The Alternative Investment Management Association's

AIMA Journal

The global forum for the global hedge fund industry

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Cyber security for hedge funds p34

The development of the non-bank finance market p39

Benchmark reform – for better or worse p47

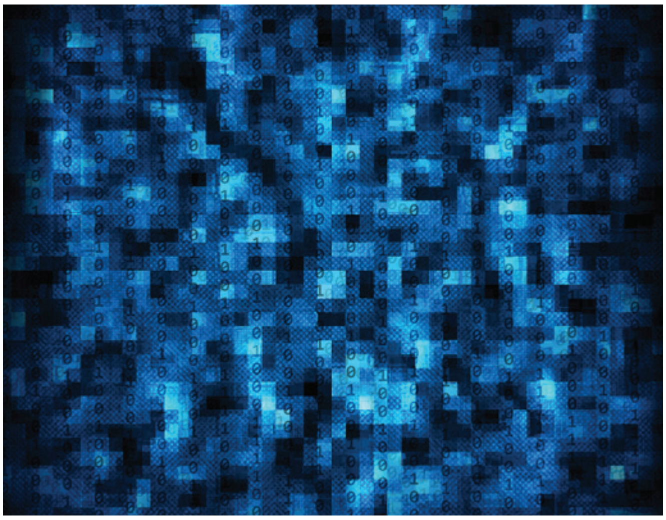
Shanghai-Hong Kong Stock Connect: Understanding the issues p60

Q4 2014 www.aima.org Number 101

Contents

AIMA updates

From our members



continued ▸

Contents

The HedgeFund Intelligence European Summit 2015

Incorporating

EuroHedge Summit and InvestHedge Forum

28-29 APRIL 2015

PALAIS DE LA BOURSE, PARIS

Bringing together the best of both the EuroHedge Summit and the InvestHedge Forum, the HedgeFund Intelligence European Summit will take place on 28-29 April 2015 in Paris. The Summit is the leading alternative investment management event in Europe.

The HedgeFund Intelligence European Summit will explore how hedge funds, funds of funds and investors are evolving – within themselves and in their relationships with each other - and will discuss how to exploit the available opportunities as well as how to successfully navigate the challenges in today's investment landscape.

To book your place, please visit www.hfieuropeansummit.com

* NB. All registrations are subject to approval by HedgeFund Intelligence. Only end investors (such as sovereign wealth funds, pension funds, endowments and foundations) and CEOs, CIOs and portfolio managers from funds of funds qualify for free places.

HedgeFund Intelligence

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The only 360° view of the hedge fund world

EDITORIAL: Making a difference on our members' behalf

By Jack Inglis, CEO, AIMA

As the year draws to a close, I wanted to take this opportunity to highlight some of the key areas where AIMA is making a real difference on our members' behalf:

AIMA expertise
In increasing numbers, our members are directly accessing our strong bench of senior staff for guidance and advice.

Policy and regulation
Our proactive engagement with policy makers and regulators across the full suite of legislation impacting our industry (e.g. AIFMD, UCITS V, MiFID, global derivatives reforms, CPO registration, dealing commissions, beneficial ownership rules and the Net Stable Funding Ratio) continues to secure significant improvements to initial regulatory proposals.

Compliance & training
We are expanding our toolkit of implementation guides and increasing the number of hedge fund manager training programmes for hedge fund staff in all three global regions.

Sound practices
In response to high demand, we are significantly extending our library of sound practice guides and DDQs, available only to AIMA members.

Industry image
Our evidence-based published research is demonstrating the real value of hedge funds to the economy and to investors, and we are gradually altering the embedded misperceptions of our industry.

Global influence
Each year we create new records for the number of forums we host that help our members tackle the important issues that affect their businesses. In addition to the key financial hubs across the US and Europe, these extend from Cayman to Canada, Sydney to Singapore, Hong Kong & Tokyo.

New markets
This year we signed a cooperation agreement with AMAC in China in recognition of the future importance of inbound and outbound capital flows to and from the country and have hosted forums in Shanghai and Beijing.

Member engagement
Member involvement is at all-time highs. The power of our organisation is the huge input and active engagement of our members on our many committees, thus enabling us to quickly get to the heart of what really matters to our members. Delivering value to our members is my number one priority and I look forward to continuing our work on our members' behalf in 2015.

- *2015 AIMA membership renewal: We have distributed invoices to our main contacts at member firms for memberships due for renewal as of 1 January 2015. Anyone with any questions or requiring a copy of their invoice can contact us at info@aima.org.*

Q4 AIMA regulatory and tax submissions and summaries

Please note that the hyperlinks in this table are restricted to AIMA members — please log in to www.aima.org.

Date	Authority	Description
9 December	UK Department for Business Innovation and Skills	Register of people with significant control (PSC register)
4 December	CBI	Fund Management Company Effectiveness - Delegate Oversight
3 December	ASIC	Proposed class order
2 December	CFTC	Proposed Regulations Concerning Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants
1 December	FSB	Submission - Cross-Border Recognition of Resolution Actions
28 November	HKEx	Submission - Concept Paper on Weighted Voting Rights
27 November	EC	DG Competition's White Paper Towards more effective EU merger control
24 November	Office of the Comptroller of the Currency	Submission - Prudential regulators' margin and capital requirements for covered swap entities
14 November		AIMA Briefing Note - Basel III Net Stable Funding Ratio
11 November	ESMA	Submission - Clearing of FX NDFs
6 November	ESMA	Submission - Clearing Obligation under EMIR (no. 3)

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5 November		AIMA Guidance and FAQs – FATCA
4 November	FSB	Submission - Joint trade association letter to the FSB on suspension of early termination rights
4 November		General Guidance - Scope of the Securitisation Retention Provisions under AIFMD
4 November		AIMA Briefing Note - CPO delegation relief
3 November	EC	Submission - Frontloading Concerns
3 November	Federal Dept of Finance	Submission - Federal Financial Services Act (FFSA) and Financial Institutions Act (FinIA)
22 October		AIMA Position Paper - CCP Recovery and Resolution
22 October	HMRC	Submission - Implementing agreements under the global automatic exchange of information to improve tax compliance
16 October	ESMA	Submission – Draft Technical Advice on Market Abuse
16 October	ESMA	Submission - Draft Technical Standards on Market Abuse Regulation
10 October	FCA	Submission – Discussion paper DP14/3
8 October	MAS	Submission – Notice on Outsourcing and Guidelines on Outsourcing
3 October	SEC	AIMA Guidance Note - Changes to U.S. Private Placement Rules under Regulation D from 23 September 2013
2 October		AIMA Position Paper - Shareholder Rights Directive II

Q4 regulatory, tax and policy developments globally

Many of the hyperlinks in this section are restricted to AIMA members – please log in to www.aima.org.

Global

ISDA Protocol to recognise stay on early termination rights under resolution

The International Swaps and Derivatives Association (ISDA) has announced the launch of the ISDA 2014 Resolution Stay Protocol. The Protocols follows a Financial Stability Board (FSB) request made to ISDA as part of its work on the cross-border recognition resolution actions and enables counterparties to amend the terms of their Protocol Covered Agreement to contractually recognise the cross-border application of special resolution regimes applicable to certain financial companies and support the resolution of certain financial companies under the United States Bankruptcy Code; most notably, this includes acceding to stays on early termination rights for cross-border swaps. AIMA recently co-signed a joint letter alongside a coalition of trade associations expressing our concerns with both the policy and process of the FSB's work and the ISDA Protocol.
(AIMA Weekly News, 18 November 2014)

IOSCO report on post-trade transparency in the CDS market

The Task Force on Over-the-Counter Derivatives Regulation of the International Organization of Securities Commissions (IOSCO) published a report on post-trade transparency in the CDS market. The report seeks to analyse the potential impact of mandatory post-trade transparency in the CDS market, and is based on an analysis of publicly available data about CDS transactions before and after the introduction of mandatory post-trade transparency in certain CDS markets in the United States. On the basis of this analysis, IOSCO preliminarily concludes that the data does not suggest that this introduction of mandatory post-trade transparency had a substantial effect on market risk exposure or market activity for those products. IOSCO also reviewed relevant works of international standard-setting bodies and academic literature and conducted a survey of market participants and other market observers regarding their use of certain publicly available post-trade data and its perceived impact on the market.
(AIMA Weekly News, 26 November 2014)

FSB publishes consultation on SFT reporting

On 13 November 2014, the Financial Stability Board (FSB) published a Consultative Document on Standards and Processes for Global Securities Financing, Data Collection and Aggregation. This consultation follows FSB recommendations for improved data collection by national authorities on securities financing transactions (SFTs), including securities lending and repos, to detect financial stability risks and for the FSB to aggregate this information to provide a global picture. The consultation sets out proposed standards and processes for such global SFT data collection and aggregation, including proposals on: data elements; the data architecture for collection and transmission to the FSB; and the uses by the FSB of aggregated data. AIMA intends to submit a response.
(AIMA Weekly News, 26 November 2014)

Proposed changes to the definition of PE

On 31 October 2014, the Organisation for Economic Co-operation and Development (OECD) released a discussion draft on proposed

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changes to the definition of permanent establishment (PE) to prevent artificial avoidance of PE status. Stakeholders may submit comments by **9 January 2015** and register for a public consultation in Paris on 21 January. The proposals examine a number of changes in article 5 of OECD's model tax convention, and are directly linked to the analysis contained in the OECD report 'Addressing the tax challenges of the digital economy'. Commissionaire arrangements and similar strategies will be deemed within the scope of article 5(5-6), so any enterprise will be considered to have a sufficient taxable nexus when "*activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise*"; certain preparatory and auxiliary activities that are exempted from PE application such as the use of a warehouse to satisfy orders (article 5(4)) will be deemed taxable, in particular, when "*activities are fragmented between related parties by dividing a cohesive operation business into several small operations*"; and the splitting-up of contracts to circumvent article 5(3) will be addressed by adding a general anti avoidance rule or a principal purpose test. The discussion draft also covers insurance dependant agents and interaction with transfer pricing action points. However, the proposals in the discussion draft do not affect the special concept of independent agent, and, therefore, in our view tax regimes based upon it such as the UK investment manager exemption should not be put in doubt and will continue to be considered a proper application of the permanent establishment exception.
(AIMA Weekly News, 11 November 2014)

Basel Committee publishes finalised net stable funding ratio

The Basel Committee on Banking Supervision (BCBS) has published its final standard for the net stable funding ratio (NSFR) and timeline for its implementation. The NSFR was included in the 2010 Basel III agreement and is a significant component of the Basel III reforms. In addition to the liquidity coverage ratio (LCR), NSFR is part of BCBS' strengthened liquidity framework and is intended to meet its objective to reduce funding risk by requiring banks to fund their activities with sufficiently stable sources of funding in order to mitigate the risk of future funding stress. AIMA has previously expressed its concerns about the likely impact of the NSFR for hedge fund clients of banks. Helpfully, the final standard now includes a new provision on "interdependent assets and liabilities" which could help to soften the impact of the NSFR when it comes to certain securities financing transactions. We will continue to engage on this topic as the NSFR is implemented regionally. The NSFR will become a minimum standard by **1 January 2018**.
(AIMA Weekly News, 4 November 2014)

Principles regarding the Custody of Collective Investment Schemes' Assets

On 10 October 2014, the International Organisation of Securities Commissions (IOSCO) published a consultation report on Principles regarding the Custody of Collective Investment Schemes' Assets. The report aims to gather views on the development of a set of principles for the custody of Collective Investment Schemes' (CIS) Assets. The report sets out 9 principles, such as that the regulatory regime should make appropriate provisions for the custodial arrangements of the CIS and that the custodian should be functionally independent from the responsible entity.
(AIMA Weekly News, 14 October 2014)

Haircuts on non-centrally cleared securities financing transactions

The Financial Stability Board (FSB) published a regulatory framework for haircuts on non-centrally cleared securities financing

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transactions. This framework is part of the FSB's policy recommendations to address shadow banking risks in relation to securities financing transactions, and takes into account public responses received on the consultative proposals issued on 29 August 2013, to which AIMA responded, as well as the results of a two-stage quantitative impact study (QIS). In revising the framework, the FSB has decided to raise the levels of numerical haircut floors based on the QIS results, existing market and central bank haircuts, and data on historical price volatility of different asset classes. The document includes a consultation on whether the numerical haircut floors should be expanded to cover non-bank to non-bank transactions.
(AIMA Weekly News, 21 October 2014)

Key Attributes of Effective Resolution Regimes for non-banks

On 15 October 2014, the Financial Stability Board (FSB) reissued its 'Key Attributes of Effective Resolution Regimes for Financial Institutions' with new guidance on the resolution of non-bank financial institutions and on information sharing. Originally published in 2011, the FSB's 'Key Attributes' provide 12 central features that should form part of the resolution regimes of all jurisdictions for systemically important financial institutions. The reissued Key Attributes now contain four new Annexes which deal with the specificities of institutions including central counterparties (CCPs) and insurers, as well as provision for client assets protection in resolution and information sharing for resolution purposes. The new guidance follows consultations undertaken in 2014 by both the FSB and CPSS-IOSCO to which AIMA submitted responses.
(AIMA Weekly News, 21 October 2014)

EMEA

AIFMD

ESMA call for evidence

ESMA has published a call for evidence on the AIFMD passport and third country AIFMs. The deadline for responses is **8 January 2015**. Responses will be used as input for two pieces of advice that ESMA needs to issue by 22 July 2015: (i) an opinion on the functioning of the passport for EU AIFMs and on the functioning of the national private placement regimes, and (ii) an advice on the application of the passport to non-EU AIFMs and AIFs. In order to prepare a response to this call for evidence, AIMA will need input from members on their experiences with the passport and private placement regimes.
(AIMA Weekly News, 11 November 2014)

AIFMD securitisation retention requirement

AIMA has published a Guidance Note for members on the AIFMD securitisation provisions, which was produced by Eversheds for AIMA, the IMA and ICI. The note aims to provide guidance for firms on the general legal principles that apply when assessing whether they may be subject to the securitisation requirements set out in the AIFMD. However, the analysis is both legally complex and highly fact-specific, and the position of individual firms will vary.
(AIMA Weekly News, 4 November 2014)

UK – AIFMD reporting information

On 29 September 2014, the UK Financial Conduct Authority (FCA) published information for Full-Scope UK alternative investment fund managers (AIFMs), Small Authorised UK AIFMs and Small Registered UK AIFMs as well as information for Above-Threshold non-EEA AIFMs and Small non-EEA AIFMs regarding reporting obligations under the Alternative Investment Fund Managers Directive (AIFMD).

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The documents discuss the transparency requirements that AIFMs authorised in the UK and non-EEA AIFMs marketing their alternative investment funds (AIFs) in the UK must comply with and set out various pieces of information that may be helpful to AIFMs reporting to the FCA.
(AIMA Weekly News, 30 September 2014)

France – AIFMD reporting

On 23 September 2014, the French Autorité des Marchés Financiers (AMF), published a position (DOC-2014-09) integrating ESMA's Guidelines on reporting obligations under the Alternative Investment Fund Managers Directive (AIFMD) into French law. The position sets out information that portfolio investment companies must provide to the AMF if they manage an alternative investment fund (AIF) or are a self-managed AIF under French law. At present, the document is only available in French.
(AIMA Weekly News, 30 September 2014)

Spain – Transposition of AIFMD

On 19 September 2014, the Spanish ministry for economy and competition (el Ministerio de Economía y Competitividad) published a draft of the laws transposing the AIFMD. Comments on the Royal Decree may be submitted via email to audiencia@tesoro.mineco.es by 7 October 2014. This Decree will complement the UCITS law which is currently undergoing a review in Congress. The two together will allow for a total transposition of the AIFMD in Spain.
(AIMA Weekly News, 30 September 2014)

EMIR

ESMA delays CDS clearing standards

On 20 November 2014, ESMA published a letter to the European Commission stating that it will delay the delivery of the forthcoming draft regulatory technical standards (RTS) on the clearing obligation of credit derivatives until the European Commission finalises the assessment process of the first RTS on OTC interest rate swaps. This is because the outcome of the Commission's assessment could affect similar content of the second subsequent RTS, particularly in relation to the question of how counterparties are categorised for the purposes of the clearing start date.
(AIMA Weekly News, 26 November 2014)

ESMA consultation on clearing of FX NDFs

On 6 November 2014, AIMA submitted a response to the European Securities and Markets Authority (ESMA) consultation on the EMIR clearing obligation No.3 dealing with FX NDFs referenced to 11 currencies and settled in US dollars. The response highlighted the lack of empirical data currently available for FX NDF clearing which meant that clear conclusions on the application of the clearing obligation to such contracts are not possible. We recommended, in particular, that ESMA delay its decision to mandatorily clear FX NDFs so that it may coordinate effectively with the CFTC. AIMA also expressed member concerns about the application of frontloading, proposed categorisation of counterparties and certain issues within ESMA's analysis.
(AIMA Weekly News, 11 November 2014)

ESMA publishes updated Q&As on EMIR

On 24 October 2014, ESMA published an updated version of its Questions and Answers on Regulation (EU) No.648/2012 on OTC derivatives, CCPs and trade repositories (EMIR). This is the latest of a series of updates and deals, in particular, with: backloading of trade reports by third country entities which become financial or non-financial counterparties; guidance on UTIs and reporting data fields; the identification of counterparties

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in FX swaps and forwards; access to reported data by competent authorities; reporting of terminated trades; and, the treatment of block trades.
(AIMA Weekly News, 28 October 2014)

ESMA consults on elements of EMIR reporting obligation

ESMA has published a consultation proposing a draft amendment to the RTS and ITS relating to the reporting obligation under Article 9 of EMIR to incorporate certain elements of the guidance currently contained within ESMA's Questions and Answers and adapt existing data fields to account for needs that have become evident since the reporting start date. Areas dealt with include the amendment and splitting of the notional amount and value of collateral fields, as well as differentiation between position-level versus trade-level reporting.
(AIMA Weekly News, 11 November 2014)

ESMA publishes Final Report on mandatory clearing of IRS

On 1 October 2014, the European Securities & Markets Authority (ESMA) published its Final Report on draft regulatory technical standards (RTS) on the clearing obligation of Interest Rate OTC derivatives (IRS). The Final Report follows a consultation process undertaken during Q3 2014, to which AIMA submitted a response, and now falls to the European Commission to formally adopt the final RTS within three months. The Final Report groups all classes of cleared IRS together for consideration, breaking down IRS to become subject to the clearing obligation into four classes (plain vanilla IRS, basis swaps, FRAs and overnight index swaps). It also separates counterparties into four categories for the purposes of the date of implementation and the frontloading requirement, utilising the gross notional exposure thresholds within the ESMA draft RTS on margin for uncleared derivatives. AIFs that are financial counterparties (FCs) or non-financial counterparties above the clearing threshold (NFC+s) and have an aggregate month-end average notional exposure to uncleared derivatives above €8bn over the three months preceding the publication of the RTS will be designated as Category 2 entities and have 12 months to comply; all other AIFs that are FCs or NFC+s will be Category 3 entities and have 18 months to comply. Frontloading remains within ESMA's Final Report although it is limited to contracts entered into by Category 1 and Category 2 FCs (all NFCs are excluded) on or after the date of publication of the RTS which have a remaining maturity of six months on the date from which the clearing obligation takes effect.
(AIMA Weekly News, 7 October 2014)

Commission adopts equivalence determinations for CCPs under EMIR

The European Commission adopted its first 'equivalence' decisions for the regulatory regimes dealing with CCPs of Australia, Hong Kong, Japan and Singapore. The CCPs established in these third-country jurisdictions will now be able to be recognised by ESMA under Article 25 of EMIR and, therefore, used by market participants to clear OTC products subject to the EU mandatory clearing obligation when this comes into effect. We still await a formal decision of equivalence as to the US regime for CCPs.
(AIMA Weekly News, 4 November 2014)

EMIR consultation on clearing obligation No.2

AIMA submitted a response to the ESMA consultation paper (No.2) on the mandatory clearing obligation under EMIR, which covered the potential application of mandatory clearing in the EU to CDS contracts. The response supports ESMA's position which limits the

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clearing determination to two iTraxx indices, with a view to monitoring indices and single name CDS on an ongoing basis; in particular, we recommend that international coordination be maximised between ESMA, the CFTC and the SEC when making future clearing determinations. In the situation of the iTraxx Main and Crossover indices the response expresses concerns that only one CCP is currently authorised to clear the relevant contracts and recommends that mandatory clearing be delayed until an additional CCP is authorised. We also express concerns that ESMA currently has no power to consider changes in liquidity profile of contracts subject to the clearing obligation and to temporarily suspend the clearing obligation. The response reasserts several AIMA positions put forward in our response to the previous ESMA consultation on the clearing obligation dealing with interest rate swaps, including our position against frontloading, the urgency of solving issues of cross-border regulatory conflicts that currently threaten certain AIMA members and concerns about the potential application of the counterparty categorisations proposed by the consultation. ESMA will now finalise draft regulatory technical standards to be submitted to the European Commission for adoption.
(AIMA Weekly News, 30 September 2014)

