1990 | 2015 25 YEARS

The global forum for the global hedge fund industry

aima Alternative Investment Management Association

AIMA Journal

The new lenders:
Modern finance's quiet revolution

Q2 2015 www.aima.org Number 103

Contents

AIMA updates

From our members

Contents

Would you like to write for a future AIMA Journal?

The next edition of the *AIMA Journal*, the global forum for the hedge fund industry, will be released at the end of September 2015.

If you are an AIMA member and would like to contribute to this edition, please contact Dominic Tonner by the end of July at dtonner@aima.org.

Only AIMA members may write for the AIMA Journal. If your firm is not currently a member and you would like to learn more about the benefits of joining, please contact us at info@aima.org.

CREATING THE WINNING PLATFORM

Working together with our clients in the funds and investment management sector as one seamless global team, Clifford Chance helps international and domestic players across the industry achieve their goals.

IRB RUGBY WORLD CUP 2015
OFFICIAL LAW FIRM

CLIFFORD CHANCE

Funding the real economy

By Jack Inglis, CEO, AIMA

The theme of this edition of the AIMA Journal is the "new lenders" including hedge fund firms who are revolutionising modern finance. The centrepiece is a summary of our new paper, 'Financing the economy', which we published in May 2015. The paper states that private debt funds such as hedge funds manage around $440 billion in assets, with some $64 billion of new capital allocated to the sector in 2014. This new capital has flowed in to fill a void left by traditional banks, who of course have reduced lending since the financial crisis.

The most popular borrowers of non-bank private debt, according to our paper, are small and medium-sized enterprises (SMEs). Such businesses are typically too small to raise capital through the public corporate bond market and have been finding it difficult to borrow from the traditional banking sector since the crisis. Refinancing existing loans, pursuing acquisition and expansion plans and improving working capital are all common uses of such private finance.

A number of case studies are published with the paper, including examples of private debt funds that have supported sectors as diverse as social housing, health, renewable energy and shipbuilding. It builds on our previous research in highlighting the 'real economy' impact of hedge funds. This is a key area of focus for us – demonstrating the tangible benefits that hedge funds can bring to markets, investors and society at large, and underlining that our industry is connected to the 'real world'. Our paper last year showed a clear correlation between capital market depth and economic growth. The prospect of a capital markets union is something we of course support. In May, we submitted a response to the European Commission green paper on Building a Capital Markets Union. Our submission focused in particular on improving the securitisation framework and openings for direct lending.

We are keen that asset management activity in the private credit space is well understood - lest unnecessary or inappropriate controls are introduced to curb it. We had the opportunity to discuss this in more detail last month when my colleague Jiri Krol and I, joined by several manager representatives, travelled to Brussels for a very useful and constructive meeting with Lord Hill, the European Commissioner for Financial Stability, Financial Services and the Capital Markets Union. Meanwhile, credit opportunities were a recurring theme at the recent annual SALT conference in Las Vegas.

Finally, I am very much looking forward to the post-summer period and AIMA's 25th Anniversary Dinner, which will precede our Annual Conference in London. This will be in aid of the NSPCC (National Society for the Prevention of Cruelty to Children) and channelled through the charity Hedge Funds Care. We will take the opportunity to look back at the lessons learned over the past 25 years and look to the future with the optimism of a fully grown up industry. Please save the date for this very worthwhile cause: 23rd September 2015. The Annual Conference and 25th Anniversary AGM is on 24th September, both at Guildhall in the City of London. I look forward to catching up with many of you there.

Financing the economy: The role of alternative asset managers in the non-bank lending environment

Earlier in Q2, AIMA published a research paper into private debt funds. The full paper is here. An executive summary follows.

Introduction

Alternative asset managers of all stripes have stepped up their direct financing of the economy. Non-bank private debt financing, as distinguished from public corporate debt markets, has grown dramatically in popularity and volume in recent years. Buoyed by both increased demand from investors as well as a growing appetite from businesses for alternative sources of funding, these markets are starting to have a noticeable impact on economic activity.

Across the globe's lending landscape, a quiet revolution is taking place in the way companies secure their finance. In the US, where the activity is most established, the private debt markets are the biggest and deepest. In Europe, amidst tighter banking restrictions and a consequent reduction in bank lending, the past two years have seen a significant rise in volumes, albeit from a much lower base.

These alternative lenders are active in a great number of markets including direct lending, mezzanine finance, distressed debt and various derivatives-based strategies which help support bank loan portfolios. Recent industry estimates (by Preqin) put the private debt market approaching $450bn in assets under management globally. Hedge funds have also dramatically increased their exposure to this sector.

Some of the world's largest institutional investors are helping to bridge the financing gap for the SME sector by investing in alternative credit funds or taking a more direct approach
and doing it for themselves. Non-bank lenders enjoy a growing credit portfolio across a wide range of businesses as well as providing support to a broad variety of infrastructure and real estate projects.

Arguably, the role of non-bank finance has never been more important than today. A recent survey by the European Central Bank showed that mid-market corporates continue to report a reduced supply of bank loans for the fifth consecutive year, while access to direct bank finance for SMEs is increasingly difficult.

In this latest research piece, we explore the development of alternative credit and the increasingly important role asset managers are playing as participants in non-bank finance.

To help us in our understanding of this area, we conducted a global survey among a variety of asset management participants in the private debt market throughout November and December of 2014.

What the research shows is that private debt funds are financing an eclectic mix of smaller companies as well as funding socially beneficial projects including student housing and hospitals.

It also shows that the liquidity profile of the funds is very much at the forefront of the manager's concern and consequently, that these funds are structured in a responsible manner and pose little to no risk to the financial system.

The paper's key findings at a glance

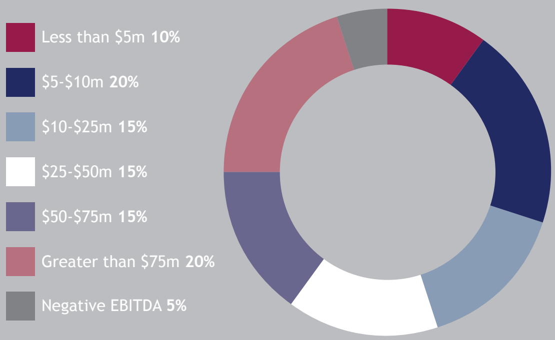
Alternative asset managers are playing an important role in direct financing of the economy

Asset management vehicles such as hedge funds and private equity funds are lending to a variety of private debt markets beyond the SME market including real estate and infrastructure projects. Further, they are lending for a variety of purposes

continued ▸

At a glance: Private debt funds

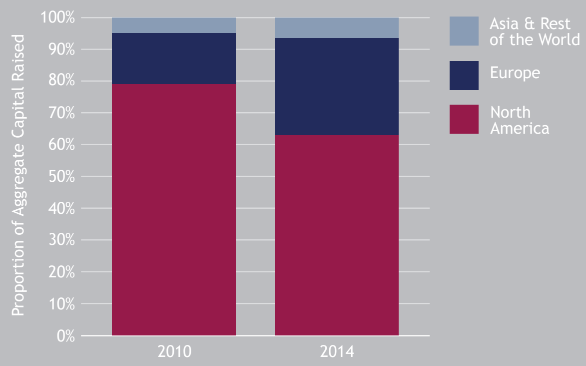
Funds typically finance smaller firms



Average size of the borrowers in private debt (EBITDA)

Source: AIMA Private Debt Survey

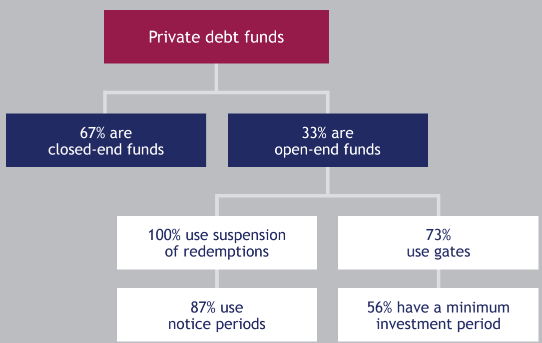
US funds dominate but European funds are growing in prominence



Annual private debt fundraising by fund focus (2010 versus 2014)

Source: 2015 Preqin Global Private Debt Report

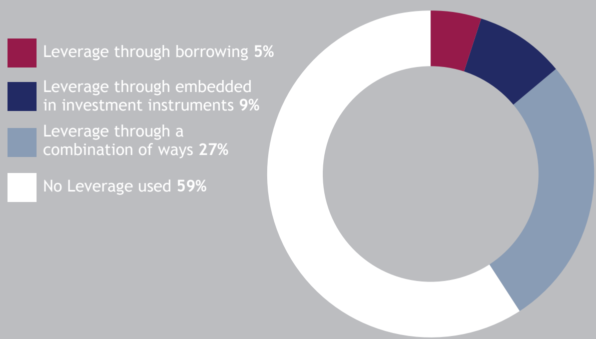
Private debt funds are structured in a way to prevent liquidity mismatches



Liquidity profile of private debt funds

Source: AIMA Private Debt Survey

Most private debt funds do not use leverage. Of those that do, leverage levels are between 1-1.5x NAV



Use of leverage among private debt funds

Source: AIMA Private Debt Survey

$440 Billion

ASSETS UNDER MANAGEMENT BY PRIVATE DEBT FUNDS

Source: 2015 Preqin

$64 Billion

IN CAPITAL RAISED BY PRIVATE DEBT FUNDS IN 2014

Source: 2015 Preqin

continued ▸

with refinancing and acquisition/expansion the most common reasons that borrowers seek capital.

With sophisticated institutional investors providing the capital, funds are well suited to lend for the medium- to long-term providing borrowers with stable capital to accomplish their objectives.

Private debt funds do not create liquidity mismatches

Liquidity management is an important consideration for private debt funds. Unlike bank depositors, investors cannot instantly withdraw their capital.

Most funds are structured as closed-end private equity style funds. Given their long dated liability profile, they are therefore less likely to generate financial stability concerns.

Private debt funds use responsible risk management techniques

The majority of private debt funds do not use any leverage. The funds that do, use modest amounts (1-1.5x NAV). Managers are also using diverse and sophisticated methods to manage and monitor risk in their private debt portfolios from origination to liquidation of investments.

Alternative asset managers in the private debt space are regulated and supervised

Private debt alternative funds and their managers are part of the wider asset management sector.

They must be authorised or registered with government agencies and are the subject of strict regulation across all major financial jurisdictions, including that which relates to investor protection, prudential standards and systemic risk.

They are subject to strict micro-prudential operational standards and organisational requirements such as conflict of interest and conduct rules, the protection of client assets as well as prudential regulations on liquidity and risk management.

Regulatory and tax constraints pose the biggest challenge to private debt

Many jurisdictions around the world impose heavy restrictions on non-bank finance. These range from drastic measures such as a prohibition of direct lending to creating an unfavourable tax environment.

Securitisation regulations make it very difficult and complicated for asset managers to act as sponsors or originators of deals or even to act as investors in certain circumstances.

Asset managers also often face an adverse environment in securing and enforcing their claims in jurisdictions which favour bank finance over non-bank lending.

Credit fund strategies across the liquidity spectrum

By James Oussedik, Counsel – Investment Funds Group, and Nicole Suignard, Associate – Investment Funds Group, Sidley Austin LLP

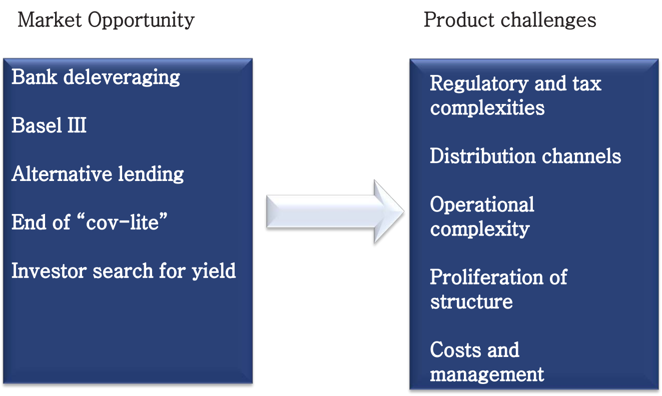
The challenges faced by the banking sector post-2008 have created significant opportunities for alternative asset managers in a field formerly the domain of banks and other financial institutions. In particular, over recent times there has been a growing trend in managers seeking to access investments in less liquid credit markets, such as distressed and special situations debt, regulatory capital transactions and direct lending.

In this article, we consider some of the specific structuring, regulatory and tax issues which arise where managers, particularly those more familiar with liquid "hedge" type products, move into less liquid credit strategies.

Opportunities and product challenges

The table below summarises some of the main issues which managers need to get grips with in order to develop a product which is fit for purpose, both in terms of structure but also in terms of commercial and business issues.

The main focus of structuring must be to reconcile investor liquidity with the liquidity of underlying



investments. In terms of the technology available to manage liquidity within the confines of a typical open-ended hedge fund, many managers will seek to include terms such as gates, side-pockets and/or partial lock-ups. However, since 2008 such liquidity constraints have been more open to challenge from investors: although there may be sound investment reasons for side-pocketing assets, doing so can be stigmatic for the manager unless investors' perceptions are effectively managed, particularly where a significant proportion of the portfolio is affected.

As less liquid strategies such as direct lending and special situations debt have gained interest in the market over recent times, there has been a logical increase in the number of managers exploring means by which to lock-up investor capital for longer periods, beyond the reach of most open-ended hedge fund structures.

In order to deliver a product which ensures a prolonged lock-up and alignment of interests with investors, many managers have implemented limited partnership structures with features more commonly encountered in private equity-style funds and which are significantly different to those included in typical hedge products. Such terms commonly include: capital commitment and drawdown structures; economics based on a "waterfall" model for distributing realised investment proceeds; carried interest based on realised profit rather than net asset value; and investor protection terms such as kick-out rights to remove the sponsor's control of the fund in the event of "cause" type conduct or as a result of an resolved key man event.

Familiarity with the concepts, jargon and ethos behind terms historically more associated with the private equity world can be a major challenge for managers looking to utilise limited partnership technology in their fund offering.

continued ▸

Furthermore, building an illiquid fund structure will in most cases lead to a proliferation of structure and associated entity costs, giving rise to new corporate governance challenges and new operating models including investor reporting and valuation.

Distribution is another common challenge for managers more used to the liquid strategy world, for two main reasons: (i) often the investor team responsible for liquid fund allocations will not be the same as the team responsible for illiquid investment allocations, and (ii) credit, and in particular illiquid credit, can be difficult for investors to categorise in terms of traditional allocation buckets. Managers should seek to be on the front foot on these issues as early as possible in the marketing process.

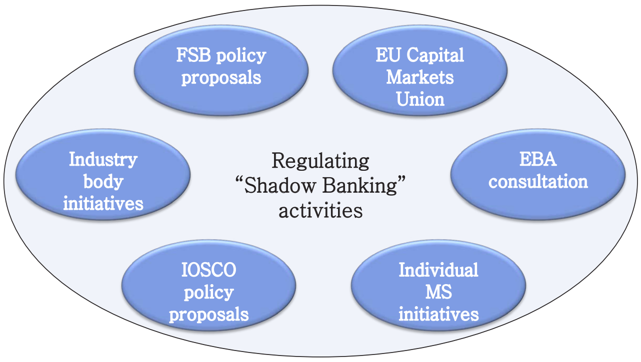
Shadow banking and regulation

It remains the case that there is no harmonisation among EU member states of the regulation of originating, arranging or trading in loans. For market participants, including funds engaged in direct lending or secondary trading of loans, this can cause a great deal of complexity and, in some cases, uncertainty. Which specific activities are regulated varies between jurisdictions, as does the key issue of where the regulated activity is deemed to be taking place: the location of the lender, the arranger, the borrower, all three potentially? However this fragmentation of regulation could be perceived to be preferable in comparison to a uniformly restrictive EU regulatory regime. Although, as we discuss further below, that outcome may have receded somewhat, it cannot be ruled out entirely at this stage.

In the absence of a coherent European-level framework, the debate over the future regulation of shadow banking continues. Following numerous initiatives and consultations, the fundamental question remains as to whether, and to what extent, so-called "shadow banking" activities should be more vigorously regulated where they are carried out by non-financial institutions such as investment funds.

In March 2015, the European Banking Authority (EBA) issued a consultation (to close in June 2015) on guidelines on the criteria to set limits on EU institutions' exposures to shadow banking entities (SBEs). Under the draft guidelines, it is proposed that EU financial institutions will have to undertake a risk management exercise to limit their exposure to SBEs based on the "principal approach" (involving detailed analysis of exposure types and status of SBEs) or, failing that, the "fall-back approach" (a 25% limit on aggregate exposure to SBEs).

Similarly, the Financial Stability Board (FSB), responsible for monitoring and devising recommendations on the global financial system following a directional policy agreement at the G20 level, recently issued a position paper on



shadow banking, including an outlook for 2015, adopting a two-pronged strategy: (i) a system-wide monitoring framework; and (ii) the development of policy measures. By the end of 2015, the FSB is looking to consolidate a number of peer reviews (including those conducted by IOSCO to monitor the progress to date with respect to shadow banking regulation) and report to the G20 in November 2015.

Alongside these initiatives, a key part of the European Commission Green Paper on the Capital Markets Union (CMU) concerns improving access to the capital markets for small and medium enterprises, which may provide a policy background for a more liberal approach to shadow banking activities than previously anticipated. The Commission is looking to put together the

continued ▸

building blocks for the CMU by 2019. In addition, certain jurisdictions such as Luxembourg, and more recently Germany, appear to have loosened the regulatory grip on certain types of lending activities to non-retail borrowers. A further sign perhaps that there is reason to be cautiously optimistic that a workable regulatory environment may emanate at EU level in the near future.

Tax considerations

Tax structuring for credit funds with a European focus will often require the establishment of "under the fund" investment vehicles, with the intention of accessing double tax treaties where available, as well as enhancing the limitation of potential liabilities in the fund structure. Such vehicles are commonly established in Ireland (often as section 110 companies) and in Luxembourg (typically using a S.à r.l.).

In recent times there has been an increase in the scrutiny placed on the substance of such investment vehicles and on their ability to obtain relief under applicable double tax treaties; arising both due to local regulatory requirements, and local tax authorities raising concerns as to whether such vehicles have beneficial ownership of the underlying interest payments.

Furthermore, the OECD last September published seven recommendations pursuant to its Base Erosion and Profit Shifting initiative. Two of the suggested actions may limit the ability of credit funds to effectively utilise such investment vehicles. Action 2 concerns the use of hybrid instruments in funding structures, where an instrument may be treated as debt in one jurisdiction, but as equity in another. It is common for Luxembourg structures to make use of hybrid instruments in order to minimise overall tax leakage.

Action 6 seeks to target the use of entities in structures with the intention of gaining the benefit of double tax treaties (i.e. an investment vehicle in Luxembourg) which would not otherwise be available to the ultimate investing entity (i.e. the main fund entity). However, it should be noted that the application of Action 6 to investment fund structures remains subject to ongoing discussion. Managers currently using, or considering, investment vehicle structures should monitor implementation of these proposals and discuss with their tax advisers their potential effect.

In the US, safe harbours generally afford protection to managers engaged in the secondary trading of loans from the risk of being deemed to be engaged in a US trade or business. However such provisions do not generally apply to loan origination activities. Unless tax structuring is carefully considered, this can result in non-US investors bearing a 35% US tax on all income deemed to be effectively connected with US loan origination activities, as well as having to file US tax returns. In addition, if the loan origination employs leverage to enhance returns, US tax-exempt investors will be at risk of earning imputed "unrelated business taxable income" which will cause unwanted issues, including the need to file tax returns. Structuring solutions can generally be designed to mitigate both these issues.

Conclusion

Whilst the scale of the opportunity in European credit markets looks set to continue to attract alternative investment managers, there are key commercial and legal issues to understand, particularly where longer lock-up vehicles are required. Accessing advisers who can provide a deep understanding of fund terms, together with insights into changes in the regulatory and tax climate, is a crucial part of a successful product launch in this fast evolving space.

joussedik@sidley.com
nsuignard@sidley.com
www.sidley.com

Funding UK agriculture's renewable energy strategy - How investors are turning to non-traditional sectors for income streams

By Craig Reeves, Founder, Prestige Asset Management / Prestige Capital Management

Since the financial crisis of 2008, many of the economic factors that have been taken for granted in global investment simply no longer apply. We are living in a new world of risk and opportunity. Austerity and a change in the regulation of the banking sector are having unanticipated consequences on the way businesses are financed and the role banks play in the economy.

