers to entry, increased regulatory demands, fee pressures and rising costs.

Not all Singaporean alternative investment firms are small. At the other end of the spectrum, at least

seven investment management businesses in the city have advanced to the elite "billion dollar club" of firms with US$1 billion or more in hedge fund assets. Indeed in the list maintained by HedgeFund Intelligence (HFI), a data provider, Singapore has more firms than the likes of Paris, Sao Paulo, Sydney, Toronto and Geneva.

The industry continues to make a positive economic impact. It employs around 4,000 people in the city and serves the interests of some of Singapore's most important investors. GIC, Singapore's sovereign wealth fund, is one of the 10 biggest hedge fund investors in the world, with a total allocation worth about US$10.5 billion, according to Preqin. Another notable allocator is the endowment fund of the National University of Singapore (NUS), with around US$800 million invested with hedge funds. In total, more than 60 Singapore-based institutions entrust their assets to hedge funds and they have the highest average allocations to hedge funds – roughly 14% of their total portfolios – in the region.

Competition with other jurisdictions in Asia-Pacific is healthy and inevitable. But co-operation between regulators, highlighted by the progress being made towards an Asian funds passport, has never been stronger. Amid rising private wealth, an ever more sophisticated investor base and growing regional integration, the value proposition of Singapore- (and Asian-) managed hedge funds, private credit funds and other alternative investment funds operating across markets and jurisdictions continues to grow.

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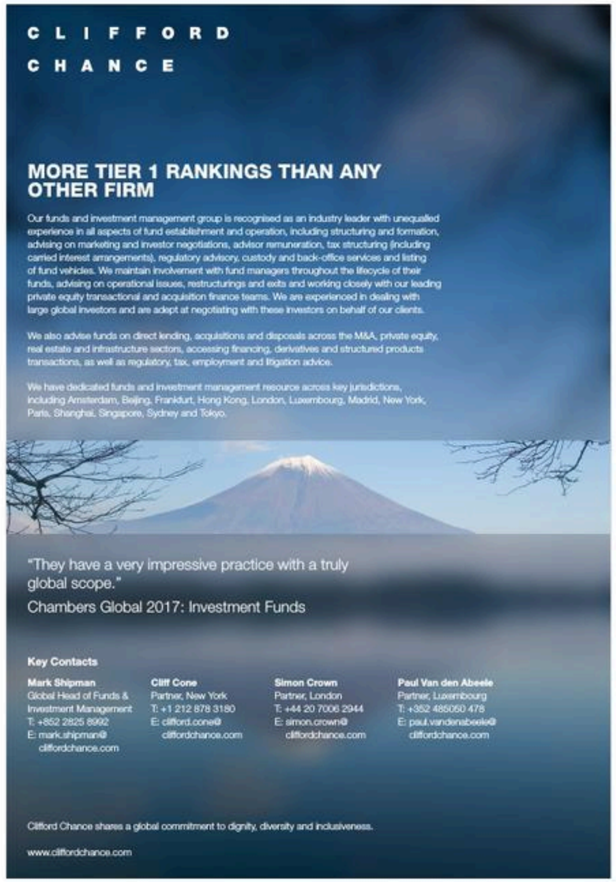