UCITS

UCITS consolidated text

On 28 August 2014, the Directive to update Directive 2009/65/EC (the 'UCITS IV Directive') on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) in relation to depositary functions, remuneration policies and sanctions ('UCITS V') was published in the Official Journal. Since UCITS V contains amendments to the UCITS IV Directive but does not recast the UCITS IV Directive, the two directives must be read together. In order to assist members, AIMA has produced an unofficial consolidated version of the UCITS IV text showing the changes made by UCITS V and other EU directives that have amended Directive 2009/65/EC.
(AIMA Weekly News, 4 November 2014)

UCITS V delegated acts regarding depositaries

On 26 September 2014, the European Securities and Markets Authority (ESMA) launched a consultation paper titled 'ESMA's technical advice to the European Commission on delegated acts required by the UCITS V Directive'. In the paper, ESMA is consulting on draft implementing measures regarding the depositary role of UCITS funds. ESMA's consultation seeks stakeholders' views on proposals in two areas related to the depositary function: (1) insolvency protection when delegating safekeeping; and (2) independence requirements.
(AIMA Weekly News, 30 September 2014)

MiFID

ESMA consults on the definition of derivatives

The European Securities and Markets Authority (ESMA) has published a consultation paper on future guidelines clarifying the definition of derivatives as financial instruments under the current Markets in Financial Instruments Directive (MiFID I). The different approaches to the interpretation of MiFID I across Member States mean that there is no commonly-adopted application of the definition of derivative or derivative contract in the EU for some asset classes. Whilst this issue has in the past been noted as a concern since the implementation of MiFID, the practical consequences have come

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to the forefront with the implementation of the European Markets Infrastructure Regulation (EMIR). ESMA is seeking to ensure, amongst other things, a consistent application of EMIR in the EU and is therefore considering the adoption of guidelines to ensure the consistent classification of certain financial instruments as derivatives. This will allow a common approach by national competent authorities in the implementation of EMIR from the date these guidelines start applying and until this issue is addressed through formal legislation to be adopted in the context of MiFIDII.
(AIMA Weekly News, 30 September 2014)

Dealing commission

FCA Discussion Paper on dealing commission

On 10 October 2014, AIMA responded to the Financial Conduct Authority (FCA) Discussion Paper regarding the use of dealing commission regime. In the response, AIMA commented that unbundling of research from dealing commissions would constitute a significant change for the market which would be unnecessarily disproportionate. Instead, AIMA suggested that rules or guidance should be implemented to require investment managers to adopt a robust governance and controls framework (based principally on the use of commission sharing arrangements).
(AIMA Weekly News, 14 October 2014)

AIMA summary of the soft dollar/dealing commission rules

AIMA has published a Guidance Note which sets out a high-level comparison of the U.S. soft dollars regime and the UK dealing commission regime with regard to research. The note aims to provide members with a comparison of the general principles and conditions under which client assets may be used by a fund manager to purchase research from brokers and independent research providers applicable under the U.S. Securities and Exchange Commission rules and those applicable under the UK Financial Conduct Authority's rules.
(AIMA Weekly News, 30 September 2014)

Other updates (EMEA)

FTT - ECOFIN discussion

The agenda for the ECOFIN Council meeting on 9 December 2014 included FTT. We understand that there was a short exchange which mainly confirmed that no real progress is to be expected before the end of this year and that discussions will be continued under the Latvian Presidency. Whether that Presidency will show any substantial commitment to the process is not clear.
(AIMA Weekly News, 9 December 2014)

UK - Autumn Statement 2014

The Autumn Statement (here) delivered on 3 December 2014 included several tax measures as well as budget and economic forecasts for 2015 and beyond. A few proposals should be noted: (i) regarding business taxes, the Government will introduce (in the context of the BEPS project) a new tax on diverted profits from the UK (25%), a restriction on banks' losses accrued during the financial crisis that can be used to offset against profits, and a withholding tax exemption on interest for private placements. The Chancellor also announced a measure to stop investment managers disguising their guaranteed management fee income as capital gains. The Government will introduce legislation, effective from 6 April 2015, to ensure that sums which arise to investment fund managers for their services are charged to tax as income. It will affect sums which arise to managers who have entered into

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arrangements involving partnerships or other transparent vehicles, but not sums linked to performance, such as 'carried interest', nor returns which are exclusively from investments by partners. The tax policy costing document describes the proposals as follows: "Annual management fees are paid to managers of investment funds, based on a percentage of assets under management. Historically, these fees were charged to tax as income; however over the last few years Private Equity funds in particular have structured themselves in ways to avoid tax by enabling these fees to be charged to Capital Gains Tax (CGT); (ii) in relation to tax avoidance measures, legislation will be introduced to strengthen the DOTAS regime, further steps will be taken to implement the OECD model for country-by-country reporting, and HMRC has published a consultation on the implementation of the OECD's approach to address hybrid mismatch arrangements (responses due 11 February 2015), ahead of developing further draft legislation.

(AIMA Weekly News, 9 December 2014)

Council text of SFT reporting and transparency endorsed

On 20 November 2014, the European Council Permanent Representatives Committee endorsed a general approach agreement reached by the European Council for a Regulation on the reporting and transparency of securities financing transactions (SFTs) and rehypothecation first proposed by the European Commission in January 2014. The Proposal was published to complement the European Commission's proposal on bank structural reforms and to improve the transparency of SFT markets, including repos and securities lending. The Regulation seeks to do this by requiring the reporting of all SFTs to a registered trade repository. It also contains added investor disclosure obligations for AIFMs and UCITS managers, as well as requirements for consent and risk disclosure for the reuse of collateral assets. In terms of next steps, once the European Parliament reach their own internal agreement on the Proposal, formal inter-institutional Trialogues for a final Level 1 text will be able to commence.

(AIMA Weekly News, 26 November 2014)

QCCP status transitional deadline

On 14 November 2014, the European Commission's European Banking Committee voted on the Commission's proposed revision to the implementing act granting an extension of the transitional periods related to own funds requirements for exposures to central counterparties in CRR. The deadline, which has already been extended once to 15 December 2014, will now be extended by another six months in order to allow time for the assessments of third country jurisdictions to be made. Under the Capital Requirements Regulation, exposures to QCCPs attract a lower charge than exposures to CCPs that do not have QCCP status.

(AIMA Weekly News, 18 November 2014)

UK – PSC register

AIMA has responded to the UK Department for Business Innovation and Skills' (BIS) discussion paper entitled 'The register of people with significant control (PSC register): Understanding the new requirements, recording control on the PSC register and protecting people at serious risk of harm'. In the response, AIMA commented, amongst other things, that there should not be a requirement to look through a fund vehicle to identify any individual who is able to exercise control/influence on behalf of that fund/those investors and to record those individuals on a company's PSC register.

(AIMA Weekly News, 9 December 2014)

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Switzerland - Federal Financial Services Act and Financial Institutions Act

AIMA filed a submission in response to the Swiss Federal Council consultation on the Federal Financial Services Act (FFSA) and Financial Institutions Act (FinIA). In our response, we highlight the fact that regulating the distribution of funds under the Collective Investment Scheme Act (CISA), rather than the FFSA, will create unnecessary operational burdens, whilst distorting the level playing field across product types. We propose the transfer of relevant CISA provisions into the FFSA. We also suggest an enhanced approach in respect of cross-border business, with appropriately crafted exemptions for intragroup business, services provided to eligible counterparties and for "reverse solicitation". Finally, we propose alignment with concepts that are already established in European law; this is the case in respect of client categorisation, for example.
(AIMA Weekly News, 4 November 2014)

Ireland - AIMA's response to CBI consultation

AIMA submitted a response to the Central Bank of Ireland (CBI) consultation paper entitled 'Consultation on Fund Management Company Effectiveness – Delegate Oversight'. In the response, AIMA comments, amongst other things, on the proposal to require fund management companies to document the rationale for the board composition, noting that a more proportionate approach would be to focus on the CBI having the ability to require fund management companies to justify the appointment of directors at any time.
(AIMA Weekly News, 9 December 2014)

AIMA position paper on SRD II

AIMA has published a position paper regarding the European Commission's proposal to amend the EU Shareholders' Rights Directive (SRD II). In the paper, AIMA argues, amongst other things, that it is worth considering that many shareholders may be discouraged from investing in companies if the law applicable to their investment becomes overly burdensome. The position paper suggests that the main focus of the SRD II should be to give rights to investors rather than imposing certain obligations on those investors or asset managers.
(AIMA Weekly News, 30 September 2014)

UK - BIS consultation on corporate directors

On 27 November 2014 the UK Department for Business Innovation and Skills (BIS) published a discussion paper entitled 'Corporate directors - Scope of exceptions to the prohibition of corporate directors'. The paper seeks views on circumstances where use of corporate directors of UK companies should be allowed. It also covers other legal entities, including Limited Liability Partnerships (LLPs) and their corporate members. In the paper the BIS states that "we have heard representations that the unique structure of LLPs and value of corporate members do not support a restriction on corporate members of LLPs" and that there is not currently a strong case for action to prohibit corporate members of LLPs. The BIS also state that they "propose to review the position in parallel with the review of the Small Business Enterprise and Employment Bill provisions covering corporate directors of companies, or sooner if compelling evidence of abuse of the LLP structure were to emerge." Responses to the consultation must be submitted by 8 January 2015. If you would like to contribute towards a response to this consultation paper or have any questions in relation to this, please contact Anna Berdinner or Jennifer Wood.

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EBA consults on whether an institution is failing or likely to fail

The European Banking Authority (EBA) issued a consultation paper on draft Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail. Clarity as to the point at which an institution is deemed to be failing or likely to fail by its national competent/resolution authority is important as it is necessary for the commencement of any resolution process. The guidelines are intended to provide guidance for competent authorities in order to promote convergence of supervision and resolution practices under the Capital Requirements Directive and Bank Recovery and Resolution Directive. The Guidelines provide separate guidance for competent authorities – which are expected to primarily use the assessment under the European Supervisory Review and Examination Process - and resolution authorities - which are expected to base their assessments on the objective elements based in the guidelines.

(AIMA Weekly News, 30 September 2014)

EBA consults on draft guidelines for triggering early intervention under BRRD

The European Banking Authority (EBA) issued a consultation paper on Draft Guidelines on triggers for the use of early intervention measures pursuant to Article 27(4) of Directive 2014/59/EU (BRRD). The guidelines are aimed at competent authorities to promote the consistent application of triggers for when to apply early intervention measures to a distressed credit institution or investment firm subject to the BRRD. They identify triggers within the proposed common European supervisory review and examination process (SREP) framework and elaborate upon circumstances prompting consideration of whether to apply early intervention measures, but are not intended to oblige competent authorities to apply or refrain from applying any measure.

(AIMA Weekly News, 30 September 2014)

Qualitative and quantitative indicators for BRRD recovery

On 26 September 2014, the European Banking Authority (EBA) launched a consultation on draft guidelines which specify the minimum list of qualitative and quantitative indicators to be included in a recovery plan under the EU Bank Recovery and Resolution Directive (BRRD). The BRRD requires banks to draw up recovery plans and establish indicators to identify when to trigger the recovery process and to assess whether appropriate recovery actions are to be taken. Competent authorities are required to assess both the recovery plans and the recovery indicators, ensuring that institutions put in place appropriate arrangements for the continuous monitoring of the indicators. The draft guidelines, in particular, specify a minimum set of qualitative and quantitative indicators that institutions should include in their recovery plans, namely in relation to capital, liquidity, profitability and asset quality. The EBA specifies that institutions should not limit their set of recovery plan indicators to the minimum list provided by the draft Guidelines and therefore provides a list of additional micro and macro-economic indicators for illustration purposes only.

(AIMA Weekly News, 30 September 2014)

Ireland - Fund management company effectiveness

The Central Bank of Ireland (CBI) published a consultation paper entitled 'Consultation on Fund Management Company Effectiveness – Delegate Oversight'. The consultation paper sets out a number of proposed initiatives which are designed to underpin the achievement of substantive control by fund management

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companies, acting on behalf of investment funds, over the activities of their delegates. These initiatives are focused on two areas, firstly, the authorisation process where the quality of the boards and internal arrangements of fund management companies are scrutinised and secondly the day-to-day process of guiding and overseeing the administration and investment of the monies invested with investment funds. In the paper, the CBI are proposing a relaxation of the requirement to have two Irish resident directors.
(AIMA Weekly News, 30 September 2014)

ESMA consultations on MAR Level 2

On 15 October 2014, AIMA submitted responses to ESMA's Level 2 consultation papers on draft technical standards and technical advice to the European Commission on potential delegated acts under the Market Abuse Regulation (Regulation (EU) No.596/2014 on market abuse). The consultations follow an ESMA discussion paper on potential Level 2 measures under MAR issued in 2014, to which AIMA also responded. Key issues for AIMA members include the lack of certainty as to the ability for entities receiving market soundings to place reliance upon representations made by disclosing market participants (DMPs) through scripted communications, as well as the removal of proposals for DMP cleansing strategies for entities receiving market soundings. The most controversial issue, however, was the proposal to extend the disclosure and periodic prohibition on trading for persons discharging managerial responsibility in an issuer (PDMRs) to transactions undertaken by a collective investment fund manager on behalf of a collective investment fund in which the PDMR has invested. ESMA now has until August next year to finalise its draft technical standards and until April to finalise its draft technical advice.
(AIMA Weekly News, 21 October 2014)

Germany - Tax reporting requirements for investment funds

The Court of Justice of the European Union (CJEU) has determined that German tax rules levying a flat tax rate on unit holders in an investment fund when the fund has not made sufficient disclosure, constitutes a breach of EU law (van Caster, case C-326/12). German tax reporting rules apply without distinction to resident and foreign non-transparent funds, but given the strict requirements, including that the report be in German and published in the Federal bulletin, investment funds not active in the German market have little incentive to comply. The CJEU accepted the argument that the reporting requirements indirectly restrict the free movement of capital in the EU, by making it less attractive for German residents to invest in foreign funds and more complex for such funds to attract German investors. The German tax authorities argued that the reporting requirements were justified by the need to ensure (i) a balanced allocation of taxing rights between member states and (ii) effective fiscal supervision. The CJEU held that the first argument was not relevant to the circumstances and that, though member states are entitled to require information to ensure fiscal supervision, the German disclosure conditions were not proportionate when imposing a tax on the investor, since they did not permit an investor to obtain and provide the relevant information in place of the fund. Therefore, the restriction on free movement of capital arising from the tax rules could not be justified and is unlawful.
(AIMA Weekly News, 21 October 2014)

UK - Employee entitled to tax relief for "negative taxable earnings" on signing bonus repayment

In *Martin v. HMRC [2014] UKUT 429*, the Upper Tribunal has upheld the judgement of the First Tier Tribunal in relation to a claim for tax relief

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for a repayment made by an employee of his signing bonus. The appellant entered into an employment contract committing him to work for a period of at least five years, for which he received, and was taxed on, a signing on bonus of £250,000. However, the contract provided that the bonus was repayable in part if he gave notice to terminate his employment within the five-year period which he did, and was required to refund £162,500. HMRC refused his claim for relief under section 128 Income Tax Act 2007. The Upper Tribunal has confirmed the First Tier Tribunal decision that: (i) the nature of the repayment as arising under a contractual provision meant it arose from the employment rather than being a distinct claim against the individual for liquidated damages for a breach of contract; and (ii) the repayment gave rise to negative taxable earnings that could be offset first against other earnings for the tax year and then, as to any excess, against other taxable income. Given the growing relevance of bonus clawbacks, it is likely that HMRC will wish to make clearer the statutory basis for the tax treatment.
(AIMA Weekly News, 21 October 2014)

Americas

Swaps

Q&As regarding CFTC Forms CPO-PQR and CTA-PR and NFA Forms PQR and PR

In conjunction with the Investment Adviser Association (IAA) and the Investment Company Institute (ICI), AIMA has submitted a letter to the Commodity Futures Trading Commission (CFTC) Division of Swap Dealer and Intermediary Oversight regarding CFTC Form CPO-PQR and CFTC Form CTA-PR and to the National Futures Association (the NFA) regarding NFA Form PQR and NFA Form PR jointly seeking guidance in the form of questions and answers. The letter sets out various questions regarding the forms and proposed answers to each question posed. Where appropriate, the letter also indicates the reasoning behind the suggested answer.
(AIMA Weekly News, 9 December 2014)

CFTC no-action relief on cross-border

The U.S. Commodity Futures Trading Commission's (CFTC) Divisions of Swap Dealer and Intermediary Oversight (DSIO), Clearing and Risk, and Market Oversight (Divisions) issued a time-limited no-action letter that extends relief to swap dealers (SDs) registered with the Commission that are established under the laws of jurisdictions other than the United States (Non-U.S. SDs) from certain transaction-level requirements under the Commodity Exchange Act. On 14 November 2013, DSIO issued an Advisory (DSIO Advisory) in response to inquiries from swap market participants regarding the applicability of the Commission's transaction-level requirements in certain situations. Subsequent to the issuance of the DSIO Advisory, concerns were raised by certain Non-U.S. SDs regarding compliance with the transaction-level requirements, who represented that, in order to avoid market disruption for their non-U.S. counterparties, additional time would be necessary to come into compliance. The CFTC has requested public comment regarding the subjects addressed by the DSIO Advisory. In view of the foregoing, the Divisions are extending the date of the time-limited staff no-action relief provided in CFTC Letter No. 14-74.
(AIMA Weekly News, 21 October 2014)

FATCA

Deadline for FATCA IGAs to be signed is extended

The IRS and U.S Treasury published on 1

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December announcement 2014-38 (here) which provides a deadline extension to any jurisdiction that had reached an agreement in substance under the terms of the US IGAs on or before 30 June 2014, but has not signed formally such agreement. The extension will apply as if the IGA was in effect beyond 31 December 2014, as long as the jurisdiction corroborates its commitment to affirm the IGA at the earliest convenience. It was also announced that those jurisdictions that did not agree an IGA in substance before June 2014 but subsequently reach agreement will be considered to have an IGA in place as of 30 November 2014 (Angola, Cambodia, Greece, the Holy See, Iceland, Kazakhstan, Montserrat, the Philippines, Trinidad and Tobago, and Tunisia – Model 1 IGA; Macao - Model 2 IGA).)
(AIMA Weekly News, 9 December 2014)

Other updates (Americas)

SEC adopts Regulation on Systems Compliance and Integrity

The five SEC Commissioners voted unanimously to adopt new rules intended to strengthen the technology infrastructure of U.S. securities markets – Regulation Systems Compliance and Integrity (Regulation SCI). The rules follow a consultation undertaken in 2013 and impose requirements on self-regulatory organisations, certain alternative trading systems, plan processors and certain exempt clearing agencies to have comprehensive policies and procedures in place for the operation of their technological systems. In particular, Regulation SCI requires in-scope entities to report systems issues to the SEC, inform members and participants and take relevant corrective action. Regulation SCI also requires in-scope entities to conduct business continuity testing and an annual review of compliance. The rules will become effective 60 days after their publication in the Federal Register and will subsequently be phased in over a nine month period, with a requirement for coordinated testing set to apply after 21 months.
(AIMA Weekly News, 26 November 2014)

CPO delegation relief

On 12 May 2014, the Division of Swap Dealer and Intermediary Oversight (DSIO) of the Commodity Futures Trading Commission (CFTC) issued CFTC Letter No. 14-69 ('Letter 14-69'), which provides certain commodity pool operators (CPOs) with guidance concerning the delegation of CPO functions to another registered CPO. On 15 October 2014 DSIO published a further no-action letter ('Letter 14-126'), this time offering self-executing no-action relief in certain limited circumstances and provided the specified conditions are met. AIMA has produced a summary note of Letter 14-69 and Letter 14-126 which explains what is required in order to be able to rely on the relief offered by Letter 14-126.
(AIMA Weekly News, 4 November 2014)

Tax on convertible bonds

Under section 305 of the Internal Revenue Code, a change in the conversion ratio of a convertible bond may be treated as giving rise to a deemed dividend. Brokers or other financial intermediaries may have a withholding tax obligation and the owner of the bond may have a tax liability to report and account for. It appears that generally withholding tax is not being collected as prime broker systems are not set up to identify the taxable event and offshore funds that are owners of affected convertible bonds may not identify the liability.
(AIMA Weekly News, 9 December 2014)

Asia-Pacific

Shanghai-Hong Kong Stock Connect

The China Securities Regulatory Commission and the Securities and Futures Commission have approved the launch of the Shanghai-Hong Kong Stock Connect program and trading commenced on 17 November 2014. This enables shares in PRC companies listed in Shanghai to be traded through Hong Kong (and vice versa). The Ministry of Finance and Tax Administration of China issued on 14 November two circulars (Caishui [2014] No.79 and Caishui [2014] No.81) concerning the tax treatment of (i) equity investment assets held by qualified foreign institutional investors (QFIIs) and Renminbi QFIIs (RQFIIs) and (ii) those dealt in through Stock Connect. Both circulars provide for a temporary exemption from business tax, corporate income tax and individual income tax for gains realised from 17 November, while dividends are subject to a 10% withholding tax. Additional tax treaty relief can be claimed. It is important to note that (i) circular 79 states that gains obtained by QFIIs and RQFIIs prior to 17 November remain subject to corporate income tax according to the law and (ii) the exemptions are stated to be temporary but without any indication on how long the exemptions will continue to be in force.

