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# EDITORIAL: How to better understand hedge fund performance

*By Jack Inglis, CEO, AIMA*

At a time when many commentators have said that hedge fund performance is "disappointing", investor satisfaction levels continue to rise. At the end of 2013, a Barclays survey of investors found that hedge fund performance for that year had been either in line with or better than the expectations of more than half of all institutional investors. A survey by Preqin in January 2014 found that more than 80% of institutional investors were satisfied with performance the previous year, despite the "average" hedge fund appearing to underperform the S&P 500. Why the disparity?

Seeking to answer this question was one of the inspirations behind our new research paper, 'Apples and Apples: How to better understand hedge fund performance'. That paper can be downloaded as a pdf here. We also have reprinted much of it in this edition of the AIMA Journal (turn to page 7).

What we have found, we hope, has added fresh insight into a very old debate — how to understand hedge fund performance and compare it to other investments. Our paper recommends that everyone from non-investment specialists (such as trustees of public and private sector pensions) to commentators in the media follow five steps in order to better understand hedge fund performance: look at risk-adjusted returns (hedge funds have outperformed even the S&P since 2009 on this basis, our paper shows); look at long-term data (hedge funds have beaten stocks and bonds on an absolute basis since 2003); look at the returns by strategy rather than in aggregate (hedge funds are diverse and should not be treated as an asset class); compare with the most relevant asset class (for example, many hedge fund strategies are designed to behave differently to equity markets); and be aware of differences between hedge fund indices (from 2009-2013, the dispersion of performance between the lowest and highest performing indices was 35.9%).

Of course, comparing equity and hedge fund indices presents them as a binary choice that investors make. Institutional investors tend to have large equity allocations (60% of the total portfolio, historically) and they are looking for investments that complement those large allocations. It's not an either/or choice between equities and hedge funds. An institutional investor will often not be taking an abstract decision to invest in hedge funds but they may well see hedge fund allocations as a good way of accessing particular markets or assets, such as China, or credit, or distressed debt.

Many institutional investors may prefer steadier returns achieved with lower volatility to higher returns achieved with higher volatility. Investors are not allocating to hedge funds to beat the S&P 500, but to allow them to meet their asset-liability management objectives in terms of risk-adjusted returns, diversification, lower correlations, lower volatility and downside protection. Rather than merely chasing performance, many institutional investors use hedge funds and other alternative investment options as tools to customise their portfolios.

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**This version of our ‘Apples and Apples’ paper is special to the AIMA Journal. To download the full paper, click here.**

## Introduction

It is still common for comparisons between aggregated hedge fund indices and equities indices like the S&P 500 to be made. For example, a set of monthly hedge fund index figures is often compared to the S&P in that period with the latter used as a proxy for the “market”, with the difference between the two interpreted as hedge funds either under- or over-performing “the market”.

These comparisons may have made sense at one point. Prior to 1990, the hedge fund industry was very largely based in the US and long/short US equity was one of the most common strategies. But the hedge fund sector today is now more diverse — AIMA has members in over 50 countries — and more global — investors in hedge funds have a choice of at least 20 different investment strategies, many of them designed to be uncorrelated to equity markets. Indeed only a relatively small number of individual funds — perhaps fewer than 20 of the roughly 374 hedge funds managing over $1 billion[1] — are

1 HedgeFund Intelligence

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understood to be invested in US equities alone. So does it still make sense to compare hedge fund returns to the S&P 500? To what extent are such comparisons realistic? Are they a "like for like" comparison or are they comparing "apples and oranges"? Is this even the approach investors take?

What would be an "apples and apples" comparison? This short paper seeks to answer these questions and makes the following recommendations about how to better understand hedge fund performance, set out in five steps:

- **Step 1 - Look at risk-adjusted returns**
- **Step 2 - Look at long-term data**
- **Step 3 - Look at the returns by strategy**
- **Step 4 - Compare with the most relevant asset class**
- **Step 5 - Be aware of differences between hedge fund indices**

## Step 1 — Look at risk-adjusted returns

Figure 1 shows that over a 10-year or 20-year time horizon, hedge funds outperformed equities and bonds on an absolute basis — also known as the "headline" return. However, informed investors do not only look at "headline" return figures. They often also look at "risk-adjusted" returns — a way of measuring the value of the return in terms of the degree of risk taken. They would often rather have steadier returns with lower volatility than higher ones with greater volatility, because of the risk of potential loss that higher volatility brings (as in 2008 when equity markets plunged).

And what Figure 1 also shows, significantly, is that hedge funds outperformed equities and bonds on a risk-adjusted basis over the last five years, despite the scale of the post-financial crisis equity bull market. This risk-adjusted out-performance was for both hedge funds as a whole and funds operating "equity hedge" strategies.

Risk-adjusted returns are calculated by the volatility of the return using "standard deviation", which considers the scale of fluctuation from peak to trough in a particular period of time. In effect, the lower the value of standard deviation, the lower the volatility. Standard deviation is a key metric for investors seeking smoother and more stable returns over the long term.

**Figure 1: Comparison of both annualised 'headline' returns and risk-adjusted returns for hedge funds as a whole, equity hedge funds, bonds and equities, for various periods to end-2013**

| | 5 year | | | 10 year | | | 20 year | | |
|---|---|---|---|---|---|---|---|---|---|
| Index | Annualised 'headline' return | Annualised standard deviation | Sharpe Ratio* | Annualised 'headline' return | Annualised standard deviation | Sharpe Ratio* | Annualised 'headline' return | Annualised standard deviation | Sharpe Ratio* |
| HFRI Fund Weighted Composite | 7.79% | 5.88% | 1.28 | 5.71% | 6.39% | 0.84 | 8.84% | 6.99% | 1.23 |
| HFRI Equity Hedge (Total) | 9.14% | 8.45% | 1.05 | 5.26% | 8.71% | 0.56 | 10.30% | 9.18% | 1.09 |
| S&P 500 | 15.40% | 15.85% | 0.95 | 5.21% | 14.63% | 0.33 | 7.13% | 15.21% | 0.45 |
| MSCI World | 12.54% | 18.07% | 0.68 | 4.87% | 16.41% | 0.28 | 5.24% | 15.55% | 0.32 |
| Barclays Global Aggregate ex-USD | 3.51% | 8.46% | 0.38 | 4.35% | 8.25% | 0.49 | 5.52% | 8.17% | 0.64 |

*Sharpe Ratio calculations assume an annualised risk free rate of 0.3%, 0.35% and 0.25% over the 5, 10 and 20-year periods respectively. The risk free rate is calculated as the average rate of a US treasury security during the relevant period for a security of the same maturity as the period in question (eg. for the 5 year period, the risk free rate is the average rate of a 5 year treasury note over the 2009-2013 period). Source: AIMA.

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**Figure 2: Annualised Volatility (%)**

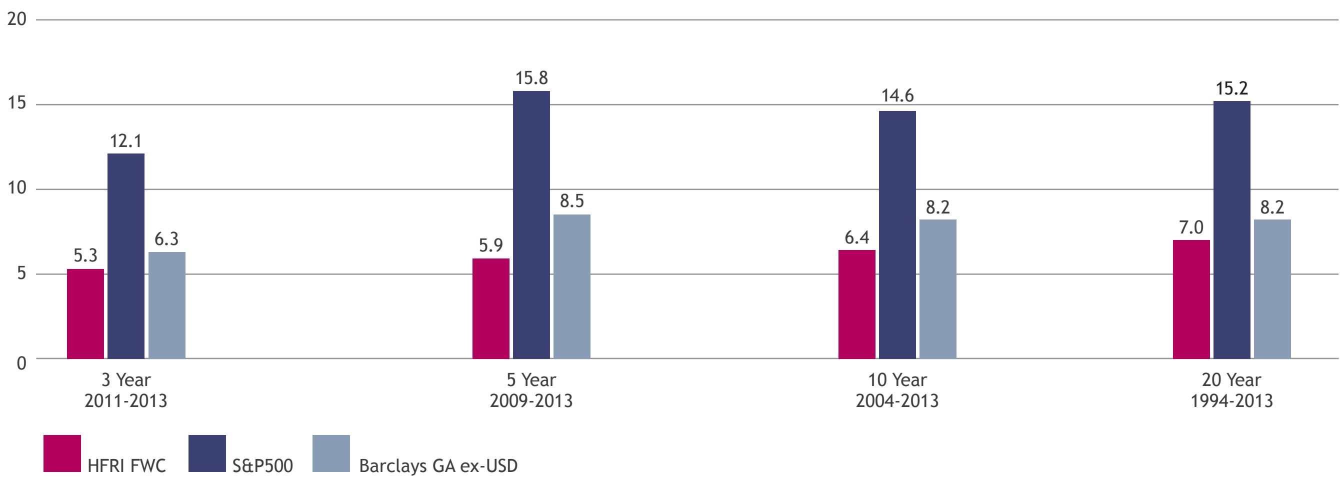


Figure 2 compares the volatility of hedge funds with equities and bonds. As a proxy for the hedge fund industry it takes the HFRI FWC[2]. For equities, it uses the S&P 500 and for bonds, the Barclays Global Aggregate ex-USD Bond Index[3].

What it shows is that hedge funds are not only less volatile than equities, which might be expected, but bonds, too. And it suggests that hedge funds are lower-risk investments than a traditional combination of long-only equities and bonds.

The risk-adjusted return is measured by the "Sharpe Ratio" — calculated by subtracting the risk-free rate (the return on US Treasury securities) from the fund or index performance (returns net of fees) and then dividing this by the fund or index's volatility. The higher the ratio, the better the risk-adjusted return.

2 The HFRI FWC is Hedge Fund Research's industry-wide index and encompasses over 2,000 hedge funds.

3 The Barclays Global Aggregate ex-USD Bond Index covers the most liquid portion of the global investment grade fixed-rate bond market, including government, credit and collateralised securities. It excludes illiquid and junk bonds.

Taking the headline returns data and the volatility data, it is possible to calculate the risk-adjusted rate. Figure 1 reveals that hedge funds as a whole had a Sharpe Ratio for the five years to the end of 2013 of 1.28, while equity hedge funds had a ratio of 1.05. These ratios were higher, despite the equity market rally, than for the S&P 500 (0.95) and the MSCI World (0.68).

They also significantly outperformed the ratio for bonds (0.38) as measured by the Barclays Global Aggregate ex-USD index.

## Step 2 — Look at long-term data

If direct comparisons are to be made between aggregated hedge fund indices and the S&P, they should be over the long term, since short-term data can create false impressions. Comparing equity returns with hedge fund returns during a short-lived equities bull market, for example, may be misleading because many hedge fund strategies are designed to protect investments during drawdowns rather than necessarily outperforming during rallies.

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That means that their usefulness to investors often increases later in the cycle. Investments that preserve capital during drawdowns will frequently outperform long-only investments over the long term because of the destructive impact of drawdowns — if an investment is down 50% one year, it needs to grow 100% the following year simply to recover those losses.

The impressive returns that equities in general achieved from 2009-2013 should be placed in context. Many investors attributed this period of growth to the impact of widespread quantitative easing (QE) globally, which inflated asset values in general and those of equities in particular. If there is a lesson historically both from equity boom markets and experiments in unconventional monetary policy, it is that what goes up often comes down, and that experiments often have unforeseen consequences.

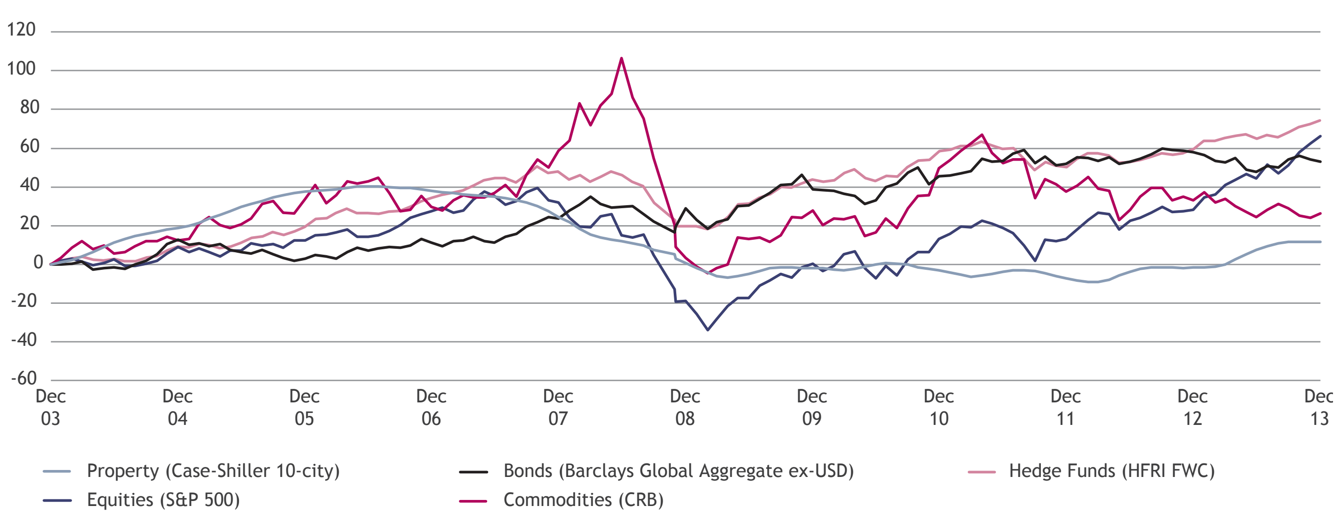
In any case, equities fell much further than hedge funds in 2008 (the S&P 500 was down nearly 40%), which meant that a significant portion of the subsequent growth merely made up ground that was previously lost. As Figure 3 shows, hedge funds have outperformed the main standalone asset classes over the last 10 years with a cumulative return of 74% in the period.

This return was accomplished with a maximum drawdown (largest peak-to-trough loss over a period) of only 21.4% (this occurred between November 2007 and February 2009). In comparison, investors in the S&P 500 experienced a 57% drawdown from November 2007 to March 2009, while investors in commodities experienced a similarly large drawdown of 54% from June 2008 to February 2009. Of the other main asset classes over this period, the biggest drawdown for property was 35% and for fixed income was 10%.

## Step 3 — Look at the returns by strategy

The hedge fund industry is extremely diverse. Aggregated hedge fund indices can be useful measures of the overall direction of travel of the hedge fund industry and they enable investors

**Figure 3: Hedge funds versus main asset class cumulative returns (%)**
**Jan 2004 - Dec 2013**




Source: AIMA

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to draw broad-brush conclusions about the growth trajectory of the industry as a whole. But they are often interpreted as capturing the performance of the "average" hedge fund, when arguably there is no such thing.

Investors do not invest in the "average" hedge fund — one that would aim to encapsulate the characteristics of all hedge fund strategies. Rather, they allocate to specific hedge funds and strategies in order to customise their portfolios.

Hedge funds are not an asset class. They are a way of managing money that typically features managers who have more tools at their disposal, more freedom of manoeuvre and more specialised strategies. There is a large dispersion in terms of performance between the different strategies. Averaging out strategy-by-strategy data can create aggregated performance figures that bear little relation to the actual experience of many investors.

Indeed, including multiple hedge fund strategies with different performance dynamics in one bucket can result in them "netting out". This is because different hedge fund strategies are often uncorrelated or indeed negatively correlated. If one strategy is up 3% and another is down 3%, the aggregate figure would suggest the industry flat-lined, but that would miss what really happened with those two strategies.

**Figure 4: Main hedge fund strategies**

| | |
|---|---|
| **Equity Hedge**<br>• Equity Market Neutral<br>• Fundamental Growth<br>• Fundamental Value<br>• Quantitative Directional<br>• Energy/Basic Materials<br>• Technology/Healthcare<br>• Short Bias<br>• Multi-Strategy (Equity Hedge) | **Macro**<br>• Active Trading<br>• Commodity<br>• Currency — Discretionary<br>• Currency — Systematic<br>• Discretionary Thematic<br>• Systematic Diversified<br>• Multi-Strategy (Macro) |
| **Event-Driven**<br>• Activist<br>• Credit Arbitrage<br>• Distressed/Restructuring<br>• Merger Arbitrage<br>• Private Issue/Regulation D<br>• Special Situations<br>• Multi-Strategy (Event-Driven) | **Relative Value**<br>• Fixed Income — Asset Backed<br>• Fixed Income — Convertible Arbitrage<br>• Fixed Income — Corporate<br>• Fixed Income — Sovereign<br>• Volatility<br>• Yield Alternatives<br>• Multi-Strategy (Relative Value) |

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For example, a "tail risk" fund may be down or flat when equities are doing well and may do very well when equities do very badly. Equity hedge funds often perform very differently to CTA (managed futures) funds – CTAs did very well in 2008, when equities were down hugely, but did less well during the subsequent equity market rallies, for instance.

This is why it is better to separate the industry data by strategy, as some of the index providers have done, and to compare those average returns for a particular strategy to a relevant benchmark for the investments underpinning that strategy, whether bonds, commodities or equities.

Figure 4 on the previous page illustrates the scale of the diversity in the industry. It identifies 29 different hedge fund sub-strategies and shows there is not one single sub-strategy that dominates. Indeed, some of these sectors are extremely small. Some of the sectors that attract a lot of attention from policymakers and the media – such as "short bias" hedge funds and funds focused exclusively on sovereign debt – are tiny in comparison to the size of the industry as a whole.

Admittedly, hedge fund strategies are complex and classifying them can be subjective. However, under Hedge Fund Research's classification, these 29 sub-strategies come under four main strategy groups: "equity hedge"; "event-driven"; "macro"; and "relative value".

## Step 4 — Compare with the most relevant asset class

Many hedge fund strategies are designed to behave differently to equity markets. Macro and relative value strategies, for example, traditionally have exhibited low correlations with common equity indices and to compare the two is akin to comparing "apples and oranges".

An "apples and apples" comparison can be made only if an individual hedge fund strategy is judged against its underlying asset class. For example, equity long/short with the S&P 500, or fixed income strategies with bond indices. Many strategies, of course, trade multiple asset classes.

Investors will consider how different strategies perform in relation to the most relevant asset classes (whether fixed income, commodities or equities) and the degree of correlation or volatility inherent in the strategy.

It is worth bearing in mind that a hedge fund allocation may have a particular role in an investor portfolio and a headline return comparison may not reflect that. For example, the role of the allocation may be to provide downside protection, or dampen volatility, or provide diversification.

It is also worth considering that investors may well not be using indices as their point of comparison. They may have a particular return figure or band in mind for the hedge fund part of their portfolio. They may for example be seeking a return of T-bills plus X%.

In addition, investors often look at multiple factors when considering making hedge fund allocations. They could include peer analysis (comparing the size and quality of the returns for hedge funds that use broadly similar strategies) and risk analysis (encompassing a wide range of measures including value-at-risk, asymmetry of returns, tail risks and risk-adjusted returns). Other factors that influence the investor's choice include management experience; the level of fees, transparency, liquidity and

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stability; past treatment of investors; back office infrastructure and reliability; decision and execution processes; fund domicile; and the firm's ability to manage growth (among other things). Depending on the scope, investor due diligence often takes many months to complete.

## Step 5 — Be aware of differences between hedge fund indices

A measure of how problematic it can be to assess the performance of the "average" hedge fund comes in the different return profiles of the main hedge fund indices. Different indices have different constituencies and use different methodologies, and these variations can lead to differences in performance data.

The hedge fund industry comprises hedge funds that are both "open" and "closed". "Open" in this context means the fund is open to new investors, while "closed" means the fund is closed to new investors. These terms are occasionally misunderstood. The manager of a "closed" fund has not itself closed, nor does it mean that the fund has gone out of business or has returned all its outside investors' capital. On the contrary, some of the industry's oldest and most successful hedge funds today are "closed" and have been for many years.

Some indices, such as the HFRX, are "investable", meaning they comprise only those funds that are open to new investors. Other indices, such as the HFRI, are "non-investable", which means they comprise both funds that are open and that are closed.

Some indices are updated daily and others are updated monthly. The HFRX is based on transparent managed accounts with each of the underlying constituents offering daily performance. The HFRI, the Barclay Hedge Fund Index, the Credit Suisse Hedge Fund Index and the Eurekahedge Hedge Fund Index are broad-based composites of hedge fund performance, with the constituent funds reporting monthly to the respective providers.

The funds that make up the index also have a significant bearing on the overall return, since no single composite index has all the hedge funds in the industry. Some indices have a higher proportion of CTAs, while others have more equity hedge funds, for example.

Regarding methodology, different indices take fundamentally different approaches to calculating the performance data. Some indices, such as the HFRX and the Credit Suisse All Hedge Fund Index, are "asset-weighted", which means that the contribution of each constituent fund to the index's overall return is weighted by their respective assets under management. The practical impact of this is that the performance of large funds has a greater impact on the index's overall performance than the performance of smaller funds.

Others, such as the HFRI indices, are "equal-weighted", which means that each fund has an equally weighted contribution to the index, irrespective of size – the index's overall performance is calculated by simply adding together and averaging out all the constituent funds' returns. Equal weighted indices are particularly good indicators of the hedge fund industry's performance from year to year.

Figure 5 overleaf, covering the five years to end-2013, demonstrates that the five main hedge fund indices, with their different constituents and methodologies, have very different return profiles. Over the five-year period, the one index that is investable and based on managed accounts, the HFRX, returned a cumulative

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**Figure 5: Dispersion of performance reported by hedge fund indices**

| Hedge Fund Index | 12 month (ytd) | | | 36 month (ytd) | | | | 60 month (ytd) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cumulative Return | Annualised Standard Deviation | Sharpe Ratio* | Cumulative Return | Annualised Return | Annualised Standard Deviation | Sharpe Ratio* | Cumulative Return | Annualised Return | Annualised Standard Deviation | Sharpe Ratio* |
| HFRI Fund Weighted Composite Index | 9.1% | 3.7% | 2.5 | 10.0% | 3.2% | 5.3% | 0.6 | 45.5% | 7.8% | 5.9% | 1.3 |
| HFRX Global Hedge Fund Index | 6.7% | 3.0% | 2.2 | 0.7% | 0.2% | 4.2% | 0.0 | 20.1% | 3.7% | 4.3% | 0.8 |
| Credit Suisse Hedge Fund Index | 9.7% | 3.6% | 2.7 | 15.1% | 4.8% | 4.4% | 1.0 | 51.5% | 8.7% | 5.0% | 1.7 |
| Eurekahedge Hedge Fund Index | 8.0% | 3.1% | 2.5 | 12.4% | 4.0% | 4.1% | 0.9 | 51.3% | 8.6% | 4.9% | 1.7 |
| Barclay Hedge Fund Index | 11.1% | 3.9% | 2.8 | 13.7% | 4.4% | 5.9% | 0.7 | 56.0% | 9.3% | 6.5% | 1.4 |
| *Range* | *4.4%* | *0.9%* | *0.6* | *14.5%* | *4.6%* | *1.8%* | *1.0* | *35.9%* | *5.6%* | *2.1%* | *0.9* |

Range is calculated as the highest indice value within a category minus the lowest.
*Sharpe Ratios assume an annualised risk free rate of 0.13%, 0.19% and 0.3% over the 1, 3 and 5-year periods respectively.

20.1%. By contrast, two of the indices which are non-investable and equal-weighted - the Eurekahedge Hedge Fund Index and the Barclay Hedge Fund Index — had cumulative returns of over 50%. This underlines how, when comparing hedge fund industry performance to other indices, the choice of index and underlying methodology and make-up is significant.

## What do investors want from hedge funds?

### *1. A complement, not an alternative, to equities*

Comparing equity and hedge fund indices presents them as a binary choice that investors make. Institutional investors tend to have large equity allocations (60% of the total portfolio, historically) and they are looking for investments that complement those large equity allocations. It's not an either/or choice between equities and hedge funds. Investors choose what works for their portfolio as a complement to equities, and what often works is that which is less correlated or uncorrelated to equities — i.e., increases the diversification of the portfolio, has lower volatility than equities, and provides downside protection against the large drawdowns that equities sometimes experience.

### *2. Tools to customise their portfolios*

There is such diversity of investment strategies among hedge funds that allocations can increase the diversification of the portfolio and also be used as portfolio construction tools and ways to access particular markets or assets. An institutional investor will often not be taking an abstract decision to invest in hedge funds but they may well see hedge fund allocations as a good way of accessing particular markets or assets — for example China, or credit, or distressed. Rather than merely chasing performance, many institutional investors use hedge funds and other alternative investment options as tools to customise their portfolios[4].For example, allocating to hedge funds allows them to meet individual and more customised asset-liability management objectives in terms of risk-adjusted returns, diversification, lower correlations, lower volatility and downside protection.