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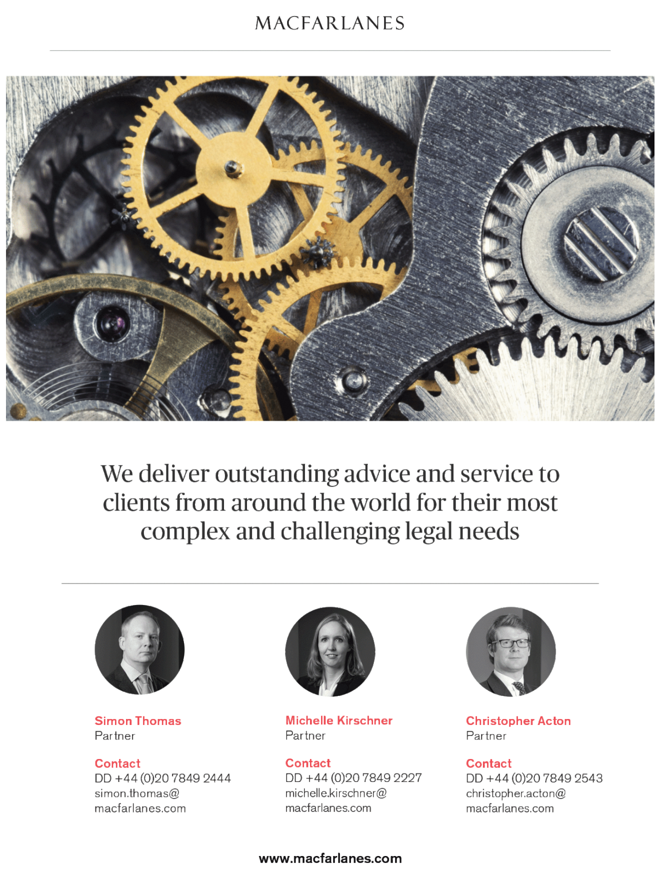

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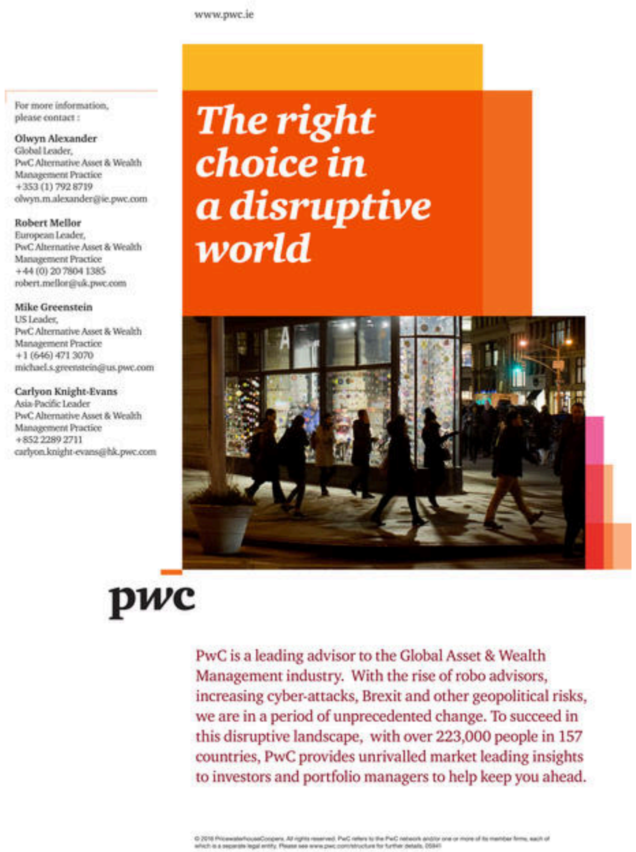

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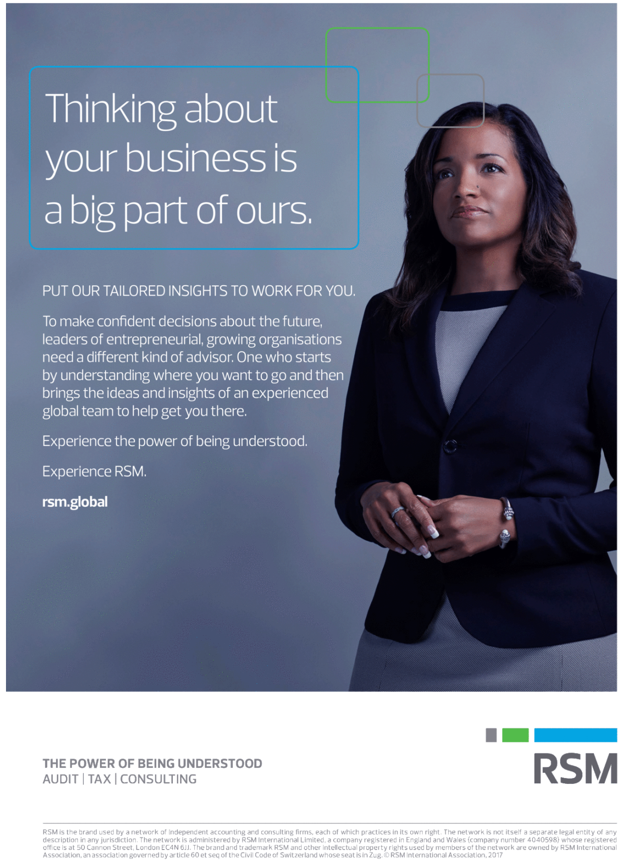