(AIMA Weekly News, 18 November 2014)

For more information on these and other regulatory and tax matters, AIMA members may contact:

Jiri Krol
Deputy CEO, Head of Government and Regulatory Affairs
E: jkrol@aima.org

Jennifer Wood
Director, Head of Asset Management Regulation
E: jwood@aima.org

Adam Jacobs
Director, Head of Markets Regulation
E: ajacobs@aima.org

Paul Hale
Director, Head of Tax Affairs
E: phale@aima.org

Anna Berdinner
Regulatory Analyst, Asset Management Regulation
E: aberdinner@aima.org

Oliver Robinson
Regulatory Analyst, Markets Regulation
E: orobinson@aima.org

Enrique Clemente
Analyst, Tax Affairs
E: eclemente@aima.org


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AIMA news in brief

Updated AIMA Guide to Sound Practices for Selecting a Prime Broker

This Guide for AIMA members, published in December 2014, incorporates changes to the regulatory framework that affects the relationship between managers and prime brokers, including reporting requirements and other new measures introduced under the Dodd-Frank Act in the US and Europe's Alternative Investment Fund Managers Directive (AIFMD) and the European Market Infrastructure Regulation (EMIR). It also reflects the greater degree of due diligence being conducted on prime brokers today and the evolution in the prime brokerage model since the financial crisis. It contains guidance on appointing a prime broker and issues to be aware of when selecting more than one prime broker, and also highlights the likely impact of future regulatory changes. In addition, it discusses the core services of prime brokers and defines a number of key commercial terms.

AIMA welcomes Bank of America Merrill Lynch as a Global Partner

We are delighted to announce that Bank of America Merrill Lynch has become a Global Partner of AIMA. Our other Global Partners are Citco, Citi Prime Finance, Clifford Chance, Deutsche Bank, KPMG, Maples & Calder, Newedge, State Street, UBS and Wells Fargo Global Fund Services.

AIMA Australia

We are pleased to announce that Paul Chadwick has been re-appointed Chair of AIMA Australia. Since taking up the post two years ago, Paul has worked tirelessly on repositioning AIMA in Australia and along with his team of volunteers has implemented the Annual Hedge Fund Forum, revamped the Education Committee and has made successful inroads with the main regulatory bodies in Australia. Paul has also been instrumental in the regional connectivity of Australia, Singapore and Hong Kong.

AIMA announces new Council directors

AIMA has confirmed the composition of the AIMA Council, its global governing body. The Council has 15 members -

- Kathleen Casey (Chair), Senior Advisor, Patomak Global Partners;
- Olwyn Alexander, Partner, EMEA Hedge Funds Leader, PricewaterhouseCoopers;
- Andrew Bastow, Vice-President – Head of European Structuring and Regulatory Affairs, AQR Capital Management;
- Fiona Carpenter, Partner, EY LLP;
- Stuart Fiertz, President, Cheyne Capital Management;
- Jack Inglis, Chief Executive Officer, AIMA;
- Simon Lorne, Vice Chairman and Chief Legal Officer, Millennium Management;
- Tim O'Brien, General Counsel and Chief Compliance Officer, Pine River Capital Management;
- Martin Pabari, Chief Operating Officer, CQS (UK) LLP;
- Christopher Pearce, Chief Operating Officer, Marshall Wace Asia;
- Eva Sanchez, General Counsel, Citadel Europe;
- Henry Smith, Global Managing Partner, Maples and Calder;
- Philip Tye, Director, Nighthawk Capital;
- Karl Wachter, General Counsel, Magnetar Capital; and
- Choo San Yeoh, Director, Albourne Partners (Asia).

Q4 press releases

Date	Title
8 December	AIMA publishes updated guide for selecting a prime broker
24 November	AIMA announces new Council directors

Media coverage of AIMA

Many of the hyperlinks in the section below are restricted to the subscribers of the particular publications

Articles by AIMA

Comment: Jack Inglis (HFMWeek)
23 October 2014
In his quarterly column for HFMWeek, the AIMA CEO Jack Inglis says that the case for including hedge funds in institutional investor portfolios has never been stronger.

Building the case for hedge funds (HedgeFund Intelligence)
1 October 2014
Jack Inglis discusses the value of the hedge fund industry in HFI's Autumn 2014 Global Review.

AIMA in the news

AIMA updates guide for prime broker selection (Hedge Fund Journal)
8 December 2014
Coverage of the publication of an updated AIMA guide for hedge fund managers to use when selecting a prime broker.

AIMA urges EC to retract 'burdensome' assessment (HFMWeek)
1 December 2014
Jiri Krol is quoted in this article on new European Commission proposals for shareholding assessments.

AIMA announces new Council directors (Funds Europe)
24 November 2014
Coverage regarding the appointment of Fiona Carpenter (Partner, EY) and Martin Pabari (Chief Financial Officer, CQS) to our global Council.

Tye reappointed as AIMA Hong Kong chairman (AsiaHedge)
24 November 2014
Phillip Tye has been reappointed as chairman of AIMA Hong Kong.

Chinese take-off: The range of hedge fund opportunities (HFMWeek)
21 November 2014
AIMA's Heide Blunt is quoted in this article on the development of the Chinese hedge fund industry.

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[Value of legal talent rising in funds industry (AsianInvestor)](#)
10 November 2014
Jiri Krol is quoted highlighting the increasing prominence of in-house lawyers at investment management firms in this piece about a new list of leading counsels in Asia-Pacific.

[Hedge fund sector welcomes NSFR carve out (HFMWeek)](#)
5 November 2014
AIMA is referenced in this article on upcoming net stable funding ratio requirements.

[Hedge fund, investor groups hammer swaps 'stays' (Wall Street Journal)](#)
4 November 2014
AIMA is referenced in this article on changes endorsed by global regulators that would require banks and investors to give up their contractual rights to terminate swaps deals with troubled financial institutions.

[Market hits out at 'misleading' leverage method (HFMWeek)](#)
23 October 2014
AIMA is quoted in this article on leverage calculations under the AIFMD.

[EU regulators must learn lessons from EMIR when implementing SFT rules (COOConnect)](#)
2 October 2014
AIMA's Adam Jacobs is quoted in this piece on reporting requirements for securities financing transactions.

[Two major UK schemes join hedge fund pullback (Wall Street Journal)](#)
29 September 2014
Jack Inglis is quoted in this article on two of the largest pension funds in the UK reducing their exposure to hedge funds.

AIMA blog posts

[MiFID Blog Series – Third countries, welcome to the EU?](#)
8 December 2014
AIMA's Oliver Robinson discusses the MiFID II / MiFIR third countries regime.

[Update from the CEO - Making a difference on our members' behalf](#)
2 December 2014
When considering what we do, it is always with an eye to maximising our value to members, writes AIMA CEO Jack Inglis in his latest blog entry.

[MiFID II – Commodity Position limits and reporting](#)
14 October 2014
The final post in AIMA's MiFID II blog series looks at commodity position limits and reporting requirements.

[MiFID II Blog Series - The Taming of the Algorithm?](#)
1 October 2014
Oliver Robinson discusses growth in algorithmic trading and rise of high-frequency trading.

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Special Guest Speakers:

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John Mauldin
Chairman, Mauldin Economics

Nouriel Roubini
Chairman, Roubini Global Economics

Emmanuel Jal
Renowned recording artist, award winning activist

Jacqueline Novogratz
Founder and CEO, Acumen

Paul Lindley
Founder and CEO, Ella's Kitchen

Louis Hernandez, Jr.
President and CEO, Avid

Brad Katsuyama
President, CEO and Co-Founder of IEX Group, Inc.

Gregory Coleman
Special Agent, FBI
Case Agent, Wolf of Wall Street Investigation

Industry Guest Speakers:

Richard Addlestone - Partner, Solomon Harris
Sahm Adrangi - Portfolio Manager, Kerrisdale Capital Management, LLC
Shiloh Bates - Head of Structured Products, Business Development Corporation of America
Keith Benedict - COO, A.G. Hill Partners, LLC
Anric Blatt - Chairman, Global Fund Exchange
Robert 'Bob' Borden - Managing Partner and CIO, Delegate Advisors
David Bonderman - Co-Founder, TPG Capital
Matt Botein - CIO and Co-Head of Alternative Investors, BlackRock, Inc.
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Johnston L. Evans - Managing Director and General Partner, INVESCO Private Capital
Tim Fitzgerald - Head of Alternative Fund Services, Deutsche Bank
John Franklin - COO, Hedge Funds, Investcorp Investment Advisers LLC
James G. Glasgow, Jr. - Managing Member and Portfolio Manager, Five Mile Capital
Debra Granatstein - General Manager, Private Equity & Infrastructure, Canada Post
Ronan Guilfoyle - Managing Director, DMS Offshore Investment Services Ltd.
Jane Amanda Halsey - Founder and President, Roundtable Forum, LLC
Lord Michael Hastings - Vice President, UNICEF UK
Kenneth J. Heinz - President, Hedge Fund Research, Inc.
Tim Houghton - Managing Director and Principal, Cortland Capital Market Services, LLC
Andrew Hoine - Director of Research, Paulson & Co. Inc.
Constance Hunter - Chief Economist, Alternative Investments, KPMG
Hayden Isbister - Partner, Mourant Ozannes
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Richard R. Lebrun - Executive Vice President, Attorney, PIMCO
Eric Lloyd - CEO, Babson Capital Finance
Robert 'Bob' Maynard - CIO, Public Employee Retirement System of Idaho (PERSI)
James P. McCaughan - CEO, Principal Global Investors
Andrew Mehalko - Founder and CIO, AM Global Family Investment Office
Angela Moss - Director of Investments, UNC Management Company
Mark Okada - Co-Founder and CIO, Highland Capital Management, LP
Brian Pellegrino - CIO, United Parcel Service
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Yi (Sonny) Shen - CEO, Shanghai Shenyi Investment Consulting Co.
Brian Sponheimer - Portfolio Manager, Gabelli and Partners
Sally J. Staley - CIO, Case Western Reserve University
Lisa Stanton - Legal Counsel, Man Investments Inc.
Dr. Daniel Summerfield - Co-Head of Responsible Investment USS Ltd.
Drew Sweeney - Senior Portfolio Manager, Bradford & Marzec
Josh Tilley - Principal of Investments, Morgan Creek Capital Management
David Treitel - Managing Director, Apollo Aviation Group LLC
Michael Underhill - Co-Founder and CIO, Capital Innovations, LLC
Mark W. Yusko - CEO and CIO, Morgan Creek Capital Management
Bruce Zimmerman - CEO and CIO, University of Texas Investment Management Co.

Large turnout for fifth AIMA Annual Conference

AIMA's fifth Annual Conference was held in London on 7 October 2014. The event drew more than 370 attendees from more than 15 countries and was sponsored by CME Group, PwC and Simmons & Simmons.

Speakers included Loïc Fery, Founder, CEO & Co-CIO, Chenavari Investment Managers; Tim O'Brien, Partner, General Counsel and CCO of Pine River Capital Management LP; and Jack Inglis, CEO, AIMA.

Videos of the keynote speeches and panel discussions at AIMA's fifth Annual Conference are now available for members to view on our website.

Note — this material and the remarks therein should not be further distributed, placed into the public domain, or referenced or reported in any other internal or external communications.

Jack Inglis, CEO, AIMA

Loïc Fery, Founder, CEO & Co-CIO, Chenavari Investment Managers

The event was held at the Guildhall, in the City of London

Tim O'Brien, Partner, General Counsel and CCO, Pine River Capital Management LP

Forthcoming AIMA events

Hong Kong - AIMA in Asia Regional Forum 2015
22 January 2015

Venue: The Hong Kong Convention and Exhibition Centre, 1 Expo Drive, Wan Chai

Canada - AIMA Canada Annual Ontario Ski Day 2015
5 February 2015

Venue: Osler Bluff Ski Club, Blue Mountains, Ontario

Canada - AIMA Canada Annual Québec Ski Day 2015
16 February 2015

Venue: Mont Saint-Sauveur, 350 Saint-Denis Ave, Saint-Sauveur, Québec

US - AIMA's Global Policy & Regulatory Forum 2015
16 April 2015

Venue: Trump SoHo, 246 Spring Street, New York City

AIMA events globally in Q4

UK - The Future of Dealing Commission and Independent Research
1 October 2014
Venue: Simmons & Simmons, CityPoint, 1 Ropemaker Street, London

Singapore - The Next Iteration of Hedge Funds
2 October 2014
Venue: UBS, One Raffles Quay, North Tower, Singapore

UK - AIMA Annual Conference 2014
7 October 2014
Venue: Guildhall, Gresham Street, London

Hong Kong - Valuation: Changes and Challenges
7 October 2014
Venue: 22/F, Citic Tower, Tim Mei Avenue, Central, Hong Kong

US - AIMA Sound Practices & Global Regulatory Update
14 October 2014
Venue: Ernst & Young, 5 Times Square, New York City

Singapore - AIMA Singapore Social Networking Night
15 October 2014
Venue: The Exchange, Asia Square Tower One, 8 Marina View, Singapore

Dubai - AIMA Middle East Hedge Fund Investor Summit
23 October 2014
Venue: DIFC Conference Centre, Gate Precinct 4, Dubai

France - AIMA Briefing
23 October 2014
Venue: Gide Loyrette Nouel, 22 Cours Albert 1er, 75008 Paris

Canada - AIMA Canada, SFU and UBC Career Panel - Vancouver
23 October 2014
Venue: Segal Graduate School, 500 Granville Street, Vancouver

Singapore - Private Funds in China
28 October 2014
Venue: Morgan Stanley, 23 Church Street, 16/F, Singapore 049481

Hong Kong - Valuation: Changes and Challenges
28 October 2014
Venue: Courses & Seminars Limited, 10/F, 122 Queen's Road, Central, Hong Kong

Canada - Starting a Hedge Fund, Wine & Cheese
28 October 2014

Venue: The Vancouver Club, 915 West Hastings Street, Vancouver

continued ▸

Australia – Risk Process and Analysis for Investors: An Essential Part of 'Good' Management
29 October 2014
Venue: Credit Suisse, Level 31, Gateway, 1 Macquarie Place, Sydney

UK – Digital & Social Media for Hedge Funds - An Educational Workshop
29 October 2014
Venue: AIMA, 167 Fleet Street, London

Canada – Alberta Investor Panel & Wine and Cheese Reception
29 October 2014
Venue: Saltlik Steakhouse, 101 8 Ave SW, Calgary

Hong Kong – OTC Regulation and Reporting Regimes - A Guide to Global Themes and Best Practice Implementation
13 November 2014

Venue: Dot Cod, Basement, Landmark Prince's Building, 10 Chater Road, Central, Hong Kong

Hong Kong – Recent Amendments to HK's 'Professional Investor' Regime and an Overview of Marketing Related Regulatory Trends
17 November 2014
Venue: State Street, Finance Street, Hong Kong

US – Navigating Private Placement Regimes Around the World
19 November 2014
Venue: EY, 5 Times Square, New York City

UK – Navigating Private Placement Regimes Around the World
25 November 2014

Venue: EY, 1 More London Place, London

Canada – Toronto Wine and Cheese Reception 2014
25 November 2014
Venue: BMO Reception Floor, First Canadian Place, 100 King Street West, Toronto

Hong Kong – 2014 Retrospective: Key Licensing and Supervision Themes
26 November 2014
Venue: Clifford Chance LLP, 27/F, Jardine House, 1 Connaught Place, Central

Australia – End of Year Networking Drinks
26 November 2014
Venue: Uncle Ming's Bar, 55 York Street, Sydney

continued ▸

Canada - Montréal Wine and Cheese Reception 2014
27 November 2014
Venue: BMO Musée, 129 Rue Saint-Jacques, Montréal, Québec

Brazil - Insider Trading: A Global Perspective
1 December 2014
Venue: Skadden, Arps, Slate, Meagher & Flom LLP, São Paulo

Canada - Montréal Emerging Markets Panel
1 December 2014

Venue: Hotel Omni Mont-Royal, 1050 Rue Sherbrooke Ouest, Montréal, Québec

Singapore - AIMA Singapore Christmas Party
3 December 2014
Venue: The Black Swan, 19 Cecil Street, Singapore

Q4 AIMA webinar

Click on the hyperlinks in red to view the webinar

Government & Regulatory Affairs Quarterly Update
21 October 2014

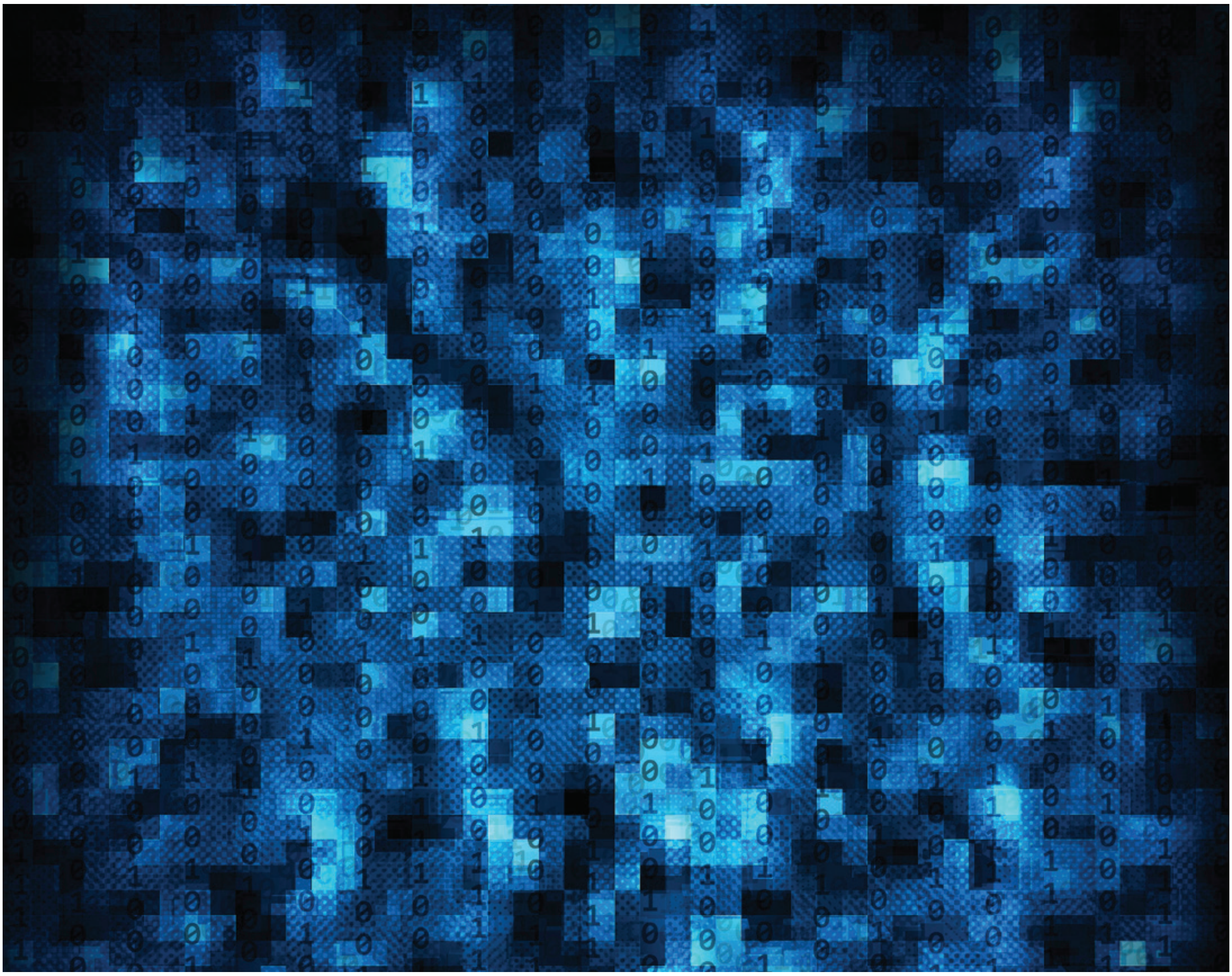
Hong Kong - Member Christmas Networking Drinks
4 December 2014

Venue: Mama San, 46 Wyndham Street, Central, Hong Kong

Brazil - Insider Trading: A Global View
5 December 2014
Venue: JGP, Humaitá 275,11° e 12° andares, Rio de Janeiro

Ireland - AIMA Briefing
9 December 2014
Venue: PwC, One Spencer Dock, North Wall Quay, Dublin 1

Japan - AIMA Japan & CAIA 'End of Year' Drinks and Networking Event
11 December 2014
Venue: The Tokyo Club, 1-9-14 Roppongi, Minato-ku, Tokyo 106-0032



Cyber security for hedge funds

By Matthew Martindale, Director, KPMG

AIMA GLOBAL PARTNER

According to the latest KPMG Business Instincts survey, under-investment in technology over the past six years has left many C-suites fearful that they are vulnerable to some form of cyber attack. Proactively managing cyber risk has become a key consideration for C-level executives with as many as one in three senior executives saying that investing in cyber skills to protect their business is now their major concern. Little wonder when the front pages of newspapers scream headlines about Heartbleed or Shellshock vulnerabilities.