## Are investors satisfied with their hedge fund investments?

At a time when many commentators have said

4 Beyond 60/40: The evolving role of hedge funds in institutional investor portfolios', AIMA Investor Steering Committee paper, May 2013 - www.aima.org/en/document-summary/index.cfm/docid/77A589A0-3BEA-4559-B0F0EE38CF21B1CF

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that hedge fund performance is "disappointing", investor satisfaction levels continue to rise. At the end of 2013, a Barclays survey of investors found that hedge fund performance for that year had been either in line with or better than the expectations of more than half of all institutional investors, with only 38% saying that performance was worse than expectations. A survey by Preqin published in January 2014 found that more than 80% of institutional investors were satisfied with performance the previous year, despite the "average" hedge fund appearing to underperform the S&P 500.

## Conclusion

To better understand hedge fund performance, it is important to:

1. **Look at risk-adjusted returns** — Hedge funds as a whole consistently outperform US equities (as measured by the S&P 500), global equities (MSCI World) and global bonds (Barclays Global Aggregate ex-USD Index) on a risk-adjusted basis, a measure that is highly valued by investors. Even during the stock-market rally of recent years, hedge funds performed better on a risk-adjusted basis than the S&P 500 and MSCI World.

2. **Look at long-term data** — The stock market rally of recent years may not last forever. Even taking the index data, hedge funds have outperformed the main standalone asset classes over the last 10 years with a cumulative net return of 74%.

3. **Look at the returns by strategy** — Hedge fund strategies are very diverse and often behave very differently to each other. Putting them all in one bucket and saying it represents the performance of the "average" hedge fund can be misleading.

4. **Compare with the most relevant asset class, not just equities** — When benchmarking hedge fund performance, reference should be made to how different strategies perform in relation to the most relevant asset class, whether fixed income, commodities or equities.

5. **Be aware of differences between the indices** — In the five years to the end of 2013, the main hedge fund indices produced notably different results, reflecting variations in constituency and methodology.

6. **Remember investors do not make either/or choices between equities and hedge funds** — Investors allocate to hedge funds as a complement to their equities, not instead of them. They will often want different things from their hedge fund allocations and their equities allocations.

7. **Consider how investors use hedge funds** — Investors use alternatives in general and hedge funds in particular as tools to customise their portfolios. Allocating to hedge funds allows them to meet individual and more customised asset-liability management objectives in terms of risk-adjusted returns, diversification, lower correlations, lower volatility and downside protection. This may explain the high levels of investor satisfaction from their hedge fund allocations that many surveys have reported, even at a time when many commentators have been arguing the industry "under-performed" relative to the S&P 500. It suggests that many institutional investors may prefer steadier returns achieved with lower volatility to higher returns achieved with greater volatility.

# AIMA/BARCLAYS PAPER 'The Extra Mile: Partnerships between Hedge Funds and Investors'

**This version of 'The Extra Mile' is special to the AIMA Journal.**
**To download the full paper, click here.**

## Foreword by Michelle McGregor-Smith

I am delighted to introduce, on behalf of the AIMA Investor Steering Committee, our new paper, 'The Extra Mile: Partnerships between Hedge Funds and Investors'[1], written in conjunction with Barclays Capital Solutions. The paper is based on a survey of major hedge fund investors and hedge fund managers with a combined $2.2 trillion in assets.

The publication of this paper comes at an important time in the evolution of the hedge fund industry globally. Amid the ongoing process of institutionalization (a theme that we first addressed in AIMA's Roadmap to Hedge Funds in 2008), institutional investors are actively pursuing a more direct engagement

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with the underlying hedge funds in which they are invested.

This paper explores the changing relationships between hedge fund managers and investors. What we have found is that investors are increasingly striking up partnerships with hedge funds. These partnerships take many forms, including the sharing of knowledge on expertise and risk management, the building of more customized products, co-investment solutions, product seeding and equity investment. As the title of the paper implies, both parties are properly investing in these relationships – they are going the extra mile – and, in doing so, are achieving significant benefits for both sides.

I would like to express our sincerest gratitude to Barclays for collaborating with the AIMA Investor Steering Committee ('ISC') on this project. I would also like to thank AIMA on behalf of the ISC for their continued commitment to investor engagement, which is so widespread today. The ISC has been responsible for a number of publications in recent years including Beyond 60/40: the evolving role of hedge funds in institutional investor portfolios, the Roadmap to Hedge Funds, the world's first educational guide for institutional investors in hedge funds, and the Guide to Institutional Investors' Views and Preferences, which discusses a variety of important operational and organizational issues. A final word of thanks is due to my fellow investors for devoting so much of their time to this initiative. I hope that you enjoy this paper and find it to be as useful a reference tool as those earlier ISC publications.

*Michelle McGregor-Smith*
*Chair, AIMA Investor Steering Committee*
*Chief Executive, British Airways Pension Investment Management Ltd*

## Study overview

As the hedge fund ('HF') industry evolves and becomes increasingly institutional, many hedge funds are reorienting their business models, away from the idea of selling a fixed product offering, and instead toward the principle of becoming partners, using their expertise to deliver solutions for investors.

In this piece, undertaken in conjunction with the AIMA Investor Steering Committee, we explore the development of this new trend, looking at the rationale for the development of these partnerships, what they consist of, and how managers looking to get involved in partnerships should think about them.

The main areas we address in this piece are the following:

### *1. Partnership rationale*

a. What have been the factors driving recent growing interest in partnerships?
b. What are the benefits to HF managers and investors in forming partnerships?

### *2. Elements of partnerships*

a. What are the typical elements of partnerships between HFs and investors?
b. What defines each element, and how do they work?
c. How prevalent are these elements relative to each other?

### *3. Attributes of partners*

a. What criteria do investors use to select HF managers as partners?
b. Are HFs of a certain size / strategy more attractive?

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c. Are fee concessions essential in the context of partnerships?

### *4. Key considerations for HFs*

a. How should HF managers think about partnerships in the context of their strategy? Are certain types of partnerships more or less attractive?
b. How should HFs select investors to target for building partnerships?
c. What lessons can HFs learn from FoHFs?

## Methodology

With these areas in mind, Barclays Strategic Consulting team tapped three sources to gather the required information for the study:

### *1. Investors*

- A total of 30 investors were surveyed, including a number of members of AIMA’s Investor Steering Committee.
- These investors manage over $2tn of overall AUM and over $260bn of AUM invested in HFs.

### *2. Managers*

- Interviewed 21 managers, including several that have been at the forefront of developing the concept of partnership with investors.
- Focused on established managers, across a range of strategies / sizes.

### *3. HF industry databases*

- Over 10,000 data points analyzed from HFR, BarclayHedge, and HFN.

## Executive summary

The following are high-level takeaways from the study:

### *Partnership rationale*

- Partnerships present significant benefits for investors and managers alike.
- HF investors have become increasingly sophisticated in their view of their HF investments, looking at HFs as a way to tailor the risk-return of their entire portfolio and, simultaneously, they have concentrated their HF portfolios to a smaller number of managers. As such, they are looking to have fewer but more meaningful relationships with HFs to obtain the following benefits:

    1. Access to HF expertise/skills: Partner investors can leverage HFs’ knowledge and expertise.
    2. Customization: Partner investors can work with HFs to develop customized solutions for their investment needs.
    3. Increased understanding: Partner investors are likely to have greater knowledge and understanding of the managers they are partnered with.
    4. Value for money: Partner investors say they can obtain more value from their HF investments, often for the same or sometimes lower fees.

- Managers have five main reasons for forming partnerships with investors:

    1. ‘Stickier’ tickets: Partner investors are more likely to be loyal investors and allocations to partner HFs are generally for the longer term.
    2. New product development: Partner investors can help launch new products

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by providing seed capital or being early investors.
3. Cross-selling opportunities: Partner investors may be more open to investing in the manager’s other products.
4. Knowledge sharing: HFs can learn from investors – e.g., a pension fund partner can be helpful in showing HFs how to interact with pensions and to cater better to their needs.
5. Investor references: Investors can act as a positive reference to fellow investors.

### *Elements of partnership*

- Investors and managers cite six key elements they value in partnerships: highly responsive and proactive client service, knowledge sharing, customization, co-investments, product seeding and equity stakes
- A highly responsive and proactive client service is a prerequisite to form a partnership with HFs, but partnerships have to be based on much more than that.
- Knowledge sharing comes in different flavours, each having different cost and scalability characteristics, as well as appeal to investors. No matter what form such knowledge sharing takes, the objective of HF managers is to demonstrate to investors they are the ‘go-to’ on their specific areas of expertise.
- Customization is often at the core of what partnership is for most HF investors. As investors are becoming more sophisticated, they are utilizing customized mandates to tailor their investments and risk exposures to suit their own preferences.
- Co-investments are an important way in which HFs and investors partner on opportunistic investments, many of which do not fit neatly into a commingled fund vehicle.
- Equity stakes represent a full alignment of interest and allow investors to share in the economics of HF management companies; however, they also present drawbacks and therefore only a few investors and managers choose to take this route.

### *Attributes of partners*

- Investors care about both the right set of capabilities as well as the right attitude toward investors in the HF managers they decide to partner with.
- In terms of capabilities, larger HF firms with broad strategies are most often described as good partners, although smaller managers with narrower strategies also have a role to play and are indeed preferred by some investors.
- Investors typically value HFs which are ‘solutions-oriented’ and transparent above all else when they have to choose a partner.
- Investors are divided as to whether fee concessions are a necessary part of partnership, with half stating they are an integral part of what partnerships are and the remainder saying that partnerships are not about fees.

### *Key considerations for HFs*

- HFs’ strategy-related characteristics have a role to play in determining the types of partnerships that make the most sense for them.
- Partnerships require time and effort, so HF managers must choose the investors they partner with carefully. Choice is a function of the size of an investor and their appetite for various elements of partnership.
- HFs can learn from the successful funds of hedge funds (FoHFs) that have reoriented themselves from being product-oriented

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businesses toward a solutions-based model.

- Some HF managers have made the decision not to seek partnerships for a variety of reasons, suggesting that this too could be a viable strategy in the right circumstances.

## Conclusions

The growth of partnerships between HF managers and investors represents an exciting new direction for the HF industry as it continues to evolve.

Investors should certainly take advantage of the openness of the majority of HFs to work with them to find the right solutions for their investment needs. It might require that some investors break down the silos between traditional investments and hedge funds / alternatives: this is not always easy to do but worthwhile according to the vast majority of the investors we interviewed.

For managers for whom this new direction represents an interesting concept, we would conclude with the following key takeaways:

1. **There are multiple reasons why both HF managers and large investors are increasingly seeking partnerships with each other**; both stand to benefit from a closer relationship.

2. **Not all HF managers can or should seek partnerships** – Based on size, capability set / approach, and strategy, some HFs may be better off just focusing on making their product a success.

3. **Consider putting in place a strategy** if you decide that you do want to pursue partnerships with select investors, i.e., decide what form your partnerships should take in advance and plan accordingly:
   - What elements of partnership do you want to offer and why do you think you are well positioned to be successful?
   - Where is investment required within your firm to deliver on these elements?
   - Which investors do you plan to target and what are the criteria you used to come up with this list?

4. Partnership is more than just client service, but enhanced client service is the first step – Managers seeking to pursue partnerships need to:
   - Hire high-quality individuals in the client service area who have strong product expertise.
   - Structure organizations and client service teams to be able to deliver on the partnership value proposition.

5. Don’t try to be all things to all people – One of the key risks of partnerships is that a manager tries to cater to the disparate needs of more than a handful of investors; this can be a distraction and hurt the business in the long run

6. Choose your partners carefully – The best partners aren’t necessarily the biggest; managers also need to consider which investors are likely to make the best long-term collaborators, not potential competitors down the road

# Q2 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 |
|---|---|---|
| 19 June | FSTB | Submission - Proposed Open Ended Fund Company (OFC) |
| 16 June | UK Dept of Business Innovation & Skills | Submission - Transparency and Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business |
| 12 June | | Position Paper - Commodity Exchange Act: Suggested Improvements on Extraterritorial Application and Other Related Amendments |
| 10 June | Cayman Islands Govt | Briefing Note - The Cayman Islands' Directors Registration and Licensing Law, 2014 |
| 30 May | IOSCO | Submission - IOSCO Task Force on Cross Border Regulation |
| 30 May | | Position Paper - Proposed Regulation on reporting and transparency of SFTs and rehypothecation |
| 28 May | EC | Summary - Encouraging Long-Term Shareholder Engagement: Proposed Amendments to the Shareholder Rights Directive |
| 27 May | CFTC | Submission - Review of Swap Data Recordkeeping and Reporting Requirements |
| 20 May | FCA | Briefing Note – Use of Dealing Commission Rules |
| 6 May | FCA | Submission - Fourth Quarterly Consultation Paper - Changes to the Handbook impacting AIFMs, UCITS managers and certain AIF depositaries |
| 2 May | MAS | Submission – short selling |

| | | |
|---|---|---|
| 1 May | OECD | Submission – BEPS |
| 30 April | MAS | Submission – Review of Securities Market Structure and Practices |
| 28 April | Australian Treasury | Submission – Elements of an IMR |
| 25 April | SFC | Response - Regulation of Alternative Liquidity Pools |
| 15 April | NFA | Submission - CPO/CTA Capital Requirement and Customer Protection Measures |
| 8 April | HMT | Note – Remuneration Codes |
| 8 April | HMT | Submission - Tackling aggressive tax planning in the global economy: UK priorities for the G20-OECD project for countering base erosion and profit shifting (BEPS) |
| 7 April | FSB | Submission - Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions |
| 4 April | FSTB | Response - Resolution of Financial Institutions |
| 3 April | OECD | Submission - OECD discussion draft BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances |
| 2 April | FCA | Summary - Categorisation of investment firms under the FCA's proposals to implement the CRD IV legislation |
| 31 March | Cayman Islands Govt | Submission - The Directors Registration and Licensing Bill, 2014 |
| 17 March | ESMA | Submission – AIFMD passporting fees |

# Q2 regulatory, tax and policy developments globally

*Please note that many of the hyperlinks in this section are restricted to AIMA members — please log in to www.aima.org.*

## Global

### AIMA submission - IOSCO Task Force on Cross-Border Regulation

AIMA has made a written submission to the International Organization of Securities Commissions (IOSCO) Task Force on Cross-Border Regulation. The IOSCO Task force is currently looking at cross-border challenges in regulation (including in OTC derivatives markets) and how these could be solved. In the submission, AIMA explains: the diverse ways in which our member firms react to cross-border conflict; the value and shortcomings of existing relief mechanisms, notably substituted compliance; the role that IOSCO could play in ensuring that overlap and conflict between rules is minimised as far as is possible; the importance of comprehensive information exchange mechanisms; and the need for a new forum at IOSCO level in which members could identify, discuss and resolve specific cross-border issues.
*(AIMA Weekly News, 3 June 2014)*

### Base erosion and profit shifting (BEPS)

The Organisation for Economic Co-operation and Development (OECD) has published a number of discussion documents relating to various Actions being undertaken in respect of the BEPS project at the behest of the G20 countries. One of these - Action 6 - seeks to prevent abuse of double tax treaties and proposes a Limitation of Benefit (LoB) article for inclusion in tax treaties, both where a new tax treaty is negotiated and for incorporation into existing tax treaties through a proposed multilateral amending instrument. The LoB article could affect the ability of collective investment schemes to benefit under double tax treaties and seems to have consequences that are contrary to the recommendations of an existing Report by the OECD on collective investment schemes. AIMA has submitted representations to the OECD.
*(AIMA Weekly News, 15 April 2014)*

### AIMA submission - Systemically important financial institutions

AIMA submitted a response to the Financial Stability Board (FSB) and the International Organization of Securities Commissions' (IOSCO) consultation paper entitled Assessment Methodologies for Identifying Non-bank Non-insurer Global Systemically Important Financial Institutions (NBNI G-SIFIs) (see AIMA's Summary of the Consultation Paper). In the response, AIMA argued that gross notional value of derivatives is not a useful metric for systemic risk as it does not measure actual risk exposure, does not reflect differences by asset or tenor, and does not reflect netting, collateralisation, or the impact of clearing. As a result, among other misleading outcomes, it exaggerates activity in the largest and single most liquid derivatives market (interest rate swaps). AIMA suggested that there are other viable methodologies for identifying any systemically important hedge funds, such as using initial margin data or using the major swap participant definition as a threshold. AIMA also argued that: (i) the agency model of asset managers needs to be taken into account in systemic risk analysis; (ii) the financial crisis provided a credible stress test of the hedge fund industry; (iii) regulatory reforms introduced so far should be taken into account when assessing systemic risk; (iv) based on available data, it is unlikely that, today, an individual hedge fund or family of funds managed by a hedge

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fund manager could pose systemic risk; (v) it is imperative that when looking at measures of size and leverage as potential indicators of systemic risk, consistency is achieved across sectors; and (vi) consideration should be given to risk mitigants as well as to the various risk indicators.
*(AIMA Weekly News, 8 April 2014)*

### Updated ODRG report on cross-border implementation issues

As part of the G20 leaders commitment to "report on their timeline to settle the remaining issues related to overlapping cross-border regulatory regimes and regulatory arbitrage" (see September 2013 Declaration), the OTC Derivatives Regulators Group (ODRG) has produced its first report, as part of a series it plans to produce over the course of 2014, to the G20 which identifies the list of remaining cross-border implementation issues. These outstanding issues relate to: (i) the treatment of branches and affiliates; (ii) organised trading platforms and implementation of the trading commitment; (iii) equivalence and substituted compliance (iv) clearing determinations; (v) risk mitigation requirements for non-centrally cleared derivatives; (vi) data in trade repositories; (vii) access to registrants' books and records; (viii) barriers to reporting to trade repositories; and (ix) cooperative oversight between regulators.
*(AIMA Weekly News, 1 April 2014)*

## EMEA

AIFMD

### AIMA publishes AIFMD planners

AIMA has published a new set of practical and country specific guides for hedge fund managers wishing to comply with the Alternative Investment Fund Managers Directive (AIFMD). The new guides relate to the AIFMD transposition in the UK, Ireland and Luxembourg and build on the generic AIFMD implementation guide originally published in January 2013. The generic planner has also been updated to reflect the developments that have occurred since it was originally published. The new guides are intended to help managers understand how the AIFMD as implemented in the UK, Ireland and/or Luxembourg will impact their business and set out some of the strategic and operational choices that they face in order to respond to and comply with the AIFMD as transposed into national law in those countries.
*(AIMA Weekly News, 22 April 2014)*

### UK Treasury publishes amendments to AIFM regulations 2013

On 23 May 2014, Her Majesty's Treasury (HMT) laid The Alternative Investment Fund Managers Order 2014 (the Order) before parliament, which has been published along with an Explanatory Memorandum. The Order makes various amendments to the UK's implementation of the Alternative Investment Fund Managers Directive (AIFMD). In particular, the Order also makes various amendments to the transitional provisions which apply to alternative investment fund managers (AIFMs). For example, where a manager of an alternative investment fund (AIF) has applied for, but has not been granted, registration or authorisation as such a manager before the end of the existing transitional period on 22nd July 2014, the prohibition on carrying on the relevant regulated activity without permission will not apply until the firm's application has been determined (see Article 4(5) of the Order).
*(AIMA Weekly News, 3 June 2014)*

### AIFMD Q&A

The European Securities and Markets Authority (ESMA) has published an updated version

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of its Question and Answers (Q&As) on the Alternative Investment Fund Managers Directive (AIFMD). The document provides new responses to questions which relate to reporting to competent authorities under the AIFMD. For example, the document states that ESMA recommends that the national competent authority allow AIFMs to report the information in English. However, this will depend on the national legislation transposing the AIFMD. This document is intended to be continually edited and updated as and when new questions are received. ESMA states that general questions on the practical application of the AIFMD may be sent to the following email address: AIFMDquestions@esma.europa.eu. Questions that relate specifically to technical IT issues regarding the AIFMD reporting requirements (such as on the XSD documents or the IT technical guidance) should be sent to: info.it.aifmd@esma.europa.eu.
*(AIMA Weekly News, 1 April 2014)*

## MiFID

### MiFIDII and MiFIR published in the Official Journal

On 12 June 2014, the Final Level 1 texts for Directive 2014/65/EU on markets in financial instruments (MiFID II) and Regulation (EU) No 600/2014 markets in financial instruments (MiFIR) were published in the Official Journal of the European Union. The texts will enter into force on 2 July 2014, with entry into effect 30 months later.
*(AIMA Weekly News, 17 June 2014)*

### ESMA publishes discussion and consultation papers on MiFIDII/R

The European Securities and Markets Authority (ESMA) has launched its Level 2 consultation process for the implementation of the Level 1 texts of the revised Directive and new Regulation on markets in financial instruments (MiFIDII/R). MiFIDII/R, which have been given final approval by the Council of the European Union, contain over 100 requirements for ESMA to provide technical advice to the European Commission on potential delegated acts, and for ESMA to develop draft regulatory technical standards (RTS) and implementing technical standards (ITS). ESMA has now published a: Consultation Paper on its technical advice on MiFIDII/R delegated acts that it must provide to the European Commission by December 2014; and, Discussion Paper on MiFIDII/R draft RTS/ITS which is intended to provide the basis for a further consultation paper to be issued in late 2014/early 2015. The deadline for both Discussion and Consultation Papers is 1 August 2014. AIMA intends to submit responses to both papers.
*(AIMA Weekly News, 27 May 2014)*

### FCA webpages on revisions to MiFID

The UK Financial Conduct Authority has completed and published a series of webpages relating to the implementation of the amended EU Directive and new Regulation on markets in financial instruments (MiFIDII/R). The webpages represent part of the first phase of the FCA's communication with industry participants on the implementation of MiFIDII/R and will be developed by the FCA on an ongoing basis. The webpages, in particular, include the details of an FCA inbox where firms can register to be included within the FCA distribution list for MiFIDII/R implementation updates. This inbox, however, is not intended to be a queries inbox, which will be developed by the FCA in due course.
*(AIMA Weekly News, 13 May 2014)*

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## EMIR

### ESMA issues updated EMIR Q&As

The European Securities and Markets Authority (ESMA) has issued an updated Question & Answers (Q&As) on the implementation of Regulation (EU) No.648/2012 on OTC derivatives, CCPs and trade repositories (EMIR). Areas covered by the updated questions include: the application of EMIR to Alternative Investment Funds (AIFs); intra-group exemptions; the treatment of non-EU non-exempt central banks; segregation and portability; and, CCP organisational requirements.
*(AIMA Weekly News, 27 May 2014)*

### Recognition of third-country CCPs under EMIR

Under the European Capital Requirements Regulation (CRR), exposures to Qualifying Central Counterparties (QCCPs) attract a lower capital charge than exposures to CCPs that do not have QCCP status. While many third-country CCPs obtained QCCP status under a transitional provision in the CRR, that transitional period was due to expire on 15 June 2014. Thereafter, in order to achieve QCCP status, third-country CCPs must register with the European Securities and Markets Authority (ESMA) according to the approach set out in the European Market Infrastructure Regulation (EMIR), which requires the European Commission to have adopted a positive equivalence determination in respect of the clearing rules of the CCP's home jurisdiction. At this stage the European Commission has not yet adopted any such equivalence determinations, meaning that no third-country CCPs can successfully register under EMIR or achieve QCCP status. On 6 May 2014, Commodity Futures Trading Commission (CFTC) Commissioner Scott D. O'Malia sent a letter to European Commission (EC) Commissioner Michel Barnier, expressing concern about the "prohibitive cost" for EU banks to clear through third-country CCPs not recognised as QCCPs. Commissioner O'Malia encourages the EC to adopt a determination of equivalence in respect of the US regime for US CCPs prior to 15 June 2014, allowing ESMA to recognise those CCPs. Alternatively, the EC may extend the transitional period for QCCP status until 16 December 2014, although it has not expressed any intention to do so at this stage.
*(AIMA Weekly News, 13 May 2014)*

### Frontloading under EMIR

Members will note that the recent authorisations of several central counterparties (CCPs) by European Securities and Markets Authority (ESMA) marks the commencement of the so-called 'front loading period' under the European Market Infrastructure Regulation (EMIR). Any trade entered into or novated within the front loading period, that is of a class which is also subject to the mandatory clearing obligation, could be required to be cleared, subject to certain conditions relating to the maturity of such OTC derivatives contract. In effect, this means the mandatory clearing obligation could have retrospective effect. However, in a letter to the European Commission dated 8 May 2014, ESMA announced a proposal to negate the effect of the frontloading period. ESMA's proposal effectively moves the commencement date of the front-loading period from the date on which a national competent notifies ESMA of the classes of OTC derivatives the relevant CCP has been authorised to clear to the date on which the regulatory technical standards mandating the clearing of certain OTC derivatives come into effect.
*(AIMA Weekly News, 13 May 2014)*

### Definition of 'derivative'

The European Commission responded to the European Securities and Markets Authority's

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(ESMA) letter of 14 February 2014 that requested clarity in relation to the definition of 'derivative' for the purposes of the European Market Infrastructure Regulation (EMIR). Members will note the lack of clarity with respect to the application of EMIR in relation to FX forwards and physically settled commodity forwards stems from the fact that the definition of 'derivative' or 'derivative contract' under EMIR refers to the list of financial instruments contained within Section C of Annex I of MiFID. As such, the different transpositions of MiFID across each EU Member State, specifically the different forms of financial instruments considered to be derivatives by each EU Member State, have prevented the convergent application of EMIR. The European Commission has agreed with ESMA that further work needs to be done and has undertaken that this further assessment will be done urgently. It has also asked ESMA to provide it with further information, such as how each EU member state has transposed MiFID in relation to the distinction between an FX spot and an FX forward.
*(AIMA Weekly News, 25 March 2014)*

## Contracts having a 'direct, substantial and foreseeable effect' in the EU

The Commission Delegated Regulation (EU) No 285/2014 of 13 February 2014 (Regulation) with regard to the meaning of "direct, substantial and foreseeable effect of contracts within the EU and to prevent the evasion of rules and obligations" under the European Market Infrastructure Regulation (EMIR), has been published in the Official Journal of the European Union. The Regulation has relevance with respect to the mandatory clearing obligation and the risk mitigation obligations for non-cleared trades. The Regulation entered into force on 10 April 2014, but its provisions will not start to apply until 10 October 2014. For member information, an OTC derivative transaction will have "direct, substantial and foreseeable effect" only if: (i) at least one of the third-country entities (TCEs) benefits from a guarantee from a financial counterparty established in the EU in respect of its OTC derivatives transactions; or (ii) both of the TCEs enter into the relevant transaction through their branches in the EU.
*(AIMA Weekly News, 25 March 2014)*

# FTT

## Update on the FTT

Ahead of an all-Member State Council Working Group meeting at the end of May 2014, the Greek Presidency circulated papers on options for phased, progressive implementation of an FTT (commencing 1 January 2016) and on derivatives that could be in scope. The options proposed are:

1. Implementation by two separate pieces of legislation, one covering shares and an initial set of derivatives with expanded scope, to include instruments such as bonds, other derivatives and structured products, at a later date.
2. A single FTT legislation, setting a January 2016 deadline for shares and some derivatives and, subject to a review and at a later, unspecified date, to bring other instruments within scope.
3. All financial instruments to be in scope from the outset, with a January 2016 start date for shares and some derivatives and a later start date or an initial zero-rate tax for other instruments.