The printing of money by central banks is also changing the complexion of global financial markets, with higher premiums now being placed on real assets like property. Traditional sources of yield have dried up and investors are now turning to alternative investments and equities.

We can see this new world order exhibited in the fact that equity market volumes have tended to stay below 2007 levels, real wages have failed to rise and while unemployment has dropped, government debt piles have remained steadfastly high. We can see signs of deflation and markets that have acted as traditional sources of diversification, like commodities for example, failing to provide the returns they historically delivered.

Taken together, these factors are creating a new and unfamiliar environment for the investor to navigate. Allocators are starting to investigate strategies that can take advantage of this new reality, capitalising on opportunities that did not exist to the same extent five years ago. Prized among these are real-asset strategies, or those which take a more traditional approach to generating returns, for example by replacing banks as sources of credit finance.

The new economic landscape is creating investment opportunities at the same time as investors go looking for non-traditional sources of returns. Take the energy sector in the UK: it is changing drastically, both in terms of how energy is generated, and how it is consumed. The UK urgently needs to develop new sources of electricity, including from renewables, as other projects are decommissioned. A potential gap in generating capacity is starting to emerge.

The last government identified eight technologies capable of delivering 90% of the UK's energy needs by 2020, and in 2011 adopted a program to provide +15% of the country's energy from renewable sources by 2020. Investors domestic and foreign are being asked to help with the costs of this huge transformation of the UK power infrastructure.

Large power projects like that at Hinkley Point in Somerset, which is being jointly financed by France's EDF and China's General Nuclear Power Corp, bring with them guaranteed price tags for the electricity they will provide over three decades or more. For investors, projects like this can provide government-guaranteed income streams outside the bond market, as the government will need to underwrite price levels in order to attract capital.

Beyond the energy sector, the UK's farming and food processing industries have also seen tremendous change. Energy costs have been rising for farmers and food groups, along with the price of specialist equipment, machinery and farmland itself. Energy consumed by UK agriculture exceeded £1.4 billion in value in 2012, and while farmers hope to see costs drop as a consequence of more renewable energy coming online, the capital investment cost of alternative sources of energy remains a significant barrier to the UK agriculture and food related industries. The cost of electricity in the UK has not fallen materially in the past year, despite the decline in the oil price, and the cost of electricity for UK consumers is approximately 87% higher than it was

continued ▸

a decade ago. Farmers and food groups are also finding that waste disposal via landfill is becoming economically challenging: on top of normal landfill rates – UK taxes on landfill have risen from £56 per tonne at the standard rate in 2011, to £80 per tonne in 2014. UK agricultural waste tends to be active and priced at the higher end of the market (compared with inactive waste like concrete), hence cost effective alternatives are starting to look far more attractive. As banks have exited the credit finance market, farm groups and food processing groups have experienced difficulty in obtaining the loans they need, including to improve infrastructure on farms and on site (e.g. investment in specialist equipment, machinery and renewable energy generation). Although lending to UK SMEs increased slightly last year (9% more than in 2013, according to the British Bankers Association), approved borrowing overall was lower in Q4. Borrowing from the agriculture sector from banks was also lower in Q4 2014 versus the previous year.

For the Bank of England, the problem has been how to encourage much-needed new lending to the UK agriculture and food processing related sectors. Business investment has fallen 34% in five years and new firm creation in the UK is oddly low. The overall impact is a negative one for UK farming and food processing – recent figures from the likes of the OECD and the US Department of Agriculture demonstrate that the British agriculture sector's level of comparative efficiency has been falling steadily when compared with other developed economies.

Lack of investment in new equipment, machinery and vehicles also has a large part to play in this tale. While the UK government has devoted some money towards R&D, it has not compensated for the high cost of power nor the ageing farming and food processing infrastructure. A gap has been created here for private investment strategies that can step into the vacuum created by the retreating banks. Credit strategies typically offer consistent positive returns with lower volatility than market-based funds with the added benefit of low correlation to public markets.

In the alternative investment sector we have seen an increase in the number of credit funds on the market. Like real estate funds, they require portfolio management teams that understand the SME sectors they are dealing with, and who can draw on backgrounds in commercial lending and auditing, for example. Credit strategies are scalable, as the demand is there for loans, and a well-managed fund can oversee a considerable loan portfolio with relatively few capacity issues.

Both farming, food processing and renewable sectors present an attractive income stream for allocators who are casting around for consistent and non-correlated return profiles at a time when government bonds like the German 10 year bund are threatening to enter negative yield territory. Together, they can also provide a combined investment opportunity, namely the provision of 'on farm' renewable energy. This can include wind turbines, solar panels, and increasingly even bio mass and bio gas using waste from the same farm which would otherwise be costly or increasingly impossible to dispose of in landfill.

On farm energy generation brings with it the combined attractions of loans secured against UK farmland (which may now be the most valuable in world) and additional 20-30 year guarantees from the UK government, which is acutely aware of the problems of a lack of commercial bank financing in this sector. The availability of dedicated credit finance pools for the development of local renewable energy sources is already helping farmers make their businesses more cost effective, and the sector is becoming increasingly aware of the implications of potential power shortages in the future, as more of the UK's nuclear power generating capacity is decommissioned. Emphasis now lies on the proper delivery of investment finance to the sector through managed assets strategies that can be effectively deployed, with the right terms and guarantees to support them over the medium to long term.

craig.reeves@prestigefunds.com
www.prestigefunds.com

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
24 June 2015	ESMA	Summary - The European Long-Term Investment Fund Regulation
22 June 2015	CBDT	Submission - Representation for non-applicability of the Minimum Alternate Tax provisions to Foreign Portfolio Investors for years prior to 1 April 2015
19 June 2015	EBA	Submission - EBA draft guidelines on limits on exposures to shadow banking entities
18 June 2015	HMT	Submission - Transposition of MiFID II
17 June 2015	OECD	Submission - BEPS 6
4 June 2015	EBA	Submission - Draft Guidelines on sound remuneration policies
2 June 2015	SFC	Submission - Principles of Responsible Ownership
1 June 2015	FSB	Submission - second FSB and IOSCO Consultation Paper on Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions
26 May 2015	FCA	Submission - Developing our approach to implementing MiFID II conduct of business and organisational requirements
13 May 2015	EC	Submission - Prospectus Directive
13 May 2015	EC	Submission - EU framework for simple, transparent and standardised securitisation
12 May 2015	EC	Submission - Capital Markets Union

continued ▸

5 May 2015	FCA	Submission – Eighth Quarterly Consultation Paper
30 April 2015	OECD	Submission - BEPS Action 3: Strengthening CFC rules
27 April 2015	HMT	Summary - Transposition of the Markets in Financial instruments Directive
27 April 2015	EC	Submission – AIFMD: additional measure of leverage
20 April 2015	FSTB	Submission - Effective Resolution Regime for Financial Institutions in Hong Kong
9 April 2015	HKEx	Submission - Proposal For Introduction of Volatility Control Mechanism in The Securities and Derivatives Markets and Closing Auction Session in The Securities Market
8 April 2015	Australian Treasury	Submission – Implementing Element 3 of the IMR
7 April 2015	FCA	Summary - Updates from the FCA on the use of dealing commission regime

Q2 regulatory, tax and policy developments globally

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

Global

AIMA publishes update to DDQ for Selecting a Fund of Hedge Funds Managers

9/6/15

AIMA has published a revised version of its Illustrative Questionnaire for Due Diligence of Fund of Hedge Funds Managers, which was last updated in 2009. The AIMA DDQ for Funds of Hedge Funds Managers is used by prospective investors prior to making an allocation and is considered to be the industry-standard template. By having a standardised set of questions, the DDQ also helps managers of funds of hedge funds to respond efficiently to requests for information from multiple investors. AIMA consulted with a broad range of hedge fund managers and institutional investors during the drafting of the new DDQ and overall the revisions and additions to the questionnaire have been designed to assist investors and managers further in the due diligence process and to reflect regulatory changes since the DDQ was previously updated in 2009. To request the updated DDQ, click here.

continued ▸

Hedge funds step up financing of the economy – new AIMA paper

12/5/15

Hedge fund firms and other alternative asset managers are playing an increasingly important role in financing the economy, according to a new paper published by AIMA. The paper, titled 'Financing the Economy: The role of alternative asset managers in the non-bank lending environment', says that private debt funds such as hedge funds now manage around $440 billion in assets, with some $64 billion of new capital allocated to the sector in 2014 alone. The paper also finds that the most popular borrowers of non-bank private debt are small and medium-sized enterprises (SMEs). Such businesses are typically too small to raise capital through the public corporate bond market and have been finding it difficult to borrow from the traditional banking sector since the crisis. Refinancing existing loans, pursuing acquisition and expansion plans and improving working capital are all common uses of such private finance. A press release is available here.

AIMA publishes update to its DDQ for Prime Brokers

5/5/15

AIMA has published a revised version of its Illustrative Questionnaire for Due Diligence of Prime Brokers, which was last updated in December 2011. This due diligence questionnaire (DDQ) accompanies the AIMA Guide to Sound Practices for Selecting a Prime Broker which was updated in December 2014 (available here). Overall the revisions and additions to the questionnaire have been designed to assist managers in getting a clearer and more complete picture of the service offering and regulatory status of the prime brokers they are using or considering. To request the updated DDQ, click here.

AIMA updates guide for fund directors

5/5/15

On 29 April 2015, AIMA published an updated Fund Directors' Guide. The Guide, last published in 2008 and sponsored by the law firm Schulte Roth & Zabel LLP, takes account of regulatory and tax reforms since the financial crisis, such as the Alternative Investment Fund Managers Directive (AIFMD) and the Foreign Account Tax Compliance Act (FATCA), which have brought significant changes to the role and responsibilities of fund directors and boards. The Guide is designed to be used by investment managers, fund promoters and existing and prospective fund directors. New sections have been added covering, among other topics, the general approach to fund governance, monitoring of trading practices and business continuity planning. The Guide is available to AIMA members here. Additional copies can be ordered via this executive summary for a fee, with net proceeds to be donated to the charity Hedge Funds Care. Finally, a press release about the launch of the Guide is here.

AIMA responds to FSB/IOSCO consultation on NBNI G-SIFIs

2/6/15

On 1 June 2015, AIMA responded 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). In the response, AIMA argued that the assessment methodology outlined in the consultation paper appears to introduce a number of methodological inconsistencies and incongruities, which, if left unaddressed, would greatly undermine the credibility of the entire exercise. AIMA highlighted, amongst other things, that asset managers are not the appropriate entities to analyse for systemic risk purposes and that gross notional exposure is not a measure of systemic risk. AIMA suggested that in order to improve the methodologies, more attention should be given to (i) the size of the global financial market; (ii) the relative size and activities of the respective financial market participants; and (iii) the comparative levels of risk and leverage employed by financial market participants.

continued ▸

IOSCO Consultation on fees and expenses of investment funds

30/6/15

On 25 June 2015 the International Organization of Securities Commissions (IOSCO) published the consultation report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds, which proposes an updated set of common international standards of best practice for the operators of Collective Investment Schemes (CIS) and regulators to consider. The report examines and consults on issues identified as being key across jurisdictions, including: (i) types of permitted fees and expenses; (ii) performance-related fees; (iii) disclosure of fees and expenses; (iv) transaction costs; and (v) hard and soft commissions on transactions. Comments should be submitted by Wednesday 23 September 2015.

OECD responds to EU's non-cooperative jurisdictions "blacklist"

23/6/15

The OECD has expressed its concern over the part of the EU tax transparency Action Plan relating to tax havens (here). On 19 June, an email to the 127 members of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes jointly signed by the director of the OECD's Centre for Tax Policy and Administration and the head of the secretariat for the Global Forum took issue with the basis and authority on which the EU Commission's non-cooperative jurisdictions list has been compiled. The email notes that the EU Commission has incorporated the Global Forum's terms of reference into its principles of good governance in tax matters but that it is not clear how this is factored into either the EU Commission's list or the national blacklists on which it is based. In addition, the inclusion of harmful tax practices or "other criterion" in determining inclusion in a national blacklist makes it impossible to determine how this independently reflects on a jurisdiction's compliance with the Global Forum standards.

The OECD contends that "the only agreeable assessment of countries as regards their cooperation is made by the Global Forum and that a number of countries identified in the EU exercise are either fully or largely compliant and have committed to AEOI, sometimes even as early adopters'. A number of jurisdictions judged by the OECD to be "largely compliant" (the same ranking as given to the UK and the US) appear in the EU Commission list, and government bodies have expressed their regrets over their inclusion. The Hong Kong Treasury stated that "Hong Kong has all along been supportive of international efforts to enhance tax transparency and combat tax evasion. We strongly disagree with any allegation that Hong Kong is a 'non-cooperative tax jurisdiction', which is totally unfounded". The Cayman Islands Financial Services Ministry noted that the Cayman Islands sits on the Global Forum's 19-member Steering Group and 30-member Peer Review Group.

OECD Common Reporting Standard FAQs

21/4/15

On 17 April 2015, the Organisation for Economic Co-operation and Development (OECD) published a set of 'Frequently Asked Questions' (FAQs) related to the OECD/G20 common reporting standard (CRS) project. Approved by the Working Party 10 on 18 March, the FAQs provide further guidance on: (i) reporting financial institutions; (ii) financial accounts; (iii) due diligence procedures; (iv) reportable accounts and information; and (v) confidentiality/ data protection. These may assist members in preparing for the commencement of CRS reporting, though members will be subject to the implementing laws of each relevant jurisdiction which may depart from the OECD FAQs.

IOSCO consults on trading venue electronic trading risk management

28/4/15

The International Organization of Securities Commissions (IOSCO) has issued two consultation reports - Mechanisms for Trading Venues to Effectively Manage Electronic Trading Risks and Plans for Business Continuity and Market Intermediary Business Continuity and Recovery Planning – aimed at enhancing the

continued ▸

ability of financial markets and intermediaries to manage and withstand risks. The first provides a comprehensive overview of the steps trading venues take to manage the risks associated with electronic trading and the ways they plan for and manage disruptions through business continuity plans. The second proposes standards and sound practices that regulators could consider as part of their oversight of the business continuity and recovery planning by market intermediaries.

Preventing the artificial avoidance of Permanent Establishment (PE) status

19/5/15

On 15 May 2015 the OECD published a follow-up discussion draft (here) that includes revised proposals, under action 7 of the BEPS project, which would amend article 5 of the OECD model double taxation convention in order to prevent the artificial avoidance of PE status. This is the result from the first discussion draft released on 31 October 2014, the comments received from interested parties, and the public consultation meeting held on 21 January 2015 in Paris. AIMA made a representation responding to the first paper (here) criticising (as did other respondents) a proposed amendment of article 5(6). We are pleased that the OECD seems to have accepted the argument on that point, but will consider whether there are further issues that should be raised.

BEPS Action 6 - Prevent treaty abuse

2/6/15

On 22 May 2015, the OECD published a revised discussion draft (here) that includes amended proposals, under Action 6 of the BEPS project, concerning tax treaty access for entities. A new article 10 [treaty entitlement] would be included in the OECD model double taxation convention. This is the result from the report published on 16 September 2014 (here), the comments received from interested parties, and the follow-up work released on 21 November 2014 (here). AIMA made representations responding to the first drafts (here) and follow-up work (here) criticising (as did other respondents) the proposed framework, since it would not take into account the special nature of collective investment schemes, when designing the proposed limitation on benefits (LOB) and principle purpose test (PPT) rules. The revised discussion draft takes account of some important items - the OECD’s 2010 report on (regulated) collective investment vehicles (CIV); its TRACE project for operating relief from withholding taxes; and the economic relevance of investment funds - but other key issues that will generate difficulties for non-CIVs to access double tax treaties have not been addressed. In this context, the position of alternative investment funds remains largely unclear and will be subject to further work after September 2015. AIMA remains committed to presenting the hedge fund industry’s case. Responses to the revised discussion draft must be submitted by 17 June 2015, and that no public consultation is expected to be held.

BEPS update

9/6/15

On 8 June 2015, the Organisation for Economic Co-operation and Development (OECD) released the last piece of the Action 13 country-by-country (cbc) reporting package (here). This is the third element of the transfer pricing reporting provisions intended to encourage transparency for MNEs. The main proposals include model domestic legislation that national tax authorities can adapt, and a competent authority agreement (CAA) based on the common reporting standard framework (CRS) to achieve the exchange of information between jurisdictions (both the bilateral and multilateral model). The reporting obligations will have to be fulfilled by the ultimate parent company or a nominee when the MNE has multiple subsidiaries. (If the parent company is resident in a non-cbc reporting jurisdiction, a surrogate entity will be liable). Separately, the OECD also produced a webcast update on the 15 BEPS action points, in which these were the main issues raised: (i) the BEPS project will be delivered in September, presented in Lima to the finance ministers in October and approved by the G20 leaders in November; (ii) action 3 (CFC regimes) – confirmed that the framework is designed as best practice (rather than primary/secondary rules) and the Working Party discussions will now address issues

continued ▸

on the definition of income in this context; (iii) action 4 (interest deductibility) - the OECD seems to be combining the different approaches proposed in the discussion draft (fixed ratio and group ration rule, removal of low risk entities, operational carry forward of disallowed interest/ unused capacity, and targeted rules); (iv) action 6/7 (treaty abuse/permanent establishments) – review of the content available in the recent discussion drafts; (v) action 15 (multilateral instrument) – on 27 May the first meeting took place to determine procedural aspects (chaired by the UK Treasury) and substantial discussions on the content of the instrument will begin next November.

EMEA

AIFMD

ESMA Q&A on AIFMD

On 12 May 2015, the European Securities and Markets Authority (ESMA) published an update of its Questions and Answers (Q&A) on the application of the Alternative Investment Fund Managers Directive (AIFMD). The update contains eight new Q&As relating to reporting as well as new Q&A on positions AIFMs should take into account when calculating their exposure under the commitment approach pursuant to Article 8 of the Level 2 Regulation. Among other things, the new Q&As clarify that AIFMs should take into account cash and cash equivalents for the purpose of the main instruments in which the AIF is trading (questions 64 to 77 of the consolidated reporting template), the principal exposures of the AIF (questions 94 to 102 of the consolidated reporting template) and the five most important portfolio concentrations (questions 103 to 112 of the consolidated reporting template).

AIMA letter regarding AIFMD leverage calculation

28/4/15

On 27 April 2015, AIMA submitted a letter to the European Commission regarding the measure for calculating leverage under the Alternative Investment Fund Managers Directive (AIFMD). The AIFMD gives the Commission power to develop an additional (and optional) measure of leverage if it finds that the gross and commitment methods currently used under the AIFMD are not sufficient or appropriate for all types of AIFs. AIMA's letter argued that the Commission should develop an additional measure for calculating leverage under the AIFMD which may be used by AIFMs in addition to the gross and commitment method if AIFMs wish to do so. AIMA suggested a methodology that would deal with potential future exposure in the same way as the Capital Requirements Regulation would be the most appropriate alternative measure, as it would take a calibrated view of what are the likely risks and exposures from derivatives portfolios by taking into account both the nature and type of a derivative as well as its the maturity profile.

MiFID

ESMA Consultation on draft guidelines for the assessment of knowledge and competence in MiFID II

5/5/15

The European Securities and Markets Authority (ESMA) is consulting upon Draft Guidelines required under Article 25(9) of MiFID II to specify criteria for the assessment of knowledge and competence of natural persons in investment firms that provide investment advice or information about financial instruments, investment services or ancillary services to clients so as to meet the investor protection principles under Article 24 and 25 of MiFID II. The Consultation Paper focuses on 'appropriate qualifications and experience' and sets out the areas of knowledge and competence that should be assessed in order to provide investment advice or information to clients. Once finalised, Member States will each be tasked with publishing a list of 'appropriate qualifications' sufficient to meet these criteria in their respective jurisdictions. The deadline is 10 July 2015.

continued ▸

AIMA Summary of HMT consult on UK implementation of MiFID II

28/4/15

AIMA has produced a Summary of the HM Treasury Consultation 'Transposition of the Markets in Financial instruments Directive' which was published on 27 March 2015. The Consultation accompanies four pieces of draft secondary legislation intended to implement various MiFID II rules, including: commodity derivative position limits and reporting; FCA/PRA powers to remove board members; and the application of MiFID II rules to unauthorised persons. The CP overall is procedural in nature, but does request input on two areas of policy: (i) the decision as to whether the UK should opt-in to the Article 39 MiFID II branch regime; and (ii) the application of MiFID II to certain binary options.