Every day we hear of new vulnerabilities, attacks and incidents which undoubtedly leave leadership teams wondering what they really need to do, how much is really enough and who they can trust to help them get it right.

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What is cyber security?

Cyber security is about understanding the risks of doing business in our modern world wherever a business is in its life cycle. As our economy becomes increasingly digital, so does crime. Attackers are using sophisticated means to achieve one of a number of very old objectives; theft, subversion, sabotage or espionage.

Take a moment to go back to the 1920s when John Dillinger and his fellow gangsters were ruling the streets of Chicago. They simply marched through banks' front doors with guns in hand, stole thousands of dollars and then walked out. Now fast forward to the early twenty-first century. Something very similar is happening today in cyber space, but now the weapon of choice isn't a physical gun and it isn't just banks that are being targeted. All financial services organisations - irrespective of size - are exposed to cyber risk.

What does this mean for hedge funds?

Cyber risk for hedge funds could range from fraud to stolen intellectual property such as investment strategies and trading platform algorithms, or data relating to investors, trading, portfolios, funds or finances. In addition, there is also a risk that an attacker could launch a denial of service attack to prevent organisations from doing business, slow down the ability to complete trades or to take out important connections to other parties such as market data feed providers, prime brokers and fund administrators. Any kind of cyber breach could result in significant reputational damage for a hedge fund, which in turn could result in a loss of investor confidence.

The threat to data and systems is multi-faceted and constantly evolving. External threats come from organised criminals operating a sophisticated business on a profit and loss basis, competitors using aggressive tactics to gain insights and hactivists utilising political motivation to strike. In addition there is a significant insider threat posed by careless, disgruntled or malicious employees.

Questions to consider:

- Do you have the right level of protection for your crown jewel assets?
- What would the impact be on your business if you suffered a cyber-security breach?
- How are you managing your suppliers to ensure they're not a weak point in your security?
- How do your cyber security capabilities compare to your peers?

But taking action through fear is not the answer. As organisations become increasingly aware of the value of cyber security, those who adopt a positive approach to managing it will be viewed as more attractive and likely to retain clients and investors. They will be the ones who 'feel free' to act and are in a better position to anticipate and prevent wide-scale attacks.

What regulation do I need to be aware of?

Recent security incidents have led to litigation, regulatory action, reputational damage and even resignations. The Data Protection Act 1998 requires data controllers who are processing customer and staff personal

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information electronically to register with the Information Commissioners Officer (ICO). The ICO can issue fines of up to £500,000 and "names and shames" companies that suffer a serious breach of the act. In the US the Securities Exchange Commission (SEC) Office of Compliance Inspections and Examinations (OCIE) is concerned with the integrity of the market system and customer data protection[1]. OCIE's cyber security initiative is designed to assess cyber security preparedness in the securities industry and to obtain information about the industry's recent experiences with certain types of cyber threats.

Overlaying this is the draft European Union data protection regulation expected to be finalised in 2015 which will penalise businesses for information failures or breaches involving customer or other personal data. Those fines are likely to be up to 5% of global turnover depending on the outcome of the debate between the European Parliament and Council of Ministers[2].

Where do I start?

With the global cost of cyber crime reaching $575 billion[3] and the World Economic Forum Global Risks 2014 Insight Report[4] ranking cyber attack in the top three technological risks, the UK government is shining a spotlight on the cyber security issue.

A great starting place for organisations is to use the UK Government's Cyber Essentials Scheme[5]; a set of basic technical controls for organisations to protect them from a cyber attack which is supplemented by the 10 Steps to Cyber Security[6].

Hedge funds should think about the protection of their business in three interconnected ways:

1. *People* – implementing regular security awareness training and developing easy to understand security policies of what is acceptable on corporate equipment and when working remotely, will position your employees as your first line of defence. Better security doesn't necessarily mean acquiring the latest technological solution. The most important component of a cyber-security model is that it must be understood by all employees.

2. *Process* – developing an adaptive approach that focuses on speed and agility in response to an attack can prevent downtime, avoid expensive disruptive responses and maintain business operations, whilst appeasing regulators, investors and

1. *National Exam Program Risk Alert – OCIE Cyber Security (Volume IV, Issue 2 – 15 April 2014)* - www.sec.gov/ocie/announcement/Cybersecurity+Risk+Alert++%2526+Appendix+-+4.15.14.pdf

2. *European Commission - MEMO/14/186 12/03/2014 - http://europa.eu/rapid/press-release_MEMO-14-186_en.htm*

3. *Net Losses: Estimating the Global Cost of Cybercrime, June 2014 - http://www.mcafee.com/uk/resources/reports/rp-economic-impact-cybercrime2.pdf*

4. *http://www3.weforum.org/docs/WEF_GlobalRisks_Report_2014.pdf*

5. *https://www.gov.uk/government/publications/cyber-essentials-scheme-overview*

6. *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/73128/12-1120-10-steps-to-cyber-security-executive.pdf*

industry partners. Ensuring security requirements are built into key processes such as application management, change management, user access management and patch management will ensure you have some of the fundamental security components in place. Establishing security requirements in contracts and exercising the right to audit with third parties (such as IT managed services, cloud service providers and payroll providers) will provide assurance to you that your data and systems are being protected effectively.

3. *Technology* - focusing on monitoring and detection of security breaches is where technology can add real benefit. Implementing fundamental security controls, such as firewalls, anti-malicious software, secure configurations and security logging and monitoring will enable you to stay ahead of the curve.

Hedge funds that accept cyber attacks as an inevitable part of today's business landscape and who put the right level of protection in place to defend themselves from the bad guys, like the banks had to with John Dillinger, will secure the future of their business.

Matthew.Martindale@KPMG.co.uk
www.kpmg.com/uk/cyber

The development of the non-bank finance market in Europe and the opportunity it presents for asset managers

AIMA SPONSORING MEMBER

By Pat Wall, Partner – International Tax Structuring, and Colin Farrell, Senior Manager – International Tax Structuring, PwC Dublin

Europe has been slow to recover from the financial crisis with levels of unemployment remaining stubbornly high in most European countries. This is in contrast to the US which has shown clear signs of recovery. One of the key factors hindering Europe's recovery is the lack of credit available to fuel business investment, working capital and large scale infrastructure and real estate projects. Banks in Europe and the US are being squeezed by regulators, politicians and investors but the impact in Europe is much greater where business has long been far more reliant on bank funding.

Depending on who you believe, the European funding gap (i.e. the difference between what banks can lend and what businesses will need) is estimated to be somewhere between €2 trillion and €4 trillion over the next five years. Non-bank finance has to play a major role in bridging this gap. The opportunity is huge but a note of caution is warranted. Despite the EU single market and the existence of the Euro, the lending market is still a patchwork of different banking, lending and bankruptcy laws. It is not possible to adopt a one size fits all approach. Asset managers will need to be smart about the sectors and countries they target.

Europe compared to the US

It is estimated that banks in the US account for about 25% of corporate lending compared to about 80% in Europe. This, coupled with the deleveraging of European banks has led to a significant European debt funding gap. As the percentages show, the US has a much more developed non-bank finance market allowing investors to participate in direct lending activity. It is sobering to reflect that the US has an 80-year head start on Europe. The more diverse funding landscape is attributed to the 1933 Glass-Steagall bank reforms following the Wall Street Crash of 1929. The greater flexibility and maturity of the US market has created a virtuous cycle resulting in a well regulated, deep market for loans making them a suitable asset class for both mutual funds and pension funds alike. The secondary market for debt in the US amounts to approximately $400 billion annually. By comparison, the European market is small. But that must and will change, rapidly.

The sword of "shadow banking"!

The need to respond appropriately to the squeeze on bank credit has not been helped by muddled regulatory thinking on so called "shadow banking". However, it appears that the light is beginning to dawn that not all non-bank financing activity is shadow banking and not all shadow banking is bad. In fact, shadow banking activity provides an important financial intermediation function distinct from those provided by banks. The functions can be economically useful and need to be understood and properly regulated.

The term "shadow banking" has acquired negative connotations but to equate non-bank financing to "shadow banking" is dangerously simplistic. Alternative sources of financing cannot be developed if all lending is straight-

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jacketed into traditional banking rules. It was those very rules and the dominance of bank lending in Europe that has given rise to its current problems, In essence non-bank finance is the process of directly matching investor capital with lending opportunities. If properly conducted, non-bank lending has the potential to eliminate the central problem of traditional banking; the conversion of short term liabilities (deposits and wholesale funding) into long term assets. Non-bank finance eliminates this problem by matching investors and borrowers with similar risk and maturity appetites. It needs to be understood as a separate and distinct activity to traditional bank lending and regulated accordingly. The provision of non-banking funding can be mutually beneficial to investors, borrowers and asset managers alike.

A change in the European mindset

So what is the stumbling block? The fragmented European lending market certainly provides challenges but none of this is unsurmountable. The main stumbling block in Europe to date has been regulatory mindset about the dangers of shadow banking. Thankfully that now appears to be changing. Ireland and Malta have recently introduced regulations to allow investment funds to originate loans and the EU has proposed the introduction of the European Long Term Investment Fund for large scale infrastructure projects open to retail investors.

The growth in the "peer to peer" or "crowd funding" industry in Europe further signifies that politicians, regulators and most importantly borrowers and investors have realised that there is a need and an opportunity in relation to regulated non-bank financing channels.

As the European market in non-bank lending matures, deepens and becomes more liquid, loans as an asset class will be increasingly attractive to Investors struggling to access adequate yields. On the other side of the equation sound business borrowers who risk being starved of credit are increasingly looking to non-bank funding.

The asset management industry is ideally placed to fill the void left by the de-leveraging of banks. This not only creates an opportunity for asset managers but also aids the European recovery and, if properly regulated, builds a more diverse and stable European financial framework for the future.

pat.wall@ie.pwc.com
colin.d.farrell@ie.pwc.com
www.pwc.ie

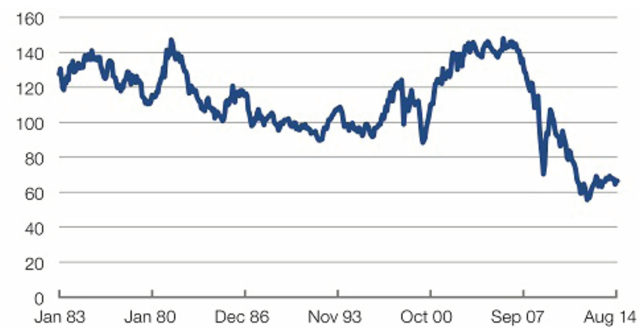
Mario Draghi, moral suasion and Eurozone banks

AIMA SPONSORING MEMBER

By Ben Funnell, Portfolio Manager, Man GLG

The rescue, recapitalisation and restructuring of the European banking system has been a long and painful process and is not yet over. As many will be aware, European bank equity has been a horrible asset to own during much of the pre- and post-financial crisis era. In fact, as the chart below illustrates, with the exception of the periods following the bursting of the TMT bubble and the end of 1970s stagflation, bank equity has been a very unrewarding investment to hold over the last 40 years. Accordingly, we have not been advocates of bank equity during much of my tenure at GLG. However, we have recently adopted a much more positive stance towards European banks within our global and European portfolios and I will now seek to explain the rationale behind this change of heart.

Banks - Performance relative to MSCI Europe



Source: MSCI, Morgan Stanley, GLG Partners

Dynamic Draghi

Mario Draghi was appointed ECB President on 1 November 2011 and it is the determination that he has demonstrated during the ensuing period that has principally driven the reassessment of our view. Within five weeks of his appointment, he had announced and implemented the first LTRO (€489bn). Within three months he had issued the second LTRO (€530bn). Seven months after he took office he made the "whatever it takes" speech. This ultimately proved the trough in Eurozone banks' relative performance.

The LTRO programme of December 2011 was designed to break the negative feedback loop between the sovereign and the banks. Banks received €1trn to put on an outsize carry trade on the peripheral bond curve. Sovereigns were subsequently able to watch their funding costs collapse. Spanish 10 year government bonds yielded 7.64% back then, a 625bp spread to the US 10 year Treasury. By the first week of October the Spanish yield had slumped to 2.14%, displaying a negative spread to its US counterpart. (Spain could fund cheaper than the United States?! Ridiculous, but anyone trying to short SPGs is "fighting the Fed".) "Mission accomplished" for part one of Draghi's plan.

The 'targeted' LTRO (TLTRO) / ABS programme is Draghi's phase 2. This is explicitly concerned with pushing inflation expectations back up (as he pointed out during the initial announcement on 5 June) and attempting to stimulate bank lending (a point he reiterated no fewer than four times at his 2 October press conference). The chart below shows Euro 5yr inflation and this is what Draghi referenced as having fallen below 2% in the speech. Indeed, it is a lot worse now. What is interesting to note is that every

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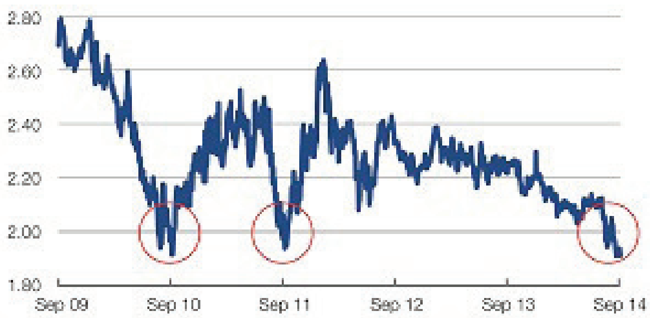
time inflation has fallen below 2% the ECB has acted; the 2010 episode prompted the EFSF, the 2011 dip catalysed bailouts and the TLTRO/ ABS response has been triggered this year.

Eurozone Inflation expectations (5 years forward, in %)



Source: Bloomberg

We received some details of the ABS programme at that 2 October press conference, with more details promised in the coming weeks, but, according to our interpretation:

- It has the scope to be much bigger than the market thinks;
- The national resolution institutions (KfW in Germany, EIF in the Eurozone) will be able to buy mezzanine tranches of special purpose vehicles (SPVs), obviating the need for sovereign guarantees;
- In turn, this will free up substantial capital for banks and raise their return on equity (ROE)[1].

A positive impact on bank lending

In our opinion, the TLTROs are very well designed and this view is selectively reflected elsewhere, with Redburn, Citigroup and Morgan Stanley having published notes on the subject. The ingenious aspect is the mechanism for allocating capacity in tranches 3 to 8 (Mar 2015 to June 2016, quarterly), based on the deviation of outturn lending from the current baseline, which is a projection of current trends. (For example, if an Italian bank is shrinking its loan book at a 10% annual rate now, the ECB assumes that it will continue to do so through to March 2015 – the baseline).

In the example above, that bank's allocation of capacity in the March 2015 TLTRO will be calculated as actual loan book (at that time) less baseline projected loan book, times 3. In other words, if four year funding from the ECB at 15bps can be obtained (and we really think that banks should take them up on this offer, although even that is disputed) it will provide the ability to slow the contraction in lenders' loan books or accelerate the expansion, whichever applies. And it is important to start doing that as soon as possible. Run in tandem, we think the TLTRO and ABS purchase programme will have a positive impact on bank lending, and we are in a minority in thinking that. The main objection to our view that we encounter is not that banks won't have capacity to lend (especially once the Asset Quality Review and

1. *This assumption is based on our belief that the ECB would be a willing buyer of the investment grade tranches at a premium to marks and that the non-bank financial sector (asset managers, life companies, hedge funds) would be willing co-investors in the mezzanine tranches if the national resolution funds were involved too.*

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stress test have confirmed that they have enough capital), the contention is simply that there is no demand for loans. And while this view has been quite correct until now, we think that demand for credit is emerging. SME lending is now growing in Italy and Spain. It is just the large corporates where demand is weak, and that is because they are able to fund for term and very cheaply in the bond markets.

However, the key point, which is dismissed, is that the ECB's own Euro Area Bank Lending Survey has shown positive net demand for credit for the last two quarters.

The survey is dismissed because it showed a recovery to positive net demand for loans in 2011 but then faded and went back into contraction mode. But that was in the middle of the euro sovereign lending crisis. Today's world is very different.

Aside from these more structural observations, we also note that the set up for owning Eurozone bank equity is, to our eyes, attractive. Consider:

- We have recently witnessed record monthly outflows from European equity[2].
- On 5 November the IMF slashed its Eurozone GDP forecasts for the second time in six months[3].
- Banks are the outstanding value sector in Europe today, trading at a 50% price-to-book discount to the market[4].
- Fundamentally, a regulator needs its banking sector to lend, and for that to happen that lending has to cover its cost of capital. Put another way, the regulator needs banks to trade above book value.
- Risk / reward appears positively asymmetric.

At the low in 2009, banks were trading at 0.65x book, but the book value was very uncertain at that time in advance of multiple rounds of equity recaps, which carried a dilutive impact on shareholder value.

Conversely, the outlook is far less shrouded now, especially as the AQR will (probably) reveal that 99% of the required recaps are behind us.

Hence, in the worst case scenario, we could see banks trade back to around 0.8x book or so, but find it unimaginable (ex 2008 redux) that banks could return to trough 2009 valuations. So the absolute downside in being long Euro banks is 20%, in our view.

What about the upside? Well, we cannot envisage any reason why banks cannot trade at 1.5x book if ROE can get back to 10%, which we believe is perfectly plausible over time[5]. It is also worth noting that Euro banks currently, and for the last 18 months or so, have had the best earnings revisions in the market[6].

2. *Markit, 23.10.2014.*

3. *IMF.*

4. *Morgan Stanley, 01.11.2014.*

5. *ROE is currently 5% but non-performing loans (NPLs) are falling post the peak in Eurozone unemployment three quarters ago; net interest margin (NIM) compression is late stage and TLTRO + ABS programme is likely to raise ROE; and we think loan balances outstanding will stop falling as higher return front book replaces lower return back book, raising ROE.*

6. *MSCI, Morgan Stanley and GLG Partners.*

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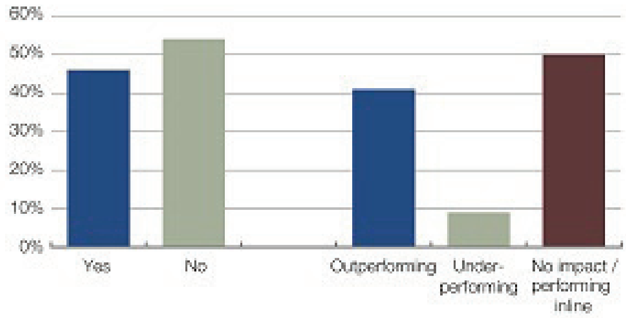
Finally, we notice that there seems to be a disconnect between institutional investors' views and their positioning.



A Goldman Sachs survey of investors from early September asked whether they thought the TLTRO would result in the banks sector outperforming. They thought so, with a 4:1 margin (see chart on next page).

Will TLTRO result in a) increased bank lending and b) banking sector outperforming / underperforming? (Poll of 120)

Source: "LTRO-3: A liquidity operation, not a silver bullet for lending" Omahen et al, Goldman Sachs Global Investment Research, 9 Sept 2014

However, the positive extent of these expectations is far from evident in positioning. In fact, rather than being overweight banks, analysis from EPFR / HSBC shows that, on average, institutional investors remain underweight European banks, albeit that the size of the underweight has come down significantly since July 2012[7].

A "game changer" for hedge funds?