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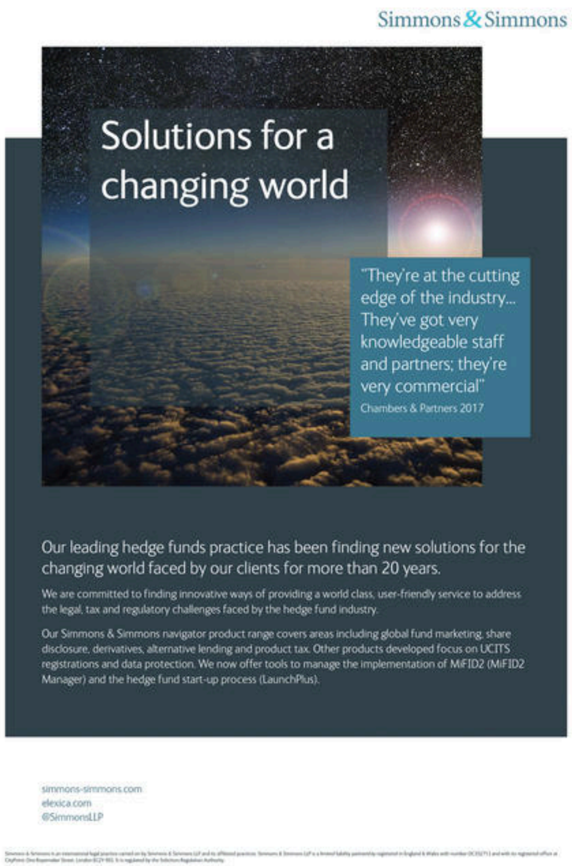

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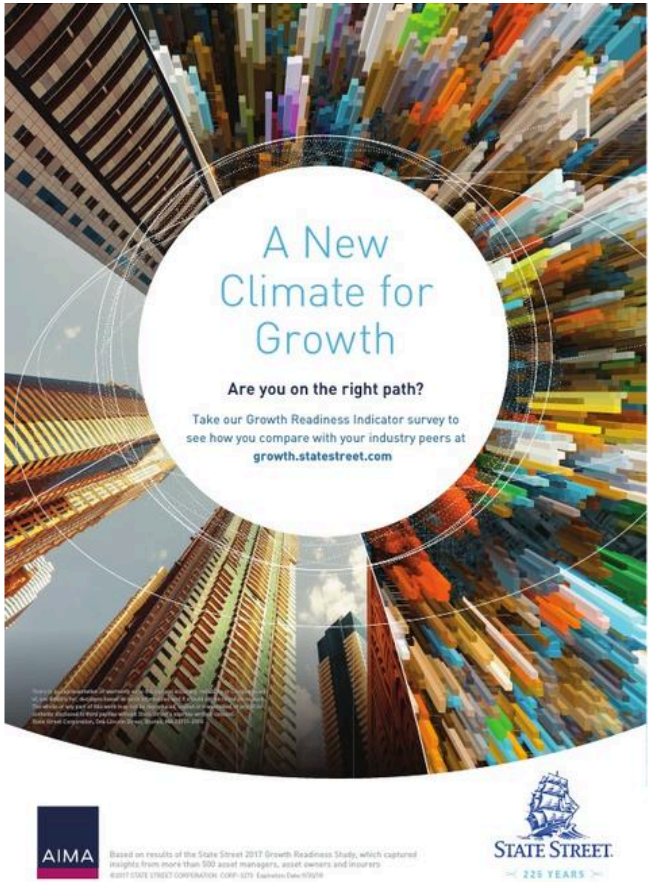

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