EMIR

ESMA recognises 10 third country CCPs

5/5/15

Last week ESMA recognised 10 third-country CCPs in accordance with its powers under Regulation 648/2012 on OTC derivatives, CCPs and trade repositories (EMIR). This recognition enables those CCPs to provide clearing services to clearing members and trading venues established in the EU, in particular enabling contracts to be cleared with those third-country CCPs in satisfaction of the EU mandatory clearing obligation. CCPs are established in Australia, Hong Kong, Japan and Singapore – all of which have been assessed as equivalent by the European Commission. No equivalence decision has yet been reached with the US.

AIMA publishes its white paper on CCP recovery and resolution

14/4/15

AIMA has published a new version of its white paper on the Recovery and Resolution of CCPs in light of the European Commission's formal proposal for a Regulation on the issue, likely to be published in Q3 this year, and taking into account developments in our position. Originally published last October, the AIMA White Paper elaborates upon a series of AIMA Policy Principles which we suggest should form the foundations of any CCP recovery and resolution regimes globally. In particular, we describe the importance of a clear distinction between recovery and resolution, with client margin remaining off-limits for loss absorption at the recovery phase, as well as the need to maximise transparency into the financial condition of a CCP for all of its participants. Our recommendation for resolution remains the fast and efficient wind-down and liquidation of the CCP with any residual client margin returned subject to the no-creditor-worse-off-than-ordinary-insolvency principle.

ESMA publishes consultation (No.4) on EMIR clearing obligation for additional IRS

12/5/15

ESMA launched its Consultation Paper (No.4) on the EMIR clearing obligation. The Consultation seeks stakeholder views on proposed RTS on the application of the EMIR clearing obligation to additional classes of interest rate swap not covered by the previous round of consultation covering IRS products in major currencies last year. These additional products are: (i) fixed-to-floating IRS denominated in: CZK, DKK, HUF, NOK, SEK and PLN; and (ii) FRAs denominated in NOK, SEK and PLN. Although counterparty categorisations, clearing start-dates and frontloading are largely the same, the Consultation does propose a slight delay in the clearing start date for these IRS if the Final RTS were to be published less than three months after the RTS for the clearing of IRS in the major currencies consulted upon last year and for which ESMA has submitted its Opinion to the Commission. The deadline for responses is 15 July 2015.

ESMA updates EMIR Q&As

28/4/15

ESMA has published a 12th update of its Question and Answers on EMIR, with the three new and amended Q&As focusing entirely on trade repositories. In particular, the Q&As now state

continued ▸

that: TRs will be expected to not only ensure that all relevant fields are completed, but to ensure that the information contained within each field complies with the required standards of content and form; and, whenever a maturity date change occurs that is already envisaged by the original contract specifications, a modification report will need to be sent to the initial entry modifying the maturity date field.

ESMA launches centralised data projects for MiFIR and EMIR

7/4/15

The European Securities and Markets Authority (ESMA) launched its work on two centralised projects at the request of national competent authorities. The first is an Instrument Reference Data Project which plans a central ESMA facility in relation to instrument and trading data, as well as the calculation of the MiFIR transparency and liquidity thresholds. This project is intended to collect data directly from approximately 300 trading venues across the EU which will send their data directly to ESMA. The second is a Trade Repositories Project which would involve ESMA providing a single access point to TR data under EMIR across all EU Member States. The Trade Repositories Project is planned to go live in 2016 whilst the Instrument Reference Data Project is only expected to go-live in early 2017, although both of these dates are to be viewed as indicative and could well be subject to push-back.

Other updates

Financial Transaction Tax - State of Play

30/6/15

As of 30 June 2015, ending the second quarter of 2015, the EU proposal for a Financial Transaction Tax (FTT) has not made any significant progress. On 19 June an ECOFIN meeting was held, and although the Tax Commissioner Moscovici stated that "discussions were moving in a positive direction", no further announcement was made from any of the 11 ECP Member States. Indeed, Finance Ministers were focused on other pressing matters, and as a result, the existing disagreement still remains on the fundamental issues that would structure any future financial transactions levy. The state of play, with the summer recess imminent, considering the self-imposed deadline for the application of FTT from January 2016, and the upcoming Presidency of Luxemburg (which is opposed to the FTT) leaves it an unlikely scenario that FTT will experience any major development. However, it will always depend on what political appetite exists in the latter half of the year. AIMA has consistently argued against the adoption of an FTT, and remains opposed to it, and believes that trade associations, representative bodies, and interested parties should continue to emphasise the disruptive effects that an FTT would generate in the European financial markets.

AIMA summary of the ELTIF Regulation

30/6/15

On 19 May 2015, Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds (ELTIFs) was published in the Official Journal of the European Union. AIMA has now published a summary of the regulation, which is available here. ELTIFs will be able to provide finance to various infrastructure projects or unlisted companies of lasting duration that issue equity or debt instruments for which there is no readily identifiable buyer. ELTIFs will be able to originate loans and use hedging techniques that serve the purpose of hedging risks inherent to other investments of the ELTIF, but are unable to taking exposure to commodities or invest in real estate. Only EU alternative investment funds (AIFs) will be eligible to become ELTIFs. Managers of ELTIFs will be able to choose to create ELTIFs that would be open for retail investors and/or for professional and/or investors treated as professional. Once authorised as an ELTIF, the fund will be able to be marketed across the EU using a passport. In order to broaden retail investors' access to ELTIFs, a UCITS is able to invest into shares or units issued by an ELTIF to the extent that the ELTIF shares or units are eligible under Directive 2009/65/EC (UCITS). The regulation will enter into force on 8 June 2015 and become applicable in Member States from 9 December 2015.

continued ▸

BIS Consultation on the draft Register of People with Significant Control Regulations 2015

30/6/15

On 19 June 2015 the UK Department for Business Innovation and Skills (BIS) published a Consultation Paper on the draft Register of People with Significant Control (PSC) Regulations 2015. The consultation paper explains how the PSC register will work and seeks views on draft regulations covering the following aspects of the register: (i) the register's scope; (ii) how the nature of control is recorded on the register; (iii) what a company should record in its register if it has no PSC or cannot confirm information about PSCs; (iv) fees; (v) the protection regime; and (vi) how a company may seek to compel others to provide information. The deadline for responses to the consultation is 17 July 2015.

HMRC's soft approach to FATCA deadline

2/6/15

The deadline for the first annual reporting in the UK to HMRC under US FATCA was set on 31 May 2015. Due to online delays and problems experienced with validating FATCA registrations in advance (similar problems have occurred in the Cayman Islands), HMRC will not apply late FATCA filing penalties when there was a reasonable excuse for delays in filing (HMRC's guidance is expected to be updated - here). Penalties will apply to returns filed after 31 May, at the time when the delays have been addressed.

EU Short-Selling Regulation: Potential inconsistencies in national implementation

16/6/15

AIMA CEO Jack Inglis has this week published a blog post highlighting recent questions that have been raised about the interpretation by the Greek regulator, the Hellenic Capital Market Commission (HCMC), of the European Short-Selling Regulation (SSR) in respect of rights issues by several Greek banks in 2014. Read more here.

EBA issues draft guidelines on limits on exposures to shadow banking entities

23/6/15

On 19 June 2015, AIMA responded to the European Banking Authority (EBA) consultation paper titled 'Draft EBA Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395 para. 2 Regulation (EU) No. 575/2013 [(the 'CRR')]' (the 'Consultation Paper'). In the response, AIMA strongly disagreed with the EBA's comments that all AIFs and UCITS that are MMFs should be considered to be 'shadow banking entities' and commented that funds that do not engage in bank-like activities should be outside of the definition of 'shadow banking entities'. Amongst other things, AIMA's response also encourages the EBA to take into account the work of the Financial Stability Board (FSB) in this area which did not designate any types of funds as automatically being shadow banking entities.

AIMA responds to EBA consultation on remuneration

9/6/15

On 4 June 2015, AIMA responded to the European Banking Authority (EBA) consultation on its Draft Guidelines on Sound Remuneration Policies, which relate to the fourth Capital Requirements Directive (CRD IV). In the response, AIMA commented that we strongly disagree with the interpretation of the proportionality principle that is presented in the Consultation Paper. AIMA highlighted that the change of approach is both contrary to the express wording of the CRD IV text as well as the concept of proportionality under the Treaty of the European Union (TEU), Regulation No 1093/2010 (the EBA Founding Regulation) and case law. AIMA also provided an explanation of why the proposed change to the application of the proportionality principle would have serious negative implications for our membership. AIMA therefore encouraged the EBA to retain the possibility for firms to neutralise certain provisions of the remuneration principles, on a case-by-case basis, where it is proportionate for them to do so. AIMA also commented on the application of the

continued ▸

guidelines to delegate entities and the unintended tax and regulatory impacts of the proposals.

AIMA responds to EC consultation on securitisation

19/5/15

On 13 May 2015, AIMA responded to the Public consultation on securitisation: An EU framework for simple, transparent and standardised securitisation. In the response, AIMA commented that (i) detailed or comprehensive identification criteria require development, which should not be designed to exclude particular asset classes or types of transaction per se, (ii) qualifying securitisations should be exempt from risk retention requirements and (iii) there should be a central register of qualifying securitisations that market participants (including investors) are entitled to rely on.

AIMA response to the FCA's 8th QCP

12/5/15

On 5 May 2015, AIMA responded to the UK Financial Conduct Authority's (FCA) eighth quarterly consultation paper (QCP). In the response, AIMA welcomed the FCA's valuation guidance but suggested that some changes should be made in order to avoid disruption with respect to contractual arrangements currently in place between alternative investment funds (AIFs), their external fund administrators and their alternative investment fund managers (AIFMs). AIMA also queried what the FCA considered to be the correct approach for calculating the reporting frequency for EEA AIFMs with non-EEA AIFs which are not marketed in the EEA.

CBI Consultation on Corporate Governance Requirements for Investment Firms

30/6/15

On 5 May 2015 the Central Bank of Ireland (CBI) published a Consultation Paper on Corporate Governance Requirements for Investment Firms (CP94). In CP94 the CBI proposes introducing statutory corporate governance requirements for investment firms which require a firm (i.e. a firm authorised pursuant to MiFID or a non-retail investment intermediary authorised under Section 10 of the Investment Intermediaries Act 1995) to promote strong and effective corporate governance and to, at a minimum, meet the requirements set out by the CBI in CP94. Responses to CP94 should be submitted to the CBI by 5 August 2015.

UK - Implementing agreements under the global standard of automatic exchange of information (CRS)

14/4/15

On 26 March 2015, HM Revenue & Customs (HMRC) published a summary of responses on the public consultation on implementing agreements under the global standard on automatic exchange of information, and also released legislation amending the International Tax Compliance Regulations (here). Regulations have now been laid to implement the UK's obligations under the European Union (EU) Revised Directive on Administrative Cooperation (DAC) (Council Directive 2014/107/EU) to improve international tax compliance, and under the Multilateral Competent Authority Agreement implementing the Common Reporting Standard (CRS). The regulations will take effect from 15 April 2015 (1 January 2016 in the case of the CRS/DAC) and incorporate with minor changes the existing legislation implementing the UK's exchange of information agreement with the USA relating to FATCA (Foreign Account Tax Compliance Act). The regulations relating to the similar arrangements with the Crown Dependencies and Overseas Territories will remain separate with a view to being repealed for 2017, from when the CRS regime will apply. Two major amendments have been made in respect of FATCA obligations: (i) as with CRS reporting requirements, financial institutions will not be required to make nil returns where they have no reportable accounts; (ii) Holding Companies and Treasury Companies (as defined) will be removed from the definition of a reporting financial institution (RFI), so standardising the definition of RFIs across the different regimes. On 13 April, HMRC has released a public statement underlining those new requirements, further amendments, and emphasised 31 May 2015 as a

continued ▸

deadline for reporting obligations. Additionally, HMRC has declared that it will continue to work with stakeholders to develop guidance on the CRS with a view to publication in summer 2015.

AIMA responds to EC consultation on Prospectus Directive

19/5/15

On 13 May 2015, AIMA responded to the European Commission's consultation paper on the Prospectus Directive. In the response, AIMA commented that the Prospectus Directive should contain an exemption from the obligation to prepare a prospectus for all alternative investment funds (AIFs) as defined in the Alternative Investment Fund Managers Directive (AIFMD), including European Long-Term Investment Funds (ELTIFs). AIMA also commented that there should be a removal of any requirement in the ELTIF Regulation, which is pending final approval and publication, for ELTIFs to prepare a prospectus that meets the requirements of the Prospectus Directive and any related regulations.

Commission extends transitional period for bank exposures to CCPs under CRR

19/5/15

The European Commission adopted an implementing act that will extend the transitional period for capital requirements for EU banking groups' exposures to CCPs under the Capital Requirements Regulation (CRR) from 15 June 2015 to 15 December 2015. The extension is intended to provide interim relief from the higher capital charges under the CRR Qualifying CCP (QCCP) regime for exposures to CCPs that are not authorised or recognised under EMIR, in particular whilst cross-border equivalence issues are ironed out between the EU and key third-country jurisdictions such as the US.

UK - Diverted profits tax

14/4/15

On 10 December 2014, HMRC released draft legislation on the diverted profits tax (DPT) announced in the Autumn Statement. This new tax, distinct from corporation and income tax, is to be targeted to profits "diverted" from the UK either through the use of an "avoided PE" or though "tax mismatch" arrangements. The tax will be levied at 25% on the diverted profits and effective from 1 April 2015. Although the legislation is aimed chiefly at multinational corporations, there are possible impacts for funds.

AIMA responded to the consultation on 4 February 2015. The representation underlined concerns of the asset management industry that under the draft legislation, the DPT is likely to apply much more widely than to contrived arrangements, affecting valid commercial structures that do not constitute abusive or aggressive tax avoidance. While it would be unlikely that funds will be within the charge to the DPT, the references in the legislation to supplies of goods or services made to customers in the UK could extend to supplies made to funds established outside the UK but which have some number of their investors in the UK. AIMA advocated a delay to the legislation to ensure it is compliant with EU and international law, and also aligned with the BEPS coordinated approach. Further guidance has been released on DPT and although there are no specific exemptions for the asset management industry, important changes have been achieved: (1) the reference to customers' location is omitted – so the charge will only depend on there being UK activity; (2) there is a further exclusion where UK-related expenses are below a de minimis amount of £1M; (3) the economic substance test will not be failed if the majority of the income is shifted to a low tax jurisdiction, provided that actual economic activity takes place there; (4) DPT will not apply to transactions involving tax-exempt bodies; (5) guidance also envisages that the DPT charge does not apply to transactions where the recipient of a payment is an authorised investment fund or offshore fund provided that either (a) it meets the genuine diversity of ownership condition (meaning that interests in the fund are intended to be widely held) or (b) 75% or more of the investors in the fund are charities, pension schemes or persons exempt from tax as a result of sovereign immunity. The legislation was included in the Finance (No 2) Act 2015.

continued ▸

Luxembourg - FATCA reporting date extended

9/6/15

Following extensions to the FATCA reporting due dates in the Cayman Islands and the UK, the Luxembourg tax authorities are reported to have deferred the deadline for Reporting Luxembourg Financial Institutions to report FATCA information with respect to 2014 from 30 June 2015 to 31 July 2015.

UK – Final Report of Fair and Effective Markets Review published

16/6/15

The Final Report for the UK's Fair and Effective Markets Review (FEMR) was published. The FEMR Final Report sets out 21 recommendations falling within six near-term actions to improve conduct in the FICC markets, as follows: (1) Raise standards, professionalism and accountability of individuals; (2) Improve the quality, clarity and market-wide understanding of FICC trading practices; (3) Strengthen regulation of FICC markets in the United Kingdom; (4) Launch international action to raise standards in global FICC markets; (5) Promote fairer FICC market structures while also enhancing effectiveness; and (6) Promote forward-looking conduct risk identification and mitigation. Of particular concern for AIMA members is the FEMR recommendation that the Senior Managers and Certification regimes be extended to a broader range of regulated firms active in the FICC wholesale markets – against which AIMA argued in our response to the FEMR consultation earlier this year. HM Treasury has now been tasked with conducting further consultation on the issue, to which AIMA intends to submit a formal industry response.

Automatic exchange of information on tax rulings

16/6/15

On 8 June 2015, the EU Council released a state of play document (here) on the automatic exchange of information on tax rulings among the EU MS. The report, that follows the proposal for a Council Directive amending Directive 2011/16/EU (DAC) (here), raises some issues that will be key in the upcoming discussions to develop an EU framework: (i) scope of information to be exchanged and alignment with OECD work (MS believe the wide definitions proposed could bring too much room for interpretation as to which Advance Price Arrangements (APAs) and Advance Cross-border Tax Rulings (ATRs) are to be included in scope); (ii) the starting dates from which information should be exchanged (MS would require 12 months for transposition into national law) and the issues with its retroactive application (10 years look back seemed beyond what is reasonable for many delegations); and (iii) the role of the Commission in the information exchange mechanism (MS question its involvement as it is not a tax authority).

ELTIF Regulation published in the Official Journal

19/5/15

On 19 May 2015 Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds (ELTIFs) was published in the Official Journal of the European Union. ELTIFs will be able to provide finance to various infrastructure projects or unlisted companies of lasting duration that issue equity or debt instruments for which there is no readily identifiable buyer. ELTIFs will be able to originate loans and use hedging techniques that serve the purpose of hedging risks inherent to other investments of the ELTIF, but are unable to taking exposure to commodities or invest in real estate. Only EU alternative investment funds (AIFs) will be eligible to become ELTIFs. Managers of ELTIFs will be able to choose to create ELTIFs that would be open for retail investors and/or for professional and/or investors treated as professional. Once authorised as an ELTIF, the fund will be able to be marketed across the EU using a passport. In order to broaden retail investors' access to ELTIFs, a UCITS is able to invest into shares or units issued by an ELTIF to the extent that the ELTIF shares or units are eligible under Directive 2009/65/EC (UCITS). The regulation will enter into force on 8 June 2015 and become applicable in Member States from 9 December 2015.

continued ▸

Germany - BaFIN practice relating to loan funds

19/5/15

On 12 May 2015, the German Federal Financial Supervisory Authority (BaFin) issued a letter which declared that it is changing its administrative practice relating to loan funds (the English press release is available here). The letter explains that the granting of loans as well as loan restructuring and prolongation by alternative investment funds (AIFs) are now permissible activities to the extent that they are consistent with the provisions of the German Investment Code (Kapitalanlagegesetzbuch – KAGB), which specifies only limited product requirements for AIFs. The letter sets out various recommendations in relation to loan funds, relating to areas such as leverage limits, risk management, maturity transformation, risk spreading and minimum liquidity. These recommendations include a recommendation that AIFs should not issue loans to 'consumers' and that the granting of loans should only be done by closed-ended 'Spezial-AIFs'.

Switzerland – Withholding tax

16/5/15

On 5 May 2015, the Swiss Supreme court issued two important decisions in relation to the concept of beneficial ownership of income under tax treaties and in particular, its application to transactions involving derivatives such as total return swaps and future contracts. Both cases involved Danish banks claiming a refund of Swiss withholding tax (WHT) on dividends received on Swiss equities. However, since both financial institutions hedged their equity positions with derivatives, the Federal tax administration (FTA) argued that by entering into those transactions the banks lost beneficial ownership of the dividends. The Supreme Court found in favour of the FTA. Each Danish bank did not assume any risk in the transaction as it was obliged to forward the dividends it received to the swap/future counterparties and therefore it could not be considered the beneficial owner of the income for tax treaty purposes and was not entitled to any reduction in WHT. Although these decisions are not directly applicable to other cases, which will be decided on their own facts, hedge fund managers should consider whether their funds are party to any such instruments and the implications of treaty access being denied. Similar decisions could be reached by courts in other jurisdictions.

EU / Switzerland tax transparency agreement

16/5/15

On 27 May 2015, the EU and Switzerland signed a new tax transparency agreement, as an action against tax evasion. The new agreement will update the existing framework dating from 2004 under the EU Savings Directive (EUSD) and is aligned with the OECD's Common Reporting Standard (CRS) and the EU amendment of the directive on administrative cooperation (DAC). Both parties would be committed to the automatic exchange of financial information from 2018. The Commission is also concluding tax transparency agreements with Liechtenstein, San Marino, Monaco and Andorra.