In conclusion, we believe that the risk/reward dynamics of taking long positions in European banks are significantly skewed to the upside, even though banks remain out of favour on a relative basis. This has the potential to constitute a major change in the opportunity set for hedge funds, which have largely been avoiding the sector in the post-crisis period because of intermittent short-selling bans and a lack of a catalyst to prompt upside conviction. As far as we are concerned, the 'game changer' is Mario Draghi's mission to raise inflation expectations. Even if he fails to succeed in the long run, there are a number of levers that he can pull in the pursuit of this objective in the medium term. Unlike his less dynamic predecessor, Draghi is pulling these levers one by one.

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7. *HSBC Strategy Research (August 2014)*

Reporting under EMIR — what lies ahead?

By Ian McLelland, CEO, DTCC Derivatives Repository Ltd

Almost one year since the trade reporting mandate came into force under the European Market Infrastructure Regulation (EMIR) buy-side firms have made good progress in meeting their reporting obligations, in addition to those under the Alternative Investment Fund Managers Directive (AIFMD).

The focus is now shifting from initial compliance with regulation to addressing data quality challenges to ensure that information reported to trade repositories can be used by regulators to accurately identify and mitigate the build-up of risk in the financial system.

The introduction of trade reporting in February 2014 was an unprecedented undertaking which mandated the reporting by buy-side and sell-side firms of both over-the-counter (OTC) and exchange-traded derivatives. This was followed six months later by the August 2014 deadline for collateral and valuation reporting. This required primarily all financial counterparties to report on a daily basis the mark-to-market value of their derivatives trades, whether a trade is collateralised and the value of collateral posted against that trade.

But the reporting implementation process did not stop there. Over the course of the year, regulators have been working with the industry to validate and improve the quality of derivatives data being reported to trade repositories to ensure that trades can be matched and reconciled efficiently. This has culminated in the European Securities Markets Authority (ESMA) requiring all trade repositories and the industry to meet certain requirements by 1 December 2014. This initiative, referred to as the "level one validation" process will require all trade repositories in Europe to reject ESMA reportable fields that do not meet specified reporting formats and patterns. There are 32 functional changes, but two examples are: the Unique Trade Identifier (UTI) for a reported trade cannot be blank and cannot be changed or amended once it is submitted to the trade repository. Also the field used to identify whether the trade is reported due to a compression event cannot be left blank and must contain a yes or no.

As we approach 2015, this initiative is set to be supplemented by level two and possibly level three measures under EMIR. Furthermore, August 2015 will mark the third year since the implementation of EMIR which is likely to be subject to further revisions by the European Commission. With these deadlines in mind, now is the time for firms to think about their current reporting processes and which reporting model is best suited to their specific needs.

For some firms, reporting directly to a trade repository may seem a more practical solution. However, as the 1 December 2014 compliance deadline approached, these firms had to ensure they were implementing the necessary changes to their systems and interfaces to meet these requirements. This has meant understanding and populating these new ESMA required fields so that their submissions will be accepted by their trade repository. Wherever possible, firms must also take advantage of user acceptance testing offered by their trade repository to ensure

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they are prepared to meet the requirements of the level one validation process.

These same firms must also think about how they can make the most of the services offered to them by their service provider, such as the different connectivity options, to ensure the reporting process is as efficient as possible. For example, the usage, frequency and volume of derivatives trading will play an important part in the decision as to which connectivity option firms adopt when reporting their trades to a trade repository. To give an example, low-volume users may choose to upload their trade reports using a web-based, manual spreadsheet, but medium-high volume users of derivatives may wish to adopt more automated solutions offered to them by their trade repository.

For buy-side firms who choose to delegate reporting, compliance with the level one validation process can be facilitated through their dealer counterparty. Under a delegated model, the buy-side firm's dealer or a nominated third party will report both sides of the trade using one UTI so that a trade can be paired and then matched by a trade repository. The buy-side counterparty is then able to retrieve the UTI for reconciliation purposes, which has been generated on their behalf, from the reports sent to them by the trade repository. It is important to note, however, that although a buy-side firm can delegate reporting to their dealer or another third party, such as a custodian, they will remain responsible for the accuracy of the counterparty data submitted on their behalf. Longer term, as EMIR becomes subject to future revisions, buy-side firms will be able to look to their dealer or third party provider, who will continue to take responsibility for the reporting of their trades.

Reporting under EMIR continues to be a work in progress. Whichever reporting option a firm chooses to adopt, it is essential that they think about future developments. By acting now and ensuring long term strategic reporting solutions are in place, firms can be better prepared to respond to any changes ahead.

GTR-EMEA@dtcc.com
www.dtcc.com

Benchmark reform — for better or worse

By Lucy Frew, Financial Regulatory Partner, Kemp Little

The manipulation of LIBOR and EURIBOR, and investigations and enforcement action by regulators into these and other benchmarks, have raised significant concerns about the integrity of benchmarks. Benchmarks are vital to the pricing of many financial instruments and commercial and non-commercial contracts. It is in this context that on 18 September 2013 the European Commission ("Commission") published its proposal for a regulation on indices used as benchmarks in financial instruments and financial contracts ("Regulation").

Hedge fund businesses and underlying investors need benchmarks to be accurate and not subject to manipulation and, as such, should generally welcome regulation of benchmarks. However, some aspects of the Regulation may be negative. This piece outlines the current proposals for the Regulation and its likely impact on key stakeholders, including hedge fund businesses.

Current status and timing

On 28 October 2014 the Commission published the latest compromise proposal on the Regulation. Agreement is expected to be reached on the text of the Regulation in 2015, following which it will be adopted and published in the Official Journal. It will come into force on the following day, and apply twelve months from then.

Scope of the Regulation

The scope of the Regulation is very wide. A benchmark is defined in the Regulation as any index by reference to which the amount payable under a financial instrument or a financial contract, or the value of a financial instrument, is determined. An index that is used to measure the performance of an investment fund (meaning an AIF or a UCITS) is also a benchmark. Accordingly, is not the nature of the input data which determines whether a benchmark is with scope of the Regulation.

An index is both 'published or made available to the public' and regularly determined, entirely or partially, by the application of a formula, other method of calculation, or assessment, where this determination is made on the basis of the value of one or more underlying assets, or prices, including estimated prices, or other values.

The extent to which indices are regulated will depend on whether they are 'published or made available to the public'. This could lead to privately constructed indices being subject to regulation.

In defining benchmarks broadly, the Regulation does not sufficiently distinguish between rate benchmarks such as EURIBOR and LIBOR and market indices that value the return on a basket of securities. The risk of manipulation is clearly significantly greater where the benchmark is based on submitted rates rather than transaction data.

Additional requirements for certain benchmarks are addressed by the Commission with annexes to the Regulation in relation to inter-bank interest rate benchmarks (that is, benchmarks referenced in relation to the rate at which banks may lend to, or borrow from,

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other banks, such as LIBOR and EURIBOR) and commodity benchmarks.

'Critical benchmarks' mean those where the majority of the contributors are 'supervised entities' (namely credit institutions, investment firms, insurers or reinsurers, UCITS, AIFMs, CCPs, trade repositories or administrators) and the benchmark is referenced by financial instruments worth at least EUR 500 billion. The Commission is required to draw up a list of 'critical benchmarks'. 'Critical benchmarks' are subject to additional requirements.

The Regulation will affect three main categories of stakeholders, namely benchmark administrators, contributors and users.

Administrators

An 'administrator' is defined as the person that has control over the provision of a benchmark. The activity of 'provision of a benchmark' is comprised of administering the arrangements for determining a benchmark; collecting, analysing or processing input data for the purpose of determining a benchmark; and determining a benchmark through the application of a formula or other method of calculation or by an assessment of input data provided for that purpose.

There will be extra burdens on an administrator. Administrator will need to apply for authorisation by the competent authority in the member state and to comply with the conditions for authorisation.

The Regulation contains a number of provisions governing the input data of a benchmark and the methodology used by an administrator to determine a benchmark. Input data must be sufficient to represent accurately and reliably the market or economic reality that the benchmark is intended to measure. It should be transaction data, unless it is necessary to use alternative, non-transaction data, in which case that data must be verifiable. Transaction data is defined as 'observable prices, rates, indices or values representing transactions between unaffiliated counterparties in an active market subject to competitive supply and demand forces'. The administrator must put in place adequate systems and controls to ensure the integrity of the input data. A reliable and representative panel or sample of contributors must be used by the administrator to obtain the input data. The administrator must use a robust and reliable methodology to determine a benchmark, with clear rules identifying how and when discretion may be exercised in the determination of that benchmark. The administrator must develop, operate and administer the benchmark data and methodology transparently.

Administrators must publish the input data used to determine a benchmark immediately after publication of the benchmark, except where this would have serious adverse consequences for the contributors or adversely affect the reliability or integrity of the benchmark (in which case, publication may be delayed to minimise the impact). An administrator must also publish a procedure concerning the actions it will take in the event of changes to, or the cessation of, a benchmark.

Administrators are also required to publish a benchmark statement for each benchmark provided. This must unambiguously define the market or economic position measured by the benchmark and the circumstances in which measurement may become unreliable. It must describe the purposes for which it is appropriate to use the benchmark and the circumstances in which it may cease to be fit for these purposes. The statement must set out

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technical specifications on the elements of the calculation where discretion may be exercised, the criteria applicable to the exercise of this discretion and the persons by whom discretion is exercised. Notice must be given of the factors (including external factors beyond the control of the administrator) which may necessitate changes to, or the cessation of, the benchmark and the administrator must advise that any financial contracts or other financial instruments that reference the benchmark should be able to withstand, or otherwise address the possibility, of changes to, or cessation of, the benchmark.

Administrators must monitor the input data and contributors to identify, and notify the relevant competent authority of, any suspicions of a material breach of MAR and conduct that may involve manipulation or attempted manipulation of a benchmark. The administrator must operate procedures for its staff and other relevant persons to report internally any breaches of the Regulation.

The administrator must establish and maintain robust governance arrangements, including a clear organisational structure with well defined, transparent and consistent roles and responsibilities for all persons involved in benchmark provision. The administrator must have an accountability framework covering record keeping, auditing and review, and a complaints process, that provide evidence of compliance with the requirements of the Regulation. The administrator must ensure that actual or potential conflicts of interest do not affect the provision of a benchmark and that the exercise of any required discretion or judgement in the benchmark process is independently and honestly exercised. The administrator must establish an oversight function to provide oversight of all aspects of the provision of its benchmarks. The administrator must have a control framework that ensures benchmarks are provided and published or made available in accordance with the requirements of the Regulation.

Administrators must adopt a legally binding code of conduct for each benchmark, clearly specifying the administrator's and contributors' responsibilities and obligations, including a clear description of the input data to be provided and specified matters relating to the systems and controls a contributor is required to establish. Administrators must not outsource functions relating to benchmark provision if it would materially impair the administrator's control over the provision of the benchmark or the ability of the relevant competent authority to supervise the benchmark. If an outsourcing arrangement is to be entered into, the relevant administrator must ensure the requirements of the Regulation are satisfied. Notwithstanding any such arrangement, the administrator remains fully responsible for discharging its obligations.

Exclusion of administrators from scope of Benchmark Regulation

Where an administrator produces an index that it is unaware (and could not reasonably have been aware) constitutes a benchmark that is used as a reference to a financial instrument or a financial contract without their knowledge, the Regulation will not apply to that administrator. In addition, where ESMA notifies an administrator that their index has or may become a benchmark, the administrator need not consent, in which case the index may not be used as a benchmark and the requirements of the Regulation will not apply.

Contributors

A 'contributor' is defined as a person contributing the input data used by the administrator to calculate the benchmark.

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The Regulation requires all contributors to sign up to, and comply with, the legally binding code of conduct that has been adopted by the benchmark administrator in relation to each benchmark to which they provide input data. Where, in any year, at least 20% of the contributors to a 'critical benchmark' have ceased contributing, or there are indications this is likely, the competent authority of the administrator of the critical benchmark will have the power to require selected supervised entities to contribute input data to the administrator.

Additional requirements apply to 'supervised contributors', defined as a supervised entity that contributes input data to an administrator located in the EU. 'Supervised contributors' must ensure their provision of input data is unaffected by any existing or potential conflict of interest and must exercise any discretion honestly and independently, based on relevant information and in accordance with the code of conduct. They must also operate a control framework that ensures the integrity, accuracy and reliability of the input data and that this data is provided in accordance with the provisions of the Regulation and the code of conduct. 'Supervised contributors' must also comply with the additional systems and controls requirements specified in the Regulation. Among other things, these include training submitters on the Regulation and MAR and conflict management measures, including physical separation of employees, consideration of how to remove incentives to manipulate any benchmark that are created by remuneration policies and the retention for an appropriate time period of records of communications concerning input data provision.

ESMA will develop draft regulatory technical standards to further specify the internal oversight and verification procedures of a contributor that the administrator shall use seek to ensure the integrity and accuracy of input data.

Users

Only benchmark users that are 'supervised entities' that will be subject to the Regulation. If the supervised entity is a party to financial contracts, or issues or owns financial instruments, that reference a benchmark it becomes subject to a requirement to produce, and on request submit to the competent authority, 'robust written plans' setting out what it would do if the benchmark were to materially change or cease to be produced.

Before entering into a financial contract with a consumer, a 'supervised entity' must conduct a suitability assessment to determine whether referencing the contract to a benchmark is suitable for the consumer, by obtaining information about the consumer's knowledge and experience of the benchmark and financial situation and objectives concerning the financial contract. It must also obtain the benchmark statement that the administrator is required to publish. If the 'supervised entity' considers that the benchmark is not suitable, it must warn the consumer in writing.

Crucially, a 'supervised entity' may only use a benchmark in the EU as a reference in a financial instrument or financial contract, or to measure the performance of an investment fund, if it is provided by either an authorised administrator or a non-EU administrator located in a third country that has satisfied the equivalence requirements of the Regulation.

Third country framework

Concern has been expressed about the requirement for non-EU administrators

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located in a third country to have satisfied the equivalence requirements of the Regulation, including compliance with requirements which are as stringent as those in the Regulation, that the administrator is registered by ESMA and that prescribed co-operation arrangements are in place. Situations may arise where a benchmark administrator is based in a jurisdiction whose rules are not perceived as equivalent. The least favorable scenario would be if the equivalence framework meant that some benchmarks could no longer be used in the EU, thereby constraining investors' exposure to to non-EU markets and preventing existing agreed investment strategies from being followed.

In an effort to avoid this outcome, some administrators may choose to establish EU subsidiaries to be able to seek EU authorisation. This approach may, however, expose users and, in turn, end investors to higher costs.

Is the scope of the Regulation too wide?

Manipulation of EURIBOR and LIBOR was possible due to compilation based on submitted rates and allowing an element of discretion or subjectivity. For many benchmarks, particularly market benchmarks, the process of calculating the benchmark rate relies entirely on public data. Arguably, the focus of regulatory measures should be on addressing the issues that emerged in respect benchmarks based on submitted rates, where there is a clear need for regulation of the administrator and the submitters. Market indices such as the FTSE 100 and the S&P 500 are privately owned by the relevant provider, who makes them available for a licencing fee. The Regulation may constrain the ability of fund managers to use market indices at the level of individual securities and to create index-tracking funds. Such constraints would detrimentally narrow end investors' choice of strategies.

Fund may gain exposure to assets by constructing a bespoke private index that delivers a particular strategy, then entering into swaps transactions with dealers to gain exposure to the assets that comprise the index. This is desirable where a fund is unable or unwilling to pursue a strategy through direct holding of assets, for example, if they assets are traded on venues to which the fund does not have access or where it would be excessively costly to execute trades in all the assets necessary to deliver the strategy. The application of the Regulation depends on the meaning of an index being 'published or made available to the public'. If 'public' is construed to mean investors in a fund, then the impact of the proposals could be to cast many fund managers as benchmark administrators even in relation to private indices. Similarly, the marketing of a fund could suggest that the index is 'made available to the public'. The final Regulation needs to be clear that it is not intended to apply to private indices or benchmarks provided only to a specific set of fund investors.

Conclusion

The Regulation constitutes an effort to address the benchmark manipulation scandals by instituting strict controls and requirements for all of those involved in the benchmarking process, namely administrators, contributors and users. However, it creates issues around the third country equivalence provisions and the impact on market indices and private indices and it is hope that these will be resolved favourably in the final Regulation. Firms will need to review their procedures and be ready for the cost and compliance implications associated with regulatory reforms.

lucy.frew@kemplittle.com
www.kemplittle.com

Big data's impact on hedge fund investing

By Heinrich Merz, Deputy Chief Investment Officer, Permal Group

AIMA SPONSORING MEMBER

PERMAL

If Alfred Jones and Benjamin Graham were alive today, I believe they would be surprised by the success of the "hedged" investment approach that they helped bring to life over 60 years ago. Even for those with direct experience of compound performance and the avoidance of permanent loss of capital, the growth of the hedge fund industry since then to $2.8 trillion today has been significant[1].

For investors as passionate about analysis as Jones and Graham, they might, nevertheless, be more surprised to see how little the conversation between investors and allocators has changed. Despite analytical advances made in other fields, both literature reviews and institutional investor surveys still overwhelmingly show that allocators rely on a combination of high-level manager conversations and the quantitative analysis of monthly performance since inception to help inform their decisions.

Despite the lack of change, institutional investors are, in truth, sophisticated relative to other investor types. Unlike retail investors – who are more sensitive to brand and trailing performance over one and two years – institutional investors focus on active risk and return, adjust for investment style and prize consistency over a longer-term time horizon. On the qualitative side, institutional investors and their consultants prefer older funds with mid-sized, rather than very large, asset bases and give significant weight to onsite due diligence. Here discussions focus on the background and motivations of the manager, their drive, investment philosophy and ability to articulate an investment rationale for performance. Nevertheless, as with retail investors, once a fund gains traction within an allocator group it tends to receive subsequent inflows from that group[2].

Benefiting from big data

Survey data and anecdotal examples suggest that, up until now, manager due diligence has been broadly shielded from one far-reaching trend: 'big data' - the ability to analyse large, often complex, datasets quickly and efficiently, while extracting valuable insights not discernible at less granular levels. This trend, which has had a significant impact on the world around us - from finance, to medicine, marketing and sport - is now increasingly shaping manager due diligence[3]. In our field, the wider adoption of separately managed accounts (SMAs) post-2008 has proved to be a key turning point, for alongside the more

1. *HFR Global Hedge Fund Industry Report, October 20, 2014, Hedge Fund Research, Inc.*

2. *Heisler, Jeffrey, Christopher R. Knittel, John J. Neumann, and Scott D. Stewart. 2007. "Why Do Institutional Plan Sponsors Hire and Fire Their Investment Managers?" Journal of Business and Economic Studies, vol. 13, no. 1 (Spring):88-115. Foster, F. Douglas, and Geoffrey Warren. 2013. "Equity Manager Selection and Portfolio Formation: Interviews with Investment Staff." Financial Research Network (FIRN) Research Papers, vol. 2, no. 2 (3 May).*

3. *Kenneth Cukier and Viktor Mayer-Schönberger. May 2013." The Rise of Big Data: How It's Changing the Way We Think". Foreign Affairs, Vol. 92, No. 3.*

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traditional advantages of asset segregation, liquidity and control, SMAs provide the raw information on which innovative analytical techniques can be used, both on an individual account basis, but also across a wider portfolio of alternative investments.

By synthesising and analysing the entire data set in aggregate, there are tangible benefits to the investor. These can include greater insight and accuracy regarding the drivers of a manager's performance, the repeatability of their investment process, its strengths and potential weaknesses. By digging deeper into position-level data and evaluating it alongside market data, the characteristics of a firm, a manager, their team and a fund's track record, for instance, lets one identify style drift, behavioural responses to drawdowns and liquidity risks more efficiently and accurately. Critically, during manager reviews, the data sharpens the conversation around many of the standard questions institutional investors ask:

- How differentiated is your research? How contrarian?
- How crowded are your underlying positions? Are you early to ideas?
- What is the maximum capacity of your strategy? Have changes in market liquidity had an impact?
- To what extent does performance come from market timing, sector/style timing, short-term trading and stock selection?
- How stable is your investor base and your portfolio to macro shocks?
- How do you manage risk? How do you react to drawdowns?
- How do you manage the liquidity of your portfolio relative to the liquidity you offer investors?

Solid data analysis will always remain a supplement rather than a substitute for informed investment decisions. However, it can provide evidence-based answers to many of the standard questions institutional investors ask. It also provides a welcome tonic to promotional managers or those resting on the laurels of successful outlier investment examples and brand name prior employers.

At the portfolio level, systematically tracking market opportunities across regions and sectors and comparing these to portfolios' look-through position-level exposure, allows gaps to be more readily identified. It provides a high-level framework that informs qualitative discussions with managers and analysts. Dynamic asset allocation becomes more robust when timely information is at hand regarding a portfolio's precise underlying exposures and the developing opportunity set.