A separate paper puts forward options for classifying derivatives, to decide which should be included in a first phase tax, namely:

- Selecting derivatives based on underlying –

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e.g., those based on securities, currencies, interest rates, financial indices and commodities; or

- Determining inclusion at the first phase according to type – e.g., options, forwards, futures, contracts for difference and swaps.

That paper also covers methods of taxing derivatives, with reference to previous discussions on whether the Commission's proposal to define uniformly the notional amount as the taxable base for all categories of derivatives could lead to unequal treatment.
*(AIMA Weekly News, 27 May 2014)*

## European Court rejects FTT challenge

The Court of Justice of the EU has ruled that the UK government's bid to set aside the Council of Ministers' January 2013 decision authorising 11 Member States to proceed with a Financial Transaction Tax (FTT) under the enhanced co-operation procedure (ECP) cannot succeed. The Court's decision was largely expected and is consistent with case law.

The Court's reasoning is that the permission to proceed under ECP was properly granted by the Council and cannot be invalidated even if the ECP Member States appear to be considering a proposal that exceeds what is possible under the ECP. The appropriate time for the UK government to bring its challenge would be when the ECP Member States finalise a Directive. The Court expressed no view on whether the UK government's arguments might then prevail. The present court action can be seen as tactical and forestalls any later argument that the UK government should have initiated proceedings at this stage.

There was further discussion on the proposed FTT at the ECOFIN meeting on 6 May. Little progress seems to have been made, though there may be support for an FTT that applies initially to equities and some derivatives, with the possibility of it being extended in due course, and Member States would be free to implement a broader scope tax. The meeting drew negative comments from non-participants (especially the UK, Sweden, Denmark and the Netherlands) about the process of enhanced cooperation and the lack of the transparency of the discussions on FTT. The UK reiterated its opposition to aspects of the proposed FTT that it considers do not conform to the ECP and stated that it would return to the CJEU if it considered that any final FTT did not comply. The Commission remains confident that an FTT will be effective from **1 January 2016**.
*(AIMA Weekly News, 6 May 2014)*

# Other updates (EMEA)

## AIMA briefing note - Dealing commission

The UK Financial Conduct Authority's (FCA) revised rules on the use of dealing commission came into effect on 2 June 2014. All AIMA member firms should re-examine their internal systems, controls, policies and procedures as a matter of priority to ensure that they are consistent with the new rules. To assist members in this process, AIMA has produced a briefing note setting out some particular issues which member firms should consider.
*(AIMA Weekly News, 20 May 2014)*

The UK Financial Conduct Authority (FCA) on 8 May 2014 published a Policy Statement which finalised the rules on the use of dealing commission which were set out in the FCA consultation paper on the use of dealing commission (see also AIMA's summary of the consultation paper). The key changes relate to: (i) the rules regarding the use of client dealing commission to pay for a good or service that is

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directly related to executing trades or amounts to the provision of substantive research; (ii) preventing the use of dealing commission to pay for corporate access; and (iii) new guidance (COBS 11.6.8A G) on valuing unpriced goods and services and making mixed-use assessments where an investment manager receives bundled services containing both elements that can be paid for with dealing commissions, and others which cannot. The policy statement sets out rules which are broadly the same as the proposals set out in the consultation paper, for example, the definition of corporate access has remained the same. However, some changes have been made. For example, the proposal suggested removing the requirement that an investment manager could use dealing commission to purchase goods or services if it has "reasonable grounds to be satisfied" that the good or service would reasonably assist the investment manager in the provision of its services to its customers. This has been reinstated in the policy statement with regard to research, although not with respect to executing trades. The new rules come into effect on 2 June 2014.
*(AIMA Weekly News, 13 May 2014)*

### AIMA note - FCA Remuneration Codes

AIMA has published a note which provides a high-level list of issues and a list of documents that asset managers should bear in mind when considering how to comply with the Financial Conduct Authority (FCA) Remuneration Codes (SYSC 19). Following the transposition of the Alternative Investment Fund Managers Directive (AIFMD) and the fourth Capital Requirements Directive (CRD IV) in the UK, there are now three remuneration codes (collectively referred to as the Codes) set out in the FCA Handbook. Each of the Codes sets out detailed requirements regarding a firm's remuneration policies and practices which must be applied in relation to specific categories of identified staff. Asset management firms will need to consider if they fall directly within the scope of any of the Codes and, if not, whether they are indirectly subject to any of the Codes by virtue of a delegation arrangement between that firm and another firm that is itself within the scope of one of the Codes. Once a firm has determined the rules that apply to them, they will need to consider whether and to what extent any of the provisions can be disapplied.
*(AIMA Weekly News, 15 April 2014)*

### UK updated guidance

HMRC's update guidance (published as a standalone update) clarifies that UK investment managers which are foreign financial institutions (FFIs) solely because of their investment management activities (and who do not, for example, also act as a custodial institution) will be treated as Certified Deemed Compliant FFIs (and therefore do not need to register with the IRS). HMRC is publishing significant changes to the UK guidance as standalone updates. The guidance will be consolidated to include the updates, with other necessary changes, at six-monthly intervals; the next updated guidance is due in August 2014. These documents now appear on HMRC's site and supersede previous versions:

- Guidance published on 28 February 2014 – highlighted to show amendments or additions, e.g. paragraph 2.28(a) on Investment Advisers and Managers.
- Immediate updates to guidance - to be included on review.

*(AIMA Weekly News, 29 April 2014)*

UK Crown Dependencies revised draft guidance: Revised draft guidance has been issued, with a marked revision version posted on the Guernsey government website. The guidance is not final (it has not been possible to fully consider all

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of the matters raised within the timeframe for publication), but it covers the most critical aspects raised in consultation. A further version, including further Guernsey-specific items, will be issued in due course. For a longer summary, click here.
*(AIMA Weekly News, 8 April 2014)*

### AIMA Position Paper - EU proposal on SFT transparency

AIMA has published a Position Paper setting out our thoughts and comments on the European Commission's Proposal for a Regulation on reporting and transparency of securities financing transactions (SFTs). The Commission's Proposal was released on 29 January 2014 and provides for a potential harmonised regime for the reporting of SFTs, such as repo, stock lending and other economically equivalent transactions, to registered trade repositories (TRs). It is intended that this will assist regulators in monitoring the build-up of systemic risk in the shadow-banking sector. The Proposal also contains additional rules for periodic and ex ante disclosure to investors by alternative investment fund managers, UCITS managers and UCITS funds of certain information on their use of SFTs, as well as rehypothecation. Rules for providing risk disclosure and gaining investor consent for the rehypothecation of collateral assets by a receiving entity are also provided.

The AIMA Position Paper supports the increased transparency for SFTs, but expresses reservations that the pitfalls of TR reporting under EMIR are not repeated. We also argue against disproportionate disclosure requirements for investment funds. We are supportive of the rehypothecation provisions, but nonetheless suggest amendment of the definition of rehypothecation as rehypothecation can only occur to collateral posted by way of a security interest.
*(AIMA Weekly News, 3 June 2014)*

### MAR and MADII published in the Official Journal

On 12 June 2014, Regulation (EU) No 596/2014 on market abuse (MAR) and Directive 2014/57/EU on criminal sanctions for market abuse (MADII) were published in the Official Journal of the European Union. The texts were both adopted earlier in the year, however, publication was delayed whilst the amended Directive and new Regulation on markets in financial instruments was finalised and published. The texts of MAR and MADII will enter into force on 2 July, and enter into effect on 3 July 2016.
*(AIMA Weekly News, 17 June 2014)*

### Commission requests technical advice on MAR implementing acts

The European Commission has issued a request to the European Securities and Markets Authority (ESMA) for technical advice on implementing acts concerning the EU Regulation on insider dealing and market manipulation (MAR). The implementing acts will specify, in particular, the procedures to enable the reporting to competent authorities of actual or potential infringements of MAR, measures for the protection of persons working under a contract of employment and measures for the protection of personal data. The deadline set for ESMA to deliver its technical advice is eight months after the entry into force of MAR, which took place on 12 June 2014 (see above). ESMA is likely to issue a consultation paper in order to help formulate its technical advice, to which AIMA intends to respond. Once submitted to the Commission, the deadline for finalisation and publication of relevant implementing acts will be 23 months following entry into force of MAR, with MAR and the relevant implementing acts entering into effect a month later.
*(AIMA Weekly News, 3 June 2014)*

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## Corporate governance framework

The European Commission has published a proposal to amend the EU Shareholders' Rights Directive (the Proposal). The Proposal would extend certain requirements regarding transparency and compliance requirements to both European and non-European asset managers. These requirements will apply in addition to any existing requirements imposed on asset managers by other regulation, such as the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive. AIMA has produced a summary of the Proposal for members and will be establishing a working group to cover the issues raised by the Proposal.

*(AIMA Weekly News, 3 June 2014)*

## AIMA note - Partnership Tax Rules - UK Finance Bill 2014 provisions

In the 2013 Budget, the Government announced changes to be introduced into the taxation of partnerships and limited liability partnerships (LLPs) in the UK. These have been included in the Finance Bill 2014 and have effect from 6 April 2014. The measures include the possible treatment of members of limited liability partnerships as employees for tax purposes, rules to prevent partnership profits from being shifted by individual members to corporate members and a statutory arrangement to assist partnerships that manage one or more alternative investment funds (an AIFM) or act as a delegate of an AIFM, and operate remuneration deferral regimes that are consistent with that required by the AIFM Directive. AIMA has prepared a note for members on these provisions.

*(AIMA Weekly News, 8 April 2014)*

## Omnibus II published in the Official Journal

On 22 May 2014, Directive 2014/51/EU amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA) (Omnibus II) has been published in the Official Journal of the European Union. Omnibus II introduces amendments to various EU secondary legislative instruments in order to enable the implementation of Directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) and provides specific tasks for EIOPA and ESMA, in particular clarifying the role of EIOPA in ensuring harmonised technical approaches on the calculation of technical provisions and capital requirements.

The new rules also amend Solvency II itself, as well as the Prospectus Directive, to take account of the new EU financial services supervisory system following the creation of EIOPA and ESMA in 2010. Overall, the amendments can be broadly categorised as: the definition of the appropriate scope of technical standards; enabling EIOPA and ESMA to settle disagreements; enabling the existing rules to operate in the context of the new supervisory system; and, transitional requirements and other amendments to Solvency II. Member States must transpose Omnibus II by 31 March 2015, with application of the rules from 1 January 2016.

*(AIMA Weekly News, 27 May 2014)*

## Non-residents' gains on Greek bonds sold during 2012/13

The Greek Ministry of Finance issued a Circular (POL 1117/2014) concerning capital gains tax obligations arising on gains derived from listed and unlisted Greek state and corporate bonds earned by non-resident corporations and individuals that do not have a permanent establishment in Greece. The Circular relates

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only to gains realised on securities between 29 February 2012 (the date on which law was introduced) and 31 December 2013 (gains realised on or after 1 January 2014 fall under a new tax regime). However, a press release issued on 15 May 2014 has (to an extent which is not clear) revoked the Circular. Please click here for a more detailed note.
*(AIMA Weekly News, 20 May 2014)*

## AIMA response to fourth QCP

AIMA has responded to the Financial Conduct Authority's (FCA) fourth Quarterly Consultation Paper (QCP). In the response, AIMA commented on several issues arising from the transposition of the Alternative Investment Fund Managers Directive (AIFMD), which related to reporting, the requirements for Article 36 custodians, the remuneration requirements and the FCA's proposed notification forms. AIMA also commented on two issues not directly covered by the QCP: (i) the disclosure of prime brokerage contracts to depositaries and Article 36 custodians; and (ii) the application of Level 2 requirements to Article 36 custodians.
*(AIMA Weekly News, 13 May 2014)*

## AIMA response to FX consultation

AIMA submitted its response in relation to the European Commission's Consultation Document: FX Financial Instruments. In its response, AIMA emphasises the need for a clear definition of FX spot which could be applied across all EU Member States and avoid the current inconsistency as to which FX financial instruments fall within the definition of a 'derivative' under Regulation No 648/2012 (EMIR) (which incorporates by reference the definition of 'financial instrument' in Directive 2004/39/EC (MiFID)). On this basis, AIMA suggests a definition of FX spot contract which includes any instruments with a settlement period of T+7 or less.
*(AIMA Weekly News, 13 May 2014)*

## Taxation of savings

The European Commission's Expert Group on Taxation of Savings met on 28 April to review the Amended Directive 2014/48/EU and to discuss the Organisation for Economic Co-operation and Development's (OECD) work on automatic exchange of information.

The Amended Directive is intended to be implemented by EU Member States by 1 January 2016 (although it would not take effect until 1 January 2017 at the earliest) but uncertainty remains as to whether that will happen if the OECD Common Reporting Standard is implemented before then. The group's mandate and participation will, however, be broadening, probably to include data protection and legal issues. The Commission is seeking data to help with the review and has also:

- Put out a call for participation in an Expert Group on "removing tax problems facing individuals who are active across borders within the EU".
- Launched two public consultations, both with a response date of 3 July:
    - On tax problems faced by citizens when active across borders within the EU.
    - On cross-border inheritance tax problems within the EU.

AIMA is not planning to respond to these consultations but will keep members advised of other significant developments.
*(AIMA Weekly News, 6 May 2014)*

## Statutory audit legislation

On 27 May 2014, Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, and Regulation (EU) No 537/2014 of the European Parliament and of the

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Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC were published in the Official Journal. The Directive and the Regulation will apply to 'public-interest entities', which will include listed entities (including listed alternative investment funds (AIFs), listed alternative investment fund managers (AIFMs) and listed undertakings for collective investment in transferrable securities (UCITS)), undertakings the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account and entities designated by individual Member States as public-interest entities. Both the Directive and the Regulation will enter into force on 16 June 2014 and shall be applicable as of 17 June 2016.
*(AIMA Weekly News, 10 June 2014)*

### Extension of s363A TIOPA - UCITS and AIFs

As announced in the UK Budget 2014 and now set out in the Finance Bill, the scope of section 363A of the Taxation (International and Other Provisions) Act 2010 has been widened. In addition to UCITS, the 'carve out' provided by s363A will apply, with retrospective effect from 5 December 2013, to Alternative Investment Funds (AIFs) authorised or registered in a foreign country or territory or those not authorised or registered but having their registered office in a foreign country or territory (unless the UCITS or AIF is an excluded entity). Following consultation over the summer, s363A will be amended accordingly. The current provisions treat offshore funds that are UCITS as not being resident in the UK if they are resident in another Member State for the purposes of any tax imposed under the law of that state on income. The amendment means that any AIF or UCITS (within the meaning of the AIFMD or the UCITS Directives) established in a country outside the UK and which is a body corporate cannot become UK tax resident by reason of being managed and controlled in the UK. That does not mean that it is now possible, sensible or desirable to place central management and control of foreign funds in the UK, as there could still be other consequences (not least, VAT). Rather, the extended s.363A should be seen as a 'safety net', providing comfort that the fund will not become UK tax resident.
*(AIMA Weekly News, 6 May 2014)*

### South Africa - Draft hedge fund regulations

The National Treasury and Financial Services Board released Draft Regulations for hedge funds and a related Explanatory Memorandum. The regulations are to be finalised by Q2/3 2014.
*(AIMA Weekly News, 22 April 2014)*

### AIMA response - Beneficial ownership

On 17 June 2014, AIMA submitted a response to the Department for Business, Innovation and Skills (BIS) discussion paper titled Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business. In the Government response, the BIS suggests that Limited Liability Partnerships (LLPs) should be included "alongside companies" and "for consistency" in relation to the proposal to prohibit corporate directors of companies. AIMA's response argues that this is inconsistent with the proposals for prohibiting corporate directors of companies, as corporate directors are not the same as corporate members and should not be equated as such. Since members of LLPs are "owners" as well as "managers", AIMA argues that the proposal represents a significant change in approach that would negatively affect a significant number of existing businesses and discourage new investment into the UK.
*(AIMA Weekly News, 17 June 2014)*

### BRRD published in the Official Journal

On 12 June 2014, Directive 2014/59/EU

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establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD) was published in the Official Journal of the European Union. The Directive provides national authorities with tools to pre-empt bank crises by introducing instruments at: i) preparatory and preventative; ii) early intervention and; iii) resolution stages of bank failure, with the objectives of minimising systemic risk and avoiding extraordinary public funding. It includes provisions for the use of a bail-in tool through which shareholders and creditors of an institution under resolution may have their interests written down or converted. The BRRD will enter into force on 2 July and enter into effect on 1 January 2015.
*(AIMA Weekly News, 17 June 2014)*

### EP adopts agreed text for CSDR

On 15 April 2014, the European Parliament in its Plenary format approved the proposed EU Regulation on improving securities settlement in the EU and on CSDs and amending Directive 98/26/EC on settlement finality (CSDR). The Regulation is expected to be published in the Official Journal of the European Union and enter into force during Q3 2014. The Level 2 process providing the technical details of the CSDR has also commenced, with the publication of an ESMA discussion paper on 20 March 2014.
*(AIMA Weekly News, 22 April 2014)*

### EU corporate governance framework

The European Commission has published a package on corporate governance issues including a proposal to amend the EU Shareholders' Rights Directive (SRD), a Recommendation on the quality of corporate governance reporting (which applies to EU undertakings listed on an EU exchange) and a proposal for a Directive on single-member private limited liability companies. The SRD proposal would, amongst other things, require asset managers (which includes alternative investment fund managers (AIFMs), UCITS management companies and MiFID investment firms) and institutional investors (i.e. life assurance undertaking as defined in the Life Assurance Directive and occupational retirement undertaking as defined in the IORP Directive) to develop a shareholder engagement policy which includes policies to manage actual or potential conflicts of interests. For more information, click here.
*(AIMA Weekly News, 15 April 2014)*

### Investment firms under CRD IV

AIMA has published an updated version of a note regarding the categorisation of investment firms under the FCA's implementation of the CRD IV legislation, which sets out how to determine whether a firm will be categorised as an exempt CAD firm, a BIPRU firm or an IFPRU firm. The annex to the note then provides details on which provisions of the CRD IV legislation apply to each type of firm under the FCA's implementation of the CRD IV legislation, which came into force on 1 January 2014.
*(AIMA Weekly News, 8 April 2014)*

### New 'white list' and Investment Manager regulations in UK

New regulations published on 18/19 March 2014, with an explanatory memorandum, are available here and new IME regulations are here. The regulations come into effect on 8 April 2014 and expand and consolidate various lists. The IME regulations identify activities that may qualify for the IME, so that for collective investment vehicles (subject to conditions in the relevant regulations) certain transactions are not treated as trading transactions for UK tax purposes. The addition of "any transaction in rights under a life insurance policy" and the amended definition of carbon emission trading product may be of particular interest to members.
*(AIMA Weekly News, 1 April 2014)*

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### AIMA summary - EU directive on recovery and resolution of banks

AIMA has published a summary of the final text of the EU Directive establishing a framework for the recovery and resolution of credit institutions and investment firms, which was agreed in December 2013. The Directive seeks to meet the EU's G20 commitments to ensure systemically important banking institutions can fail in an orderly manner and that the moral hazard of taxpayer funded bail-outs of such institutions is avoided. Among other things, the Directive provides national resolution authorities with an alternative to normal insolvency proceedings and contains a host of tools and powers with which to intervene in the activities of a failing/failed banking institution in order to preserve critical functions whilst avoiding contagion of the broader financial system. In particular, it includes a bail-in tool through which the claims of shareholders and unsecured creditors can be written-down, diluted and/or converted to equity. The text of the Directive is currently subject to legal review, after which it will be published in the Official Journal of the EU. Member States will be required to transpose the Directive into national law by 31 December 2014, with the provisions entering into effect on 1 January 2015, with the exception of the bail-in tool which will apply from 1 January 2016.
*(AIMA Weekly News, 11 March 2014)*

### CRD 4 – RTS on Identified Staff published in the Official Journal

The Commission Delegated Regulation (EU) No 604/2014 supplementing the Capital Requirements Directive (CRD 4) with regard to regulatory technical standards (RTS) with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile has been published in the Official Journal of the EU. The Delegated Regulation will come into force on 26 June 2014.
*(AIMA Weekly News, 10 June 2014)*

### VAT in EU

The European Court of Justice has followed the opinion given by the Advocate-General and held that a defined contribution pension scheme (unlike a defined benefits pension scheme) is capable of being a "special investment fund" for the purposes of the VAT Directive – ATP PensionService (C-464/12). Investment management and administration services provided to a special investment fund are exempt from VAT. Pension schemes that have been charged VAT in respect of a managed account are likely to ask for repayment of the VAT from the investment manager as wrongly charged. Further, the ability of investment managers to recover VAT charged by their suppliers (input VAT) may be restricted where they provide managed accounts to such pension funds.
*(AIMA Weekly News, 18 March 2014)*

## Americas

**Swaps**

### AIMA/MFA joint response to CFTC review of swap data reporting requirements

On 27 May 2014, AIMA and the MFA submitted a Joint Response to the Commodity Futures Trading Commission (CFTC) Consultation on the Review of Swap Data Recordkeeping and Reporting Requirements. The CFTC Review was intended to enable public comments to be submitted in relation to the CFTC recordkeeping and reporting requirements under Part 45 of Title 17 of the US Code of Federal Regulations. The Response targets certain questions posed by the Consultation and recommends, inter alia: that confirmation data reported to swap data repositories (SDRs) include standardised data

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fields; only derivatives clearing organizations (DCOs) be required to report valuation data for cleared swaps to an SDR; a reasonable phase in period be provided by the CFTC to enable compliance post status change by any firm assuming reporting counterparty obligations; that the CFTC monitor the development of bespoke, exotic or complex swaps and work alongside industry bodies to ensure reporting data fields are suitable; that packaged transaction components be reported individually, but public data be limited to the actual economic transactions; caution as to the importing of the EU collateral information reporting requirement; and, that alpha swaps need not be reported when executed with the intention to be cleared.
*(AIMA Weekly News, 3 June 2014)*

### SEC proposed rulemaking on reporting requirements for SBSDs and MBSPs

On 16 April 2014, the Securities and Exchange Commission (SEC) voted to issue proposed rules pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, for: (i) the recordkeeping, reporting and notification requirements of security based swaps (SBSs) by Security Based Swap Dealers (SBSDs) and Major Security Based Swap Participants (MSBSPs); (ii) securities count requirements applicable to certain SBSDs; (iii) additional and amended recordkeeping, notification and reporting requirements applicable to broker-dealers; and (iv) an additional capital charge provision that would be added to the proposed capital rule for certain SBSDs. The deadline for comments is 60 days after publication in the Federal Register. AIMA intends to submit a formal response.
*(AIMA Weekly News, 22 April 2014)*

### AIMA letter - proposed 100% capital charge

AIMA has submitted a letter to the SEC providing further comments on its Proposed Rulemaking on Capital, Margin and Segregation Requirements for Security Based Swap Dealers (SBSDs) and Major Security Based Swap Participants (MSBSPs). The AIMA letter follows up on work undertaken by the Managed Funds Association (MFA) and AIMA and expresses support for a letter submitted to the SEC by the MFA on 24 February 2014 which articulates concerns about the potential imposition of a 100% capital charge on SBSDs for initial margin held within a tri-party segregated account. In particular, AIMA supports the arguments that: the structural benefits of tri-party segregation, including mitigation of credit risk, should be considered; the proposed capital charge would be inconsistent with the objective of customer protection; SBSDs do retain legal control over posted collateral and access upon counterparty default; and no other regulator, globally, has imposed such a charge. We also support the MFA letter in relation to its position on segregation documentation.
*(AIMA Weekly News, 18 March 2014)*

## FATCA (Americas)

### IRS publishes first FFI list

The Internal Revenue Service (IRS) has published the initial Foreign Financial Institution (FFI) list. The list contains the names of some 77,000 financial institutions and other entities that have completed Foreign Account Tax Compliance Act (FATCA) registration with the IRS and obtained a global intermediary identification number. The FFI List can be searched and downloaded. From 1 July, the IRS will publish a cumulative, updated FFI list each month.
*(AIMA Weekly News, 3 June 2014)*

### Further guidance on implementation and related withholding provisions

In its Notice 2014-33, the Internal Revenue

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Service (IRS) has said that it will treat 2014 and 2015 as a transition period for purposes of IRS enforcement and administration of FATCA, to "facilitate an orderly transition for withholding agent and foreign financial institution (FFI) compliance with FATCA's requirements" and to respond to comments received on certain aspects of the regulations. During that period, the IRS will take into account the good faith efforts made by FFIs, non-financial foreign entities and withholding agents to comply with FATCA to modify account opening procedures, apply standards of knowledge under FATCA and identify and register each member of an expanded affiliated group. For more information on Notice 2014-33 and its provisions, click here.
*(AIMA Weekly News, 6 May 2014)*

### IGAs and "agreements in substance"

The revised UK FATCA Regulations (SI 2014/1506) have now been published and come into force on 30 June 2014, replacing the previous regulations in their entirety. The Regulations reflect delays in the implementation of FATCA and incorporate some more favourable provisions which the US has introduced into recent intergovernmental agreements (IGAs). A link to the Regulations will be added to the HMRC FATCA Index Page.