Ireland - Extension of FATCA reporting deadline

30/6/15

On 23 June, the Irish Revenue announced the extension of the FATCA reporting deadline from 30 June 2015 to 31 July 2015 for Irish Reporting Financial Institutions to file a FATCA return with respect to 2014 (in future periods the reporting deadline will remain 30 June). This follows the briefing released on 17 June (here) confirming that relevant Holding or Treasuries Companies will no longer be treated as FI unless meeting the definition of the four original categories of FI. Please also note that (i) Financial Institutions must be registered on the Revenue On-Line Service (ROS) in order to file a FATCA return; and (ii) a set of FATCA FAQs have also been published in the automatic exchange of information section of the Irish Revenue website (here).

Italy - Changes to blacklist

5/5/15

Italian tax law maintains a blacklist of jurisdictions regarded for particular provisions as tax havens.

continued ▸

A recent change has removed the Cayman Islands and other countries which have arrangements with Italy for the exchange of tax information from the deduction blacklist. Italian companies will no longer have to report to the Italian tax authorities payments made to residents of these countries as a condition of claiming a deduction in computing their taxable profits. However, the change does not apply to other provisions and Cayman and other countries remain on the controlled foreign companies blacklist.

European Commission adopts corporate taxation action plan

23/6/15

On 17 June, the European Commission approved its action plan on reforming corporate taxation. This follows the presentation of the transparency package (18 March – here), and shows the intention to increase transparency and ensure effective taxation where profits are generated. The action plan will build on many of the OECD's BEPS recommendations, such as on transfer pricing, and includes as key features: (i) the relaunch of the common consolidated corporate tax base (CCCTB) with a new proposal expected for early 2016 (its implementation will be through a step-by-step approach); (ii) a public consultation on corporate tax transparency, including country-by-country reporting and harmful tax practices (here); (iii) a list of non-cooperative tax jurisdictions; and (iv) the aim of reaching an agreement on the automatic exchange of information on tax rulings. The tax rulings proposal received unanimous political support from Finance Ministers at the Informal ECOFIN in April and Member States are now discussing it at technical level with the aim of reaching agreement by the end of the year.

Americas

Proposed rulemaking on business conduct standards for security-based swaps dealers

5/5/15

The SEC has approved a Proposed Rulemaking intended to ensure that both US and foreign security-based swap (SBS) dealers are subject to Title VII of the Dodd-Frank Act when they engage in SBS activity in the US. The SEC are proposing to extend the list of transactions to be counted towards the threshold calculations for registration as a SBS dealer to incorporate any SBS transaction by a non-US person that is arranged, negotiated or executed by personnel or the personnel of an agent, located within the USA. It also proposes the extension of reporting/public dissemination requirements under Regulation SBSR for such transactions, and external conduct of business requirements under Title VII of Dodd-Frank to such transactions by a non-US SBS dealer. Once published in the Federal Register, stakeholders will have 60 days in which to respond.

SEC guidance on cyber security

5/5/15

In late April 2015, the Division of Investment Management of the US Securities and Exchange Commission (SEC) issued a guidance update on cybersecurity (the Update). The Update highlights the importance of cybersecurity issues and discusses a number of measures that funds and advisers may wish to consider when addressing cybersecurity risks, including periodic assessments of matters such as: (i) the nature, sensitivity and location of information that the firm collects, processes and/or stores, and the technology systems it uses; (ii) internal and external cybersecurity threats to and vulnerabilities of the firm's information and technology systems; and (iii) security controls and processes currently in place.

continued ▸

Reporting and disclosure of information by investment companies and advisers

26/5/15

On 20 May 2015, the Securities and Exchange Commission (SEC) proposed rules, forms and amendments to modernise and enhance the reporting and disclosure of information by investment companies and investment advisers. Amongst other things, the investment company proposals would require a new monthly portfolio reporting form (Form N-PORT) and a new annual reporting form (Form N-CEN) that would require census-type information in a structured data format. The proposals would also require enhanced and standardised disclosures in financial statements, and would permit mutual funds and other investment companies to provide shareholder reports by making them accessible on a website. The proposed Form ADV amendments would require investment advisers to provide, among other things, additional information on an aggregated basis regarding managed accounts. The comment period for the proposed rules will be 60 days after publication in the Federal Register.

Cayman Islands – AEOI portal update

26/5/15

The Cayman Islands Department of International Tax Cooperation (DITC) has issued a series of guidance notes. On 5 May 2015, an industry advisory note updated its guidance concerning issues that have arisen with the AEOI portal. Members who have submitted or are in the process of submitting a notification for a Cayman entity should refer to the industry advisory note, particularly if there is any concern that the submission may not have been validly recorded on the AEOI portal. This follows another industry advisory note where the DITC made clear the soft approach to enforcement during the first year of FATCA compliance. The AEOI portal was taken offline on 9 and 10 May in order to process notifications and remedy identified issues, and was also unavailable on 13 May in order to continue implementing system updates. In a further industry advisory note (20 May), the deadlines for notifications and reporting have been extended to 29 May and 26 June respectively.

Cayman Islands - Statement of Guidance on Outsourcing

21/4/15

On 10 April 2015, the Cayman Islands Monetary Authority (CIMA) issued a Statement of Guidance: Outsourcing (April 2015) (the 'SOG') and a Consultation Paper on the Statement of Guidance for Outsourcing (the 'Consultation Paper'). The SOG is intended to provide guidance to regulated entities on the establishment of outsourcing arrangements (including sub-outsourcing) and the outsourcing of material functions or activities. The SOG is expressed to exclude "regulated mutual funds" but covers entities "regulated under the Securities Investment Business Law" and will therefore apply to a significant number of Cayman regulated entities, such as administrators.

Cayman moves forward with implementing CRS

23/6/15

On 16 June 2015, the Cayman Islands Department for International Tax Cooperation (DITC) issued an industry advisory note highlighting the future steps towards the implementation of the Common Reporting Standard (CRS). Implementing regulations should be expected by October 2015, but the DITC is also advising RFIs to begin preparations for new account opening procedures, due diligence requirements and IT system developments. The Cayman Islands signed the multilateral competent authority agreement and as an 'early adopter' committed to the following timetable: (i) pre-existing accounts are those that are open on 31 December 2015 (new accounts would be those opened from 1 January 2016) and, by 1 January 2016, industry will be required to have new account opening procedures; (ii) due diligence procedures for identifying high value pre-existing individual accounts will be required to be completed by 31 December 2016, while the due diligence for low value pre-existing individual accounts and for entity accounts is due by 31 December 2017; (iii) the first reporting from industry to the DITC is expected to be required by 31 May 2017. (Members should assume that substantially the same timetable will apply in other jurisdictions implementing the CRS as early adopters.)

BVI extends FATCA deadlines for registration and reporting

16/6/15

On 11 June, the government of the British Virgin Islands (BVI) released an industry advisory note, replicating the relaxed approach taken by the UK (HMRC) and the Cayman Islands tax authorities. Reporting financial institutions (RFIs) that needed to register under the BVI Financial Account Reporting System (BVIFARS) by 1 June, will not be subject to enforcement action if enrolling prior to 30 June 2015. Similarly, the deadline for RFIs reporting has also been extended to any submissions made to the ITA before 31 July 2015. Finally, the deadline for notifying the use of the UK FATCA alternative reporting regime (ARR – for UK non-domiciled residents) is now set for 30 September 2015.

Asia-Pacific

Australia – IMR passes through Parliament

30/6/15

As we noted in a press release on 17 June 2015, Australia has taken a decisive step towards its advancement as a global investment market, with the smooth passage of the Investment Manager Regime (IMR) legislation through the Australian Parliament. It received Royal Assent on 25 June 2015. The IMR legislation is the product of consultations between the Australian Treasury and the financial services industry which began in 2012. The IMR has through that process developed into a measure that should be capable of delivering what it was proposed to achieve – the development of Australia as an attractive destination for foreign capital and fund trading operations. AIMA, working through the National Group and the Tax Committee, participated in the several rounds of public and informal consultations from the outset when it became clear that Australian tax rules produced potential liabilities for non-resident investors. Our representations were developed with other Australian and international industry representative bodies, principally the Managed Funds Association in the US and the Financial Services Council in Australia and helped to encourage the Treasury to move away from their early unsatisfactory proposals and decide to model the IMR on the UK's investment management exemption.

HK - Common reporting standards

30/6/15

The Hong Kong FSTB has launched a consultation on proposals to apply to prevailing international standards on the automatic exchange of financial account information (AEOI) in tax matters, also known as Common Reporting Standards. For the full FSTB press release see here. To access the consultation itself, see here.

Responsible ownership consultation

30/6/15

In Hong Kong, a consultation on some proposed Principles of Responsible Ownership closed on 2 June 2015. The SFC's three-month consultation had proposed some Principles of Responsible Ownership intended to provide guidance to investors on how they should fulfil their ownership responsibilities in relation to their investment in a listed company. In other jurisdictions, these types of responsibilities are also known as Stewardship Codes. The SFC principles, as proposed, were to operate on a "comply-or-explain" basis; and asked investors. AIMA has now responded to the SFC's request for feedback and our submission can be found here.

Singapore - GST rules for fund management updated

14/4/15

The Inland Revenue Authority of Singapore (IRAS) has recently released further guidance on the Goods & Services Tax (GST) rules for the fund management industry, in response to a wide debate generated with last year's revision of GST treatment of services provided to investment

continued ▸

funds (MAS Circular 2014). The main points of the revised rules (2015) are: (i) an overseas fund will be treated as having a business establishment in Singapore if it wholly relies on the Singapore-based manager (SGM) to carry on its business (and an overseas fund manager may be regarded as wholly relying on an SGM if it lacks necessary capabilities/resources of its own; (ii) a fund will have a fixed establishment in Singapore if conducts regular board meetings in Singapore or has its administration office there; and (iii) the GST charge is applicable from 1 April 2015 (any GST charged from 1 April 2014 to 31 March 2015 will be granted on a credit note for refund). Please also see this recent PwC tax bulletin.

AIMA Japan, Eurekahedge survey

16/6/15

AIMA in collaboration with Eurekahedge conducted a survey of Japanese investors to gauge important insights into market sentiment, investment trends and key regulatory changes facing the Asian asset management industry, with a particular emphasis on the outlook for Japan. Eighty-eight investors contributed their insights, with 52% hailing from asset management companies, 21% from hedge funds and fund of hedge funds, 15% from banks, with the remainder from insurance companies and pension funds. For more information, click here.

India - Minimum Alternative Tax (MAT)

2/6/15

The committee headed by Justice A P Shah which has been instructed to report on the scope of the tax has invited views from interested parties. On 22 June AIMA submitted a representation to the committee headed by Justice A P Shah (here). The response endorsed the non-applicability of the MAT to foreign portfolio investors prior to 1 April 2015, with the technical arguments and judicial precedents that support the industry's position.

More news from Asia-Pacific is available via our monthly AIMA Asia-Pac newsletter. Any member interested in subscribing to our Asia-Pacific newsletter is asked to contact apac@aima.org.

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

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

Jennifer Wood
Managing Director, Global Head of Asset Management Regulation & Sound Practices
E: jwood@aima.org

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

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

Anna Berdinner
Associate Director, Asset Management Regulation
E: aberdinner@aima.org

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

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

Global Fund Services

WELLS FARGO SECURITIES

A global partner in hedge fund and private equity fund administration and operations outsourcing services

Wells Fargo Global Fund Services offers comprehensive fund administration and operations outsourcing services to investment managers worldwide. Our services include:

- Hedge fund administration
- Private equity administration
- Specialized operational services for family offices, endowments and foundations
- Middle- and back-office operations services
- Compliance and regulatory reporting tools and investor transparency services

Clients also gain access to ***Fund View***, an operational management system providing real-time access to middle- and back-office operations information (Operations View), fund accounting information (Accounting View), and investor and regulatory information (Investor View).

With ***Fund View***, COOs, CFOs, CCOs, Investor Relations professionals, and their designated staff can monitor and analyze operational activities, measure and mitigate their operational risk, and maintain and access fund and investor information from a single web access point. ***Fund View*** also provides critical information for fund directors, operational due diligence analysts, auditors, and other related parties to perform their respective functions.

To learn more, visit **wellsfargo.com/fundservices**.

Americas
Leslie Flaws • 952-857-4731
leslie.a.flaws@wellsfargo.com

Europe
Rob Helszajn • +44 (0)1932-586331
robert.helszajn@wellsfargo.com

Singapore
Serene Ho • +65-6768-8201
serene.ho@wellsfargo.com

Hong Kong
Johnson Har • +852-3650-8215
johnson.har@wellsfargo.com

Together we'll go far

Review of AIMA's Global Policy and Regulatory Forum 2015

On 16 April 2015, AIMA hosted its annual Global Policy & Regulatory Forum at the Trump SoHo in New York City. The forum, which addressed a number of regulatory, policy and operational focus areas, attracted close to 300 attendees.

The event opened with a keynote from Martin Wheatley of the FCA. Other speakers included Daniel Gallagher of the SEC; Mark Wetjen of the CFTC; Carolyn Wilkins of the Bank of Canada; Peter Lindner of the IMF; Kay Swinburne of the European Parliament; Marianne Thiery of France's Finance Ministry; and Jean-Paul Servais of the Belgian FSMA. Panel discussions addressed the impact of regulatory changes on hedge fund products and businesses, new trading rules, potential rules to address systemic risk, CCP resolution regimes, dealing commission/soft dollar rule changes, and the impact of banking regulations on hedge funds, among other issues.

The Forum was conducted under the Chatham House rule. However, we are able to publish the broad themes that emerged during the day. For our review of the event, click here. In addition to those below, some of the photos of the day are here.

Jack Inglis, CEO, AIMA

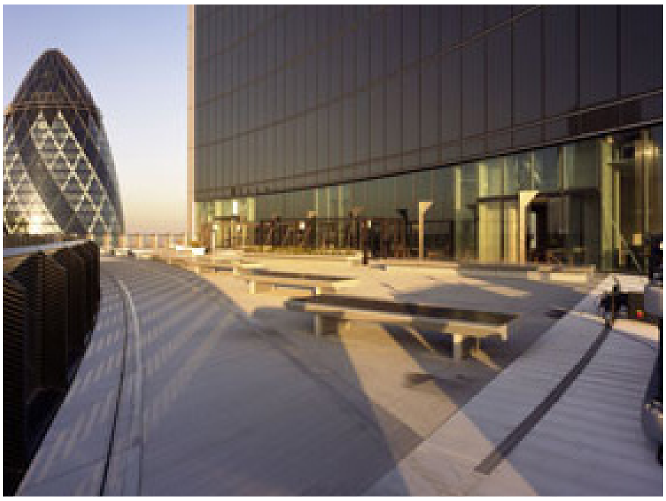
Daniel Gallagher, Commissioner, U.S. Securities and Exchange Commission, in conversation with Robert Van Grover and Pat Poglinco, Partners, Seward & Kissel LLP

Martin Wheatley, Chief Executive, U.K. Financial Conduct Authority

Natasha Cazenave, Head of Asset Management Regulation Policy Division, Autorité des Marchés Financiers, France

Forthcoming AIMA events

AIMA Summer Drinks
Date: 8 July 2015
Time: 1800 - 2030
Venue: Willis, 51 Lime Street, London



AIMA Australia Education: Going Retail Series
Date: 16 July 2015
Time: 1215 - 1400
Venue: Perpetual, Angel Place, Sydney

AIMA Australia Networking Drinks: Melbourne
Date: 23 July 2015
Time: 1700 - 2000
Venue: Stoke House City, Melbourne

AIMA Australia Education: Investor Advisory Group
Date: 11 August 2015
Time: 1600 - 1800
Venue: AMP Capital, 50 Bridge Street, Sydney

AIMA Australia Networking Drinks: Sydney
Date: 20 August 2015
Time: 1800
Venue: Bull and Bear, 16 Phillip Lane, Sydney

AIMA Australia: COO/CFO Roundtable
Date: 27 Aug 2015
Time: 1600 - 1900
Venue: EY, 680 George Street, Sydney

AIMA Australia Hedge Fund Forum 2015
Date: 15 September 2015
Venue: Sydney

AIMA Australia Education: Albourne Workshop
Date: 16 September 2015
Time: 1600 - 1900
Venue: Deutsche Bank, 126 Phillip Street, Sydney

Switzerland – AIMA Country Briefing - Geneva
Date: 16 September 2015
Time: 1200 - 1400
Venue: UBS, Rue de la Confédération 2, Geneva

Switzerland – AIMA Country Briefing – Zurich
Date: 17 September 2015
Time: 0830 - 1030
Venue: Carigiet Hall, UBS, Paradeplatz 6, Zurich

Canada – Toronto Quarterly Social
Date: 21 September 2015
Time: 1730 - 1930
Venue: The Duke of Westminster Pub, Toronto

25th Anniversary AGM & Annual Conference
Date: 24 September 2015
Time: 1300 - 2000
Venue: The Guildhall, London

AIMA Canada Hedge Fund Conference 2015
Dates: 7-8 October 2015
Venue: St. Andrew's Club and Hockey Hall of Fame, Toronto

Building a European Capital Markets Union – A five year plan

AIMA SPONSORING PARTNER

CLIFFORD CHANCE

By Michael Dakin, Partner, Simon Gleeson, Partner, Kevin Ingram, Partner, Philip Souta, Partner, and Jacqueline Jones, Senior Professional Support Lawyer, Clifford Chance

The European Commission has unveiled its plan to boost funding and growth across Europe by the creation of a Capital Markets Union – a single market for capital across the 28 EU member states. The Green Paper on 'Building a Capital Markets Union' was issued on 18 February 2015, to stimulate debate on the measures needed to achieve the Commission's 'top priority of jobs and growth', by removing the many obstacles to deep and integrated capital markets. Two technical consultations, on 'simple, standard and transparent' securitisation and the Prospectus Directive, were launched alongside the Green Paper. The closing date for all was 13 May 2015. Based on the feedback received, the Commission will adopt an action plan later in 2015, which will set out the actions to be carried out over the next five years. This article highlights the main aspects of the Green Paper. Our response to the Green Paper can be found here.

The arguments for Capital Markets Union

The Commission argues that Capital Markets Union is needed to diversify sources of finance, strengthen cross-border capital flows and improve access to finance for businesses and infrastructure projects across Europe, so as to reduce the cost of raising capital, particularly for SMEs, and lessen Europe's heavy dependence on bank funding.

Building a Capital Markets Union, block by block

In seeking to build a Capital Markets Union, the Commission has three broad objectives:

- To improve access to finance for all businesses and infrastructure projects across Europe
- To increase and diversify sources of funding
- To 'make markets work more effectively'

Recognising that achieving Capital Markets Union is a long-term project, with significant obstacles to overcome, the Commission aims to put in place the 'building blocks' by 2019. No single measure will achieve these ambitious objectives and, indeed, it might not necessarily mean more legislative measures. Recognising the need to reduce burdensome legislation, the Green Paper confirms that more legislation might not always be the most appropriate policy response and that non-legislative steps and the enforcement of existing regulations might be the best way forward.

Nevertheless, despite the long-term nature of the project, there are some areas where progress could, so the Commission believes, be made in the short term and the Green Paper outlines five priority actions, some of which were also identified in the Investment Plan for Europe which was published in November 2014. These are: (i) lowering barriers to accessing capital markets through a review of the current prospectus regime; (ii) widening the investor base for SMEs by improving credit information; (iii) developing proposals to encourage simple, standard and transparent securitisation; (iv) supporting take-up of European long-term investment funds (ELTIFs) and (v) supporting industry-led work to develop European private placement markets.

continued ▸

Overcoming the barriers to Capital Markets Union

The Green Paper discusses some of the barriers impeding fulfilling the objectives of Capital Markets Union and seeks feedback on how these barriers might be overcome in the medium to long-term.

Objective 1 – improving access to finance

Priority Actions

Lowering barriers to accessing capital markets

The Commission is reviewing the current prospectus regime through a separate public consultation launched in parallel to the Green Paper. The aim is to make it easier for companies (including SMEs) to raise capital throughout the EU and to boost the take-up of SME Growth Markets. The review will look at when a prospectus is required, streamlining the approval process, and simplifying the information included in prospectuses.