While the benefits of big-data and advanced analytics are clear, getting there is not an easy matter. To give one illustration: more accurately estimating a firm's asset stability under stress requires one to track fund flows over time, different share class terms, investor base characteristics, underlying position characteristics and market liquidity. How these factors interact with manager behaviour will determine where structural weaknesses will surface in times of stress.

Implementing a system that can track the required data and generate robust insights involves a diverse team of investment officers, analysts, technology developers, data scientists and data gatherers working seamlessly together across an organisation. It requires an integrated data architecture that can track structured and unstructured information from multiple sources over time. It requires talented people with the creativity, practical

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investment experience and programming skills to know what type of relationships to look for and to build the tools that point allocators in the right direction.

Customising the components

The very success of the industry brings with it its own challenges, with crowding being one such issue. Back in 1949, Alfred Jones speculated at the end of the article that preceded the launch of his hedge fund, that if enough "technicians" entered the market and their tools improved, they might "soon work themselves out of their present advantage". While we are still far from this point, crowding in positions, themes, exposures and underlying return drivers is most certainly present. Informed manager selection, supported by deep data analysis, can help moderate this in hedge fund portfolios.

An additional tool to limit crowding is greater customisation through managed accounts. Customisation seeks to maximise a manager's positive attributes, while avoiding the temptation to be overly prescriptive. We may take a view – backed by analytics – that the core strength of the team resides in the mid-cap segment of their portfolio, for example. As a result, performance may be enhanced by constraining the SMA's remit to mid-cap equities and a maximum number of positions. Risk, in turn, may be mitigated by excluding less liquid security types. From a portfolio perspective, customisation seeks to tailor the portfolio's components to suit the objectives and constraints of that particular portfolio. At the portfolio-level, customisation also allows greater differentiation across underlying return drivers.

Conclusion

Asset allocation and manager selection will remain a combination of art and science. While we continue to strive to improve analysis, good research relies on a degree of humility about the true confidence bounds of results. Nevertheless, as our ability to narrow these bounds increases through improved data usage and analysis, the capacity to make evidence-based investment decisions increases.

The views expressed in this article are the employee's as of 12 November 2014, are subject to change and do not necessarily represent the firm's opinion.

permalinfo@permal.com
www.permal.com

Putting the JOBS Act to work: New platforms for building hedge fund reputation

By Thomas Walek, President, Peppercomm

Question: How do you hide a business sector that controls nearly $3 trillion dollars in assets, employs tens of thousands of people around the globe, directly impacts markets and businesses, and helps improve the long-term financial well-being of millions of people from all walks of life?

Answer: Call them hedge funds.

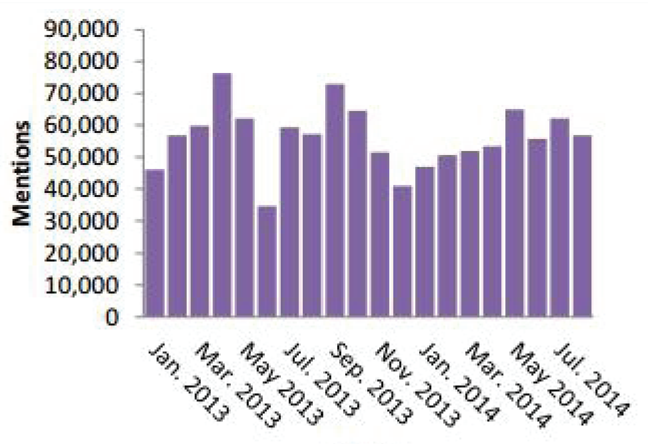
From secret and humble beginnings, hedge funds today have grown fantastically in size. They are part of virtually every pension fund portfolio, every corporate deal, every market headline and many business bankruptcy turnarounds. Hedge funds are widely held to be "the smartest guys in the room".

Lagging that growth in size is the reputation of hedge funds. Until recently, hedge funds have lacked the legal leeway and business cultural desire to engage with the public or the press. As a result, they are often known for insider trading scandals, big compensation, blowups, and finger-pointing about virtually every financial disaster – rightly or wrongly. The resulting bad reputation is pervasive for both individual firms and the industry as a whole.

That's starting to change.

Thanks to competitive pressures, new retail products, enlightened regulations treating hedge funds as Registered Investment Advisors and new regulations like the one-year-old JOBS Act, the mandated secrecy of the industry is being lifted. In response, some surprising new levels of information, transparency, and public engagement are starting to emerge from the hedge fund shadows. We are seeing this activity firsthand. As part of our just-released Peppercomm study[1] on the changing hedge funds communications landscape, we found that:

- 66% of 2014's largest 292 hedge funds are on LinkedIn, and 10% are on Twitter. Of these, six hedge funds post on LinkedIn at least once a month and seven hedge funds Tweet at least 10 times a month.
- Monthly hedge fund mentions on Twitter recently reached a high of 80,000 Tweets, and have not fallen below 40,000 in the last two years.



- Among the largest 285 global hedge funds in 2013, 14% launched websites in 2014.
- Among the 185 global hedge funds with $1

1. *"The JOBS Act at Year One: A Changing Hedge Fund Communications Landscape"* at www.peppercomm.com/JOBSAct

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billion-$5 billion in assets, 23% had websites in 2013. By June of 2014, an additional 39 funds launched websites and 11 more moved from a closed site to a more open site.

- Media mentions of hedge funds are projected to reach record levels above 100,000 in 2014, up nearly five-fold over the last decade.
- Hedge funds are hiring internal communications executives to manage brand, visibility and reputation.
- This snapshot shows that hedge funds are beginning to think about and execute strategic communications in the form of engaging with stakeholders on social media platforms, opening up their web sites and promoting thought leadership content in an attempt to build brand and reputation. Yes, these are just first steps. But don't underestimate the power of one step – these are industry-changing movements.

"It's massively different working with hedge funds than it was 10 years ago," said one veteran journalist covering the hedge fund space. "And I'm seeing changes in the last year — a little more open to talking with the press and a more strategic interest in engaging — though certainly that's not across the board. Some managers continue to have zero interest in engaging with us."

This shift towards greater openness has significant implications for retail investors as well, who are now frequently exposed to alternative investment products in the form of UCITS and so-called liquid alts. However, for all the attention devoted to the discussion of hedge fund advertising, asset management firms have largely shied away from this form of marketing.

One publisher of a trade magazine expressed being "surprised by the fact that more firms have not taken advantage of the opportunity to market themselves," pointing to the proliferation of sponsored profiles and commentaries – so-called native advertising – in other mediums. The opportunities to be more transparent, demonstrate financial insight and better engage with investors and partners are emerging. What's yet lacking is a clear desire to fully employ these platforms strategically.

Make no mistake, these steps toward more openness by hedge funds have additional motivations beyond a desire to be better thought of in the neighborhood. Repeatedly, figures show that big investors direct assets to better-known, well-trusted brand name hedge funds. That's a powerful incentive.

Reputation is built on a careful calculus of transparency, engagement and honesty. That's happening now as hedge funds open up and take a few steps in that direction. It's healthy and it's good for the future of the industry. Let's keep moving in the right direction.

twalek@peppercomm.com
www.peppercomm.com

Launching your fund on a proper platform

By Steve Bernstein, Chief Executive Officer, SinoPac Solutions and Services

So you've heard the siren's song – you're thinking of starting a hedge fund. You're not alone. More than 800 new funds launched globally in 2013, including 71 in Asia. Clearly, in spite of mounting regulatory barriers, the idea of launching and running one's own fund still has a lot of appeal among investment professionals.

You've got the talent and experience, some capital and some prospective investors, and the commitment that the endeavor requires. Now, you face a crucial decision. Should you try and launch a fund on your own or should you sign on with an established asset management platform?

There are many compelling reasons to consider an established platform as the better path for a start-up fund. The first is economics. The costs of creating a legal entity and building out the infrastructure to support a fund – licensing, attorneys' fees, compliance, technology, office space, staff – can add up quickly. In the general opinion of market professionals, a new hedge fund needs to raise about $50 million to break even. And trying to do things on the cheap — particularly where technology is concerned — is a recipe for disaster down the road. The market has shown to be unforgiving of funds that lack a strong operational backbone.

With an established platform, you could be up and running with as little as $5 or $10 million. A proper platform serving multiple managers should have the scale to provide all the infrastructure and middle- and back-office services that larger, more established funds are accustomed to, regardless of your size.
Economics, however, are only one factor. Even if you have plenty of investment capital to start, the platform route allows you to focus on investing, and leave the administrative tasks to experts who perform them for a living.

Think of all the master chefs who have started their own restaurants. If they become too focused on cleaning the restrooms and repairing the fixtures, the restaurant will not likely succeed. The chef needs to focus on the food, and leave the rest to others. The same can be said of fund managers. Time spent on administration and operations is time spent away from what really matters, namely identifying opportunities in the market, raising money and investing it effectively. Distractions from that focus could well be reflected in performance.

The freedom to focus on investing is what really makes the platform proposition compelling for start-up, small and medium-sized funds. Not all platforms, however, are alike – quite the contrary. They can vary widely in services and capabilities. Some firms that bill themselves as platforms have significant gaps in their offerings. Others may be no more than hedge funds looking for partners to scale their operations. That is why it is important to do your due diligence, know what to look for and what questions to ask when talking to platform providers.

The pillars of a proper platform

What constitutes a proper platform? The two most important pillars are people and technology.

Who are the people looking after your business? What is the depth of their experience?

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Where have they worked before? Do they know what you need, perhaps even before you do? You're entering into an important, everyday relationship. You'll want to work with people whose resumés and credentials inspire confidence that they know what they are doing.

It is equally important that the platform offers a strong technology infrastructure, built around state-of-the-art systems, with a high level of automation and integration to enable straight-through processing and help mitigate your operational risk. Be wary of any firm that says they have built their own in-house fund accounting or middle-office system. Homegrown systems often raise questions about support, upgrades, scalability, and integration with industry-standard technology, and may pose operational risks if these issues are not adequately addressed.

For your crucial applications – fund and investor accounting, trade order management, and clearing and settlement – look for proven, brand-name technology that is well known and widely used in the industry. The infrastructure needs to be highly scalable to accommodate escalating transaction volume and asset growth. And it needs to be able to support complex fund structures and multi-currency, multi-asset class strategies. Most importantly, the systems should be backed by global service and support organizations with deep bench strength, and kept up to date with regularly scheduled enhancements and upgrades. Moreover, they should have a roadmap to the future, in which cloud-based services and mobile accessibility are expected to become the norm.

The practical, everyday benefits of such an infrastructure are optimal efficiency, data integrity, and risk management. There is another important benefit, however, that should not be minimized: the signal you send to investors. Institutional investors now account for the majority of money flowing into alternative investment strategies. Institutions and their consultants perform rigorous, ongoing due diligence on fund managers, with operations a key focus of their inquiries. Furthermore, they are becoming increasingly tech-savvy. In order to tap into this critical source of funding, you will need to be on a platform that can stand up to the most intense scrutiny.

The importance of superior technology cannot be overemphasized – and the risks of sub-par technology should not be underestimated. Funds in the billions of dollars have been known to fail, not because of bad trades or market forces beyond their control, but because of inadequate infrastructure and poor administration.

Another important part of the technology equation is a solid disaster recovery and business continuity program. You should ask any prospective platform provider how they plan to protect your fund and investor data — meaning your business — in the event of a natural or man-made disaster.

As you review a platform provider's service offerings, it is important to know which services are performed in-house and which are being outsourced. It's not uncommon to have fairly narrow, standardized services farmed out to specialists. However, certain aspects of your business — risk management, for example — are too important to be taken outside. Find out how much is being outsourced and decide for yourself how that fits with your comfort level.
Beyond that, what is the provider willing and able to do to help you launch successfully and stay afloat? Do they provide capital introduction

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services? Do they have connections with qualified and engaged investors? Will they go so far as to help you prepare your pitchbooks and presentations? Those kinds of questions should be on your checklist. Anything less falls short of "full service".

Now, if the platform proposition is so appealing, why isn't everybody doing it? Some managers may feel they are giving up a measure of independence – even though they are branding the fund, setting the strategy, raising the money and making the decisions. Considering the cost advantages for a small or medium-sized fund, it seems a small price to pay.

A more legitimate concern is that some platforms make it difficult to leave. Nobody starts small with the intention of staying small. What happens when you reach a threshold where your fund is sufficiently profitable to cover much of your overhead? You should know the answer going in. Ask any prospective provider what their off-boarding practices and policies are. Make sure you can still have access to fund administration services without having to give up a cut of your management or performance fees. The right provider should be willing to work with you when it makes sense to break or at least loosen the ties.

The proper platform, one that handles not only your fund administration but also your business administration, should ultimately give you a better chance of gaining traction and attracting capital. It allows you the time you need to travel and meet investors. It provides the technology infrastructure with the risk controls that investors expect. And it provides a level of support that allows you to focus on analyzing opportunities and making decisions – the very reasons you decided to launch a fund in the first place.

steve.bernstein@sinopac.com
www.sinopacsolutions.com

Shanghai - Hong Kong Stock Connect: Understanding the issues

AIMA GLOBAL PARTNER

CLIFFORD CHANCE

By Helen Fok, Consultant, Clifford Chance Hong Kong

Hailed as one of the most exciting developments in the Hong Kong and China equity markets in recent years, the Shanghai-Hong Kong Stock Connect pilot programme was launched on 17 November 2014, and establishes mutual stock market access between mainland China and Hong Kong. Sometimes dubbed the 'through train', the scheme permits, via its 'northbound link', Hong Kong and international investors to invest in designated shares listed on the Shanghai Stock Exchange (SSE) and, via its 'southbound link', certain PRC investors to invest in eligible securities listed on the Stock Exchange of Hong Kong (SEHK).

Stock Connect is effectively 'one market, two systems' and investors will need to familiarise themselves with the exchange trading rules and the laws and regulations in both Hong Kong and China. Many have been doing so since the pilot was first announced in April 2014, and in this article we explore some of the key issues that have arisen for market participants contemplating investing in SSE shares through the northbound link.

Beneficial ownership of SSE shares from PRC law perspective

One of the key considerations - albeit a highly technical issue - has been the beneficial ownership of SSE shares. Contrary to the position in Hong Kong, PRC law does not clearly recognise the distinction between legal and beneficial ownership. In addition, under the general principles of Hong Kong trust law, Hong Kong law will not recognise a trust over SSE shares where PRC law does not provide for such a trust.

The *SEHK Shanghai-Hong Kong Stock Connect FAQs for Investors* covers this issue, noting that the China Securities Regulatory Commission (CSRC) Stock Connect Rules provides for the concept of a nominee holder. Under the northbound link clearing and settlement structure, Hong Kong Securities Clearing Company Limited (HKSCC) is the nominee holder of SSE shares on behalf of Hong Kong and overseas investors, who are the beneficial owners of the SSE shares. This means that it is the Hong Kong and overseas investors, as the ultimate owners (rather than any broker, custodian or intermediary through whom such investors hold the SSE shares) who *should* (emphasis added) be recognised under the laws and regulations of the PRC as having beneficial ownership.

Northbound investment in SSE shares - key issues:

- Beneficial ownership
- Taking security
- Pre-trade checking requirements
- No off-exchange transfers
- Order priority
- Complying with applicable Hong Kong and PRC laws and regulations
- Restrictions on trading strategies
- Tax

However, notwithstanding the FAQs, the issue of beneficial ownership of SSE shares from a PRC law standpoint is still under consideration by the

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industry. Although the statements in the FAQs are helpful to clarify the SEHK's views on legal/ beneficial ownership of SSE shares, the FAQs themselves are not regulations and, therefore, are not legally binding.

Taking security over SSE shares

There are questions over the feasibility and risks involved in collateral and security arrangements over SSE shares, in particular whether a broker, custodian or settlement agent may take enforceable security over SSE shares it holds for clients from a Hong Kong law perspective and from a PRC legal and regulatory perspective (since, in addition, PRC law limits the way that A shares can be pledged).

In a nutshell, while the Hong Kong law position on how security can be taken is clear, it will also be necessary to consider the PRC law position, which will be relevant in determining the validity and enforceability of the security right (as opposed to the agreement which creates the security itself). The rules do not make it clear whether or not northbound link investors can pledge SSE shares acquired through the northbound link. Accordingly, we anticipate that the PRC and HK authorities will establish an effective mechanism to allow the enforcement of the security over SSE shares under the PRC law in the near future.

Pre-trade checking requirements

The pre-trade checking requirements have raised a number of questions, particularly how these will work in practice, as there are a number of steps involved.

Mainland investors are only allowed to sell SSE shares which are available in their ChinaClear accounts at the end of the previous day (T-1). Such shareholding information is forwarded to SSE each day-end. Based on the T-1 shareholdings, SSE will reject a sell order if the investor does not have sufficient shares in its account.

SEHK will apply similar checks on the sell orders of SSE shares against the relevant exchange participants' shareholding records in their designated CCASS stock account(s) to ensure there is no overselling by exchange participants. A sell order will be rejected if the cumulative sell quantity in that SSE security put through by the exchange participant for the day is higher than its stock holding position in that SSE security at market open.

The pre-trade checking requirements may raise issues for fund managers wishing to sell SSE shares, as they may need to transfer the requisite number of SSE shares from the fund/ funds which they manage to their executing broker in Hong Kong before commencement of trading on the trade date (i.e. on T-1).

As a result of the requirement to deliver shares to the executing broker before the trade date, the Hong Kong executing broker may be deemed to be a custodian or sub-custodian in respect of these shares. This may be an issue for investors who are AIFs under AIFMD, UCITS funds, ERISA Plans or 1940 Act funds. However, as fund managers may have different arrangements for handling the pre-trade checking requirements, and as the rules relating to Stock Connect are continuing to evolve, it is premature to conduct a comprehensive analysis of the position at this stage.

No off-exchange transfer

With some limited exceptions, for example post-trade allocation of shares to different funds by fund managers, there are restrictions on off-exchange transfers of shares.

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Generally speaking, under the PRC Securities Law, all trading and transfer of listed companies' shares must be done via PRC stock exchanges or other places approved by the State Council. The rules relating to Stock Connect are based on this premise. Under the CSRC China Connect Rules, unless otherwise provided by CSRC, securities trading service companies and securities companies or brokers must not arrange for investors to place orders off-exchange and must not provide any off-exchange services relating to the transfer of shares traded under Stock Connect, in any other way than that set out under the Stock Connect programme.

Article 32 of the SSE Stock Connect Rules includes a very similar provision in respect of the northbound link and the requirement is also reflected in Rule 14A12 of the SEHK rules.

The prohibition of off-exchange transfers will restrict the ability of a broker to carry out certain trading strategies which require the execution of one or more transactions with its clients off-exchange (e.g. facilitation trading, guaranteed or benchmark trading).

Order priority

An order queue will be formed through the order routing system of Stock Connect in respect of the northbound link. Given that there are daily quotas and aggregate quotas in place, priority of orders may become an issue, in that orders given a lower priority in the order queue may not be fulfilled if any such quota is reached.

Hong Kong and PRC laws and regulations

Investors will need to comply with applicable Hong Kong and PRC laws and regulations relating to share ownership including, disclosure of interest obligations in both Hong Kong and the PRC, the PRC 'short swing profit rule' as well as foreign ownership limits for SSE shares.

Restrictions on trading strategies

Investors will face additional trading restrictions when dealing in SSE shares, including restrictions on block trades, day trading, short selling, margin trading and securities lending. These restrictions may restrict fund managers in the ways in which they might implement their investment strategies.

Tax

The Ministry of Finance, the State Administration of Taxation and the China Securities Regulatory Commission of the People's Republic of China jointly issued the "Circular on the Relevant Tax Policies concerning the Shanghai-Hong Kong Stock Connect Pilot Programme" on 31 October 2014. It clarifies, amongst others, the treatment of tax arising from trading gains and dividends under Stock Connect. Specifically, investors which invest in the SSE Securities through Stock Connect will be temporarily exempted from capital gains tax and business tax in relation to those securities, but will be subject to a 10% withholding tax on dividend payments.

helen.fok@cliffordchance.com
www.cliffordchance.com

Central bank policy divergence: With new FX trends may come surprises and volatility

AIMA SPONSORING MEMBER

CME Group

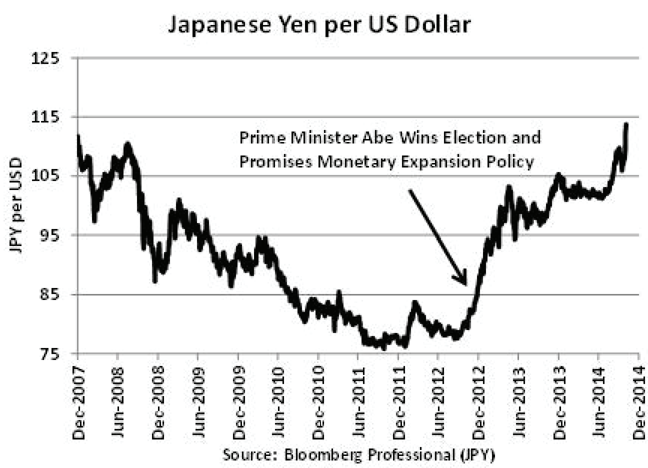
By Bluford Putnam, Chief Economist, Strategic Intelligence & Analytics, CME Group

In the US and UK, quantitative easing has ended, and relatively healthy economic prospects are ushering in a debate on whether a rise in short-term rates might be appropriate in 2015. In Japan and the eurozone, though, fears of deflation are spurring expanded quantitative easing. Emerging markets are also seeing divergent patterns. For example, Brazil recently raised rates to defend its currency, while Mexico has taken its short-term rates to just slightly below the prevailing rate of inflation to prevent a currency rise hurting exports.