The Swiss implementing legislation has been approved by Parliament and is effective on 30 June 2014. The Federal Council has approved a draft mandate for negotiations with the US on switching to a Model 1 IGA (from the current Model 2) but it is unclear whether/when such negotiations will occur. A press release is available here.
*(AIMA Weekly News, 17 June 2014)*

Further jurisdictions concluding IGAs or reaching agreement in substance with the US to implement FATCA are Liechtenstein (Model 1 IGA reciprocal) and United Arab Emirates (in substance, Model 1). The complete US Treasury list is here.
*(AIMA Weekly News, 27 May 2014)*

Jurisdictions continue to enter into IGAs, or reach agreement in principle, with the US to implement FATCA. The noteworthy ones announced are Gibraltar (Model 1 IGA) and Hong Kong (in principle, Model 2). The complete US Treasury list is here.
*(AIMA Weekly News, 13 May 2014)*

- Austria has signed a Model 2 and Jamaica a Model 1 Intergovernmental Agreement (IGA).
- Israel, Bulgaria, Colombia and Curaçao have reached agreement "in substance" with the US, on Model 1 IGAs.
- Singapore's Ministry of Finance has announced that a Model 1 IGA has been initialled.
- The US-Mexico IGA has been revised to reflect recent changes to Model 1 IGAs and extends exemptions granted to other countries in other recent IGAs to Mexico.

There have now been some 60 signed IGAs or 29 agreements in substance – the complete US Treasury list is here.
*(AIMA Weekly News, 6 May 2014)*

- Honduras signed a Model 1A Intergovernmental Agreement (IGA) on 31 March - the text is available here.
- Australia signed a Model 1A IGA on 28 April, with an accompanying Memorandum of Understanding – both accessible here. A public consultation will now commence on draft implementing legislation.

Others who have reached agreement in substance are:

- Estonia (deemed in effect on 3 April).
- India (11 April) – India has announced it is a

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Model 1 IGA. The Securities and Exchange Board of India (SEBI) is expected to issue appropriate guidelines in 2014-2015 to market intermediaries on due diligence and reporting requirements.
- Slovak Republic (11 April).
- Bahamas (17 April).
- Russia - negotiations with the U.S. over an IGA have apparently stalled, given escalated tensions over Crimea and Ukraine. The Russian Finance Minister met U.S. Treasury Secretary Jack Lew in Washington to discuss a number of financial matters and indicated that the most pressing discussion points concerned the prospects of signing an IGA as soon as possible.

*(AIMA Weekly News, 29 April 2014)*

Luxembourg has signed a Model 1 IGA and MoU with the U.S. The IGA appears on the Luxembourg Ministry of Finance site here and the MoU here. An ALFI press release reports that the Luxembourg Tax Authority has set up two implementation working groups of public and private parties, one to focus on legal implementation and the other to concentrate on technical questions regarding electronic communication of data and information between Luxembourg FIs and the government.
*(AIMA Weekly News, 1 April 2014)*

The British Virgin Islands (BVI) and the U.S. have initialled an Intergovernmental Agreement (IGA). Once the IGA is signed, the BVI will join the Cayman Islands, Ireland, Luxembourg and Mauritius (among other fund jurisdictions) in providing tax information under FATCA.
*(AIMA Weekly News, 18 March 2014)*

## IRS revised FAQs, including on 'disregarded entities'

On 1 May 2014, the IRS added new questions and answers to its FATCA FAQs:

- Two of the FAQs address who may act as Responsible Officer for an FFI and the scope of certification required by such Responsible Officer in connection with the FFI's registration with the IRS, in each case depending on the status of the particular FFI under FATCA. another FAQ discusses the impact of completing Part IV of the Registration, which also differs according to the status of the FFI being registered.
- Other FAQs deal with registering disregarded entities and branches located in Model 1 IGA countries and those that are located in non-IGA countries or in Model 2 IGA countries.
- Another FAQ deals with a change of approach on registration of 'disregarded entities' (DEs): a DE in a Model 1 IGA jurisdiction whose laws disregard US tax classification elections ("check-the-box elections") should instead register with the IRS and not be listed as a branch of its sole owner.

*(AIMA Weekly News, 6 May 2014)*

## Deferral of start date requested

As the FATCA implementation date of 1 July 2014 approaches, Bank of New York Mellon, Northern Trust Corporation and State Street Bank and Trust Company have jointly requested the Internal Revenue Service and U.S. Treasury to apply a further deferral until 1 January 2015. The banks state that, despite their efforts and those of their advisers and software providers, "it is simply not possible to implement FATCA in an effective manner by 1 July, 2014". The Securities Industry and Financial Markets Association (SIFMA) has also written to confirm its belief that deferral is necessary, but has suggested in the alternative a transitional relief which would not apply FATCA before 1 January 2015 to accounts held by or payments made to foreign entities (so individuals would remain within scope from 1 July 2014).
*(AIMA Weekly News, 29 April 2014)*

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## Other updates (Americas)

### Cayman Islands - New Director registration and licensing requirements

Following a consultation period, the Cayman Islands government has moved ahead with the introduction of the Directors Registration and Licensing Law, 2014 (the 'Law') (see The Directors Registration and Licensing Regulations, 2014 - Supplement No. 2, The Directors Registration and Licensing Law, 2014 - Supplement No. 6 and The Directors Registration and Licensing Law, 2014 - Frequently Asked Questions). AIMA has published a note regarding the key requirements of the Law which is available here. The Law introduces a requirement to register with or be licensed by the Cayman Islands Monetary Authority (CIMA), which applies to any natural person who is a director of: (i) a CIMA regulated mutual fund; or (ii) an entity registered with CIMA as an "excluded person" under certain heads of the Securities Investment Business Law (2011 Revision). The Law also brings in a licensing regime for corporate directors of covered entities. An existing director of a covered entity that is a natural person has only a three-month period from the date that the Law comes into force to comply with the Law's registration or licensing requirements (as applicable). An existing corporate director of a covered entity has a six-month period from the date that the Law comes into force to comply with the Law's licensing requirements. As a result of these deadlines prompt action is required.

*(AIMA Weekly News, 10 June 2014)*

### New CFTC Chairman and Commissioners

On 3 June 2014, the United States Senate confirmed the appointment of Timothy Massad, Christopher Giancarlo and Sharon Bowen as Commissioners of the Commodity Futures Trading Commission (CFTC). On 5 June 2014, Timothy Massad, who previously served as the Assistant Secretary for Financial Stability at the U.S. Department of the Treasury, was sworn in as Chairman of the CFTC and assumed his responsibilities immediately. These appointments may have the effect of helping to clear the backlog of matters that have been left undecided in the absence of a Chairman and a full commission.

*(AIMA Weekly News, 10 June 2014)*

### Expedited registration no-action relief

The Commodity Futures Trading Commission's (CFTC) Division of Swap Dealer and Intermediary Oversight published a letter setting out a procedure by which commodity pool operators (CPOs) who delegate certain activities to a registered CPO can request registration no-action relief on an expedited basis and the conditions which must be met for such requests to be granted. For corporate fund directors who are natural persons and who are not affiliated with the designated CPO or any of its affiliates, the requirement to retain joint and several liability and the requirement to for one CPO to control, be controlled by, or be under common control with the other CPO will not apply.

*(AIMA Weekly News, 13 May 2014)*

### AIMA response - NFA request for comments

AIMA submitted a response to the National Futures Association's (NFA) Notice to Members (the Notice) requesting comments on a variety of commodity pool operator (CPO) and commodity trading advisor (CTA) capital requirement and customer protection measures. AIMA commented that capital requirements and the other types of provisions contemplated in the Notice are not likely to enhance existing customer protection measures already applicable to CPOs and/or CTAs. AIMA stated that capital requirements should not be imposed on CPOs/CTAs and the focus should be on making sure that CPOs/CTAs

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are prevented from misappropriating customer funds. If adequate measures are in place to address this, then the amount of capital retained by CPOs/CTAs should be irrelevant and additional and potentially conflicting requirements should not be adopted. Amongst other things, AIMA also commented that: (i) the concerns underlying the NFA's questions regarding independent third-party review and authorisation for the disbursement of pool assets are sufficiently met by existing requirements and that additional requirements for CPOs/CTAs are not necessary or appropriate; (ii) verification of account statements by an independent third-party is not necessary from an investor protection point of view; and (iii) any further requirements in respect of performance verification imposed by the NFA would be an additional cost with low incremental benefit based on the cases cited by the NFA.
*(AIMA Weekly News, 15 April 2014)*

### US Treasury large position reporting rules

On 10 June 2014, the U.S. Department of the Treasury issued a notice of proposed rulemaking regarding its large position reporting rules. The proposed rulemaking is intended to solicit public comment on proposed amendments to the Treasury's rules for reporting large positions in certain Treasury securities. The proposed amendments are designed to improve the information available to the Treasury and simplify the reporting process for many entities subject to the large position reporting rules. The deadline for comments is 9 August 2014.
*(AIMA Weekly News, 17 June 2014)*

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


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# 'The long and the short of it' — AIMA's new blog

On 4 June 2014, AIMA CEO Jack Inglis (pictured) announced the launch of AIMA's blog, which we intend to update regularly. The first blog post, by Jack, was headed "100 days on" and reflected on his first four months in the job. The full text follows.

## '100 days on'

It is now over 100 days since I took on the CEO role at AIMA and thus high time I delivered a report! In short it has been a rewarding and productive period which has helped shape my ideas for AIMA's future strategy and our ongoing value to members. I have been determined to meet with as many of our members, staff and volunteer committees as possible. In addition I have sought to meet with policymakers and regulators in every region. To this end, in addition to Europe, I have visited New York and Washington DC (twice), Hong Kong, Shanghai, Beijing, Singapore, Tokyo, Toronto, Montreal and Grand Cayman, and later this month I will be returning to China.

I am very grateful to all the members I've met and for all the constructive comments and ideas they have shared about AIMA and the hedge fund industry. The one thing about being new to a role is that nobody is shy about offering opinions! The good news is that AIMA seems to be getting it largely right, although within that there are always things we could be doing better, so I encourage regular feedback from all our members. I am also delighted to have welcomed three new directors to the AIMA Council[1]. I am assisted greatly by the guidance of this group and these new directors from eminent manager firms bring additional strength to our governance.

While AIMA staff and our many member committees and working groups around the world remain busy on multiple fronts, regulatory or otherwise, we have not always done the best job of communicating the positive outcomes arising from these efforts to our broad membership base. What has impressed me most is the calibre and commitment of our committee volunteers who give so much of their time and expertise to our activities. This is the real strength of our organisation and we owe it to them that their work does not go unnoticed. You can expect to see more from us by way of explanation of what we are doing and the benefits it brings.

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1 *http://www.aima.org/en/media/press-releases.cfm/idB278C5FC-2821-4025-AA87A941855C1732*

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My visits to our various National Groups have brought home to me the diversity of our local organisations. Each one is different and has its own particular characteristics, reflecting the differences in content and structure of the local industry. Cayman is obviously a centre of excellence for the offshore service provider community. Our Asia Pacific groups in Hong Kong, Singapore, Japan & Australia all have keen manager membership and China presents an exciting opportunity for the industry. The local industry in Canada is growing and there is clearly a powerful investor presence there. In all these countries, our staff and volunteers continue to cement AIMA's position as a respected voice of the industry and a trusted partner of local policymakers and regulators. A key focus for me is to better harness our local strengths and activities to achieve a more cohesive and consistent service at wider regional and global levels.

The US, as the largest hedge fund community, continues to be our fastest-growing jurisdiction in terms of members and these now make up over 50% of the aggregate AUM of our global membership. Many of our larger US members have physical presences in all three regions so it is particularly important that AIMA can deliver comparable and connected services in these three places. We will continue to boost our presence in the US.

I was pleased to host our annual AIMA Global Policy and Regulatory Forum[2] in New York for the first time. We had a strong turnout of senior regulators from many global agencies and AIMA members as they came together in March for a lively discussion on whether hedge funds could possibly be categorised as shadow banks.
The ongoing review into potential systemic risk within the asset management sector by FSB/IOSCO and the FSOC prompted our academic paper on the importance of capital markets[3] as well as follow up articles written by us in the press (such as these in *EU Reporter*[4], *HFMWeek*[5] and the *HFI Global Review*[6]). There is more to come from us as we conduct research to demonstrate the economic benefits of specific hedge fund strategies in credit and activist equity. This will help educate policymakers as they review further asset management regulation.

I am eager to expand the range of our published research in fostering better understanding for key hedge fund stakeholders, namely investors and regulators. In April, we published 'Apples and Apples: How to better understand hedge fund performance'[7], which has received widespread coverage (e.g. *Hedge Funds Review*[8], *Forbes*[9], AllAboutAlpha.com[10] and *Pensions*

2 *http://www.aima.org/download.cfm/docid/D8BD3C4E-98B9-4EF0-B35481E53F68BB42*

3 *http://www.aima.org/en/education/research-into-capital-markets-and-economic-growth.cfm*

4 *http://www.eureporter.co/economy/2014/03/25/comment-capital-markets-and-the-eus-growth-strategy*

5 *http://www.hfmweek.com/comment/the-long/jack-inglis/comment-jack-inglis*

6 *http://www.hedgefundintelligence.com/IssueArticle/3331517/COMMENT-Hedge-funds-and-the-real-economy.html*

7 *http://www.aima.org/download.cfm/docid/4FD1E0A5-E66F-46A9-956F3A983ECB518F*

8 *http://www.risk.net/hedge-funds-review/opinion/2344558/equity-benchmarks-unsuitable-hedge-universe-measure*

9 *http://www.forbes.com/sites/brianportnoy/2014/05/27/taking-issue-with-a-litany-of-well-worn-claims/*

10 *http://allaboutalpha.com/blog/2014/05/12/why-are-hedge-fund-assets-reaching-all-time-highs-while-they-underperform-the-sp-500/*

continued ▸

& *Investments*[11]). I also remain committed to improving understanding of our industry in the media and to be ready to address misconceptions as they arise. We continue to brief privately as well as write publicly. Early on I gave an interview to *EuroHedge*[12] and we have also written recently in *Financial News*[13] (about systemic risk) and on capital markets (as above). We have now created a new "media coverage" section on the global AIMA website[14].

Specifically on the regulatory and compliance front, AIFMD is well in to the implementation phase and we have recently published updated tools and planners for members to navigate this complex Directive[15]. We have also embarked on a programme to update and augment our full suite of sound practice guides and DDQs. Members will also have noticed that we are holding a series of FATCA webinars to help meet the fast-approaching compliance date. Amongst other priority items are the need still to address the cross-border aspects of derivatives reform to ensure that managers are not put in an impossible compliance position when the European clearing obligation goes live, and also to prepare our response to the lengthy MiFID II discussion paper.

One of our working committees that I have most enjoyed getting to know is our Investor Steering Committee. This comprises a group of 20+ senior representatives from large global allocators. They bring vital insights to our work and contribute greatly to better understanding.

Among their current projects is a guide which, we hope, will be used to educate trustees who often question the role of hedge funds in portfolios.

Finally, I am asked frequently about how AIMA works alongside other associations and most notably the MFA. I have held very collaborative discussions with them and am confident we can deliver a non-duplicative and complementary service to those members of both.

Above all, it is critical we align our resources to your requirements and so I shall continue to listen to all that you say and provide regular updates on how we are doing.

Best regards,

Jack Inglis

11 *http://www.pionline.com/article/20140428/ONLINE/140429873/aima-hedge-funds-risk-adjusted-returns-top-equities-bonds*

12 *http://www.hedgefundintelligence.com/Article/3313878/AIMAs-new-advocate-in-chief-sets-out-key-areas-for-global-engagement-and-education.html*

13 *http://www.efinancialnews.com/story/2014-04-07/hedge-funds-do-not-pose-a-systemic-risk-jack-inglis-aima-comment*

14 *http://www.aima.org/en/media/media-coverage/index.cfm*

15 *http://www.aima.org/en/aifmd/implementing-aifmd/index.cfm*

## Q2 press releases

| Date | Title |
|---|---|
| 26 June | AIMA signs Memorandum of Understanding with the Asset Management Association of China |
| 25 June | Japanese investors planning to maintain hedge fund allocations - AIMA Japan and Eurekahedge survey |
| 24 June | Increased partnership between investors and hedge funds – AIMA/Barclays survey |
| 28 April | AIMA releases educational guide to understanding hedge fund performance |
| 17 April | AIMA publishes new AIFMD implementation guides |
| 11 April | AIMA announces three new Council directors |
| 20 March | Capital markets fuel economic growth – new paper |

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

## Articles by AIMA

'Understanding hedge fund performance better' (InvestHedge)
*9 June 2014*
AIMA CEO Jack Inglis writes that it is all too common today for comparisons to be made between aggregated hedge fund indices and equity indices like the S&P 500.

'Hedge funds and the real economy' (HFI Global Review)
*22 April 2014*
Jack Inglis says the hedge fund industry is making a positive contribution to the 'real economy'.

'Helping capital markets flourish' (HFMWeek)
*17 April 2014*
Jack Inglis discusses the findings of AIMA-commissioned research into capital markets and economic growth.

'Hedge funds do not pose a systemic risk' (Financial News)
*7 April 2014*
Jack Inglis says that data from the UK Financial Conduct Authority suggests that no individual hedge fund or manager is systemically important to the extent that its failure would endanger financial stability in Europe or globally.

'Capital markets and the EU's growth strategy' (EU Reporter)
*25 March 2014*
Adam Jacobs discusses the findings of AIMA-commissioned research into capital markets and economic growth.

## Video coverage

'AIMA opens Toronto Stock Exchange' (TMX)
*28 May 2014*
Jack Inglis joins TMX Group in opening the Toronto Stock Exchange.

Jack Inglis interviewed at EuroHedge Summit
*29 April 2014*
Jack Inglis is interviewed by Josh Friedlander during the EuroHedge Summit in Paris.

## AIMA in the news

Hedge funds should be partners, say AIMA and Barclays (Investment & Pensions Europe)
*24 June 2014*
Coverage of 'The Extra Mile', our new paper with Barclays on partnerships between investors and hedge funds.

'Trade mission' (HFMWeek)
*11 June 2014*
AIMA CEO Jack Inglis gives a wide-ranging interview following his first 100 days in the role.

'Three reasons *The New Yorker* is wrong about hedge funds' (Forbes)
*28 May 2014*
Our 'Apples and Apples' paper is referenced by *Forbes* contributor Brian Portnoy.

'Equity benchmarks are an unsuitable hedge universe measure' (Hedge Funds Review)
*13 May 2014*
Editorial references 'Apples and Apples' paper.

'Why are hedge fund assets reaching all-time highs?' (AllAboutAlpha)
*12 May 2014*
Our 'Apples and Apples' paper is referenced by Don Steinbrugge, CFA, Founder and Managing Partner of Agecroft Partners.

'Hedge funds wade into systemic risk debate' (Financial News)
*29 April 2014*
AIMA's response to a consultation by the FSB and IOSCO on how to identify systemically important financial institutions is referenced.

'AIMA publishes new guides for hedge fund managers who want to comply with AIFMD' (Opalesque)
*17 April 2014*
Coverage of our set of guides for hedge fund managers wishing to comply with the AIFMD.

'AIMA announces three new Council directors' (Institutional Investor's Alpha)
*14 April 2014*
A report on the three new appointments to the AIMA Council, our governing body.

'A conversation with new AIMA CEO, Jack Inglis' (Canadian Hedgewatch)
*11 April 2014*
An interview with Jack Inglis on pp4-5.

'AIMA report shows growth role for hedge funds' (EuroHedge)
*27 March 2014*
Coverage of the study we commissioned that suggests that increased capital markets activity could help boost long-term economic growth.

'UK's largest hedge funds get bigger with 82% of assets' (Bloomberg)
*24 March 2014*
AIMA comments on the findings of the FCA's latest hedge fund industry survey.