Widening the investor base for SMEs

Improving credit information (e.g. by developing a common, minimum set of comparable information for credit reporting and assessment) would, it is argued, help SMEs access capital markets. The Commission plans to hold workshops on SME credit information in 2015 to progress this. The Green Paper seeks views on what further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base.

Building sustainable securitisation

A 'qualifying' securitisation market, relying on simple, transparent and standardised securitisation instruments, could bridge banks and capital markets. The Commission is consulting on specific measures to meet these objectives in parallel with the Green Paper.

Boosting long-term investment

The recently finalised European Long-Term Investment Funds (ELTIFs) regulatory framework is expected to allow investors to put money into companies and infrastructure projects for the long-term. ELTIFs should have particular appeal to investors such as insurance companies or pension funds which need steady income streams or long-term capital growth. The Green Paper seeks views on what further role the Commission and member states could play in supporting the take-up of ELTIFs.

Developing European private placement markets

A consortium of industry bodies has established a market guide on common market practices, principles and standardised documentation for private placements, compatible with a diversity of legal frameworks. The Commission welcomes this market-led approach, which could help to facilitate the creation of a European private placement market in the short term. The Green Paper seeks views on whether any action by the EU is needed to support the development of private placement markets other than supporting market-led efforts to agree common standards.

One of the key objectives of Capital Markets Union is to improve access to finance for all businesses and investment projects across Europe.

In the belief that well-functioning equity and bond markets are crucial to achieving this objective, the Green Paper discusses some of the barriers that have impeded access to capital markets, such as

continued ▸

insufficient credit information on SMEs, the cost of accessing public capital markets (e.g. the cost of preparing a prospectus, due diligence and other regulatory requirements) 'short termism' on the part of investors and regulatory barriers which are common in new infrastructure investment.

Information problems

Ways have been suggested to improve the 'information problems' faced by SMEs. Some of these appear relatively simple, such as banks being encouraged to provide better feedback for SMEs whose credit applications are declined and to raise awareness of the alternative sources of funding that might be available.

Another suggestion is to develop a simplified, common accounting standard, tailored to the companies listed on certain trading venues such as multilateral trading facilities (MTFs). It is suggested that this could assist transparency and comparability, and become a feature of SME Growth Markets, and also be available for wider use.

For investment projects, the Commission believes that improved transparency would increase their attractiveness to investors and assist regulators in adopting a more tailored prudential regime for infrastructure investment. To this end it has proposed the creation of a European Investment Project Pipeline, with a dedicated website and common standards for presentation of information on the project.

'Standardisation'

Establishing common standards in some markets – a common set of market rules, transparency on product features and consistent supervision and enforcement – is suggested as a way to attract more investors and increase market depth and liquidity. For example, greater standardisation of corporate debt issuances could allow for a more liquid secondary market for corporate bonds to develop.

Feedback is sought on whether the possibility of developing a more standardised corporate debt market should be explored further, and whether this can best be achieved by a market-led initiative or regulatory intervention.

Continuing the theme of standardisation, the European covered bond market is to receive specific focus.

The Commission will consult in 2015 on the merits and potential shape of an EU covered bond framework and will present policy options to achieve greater integration in covered bond markets, based on experience gained from well-functioning national frameworks.

The Commission will also consider whether investors should be provided with more information about the collateral underlying covered bonds and other structured debt, similar to loan data disclosure requirements on structured finance instruments.

Alternative finance

Specific mention is made in the Green Paper of peer-to-peer lending and crowdfunding. As a follow-up to its Communication on Crowdfunding, the Commission is gathering information on industry approaches to information disclosure and member state approaches to regulation.

The preliminary results suggest that the diverse national approaches in these areas may encourage crowdfunding activity locally, but may not necessarily be compatible with each other in a cross-border context. Feedback is sought on whether there are barriers to the development of appropriately regulated crowdfunding or peer-to-peer platforms, including on a cross border basis and, if so, how should they be addressed.

Objective 2 - developing and diversifying the supply of funding

The second major objective of the Capital Markets Union project is to attract more institutional, retail and international investors, so as to maximise and diversify the supply of funding.

continued ▸

Capital Markets Union and Banks

Although one of the principal aims of Capital Markets Union is to diversify sources of finance to include non-bank sources of funding, the Commission sees banks as benefitting from Capital Markets Union. As banks are lenders to a significant proportion of the economy and act as intermediaries in capital markets, it is said they would benefit from a deeper, more integrated market, with fewer barriers and the prospect of more national and cross-border business. In addition, the Commission believes that measures such as a framework for 'simple, standard and transparent' securitisations could provide scope for banks to lend more where they transfer risks 'safely off their balance sheets'.

Boosting institutional investment

The Green Paper acknowledges the important role to be played by institutional investors – asset managers, pension funds and insurance companies, private equity and venture capital funds – in achieving Capital Markets Union and discusses some of the barriers that might be impeding investment from these sectors.

For asset managers, one such barrier is the regulatory cost of setting up funds, becoming authorised managers and selling across borders. This has become evident, for example, in the recent implementation of the AIFMD. These costs currently vary across member states and reducing these costs, it is said, would lower barriers to entry and encourage competition. Besides reducing costs, the Green Paper seeks views on what further policy measures might incentivise institutional investors – who are seen as pivotal to the success of Capital Markets Union – to invest more in a broader range of assets, such as start-ups, long-term projects and SMEs.

The pensions and insurance sectors are also noted as playing a key role. Recent developments, such as the implementation of Solvency II from 1 January 2016, which will allow insurance companies to invest more in long-term assets by removing national restrictions on the composition of their asset portfolio, it is expected, should help boost investment from the insurance sector. In response to calls for tailored treatment for infrastructure investments, the Green Paper seeks views on whether this should be included in future reviews of Solvency II and CRD IV/CRR. On the pensions front, the Green Paper considers whether the introduction of a standardised personal pension product across the EU, or removing barriers to cross-border access, would strengthen the single market in pension provision.

Private equity and venture capital funds are noted as providing valuable sources of funding, although there is wide geographic variation – 90% of all venture capital fund managers are concentrated in the UK, Germany, Sweden, Denmark, Finland, The Netherlands, France and Spain.

However, significant barriers, such as the absence of an equity investment culture, lack of information, a fragmented market and high costs mean that such markets often lack scale. The Green Paper

Capital Markets Union is not the same as Banking Union

The main objective of the Banking Union is to break the link between banks and national finances for the member states that share the euro. The Single Supervisory Mechanism gives the ECB responsibility for supervision over banks in the euro area, while the Single Resolution Mechanism ensures that when euro area banks fail, resolution would be managed through a Single Resolution Board and a Single Resolution Fund.

In contrast to the Banking Union, Capital Markets Union is a project for all 28 EU member states and the objective is to

continued ▸

diversify Europe's sources of finance to encompass non-bank funding (e.g. from insurance companies, pension funds, hedge funds and other asset managers).

However, the Commission sees Capital Markets Union and Banking Union as complementary projects. Capital Markets Union will build on the foundations of financial stability promoted by Banking Union and well-integrated capital markets will contribute to the resilience of the Economic and Monetary Union.

seeks views on whether changes are needed to the recently introduced EuVECA (European Venture Capital Funds Regulation) and EuSEF (European Social Entrepreneurship Fund) Regulations and, more generally, how private equity and venture capital might be further developed as alternative sources of finance.

Acknowledging the impact of new technology and business models, the Commission seeks views on whether there are any significant barriers to entry for bank and non-bank direct lenders who often provide funding to start-ups and SMEs.

Boosting retail investment

Noting that retail investors' appetite for investing directly in capital markets is small across the EU, the Green Paper explores ways in which this might be encouraged. These include seeking views on how cross-border retail participation in UCITS could be increased and what other policy measures might be introduced to increase retail investment.

Acknowledging that increased retail investment can only be achieved if investors believe their money to be safe, and the increased investor protection measures already introduced under MiFID 2, the Commission seeks views on how the European Supervisory Authorities can further contribute to ensuring consumer and investor protection.

Attracting international investment

Acknowledging that capital markets are global, Capital Markets Union is to be developed in the wider, global context. The Commission is keen that direct marketing of EU investment funds and other investment products in third countries should be facilitated and seeks views on measures that can be taken to achieve this, e.g. by reducing barriers for EU financial institutions accessing third country markets and opening markets for cross-border asset management in future trade agreements. Similarly, views are sought on measures that could be taken to increase the attractiveness of EU markets to international investors.

Objective 3 - improving market effectiveness

The third major objective is to improve the effectiveness of the market by removing some of the barriers that might impede cross-border flows of capital. This is an extremely broad objective and the barriers are diverse, covering areas of company, insolvency and securities laws and diverging tax treatments. The Commission acknowledges that tackling these issues will not be easy, and that 'further analysis is needed to identify the scale of the challenge in each area and the appropriate solutions and degree of prioritisation'.

Single rulebook

The single rulebook, developed over recent years through a number of key reforms, such as the legislation on markets in financial instruments (MiFID 2), market abuse (MAR/MAD), Alternative Investment Fund Managers (AIFMD), European market infrastructure (EMIR) and central securities depositories (CSDR) is seen as a major step forward, by creating a harmonised regulatory framework for European capital markets. However, it is noted that 'gold-plating' and divergent interpretation of the rules at national level has arisen and the Commission states that it will work with member states and the ESAs to ensure that financial regulation is correctly implemented and enforced.

continued ▸

Competition and barriers to entry

To support more efficient and well-functioning capital markets, the Commission believes that entry barriers should be removed where possible and access to financial market infrastructure assured. To this end, the Commission says it will continue to ensure that competition law is rigorously applied to avoid restrictions or distortions of competition. This applies to barriers within the EU as well as with third countries. As an example, the Commission states that requirements imposed by host member states on firms operating cross-border with a European marketing passport could, in some cases, constitute an unjustified barrier to the free movement of capital.

Capital Markets Union and Shadow Banking

The Commission aims to deliver transparent and resilient market-based finance while minimising systemic risks to the financial system. The intention, as stated in the Green Paper, is not to 'back pedal' on reforms introduced to tackle risks in the shadow banking sector. The Commission will continue to monitor these risks, while enabling the economy to benefit from a more diverse range of funding.

Supervisory convergence

The Commission will review the functioning and operation of the ESAs with a view to improving regulatory convergence, seen as vital to establishing harmonised regulatory frameworks for capital markets. The ESAs may be given additional powers if national regulatory regimes result in differing levels of investor protection, barriers to cross-border operation being erected or companies being 'discouraged' from seeking finance in other member states. The Green Paper seeks views on whether the ESAs' current powers to ensure consistent supervision are sufficient, or whether additional powers are needed.

Data and reporting

Continuing the theme of increased transparency, a feature of regulatory reforms post financial crisis, the Green Paper discusses how the development of common data and reporting across the EU would assist Capital Markets Union. Development of a 'consolidated tape' for equity markets is singled out as an example. This has been the subject of much debate in the context of MiFID 2.

The Green Paper makes clear that if market-led efforts fail to deliver a consolidated tape which is easily accessible to market participants on a reasonable commercial basis, other options may be considered, including 'entrusting the operation of a consolidated tape to a commercial entity' and the Commission will also take steps to ensure that the dissemination of consolidated information on commercially reasonable terms is unhindered.

Market infrastructure, collateral and securities law

The Green Paper refers to work that has already been done to develop the regulatory framework applying to market infrastructures, for example, the recent legislation relating to central counterparties, central securities depositaries and the Target2Securities project. However, it notes certain areas where there may be potential to make improvements, one of which is to 'collateral' because, it is believed, the fluidity of collateral in the EU is currently restricted.

Acknowledging the increased demand for collateral, driven by both an increase in secured funding and regulatory requirements (e.g. under EMIR and CRR) the Green Paper warns of the risk of collateral re-use and refers to work that is currently underway internationally to examine these issues.

The Green Paper seeks views on whether steps should be undertaken to facilitate an appropriately regulated flow of collateral throughout the EU and whether work should be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border.

continued ▸

Returning to an issue that has been discussed for many years, the Green Paper queries whether, 'taking into account past experiences', changes should be made to the laws relating to securities ownership, noting that legislation relating to investors' rights in securities differs across member states, making it difficult for investors to compare and assess the risks inherent to their investment.

That this is a complex area is made clear. The Green Paper seeks views on whether, given these complexities, targeted changes to securities ownership rules that could materially contribute to more integrated capital markets are feasible.

In one specific area, namely achieving greater legal certainty in cross-border transfer of claims and their order of priority, the Commission plans to issue a report in 2015.

The report will examine the problems and possible solutions in this area which, it is hoped, will help develop a pan-European market in securitisation and financial collateral arrangements and also assist other activities, such as factoring.

Company law and corporate governance

Views are sought on the obstacles arising from company law and how these might be overcome. Several are discussed in the Green Paper, including some relating to corporate governance, protection of minority shareholders, cross-border mobility and restructurings and divergent national conflict-of-laws rules.

Although the revision of the Shareholder Rights Directive aims to encourage institutional investors and asset managers to provide more long-term capital to companies, the Commission believes that more could be done in the area of corporate governance, which is often governed by domestic (rather than European) law and standards. Likewise, it believes that further reforms to company law might be helpful in overcoming barriers to cross-border establishment and operation of companies.

Insolvency

The Green Paper notes that the discussion around harmonising insolvency legislation has been slow over the past 30 years due to the complexity of the issues involved, although there has been progress on conflict-of-laws rules for cross-border insolvency proceedings. Nevertheless, the Commission believes that this is an area worth revisiting as reducing divergences in national insolvency frameworks could contribute to the emergence of a pan-European equity and debt market by reducing uncertainty for investors.

In 2014, the Commission adopted a Recommendation on a new approach to business failure in which it urges member states to put in place early restructuring procedures and 'second chance' provisions and to consider applying the principles to consumer over-indebtedness and bankruptcy. An evaluation of the Recommendation is planned for 2015.

Taxation

The Green Paper seeks views on the barriers around taxation that should be examined as a priority. A number of barriers are discussed in the Green Paper, including obstacles to cross-border investments such as pensions and life assurance products, due to distortions caused by different tax regimes across member states (e.g. to different types of market participants and to different types of financings). The effective use of incentives, such as R&D expenditure for innovative companies, is also discussed.

Technology

The Green Paper notes that European and national company law has not kept pace with technological developments and that use of modern technology, e.g. electronic voting for shareholders and European-wide on-line registration of companies, could help reduce costs, ease administrative burdens and make cross-border communication more efficient.

Also on this topic:
[Capital Markets Union – Securities Law Reform: Necessary or not?]

continued ▸

Next Steps

Reponses to the Green Paper and to the consultations on Securitisation and the Prospectus Directive must be received by 13 May 2015.

A conference will be organised for the summer of 2015 and, taking into account the feedback to the consultations, the Commission will launch a Capital Markets Action Plan later in 2015.

In addition, work on a number of other initiatives relating to various aspects of the Capital Markets Union project is scheduled to take place in 2015.

- The Commission to hold workshops on SME credit information
- The Commission to consult on the merits and potential shape of an EU covered bond framework and subsequently to present policy options
- The Commission to issue a report identifying the problems and possible solutions in relation to cross-border transfer of claims and the order of priority in cases such as insolvency
- The Commission to evaluate the Recommendation on a new approach to business failure and insolvency, which was issued in 2014

The target is to have the 'building blocks' of Capital Markets Union in place by 2019.

michael.dakin@cliffordchance.com
simon.gleeson@cliffordchance.com
kevin.ingram@cliffordchance.com
philip.souta@cliffordchance.com
jacqueline.jones@cliffordchance.com
www.cliffordchance.com

Financial crime and cyber security

AIMA SPONSORING PARTNER

Willis

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

A recently released paper by AIMA demonstrated clearly that hedge fund firms and other alternative asset managers are playing an important role in financing the economy, providing much needed capital and investment to the SME market, real estate and infrastructure projects amongst others.[1] As the sector plays an increasingly mainstream role, issues such financial crime and cyber security will remain central to further growth. As recent events show, these remain a priority for regulators and law enforcement agencies.

Financial crime

Financial crime seems to have occupied much of the Financial Conduct Authority's (FCA) time. Earlier this year, in response to an FOI request, the FCA confirmed it is investigating 67 firms or individuals that fall within the Alternative Investment Fund Managers Directive (AIFMD) for possible abuses ranging from financial crime to market abuse. These cases will take time to work through the FCA enforcement process but it is likely that some of the investigations will result in public enforcement action.

Separately, the FCA announced the findings from its thematic review into market abuse in the asset management sector, which covered 19 asset management firms. In April 2015, it issued the latest version of its guidelines "Financial Crime: A guide for firms"[2] which followed on from the FCA Business Plan 2015/16 in which the FCA identified "The importance of firms' systems and controls in preventing financial crime" as a new forward looking area of focus for this year.[3]

Not to be outdone, the Serious Fraud Office has also been busy; last year it requested "blockbuster funding" to continue its complex investigations and earlier this year it secured a successful conviction against the founder of a hedge fund that defrauded investors during the financial crisis.

The law enforcement agencies focus on financial crime follows earlier Government measures and initiatives to tackle financial crime, from the Introduction of Deferred Prosecution Agreements (under which a company charged with a criminal offence can have proceedings suspended if it agrees to various conditions, such as co-operating with prosecutions of individuals, making reparations or paying a financial penalty), to proposed legislative changes to the disclosure of beneficial ownership of companies in order to enhance transparency of UK corporates, combat tax evasion and financial crime.

Last year this work culminated in the release of the UK Government's "Anti-Corruption Plan", which set out 60 action points for the Government and its partners, both in the public and private sector.[4]

US regulators are equally as concerned with financial crime. Benjamin M. Lawsky, Superintendent of Financial Services for the State of New York, recently spoke about the need for robust transaction monitoring and filtering

1 www.aima.org/en/document-summary/index.cfm/docid/A509C9FF-F7C5-4772-9148D8A687B1573C

2 fshandbook.info/FS/html/FCA/FC/link

3 www.fca.org.uk/news/our-business-plan-2015-16

4 www.gov.uk/government/publications/uk-anti-corruption-plan

continued ▸

systems to prevent money laundering. Flawed or ineffective monitoring and filtering systems would risk creating “a gaping loophole in our financial system that terrorists, drug dealers, and other violent criminals could exploit” warned Lawsky.[5]

Against this backdrop, it is an appropriate time for hedge funds and alternative asset managers to review financial crime systems and controls. The FCA Financial Crime guide provides useful guidance on managing risks associated with key financial crime issues from money laundering, anti-bribery & corruption, fraud and data-security. It also provides useful examples of good and poor practice in relation to a range of controls, such as due diligence, managing PEPs and dealing with third parties. Regulators will be looking for senior management to demonstrate strong and effective governance and display identification and mitigation of these risks.

Cyber security

The United States administration recently warned that hedge funds are a weak link in the US financial systems defences against hackers and terrorists and has expressed concern that hedge fund investors data could be at risk. According to press reports, this blunt assessment, by the Department of Justice, also included warnings that hedge funds had been victims of cyber extortion. There was further concern that a cyber attack which resulted in the theft, sale and subsequent use of a hedge fund’s intellectual assets, such as market sensitive information or trading algorithms, might cause market disruption if cyber hackers were able to make significant sums of money in a very short period of time.

These concerns came after the Cybersecurity Examination Sweep Summary, issued by the SEC’s Office of Compliance Inspections and Examinations (OCIE), published its review of 57 registered broker-dealers and 49 registered investment advisers to better understand how broker-dealers and advisers address the legal, regulatory, and compliance issues associated with cybersecurity.[6] The OCIE asked respondents about written information security policies, periodic risk assessment and training and education. According to the results, a majority of the broker-dealers (88%) and the advisers (74%) stated that they have experienced cyber-attacks directly or through one or more of their vendors. The majority of the cyber-related incidents related to malware and fraudulent emails. The OCIE guidelines will soon be updated to take account of the findings.

The SEC’s Division of Investment Management issued Cybersecurity Guidance in February, recognising that funds and advisors are increasingly using technology and must protect confidential and sensitive information related to their business activities from third parties, including information concerning fund investors and advisory clients.[7] The Cybersecurity Guidance provided several measures to address cyber security risks, ranging from:

- Conducting periodic assessments of the nature of the information the firm collects and cybersecurity threats;
- Creating a strategy that is designed to prevent, detect and respond to cybersecurity threats, which might include controlling access to various systems, data encryption, backup and retrieval.
- Implementing the strategy through written policies, procedures and training.