Foreign exchange (FX) markets have responded to the fundamental differences in economic growth prospects and central bank policies by giving the US dollar some upward price momentum. In this report, we dissect the policy differences of selected central banks that have created the US dollar's price momentum. We also warn about the potential for volatility. Price momentum is rarely a one-way street, so while embracing the new FX market dynamics, we also want to look at possible surprises that could interrupt the trends or at least cause some meaningful bumps along the way.

Bank of Japan

On Halloween 2014, the Bank of Japan (BoJ) announced an expansion of its asset purchase program, igniting a drop in the yen and a rise in Japanese equities. Essentially, the three arrows of Abenomics (i.e., quantitative easing, fiscal expansion, and structural reforms) are failing to achieve their objectives, so the BoJ policy committee voted 5-4 to buy more Japanese Government Bonds (JGBs). The market impact was to weaken the Japanese yen and put it on a trajectory toward 120 yen/dollar, as its next stop. While JGB purchases have not spurred much in the way of credit growth, and fiscal policy was (predictably, at least to some of us) derailed by the national sales tax rise, yen-depreciation will have a lagged and measurable, if modest, impact on future Japanese inflation. As pointed out in our first analysis of Abenomics back in January 2013, it may take a 120 or even a 140 yen/dollar to break the back of Japan's deflationary psychology.



Source: Bloomberg Professional (JPY)

European Central Bank

The big story in the Euro-Zone in 2014 was the credit crunch caused by banks' responses to the ECB's stress tests. As banks sought to dress-up their balance sheets for the examinations, they rushed to pay back emergency liquidity loans from the ECB and focused on improving capital ratios while eschewing new lending.

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The results were further economic stagnation in Europe and fears of deflation. With the stress-test results having been announced and all the big banks passing (although not always with flying colors), we expect some credit expansion in 2015. And, to push the credit button a little harder, the ECB is planning purchases of asset-backed securities.

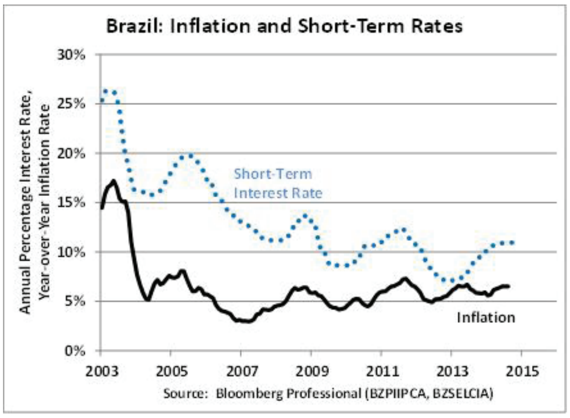
Federal Reserve Bank

The US Fed officially ended its QE program just as the BoJ expanded theirs. US labor markets are healthy enough to justify a rise in the near-zero target federal funds rate, but a lack of inflation (see previous page) may delay the decision. We still think the Fed will vote in 2015 to push the target federal funds rate upward, eventually aiming to get the federal funds rate to around 1.00% to 1.25%, more or less in line with prevailing inflation. The main impact of a rise in the federal funds rate target range would probably be symbolic – sending a message to markets that the Fed finally has confidence that the US economy can grow without emergency measures such as QE or zero-rates.

Emerging markets, oil, and the FX carry trade

In emerging markets, the current challenge is to understand the impacts of the slide in the price of oil. The Russian ruble is in the market's headlights, given that the government depends heavily on revenue from energy to fund its expenses. Venezuela, Iran, and Iraq will also feel negative economic impacts that could lead to currency depreciation. Oil importing countries, such as India will benefit, with sustained lower oil prices potentially allowing for the rupee to appreciate and further help control inflation.

A longer-term question is whether evolving risk perceptions will engender a renewed interest in the FX carry trade, in which market participants buy a high-rate currency, such as the Brazilian real (11%) or Indian rupee (8%), while selling a low-rate currency, such as the Japanese yen (0%), Euro (0%), or (in the emerging world) the Mexican peso (3%). With lower commodity prices, inflation pressures in emerging market countries are likely to ease. But those countries dependent on commodity exports could see some pressure on their credit ratings. With the prospects of stable inflation rates, even if elevated compared to the mature industrial countries flirting with deflation, risk appetites are likely to determine whether the FX carry trade is embraced. A continuation of the bull market in equities in the US may well be the best indicator of whether risk-on attitudes invade the emerging markets again.



All examples in this report are hypothetical interpretations of situations and are used for explanation purposes only. The views in this report reflect solely those of the author and not necessarily those of CME Group or its affiliated institutions. This report and the information herein should not be considered investment advice or the results of actual market experience.

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Why opt-in class actions are likely to change the way asset managers approach group litigation

AIMA SPONSORING MEMBER

Simmons & Simmons

By Paul Baker, Managing Associate, and Gerard Heyes, Supervising Associate, Simmons & Simmons LLP

Over the past few years there has been a steady and noticeable increase in the number of "opt-in" class actions being brought in the UK, across Europe and globally. That increase has coincided with an ever more sophisticated approach to promoting and handling group litigation by the law firms involved. Law firms acting for a claimant class are motivated to increase the number of participants in the proceedings they manage (as that will increase the potential total recoveries and mean that costs are shared more widely) and have identified asset managers as a good source of potential participants. This article seeks to explore some of the key considerations for asset managers when presented with opportunities to participate in opt-in group litigation, the potential risks faced, and the ways in which such risks can be managed.

Background

Historically, asset managers' involvement in group litigation has generally been limited to participation in US style "opt-out" class actions. In those circumstances, asset managers or custodians would typically receive notice of the litigation (which meant their investors or their fund formed part of the relevant class) and very limited further action or consideration was required. Opt-in group litigation on the other hand raises a number of questions for asset managers as regards their potential duties, particularly in terms of providing notification to clients and, ultimately, whether or not to participate.

What are the duties of asset managers?

Unfortunately there is no "one size fits all" answer to that question, as asset managers' duties will differ depending on: the types of investment structures that may be impacted by the class action, the investors in those investment structures (retail clients may be invested, for example), the capacity in which the asset manager acts (trustee / fiduciary etc) and, not least, the contractual terms governing the relationship between the asset manager and its clients.

While there may be circumstances in which a duty to notify investors of, or at least consider the possibility of participating in, a given opt-in class action may be said to arise, it is clear that there is no overriding duty to participate in all class actions – for example, having considered the costs and risks involved in participation in a class action, asset managers may well make a reasoned decision not to participate. What that analysis points to, however, is that the key is to put in place a process that ensures that the right factors are considered in reaching such a reasoned decision and that the decision is documented appropriately.

What processes and procedures should be considered?

While the process itself will necessarily differ from manager to manager, depending on the structure of the business, we have identified some of the issues that managers

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may wish to take into account in designing and implementing a process for assessing potential opt-in group litigation.

1. In the first instance, it may be prudent for managers to establish a central point of contact responsible for the co-ordination of opt-in class action notifications received. That central point can then take responsibility for forwarding all such notifications to the relevant fund managers / trustees etc for consideration.

2. What processes are in place, or need to be created or updated, in order to identify which investors / funds are affected by the class action? This is likely to involve consideration of who would coordinate and undertake any necessary information gathering and investigative processes (in-house, third party providers?).

3. How (if at all) will a cost-benefit analysis be undertaken in order to formulate a view on whether or not to participate in the class action? For example:

    - Is participation in potentially long-term litigation compatible with the overall investment cycle of the investor / fund concerned?
    - How might an assessment of the legal merits and any litigation funding arrangements be approached?
    - How will any potential conflicts within the decision-making structure be managed?
    - Who will bear the costs of the assessment process, and any additional costs from the litigation?
    - If those costs are being passed-on to clients, does that require additional disclosure to investors?
    - What would be the process if, during the course of the litigation, the asset manager is required to participate in the action (e.g., provide evidence or assistance as part of a test case)?

4. An essential but complex part of the above analysis is trying to determine the potential downsides of participation. Even where opt-in class actions are presented by claimant law firms as essentially "riskless" (because, for example, they are backed by third party litigation funders and insurance policies) there are nevertheless a number of risks that still need to considered:

    - Where does liability for costs (including adverse costs) lie if the third party funder goes out of business?
    - How financially secure are the particular third party funders that are backing the litigation?
    - Do the third party funders have a contractual right to walk-away from the litigation on the occurrence of specified events (e.g., if their view of the merits changes)?
    - What potentially incorrect representations may have been made to the insurers that could allow the insurers to refuse to pay out on the policy?

The questions set out above may well not be relevant in all circumstances, but they do help to illustrate some of the complex issues that can arise in the decision-making process, even before the merits of the litigation itself have been considered.

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Conclusion

It seems likely that it is only a matter of time until one of the large opt-in class actions is successful and, should that happen, there is a risk that investors who would have been eligible to participate in the class, but did not do so due to the inaction of their asset manager, may seek legal recourse against their manager for the amounts they would have received in the litigation. That said, as matters stand it seems equally possible that it may be challenging for investors to allege, even on a loss of opportunity basis, that liability through non-notification or non-participation should arise in circumstances where the relevant class action was litigated in a jurisdiction with no track record of success to suggest that the benefits of participation outweigh the risks. This may of course change if a track record of success in such jurisdictions begins to emerge. Accordingly, now may well be a good opportunity for asset managers to manage proactively the risks that may arise from group litigation in the future. This is likely to mean, as a minimum, that there is a clear audit trail regarding the decision-making process and the implementation of a policy supporting that process.

paul.baker@simmons-simmons.com
gerard.heyes@simmons-simmons.com
www.simmons-simmons.com

Loan origination — a new frontier for Irish investment funds

By Shay Lydon, Partner, Matheson

On 18 September 2014, the Central Bank of Ireland (the "Central Bank") authorised qualified investor alternative investment funds (QIAIFs) to engage in loan origination. As a result, Ireland became the first European Union (EU) member state to introduce a specific regulatory framework for loan originating investment funds. Significantly, once authorised by the Central Bank a loan originating investment fund may be marketed throughout the EU pursuant to the Alternative Investment Fund Managers Directive (AIFMD) marketing passport.

Background

Both internationally and domestically, loan origination by investment funds has traditionally been regarded with a degree of suspicion, largely because of its association with the shadow banking system. The term "shadow banking" essentially refers to the system of credit intermediation which takes place outside the regular banking sector. Shadow banking is traditionally less regulated than the regular banking sector thus generating the concern that it is may be associated with a number of specific risks, including regulatory and systemic risks.

Despite this concern, there is also wide spread acknowledgment that the shadow banking sector has an important role to play in providing alternative sources of financing, particularly for corporate entities, thereby promoting economic development. In contrast to the US where the majority of credit intermediation goes via the capital markets, the exact opposite occurs in the EU. One impact of the market turbulence of the past number of years has been that EU policymakers have become more focussed on the dangers of leaving credit intermediation in the hands of the banks. Permitting funds to originate loans is one possible way of diversifying the lending market and increasing the supply of credit to small and medium sized enterprises (SMEs). Initiatives have also begun at EU level to authorise loan origination by investment funds in the context of the proposed regulation on European Long Term Investment Funds (ELTIFs).

Before the introduction of the new regulatory framework for loan originating funds, a significant number of Irish funds already invested in loans by way of the syndicated loan market. There are differences between loan participation and origination. In particular, funds which engage in loan participation do so on the basis of multi-party proposals structured by financial institutions which carry out the credit assessment and frequently administer the loan on behalf of the participants in the syndicated loan facility. In contrast, investment funds which originate loans may do so directly and bilaterally, on the basis of their own credit assessment and without the intermediation of a financial institution. They also administer the loan directly. These differences mean that loan originating funds are exposed to risks which differ from those associated with loan participation and the Central Bank's focus in devising the new regime was on identifying and mitigating those risks within a regulated product.

The consultation process

Prior to authorising QIAIFs to originate loans, the Central Bank engaged in a lengthy consultation process designed to identify and address the associated risks. This process commenced with the publication, in July 2013, of a discussion paper on loan origination by

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investment funds, which received a number of responses, including from the European Systemic Risk Board.

Approximately a year later, on 28 July 2014, the Central Bank published a consultation paper on loan originating QIAIFs. A QIAIF is one of the two regulated alternative investment fund structures introduced upon the implementation of AIFMD in Ireland, and is one of the most successful fund structures in Ireland to date. Only qualifying investors may invest in a QIAIF, a category which includes both professional and informed investors, but not all retail investors. In the consultation paper, the Central Bank consulted both on the overall question as to whether to permit QIAIFs to originate loans, as well as more specific questions focusing on combatting the risks identified as being associated with this type of loan origination.

Subsequently, on 18 September 2014, the Central Bank announced that it would accept applications from loan originating QIAIFs from 1 October 2014. It also published a feedback statement responding to points raised in the consultation process as well as a revised version of the Alternative Investment Fund (AIF) Rulebook which now authorises closed-ended QIAIFs to engage in loan origination subject to a number of stipulated requirements. These requirements differ in certain respects from those set out in the consultation paper, following on from industry feedback. They are in addition to the requirements imposed on all QIAIFs and are principally designed to combat regulatory and systemic risks which the Central Bank considers to be associated with loan originating QIAIFs. On 5 November 2014, the Central Bank published an updated version of its AIFMD Questions and Answers which contains several new Q&A on loan originating QIAIFs.

The new regulatory framework

Under the new regulatory framework, a loan originating QIAIF must have an authorised AIFM and be closed ended. The requirement that the QIAIF be closed ended is designed to mitigate many of the financial stability risks considered to be associated with loan originating investment funds including mismatches between the maturity or liquidity of assets and liabilities. Despite being closed-ended, loan originating QIAIFs may invite requests for redemption of holdings from unitholders either at dates determined at the authorisation date, or at dates approved by the Board of the AIF Manager. However, redemptions may only be made with the approval of unitholders unless the assets of the loan originating QIAIF are valued by reference to prevailing market prices.

A loan originating QIAIF may engage in loan origination and participation in loans on the secondary market as well as activities arising exclusively therefrom, such as handling assets which are realised security, treasury management and the use of derivatives for hedging purposes. Although otherwise prohibited from investing in other investment funds or in other assets such as debts or equity securities, a loan originating QIAIF may establish an umbrella fund with a separate sub-fund for non-loan strategies. A loan originating QIAIF is restricted as regards the persons to whom it may originate loans and, in particular may not originate loans to natural persons, fund management companies, other collective investment undertakings, or financial institutions unless there is a bona fide treasury management purpose which is ancillary to the loan originating QIAIF's primary objective. Loan originating QIAIFs are also subject to a number of requirements regarding: credit assessment; investor due diligence; diversification; eligible assets; stress

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testing; liquidity and distributions; leverage; and disclosure. Of these, the requirements relating to diversification and leverage are of particular note.

Diversification requirements are principally designed to reduce investor risk within the fund. According to the Central Bank, they are particularly important in the context of loan funds which are likely to have an inherent tendency for sectoral concentration and large exposures. According to the Central Bank rules, a loan originating QIAIF must set out a risk diversification strategy in its prospectus which achieves a portfolio of loans which is diversified and which will limit exposure to any one issuer or group to 25% of net assets within a specified time limit. The AIF Rulebook imposes a number of requirements which apply if the diversification strategy is breached. A loan originating QIAIF must not have gross assets of more than 200% of net asset value and this leverage limit must be managed to ensure compliance in changing market circumstances. The limit imposed by the Central Bank is similar to the limit currently applied in the US to Business Development Companies, although there is a proposed amendment to allow these types of companies to increase their leverage. Should this amendment be adopted, the entral Bank may choose to follow suit, although there is obviously no guarantee that it will do so.

Conclusion

The new regulatory framework for loan originating QIAIFs provides an important opportunity for European funds to engage in new investment strategies under a clear and transparent regulatory framework. Significantly, such QIAIFs will also benefit from the fast-track authorisation procedure available to all QIAIFs, which means that they are capable of being authorised within 24 hours of a single filing of documentation with the Central Bank. As mentioned, once authorised a loan originating QIAIF may be marketed throughout the EU pursuant to the AIFMD's marketing passport. Despite the conditions attached to the use of loan originating QIAIFs, some fund managers will see the Central Bank's new regulatory framework as a welcome opportunity to implement their loan origination strategies through a vehicle designed to align the interests of investors and promoters of such vehicles. The Central Bank's decision to authorise loan origination by investment funds is likely to be repeated shortly at European level, with the adoption of the ELTIF regime which Commissioner Hill has identified as an immediate priority in realising the Capital Markets Union, which is itself a central objective of the new Commission. Significantly, in contrast to the loan originating QIAIF, it is anticipated that the ELTIF will be available to retail investors. However, as a corollary, the ELTIF will also have a more risk averse profile. For example, under current proposals an ELTIF will only be able to issue loans to a more limited category of entities than a loan originating QIAIF, as well as being more restricted in its use of leverage and subject to heightened diversification requirements.

Overall, the Central Bank's decision to authorise loan origination by QIAIFs, is an important step in promoting the diversification of sources of credit within the EU and helping to kick-start the EU's economy. As the financial crisis amply demonstrated, SMEs' access to bank credit is pro-cyclical and ensuring their access to alternative sources of financing is vitally important in protecting both SMEs and the wider economy in times of financial stress. Loan origination by investment funds has the potential to play a key role in providing this protection.

shay.lydon@matheson.com
www.matheson.com

FCA acts on concerns over risky coco bonds

By Robin Henry, Partner, Collyer Bristow LLP

The UK Financial Services Authority (FCA) has used new consumer protection powers for the first time in imposing a one-year ban on the sale of contingent convertible bonds (coco bonds). The FCA announced on 5 August 2014 that it would prevent the sale of coco bonds to retail investors from 1 October 2014 for one year on the grounds that the bonds were "unlikely to be appropriate" for the mass retail market. Concerns have previously been raised about the risks of investing in coco bonds. Many private investors may not have been made fully aware of the serious risks which these types of bonds involve.

This is the first time the FCA has prevented a product from being sold without issuing a consultation first. During the temporary ban, the FCA is planning to publish a consultation paper about proposed permanent rules on coco bonds. Following consideration of feedback, the FCA aims to publish a policy statement in Q2 2015, with final rules to be scheduled to take effect on 1 October 2015, when the temporary ban expires. The FCA's decision to restrict the sale of coco bonds also raises questions as to whether it will want to consider banning the sale of other products to retail investors.

Although the ban imposed by the FCA is intended to reduce the risks to which retail investors are exposed, there are arguments that the restriction on the sale of coco bonds goes against the regulator's own desire to reduce the overall risk in the financial system. When coco bonds were introduced, there was a hope that they would help protect banks from insolvency.

Over the last three years, this new form of financial security has emerged in response to regulators' demands that banks position themselves to better absorb losses during a crisis (rather than expect the taxpayer to bail them out). Known variously as bail-in bonds, hybrid bonds, wipe-out bonds and coco bonds, trades in these securities have reached €75 billion on European markets and are predicted to reach €100 billion by the end of 2014[1].

As European banks prepare themselves for the impending stress-testing of Basel III, coco bonds have provided a cheap means of improving the bank's tier one capital ratios. Banks are required to hold a proportion of their risk-weighted assets in the form of tier one capital (comprising common equity and retained earnings) so that losses will fall on shareholders rather than creditors. Coco bonds, costing roughly half the return on equity demanded by shareholders with the benefit of tax-deductible interest, appear to be a win-win for both banks and regulators.

Banks are required to pay coupons on these bonds up until the occurrence of a particular event called a "conversion trigger". A conversion trigger may be the bank crossing a nominal capital to assets ratio, or a decision by the regulator that the bank is "in trouble". At this point the bonds will either convert into shares or will simply be written down to zero. Since the losses are borne by investors rather than the taxpayer (as a result of a bail-out),

1. Financial Times, 7 May 2014 *"Regulators must act on coco bond risks"* by Alberto Gallo

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the benefits from regulators' point of view appear at face value to be clear, but concerns have been raised that in practice, coco bonds might actually worsen a future banking crisis because the effect of a conversion trigger being sprung may add downward pressure to a falling stock price. It is for this reason that coco bonds have been called "death spiral bonds".