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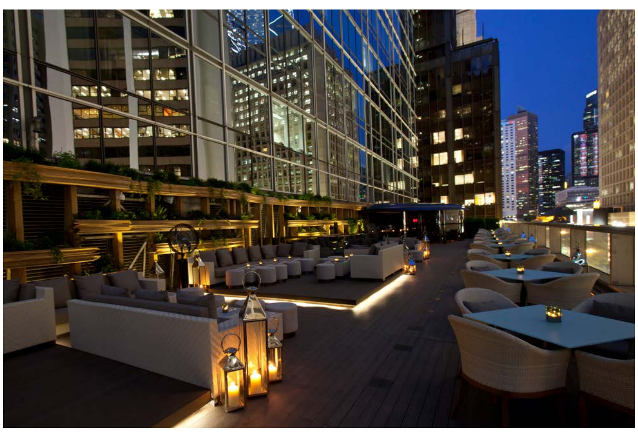
## Forthcoming AIMA events

UK — Launch of AIMA's new Guide to Sound Practices on OTC Derivatives
Date: 1 July 2014
Venue: The May Fair Hotel, Stratton Street, London

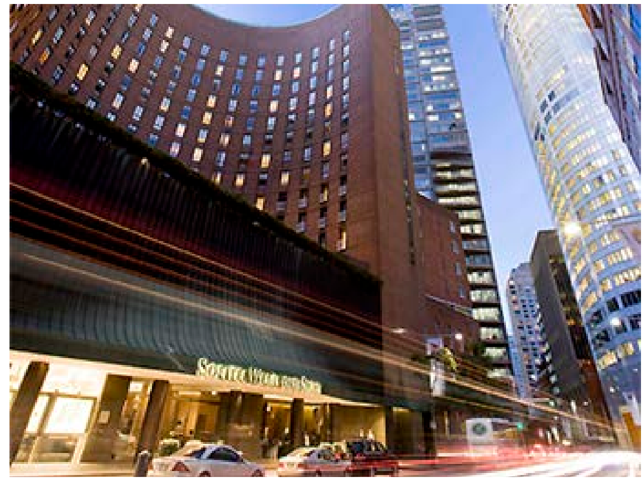
Hong Kong — AIMA Hong Kong Member Networking Drinks
Date: 3 July 2014
Venue: Armani / Prive, 2/F, Chater House, 8 Connaught Road, Hong Kong



Tokyo — Setting up a Fund Manager in Singapore: Tax and Regulatory Overview
Date: 8 July 2014
Venue: Zeirishi-Hojin PricewaterhouseCoopers, Kasumigaseki Bldg. 14F, 3-2-5 Kasumigaseki, Chiyoda-ku, Tokyo

Hong Kong — Shanghai-Hong Kong Stock Connect
Date: 9 July 2014
Venue: The Exchange Auditorium, 1/F., One and Two Exchange Square, Central, Hong Kong

UK — Opportunities and Challenges for Hedge Funds in the Coming Era of Optimization
Date: 10 July 2014
Venue: CitiGroup, Stirling Square, 5-7 Carlton Gardens, London



AIMA Australia 2014 Hedge Fund Forum
Date: 16 September 2014
Venue: Sofitel Sydney Wentworth

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

continued ▸

# AIMA events globally in Q2

**Canada - Moving Into Managed Futures**
Date: 2 April 2014
Venue: Borden Ladner Gervais LLP, Toronto

**Australia - FATCA Update Session**
Date: 4 April 2014
Venue: EY, 680 George Street, Sydney

**Cayman Islands - AIMA GAIM Ops Luncheon**
Date: 9 April 2014
Venue: The Ritz-Carlton, Grand Cayman

**Brazil - Marketing in Europe - What is AIFMD and Why Should Brazilian Managers Care?**
Date: 15 April 2014
Venue: Skadden, Sao Paulo

**Canada - AIMA Canada Alberta Ski Day 2014**
Date: 10 April 2014
Venue: Lake Louise Ski Resort, Alberta

**US - Hedge Fund Capital Raising in Canada**
Date: 16 April 2014
Venue: KPMG, 345 Park Avenue, New York City

**Hong Kong - Recruitment, Retention and Building a Corporate Culture**
Date: 28 April 2014
Venue: Shearman & Sterling LLP, The Landmark York House, 15 Queen's Road Central, Hong Kong

**Canada - Trading & Algo Issues Session - Trading Environment Today**
Date: 1 May 2014
Venue: The Cambridge Club, Toronto

**Brazil - Current trends in fund structuring, regulations and corporate governance for Cayman Islands investment funds**
Date: 7 May 2014
Venue: Skadden, Sao Paulo

**Singapore - Marketing your fund across the globe, what you need to know**
Date: 7 May 2014
Venue: UBS, Singapore


**Cayman Islands - AIMA Cayman Social**
Date: 8 May 2014
Venue: The Westin, Grand Cayman

**Brazil - Current trends in fund structuring, regulations and corporate governance for Cayman Islands investment funds**
Date: 8 May 2014
Venue: SPX Capital, Rio de Janeiro

**Hong Kong - China 2 - QFII/RQFII Update**
Date: 12 May 2014
Venue: Bank of China Tower, 1 Garden Road, Central, Hong Kong

**China - AIMA China Hedge Fund Managers Forum 2014**
Date: 14 May 2014
Vanue: 6/F DBS Tower, 1318 Lu Jia Zui Ring Road, Pudong New Area, Shanghai

**Hong Kong - Obligations of Responsible Officer**
Date: 20 May 2014
Venue: Simmons & Simmons, One Pacific Place, 88 Queensway, Hong Kong

continued ▸

**Australia - Hedge Fund Marketing and Fundraising in 2014 and Beyond**
Date: 28 May 2014
Venue: Deloitte Touche Tohmatsu, Grosvenor Place, 225 George Street, Sydney

**Canada - Life After Benchmarks (Toronto)**
Date: 29 May 2014
Venue: The National Club, 303 Bay Street, Toronto, Ontario

**Canada - Life After Benchmarks (Montreal)**
Date: 29 May 2014
Venue: Hotel Omni Mont-Royal, Montreal

**Hong Kong - Members' Networking Drinks**
Date: 29 May 2014
Venue: Mama San, Wyndham Street, Hong Kong

**Japan - The 9th Annual AIMA Japan Hedge Fund Forum 2014**
Date: 5 June 2014
Venue: The Tokyo Stock Exchange

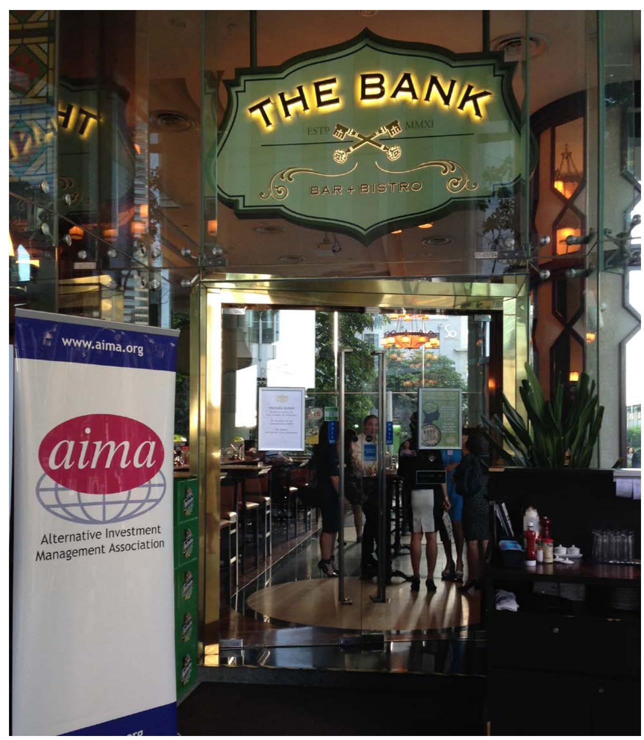

**Hong Kong - Europe Fund Structures**
Date: 9 June 2014
Venue: PricewaterhouseCoopers, Edinburgh Tower, 15 Queen's Road Central, Hong Kong

**Canada - The 10th Annual AIMA Canada Charity Golf Tournament**
Date: 9 June 2014
Venue: Angus Glen Golf Club, 10080 Kennedy Road, Markham, Ontario

Brazil - Marketing your Fund in Europe – What is AIFMD and Why Should Brazilian Managers Care?"
Date: 9 June 2014
Venue: JGP, Rio de Janeiro

**Cayman Islands - AIMA Cayman Soccer Social**
Date: 13 June 2014
Venue: Karma Restaurant & Lounge, Seven Mile Beach, Grand Cayman

**Singapore - AIMA Singapore Networking Drinks**
Date: 18 June 2014
Venue: The Bank Bar & Bistro, Singapore




**Canada - Progressive Asset Management**
Date: 18 June 2014
Venue: The National Club, Toronto

**UK - AIMA Summer Drinks Reception**
Date: 18 June 2014
Venue: The Willis Building, 51 Lime Street, London

continued ▸

**China — 1st International Hedge Fund Leadership Forum**
Date: 19 June 2014
Venue: 26/F Tower A, Beijing Fortune Plaza, 7 Dongsanhuan Zhong Road, Chaoyang, Beijing

**Singapore - Briefing on GST Changes for Funds**
Date: 24 June 2014
Venue: PwC, 8 Cross Street, Singapore

**US - Establishing an EU AIFM in the UK, Ireland or Luxembourg: Practical Considerations arising from AIFMD Implementation**
Date: 25 June 2014
Venue: PricewaterhouseCoopers, New York City

**UK - Next Generation Manager Forum 2014**
Date: 25 June 2014
Venue: Simmons & Simmons, London *(review opposite)*

## Q2 AIMA webinars

FATCA: Establishing and Continuing Compliance
Date: 24 June 2014

FATCA: Portal Registration and FFI Agreement
Date: 17 June 2014

EMIR Reporting for AIFs: The Countdown
Date: 22 May 2014

FATCA: Appointing a Responsible Officer
Date: 7 May 2014

Government & Regulatory Affairs Quarterly Update
Date: 28 April 2014

## 2nd AIMA Next Generation Manager Forum 2014

*Date: 25 June 2014*

**Venue: Simmons & Simmons, Citypoint, 1 Ropemaker Street, London EC2Y 9SS**

The second annual AIMA Next Generation Manager Forum was held on 25 June 2014 and drew an audience of close to 100 people to Simmons & Simmons in London. Speakers included Andrew Main, Managing Partner, Stratton Street Capital and Chair of AIMA's Next Generation Manager Group in London; Chris Farkas, Director, Head of European Hedge Fund Consulting, Deutsche Bank AG; and Malcolm Butler, Partner, Chairman, COMAC Capital LLP.

There were three panel discussions: 'Opportunities and challenges faced by start-up managers in attracting seed investment'; 'The costs and benefits of participating in a fund platform'; and 'What your non-executive director should be doing for you'. AIMA CEO Jack Inglis delivered the closing remarks. For the full agenda and Forum brochure, click **here**.

AIMA launched the Next Generation Manager Group in 2011 for firms managing up to $500m in hedge fund assets. AIMA estimates that roughly two-thirds of its manager members globally manage $500m or less.

The group has been meeting every other month in London and New York to drive educational initiatives and discuss issues of common concern such as marketing, governance, sound practices and wider business issues. To find out more, please contact AIMA's Head of Research, **Tom Kehoe**.

A Global ARC Initiative

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## Investment Consultant Dialogue

By bringing together the world's foremost investment consultants to engage in a dialogue with leading asset managers, Global ICON will provide consultants with a new perspectives on investing and asset managers with a deeper understanding of the issues and challenges facing consultants.

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July 14th, 15th and 16th 2014 • The Hyatt Regency Boston, Massachusetts, USA

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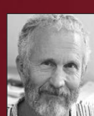
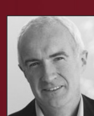
Keynote and academic speakers already confirmed, sorted alphabetically by surname:

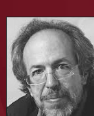
**Professor Raj Chetty**
**2013 John Bates Clark Medal Winner**
William Henry Bloomberg Professor of Economics **Harvard University** – USA



**Professor Doyne Farmer**
Scientific Co-ordinator, **CRISIS** – European Union
Professor of Mathematics and Co-Director of Complexity Economics, **University of Oxford** – UK



**Professor Tim Jenkinson**
Head of the Finance Faculty and Professor of Finance, Director of the Oxford Private Equity Institute
**Saïd Business School, University of Oxford** – UK



**Dr. Lee Smolin**
Author of *The Trouble With Physics*, Founding Member and Senior Faculty Member
**Perimeter Institute for Theoretical Physics** - Canada

**Professor Didier Sornette**
Director of the Financial Crisis Observatory, Professor of Entrepreneurial Risks
**ETH Zurich (Swiss Federal Institute of Technology)** - Switzerland

**Professor Lawrence H. Summers**
Director, **President Obama's National Economic Council**, 2009-10
Treasury Secretary, 1999-01, **US Federal Government**, Chief Economist, **The World Bank**, 1991-93
Charles W. Eliot University Professor, **Harvard University** - USA

**Professor Rakesh Vohra**
Co-Author of *Principals of Pricing: An Analytical Approach*
George A. Weiss and Lydia Bravo Weiss University Professor of Economics
**University of Pennsylvania** – USA

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# Scaling the alternative investment summit safely

*By CAIA Association*

Climbers face all sorts of variables as they scale a mountain with intent to reach the summit. The mountain they climbed last year is not the same one they are climbing now. Terrain, weather, the climber's own physical strength and mental attitude make each climb unique. Investing is no different. New products, rapidly changing markets and the occasional five-standard deviation event, in addition to different investors' goals and risk tolerance, mean that no portfolio is the same.

The path to the summit is fraught with uncertainty, as is the path to absolute return. The only way to survive and thrive in this environment is to be well educated and to stay that way. It is vitally important that all investors, intermediaries, advisors, regulators, and even the media undertake a renewed focus on what this all means to the end investor. Very sophisticated solutions are replacing more traditional products, and the bar for knowledge and education continues to go up.

As the innovator and leader in alternative investment education, the Chartered Alternative Investment Analyst (CAIA) Association is blazing new trails and has introduced the Fundamentals of Alternative Investments Certificate Program (FAI). The new online program rounds out the CAIA educational offering and makes alternative investment learning easily accessible to a broader audience.

CAIA created the program as a self-paced course consisting of 20 one-hour modules, taught by CAIA's leading experts. FAI covers an overview of portfolio construction, risk management and due diligence, along with in-depth sections on hedge funds, real assets, private equity, commodities and structured products.  The FAI program is an educational solution meant to provide the vocabulary, education, and confidence to look at the entire landscape of these more sophisticated solutions and to determine how they might be used in your portfolios.

"CAIA was founded in 2002 at a time when alternative investing was starting to become more organized, and the related products began to take on a more definable, institutional quality, look, and feel," said William (Bill) Kelly, CAIA CEO.  "Underlying alternative investment products took on more specific and repeatable investment processes, and the underlying concepts, tools, and practices formed the discipline around the core of the CAIA Charter. At our founding, alternative investment assets were about $2 trillion.  Today these assets have experienced more than a six-fold increase.  The CAIA curriculum has grown in a similar fashion and has expanded to include many new areas since our first few exam cycles," said Mr. Kelly.

The CAIA Levels I and II curriculum continues to provide education to the most sophisticated investment professionals, including the portfolio managers, analysts, some of the intermediaries, and also the regulators who need to know what is going on under the hood at a fairly detailed level.  Concepts like structures, valuation, market efficiency, liquidity, and valuation (just to cite a few) need to be built on a knowledge base that is linked to a deeper dive. That level of sophistication and understanding needs to be demonstrated and remain up-to-date.

# Update from the Regulatory Compliance Association

The Regulatory Compliance Association (RCA) supports a community of 78,000 executives from fund managers and investment advisers.

Over 18,000 alternative investment management executives use RCA curricula to obtain the most timely, relevant, detailed and comprehensive Professional Development for Fund Managers and Registered Investment Advisers™. AIMA members are entitled to RCA Curricula at RCA member tuition rates.

## PracticEdge OnDemand

Discover why over 18,000 alternative investment executives use RCA Accredited Curricula. PracticEdge OnDemand includes:

- An enterprise class, online university
- Over 75 hours of continuing professional education for legal, accounting and compliance professionals updated monthly
- A curriculum of 30 courses with detailed, comprehensive coverage
- Authoritative speaking faculty – senior regulators, CCOs, GCs, COOs from the top 100 firms, practice leaders and partners from the top law and CPA firms in the industry
- Exemplar policy & procedure language, forms and work product
- The most timely and relevant professional development for fund managers and RIAs
- A dedicated academic team with 24/7 service and support

AIMA members may enroll for PracticEdge™ OnDemand for the RCA Member Tuition Rate of only $495 per year, or $6 per credit hour. Subject matter coverage includes Asset Management Law, Practice, Compliance, Regulation, Inspections/Examinations, Enforcement, Operational Process, Due Diligence, Risk Management, Governance, Accounting and Taxation. For more information contact Terri Hays (thays@rcaonline.org or 646.415.3717).

## myUniversity

myUniversity demonstrates to regulators a comprehensive, integrated Rule 206(4)7 compliance program and Annual Review with a complete, documented and automated Compliance Training & Remediation platform, which includes:

- An enterprise class, private-labeled, on-line university
- Over 500 hours of continuing professional education for legal, accounting and compliance professionals updated monthly
- A curriculum of 100 courses with detailed, comprehensive coverage of over 2,900 subjects within approximately 7,500 pages of textbooks and course materials
- Authoritative speaking faculty – senior regulators, CCOs, GCs, COOs from the top 100 firms, practice leaders and partners from the top law and CPA firms in the industry
- Exemplar policy & procedure language, forms and work product
- The most timely and relevant professional development for fund managers and RIAs
- A dedicated academic team with 24/7 service and support

AIMA member firms enjoy the same subsidized tuition rates as RCA Members to use myUniversity – Tuition Fees as low a $6 per credit hour. For more information contact Terri Hays (thays@rcaonline.org or 646.415.3717).

# Tracking your digital footprint

*By Thomas Walek and Dmitriy Ioselevich, WalekPeppercomm*

Have you Googled yourself today? If you are an executive, portfolio manager, research analyst or trader at an investment management firm, chances are high that you've been Googled recently. Current and prospective investors are increasingly flocking to the Internet to vet you and your firm as part of their due diligence process. The only questions are: What do they find, and what can you do about it?

The Internet has completely transformed how people process information. As a result, everyone now has a digital footprint — a trail of data that tells a story about who you are, what you stand for and what you're doing. Whether you're active online or not, this trail is only getting longer as people continue to collect and disseminate information about you and your firm.

There have been efforts to curb this behavior, including most recently by the European Union in a monumental ruling that would allow individuals to request that search engines remove links to content about them.

But whether or not Google or other search engines honor people's "right to be forgotten", the sheer volume of information already out there virtually guarantees that asset managers will never be able to fully remove themselves from the public eye. But why should these managers care?

According to studies by Harris Interactive and Cross-Tab Marketing, 75% of HR executives now research potential employees online, while 70% report having found something that's caused them to reject a candidate. The relationship between an investor and an asset manager is no different.

Imagine that you are a high-net-worth or institutional investor with money to spend and you have a list of five funds that match your mandate for a specific strategy and risk-adjusted returns. How do you whittle down that list to just one? Recommendations from industry peers and third-party search firms will certainly factor into your decision, as they always have, but that's not enough anymore. Given how much information is readily available in today's digital age, the first thing you will probably do is Google the firm or its executives and, if you don't like what you find, you will immediately cross them off your list.

This happens all the time in the investment management industry. To cite one recent example, the top executive of a large asset management firm was recently embroiled in a messy personal lawsuit that received extensive media coverage. Not surprisingly, any search engine query of the firm or the executive returned negative hits regarding the lawsuit, effectively halting any momentum from investor meetings.

The firm desperately needed to shift attention to all of the great things they were doing for investors, from generating consistently high returns to sharing market insights. And over the ensuing weeks that's exactly what they did. They began securing multiple top-tier print and broadcast interviews featuring managers talking about the market and related topics.

continued ▸

Before long, any investor searching the firm would have to navigate through two or three pages of Google results before finding anything referencing the lawsuit. No firm can just make information disappear, but a dedicated media relations strategy such as the one referenced here can help transform a negative story into a positive one. The data bears this out.

According to multiple studies[1], search engine users rarely go beyond the top three search results, let alone the entire first page. Of course, the average investor will probably be a bit more diligent than that. But if they see 10 or 20 positive results before they see a single negative result then they will likely conclude that the good far outweighs the bad. That's the beauty of smart and strategic online reputation management.

### Managing your digital footprint

The best investment management firms understand the importance of risk management and utilize a rigorous process for protecting client assets. Yet, when it comes to managing their digital footprints firms tend to choose the path of least resistance — that is, doing nothing.

Corporate policies and compliance rules seeking to prevent any participation in social or traditional media often only exacerbate this situation, with firms rationalizing that it is best just to stay away if they are either unfamiliar with the online sphere or weary of drawing unwelcome attention from regulators, or both. However, by ignoring their online presences altogether these businesses are leaving themselves vulnerable to the dangers of missed information or misinformation.

*1 searchenginewatch.com/article/2049695/Top-Google-Result-Gets-36.4-of-Clicks-Study*

Instead, asset managers should seize control of their digital footprints and build a positive, powerful and engaging online presence. Here's how:

- **Open up your website.** According to an internal WalekPeppercomm study, 96% of the top 100 global hedge funds have websites, but 54% of those firms have websites that are either closed to non-investors or are just simple splash pages. This is unacceptable. Understandably, the first place any prospective investor goes is to your firm's website, so it is in your best interests to make it as easy as possible to get information. If you don't, investors may assume that you are trying to hide something. That's why it is always best to be transparent. Start by redesigning your website to better engage and inform your investors, and make sure you have a page for team biographies.
- **Fill out your social media profiles.** One of the easiest ways to improve your Google results is to complete your LinkedIn profile. Every employee at your firm should have a LinkedIn page, complete with name, title, company and previous career information. These profiles will almost always come up on the first page of Google search results whenever somebody searches your name or firm. The same rule generally applies to other social media channels such as Twitter, Facebook and YouTube, so if you or your firm uses one of those outlets then make sure make sure that the profile is completely filled out. Additionally, you should verify that the information is consistent across all the platforms so that there is no confusion about where someone works or what their title is.
- **Be a spokesperson.** News stories and press releases regularly rank highly in search results. Therefore, you can improve your

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digital footprint by talking to the media about topics relevant to your strategy and your firm. This is especially effective if you are trying to bury negative search results about a lawsuit or poor performance, as in the case study above. Also, it's important to remember that journalists use Google too when vetting potential sources. If you've never done an interview before then journalists may conclude that you're not worth their time. On the other hand, if you've done multiple high-level interviews then journalists may go out of their way to accommodate you and give you more control over the final piece.

These tactics are but a small part of building and managing your digital footprint. As the amount of information in the world grows exponentially, your footprint will only grow larger. It's up to you to actively shape and shift your footprint and ensure that your business can continue to grow.

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# Corporate governance challenges for hedge fund boards

*By James Oussedik, Counsel, and Jeremy Leggate, Associate, Sidley Austin LLP*

In part fuelled by scandals and significant cases over the past few years (those relating to Madoff and Weavering, for example), managers are by now well used to engaging with increasingly probing questions from investors around governance arrangements and the independence of fund boards.

In this article, we will seek to explore where we are in the on-going governance debate, and where we are likely to get to in the near term, as the industry faces yet more governance challenges arising from investor pressure and regulatory change.

## Where we are: governance in major fund jurisdictions

All major financial jurisdictions require fund directors to exercise care, skill and diligence in the performance of their duties. In the UK (and most other common-law based jurisdictions) this is measured against an objective standard (i.e. a minimum level of performance expected of all directors), uplifted according to any particular knowledge, skill or experience a particular director may have. These common law principles are supplemented by further laws, regulations, codes of conduct and statements of guidance, issued by both regulators and industry bodies.

The world of fund directors is however, peculiar – fund directors are bound by the usual rules applied to company directors, yet their ability to ensure they discharge the duties laid upon them is curtailed by the fact that day-to-day activities and management of the fund are delegated to service providers, including the investment manager. Moreover, although independence of judgement is a crucial requirement for fund directors, there is often a very close relationship with managers (not least due to the fact that managers will typically play a lead role in selecting directors and setting the level of their remuneration).

The *Weavering*[1] judgement has further developed the theory of directors' duties in the context of offshore funds, recognising that although much of the day-to-day operations of a fund can be managed by the fund's service providers, directors must take an active role in supervising the fund's affairs and its business, and apply their minds and independent judgement to the decisions they make.

In the face of criticism and investor pressure, certain regulatory authorities in fund domicile jurisdictions have also released new guidance concerning the role of independent directors, summarising existing legal and best practice requirements (Cayman Islands Statement of Guidance for Regulated Mutual Funds (CISOG-MF)), or issued codes of practice on a comply or explain basis (Guernsey Financial Services Commission 'Updated Guidance on Corporate Governance Guernsey').

The key areas which the new codes of practice cover are:

- *Degree of Delegation*: by way of example, section 14.2 of the Irish Governance Code ("IGC") states that, regardless of the extent of any delegation of management

1 *Weavering Macro Fixed Income Fund v Peterson and Ekstrom [Cause No. FSD 113 of 2010 (AJJ)]*

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functions, "the Board cannot abrogate its overall responsibility". CISOG-MF describes the fund's governing body as "the directing will and mind" of the fund with "ultimate responsibility" for directing and supervising the fund's activities. How easily this can be extended to the fund's investment activities will depend on the complexity of the manager's investment strategy, the extent of the manager's responsibilities as defined in the investment management agreement and the sophistication of the investors in the fund. Something stressed in section 1.3 of the CISOG-MF.

- *Expertise*: the board collectively must have sufficient knowledge and expertise not just to understand the manager's investment strategy and the risk profile this creates for the fund, but also to monitor compliance with investment strategy and evaluate performance. The IGC recognises that having a person affiliated to the manager on the board is a necessary component of maintaining sufficient oversight of the fund, i.e. directors being able to monitor and supervise the manager's strategy and performance.
- *Independence*: all corporate governance codes insist that directors, as a minimum, exercise independent judgement, and most corporate governance codes recommend that boards have at least one independent director. These essentially restate existing legal principles that are found in most major financial jurisdictions. A significant difficulty for managers is finding a pool of experienced and credible individuals who are truly independent, and not affiliated to a service provider.
- *Jumbo Directors*: in the Cayman Islands the average fund director sits on 25 boards[2], and over 15% of Cayman directors are retained by 25 different managers to sit on their funds' boards. Most corporate governance codes have declined to take a robust approach on this issue. The CISOG-MF, mindful that the number of directorships an individual can competently discharge is contingent on a number of factors, states that the board should "consider carefully" the number of directorships a potential director holds. In its Corporate Governance Survey, CIMA found that respondents were more or less split evenly over the issue of limiting the number of directorships that can be held by an individual. The alternative case is the IGC, which has introduced a presumption that a fund director should hold no more than eight non-fund directorships, and where a fund does appoint such a director, the board must fully explain its reasons to investors in their directors reports accompanying the annual audited accounts.
- *Remuneration*: the Association of the Luxembourg Fund Industry (ALFI) published its revised Code of Conduct in 2013. Recommendation 10 of the revised Code states that board remuneration should be "reasonable and fair and adequately disclosed". However other relevant jurisdictions have not taken up the issue as yet. This is most likely due to investors effectively self-policing the issue.