The UK Government has similarly expressed concerns about cyber threats and has been collaborating with the insurance sector to help firms identify cyber threats and how insurers can

5 www.dfs.ny.gov/about/speeches_testimony/sp150225.htm

6 www.sec.gov/about/offices/ocie/cybersecurity-examination-sweep-summary.pdf

7 www.sec.gov/investment/im-guidance-2015-02.pdf

continued ▸

help reduce cyber risks.[8]

The significance of the cyber threat can be difficult to convey but should not be underestimated. Cyber vulnerabilities are best viewed as enablers, amplifiers and accelerators of risks (including financial crime risks), which are already established in an organisation. Firms must understand their cyber vulnerabilities and how these impact the level of risk for the firm's portfolio of existing risk, to allocate their resources effectively and manage this threat.

The only wrong answer in this picture is not to embrace the need to start the journey to understand the cyber vulnerabilities in your business.

Starting the journey is about three key steps:

- education and awareness within your business;
- doing the simple cyber defence things well; and
- planning for the worst and rehearsing the plan.

Over time, it will become clear for all to see which of those organisations have embarked on the journey and are prepared for a breach and which have not.

jagdev.kenth@willis.com
www.willis.com

8 www.gov.uk/government/publications/uk-cyber-security-the-role-of-insurance

Hedge funds and the state of responsible investing

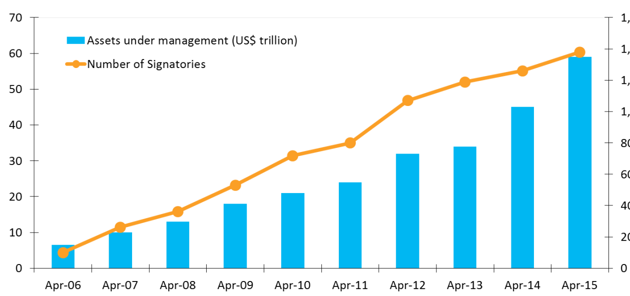
AIMA SPONSORING PARTNER

By Jason Mitchell, Fund Manager, GLG Partners, and Steven Desmyter, Managing Director and Head of Nordics and Benelux, Man

Responsible investing broadening its base

A roundtable in May 2015, cosponsored by AIMA and the United Nations Principles for Responsible Investment (UN PRI), provided the opportunity to reflect on hedge fund activity in the area of responsible investing (RI), supported by views from asset owners and consultants. While other asset classes have been quick to adopt RI codes like UN PRI's Principles, alternative asset managers have been slower to take up. Asset owners have traditionally set the RI agenda and formed the foundation of the UN PRI signatory list. Long only and private equity strategies followed suit as their longer-term investment duration cycle assigns a higher value on non-financial factors like governance. The momentum in both signatory count and assets under management (AUM) has broadened from this initial base over the past decade.

Fig 1. UN PRI total signatories and AUM



Source: UN PRI, 2015.

But while other asset classes — fixed income, for example — have become increasingly prominent, hedge funds as a strategy remain a minority voice in spite of important contributions. For many, RI remains a victim of confusing abstractions. Its many labels — negative/exclusionary screening; positive/best-in-class screening; norms-based screening; the consideration of environmental, social and governance (ESG) factors; sustainability-thematic; and impact investing — describe its methodologies and processes but often fall short in proving its materiality. Deriving precise figures around hedge fund exposure to RI strategies is difficult, given the poor consistency of reporting outside of the UN PRI's annual reporting framework. While signatory count among managers and those owners with exposure to alternatives can be tabulated, an accurate AUM figure remains tenuous because even UN PRI's reporting parameters are too broad. Nonetheless, we believe the persistent increase in both exposure and signatory count support the argument that RI is a steadily growing influence among alternative asset managers and owners.

Fig 2. UN PRI Signatories with hedge fund exposure

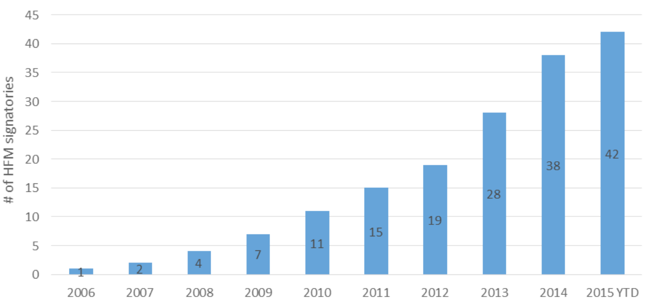
Source: UN PRI, 2015

Defining responsible investing

What does responsible investing really mean? It's perhaps best characterized as integrating non-financial criteria — environmental, social and governance factors (ESG) — into the investment process while actively engaging companies

continued ▸

Fig 3. Number of UN PRI HF Signatories



Source: UN PRI, 2015

through formal — expressing through voting — and informal exchange to improve a company's performance. But while ESG factors themselves are fairly straightforward as an input, normative codes are a more complex creature, ranging from aspirational principles like those of the UN PRI to more stringent, prescriptive codes like the UN Global Compact and ethical frameworks outlined by exclusion lists.

Though RI's definition is fairly clear, the role that hedge funds occupy in the RI dialogue remains largely undefined. This has as much to do with the fragmented nature of the universe of alternative managers as it has to do with their underrepresentation in organizations like the UN PRI relative to other asset classes. While RI represents a broad enough term to mean different things to different investors especially in terms of incorporating worldview criteria, hedge funds remain an easily-caricatured group whose offshore domiciles and higher fees promote suspicions.

Many traditional asset owners still struggle to reconcile the basic idea of shorting with the notion of RI and its longer-term investment perspective. This only grows more complicated when one addresses strategies focusing on high turnover and trend following. Unsurprisingly, many pension funds that meaningfully allocate to alternative managers remain sensitive to press highlighting this linkage. Although many activist funds don't necessarily operate strategies based around an explicit ESG framework, their emergence certainly reflects an example of hedge funds advancing corporate governance norms. Yet, it seems many owners are uncomfortable with this aggressive form of active engagement despite the strong returns posted by these strategies.

Indeed, hedge funds often face a good deal of scepticism in their motivation to address RI. A common criticism of alternative asset managers integrating RI in their investment process or more formally signing up to UN PRI is the belief that many do it solely to raise AUM under the responsible investment banner. But this is a difficult assertion to make. Few if any alternative mandates come attached with rigid RI or UN PRI requirements, the long/short funds that do exist with explicit RI integration have struggled to raise AUM unlike a number of long-only funds that have successfully marketed it as part of their strategy.

Certainly, it's in no one's interest to monetise RI in a boom-and-bust fashion much as cleantech funds did to the environmental theme several years ago. While the notion of mandates-as-incentives comes across as a crude form of encouragement for RI — one that norms would ideally fulfil — it's worth contemplating whether this incentive would at least accelerate greater adoption and align manager-owner preferences.

Quant's role in RI

Systematic investment strategies represent another area undergoing definition in the RI space. Superficially, these would seem to go against the spirit of RI and certainly the core of UN PRI's Principles, which focuses on the notion of active ownership and positive engagement with companies. Said another way, norms and aspirational codes don't count in an algorithmic context but this doesn't exempt them RI-irrelevant. Moreover, the RI approach emphasizes duration over short-term returns strategies which run counter to quantitative funds that often operate on high trading turnover.

Ironically, because of their large investment universes, systematic strategies are proving particularly compatible to exclusionary overlays.

continued ▸

For example, a cross-asset, macro or even managed futures strategy of several hundred positions with a broad investment universe will be able to better accommodate exclusionary criteria than many concentrated, equity portfolios. Hence, a number of asset owners are choosing simply to overlay these strategies with a company or sector-based exclusion list.

However, the persistent popularity of negative screening also represents a return to less rigorous form of RI. In theory, improvements in the data quality of RI to better identify materiality should resonate with the manager penchant to create proprietary investment processes. But the reality is that many asset owners still operate on a much more basic level, employing negative screens under general assurances like the UN PRI and UN Global Compact banners. Only a minority appear to be proving progressive enough to set about decarbonizing their portfolios, asking managers to run single or multi-factor models to cost ESG externalities. Few seem to demand evidence of rigorous governance engagements.

Innovating RI through fund structures

A highlight of the AIMA-UNRPI Roundtable was greater discussion by asset owners about what fund formats are best able to accommodate RI criteria. It's a subtle but pragmatic point, as it advances the RI-hedge fund debate from one centred in the past on getting asset owners comfortable with shorting strategies to more functional considerations. It also highlights that innovation isn't only related to the RI investment process. It's also increasingly about dealing with multiple asset owners with different normative investment criteria in vehicles like commingled funds. Several issues have hamstrung hedge fund participation into the RI space. Common criticisms range from a fund's offshore Cayman structure and the need for greater independent board representation to how commingled accounts can address RI screening under lower costs.

One way in broadening asset owner participation in RI alternative strategies is to examine how the format can accommodate a larger number of investors. For individual investors, managed or segregated accounts have traditionally fulfilled the function of including owner-specific preferences, affording them the flexibility to incorporate exclusionary criteria ranging from companies to larger sectors. However, as their own legal entities, this format is often prohibitively expensive for small asset owners who bear the full weight of legal, administrative, trading, audit and ISDA-related costs. While the move from a segregated account to a segregated share class can minimize the majority of these costs, trading inefficiencies remain a persistent cost problem.
Commingled structures, in contrast, aim to carry the advantages of low costs and the benefits of greater transparency. Both of these attributes lend themselves well to RI so long as there's enough overlap of the exclusionary requirements among different investors that their collective list doesn't create an unnecessary burden or cost to anyone. The structure also resolves many of the governance and transparency issues that problematize Cayman funds for asset owners. The process means that an independent board collects exclusion criteria from all investors, checks with the manager to see if it privileges or materially impacts any investors and discloses quarterly the exclusion list for allow redemptions.

Challenges in RI go well beyond definitional problems into reporting. UN PRI has stepped in as one of the most credible reporting frameworks with enough integrity to satisfy asset owners that RI is being considered and applied. However, the framework's uniform approach within asset classes isn't perfect, lacking the detail making it difficult to distinguish just how much RI is being used at the fund level or firm level, especially for large, multi-strategy alternative asset managers. There are signs this is changing, as some asset owners and consultants adopt a more hardline approach. CALPERs, for example, now requires its managers to explain how exactly their investment processes incorporate ESG factor analysis, and some consultants are increasingly asking for evidence of integration and company engagement.

continued ▸

Moving the RI – hedge fund debate forward

The AIMA-UN PRI Roundtable demonstrated that the hedge fund – RI dialogue is advancing from discussion to practice. The innovations effects can be seen in managers embedding RI into the investment process as ESG analysis, applying exclusionary screening overlaps onto systematic funds as well as new fund vehicles that take into account lower fee economics and higher standards of governance and transparency. Alternative asset managers will increasingly have to consider these areas as asset owners become more sophisticated and demanding in how their investments reflect their values and worldview.

jason.mitchell@glgpartners.com
steven.desmyter@man.com
www.maninvestments.com

Important Information
Opinions expressed are those of the author and may not be shared by all personnel of Man Group plc ('Man'). These opinions are subject to change without notice, are for information purposes only and do not constitute an offer or invitation to make an investment in any financial instrument or in any product to which any member of Man's group of companies provides investment advisory or any other services. Any forward-looking statements speak only as of the date on which they are made and are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements. Unless stated otherwise this information is communicated by Man Investments AG which is regulated by the Swiss Financial Market Authority FINMA. In Australia, communicated by Man Investments Australia Limited ABN 47 002 747 480 AFSL 240581, which is regulated by the Australian Securities & Investments Commission (ASIC). This information has been prepared without taking into account anyone's objectives, financial situation or needs. In the US, distributed by Man Investments, Inc. which is authorized and regulated, but not endorsed, by the US Securities and Exchange Commission, the Financial Industry Regulatory Authority and the Securities Investor Protection Corporation.

REGISTER TODAY TO RESERVE YOUR SEAT!

DELIVERING ALPHA

CNBC | Institutional Investor

JULY 15, 2015 • THE PIERRE • NEW YORK CITY




Delivering Alpha has become a who's who of the investor community.

Last year's meeting delivered over $2 trillion of investable assets represented by over 110 influential institutional investors. Keynote speakers included Jack Lew, the 76th United States Secretary of the Treasury; Chris Christie, the 55th governor of New Jersey; as well as Ken Griffin, Stanley Druckenmiller, John Paulson, Nelson Peltz, Bill Ackman, and Carl Icahn.

CONFIRMED SPEAKERS INCLUDE:

Carl Icahn
Chairman
Icahn Enterprises

Larry Fink
Chairman & Chief Executive Officer
BlackRock

Paul Singer
Founder & President
Elliott Management

Leda Braga
Chief Executive Officer
Systematica Investments

James Dinan
Chief Executive Officer & Founder
York Capital

Mary Callahan Erdoes
Chief Executive Officer
J.P. Morgan Asset Management

Jonathan Gray
Global Head of Real Estate
Blackstone

Marc Lasry
Chairman, Chief Executive Officer & Co-Founder
Avenue Capital Group

Eric Mindich
Chief Executive Officer & Founder
Eton Park

Richard Perry
Chief Executive Officer
Perry Capital

Barry Rosenstein
Founder & Managing Partner
JANA Partners

Jeffrey Smith
Managing Member, Chief Executive Officer & Chief Investment Officer
Starboard Value

SPONSORS:

BNY MELLON | Invested

Deutsche Bank

STATE STREET GLOBAL ADVISORS

AG & Co

EISNERAMPER
EISNERAMPER.COM/ALTINVEST

iShares by BLACKROCK®

SOCIETE GENERALE
Corporate & Investment Banking

Standard Life Investments

www.DeliveringAlpha.com

The PR challenge for the hedge fund industry

AIMA SPONSORING PARTNER

MAPLES

By Henry Smith, Global Managing Partner, Maples and Calder

Political candidates in UK, US and EU election campaigns unfortunately tend to expound populist views that there is something inherently bad about hedge and private equity funds. Views that claim they are secretive and only there to enrich the wealthy; they are unregulated, non-compliant and helped cause the global financial crisis; they cause jobs losses by asset stripping companies; they are based in secretive offshore tax havens and do not pay their fair share of taxes; and perform poorly against major market indices. The mainstream media, certain NGOs and even Hollywood movies, by focusing on the excesses on Wall Street or the few instances where a major hedge fund has failed, unfairly hype these views.

It is a tough on-going challenge to change these general public perceptions, but it is worth persevering as in many cases, they are simply uninformed and wrong. They may also lead politicians and regulators to develop bad policy and disproportionate regulation to the ultimate cost of those same voters and constituents they seek to protect or represent, and can cause unintended damaging consequences to their economies.

AIMA continues to work hard to educate politicians, regulators and journalists about what really goes on in the industry. AIMA's excellent research papers pulled together in "The Case for the Hedge Funds: A Compendium of Thought Leadership Reports" are well worth reading. Here are some of key messages to help address these PR challenges:

The global financial crisis. Blaming hedge funds for the global financial crisis was unwarranted. Official reports prepared for international regulators and various authorities acknowledged that hedge funds did not cause the global financial crisis, which was triggered by failures in the regulated banking industries. Even the largest hedge and private equity funds are neither "too big to fail" nor represent a systemic risk to the markets. Leverage in most typical hedge funds rarely exceeds one to two times assets (as opposed to 40 times assets in the banking industry) and no hedge or private equity fund required a state funded bailout. Hedge funds in fact brought much needed liquidity to the markets after the crisis.

The benefits to the global economy. Critics claim hedge funds serve no useful purpose and are merely vehicles for wild speculation, only benefiting the wealthy, often attacking currencies and shorting companies into oblivion or stripping jobs to profit hedge or private equity funds. The reality is different. Hedge and private equity funds are an integral part of the asset management industry and contribute to the economy in many ways:

a. **Job creation and tax.** Hedge funds have created an estimated 300,000 jobs globally, including 240,000 in North America, 50,000 in Europe and 10,000 in Asia-Pacific. They contribute a sizable chuck of GDP in countries where the industries are located. This in turn generates significant taxable revenue for governments, for example, in Europe this is thought to be in excess of $8 billion; and that’s before you get to the knock-on benefits to other industries - real estate, restaurants, car dealers, etc. where these jobs are located and the consequential tax revenue generated. Whilst it might be seen as politically attractive to raise further tax revenues from the funds or workers in the industry, governments need to be careful that they do not reach a tipping point where their financial centres become uncompetitive and risk losing financial services business, with all the consequential effects for the economies. Recent statements in the UK that hedge funds benefit from a special exemption on stamp duty, for example, are

continued ▸

incorrect since other UK authorised funds operate under the same regime.

b. **Capital allocation.** Hedge and private equity funds are useful capital allocators and providers of market liquidity. Since the crisis, the hedge and private funds have stepped up to provide diversified funding sources to businesses to help them grow. They facilitate global capital investment flows into the major and developing economies and finance vital infrastructure projects and assets - such as commercial aircraft, ships, hospitals, roads, power plants in emerging market countries. Again, all of these are examples of how the industry helps economies create jobs and taxable revenues.

c. Short selling. Rather than being a problem, some politicians believe short sellers provide essential liquidity to the markets and can often be an early indicator of which companies or sectors of the economy are about to experience difficulties. Short selling gives investors an ability to hedge risk of being invested on a long-only basis.

d. Just for the wealthy. Much of the negative rhetoric assumes that hedge funds are simply for the wealthy or only benefit the fund managers, and ignore other major stakeholders. Securities laws in many countries may preclude non-accredited retail investors from investing directly in hedge funds, but about 30% of the over $2 trillion invested in hedge funds comes from pension funds. So everyone, through their pension funds, indirectly benefits from hedge fund investments and much needed portfolio diversification. Any politically driven increased costs, taxes or regulatory and compliance expenses have an indirect adverse consequence for the individual pensioners invested in those hedge funds.

Performance. Market commentators unfairly criticise hedge fund performance by benchmarking performance to the long-only major market indexes. Most hedge funds are not invested in portfolios to match the market indexes in that way. Investors can buy index funds if they want to do that. Hedge funds provide alternative investment opportunities and hedged, risk adjusted and less volatile returns. Long/short funds may underperform a long-only index in a bull market as they have to pay for the hedges. Over the longer periods hedge funds have been proven to outperform many asset classes on a risk adjusted basis. Long-only focused index investing carries significant performance risk and volatility - for example, investors in the NASDAQ index have only just regained their high-water mark from 2000 after 15 years.

Regulation and compliance. It is wrong for the media to say that hedge funds lack proper regulation and do not comply with the rules. That is simply not true. The vast majority of hedge fund managers are now regulated. Hedge funds domiciled in the Cayman Islands or the British Virgin Islands are also regulated. In addition, service providers around the hedge funds – custodians, prime brokers, fund administrators and Cayman Islands independent directors – are often subject to regulation. Collectively, the hedge funds have already invested more than $3 billion on compliance and individually spend anywhere between 5% and upwards of 10% of their operating costs on compliance. Governance in the hedge fund continues to improve and a large majority of hedge funds now have independent directors on their boards.

Tax havens and transparency. Those who allege hedge funds are secretive or non-transparent and based in offshore tax havens for nefarious purposes ignore some salient facts. Hedge funds can be limited considerably by securities laws from divulging much information to the media on marketing. This may foster their reputation for secrecy; but the reality is they must make numerous informational reports to their investors and regulators in the US and the EU, for example, by filing regularly Form PF and Annex IV information.

About 70% of all hedge funds and a large number of private equity funds are Cayman Islands

continued ▸

companies for good reasons. The Cayman Islands government is often commended by the likes of the IMF, the Financial Stability Board, the FATF and governments for the way in which the Cayman Islands has promoted good governance and adopted international initiatives on AML/KYC and implemented good co-operation with international regulators (for example, in relation to the EU AIFMD), as well as committing to and implementing tax transparency initiatives such as FATCA, the European Savings Directive, a UK version of FATCA, the OECD Convention on Mutual Administrative Assistance in Tax Matters and the G5 countries' pilot project on the automatic exchange of tax information. The Cayman Islands' anti-money laundering/know-your-customer laws are rated as good as many major OECD members' laws.

Institutional investors recognise all this and, after copious due diligence, take comfort that the Cayman Islands investment funds in which they invest are established under internationally recognised legal principles which protect their rights and have been successfully tried and tested through even the most severe of financial crises.