Nonetheless these bonds have proved popular with investors. The coupons on such bonds will, depending on the perceived creditworthiness of the bank, range between 7 to 9, and even up to 10%. There has been a bull-market for these products, to say the least. In late 2012, Barclays issued $3bn of contingent convertible bonds which would wipe out investors if the bank's core tier one capital ratio fell below the 7% minimum specified by international regulations. Investors were attracted to a well-known name offering a coupon of 7.625% for 10 years and demand was purported to reach $17bn. In January 2014 the French bank Crédit Agricole received $25bn of orders for its $1.75bn issue of coco bonds paying a coupon of 7.8%. In March this year Spain's Santander and Denmark's Danske Bank joined the ranks of Barclays, Credit Suisse and UBS by offering coco bonds in what has so far been an almost entirely European phenomenon. Bank of America Merrill Lynch has recently initiated its first coco bond index, signalling that the market is entering the mainstream.

There are, however, serious risks for the investors. In good times, the bonds act in the same way as normal high yield bonds. However, the higher coupons payable may not be sufficient recompense if the trigger event occurs, particularly as a result of a regulator taking a unilateral decision to warn of problems for the issuing bank. In August 2013 journalist John Dizard, writing in the Financial Times, described coco bonds as "financial perpetual motion machines[2]" . Since then, in February 2014, Standard & Poor signalled an intention to downgrade the security rating of coco bonds stating that, "*We are signalling potential downgrades (by at least one notch) of securities that banks have been issuing in record numbers to meet new regulatory requirements*." An employee at S&P was quoted as saying "*There is a greater risk of a regulator requiring a bank to withhold the coupon long before it hits the trigger for converting into equity or being written down*[3]."

Following a trigger event, investors may find themselves either ranking equally with shareholders or even subordinated to them. This is the concern which has led the FCA to take action now.

robin.henry@collyerbristow.com
www.collyerbristow.com

2. Financial Times, 16 August 2013 *"Cocos: Ingenuity that's proving too good to be true"* by John Dizard

3. Financial Times, 28 August 2013 *"'Sudden death' bank bonds on the increase"* by Christopher Thompson and Tracy Alloway

Project Verde — Impact on asset managers and insurers

By Jagdev Kenth, Director of Risk and Regulatory Strategy, Financial Institutions Group, Willis

The Treasury Committee has published are report into the Co-operative Bank's failed bid for 632 branches of Lloyds Banking Group which were set to be divested. Deemed Project Verde, the Treasury Committee's conclusions on the current Approved Persons Regime are likely to result in the expedited application of the Senior Managers Regime to asset managers and insurers.

Approved persons regime

The Project Verde Report makes for compelling reading. It is the product of a high profile inquiry which commenced last June and which saw senior bankers and regulators questioned in detail. The Treasury Committee made various observations about corporate governance and the current Approved Persons Regime. This is not the first time that shortcomings in the regime have been identified. In June 2012, the Parliamentary Commission on Banking Standards (PCBS) was established to conduct an inquiry into professional standards and culture in the UK banking sector. The PCBS reported in June 2013 that the existing Approved Persons Regime had largely failed to hold individual decision-makers to account and that they remained behind an "*accountability firewall*[1]". In its report, the PCBS went on to state:

> "*The Approved Persons Regime is a complex and confused mess. It is the mechanism through which individuals can notionally be sanctioned for poor behaviour, but its coverage is woefully narrow and it does not ensure that individual responsibilities are adequately defined*[2]."

The PCBS recommended that the Approved Persons Regime be replaced with a new regime to address the issue of oversight and accountability.

Senior managers regime

The PCBS recommendations were incorporated into the Financial Services (Banking Reform) Act 2013. The PRA and FCA are currently consulting on the new Senior Managers Regime which aims to introduce a strengthened regime for regulating senior individuals within banks. Several changes are proposed but the most significant and controversial has been:

- Reversal of the burden of proof - provided certain conditions are met, a person will be guilty of misconduct unless that person can satisfy the FCA that he or she took such steps as a person in his or her position could reasonably be expected to take to avoid the contravention occurring (or continuing)[3].
- Criminal offence relating to a decision causing a financial institution to fail - the offence is committed when the senior manager takes a decision (or fails to prevent the taking of a decision), that leads to the failure of the firm. The offence is punishable on indictment with

1. *Changing banking for good, Report of the Parliamentary Commission on Banking Standards, Volume I, page 16, paragraph 14*

2. *Changing banking for good, Report of the Parliamentary Commission on Banking Standards, Volume I, page 32, paragraph 86*

3. *Financial Services (Banking Reform) Act 2013, section 32(2)(6)*

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up to seven years imprisonment[4].

There has been growing concern over the proposed new rules. Some feel the proposals go too far and will push people out of the industry. Two senior HSBC directors resigned earlier this month in protest at the impending changes; others may follow suit. There is also a concern that the increased emphasis on individual responsibility may place stress on governance structures that rely on collective decision-making. Senior individuals – conscious of their own personal responsibilities and liabilities – may be less inclined to agree with the boards or senior colleagues. Senior decision makers may resort to external advice for significant decisions to ensure protection from future FCA action.

Asset managers and insurers

At the moment, the Senior Managers Regime is scheduled to apply to senior bankers only. Once it is in force, it will create a two tier system, with asset managers and insurers remaining subject to the heavily criticized Approved Persons Regime. The Treasury Committee raised the dual regime issue with Clive Adamson, Director of Supervision at the FCA, and asked why the discredited Approved Persons Regime continued to be applied to other financial services institutions, such as asset managers and insurers. Mr Adamson did not seek to explain or justify the differences in application, but responded:

> *"We would have preferred the new regime to apply to all financial services firms[5]."*

The Treasury Committee was clearly concerned by the prospect of a dual regulatory regime and could not have been clearer in their conclusions and recommendations:

> *"While the Approved Persons Regime will be abolished for the banking industry, it will be retained for many in the remainder of the financial services industry, including insurance and asset management. Given its manifest failings, this appears hard to justify. Clive Adamson, Director of Supervision at the FCA, appeared in oral evidence to agree with this view. The Government and the regulators should at the earliest opportunity make proposals to extend the coverage of the Senior Managers and Certification Regimes to, and remove the application of the Approved Persons Regime from, other parts of the financial services industry[6]."*

The Treasury Committee's conclusion is very important and it carries weight. It has been reached in the context of a lengthy review into serious failures of corporate governance which caused significant problems for a UK regulated bank. The Treasury Committee do not believe it is appropriate for a regulatory regime, which has been shown to be deficient, to remain in effect. The Treasury Committee wants Government and regulators to level the playing field; this will result in the expedited application of the Senior Managers Regime to asset managers and insurers a lot sooner than many had anticipated.

Jagdev.Kenth@willis.com
www.willis.com

4. *Financial Services (Banking Reform) Act 2013, section 36*

5. *Project Verde, Volume I, page 64, Sixth Report of Session 2014-15, House of Commons Treasury Committee*

6. *Project Verde, Volume I, page 70, Sixth Report of Session 2014-15, House of Commons Treasury Committee*

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ABSOLUT RESEARCH GmbH
Country: Germany
Contact: Michael Busack
Telephone: +49 40 30 37 79 0
Business activity: Research
Website: www.absolut-research.de

ABSOLUTE RETURN PARTNERS LLP
Country: UK
Contact: Nick Rees
Telephone: +44 (0)20 8939 2900
Business activity: Hedge fund manager / adviser
Website: www.arpinvestments.com

ADRET CAPITAL LTD
Country: Singapore
Contact: Michael Stennicke
Telephone: +65 9060 5249
Business activity: Hedge fund manager / adviser
Website: www.adret-capital.com

AMAGIS CAPITAL PARTNERS LLP
Country: UK
Contact: Milo Guastamacchia
Telephone: +44 (0)20 3700 5300
Business activity: Hedge fund manager / adviser
Website: www.amagiscapital.com

ARABESQUE ASSET MANAGEMENT LIMITED
Country: UK
Contact: Omar Selim
Telephone: +44 (0)20 3709 7045
Business activity: Hedge fund manager / adviser
Website: www.arabesque.com

BROADRIDGE FINANCIAL SOLUTIONS
Country: Hong Kong
Contact: Joseph Kovacs
Telephone: +852 2869 6393
Business activity: Consultant (other)
Website: www.broadridge.com

C M HOULDER INSURANCE BROKERS (S) PTE LTD
Country: Singapore
Contact: Edward Rahtz
Telephone: +65 6236 9173
Business activity: Consultant (other), insurance services
Website: www.cmhoulder.com

CEDARKNIGHT PARTNERS LLP
Country: UK
Contact: Gilly Uppal
Telephone: +44 (0)20 3747 9493
Business activity: Hedge fund manager / adviser
Website: www.cedarknight.com

CHENAVARI CREDIT PARTNERS LLP
Country: UK
Contact: Steve Sabatier
Telephone: +44 (0)20 7259 3600
Business activity: Hedge fund manager / adviser
Website: www.chenavari.com

COLLYER BRISTOW LLP
Country: UK
Contact: Robin Henry
Telephone: +44 (0)20 7242 7363
Business activity: Legal services
Website: www.collyerbristow.com

DMS MANAGEMENT INVESTMENT SERVICES IRELAND
Country: Ireland
Contact: Derek Delaney
Telephone: +353 1 669 6640
Business activity: Fund administration, accounting & custody services
Website: www.dmsmanagement.ky

DMS OFFSHORE INVESTMENT SERVICES (EUROPE) SARL
Country: Luxembourg
Contact: Allen Foley
Telephone: +352 26 420 370
Business activity: Provision of independent fund directors, consultant (investment)
Website: www.dmsoffshore.com

EZE CASTLE INTEGRATION
Country: Hong Kong

continued ▸

Contact: Michael Leung
Telephone: +852 5804 4701
Business activity: Consultant (other)
Website: www.eci.com

FIRST DEGREE GLOBAL ASSET MANAGEMENT PTE. LTD
Country: Singapore
Contact: Tony Morgan
Telephone: +65 6681 6632
Business activity: Hedge fund manager / adviser
Website: www.firstdegree.asia

FRESHFIELDS BRUCKHAUS DERINGER
Country: Hong Kong
Contact: Tim Mak
Telephone: +852 2846 3400
Business activity: Legal services
Website: www.freshfields.com

F-SQUARED ALTERNATIVE INVESTMENTS, LLC
Country: USA
Contact: James Celico
Telephone: +1 781 772 2777
Business activity: Hedge fund manager / adviser
Website: www.fsquaredinvestments.com

FUND FIDUCIARY PARTNERS LTD
Country: Cayman Islands
Contact: Chris Rowland
Telephone: +1 345 947 5854
Business activity: Consultant (other)
Website: www.fundfiduciaries.com

GERSON LEHRMAN GROUP
Country: UK
Contact: Paul Ciraolo
Telephone: +44 (0)20 7529 4600
Business activity: It/systems/software services
Website: www.glg.it

HANNAH GOODWIN - INDEPENDENT FUND DIRECTOR
Country: UK
Contact: Hannah Goodwin
Telephone: +44 (0)20 7515 1446
Business activity: Independent fund director

HANOVER INVESTORS MANAGEMENT LLP
Country: UK
Contact: Nicholas Morland
Telephone: +44 (0)20 7766 8400
Business activity: Hedge fund manager / adviser
Website: www.hanoverinvestors.com

INDEPENDENT FUND DIRECTOR - PHILIP LOTZ
Country: USA
Contact: Philip Lotz
Telephone: +1 203 570 2865
Business activity: Independent fund director

IPM INFORMED PORTFOLIO MANAGEMENT
Country: Sweden
Contact: Anders Lindell
Telephone: +46 8 20 1929
Business activity: Hedge fund manager / adviser
Website: www.ipm.se

IRON ROAD MULTI-STRATEGY LP
Country: USA
Contact: Blair Haarlow
Telephone: +1 312 993 5800
Business activity: Hedge fund manager / adviser
Website: www.ironroadcap.com

KING MUIR FUND ADVISORS LLC
Country: USA
Contact: Kenneth Rosenbach
Telephone: +1 312 624 9244
Business activity: Hedge fund manager / adviser

KISKI PARTNERS, LLC
Country: USA
Contact: Chris Hainlen
Telephone: +1 646 412 6300
Business activity: Hedge fund manager / adviser
Website: www.kiskialpha.com

KONTIKI CAPITAL MANAGEMENT (HK) LIMITED
Country: Hong Kong
Contact: Scott Henderson
Telephone: +852 3107 2388
Business activity: Hedge fund manager / adviser

LAURIUM CAPITAL (PTE) LTD
Country: South Africa
Contact: Mark Preston
Telephone: +27 11 263 7700
Business activity: Hedge fund manager / adviser
Website: www.lauriumcapital.com

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LAVEN PARTNERS (ASIA) PTE LTD
Country: Singapore
Contact: Gordon Lai
Telephone: +65 6631 2889
Business activity: Consultant (compliance), consultant (investment)
Website: www.lavenpartners.com

LIONGUARD CAPITAL MANAGEMENT INC
Country: Canada
Contact: Andrey Omelchak
Telephone: +1 514 448 6441
Business activity: Hedge fund manager / adviser
Website: www.lionguardcapital.com

LNG CAPITAL LLP
Country: UK
Contact: Cyrena Rice
Telephone: +44 (0)20 7839 3456
Business activity: Hedge fund manager / adviser
Website: www.lngcapital.com

MANDARIN CAPITAL LIMITED
Country: Hong Kong
Contact: Manuel Gonzalez Villavecchia
Telephone: +852 3543 0810
Business activity: Hedge fund manager / adviser
Website: www.mdncapital.com

MAPLES FUND SERVICES (SINGAPORE) PTE LTD
Country: Singapore
Contact: San San Fan
Telephone: +65 6436 6900
Business activity: Fund administration, accounting & custody services
Website: www.maplesfundservices.com

MELIDON SERVICES LTD
Country: UK
Contact: Thomas Schildhammer
Telephone: +44 (0)20 3427 3950
Business activity: Hedge fund manager / adviser

MURANO SYSTEMS INC
Country: UK
Contact: Amy Davies
Telephone: +44 (0)20 3405 3370
Business activity: Data & rating services
Website: www.muranoconnect.com

NANOOK ENERGY ADVISORS, LLP
Country: UK
Contact: Jeremy Urquhart
Telephone: +44 (0)20 7428 4047
Business activity: Hedge fund manager / adviser
Website: www.nanookadvisors.com

NFT INVESTMENT PTE LTD
Country: Singapore
Contact: Gaetan d'Oysonville
Telephone: +65 6521 3835
Business activity: Hedge fund manager / adviser
Website: www.nft-invest.com

NOMURA INTERNATIONAL PLC
Country: UK
Contact: Richard Norris
Telephone: +44 (0)20 7521 2000
Business activity: Prime brokerage services
Website: www.nomura.com

NORTHILL CAPITAL
Country: UK
Contact: Sally Todd
Telephone: +44 (0)20 7016 4040
Business activity: Investor (institutional)
Website: www.northill.com

PANGOLIN INVESTMENT MANAGEMENT PTE. LTD.
Country: Singapore
Contact: Jalene Ngiam
Telephone: +65 6334 4475
Business activity: Hedge fund manager / adviser
Website: www.pangolinfund.com

PERDURANCE ASSET MANAGEMENT LIMITED
Country: Jersey, Channel Is.
Contact: Tom O'Connor
Telephone: +44 (0)15 3475 2777
Business activity: Hedge fund manager / adviser
Website: www.perdurance.je

PRINCETON UNIVERSITY INVESTMENT COMPANY
Country: USA
Contact: Jennifer M Birmingham
Telephone: +1 609 258 4136
Business activity: Investor (institutional)

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RD LEGAL CAPITAL, LLC
Country: USA
Contact: Katarina Markovic
Telephone: +1 201 568 1422
Business activity: Hedge fund manager / adviser
Website: www.rdlegalcapital.com

ROBERT WOOD JOHNSON FOUNDATION
Country: USA
Contact: Elizabeth Hewitt
Telephone:
Business activity: Investor (institutional)
Website: www.rwjf.org

SARACEN CAPITAL LP
Country: USA
Contact: Taylor Holladay
Telephone: +1 713 579 3939
Business activity: Hedge fund manager / adviser
Website: www.saracencapital.net

SLATER INVESTMENTS LIMITED
Country: UK
Contact: Ralph Baber
Telephone: +44 (0)20 7330 6130
Business activity: Hedge fund manager / adviser
Website: www.slaterinvestments.com

SMARSH
Country: UK
Contact: Anna Carless
Telephone: +44 (0)20 7947 4117
Business activity: Consultant (other), it/systems/software services
Website: www.smarsh.com

SMARTIMPACT
Country: UK
Contact: Juliet Conquest
Telephone: +44 (0)845 544 2043
Business activity: It/systems/software services
Website: www.smartimpact.co.uk

SOUTHPOINT CAPITAL ADVISORS LP
Country: USA
Contact: Anthony Joseph Buffalano III
Telephone: +1 212 692 6350
Business activity: Hedge fund manager / adviser
Website: www.southpoint-capital.com

TOCCATA CAPITAL PTE. LTD.
Country: Singapore
Contact: Assia Todorova Turner
Telephone: +65 6407 1465
Business activity: Hedge fund manager / adviser
Website: www.toccap.com

TOWERS FIDUCIARY PTE LTD
Country: Singapore
Contact: Marc Towers
Telephone: +65 9730 3124
Business activity: Independent fund director
Website: www.towersfiduciary.com

TRAIANA INC
Country: Hong Kong
Contact: Marie-Christine Merkly
Telephone: +852 2532 0802
Business activity: Consultant (other)
Website: www.traiana.com

TRIASIMA PORTFOLIO MANAGEMENT INC
Country: Canada
Contact: Ron Cheshire
Business activity: Hedge fund manager / adviser
Website: www.triasima.com

WEDGEBLOOM PTY. LTD
Country: Australia
Contact: Eduardo D Ferreira
Telephone: +61 2 9238 1922
Business activity: Hedge fund manager / adviser

WGC SYSTEMS (HONG KONG) LIMITED
Country: Hong Kong
Contact: Matthew Cartwright
Telephone: +852 3478 7319
Business activity: Consultant (other)

WILLIS (MALAYSIA) SDN BHD
Country: Malaysia
Contact: Rajini Pararajasingam
Business activity: Insurance services

WILLIS (SINGAPORE) PTE LTD
Country: Singapore
Contact: Tony Mitchell
Telephone: +65 6591 8000
Business activity: Insurance services
Website: www.willis.com

continued ▸

WILLIS CORRETORES DE SEGUROS LTDA
Country: Brazil
Contact: Marcelo Pollak
Business activity: Insurance services

WYETREE ASSET MANAGEMENT
Country: UK
Contact: Bally Gill
Telephone: +44 (0)20 7808 1760
Business activity: Hedge fund manager / adviser
Website: www.wyetreeam.co.uk

ZAFIRO CAPITAL SARL
Country: Switzerland
Contact: Tony Simmonds
Telephone: +41 79 744 7678
Business activity: Hedge fund manager / adviser
Website: www.zafiro-capital.com

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Head Office:
The Alternative Investment Management Association Ltd
2nd Floor, 167 Fleet Street, London, EC4A 2EA
Tel: +44 (0) 20 7822 8380
Email: info@aima.org

aima
Alternative Investment Management Association
www.aima.org

Contact us

AIMA Head Office
167 Fleet Street, London EC4A 2EA, UK
+44 (0)20 7822 8380
info@aima.org

AIMA in the USA
1271 Avenue of the Americas, Suite 4300 New York, NY 10020, USA
mnoyes@aima.org

AIMA Canada
Suite 504 - 80 Richmond Street West, Toronto, Ontario, M5H 2A4, Canada
+1 416 453 0111
jburron@aima-canada.org

AIMA Cayman
cayman@aima.org

AIMA Hong Kong
Room 502, 5/F, Parker House, 72 Queens Road Central, Hong Kong
+852 2526 0211
hongkong@aima.org

AIMA Singapore
12 Marina View, #21-01 Asia Square Tower 2, Singapore 018961*
+65 6535 5494
singapore@aima.org
**New address effective 2 January 2015*

AIMA Australia
GPO Box 3989, Sydney, NSW 2001, Australia
+61 (0)4 1222 4400
mgallagher@aima-australia.org

AIMA Japan
c/o G-MAC, #3 Div., ICS Convention Design, Inc., Chiyoda Bldg.,
1-5-18 Sarugaku-cho, Chiyoda-ku, Tokyo 101-8449, Japan
+81 3 3219 3644
aimajapan@ics-inc.co.jp

Alternative Investment
Management Association

www.aima.org