## The comparison with listed companies

It is sometimes felt that governance standards in the alternative funds industry lag behind standards in the more mainstream world of listed companies.

*2 Source: Foundation for Fund Governance - www.fundgov.org*

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| | Hedge Fund Directors | Listed Company Directors |
|---|---|---|
| **Governing law** | Codes of conduct and statements of guidance. | UK Corporate Governance Code, Listing, Disclosure and Transparency Rules. |
| **Standard of care** | Due care and skill. | Due care and skill. |
| **Delegation** | Overall responsibility cannot be delegated.<br>Delegation of day-to-day activities permitted/expected. | Division of responsibilities must be clearly identified.<br>No one individual should have unfettered powers of decision. |
| **Expertise** | Board must have sufficient knowledge and experience to discharge oversight responsibilities. | Board must have sufficient knowledge, experience and independence to discharge oversight responsibilities. |
| **Independence** | Must exercise independent judgement.<br>Good practice to have at least one independent director. | Must exercise independent judgement.<br>Half the board (larger companies)/two directors (smaller companies) should be independent. |
| **Directorships** | Must have sufficient time to devote directorship, although no specific restrictions. | Full time directors may take only one non-executive directorship in a FTSE 100 company. |
| **Remuneration** | Reasonable, fairly-disclosed and determined independently from investment manager. | Must not be more than necessary to attract and reward talent & set by Remuneration Committee comprised of at least 2 non-executive directors. |

In actual fact, as the table above illustrates, the standards which are applied are very similar.

One of the main differences may be however, the public nature of the role of directors of listed companies against the very private role of fund directors. With transparent and live share prices, directors of these companies have had an ever-present corporate barometer, one that fund directors have not. As a result, investors in private funds have had to take a much more active role in setting and policing standards.

## Contrast with the US

Whilst governance standards in the context of European managed funds continue to be debated, it is striking to note that the most sophisticated alternative investment market in the world has not experienced the same phenomenon – why is that?

In the context of UK managers of offshore funds, the historical reason for good corporate governance, specifically board independence, was heavily linked to UK tax compliance and mitigating the risk of “onshoring” the fund. The same risk in the context of a US fund does not exist to the same extent.

US funds have historically tended to be structured as limited partnerships, in which the general partner was (and generally still is) an affiliate of the manager or sponsor of the fund. The nature of the relationship between limited partners and a general partner, as opposed to shareholders and a fund board, is significantly different, not least due to the fact that in most jurisdictions there are at least some basic partnership duties owed between partners, and direct contractual privity. US investors have tended to focus on specific elements of governance, such as related party transactions, audit, adherence to a code of ethics, adviser remuneration, and monitoring of investment policies. In the environment of

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’40 Act funds, there is also a requirement to ensure that a proportion (not always a majority) of directors are independent.

Many large US allocators to alternative investment funds will also seek to agree specific governance requirements and standards of behaviour with managers and funds, including by way of side letter provisions.

## Potential developments in governance

For all the increased activity around corporate governance, there appears to have been no significant watershed in the ways in which fund boards and managers interact in practice, nor generally in the approach which directors of funds take to the discharge of their duties, provided they were taking their duties reasonably seriously in the first place.

This perception is supported by recent industry surveys, which illustrate that a minority of investors believe that fund boards are carrying out their duties to a sufficient standard, and a smaller minority still believe that boards retain sufficient authority and knowledge to allow them to challenge the manager.

Given this apparent lack of satisfaction, what are the likely future trends in governance for the European funds industry?

## Investor tools

For those investors who are large enough and sufficiently sophisticated, the move towards managed accounts and funds of one seems an obvious way in which to mitigate concerns and risk around governance. Such structures now generally provide that the investor is responsible for the fund structure, not the manager, and accordingly affords the investor freedom to establish such governance arrangements as it wishes, provided these do not overly inhibit the manager’s ability to carry out its investment mandate.

Another potential method by which investors may gain more certainty around governance is by seeking to confirm certain duties of the board, and responsibilities of the manager, in a contractual agreement or side letter. This mechanism gives key investors the flexibility of remaining in a commingled fund whilst providing greater comfort in relation to fund governance.

Seed investors are uniquely positioned to influence the terms and, in some cases, the governance structure of the funds they invest in. The implementation of robust governance structures may also provide the fund and the seed investor with opportunities to differentiate and provide a competitive marketing advantage.

## Continued focus on fund governance

In an environment where alternative investment funds have long since ceased to be the preserve of ultra high net worth individuals, and are now an increasingly important part of pension and insurance portfolios, it would seem very likely that the focus on fund governance is set to continue. Recent trends suggest that regulators rather than investors are likely to take more of a lead in setting and policing standards, both through regulations and codes of conduct imposed on the fund and on the manager. It remains the case that in order to work satisfactorily, managers, fund boards, investors and regulators each need to maintain dialogue and seek to ensure that governance standards are appropriate and do not become a millstone impeding commercial decisions and, ultimately, performance.

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# MiFID II: Early questions for foreign AIFMs

*By Andrew Henderson, Partner, Eversheds LLP*

The European Commission, Parliament and Council have now reached agreement on the texts for the Recast Markets in Financial Instruments Directive (MiFID 2) and the Markets in Financial Instruments Regulation (MiFIR). MiFID 2 and MiFIR, which comprise the MiFID II pieces of primary legislation, are expected to come into force by the end of 2016.

MiFID II represents the response to the Commission's review of the Markets in Financial Instruments Directive (MiFID). MiFID governs those firms that provide investment services and products in the EU. It also sets out the framework for regulating securities and investment markets and market infrastructure in the EU. MiFID II expands MiFID's scope particularly with respect to commodity derivatives, adds further investor protections and increases the requirements related to the trading of financial instruments.

In addition to these revisions to MiFID, MiFID II has introduced a special regime for non-EU investment firms, including non-EU asset managers (Foreign Managers), who wish to provide cross-border services to clients established in any EEA member state (Member State). The impact of the Third Country regime for Foreign Managers will not be immediate for not only is there some time to go before Member States are required to implement MiFID 2, but the Third Country provisions in MiFIR are also subject to transition period which means, in practice, that Foreign Managers will not be able to rely on them until at least 2019.

However, with questions being raised on the limitations on what Foreign Managers can do under the Alternative Investment Fund Managers Directive (AIFMD) and many Foreign Managers wanting to offer segregated mandates without also wanting to manage non-UCITS investment funds (AIFs), Foreign Managers may need to look at MiFID 2 in the medium term and MIFIR in the longer term. In the case of MiFID 2, of course, the extent and manner of Member State implementation will be important and, as was the case with the AIFMD, predictions as to what Foreign Managers can expect need to be undertaken with caution.

## A new package of rights

MiFIR will permit Foreign Managers to provide investment services to Eligible Counterparties, as defined in MiFID, and the entities identified in Section I of Annex II to MiFID 2 (Per se Professional Clients) throughout the EU. A Foreign Manager will be able to do so without having to establish a branch in the EU but will have to become registered with the European Securities and Markets Authority (ESMA) and comply with MiFIR.

MiFID 2 will give Member States the power to allow a Foreign Manager to provide investment services to other types of professional clients identified in Section II of Annex II to MiFID 2 (Elective Professional Clients) and Retail Clients, i.e. those clients which are neither Eligible Counterparties nor Per se Professional Clients. The Foreign Manager will need to establish an authorised branch in the relevant Member State (Host State) and comply with the Host State rules which implement MiFID 2. Member States will also have the power to allow the Foreign Manager to provide investment services to Eligible Counterparties and Per se Professional Clients.

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### MiFID 2's impact on the AIFMD: Benefits for Foreign Managers?

Where a Foreign Manager wishes to offer a segregated mandate which is not treated as managing an AIF, AIFMD would not apply: the offering/marketing of that service will be governed by the relevant Non-AIFMD related Member State rules. Moreover, where a Foreign Manager wishes to provide sub-management or sub-advisory services for an EU manager managing an EU UCITS fund or EU AIFs, under a UCITS Directive or AIFMD compliant delegation arrangement, these services should fall within the definition of a MiFID investment service. In this respect, the services and activities of *"portfolio management"* and *"investment advice"* are captured under the investment services in Annex I of MiFID and will also be captured under MiFID 2.

It is expected that in late 2015 or early 2016 Member States will be given the power to authorise Non-EU AIF managers (AIFMs) to manage EU AIFs and market EU and Non-EU AIFs in reliance on the *"AIFMD passport"*. This will include the power to authorise Non-EU AIFMs to provide MiFID investment services, which include portfolio management and investment advice (Non-Core AIFMD Services), in addition to the services set out in Annex I to AIFMD (Core AIFMD Services).

MiFID 2 has provided an important amendment to AIFMD. It is now clear that an EU AIFM authorised to manage an EU AIF in one Member State may provide Non-Core AIFMD Services together with Core AIFMD Services in another Member State. In this respect, MiFID 2 has addressed the conflicting approaches taken by the Commission, which took the view that the AIFMD passport could not be extended to Non-Core AIFMD Services, and the UK Financial Conduct Authority, which took the view that it could. However, the amendments to AIFMD made by MiFID 2 have not been extended to include Non-EU AIFMs. MiFID 2 rather than AIFMD will, therefore, be relevant where a Foreign Manager wishes to provide Non-Core AIFMD Services to clients in more than one Member State.

### Exercising the right to provide cross-border services to Per se Professional Clients or Eligible Counterparties

Under MiFIR, a Foreign Manager will have to apply to ESMA to become registered in ESMA's register of Foreign Managers (the ESMA Register). In order to register the Foreign Manager, ESMA will need to satisfy itself that: (a) the Commission has made a decision by the Commission on whether the regulatory arrangements in the country where that Foreign Manager has its registered office (Home Country) satisfy certain requirements in MiFIR (Equivalence Decision) with respect to the Foreign Manager's Home Country; (b) the Foreign Manager is authorised to provide the relevant investment services in its Home Country and subject to effective supervision and enforcement; and (c) appropriate co-operation arrangements are in place between ESMA and that Home Country. The Foreign Manager will also have to make certain disclosures to those Per se Professional Clients or Eligible Counterparties to whom it markets its investment services and agree to submit to the jurisdiction of court or tribunal in a Member State.

### Establishing a branch to provide services to Elective Professional Clients and Retail Clients

In order for a Host State competent authority to authorise a branch of a Foreign Manager, the authority would need to satisfy itself that: (a) the Foreign Manager is appropriately authorised in its Home Country; (b) there are appropriate co-operation arrangements between the Host

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State and the Foreign Manager's Home Country, dealing with the exchange of information, including an effective exchange of information on tax matters; (c) the Foreign Manager has adequate regulatory capital; (d) the Foreign Manager's senior management systems and controls are sufficient; and (e) the Foreign Manager belongs to an authorised or recognised investor compensation scheme. The Foreign Manager will have to comply with the Host State rules giving effect to many, but not all, of the provisions in MiFID 2 governing conduct of business.

MiFID 2 does not give the branch of a Foreign Manager authorised in a Host State the freedom to provide investment services to Elective Professional Clients and Retail Clients in other Member States. A branch of a Foreign Manager authorised in its Host State could not therefore provide investment services to Elective Professional Clients and Retail Clients in reliance on a MiFIR Foreign Manager Passport. MiFIR indicates that a Foreign Manager authorised as a branch in a Host State will have the freedom to provide investment services to Per se Professional Clients or Eligible Counterparties in other Member States in much the same way as if the Foreign Manager was registered on the ESMA Register. The Foreign Manager will also have to make certain disclosures to those Per se Professional Clients or Eligible Counterparties in other Member States and agree to submit to the jurisdiction of court or tribunal in a Member State.

### What next?

As is the case with AIFMD, a large part of the Third Country provisions are delayed. Under MiFIR, Foreign Managers will be able to provide investment services to Eligible Counterparties and Per se Professional Clients under the individual Member State rules. A Foreign Manager will be able to do so for a period of three years after an Equivalence Decision. Although this is described as a *"transitional period"*, it is not a transitional period in the normal sense in that it is not determined by the date on which MiFIR comes into force but rather by a decision made under MiFIR, which may occur some time later. The MiFID 2 provisions on establishing a branch to serve Retail Clients will come into force as soon as MiFID 2 comes into force although the extent to which they are brought into law in a particular Member State will be a matter for the relevant Home Member State authorities. ESMA will also be responsible for drafting approximately 100 Level 2 Measures between now and the end of 2016, when the Member States are required to implement MiFID 2 and MiFIR comes into effect. There is still a lot of work to be done.

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# Trade reporting – the story continues

*By Sandy Broderick, CEO, DTCC Deriv/Serv*

Since the onset of the global financial crisis, policymakers and regulators have been working on a system to improve the transparency and integrity of the global financial system. The need for timely access to detailed and accurate data on global derivatives activity led G20 finance ministers in 2009 to create a regulatory framework mandating reporting of OTC derivatives trades to trade repositories. Major derivatives jurisdictions such as the US, Canada, Europe, Japan, Australia, Hong Kong and Singapore have put in place regulations which require derivatives transactions to be reported to trade repositories. While the implementation of such regulations has been gradual, and the scope of the reporting requirements has varied across each jurisdiction, almost five years on from the G20 summit, we have a reporting framework which is global. This article reviews the progress of the implementation of trade reporting and analyses the challenges ahead in enabling trade repositories to act as a key risk mitigation tool.

## Trade reporting goes global

### *United States*

The US was the first jurisdiction to implement derivatives trade reporting. The Commodity Futures Trading Commission (CFTC) began the implementation of derivatives trade reporting under the Dodd-Frank Act in October 2012. The implementation was phased in by asset class and type of participant. Future reporting includes reporting to the SEC on security-based swaps.

### *Europe*

In Europe, trade reporting was enshrined into law with the European Market Infrastructure Regulation (EMIR), and reporting for all five OTC derivatives asset classes as well as exchange traded derivatives, began on 12 February 2014. EMIR did not only mandate that reporting for all derivatives asset classes begin in a single day, but it is also the regulation which impacted the largest number of derivatives users including sell-side and buy-side firms. With back-loading of derivatives trades outstanding on the reporting start date and outstanding on 16 August 2012 completed by 13 May 2014, the next reporting deadline in Europe concerns reporting of collateral and valuation information, which begins on 11 August 2014. Trade reporting requirements in Europe apply not only to EMIR, but also to other regulatory directives. For example, the Alternative Investments Fund Managers Directive requires non-EU domiciled hedge funds to register their funds by July 2014 to gain access to EU investors. To do so, such funds need to demonstrate they have met their reporting requirements under EMIR.

### *Asia-Pacific*

The region has seen a flurry of activity in trade reporting, beginning from April 2013, the deadline set by the Japan Financial Services Agency for Japanese Financial Business Operators to report their equity, FX, interest rate and credit derivatives transactions. Japan was followed by Australia in October 2013, where five of the major Australian banks active in OTC derivatives trading and other banks with total gross notional outstanding positions of over AUD 50 billion have already started reporting interest rate and credit derivatives trades as prescribed by the Australian Securities and Investment Commissions rules. Other deposit-taking institutions, Australian financial services licensees, and exempt foreign licensees

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with total gross notional outstanding positions of below AUD 50 billion will begin reporting interest rate and credit derivatives trades from October 2014.

In Singapore, under the auspices of the Monetary Authority of Singapore, the reporting regime for OTC credit and interest rate derivatives trades was launched on 31 October 2013. Singapore licensed banks started reporting in April 2014. The next reporting phase will see buy-side firms and insurance companies report interest rate and credit derivatives trades from 1 July 2014, The reporting mandate for remaining asset classes, including equity, commodity and FX derivatives, will be introduced at a later phase.

The Hong Kong reporting regime designed under the Hong Kong Monetary Authority (HKMA) began in August 2013 when Hong Kong licensed banks began interim reporting of interest rate swaps and FX non-deliverable forwards. HKMA and the Securities and Futures Commission are preparing the detailed rules for implementing the new regulatory framework, and will conduct public consultation on the draft detailed rules. Subject to the passage of the relevant legislation, the new regime is expected to take effect in the second half of 2014.

### *Canada*

In Canada, the Ontario Securities Commission, the Manitoba Securities Commission and the Autorité des marchés financiers recently published rules requiring derivatives trade reporting with respect to transactions involving local counterparties. Buy-side firms have until 20 June 2015 to comply with reporting requirements (amendments implementing these reporting dates are expected to be approved and effective 2 July 2014). Nova Scotia, Alberta and New Brunswick have legislation pending allowing supervisory authorities in each of those provinces to regulate trade repositories and derivatives.

## Lessons to be learnt

While trade reporting requirements continue to be implemented around the world, there is an opportunity to reflect about the experiences to date. First, divergent reporting requirements around the world are creating regulatory overlaps, duplication or omissions in reporting, and have increased the cost of compliance for market participants. Efforts should therefore be made to ensure that regulations are cohesive and coherent. Second, in some markets trade reporting represented a significant commercial opportunity which resulted in data fragmentation and overcapacity in the system. It is likely that over time, market forces will act to reduce the number of providers and market participants will consolidate their reporting with a global trade repository but for now market participants and regulators are faced with a complex and costly structure for trade reporting.

Third, the absence of globally agreed standards hinders the fulfilment of the trade repository potential. For regulators to be able to monitor the build-up of systemic risk, global reporting standards must be agreed upon. The entity, transaction and product identifiers are an important starting point, but the divergence in the requirement for such standards across jurisdictions and the number of providers offering them hinders the implementation of an effective global regulatory framework.

Market participants have made significant strides in meeting new regulatory mandates. However, regulators and the industry recognise that convergence on reporting practices is crucial for the trade repository function to reach its full potential as a risk management tool and enhance market transparency.

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# Blueprint for a 40 Act fund

*By Bryan Haft, Senior Vice President and Steve Hoffman, Senior Vice President, Citco Mutual Fund Services (USA) Inc.*



For a manager launching a US-registered alternative mutual fund, structure is key. Opting for an open-end or closed-end fund and deciding on the trust for the fund have major implications for how it can invest, who can invest in it and how it fits with the manager's other offerings.

The choice of open-end or closed-end is most important. Both fund types are registered with the US Securities and Exchange Commission (SEC) and subject to regulaory oversight, but only open-end funds are available to the general public. Investors in closed-end funds are required to meet the SEC's definition of an accredited investor. This distinction will have an obvious impact on the distribution channels the manager pursues and on its marketing strategies.

## Open-end funds offer daily liquidity

Liquidity requirements are also a major difference between the two structures. Open-end funds provide liquidity to redeeming shareholders on a daily basis without limit. The SEC allows up to seven days to settle redemption requests, but industry practice is to settle on a trade-date-plus-one basis.

As a result of this requirement, at least 85% of an open-end fund's investments must be in liquid securities. In contrast, a closed-end fund offers to buy back a portion, for example between 5% and 25%, of its shares on a periodic basis (for example, quarterly or semi-annually). Therefore the fund may choose an investment strategy that involves significant use of illiquid securities.

A closed-end fund must maintain enough liquid investments to meet 100% of the amount redeemed.

## Deciding on trust status

Consideration must also be given to the trust that will contain the fund. Does a shared series trust or a standalone proprietary trust make the most sense? The series trust option takes advantage of an existing trust structure. It uses a board of directors and a service provider that are already established and in operation. The new fund will be added to the trust as an additional fund (i.e., as part of a series). However, it can have its own prospectus, investment manager and unique brand.

Because some operating costs are shared among all funds in a series, certain expenses (for example, board of trustee fees) are generally lower with this option. Reduced start-up cost and time to market are also advantages. The SEC review time for a new fund being added to an existing trust is 75 days from the filing of the new fund's prospectus.

The shared series trust option is however not generally available to closed-end funds, and may not be a good fit for all managers looking to start an open-end fund.

If the proprietary trust route is pursued, a new trust will be required, with the manager acting as sponsor. As a first step, a qualified board of directors must be identified and put in place, with 60% of members independent of the advisor. The board will then need to approve and engage

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all other service providers, including legal counsel, auditor, custodian, distributor, transfer agent, fund accountant, etc. While the time frame required to establish the trust and fund will vary according to specific circumstances, six or more months is not unusual.

Redemptions and trusts are just some of the factors that will need to be addressed by managers looking to participate in this exciting and growing market segment. Partnering with a service provider that not only has the necessary experience with registered products, but that also understands the unique perspective of traditional hedge fund managers, will be key to their success.

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## Would you like to write for the next issue of the AIMA Journal?

We encourage all AIMA member firms worldwide to contribute to the *AIMA Journal*, the global forum for the hedge fund industry. If you are interested in doing so, please contact Dominic Tonner at dtonner@aima.org by the end of July 2014.

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# EMIR — is it doing its job in regulating the OTC derivatives market?

*By James Conaghan, Director, PwC*

The European Market Infrastructure Regulation (EMIR) has been live since February 2014. By all accounts it has had a rocky start with many companies not ready to comply, some repositories unable to cope with the demand and confusion in relation to what is in scope.

## A bit of background...

Why was EMIR implemented? Like so many other recent regulations the main catalyst was the global financial crisis. It exposed fundamental weaknesses in the regulation of the global US$650 trillion over the counter (OTC) derivatives market resulting in the G20 agreeing on a set of OTC market reforms designed to reduce systematic risks and to improve market transparency: by the end of 2012 the goal was that derivatives contracts would be traded on exchanges or electronic platforms, cleared through central counterparties (CCPs), reported to trade repositories (TRs) and subject to capital or other requirements to reflect the riskiness of transactions. The EU implemented most of these requirements through the European Market Infrastructure Regulation (EMIR) which came into force on 16 August 2012. EMIR introduces clearing, transaction reporting and significant risk management procedures for firms, as well as a pan-European regulatory regime for CCPs and TRs.

## Who is subject to EMIR?

- Financial firms and non-financial firms established in the EU that are counterparties to derivatives contracts;
- 'Financial counterparties' include banks, insurers, MiFID authorised investment firms, fund managers, UCITS funds, Alternative Investment Funds (AIFs)[1], spread betting firms and pension schemes; and
- 'Non-financial counterparties' include any counterparty established in the EU that is not defined under EMIR as a financial counterparty, including non-financial firms, CCPs, TRs and trading venues.

## What does EMIR require firms to do?

### *Clearing requirements*

Firms must arrange for all derivative contracts deemed 'clearing eligible' by the European Securities and Markets Authority to be centrally cleared by a CCP. Central clearing imposes a CCP between each side of a trade, thus reducing credit risk between market participants. EMIR also sets out margin and collateral standards for trades cleared through European CCPs. Non-financial counterparties will be subject to clearing requirements only if their derivatives positions exceed a clearing threshold set out under EMIR.

### *Reporting requirements*

Firms must report exchange traded and OTC traded derivative contracts to TRs. The reporting requirements will allow regulators to monitor the build-up of systemic risk through excessive risk concentrations.

As part of the new reporting requirements, EMIR requires all derivative end users to adopt

*1 This includes all funds (EU and non EU) managed by an authorised or registered AIFM.*

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new entity, product and transaction universal identifier regimes. The Legal Entity Identifier (LEI) is a newly created universal entity level identification scheme. The transaction also requires a Unique Trade Identifier (UTI). The UTI acts as a tag to ensure every trade entering one of the six European repositories can be accurately identified, and it ensures that if two sides of the same trade are reported separately to two different repositories, they can be paired.

*Risk management requirements for uncleared contracts*

Firms must comply with capital and margin requirements for derivative contracts which remain outside the clearing obligation. Firms must also comply with certain risk management requirements for uncleared contracts (including timely trade confirmation, daily mark-to-market or mark-to-model valuation, reconciliation, compression and dispute resolution).