Conclusion

These are few examples of how the industry might address the PR concerns and misconceptions. It's important we continue to educate policymakers so they only introduce workable and proportionate regulation and tax policy, which will not heap unnecessary cost on institutional investors or exclude pensions from the world's best alternative investment funds. Thousands of jobs in the industry and the well-being of millions of pensioners depend upon it.

henry.smith@maplesandcalder.com
www.maplesandcalder.com

This article is intended to provide only general information for the clients and professional contacts of Maples and Calder. It does not purport to be comprehensive or to render legal advice.

Starting a hedge fund in 2015

By Peter Astleford, Partner, Mikhaelle Schiappacasse, Senior Associate, and Gemma Burke, Associate, Dechert LLP

Whether a promoter is establishing its first or its fifth hedge fund, what are the key considerations it should take into account when starting a hedge fund in 2015?

Target investor base

One of the most important factors in structuring a fund is determining the type of investor to which that fund will be offered.

Investor domicile and tax regime

Investors will seek to invest in a vehicle that minimises any taxation to which they may be subject. To address this, funds are typically structured in one of two ways: as an opaque entity (e.g. a corporate) or as a tax transparent entity (e.g. a partnership).

Continental taxed European investors generally prefer to invest through an opaque entity that allows profits to be realised later, or as capital gains rather than income (thus attracting a lower tax rate). Opaque entities are also generally essential for U.S. tax exempt investors (e.g. pension plans). U.S. taxpayers (e.g. U.S. individuals), on the other hand, are likely to prefer an investment in a tax transparent vehicle. Opaque entities tend to be undesirable to U.S. taxpayers due to stringent U.S. anti-tax avoidance provisions.

If the fund is targeting both types of U.S. investors as well as non-U.S. investors, it is possible to satisfy the tax requirements of each type of investor by using a "master-feeder" fund structure. Here, investors will invest in different types of entities to suit their requirements, but all proceeds are ultimately invested through a single "master" vehicle (which will be an entity treated as a partnership for U.S. tax purposes). A master-feeder fund enhances the critical mass of investable assets, and avoids the need for the investment manager to split tickets or engage in re-balancing trades between the parallel structures or for the fund to enter into duplicate arrangements with service providers and counterparties. Additionally, it creates greater economies of scale for the day-to-day management and administration of the fund, which generally leads to lower operational and transaction costs.

Investor types

The trend over the past decade has been for institutional investors to replace high net worth individuals as the investor base for hedge funds. Institutional investors may have particular characteristics that a promoter may need to take into account in establishing a fund:

Seed investors – promoters sometimes look to institutional investors to provide seed capital in order to alleviate concerns that the fund launch will not raise enough capital to be viable. Seed investors may seek preferential treatment for their investment in the fund, and may also have strong views on the fund's jurisdiction, structure and/or terms. Generally, care needs to be taken that any preferential arrangements do not include terms that prejudice the interests of other investors or the long term viability of the project.

Benefit plan investors – a large investor base for promoters marketing their funds into the United States are entities characterised as 'benefit plan investors' under the U.S. Employee Retirement Income Security Act of 1974 ("ERISA"). Funds will generally want to ensure that investments by benefit plan investors remain below 25 per cent (calculated on a per class basis and ignoring the

continued ▸

investment of the investment manager and its associates), otherwise the fund and its service providers will be subject to additional burdensome requirements.

Fund of fund investors – funds of funds have their own investor base, performance and liquidity profile to consider. Accordingly, they will need to invest in hedge funds that do not jeopardise their own structure and will have a preference for funds that have a similar or better liquidity profile and will seek to limit their exposure to funds which are able to limit redemptions.

The fund's jurisdiction of establishment

Jurisdictional Considerations

Popular fund establishment jurisdictions include the Cayman Islands, Ireland, Luxembourg and the U.S. (commonly Delaware when targeting U.S. investors). Malta is also an emerging European alternative. In choosing a fund domicile, promoters should consider the following issues:

- Whether the jurisdiction is familiar with hedge funds (and therefore has the appropriate infrastructure).
- The perception of the jurisdiction amongst investors (for example, U.S. investors will generally be more familiar with Cayman or Delaware structures, whereas continental European investors may prefer Luxembourg (or Irish) funds).
- The laws and regulatory requirements of each jurisdiction (which will affect the timeframe for establishment, flexibility and continuing obligations in operating the fund).
- The tax efficiency of establishing the fund in a particular jurisdiction.
- Establishment and ongoing maintenance costs of the fund.

Implications of marketing a fund under the European Alternative Investment Fund Managers Directive ("AIFMD")

While the Cayman Islands has become the jurisdiction of choice for global promoters, the implementation of AIFMD in the EEA and the limitations on marketing funds established outside of the EEA into the EEA should lead promoters to consider whether to establish funds within the EEA if they are targeting investors in the European market. Under AIFMD, funds established outside of the EEA may only be marketed into EEA countries pursuant to each relevant country's private placement regime.

Certain EEA jurisdictions do not permit private placement (e.g. France) or impose requirements that make it costly or complex to undertake marketing on a private placement basis (e.g. Germany). However, funds established in the EEA and managed by an EEA based alternative investment fund manager for the purposes of AIFMD may be marketed, as of right and following a simple registration process, into other EEA jurisdictions pursuant to a passport. Once an EEA established fund is qualified to market into one EEA country, it should be relatively straight forward to register it for marketing in all other EEA countries.

The fund's structure

There are a number of considerations that will drive the fund's structure.

Open-ended or closed-ended

Funds can be open-ended, allowing investors to subscribe for and redeem their investment from the fund on a regular basis. Alternatively they may be closed-ended, with investment limited to one or more initial subscription dates and investors being unable to redeem their interests at will with distributions being made at set intervals or at the end of the life of the fund. Investors generally prefer to invest in open-ended structures for liquidity reasons. Closed-ended structures, however, are commonly used for specialist fund structures, particularly those engaged in real estate, infrastructure investment or debt issues. Closed-ended funds are typically associated with lower fees and better performance but marketing tends to be harder and to a different investor base.

continued ▸

Single cell or umbrella structure
If the fund will have one investment strategy and one portfolio of assets, a single cell/portfolio vehicle may be appropriate. If more than one strategy will be run with multiple portfolios of assets, an umbrella structure may be more appropriate. The advantage of an umbrella structure is that it reduces costs and the level of fund documentation. However, promoters need to be wary of the possibility of cross class liability, i.e. that in some jurisdictions and with some structures, as a matter of law, creditors of a defaulting portfolio may have recourse to the assets of a non-defaulting portfolio.

Third-party fund platforms
If a promoter does not have the time or means to establish its own fund structure, an alternative is to use a third-party fund platform. Third-party fund platforms are generally umbrella structures that allow promoters to “plug and play” by joining the platform with their own separately managed sub-funds. Platforms may benefit from shared costs, speed to market and potential distribution through capital introduction capabilities. Platforms may, however, in certain circumstances be more costly and provide limited control to the promoter of the fund.

Fund terms and service providers

Once a promoter has determined the appropriate fund structure, it can start to consider service providers and the terms of the offering itself.

Selecting key service providers
Consideration should be given to a service provider’s familiarity and expertise in servicing the asset types and markets in which the fund proposes to invest. Other considerations in appointing a service provider include: the jurisdiction and time zone of the service provider, the service provider’s reputation, and the service provider’s cost.

Classes
It may be appropriate for a hedge fund to issue different classes of interests for a variety of reasons:

Accumulation and distribution policy – some investors may wish to receive dividends, while others will prefer income to be rolled-up.

Reporting classes – if the fund is targeting, for example, UK individual investors or UK investment trusts, it should consider seeking approval of one or more classes as a reporting fund so that any gains realised by such investor on the redemption or disposal of an interest in the fund will be subject to capital gains tax rather than income tax.

Liquidity/fee terms – the fund may wish to offer lower fees to investors who commit early, to a less liquid investment or subscribe for a larger amount into the fund.

Currency – different investors might wish to invest in different currencies (for example, U.S. investors might prefer to invest in a U.S. dollar class, whereas European investors might prefer a Euro class).

New issues – restricted persons (which include broker-dealers and portfolio managers) have limited rights under the rules of the U.S. Financial Industry Regulatory Authority to invest in initial public offerings of securities made pursuant to a registration statement or offering circular. When investing in a new issue, the fund will have to confirm to its counterparty that its investors are not restricted from participating in such an investment, and may therefore want to have separate classes available for investment by restricted and unrestricted persons.

Management shares – the promoter, the investment manager and their respective personnel and connected persons may wish to invest in the fund. A management class would allow such persons to benefit from lower, or no, management or performance fees or (where appropriate) to hold the voting rights in the fund.

continued ▸

Listing the fund

The principal reason to list a fund is to enhance its marketability as certain investors (such as pension funds and insurance companies) may be required to invest mainly or wholly in listed securities. The publicity provided about a fund by, for example, the Irish Stock Exchange may prove useful in facilitating subscriptions under reverse solicitation under the AIFMD.

Investment management fees

Investment management fees usually comprise two elements: a management fee (say 1 to 2 per cent. per annum of the fund's NAV) and a performance related fee (usually 20 per cent. of profits over a specified period). Underperformance is usually carried forward so that a performance fee is not paid twice on the same performance. Performance fees can be made more investor friendly by introducing a hurdle rate of return to be reached before the performance fee is payable, such as the risk free rate of return or a percentage above a relevant market index but this is not common.

Dealing terms

Circumstances may arise where it is no longer possible or appropriate to make redemptions in the usual manner. In these circumstances, the fund needs to have tools to be able to effectively and fairly manage the situation. Such tools can include:

Gate - redemptions are limited on a particular dealing day to a stated maximum, usually in circumstances where the directors believe that, owing to the liquidity of the underlying investments, such an action would be in the overall interests of investors. Gates can be imposed on a fund level, a class level or on an investor-by-investor basis. Gates may also be imposed on a priority basis (where the first to request redemption are the first redeemed) or on a pro rata basis (where pending redemption requests as of each dealing day are honoured pro rata).

In specie or in kind –illiquid assets are transferred to a vehicle and investors are given a share in that vehicle (which the investment manager tries to wind down over time) (an "in kind" redemption) or there is an outright transfer of the fund's underlying assets to investors (an "in specie" redemption).

Side pockets – Assets or positions that are illiquid and/or hard to value are separated from the rest of the fund's portfolio. They are often established as a separate pool of assets referenced by a particular class of interests in the fund in which new investors will not participate. Redemptions are not processed from the side pocket until the relevant asset or position is sold or unwound.

Reduce dealing day frequency – the fund could provide for the ability to reduce the frequency of dealing days or even cancel certain dealing days in order to provide additional time to realise assets or impose longer notice periods in respect of redemptions which need to be met.

Suspend trading – suspension is traditionally considered an option of last resort. It may sometimes be used to provide sufficient time to implement certain of the liquidity management tools discussed above and is likely to be an appropriate tool where a significant portion of the fund's assets cannot be valued where, for example, the asset in question has been suspended from trading on a stock exchange.

Conclusion

The above description of factors is a very brief overview only. The establishment of a hedge fund requires promoters to make, in addition to decisions regarding strategy and the nature of the fund's offering, key decisions regarding target investor markets, jurisdiction, corporate structure and dealing terms. These decisions govern, in the long term, the ease with which the fund may be operated, the fund's access to available pools of capital and (along with performance) the long-term success of the fund.

peter.astleford@dechert.com
www.dechert.com

Fund structuring for European investors in a changing tax and regulatory environment

AIMA SPONSORING PARTNER

By Begga Sigurdardottir, Tax Partner on Secondment from PwC Luxembourg, and Benjamin Gauthier, consulting director, PWC Luxembourg

A changing environment

The demand for alternative asset management solutions and products is set to significantly grow in the coming years. Several factors drive this growth. Increased capital requirements for banks lead to reduced capacity for them to lend. Alternative investment funds are taking on a role as corporate lenders and provide necessary capital to businesses wanting to invest. Another reason for the growth is an aging population and a consequential shift from government funded pension systems to privately financed pension and health care systems. Private pension and insurance providers will need to generate appropriate returns which they will look to generate through alternative investments.

While high net worth individuals in Europe mainly invest in retail alternative products, institutional investors increasingly look for dedicated and customised products, specialised strategies and higher returns. This, in turn, will lead to a higher demand by pension funds and insurers for alternative investment solutions adapted or customised to the new regulatory and tax environment of these investors. When raising capital from large European institutional investors, asset managers need to be prepared to operate in a regulated and transparent environment. They need to offer products tailored to the individual tax and regulatory environment of the European institutional investor. This is particularly challenging in Europe, where despite a certain degree of harmonisation of the financial market under the rules of the European Union, each member state still decides how to implement rules governing marketing and private placement of alternative fund products. It does not make the task any easier that each European country has their own tax regime, despite a certain degree of tax harmonisation. This article outlines some of the multiple regulatory and tax aspects that fund managers need to consider when structuring a fund for European institutional investors.

Direct impact of new regulations

The main game changer for fund structuring in Europe is probably the Alternative Investment Fund Directive (AIFMD, the Directive). For several months now, the AIFMD has been transposed by most EU member states into national legislation. Although the aim of the Directive is to create an internal market for alternative investment managers (AIFM) in the EU and the European Economic Area (EEA), in practice, some countries have implemented the AIFMD with additional changes that are not required by the Directive.

For Alternative Investment Funds (AIFs) domiciled in the EU having an EU AIFM, the impact of AIFMD is wider than for Non-EU funds. For EU AIFMs the impact is mainly operational while the impact for Non-EU AIFMs is mainly related to distribution. Acting as an "authorised" AIFM requires to meet a wide range of new obligations: having a well-established risk management function and/or portfolio management functions, due diligence on delegates and the ongoing monitoring, setting-up an appropriate valuation process, taking care of the transparency requirements, being aligned in terms of remuneration requirements etc. In addition, EU AIFMs need to perform reporting under the AIFMD reporting rules. These rules require a fairly detailed reporting in the financial statements as well as reporting to the regulator

continued ▸

of the country of the AIFM and investors in the AIFs. However, meeting all these operational requirements is compensated through the access to the EU investor market by way of a European passport allowing the distribution across Europe.

In some ways AIFMD has less direct impact on AIFs not domiciled but distributed to European investors with the AIFM located outside of Europe. In such a set-up, the non-EU AIFM will mainly have to meet the transparency requirements imposed by AIFMD. However, unlike for an EU AIFM, a Non-EU AIFM needs to provide a report to the EU country regulator of each EU country where the fund is marketed. The more relevant impacts for Non-EU AIFMs, however, relates to distribution of AIFs to European investors.

When implementing the rules of the AIFMD many countries have amended and sometimes restricted existing marketing and private placement rules. In most countries in the EU private placement is still possible under certain conditions (e.g. subject to regulatory authorization or registration). However, some of the biggest countries in terms of population have taken a very restrictive approach when implementing the AIFMD and have more or less shut down private placement of any funds if they are not fully AIFMD compliant EU AIFs managed by a licensed EU AIFM. Some of these countries today may not be a key country for capital raising for alternative funds. However, one of the reasons they are less relevant today is that the pension system in these countries is still largely relying on the state pensions. Although some reforms have taken place in these countries, a wider shift to private pensions is expected in order to maintain a sustainable pension system so that these countries should become interesting markets to raise capital in.

Reverse solicitation is nonetheless a concept that is allowed in many EU member states. However, in most of the countries the concept is not at all or not properly defined and, therefore, creates significant uncertainty and risks for anyone wanting to rely on this concept alone to distribute non AIFMD compliant funds in Europe.

Based on the AIFMD, the European Securities and Markets Authority (ESMA) should make a recommendation on the question whether or not the passport regime should be extended to AIFMs and AIFs outside the EU and whether or not private placement should be abolished. It remains to be seen if in maybe a couple of years the existing discrimination between EU and Non-EU funds in terms of distribution will remain and possibly the passport may be obtained also for Non-EU funds (but assumingly under same operational conditions as for EU funds under current AIFMD rules). This will have an important impact on fund vehicles offerings for European investors in the future.

Indirect impact of other regulations

It is natural to focus on regulations which directly apply to investment funds when structuring an alternative fund. However, an increased focus by regulators globally on capital requirements as a result of the financial crisis forces many institutional investors to carefully analyse the type of investment vehicles and strategies they want to invest into. This is not different for European investors. In many situations the question is not neutral and the choice of fund structure can have wide ranging effects.

One of the key regulations that will impact the choice of alternative investment products will be the so called Solvency II rules. Solvency II is a regulatory framework governing insurance companies EU wide. The rules under Solvency II will become applicable starting from January 2016. The key elements of Solvency II impacting asset managers will be capital ratio rules and reporting requirements under Solvency II. As the capitalisation level under Solvency II is related (among other factors) to the risk exposures of the investments, when looking at capital ratios, a fund will no longer be analysed mainly from a performance standpoint but also taking into account the potential cost in capital that it could generate for the investor. Therefore, to remain attractive, asset managers will have to properly understand the capital requirements rules under Solvency II and adapt their fund products accordingly.

continued ▸

Under Solvency II insurers will need to meet certain reporting requirements (e.g. Quantitative Reporting, or QRT). In that context, insurance companies will ask a high degree of transparency from the asset managers. For banks, similar regulatory developments have taken place. Under the Basel III framework, the capital requirements will also increase and so will the selection criteria of banks when investing in funds. As for insurance companies, depending on the degree of transparency provided by the asset manager as well as the adequacy of the asset allocation with the Basel rules, some funds will end-up by being more attractive than others as.

Changes in tax environment

During the last two years the Organization for Economic Cooperation and Development (OECD) has been working on the execution of an ambitious plan to change international tax rules in a coordinated way. This comes as a result of the general perception that existing international tax rules are no longer appropriate to deal with an increasingly global, mobile and digital business environment. It is the perception that this situation leads to an unfair base erosion and profit shifting (BEPS) between jurisdictions which is considered leading to unjustified non-taxation, unfair tax results between jurisdictions and a risk to countries' tax revenues. Therefore, with the support of the G20, the OECD has initiated a large project tackling BEPS comprised of several actions in different areas to be suggested for implementation in tax treaties and national laws by all participating countries. While the OECD is still working on position papers for many of the actions, many countries are already implementing unilateral rules to address BEPS concerns.

Although the BEPS project primarily targets large multinational groups, it impacts asset managers and funds too. Among others, the OECD is proposing measures that would limit treaty access for fund structures in certain situations. These measures are likely to have significant consequences for alternative investment funds. While there seems to be general agreement that regulated widely held collective investment vehicles like UCITS or US mutual funds are very unlikely to be used for abusively access treaty benefits, there is more debate around alternative funds. The discussion at the level of the OECD is still ongoing.

BEPS has also been a trigger for many countries to step up tax audits and many countries already challenge tax benefits under treaties and are in the process of implementing special legislation addressing what is in their view unjustified tax treaty access. A general trend which can be observed is that treaty or similar tax benefits are increasingly restricted to entities and situations where it can be demonstrated that the entity claiming the benefit is the true beneficial owner and has not been implemented solely to claim tax benefits. The tax benefits are being limited to entities with substantial activities and/or that exist for true commercial reasons. Particularly alternative funds using holding companies for some of their assets may be impacted by such rules. It may be expected that tax costs in fund structures will increase in the future.

How can asset managers adapt their products to remain attractive for European investors?

The different regulatory and tax changes mentioned above are forcing asset managers to rethink their products offering and consider alternative domiciles and products to traditional offshore fund vehicles. While until now many European investors will have invested through a pooled investment vehicle, this may no longer be an attractive product for all European institutional investors.

There is already a noticeable demand for dedicated fund vehicles by large European pension and insurance company investors notably to deal with capital ratio issues. In addition to capital ratio questions, there can also be local rules driving a certain investment behaviour of regulated investors. In Germany, for example, local rules prescribe how insurance companies need to invest. These rules basically exclude non AIFMD

continued ▸

compliant AIFs as investments. As a result some investors may ask for AIFMD compliant investments or switch to other investment products altogether like a rated securitisation solution.

However, picking a European vehicle for regulatory needs is only part of the structuring. Depending on who the investors are (i.a. taxable, non-taxable, what country, how many investors) and where/what the investments are the choice will need to be made if a tax transparent vehicle or a corporate, tax opaque vehicle is better.