## Where are we now?

*Status*

The European Securities and Markets Authority (ESMA) registered the first trade repositories (TRs) on 7 November 2013, an event which triggered a 12 February 2014 start date for reporting derivative transactions under EMIR. This meant from the 12 February 2014 onwards both counterparties to a derivative transaction must file a transaction report with an EMIR authorised TR. There are six EMIR authorised TR's to date:

- CME Trade Repository Ltd. (CME TR)
- DTCC Derivatives Repository Ltd. (DDRL)
- ICE Trade Vault Europe Ltd. (ICE TVEL)
- Krajowy Depozyt Papierów Wartosciowych S.A. (KDPW)
- Regis-TR S.A.
- UnaVista Limited

## Outstanding issues

*Unmatched trades*

Europe's trade reporting mandate requires both counterparties to a listed or over-the-counter derivatives trade to report their side of the transaction to a trade repository, which involves the submission of a counterparty's Legal Entity Identifier (LEI) and the transaction's Unique Trade Identifier (UTI). The trade repository must then match up both sides of the trades. A high number of market participants still haven't registered for an LEI – the code that identifies each reporting counterparty and which is needed to generate a UTI. There has also been confusion in relation how to generate a UTI. Without a common UTI there's really no way for the repository to know it's the same trade. Additionally, TR's are having data quality issues with counterparties not reporting in the same way resulting in further mismatching of trades.

Matching such a high volume of trades was always going to be a challenge as systems are reliant on the quality of data supplied. If counterparties are not supplying key matching fields such as UTIs and LEI codes or equivalent entity identifiers it is not surprising that EMIR reporting has encountered this issue in relation to unmatched trades. It is going to take a number of months for the regulation and the technical standards around the regulation to evolve and standardise.

*No clear definition of 'derivative'*

Another outstanding issue hindering EMIR reporting is the lack of clarity with respect to the application of EMIR in relation to FX forwards and physically settled commodity forwards. This stems from the fact that the definition of 'derivative' or 'derivative contract' under EMIR refers to the list of financial instruments contained within MiFID. Due to

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the different transpositions of MiFID across each EU Member State, there are inconsistent approaches in relation to the definition of 'financial instruments' with regard to certain derivatives resulting in negative effects on the consistent application of EMIR. The European Commission has agreed with ESMA that further work is needed and has undertaken that further assessment will be done urgently. It has also asked ESMA to provide it with further information, such as how each EU Member State has transposed MiFID in relation to the distinction between an FX spot and an FX forward. On 10 April 2014, the European Commission published a consultation document on FX financial instruments. The consultation document potentially marks a significant step in the resolution of this issues arising in this area.

### *Non-compliant firms*

Numerous entities have experienced difficulties complying with the reporting start date due to various factors, including the delay in onboarding with certain trade repositories as they struggled to cope with the demand and difficulties in understanding how to generate a unique trade identifier. These difficulties in meeting the reporting start date have been communicated to key national competent authorities, specifically the Financial Conduct Authority (FCA) in the UK, the Central Bank of Ireland (CBI) and the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg. In its 'Supervisory priorities arising from EMIR', these regulators have indicated that they will take a more pragmatic approach toward those entities who fail to comply, provided firms can demonstrate that they have used reasonable best efforts to implement EMIR requirements and have a proactive and efficient plan in place for promptly complying with the new EMIR requirements.

### What next?

It is clear that EMIR requires a bedding in period as many entities are still unprepared and even those who made the February deadline still encountered issues due to unclear guidance and overloaded repositories. It will take time for the the regulation to evolve and standardise. Further guidance is needed from the EU Commission and understanding from local Regulators as entities try to implement the EMIR requirements correctly so that the EU has a working regime that regulates the OTC derivatives market in line with the G20 2015 aim.

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# Overview of recent hedge fund regulatory developments in Asia

AIMA GLOBAL PARTNER

*By Henri Arslanian, Director, UBS Prime Services, Business Consulting Services*

A number of regulatory developments have taken place over recent months in the Asia-Pacific region that may have a practical impact on hedge funds trading or operating in the region. This article sets out three main developments that have taken place in China, Hong Kong and Singapore.

## China

On 10 April 2014, the CSRC and the SFC announced the approval of the Shanghai-Hong Kong Stock Connect pilot program (commonly known as the Mutual Market Access Scheme or MMA) for the establishing mutual stock market access between Mainland China and Hong Kong operating between the Shanghai Stock Exchange (SSE) and the Stock Exchange of Hong Kong (SEHK).

### What is the Mutual Market Access Scheme?

- The MMA scheme is a securities trading and clearing program announced in April 2014 aimed at providing mutual market access between the Mainland and Hong Kong by establishing mutual order-routing connectivity and related technical infrastructure to enable investors to trade designated securities listed in the other's market.

### Who can participate in the MMA Scheme?

- Northbound Trading - All Hong Kong and overseas investors will be allowed to trade certain stocks listed on the SSE.
- Southbound Trading - Mainland institutional investors and certain eligible individual investors will be allowed to trade certain stocks listed on the SEHK.

### When will the MMA Scheme launch?

- The MMA is expected to launch in approximately six months, in or around q4 2014, as it can only take place once relevant trading and clearing rules and systems have been finalized, all regulatory approvals have been granted, market participants have had sufficient opportunity to configure and adapt their operational and technical systems and necessary investor education programs have been put in place.

### What type of instruments can be traded?

- Northbound Trading - generally able to trade constituent A Shares of the SSE 180 Index and SSE 380 Index and all the SSE-listed A shares that are not included as constituent stocks of the relevant indices but which have corresponding H shares listed on SEHK. Please note that B shares, ETFs, bonds, and other securities are not initially allowed.
- Southbound Trading - generally able to trade the constituent stocks of the Hang Seng Composite LargeCap Index and Hang Seng Composite MidCap Index, and all H shares that are not included as constituent stocks of the relevant indices but which have corresponding shares in the form of SSE-listed Shares.

### What are the quotas in place?

- The MMA Scheme will have a daily quota as well as an aggregate quota.

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Northbound Trading - daily quota of Rmb13b with an aggregate quota of Rmb300b

Southbound Trading - daily quota of Rmb10.5b with an aggregate quota of Rmb250b

- Please note that the aggregate quota and the daily quota will apply on a "net buy" basis allowing investors to always be able to sell regardless of the quota balance.

### What are the main differences with the existing QFII/RQFII schemes?

- The MMA Scheme is meant to co-exist with other existing schemes (e.g. QFII, RQFII, QDII). The main differences between the MMA and QFII/RQFII schemes are the following:

  - Eligible Investors – there are no restrictions for Northbound Trading and any Exchange Participant and their clients can participate (including hedge funds). QFII/RQFII in comparison is available mainly to institutional investors (e.g. hedge funds cannot apply for their own QFII)

  - Eligible Products - MMA only allows trading in certain specific stocks (mainly SSE 180 and SSE 380 Index) whereas the QFII/RQFII scheme allows trading in a broader range of products (inc. bonds, ETFs)

  - Quota - MMA has strict daily and aggregate quotas applicable to the market (Rmb13b/Rmb300b) whereas a QFII/RQFII has its own quota.

### Hong Kong

In March 2014, Hong Kong's Financial Services and Treasury Bureau (FTSB) issued the consultation paper on open-ended fund companies (OFC). This follows many years of lobbying by the industry and is seen by the industry as potentially one of the most important developments in recent years in Hong Kong.

Currently open-ended funds may be established in HK in the form of a unit trust but not in a corporate form due to various restrictions on capital reduction (e.g. in the event of a redemption from the fund).

### What are the main highlights of this consultation?

- Proposal - the consultation proposes to introduce OFCs in Hong Kong which will provide more flexibility in establishing funds in Hong Kong.
- Oversight - these new OFC vehicles will be regulated and supervised by the SFC. They will be established under the Securities and Futures Ordinance ("SFO") and not the Companies Ordinance ("CO"), except for certain narrow exceptions (e.g. winding up).
- New legislation - new OFC legislation and an OFC Code will be enacted.
- Responsibilities - the Companies Registry will be responsible for the incorporation but the SFC will be responsible for the registration and regulation.
- Nature - the OFC will be structured in a corporate form with limited liability and variable share capital. It will have a separate legal personality, be governed by a board of directors and the shareholders' liability will be limited.
- Type 9 license - the day-to-day management and investment functions of the OFC must be delegated to an investment manager with a Type 9 SFC license.
- Profits Tax - the existing profits tax exemption for privately offered funds (e.g. hedge funds) will be available for OFCs with their

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central management and control located outside Hong Kong. Practical impact is that initially, a HK based fund will still need to have offshore directors and ensure central management and control are offshore in order to be exempt from tax.
- Stamp Duty – as shares in an OFC are by definition Hong Kong stocks, their transfers should be subject to stamp duty (0.1%).
- Board of Directors – BOD will be comprised of only natural persons (i.e. no corporate directors).
- Name – will need to end by "open-ended fund company".
- Timeline – no timeline yet as consultation ends on 19 June 2014.

### Singapore

- In February 2014, the Monetary Authority of Singapore (MAS) proposed a Review of Securities Market Structure and Practices ("Consultation"), which includes, amongst other proposals, a proposal to introduce a short position reporting regime. The Consultation closed on 2 May 2014 and the industry is now waiting for the MAS response.

### What are the reporting regime options proposed by the Consultation?

The Consultation proposed two reporting regime options:

### 1. Aggregate Position Reporting

- Investors with net shorts positions that are the lower of 0.05% or S$100,000 of issued shares of a listed entity would be required to report weekly. The aggregate short positions would be published on a weekly basis without revealing investor identity.
- By comparison, Hong Kong has a somewhat similar reporting regime where the short reporting threshold is 0.02% or HK$30m.

### 2. Public disclosure of short positions

- Short position holders would be required to report their net short positions by T+2 days, if their net short position exceeds 0.5% of issued shares, and for every subsequent change in position of 0.1% or more. The identity of short position holders and their net short positions would be published on an ongoing basis.
- By comparison, Japan has somewhat of a similar regime that also requires a short position public disclosure if an investor holds 0.5% or more of the share capital of a company. Such a requirement does not exist in Hong Kong.

### Are swaps included?

It appears from the consultation language that swaps will be excluded as the Consultation states that net short positions for all securities listed on SGX Mainboard and Catalist "which require delivery of underlying securities" are to be reported. The Consultation however also states that derivatives "which could require delivery of an underlying security (e.g. exchange-listed options) would need to be included.

### What is the timeline?

Very difficult to estimate when this may be implemented, as it is still at the consultation stage, but the industry believes that this may be around 2H 2015.

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*The views expressed are those of the author and do not necessarily represent those of UBS.*

# Cayman Islands to revise ELP Law and introduce new third party rights law

AIMA GLOBAL PARTNER

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*By Nicholas Butcher, Partner, and Nick Evans, Partner, Maples and Calder*

On 21 February 2014, the Cayman Islands government published two eagerly awaited Bills. The first is intended as a comprehensive revision of the current Exempted Limited Partnership Law and the second will be a brand new law, the Contracts (Rights of Third Parties) Law, which will recognise third party rights and make them enforceable. The purpose of this article, which assumes the laws will be enacted substantially in the form of the Bills, is to summarise certain key provisions of both Bills and to assess their practical implications once in force. At the time of writing, the Bills have not yet been enacted. It is expected that both will be passed into law in or around the second quarter of 2014.

## Exempted Limited Partnership Law

The Exempted Limited Partnership Law (2013 Revision) is to be repealed and replaced by the Exempted Limited Partnership Law, 2014 (the "ELP Law"), but the new law will not make fundamental alterations to the nature, formation or operation of Exempted Limited Partnerships (ELPs).

The basic constitution of an ELP will remain the same. An ELP will continue to require a general partner, who will have unlimited liability, to act for and on behalf of the limited partners, who will have limited liability. As previously, an ELP will not have separate legal personality meaning that it will continue to contract through, and property or other assets of the ELP will continue to be held by, the general partner for and on behalf of the ELP. The establishment of an ELP through execution of an LPA between the partners followed by registration using a simple statement will remain the same, as will the basis on which an ELP is dissolved.

However, in a number of significant respects, the law governing ELPs will be improved or clarified and, in addition, welcome new concepts will be introduced. These include:

### *Fiduciary duties*

The ELP Law will amend the statutory duty of good faith for the general partner in the following respect:

> *"A general partner shall act at all times in good faith and, <u>subject to any express provisions of the partnership agreement to the contrary</u> [emphasis added], in the interests of the exempted limited partnership."*

This means the absolute requirement of the general partner to act at all times in good faith will be preserved, but the LPA will be able to determine in whose interests the general partner is required to act in any given circumstance. This will enable the LPA to manage competing interests, for example, in the context of conflicts of interest or where the general partner is general partner to multiple partnerships. The default position in the absence of express provisions in the LPA is that the general partner will be required to act in good faith in the interests of the ELP (which in effect means the limited partners taken as a whole).

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The ELP Law will expressly confirm that neither limited partners nor members of any board or committee of an ELP owe any fiduciary duty in exercising any of their rights or authorities or in performing any obligations under the LPA or as a member of the board or committee as the case may be. In both cases this will be subject to the express provisions of the LPA to the contrary so that the application and scope of fiduciary duties can be adjusted by agreement of the partners.

This does not mean that limited partners or members of a committee will never owe any duty or obligation in any circumstance. Duties can be accepted through contract or conduct. It is also submitted that the Cayman Islands court will not give the benefit of exculpation or indemnification provisions in the LPA in cases of dishonesty or other unconscionable behaviour. Limited partners and members of committees should continue always to act in good faith.

### *Key investor improvements*

The ELP Law will enhance the protections and safe guards available to the limited partners of an ELP which in turn will make the operation of an ELP both more efficient and certain. These improvements include:

a. An expansion of the express limited liability "safe harbours" with respect to membership and operation of boards and committees related to an ELP. The limited partners of an ELP can lose limited liability if they take part in the conduct or management of the business of the ELP. The ELP Law sets out a comprehensive list of activities which, if undertaken by a limited partner, will be deemed not to be taking part in the conduct or management of the business.

b. Ability to enforce committee terms. Where the LPA contains provisions for the establishment and regulation of any boards or committees of the ELP, or of its partners or a class or category of those partners, then subject to the express provisions of the LPA any person duly appointed to the board or committee shall have notice of those provisions which will not be unenforceable by such person by reason only that the person is not a party to the LPA. This will provide comfort to committee members that they will have the benefit of committee terms of reference set out in the LPA even if they are not an express party to the LPA.

c. Streamlining and simplifying the technical requirements for the admission of partners and transfer of partnership interests. As the LPA is simply a contract, it is necessary to make sure that all of the partners either on admission or following a subsequent transfer of an interest are brought into a contractual relationship with all of the existing partners (general and limited). The ELP Law will contain new provisions confirming that admissions or transfers will be perfected provided that any requirements for or conditions thereto contained in the LPA have been complied with or waived in accordance with their terms. This will also have retrospective effect.

d. Amendment to the circumstances in which there can be a clawback of capital contributions made to a limited partner in the event of insolvency of the ELP. Going forward, the clawback obligation will only arise if the ELP is insolvent at the time a capital distribution is made and the limited partner has actual knowledge of the insolvency of the ELP.

e. Introduction of new provisions relating to the

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maintenance of the register of partnership interests and the recording of contributions and distributions in order to simplify the requirements of the statutory register. The register of partnership interests, which can be held in the Cayman Islands or elsewhere, will need to contain simply the name and address of each limited partner, the date the person became a limited partner and the date the person ceased to be a limited partner. The register will be capable of inspection by all partners, subject to an express or implied term of the LPA to the contrary, and any other person with the consent of the general partner. However, financial details, such as with respect to contributions and payments representing a return of contribution, can be kept on a separate record maintained by the general partner in any country or territory. The record will be open to inspection only with the consent of the general partner.

### *Operational enhancements*

The ELP Law will introduce a number of new provisions and confirmations intended to simplify the administration and operation of ELPs and to assist with partnership transactions. These include:

*a.* Enabling registration of foreign limited partnerships to allow such partnerships to qualify as a general partner of an ELP. In addition to Cayman Islands companies, ELPs and registered overseas companies, overseas partnerships will be able to register in the Cayman Islands for the purposes of being a qualifying general partner of an ELP. This will require the filing of formation documentation together with a certificate of good standing with respect to the foreign partnership similar to the procedures through which an overseas company is registered in the Cayman Islands. This will avoid the need for a second, or administrative, general partner to be appointed to act as the qualifying general partner if it is intended that an overseas partnership, such as a Delaware limited partnership, should carry out the substantive general partner duties.

*b.* Introduction of a short form method of dissolving an ELP through strike-off. This ability will enable the Registrar where there is reason to believe that an ELP is not carrying on business or is not in operation to be struck from the Register and be dissolved. The strike-off may be effected directly by the Registrar or following a request by the general partner to strike the ELP. An ELP struck from the Register will be capable of restoration within two years on general application and up to 10 years with the approval of the Cayman Islands government. The striking-off of an ELP will not affect the liability, if any, of any general partner or limited partner.

*c.* Introduction of new provisions enabling an ELP to transfer by way of continuation, “migrate”, from the Cayman Islands to another jurisdiction. If allowed by the laws of the incoming jurisdiction, that continuation can be as a partnership, body corporate or other form of entity. This will provide greater certainty and ease in re-domiciling an ELP to another jurisdiction.

*d.* Enabling third parties to execute the LPA in order to take the benefit of a particular provision without being deemed a partner. This will enable stakeholders to the ELP who properly are not partners, such as managers or sponsors, to take the benefit or obligation of the terms of the LPA without risking adverse consequences if they would

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otherwise be characterised as a partner of the ELP.

e. Express confirmation that an ELP can create a floating charge over its assets or any class of assets. This will remove any uncertainty as to whether an ELP can create a floating charge due to an absence of corporate personality.

f. Express confirmation that any right to make capital calls vested in the general partner or in the name of the ELP shall be held by the general partner as an asset of the ELP. This will put the right to make capital calls on the same footing as any other asset of the ELP and will give greater certainty in the context of assignment of the right to make capital calls by way of security in finance transactions.

g. Introduction of new provisions creating a statutory novation of assets and liabilities on substitution of a general partner such that all rights and property of every description of the ELP held by the former general partner will vest without further formalities in the incoming general partner (and any continuing existing general partners). Similarly, the ELP Law will confirm that upon the withdrawal of a general partner all rights and property of the ELP will continue to be held by the remaining general partners. This will simplify the administration of changes in general partners and avoid the need, as a matter of Cayman Islands law, for express transfers of assets and liabilities as between general partners on any change in the constitution thereof.

h. Introduction of new provisions confirming that if the LPA provides that where a partner fails to perform any of its obligations under or otherwise breaches the LPA, the sanctions applicable for the failure of performance or breach will not be unenforceable solely because they are penal in nature. Pure penalty provisions (i.e. remedies which are not commensurate with loss calculated in accordance with Cayman Islands damages principles) may be unenforceable as a matter of Cayman Islands law generally. This amendment will make clear that the sanctions routinely found in LPAs, for example in the context of failure to commit additional capital when called upon to do so, will not be unenforceable solely by virtue of being deemed a penalty.

### Contracts (Rights of Thirds Parties) Law

Cayman Islands law observes privity of contract, meaning that only parties to an agreement have the benefit and burden of its terms. Consequently, it is usually not possible for a person who has not signed an agreement to enforce its terms even if the actual signatories have sought to recognise that person under the agreement (often called "third party beneficiary rights").

The Contracts (Rights of Third Parties) Law, 2014 ("CRTPL") will confer on third parties, via an opt-in requirement, a statutory right of enforcement, in their own right, of contractual terms afforded to them which are contained in a Cayman Islands law governed agreement even though they are not a party thereto. Only contractual terms that are expressed in writing to be capable of enforcement by the relevant third party will be so enforceable. Having opted in, the parties to the contract may not rescind or vary the contract so as to alter or extinguish a third party's rights without his consent, unless the contract expressly excludes that entitlement.

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### *Scope of application*

Contractual terms capable of being enforced by third parties under the CRTPL include indemnities and exculpations and other limitations of liability. However, certain contracts will be specifically excluded from the new law, including company memoranda and articles of association, bills of exchange, promissory notes or other negotiable instruments; claims against employees under an employment contract; contracts for carriage of goods by sea, road or air; and letters of credit.

### *Effect on existing contracts*

Terms and contracts entered into prior to enactment of the CRTPL will be capable of enforcement by third parties in their own right if the relevant contract:

*a.* already contains appropriate opt-in language, which will now be effective; or

*b.* is amended to contain such language.

Notwithstanding the above, however, a third party will only be able to enforce a right which occurs on or after the date on which the CRTPL comes into force or the contract is amended, as the case may be.

### *Enforcement by third party*

A third party will have no greater rights than a contracting party to enforce the terms benefiting the third party, including with respect to the availability of defences and the submission of disputes to arbitration in accordance with the terms of the agreement. The law will also disallow double recovery such that where a contract is enforceable by both a third party and a contracting party, the Cayman Islands court may take account of any previous recoveries made by the contracting party when assessing a recovery under the CRTPL.

### Conclusion

2013 saw a record number of ELPs registered in the Cayman Islands. The suite of revisions to the ELP Law and the introduction of the CRTPL are welcome additions to the already very well developed body of Cayman business laws and, once enacted, will help maintain the Cayman Islands as an attractive and versatile jurisdiction in which to establish and operate partnerships.

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# Global FATCA — the OECD's Common Reporting Standard

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*By Hatice Ismail, Managing Associate, and Martin Shah, Partner, Corporate Tax, Simmons & Simmons LLP*

The counteraction of tax evasion has been high on the agenda of most Governments keen to curb the loss of tax revenues against the backdrop of unpopular austerity measures. Despite many economies starting to move out of recession, the cross-border automatic exchange of tax information is a growing trend that is here to stay.

On 13 February 2014, the OECD, at the request of the G8 and the G20, released a proposed global standard for the annual cross-border automatic exchange of information on "financial accounts" based on the US Foreign Account Tax Compliance Act (FATCA). The proposed framework includes a Model Competent Authority Agreement (CAA), a bilateral and reciprocal agreement based on the FATCA Model 1 intergovernmental agreement (IGA), and a Common Standard on Reporting and Due Diligence for Financial Account Information (CRS) that is set out in the Annex to the CAA and would need to be implemented under local law.

The CRS is intended to provide the benefit of uniformity for financial institutions resident in jurisdictions that sign a network of CAAs, enabling them to build on the existing systems and processes put in place to comply with FATCA and thereby minimise the implementation costs and compliance burden. However, as each CAA is a bilateral agreement that will be negotiated between the partner jurisdictions, and given that the CRS will be implemented under local law, there is potential for differences of scope and interpretation to arise that will need to be monitored by affected financial institutions. It is, however, hoped that the OECD detailed commentary on the CRS, due to be released before the September G20 Finance Minister Meetings, will to a certain extent alleviate the concern that the CRS may not be operated and interpreted consistently by adopting jurisdictions.

On 19 March 2014, 44 jurisdictions (notably not including the US) issued a joint statement committing themselves to the early adoption of the CRS. They included, amongst others, the UK, the Cayman Islands, the British Virgin Islands, Jersey, Guernsey, the Isle of Man and Ireland. Based on those initial 44 jurisdictions alone, 946 bilateral CAAs could be signed.

This poses significant challenges for managers of funds resident in jurisdictions adopting the CRS, as the funds may be required to conduct due diligence to identify financial accounts held directly or indirectly by residents in a large number of partner jurisdictions. Funds and their managers will need to re-evaluate their approach to FATCA compliance to accommodate the sheer volume of information that may be required to be reported to the local tax authorities for exchange with the partner jurisdiction. Where the fund range managed includes funds resident in different jurisdictions that adopt the CRS, managers will need to contend with differences in interpretation of the CRS that may be applied by each such jurisdiction, not to mention the differences in CAA terms agreed between such jurisdiction and its partner jurisdictions. In addition, funds and their managers will need

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to accommodate the broader scope of the CRS compared to FATCA, in particular, in terms of the greater volume of account information to be reported, and certain funds and interests/products outside the scope of FATCA due diligence and reporting being brought within the scope of CRS due diligence and reporting (see discussion below). The CRS will also give rise to due diligence obligations for funds that are in non-CRS jurisdictions (see below).

It appears that the US FATCA regime will remain in place for the foreseeable future. A high level comparison of US FATCA (Model 1 IGA approach) and the CRS (as currently proposed), highlighting some of the key differences between two regimes, is set out in the table below. Some key concerns for the asset management industry arising out of differences between FATCA and the CRS include:

- that the CRS does not include the "regularly traded on an established securities market" exemption. This brings interests in exchange traded funds, UK investment trusts and other listed fund vehicles that are outside of the scope of FATCA within the scope of CRS due diligence and reporting, despite the practical difficulty in doing so caused by the lack of visibility of, and contractual nexus with, the underlying investors.
  Such interests are exempt under FATCA on the basis that listed vehicles are low-risk and other FATCA compliant financial institutions such as brokers and custodians or other nominees that have a closer nexus to the underlying investors should conduct any due diligence and reporting, but this is not necessarily the case in relation to the CRS, since it is not currently clear whether brokers, custodians and other relevant financial institutions will all be in CRS adopting jurisdictions.
  However, listed funds should, in our view, be considered low-risk enough for their interests to be exempt from due diligence and reporting under the CRS, especially since CRS adoption appears likely to be widespread. Such interests are exempt under "UK FATCA" notwithstanding that it has a more limited jurisdictional reach.

- that funds resident in non-CRS jurisdictions that hold accounts in entities in jurisdictions that have signed up to the CRS will have a significant compliance burden as a result of being treated as a passive non-financial entity (see the table below).

In addition, funds in the UK Crown Dependencies and British Overseas Territories will have to deal with the operational complexity and burden of implementing "UK FATCA" (pursuant to the IGAs those jurisdictions have signed with the UK) and then adapting to implement the CRS, as it is expected that UK FATCA will be superseded by the CRS and will therefore be short-lived. As with US FATCA, there are differences between UK FATCA and the CRS which those funds and their managers will need to navigate. For example the UK FATCA elective alternative reporting regime for UK resident and non-domiciled investors is not relevant under the CRS. There have already been calls from industry to shelve UK FATCA to avoid these practical issues.

Whilst a move towards greater harmonisation of obligations imposed on affected financial institutions and uniformity in the information that is required to be exchanged is welcome, compared with the alternative of a "patchwork quilt" of competing reporting regimes, the various areas of uncertainty and concern regarding the CRS discussed in this article and the table below will need to be ironed out in due course.

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### High level comparison of the CRS and US FATCA

| Key requirement/ feature | CRS | US FATCA | Comment |
|---|---|---|---|
| Registration required? | No, unless not already registered with local tax authority | Yes, with IRS unless exempt or certified deemed compliant | This is the expected position in relation to the CRS |
| "Responsible officer" required? | No | Yes, to effect registration and act as a point of contact for IRS queries in relation to registration only | This is the expected position in relation to the CRS |
| Who is a financial institution? | An Investment Entity, Depositary Institution, Custodial Institution or a Specified Insurance Company, with certain entities treated as exempt from reporting, such as Governmental entities, international organisations, central banks, certain retirement funds, trustee documented trusts and exempt collective investment vehicles | Similar to CRS but the entities treated as exempt from reporting are subject to the negotiated position set out in Annex 2 to the IGA. Although the exempt categories under FATCA are broadly similar to those under the CRS, FATCA includes some additional exemptions such as in relation to "local client base" financial institutions not contained in the CRS | Certain financial institutions that are treated as non-reporting under FATCA will be reporting financial institutions under the CRS, such as local client base financial institutions.<br><br>The CRS non-reporting financial institution category of "Exempt Collective Investment Vehicles" appears too narrow to be helpful in practice as it requires that the fund is regulated and all interests are held by non-reporting financial institutions or individuals or Entities that are not reportable persons (i.e. not individuals or entities resident/effectively managed in a CRS jurisdiction) |

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| Key requirement/ feature | CRS | US FATCA | Comment |
|---|---|---|---|
| Penalties for non-compliance? | - Domestic law financial penalties<br>- No withholding tax but "Investment Entities" in non-CRS jurisdictions are treated as passive non-financial entities that need to provide information about their controlling persons to entities within the CRS in which the Investment Entity holds financial accounts (see below) | - FATCA withholding tax if non-compliant or lose compliant status<br>- Domestic law financial penalties for minor breaches/ infringements | The CRS would impose a significant compliance burden for funds in non-CRS jurisdictions that hold accounts in entities in jurisdictions that have signed up to the CRS |
| What is a reportable financial account? | A financial account held by<br>- one or more individuals or entities resident (or effectively managed if the entity, such as a partnership, does not have a tax residence) in the reportable jurisdiction<br>- a passive non-financial entity with one or more controlling persons that is a reportable person described above. An "Investment Entity" in a non-CRS jurisdiction is treated as a passive non-financial entity for these purposes | A financial account of a reporting financial institution that is held by<br>- one or more US citizens or US resident individuals<br>- one or more US established partnerships, companies or trusts<br>- a non-US entity with one or more controlling US persons, other than US listed companies and certain tax exempt persons | US FATCA requires US citizens and residents that directly or indirectly hold financial accounts to be identified and reported whereas the CRS will require the residence of all reportable direct or indirect account holders to be reported |

continued ▸

| Key requirement/ feature | CRS | US FATCA | Comment |
|---|---|---|---|
| What is a:<br><br>- pre-existing account?<br><br>- new account? | <br><br>Accounts open on 31 December 2015<br><br>New accounts opened from 1 January 2016 | <br><br>Accounts open on 30 June 2014<br><br>New accounts opened from 1 July 2014 | It is helpful from an operational perspective that there will be fixed dates for when accounts are treated as pre-existing and new, although the CRS timeline overall looks ambitious |
| When do new compliant investor on-boarding procedures need to be in place by? | 1 January 2016 | 1 July 2014 | The new account procedures are similar for the CRS and FATCA in terms of requiring investor self-certification to determine their status. It is unclear how funds and other financial institutions that need to collect information on tax residence for CRS purposes will deal with individual investors who are dual resident, have no tax residence at all or whose tax residence changes part way through the calendar year |

continued ▸

| **Key requirement/ feature** | **CRS** | **US FATCA** | **Comment** |
|---|---|---|---|
| What kinds of categories of interests/ products are exempt from being treated as financial accounts for due diligence and reporting purposes? | Certain:<br>- retirement/pension accounts<br>- tax favoured savings accounts/ products<br>- life insurance contracts<br>- estate accounts<br>- other low risk accounts | Depends on the IGA negotiated but generally includes certain:<br>- retirement/pension accounts<br>- tax favoured savings accounts/ products<br>- life insurance contracts<br>- estate accounts<br>- escrow accounts<br><br>Equity and debt interests "regularly traded on an established securities market" are not financial accounts | It is potentially a very significant issue for listed funds that the CRS (as it currently stands) does not generally exempt interests that are "regularly traded on an established securities market" |
| Do de minimis thresholds for being a financial account for diligence and reporting purposes apply? | No de minimis thresholds apply, except a $250,000 de minimis that applies for pre-existing entity accounts | - $50,000 de minimis for individual and depositary accounts<br>- $250,000 de minimis for entity accounts | All individual and all new entity accounts will be subject to CRS due diligence and reporting, which means a significant increase in the compliance burdens for funds and other financial institutions in a CRS jurisdiction. However, it is helpful that the CRS includes an exemption from doing an electronic search for indicia for pre-existing low-value accounts where a residence address is held |

continued ▸

| Key requirement/ feature | CRS | US FATCA | Comment |
| --- | --- | --- | --- |
| What are the due diligence deadlines? | - 31 December 2016 for electronic and paper searches of high value (more than $1m) individual accounts<br>- 31 December 2017 for electronic searches of entity accounts and low value individual accounts | - 30 June 2015 for electronic and paper searches of high value (more than $1m) individual accounts<br>- 30 June 2016 for electronic searches of entity accounts and low value individual accounts | It is helpful from an operational perspective that there will be fixed due diligence deadlines, although the CRS timeline overall looks ambitious |
| What are the indicia that are searched for as part of the due diligence process in relation to pre-existing accounts? | Residence based indicia, akin to those included under the IGAs signed between the UK and its Crown Dependencies and Overseas Territories, but also including where one or more telephone numbers are in a reportable jurisdiction and no telephone number is in the jurisdiction of the reporting financial institution | US citizenship and residence based indicia | The residence based indicia for the CRS are sensible and welcome. Under the CRS, indicia of telephone numbers could be problematic and throw up false positives |

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| Key requirement/ feature | CRS | US FATCA | Comment |
|---|---|---|---|
| What financial account information is reportable? | Identifying details regarding reportable persons such as name, address and TIN and date of birth for individuals.<br><br>All kinds of investment income will be reportable, including interest, dividends and similar income, account balances and gross proceeds from the sale or redemption of property | Similar to CRS, but in identifying details in relation to individual reportable persons, no date of birth is required | |
| Is the "sponsoring entity regime" available to consolidate compliance in relation to one or more funds? | No | Yes | This difference may not have a significant impact on the asset management industry if the FATCA sponsoring entity regime is not widely used |
| What is the treatment of most investment managers? | Financial institutions with no financial accounts for due diligence and reporting purposes | Certified deemed compliant financial institution so no due diligence or reporting requirement | The treatment of investment managers appears broadly comparable under both regimes |

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# Shareholder activism: A Canadian perspective

*By Curt S. Cumming, President and Chief Financial Officer, Goodwood Inc*

Canadians are typically considered to be polite, apologetic and affable, and the fact is, shareholder activism is widely perceived as not very Canadian-like.

Shareholder activism entails engaging management and the Board of an undervalued company with company-specific recommendations which are expected to maximize long-term shareholder value.

These company-specific strategies may include changes to corporate governance, capital structure, dividend policy or asset composition. Periodically, especially if the company is wholly non-receptive to these suggestions and the activist investor feels they own enough shares and/or will have the support from enough fellow shareholders, the engagement may move into the public domain and perhaps evolve into proxy contests with the goal of seeking to replace certain directors or potentially a full reconstitution of the company's Board.

This investment strategy of proactive engagement with companies in an effort to maximize shareholder value has generated significant returns for shareholders but is not yet widely accepted as an independent asset class in the Canadian marketplace.

We would suggest that there are three key reasons why shareholder activism in Canada will continue to rise and will soon become a more widely accepted alternative asset class for Canadian investors:

1. **Structural Environment** – the Canadian legal and regulatory environment is more shareholder friendly than other developed economies;
2. **Growing Alternative Asset Class** – increased capital allocation and greater competition pursuing non-correlated returns;
3. **Cultural Paradigm Shift** – Canadian institutional and retail investors are increasingly more inclined to enforce their shareholder rights.

## Structural Environment - the Canadian legal and regulatory environment is more shareholder friendly than other developed economies

Canadian corporate by-laws and regulatory structure provide investors with an attractive path and framework to pursue an activist agenda. Foreign activist investors have begun to recognize that the Canadian marketplace is a much less litigious and uniquely attractive regulatory environment in which to pursue activist campaigns. In 2012, Pershing Square Capital Management LP, and JANA Partners LLC pursued very public activist strategies with two iconic Canadian corporations, Canadian Pacific Railway Limited and Agrium Inc., respectively. Foreign and domestic activists will continue to pursue opportunities because of the favourable environment relative to other jurisdictions.

- Shareholder Meetings – Shareholders with a 5% or greater ownership level have the right to requisition a shareholder meeting and table motions for shareholder approval including the removal of Directors and the election of alternative Directors.
- Early Warning Rules – In contrast to the U.S.

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where investors are required to file early warning reports when they surpass 5% of the issued and outstanding shares, in Canada the threshold is set at 10%. The higher Canadian limit makes it easier for activists to acquire an equity interest prior to the public and the Company's Board being notified.

- Proxy Solicitation Exemption - In Canada, shareholders can approach and solicit proxies from up to 15 shareholders before filing a dissident proxy information circular.
- No Staggered Boards - In Canada, it is normal practice for each Director to stand for re-election on an annual basis.
- Poison Pills - Canadian securities commissions have generally not allowed the use of a shareholder rights plan as a long-term defence mechanism.

## Growing Alternative Asset Class - increased capital allocation and greater competition pursuing non-correlated returns

Investors worldwide continue to transition their asset allocations towards alternative investments in an effort to diversify risk, improve returns and lower correlations amongst their asset allocations.

In a 2013 Towers Watson study on seven of the largest developed countries pensions systems, the aggregate alternative asset allocation has grown from 5% in 1995 to almost 20% in 2012. Canada's largest pensions have been leaders in this trend and have moved to a 23% allocation in 2012.

Investors globally have regularly increased their alternative asset allocation into the activist asset class. Worldwide dedicated activist capital has grown from US$12 billion of assets under management to over US$90 billion in the last 10 years[1]. In 2013, capital inflows of over US$5 billion[2] was a substantial increase from the prior years with increased traditional pension and institutional investor support to activist endeavors. These Investors have been rewarded with outsized returns - the average 2013 activist fund performance was up 17.5% as compared to the HFRI Fund Weighted Composite Index of 9.2%[3]. Activist Funds have been outperforming the MSCI world index since 2008[4].

Canadian institutional investors have led the world in alternative asset allocation to classes such as infrastructure, direct private equity and real estate investing but have not yet embraced activism in a scale comparable to their global peers.

For the large swath of Canadian investors, both institutional and individual, who do not have the wherewithal to invest with large, well-known U.S. and European activist funds; there is an unsatiated demand for this asset class' potentially high and uncorrelated returns. Regular and highly publicized activist participation in the Canadian public markets is being noticed by all types of local investors which is furthering the knowledge level and the desire to invest in this asset class.

## Cultural Paradigm Shift - Canadian institutional and retail investors are increasingly more willing to enforce their shareholder rights

The global perception of activist investing has

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*1 Source: Preqin Research (12-3-14)*

*2 Source: HedgeFund Research (1-21-14)*

*3 Sources: eVestment (2-11-14) and Hedge Fund Research, Inc (1-8-14)*

*4 Source: Activist Insight (2014 Annual Review)*

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evolved substantially over the past 10 years from its early objectionable predatory labels. Investors globally have embraced a broader trend towards good governance and an alignment of interests between shareholders and management teams/ Boards and therefore appreciate the role that certain activist investors have come to fill in the marketplace.

Some of Canada's largest and more mainstream institutional investors are increasingly becoming willing to enforce their shareholder rights and have become more supportive of activist investor agendas. In 2013, a Canadian proxy study completed by Fasken Martineau found that the 101 contests completed in a five-year period ending December 2013 represented an 84% increase over the 55 contests completed in the prior five years.

Canadian shareholders in those proxy contests supported the activist agenda in 53.5% of the contests which was not dissimilar from the 54% experienced in the US market[5] over the same time period. In a number of highly publicized proxy contests over the past few years, many of the largest Canadian public pensions voted in favour of the activist agenda.

Canadian investors are no longer apologetic when it comes to enforcing their shareholder rights, and as a result, activist strategies are on the rise; the cultural paradigm shift is well on its way.

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*5 Source: SharkRepellent.net*

# The SEC's Form PF data usage

*By David A.A. Ross, Global Head of Marketing, Viteos Fund Services*

The law requires the US Securities and Exchange Commission to report annually to Congress on how it has used the data it has collected from Form PF filings. The latest release of the US SEC Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports[1] is the first report of its kind. Despite the size of regulatory assets under management and the number of funds reporting, SEC experience with Form PF data is still relatively new. As various agencies within the commission gain expertise and understanding, the uses of the data will expand, providing more safety and protection for the economy, individual investors and the entire industry.

In a recent keynote presentation to an AIMA event in New York, March 2014, Norm Champ, the SEC Director of the Division of Investment Management, explained that the purpose of providing the data on Form PF is primarily to provide the SEC with the data necessary to analyze systemic risk that could lead to economic instability.

But the SEC has also found the information useful for a variety of metrics and additional programs for investor protection efforts, investigations, examinations and helping to evaluate and ensure overall market integrity. The collection of this information is also promoting international collaboration amongst regulators who collect similar data for their countries. The International Organization of Securities Commissions (IOSCO) has played an instrumental supporting role in promoting collaboration.

While the SEC adopted Form PF in 2011, the implementation of the reporting requirement was staggered so that it is only recently that the SEC has a full set of data covering all required advisors and funds. The SEC has spent the time between the first Form PF submissions and the completion of the first full set of data determining how to use the data in the best way to improve performance against its own charter and to augment and support existing and proposed programs.

For example, the SEC has provided Form PF data to the Treasury Department's Office of Financial Research (OFR), which supports the Financial Stability Oversight Council (FSOC) in monitoring risk. FSOC also uses the data in investigations, examinations and investor protection. Prior to releasing the Form PF data to FSOC, the Form PF Steering committee and senior officials from Treasury met to agree on security and confidentiality measures.

The SEC expects the second full set of data to become available later this year and it will include more information that will help the SEC spot economic risk. Within the boundaries of security and confidentiality imposed by the law, the SEC will share the data with other U.S. agencies and in addition, the Commission plans to share the data with international regulatory bodies, particularly IOSCO members.

As the SEC gains more insight into the provided data and its potential, it may uncover even

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*1 U.S. Securities and Exchange Commission, Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports (July 25, 2013) http://www.sec.gov/reportspubs/special-studies/im-annualreport-072513.pdf* more uses for the information, but information security and adviser and investor anonymity are two of the commission's key objectives for the data. Senior SEC officials sit on a Steering Committee whose role is to develop a consistent and agency-wide approach to accessing, using and sharing Form PF data, along with protecting and enforcing strict confidentiality and data security procedures.

Since Form PF's implementation, the Commission has focused on providing electronic methods for filing the form and resolving technical issues for data security collection and delivery while establishing reporting protocols that define protection of and access to Form PF data. Fund managers can now file electronically through FINRA, part of the office of the SEC's Investment Adviser Registration Depository or IARD[2]. While paper filing is still possible and allowable, electronic filing streamlines and simplifies the process.

It's important to note that Form PF does not require advisors to report specific holdings, but merely to report classes of holdings. In addition, the SEC never uses or publishes any individually identifiable information. All analysis and output uses aggregated data that cannot be traced to a specific adviser or fund. Several additional groups with the SEC have found Form PF data useful in carrying out their objectives.

For example, the Risk and Examination Office, known as REO, is a subsidiary group within the SEC that has benefited immensely from analyzing the available data. Created in 2012, REO consists of a team of experts with quantitative and qualitative financial analysis skills. They use the data to analyze strategically important investment advisers and their specific funds and investment offerings and products. This enables REO to identify trends and potential risks and to take or recommend steps necessary to protect investors and the overall economy.

In his AIMA keynote, Mr Champ, who heads up REO, noted that REO works with individual fund advisors to identify areas where the rules of the Advisors Act don't conform to current business practices. This has enabled REO to make recommendations for changes that enhance the quality of the data provided while simplifying the process for fund advisors.

Working with the industry on the reporting process and the survey form itself, the SEC has been able to establish clearer definitions and guidelines to streamline and simplify the reporting process. The Custody Ruling is a recent example of the changes brought about by the industry and the SEC working together.

Many advisors had difficulty ensuring timely and proper reporting for paper certificates under the original guidelines, particularly for private stock or funds. The new guidelines spell out how to report custody of paper certificates and private equity holdings, reducing uncertainty and guesswork when filing and improving the quality and consistency of the data used in the Commission's analyses.

The Commission also issued guidelines to private investors on methodologies for aggregating their private fund holdings to maintain investor and fund privacy while still adhering to the letter and spirit of the regulations.

The Division of Economic and Risk Analysis (DERA) has begun using Form PF data in its analytical tool that calculates aberrational

*2 Division of Investment Management: Electronic Filing for Investment Advisers on IARD http://www.sec.gov/divisions/investment/iard.shtml*

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performance, systemic trend and peer analysis in due diligence and enforcement.

REO and DERA are also working together to monitor and analyze risk-taking activity and to provide periodic reports on the private fund industry and particular market segments. REO also shares its analysis with IOSCO as part of that agency's global hedge fund industry research.

The Commission's Office of Compliance Inspections and Examinations (OCIE) expects to begin using Form PF information to improve exam scoping and provide better insight into funds managed by a particular adviser to help in risk assessment.

OCIE will also provide periodic reports across multiple filers to identify trends and potential emerging risks. The expectation is that this analysis will help the agency home in on examination priorities while allocating resources better and improving its industry training programs.

OCIE is also in the process of developing a series of standardized metrics that will trigger examinations at specific firms or firms engaged in similar activities or with similar holdings.

The table below shows the scope of the information collected in the first full year as of 15 May 2013 –

| Filer/Fund Description | Number of Funds | Cumulative RAUM |
|---|---|---|
| Hedge Funds | 6,683 | $4.061 trillion |
| Private Equity Funds | 5,928 | $1.603 trillion |
| Other Private Funds | 2,922 | $698 billion |
| Real Estate Funds | 1,121 | $299 billion |
| Securitized Asset Funds | 966 | $338 billion |
| Venture Capital Funds | 329 | $23 billion |
| Liquidity Funds | 66 | $258 billion |
| Private Fund Regulatory Assets Under Management Reported by all Filers | | $6.02 trillion |

### International Reporting

IOSCO, the International Organization of Securities Commissions, works with the G-20 and international standards boards on the global reform agenda and its membership regulates more than 95% of the world's security markets. IOSCO has created a Task Force to review major regulatory issues related to international securities and futures transactions and to coordinate global responses to the issues.

IOSCO's mission is to promote global regulatory standards to maintain efficient and stable markets, to unite efforts to establish consistent standards and reporting mechanisms and to provide mutual assistance in market regulation through rigorous enforcement of those standards through the secure and confidential exchange of information regarding markets and standards.

The IOSCO Task Force co-chairs include CONSOB (Italy) and FCA (United Kingdom). IOCO membership includes representatives from all over the world. ASIC (Australia), AMF (France), BaFin (Germany), CNMV (Spain), FSA (Japan), OSC (Ontario), SEC and CFTC (United States), SFC (Hong Kong), FINMA (Switzerland), CVM

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(Brazil), AFM (Netherlands), MAS (Singapore) are all members, while the CNBV (Mexico) is an observer.

The first IOSCO hedge fund survey took place in September 2010. However, due to legal constraints relating to sharing data, the information was not complete. Nonetheless, the survey data yielded interesting information regarding hedge fund risks.

IOSCO's second survey occurred in September 2012, and included data from Australia, Brazil, Canada, France, Germany, Hong Kong, Italy, Japan, Luxembourg, Netherlands Singapore, Spain, UK and US agencies[3].

One of the key constraints on the usefulness of the IOSCO survey data was the consistency and accuracy of the reported data. Some survey participants conducted a data cleansing exercise while others did not, so it is impossible to ensure the accuracy of the report or any inferences or conclusions based on its information.

Respondents varied widely in their interpretations of the questions and definitions, which resulted in widespread divergences in responses, particularly as relates to counterparty credit data, collateral, certain derivatives data, trading and clearing data for derivatives and borrowing. IOSCO expects survey data quality to improve as hedge fund managers become accustomed to the reporting requirements and more familiar with the survey questions, definitions and calculation methods.

To that end, IOSCO's intention is to continue its efforts to agree on common global definitions and standardized interpretations of all questions. Some respondents may be constrained by local regulations, so IOSCO notes that it may require several iterations of the survey before the data yields insights that are more consistent.

As managers complete more regulatory filings and regulators build processes and structures to facilitate sharing of data amongst agencies they can expect uses of the data will multiply. Insights into the risk-taking activities of alternative investing not possible before 2012 should offer more transparency into investment and speculation activities, thereby improving pellucidity of one segment in financial services that contributes to the risk inherent in global financial markets.

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*3 The Board Of The International Organization Of Securities Commissions, Report on the second IOSCO hedge fund survey (October 2013) http://www.iosco.org/library/pubdocs/pdf/IOSCOPD427.pdf*

*Membership of AIMA is corporate. For further details, please contact Fiona Treble at ftreble@aima.org. To learn about the benefits of an AIMA membership, click here. All information supplied in the following member profiles has been provided by the member company and its accuracy is not guaranteed by AIMA.*

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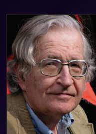

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GlobalARC


# AIMA has more than 1,400 corporate members in over 50 countries and is present in all of the major financial centres globally

## Long track record

AIMA was founded in 1990 and has grown into the only truly global hedge fund industry association, with more than 1,400 corporate members in over 50 countries.

## Representing the industry

We represent the world's hedge fund industry to regulators, policymakers, investors, the press and other stakeholders.

## Speaking for the whole industry

AIMA's members come from all parts of the global industry — including managers, service providers, allocator managers (including FoHFs), advisers and investors.

## Regulatory updates

AIMA members receive comprehensive regulatory updates.

## Education and Sound Practices

AIMA members are given access to our full range of sound practices material, covering hedge fund management, valuation and asset pricing, administration, governance, business continuity, due diligence questionnaires for managers and service providers, offshore alternative fund directors and fund of hedge funds managers.

## AIMA Knowledge Centre

Our members get access to our online library of industry knowledge and expertise. Additionally, they receive our weekly newsletter, covering all the latest key industry and regulatory developments, and our flagship quarterly publication, the *AIMA Journal*.

## A positive start

Due to the amount of information available from AIMA and assistance we can provide through sound practices guidance, membership of AIMA is often one of the first steps taken by new firms in the industry, wherever they are based.

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Our members are able to share ideas and influence outcomes by either joining one of our many committees and regulatory working groups or by taking part in one of our many events around the world, including our Global Policy & Regulatory Forum and the AIMA Annual Conference.

## Member events

Our Annual Conference, open to all AIMA members, attracts leading speakers from the industry and among policymakers, and hundreds of delegates, from around the world. We also hold regular events for our members globally, which provide helpful intelligence to delegates and networking opportunities.

## Loyal members

AIMA membership renewal rates are regularly above 85%.

## Global members

Discounts on membership fees are available to firms with offices in multiple locations.

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