The benefits of tax (exempt) opaque vehicles is that they enjoy some treaty benefits directly, but most of the time the network of treaties they benefit from is restricted. If, however, the investors have treaty access themselves it may be more beneficial to use a transparent vehicle so that the investor (rather than the fund) can directly claim benefits between the country of the investment and the country where the investor is located.

For this reason e.g. Dutch pension funds may prefer transparent vehicles over opaque vehicles. The characteristics of the investments, in turn, will drive the need for holding companies in the structure and the legal form of the fund vehicle too. For legal, commercial and tax reasons particularly real estate and private equity strategies often require the use of separate legal entities to hold the assets.

As mentioned above, in many instances, going forward, it will be necessary to demonstrate there was a valid commercial reason for using a holding company in order to get treaty benefits. This analysis of what constitutes a valid commercial reason is a country by country analysis but can e.g. be a joint venture, legal reasons (e.g. segregation of assets) or geographic location (e.g. company is in the country of investment or fund).

Once all options have been considered, there will be a conclusion that for pooled funds there is no "one-size-fits-all" However, there will be a choice of several vehicles in some of the 27 EU jurisdictions that will meet a maximum, if not all, of the criteria required to raise capital from European institutional investors. There will be a cost associated to AIFMD compliant vehicles but that would be the necessary cost to be fit for successful capital raising in a rapidly growing European alternatives market. Eventually it may even be that the additional operational cost stemming from regulation will be counterbalanced through tax savings resulting from tax benefits that regulated funds structures may have in the future compared to unregulated structures.

begga.sigurdardottir@us.pwc.com
b.gauthier@lu.pwc.com
www.pwc.com

Lehman – Coming up smelling of roses?

AIMA SPONSORING PARTNER

MACFARLANES

By Daniel Harris, Head of Hedge Funds, Macfarlanes LLP

As the Lehman Brothers International (Europe) (LBIE) administration has progressed over the last seven years, the price of unsecured claims in the secondary market has acted as a barometer of the clarity afforded to the market on the state of LBIE's balance sheet. In the early years of the administration, when the joint administrators were unable to provide an estimate as to the dividend rate for unsecured creditors (due to material uncertainties regarding the quantum of asset recoveries and the level of unsecured creditors' claims), unsecured claims on the estate were priced in the secondary market at a deep discount to par. With a clearer picture having since emerged, claims are now trading at a premium.

The questions the English courts have been asked to answer have also broadly correlated to the quality and extent of information available to creditors and customers. Early on, as knuckles whitened on the wheel in response to limited information on the state of LBIE's balance sheet, many of the issues before the courts echoed the concerns borne out of that state of affairs. For example, issues as to whether certain categories of claimant had claims with a proprietary base, as opposed to personal claims, were aired - with a proprietary claim, in contrast to a personal claim, the relevant money or securities do not form part of the insolvent estate of the failed firm, so that the claimant can recover in full priority to creditors of the estate.

More recently, good progress in the administration including the receipt by admitted unsecured creditors of 100p/£1 and the sugar-spun news that surplus funds likely to be available after payment in full of the senior claims of creditors are in the range of £4.94bn to 7.39bn, has seen a change in the nature and flavour of the issues before the courts. This resurrection of sorts has recast the underlying basis of the issues from an assumed shortfall to matters germane to the existence of a surplus fund. For example, the likely surplus of assets after payment of admitted unsecured claims has animated and encouraged the recent "Waterfall II" application. This has placed not a handful - but dozens - of questions before a Chancery judge for consideration.

Although the issues have evolved, the one constant has been the extensive involvement of the English courts throughout the administration. Arguably, one of the reasons for this is that before and then once Lehman collapsed, the London prime brokerage market rested less on prescriptive rules and more on contract and long-established legal and equitable principles, where inevitable issues on LBIE's collapse could not then be marshalled into a tailor-made insolvency regime or even a scheme of arrangement. Some of the rules that did apply, e.g. the (then) FSA client money rules, once stress-tested, fell short of affording the market the degree of certainty that had been assumed and expected.

In contrast, the prime brokerage market (and the handling of a prime broker's collapse) in New York is, comparatively speaking, governed by a regime made of stone. Relevant securities, broker-dealer and bankruptcy legislation has, for the most part, contained, prescribed and managed the aftermath. But this note does not bang the drum for one jurisdiction over another; any definitive conclusion in that regard would be unconvincing and foolish; the comparison is far more nuanced and the choice often not binary.

With LBIE, unsuspecting unsecured creditors and proprietary claimants alike found many basic assumptions scattered all across the sands, left baffled at how such uncertainty could ever come

continued ▸

to pass. UK politicians, no doubt dismayed at the delays and uncertainty that have been a feature of the aftermath, presumably feared, at least to some degree, that investor sentiment would lead to a decision that they would never play here again or, at least, that London would no longer be adored.

Fortunately, any such fear has turned out to be misplaced, as the courts have provided much needed certainty on core issues and the regulatory response has been searching and continuing.

Major collapses in the last 25 years have tended to afford the English courts the opportunity, or challenge, to develop the law and apply it in a modern context. Lehman has been no different, but the issues it has reared have not been side-show items. They have gone to the very core of the London prime brokerage and swaps markets. Three of the most noteworthy are:

1. How the value of a replacement swap is calculated when the original swap is subject to fault-based close-out. It's hard to believe, but it's true. The courts have now clarified that there is a fundamental difference between the two most prevalent valuation measures adopted by swaps users: the "Market Quotation" measure and the "Close-out Amount" measure. According to the courts (although in my view there may be scope to revisit part of this interpretation in future court cases), the "value clean" principle of the "Market Quotation" measure, put simply:

   i. assumes transaction continuity (often an improbable assumption);
   ii. disregards from the basis of the quote the determining party's lack of creditworthiness (even though a dealer's perception of credit risk may affect its quotation); and
   iii. excludes the value placed on any embedded optional termination right (which of course can have a value attributed to it).

   This is clearly artificial and perhaps, in certain circumstances, capable of producing unreasonable results. The features of the swap (and the determining party) are, in effect, photoshopped for quotation purposes. In contrast, the courts have opined that the "Close-out Amount" marks as departure from this. In effect, "Close-out Amount", not without its own problems, incorporates more of a Cromwellian "warts and all" approach to quotations.

2. Whether claimants to a client money pool, in circumstances where there is a shortfall, have a proprietary claim to money a failed firm received for clients and held, on an unsegregated basis, in its house account. The Supreme Court ruled that:

   i. the statutory trust arises on receipt of client monies, not on segregation;
   ii. segregation is not a precondition for participation in the client money pool; and
   iii. identifiable client monies in house accounts are not to be excluded from the distribution regime under the client money rules.

   The uncertainty created by the CASS rules, as aired before the Supreme Court, has promoted a set of rule changes, the general theme of which is prevention rather than cure. By improving firms' systems and controls around segregation, record keeping and reconciliations, the thinking is that this will minimise the risk of client money pool shortfalls. Hedge funds are in the midst of receiving upgraded prime broker documentation to reflect these rules changes.

3. The Lehman "Rascals" case considered, amongst other transactions, the question of whether LBIE, as buyer under a reverse repo, had acquired beneficial ownership of certain securities. Under the agreement, transfer of title from the seller to the buyer depended on payment by the buyer under the on-leg. In fact no real-world payments were made, whether on a gross basis or a net basis, through set-offs or accounting offsets of existing mutual credits and debits. In the specific circumstances of

continued ▸

the case, the repo seller was "estopped" from denying that LBIE had paid the price on the on-leg by virtue of the doctrine of estoppel by convention. In contra-distinction, when it came to the off-leg, where transfer of title from buyer to seller was conditioned on payment by the seller, the repo seller was treated as paying the price on the off-leg of the first repo when, and not until, the next repo opened. At that time the price was treated as set off against LBIE's new obligation under the on-leg of the new repo. When Lehman came to a shuddering halt, since the seller did not in fact make payment and could not rely on set-off by means of the next roll, the beneficial title did not transfer to it from LBIE under the last repo. The salutary lesson for practitioners is that care needs to be taken to ensure that contractual arrangements are not exposed to recharacterisation risk or uncertainty of outcome through conduct or implementation.

But there's more to come. At the time of writing, judgment in the Waterfall II application has not been delivered. Among the core issues before the court is the proper construction of meaning of "cost of funding" when calculating the default interest rate under an ISDA Master Agreement. Apart from its use in the swaps market, it is a phrase routinely used in other agreements between the same swaps counterparties, such as prime brokerage and master netting agreements. Despite its widespread use, the subjective element of the calculation and the self-certification process means that the underlying principles and factors that should (or indeed should not) feed into such a determination are often shrouded in secrecy. The meaning of cost of funding will at last be a secret safe with all the world.

daniel.harris@macfarlanes.com
www.macfarlanes.com

How trend-following CTAs can generate returns

AIMA SPONSORING PARTNER

By Harry Skaliotis, Head of Client Portfolio Management, Man AHL

For at least three decades, systematic Commodity Trading Advisers (CTAs)[1] have sought returns by exploiting persistence in the direction of price changes in futures and other financial markets – so-called price momentum, or trend-following. While CTAs have existed for three decades, the predominant investment style of trend-following pre-dates the label 'CTA' and has been successfully applied since the late 20th century[2].

An example of systematic CTA-style trading can be found in the famous Turtle Trader experiment of 1983[3] in which the participants generated positive returns over a four-year period by strictly following some pre-specified trading rules to exploit price momentum. The roots of AHL also go back to this era, with 2015 marking AHL's 28th year of continuous operation. It is well-known that price momentum has been present in financial markets data for many years, as evidenced by the long term track-record of trend-following CTAs.

But why is this, and why does it persist even as markets have become more liquid and efficient? Addressing these questions is key for taking an informed view on whether such opportunities in this space are likely to continue into the future. We explore below some of the possible causes of price momentum.

1 A widely used alternative name for the CTA investment style is Managed Futures, and the two terms are used interchangeably in both the financial services industry and academia.

2 See Hurst et al (2012).

3 See, for example, Covel (2009).

1. Slow macro cycles

Some of the strongest trends in futures markets coincide with phases of macroeconomic cycles. The business-cycle itself is characterised by momentum: individuals smooth their consumption expenditures, firms make long-term decisions to commit to investment projects, wages and employment are sticky and the government sector explicitly tries to smooth fluctuations.

Likewise, emerging markets take time to emerge, and do so with often predictable rises in consumption and demands on industrial commodities. Such macro trends tend to manifest themselves in the prices of many financial instruments, and trending behaviour can arise if the underlying economic factors are not fully discounted by the market.

2. Dissemination of and reaction to information

Economic and other news disseminates unevenly: different market participants react only when such news reaches them, each potentially having their own reaction rate. For example, high-frequency traders typically react to events almost immediately, whereas large institutional investors may require a lengthy decision-making process and retail investors may take longer again. Periods of sustained buying or selling thus develop as news spreads and participants react in similar ways but over different time-horizons. This effect leads to persistent trends.

3. Behavioural biases

Market participants exhibit some consistent but

continued ▸

seemingly non-rational behaviours[4]. Most studies of these behavioural phenomena in financial markets are based on observing trades and portfolios in equities, but much carries over to other asset classes. Some of the more well-known behavioural biases include:

i. holding losing trades too long in the hope they will come good,
ii. closing winning trades too soon,
iii. under-reaction, leading to sequences of incremental actions, and
iv. crowding/herding, e.g. buying because everyone else is buying.

Behavioural biases which lead to individuals losing money or foregoing profits, such as the first two examples above, are effects where a systematic trader, uninfluenced by emotion, can potentially benefit either by taking the other side of the trade or holding onto a winning trade when others have closed out. The second two examples lead to explicit trends as partial reactions and herd behaviour can induce sustained price momentum.

4. Carry

Carry represents the return earned for holding a financial asset or portfolio if the 'world stays the same' – in particular if the relationship between spot and futures/forward prices remains constant. For example, if one is holding a forward currency position (e.g. South Korean Won vs. USD) one earns the difference in nominal interest rates between the respective currencies in return for bearing the risk of spot currency movements. Further examples of carry effects include the concepts of roll-yield in commodities futures markets[5] and the pull-to-par of fixed income assets in upward-sloping yield curve environments.

It turns out that carry is a key driver of momentum returns, and tends to be greatest for systems targeting longer-term trends (6 months or more) in markets which themselves have strong carry returns. In such circumstances, carry can account for around 50% of the risk exposure in momentum. To understand how carry finds its way into momentum returns, consider an asset with an upward sloping forward curve.

If the curve retains its shape, the futures price will naturally slide down the curve, creating a negative drift (trend) over time. Conversely a downward sloping curve can create a positive trend. Thus carry can generate momentum in futures prices even without trending behaviour in the underlying spot price. This phenomenon can have significant impact: for example it may help to explain the recent positive CTA performance in fixed-income markets despite the absence of a major trend in yields since 2010.

Recent challenges and market outlook

In the post-financial crisis period of 2009-2013, global central bankers broadly coordinated intervention efforts to keep funding rates low and to provide the market with liquidity. While this has been important for the global recovery, it has created a challenging environment for CTAs. Many policy initiatives and government rhetoric over this period were last-ditch efforts to reassure nervous investors and thereby reverse trends that were undesirable.

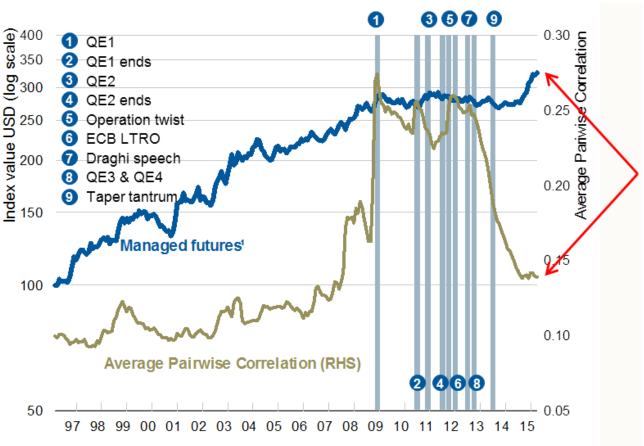
We can see the impact of these interventions on the Barclay BTOP 50 Index in the chart below. Despite producing an annualised return of 6.4% over almost two decades, it is also notable that the index performance during the 2009-2013 period was flat:

4 See, for example, the works of Kahneman and Tversky regarding heuristics, biases and prospect theory.

5 Roll-yield is the return achieved from, for example, the simultaneous sale of a near-expiry futures contract and purchase of the same, further-dated futures contact. If the further-dated futures contact is priced lower than the near-expiry contract, a positive roll-yield is realised.

continued ▸

Better environment for trend following - Correlation back to pre-crisis levels
29 February 1996 to 31 March 2015



Managed futures: Barclay BTOP 50 Index. Please note that the Barclay BTOP 50 Index data over the past may be subject to change. Please note that the March figures for Barclay BTOP 50 are based on estimates.
Correlation is measured as the average pairwise 1-year correlations of trend-following returns of AHL's futures and FX instruments using current models.
Past performance is not indicative of future results.
Source: Man Group database and Bloomberg.

So how do we explain this drop in performance? Consider the grey line in chart above, which shows diversification over time (measured by 120-day average absolute correlation of 2-day returns), across a portfolio of approximately 150 futures and forwards commonly traded by diversified CTAs.

Pair-wise correlations averaged 10-15% for a decade before the financial crisis. Then they increased sharply during the crisis and the post-crisis period (which was characterised by repeated policy interventions).

It is commonly asserted that 'diversification is the only free lunch in finance,' and certainly for CTAs the benefits of diversification have been large in prior decades. But from 2008 through early 2012, diversification became much harder to achieve as asset correlations were uncommonly high. The good news for investors is that from 2013 correlations have dropped dramatically, toward pre-crisis levels, and we think it is no coincidence that CTA performance has also rebounded. So long as correlations remain at normal levels CTAs which seek out trends across hundreds of markets around the world should be able to capitalise on some big market moves – as we saw last year in markets as diverse as the Russian Rouble, Swedish interest rates and live cattle.

Properties of CTAs

As well as delivering positive returns over the medium term, CTAs have a number of other features that investors may find desirable. One of these is positive skewness[6] of the return distribution - a general property of momentum trading that is not found in the majority of traditional or hedge-fund investments. Its presence for trend-following strategies has been detailed in academic literature[7], but where does it come from? A common view is that big market trends create it, and without such trends the positive skew disappears. However, we believe this is too simplistic and the connection between momentum trading and positive skew goes much deeper. For example, the return distribution from trend-following a random walk can have a positive skew if calculated over an appropriate time-horizon. A precise mathematical proof of this result is possible but is beyond the scope of the discussion here. However the mechanism underlying the mathematics is readily understood: negative skew arises through large sudden drawdowns, and for a momentum strategy to suffer such a drawdown it has to be holding a large position. Since such positions usually only arise is from the previous existence of a strong trend, the strategy will tend to have already generated a profit. Thus, when a large drawdown becomes a possibility we expect to have already profited – any price continuation simply increases that profit whereas a price

6 By which we mean a longer right-hand tail than left-hand tail of the returns distribution.

7 For example, see Harry Kat (2002): 'Managed futures and hedge funds: a match made in heaven.'.

continued ▸

reversal leads to giving some of it back.

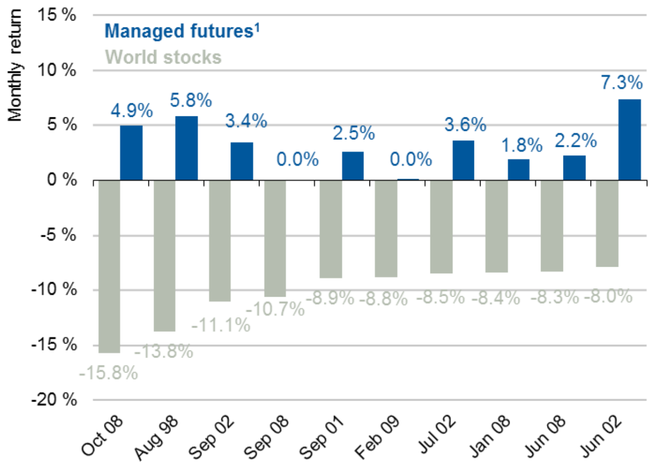
Providing returns are measured over a suitable timeframe (e.g. monthly) the net effect is a return distribution which displays positive skew. Another characteristic of trend-following CTAs is that they are uncorrelated with equities. Unlike many other strategies which claim to be uncorrelated, even in extreme events the correlation does not increase. In fact some crises – notably 2008 – turn out to be attractive environments for momentum trading as the flow of bad news accelerates. This can be seen from the chart below, which highlights the ten worst months for equity markets over the last 20 years. In almost all cases the index returns were positive, offsetting equity losses suffered by investors:

Indeed, we believe providing diversification to an external portfolio is one of the main reasons sophisticated investors allocate to CTAs. Whether combined with a traditional or hedge- fund, an exposure to CTAs has the potential to improve risk-adjusted returns, reduce drawdowns and improve skewness properties. That momentum trading can also resemble an insurance buying strategy which could pay-off in bad times – so called downside or tail protection – may be another strong attraction for investors

Conclusion

Many long-term investors in CTAs have benefitted from positive performance as well as low correlations and a degree of tail protection versus their external portfolios. This leads to perhaps the key paradox of momentum trading: why would one expect to get paid for investing in a style that appears to have such beneficial return, risk and diversification properties? We think the previous discussion provides some answers to this, but a further point is that the momentum effect is so uncertain for individual markets that creating an attractive broadly diversified medium- to long-term CTA investment vehicle requires in- depth research, process and execution efficiency, i.e. there are significant barriers to entry. Over short time horizons, or with an undiversified portfolio,

Performance during difficult equity market conditions - Ten worst monthly drawdowns for world stocks
29 February 1996 to 31 March 2015



Aug 98	**Russian crisis/LTCM**
Sep 01	**9/11 attacks**
Jun 02	**Dotcom bubble bursts**
Jul 02	**Dotcom bubble bursts**
Sep 02	**Stock market crash**
Jan 08	**Subprime crisis**
Jun 08	**Financial crisis**
Sep 08	**Bank bail out**
Oct 08	**Financial crisis**
Feb 09	**Continued financial crisis**

The periods selected are exceptional and these results do not reflect typical performance. As a consequence, they give no indication of likely performance. Additionally,selective periods are subjective and may be different to periods selected as exceptional by other sources.
1. Managed futures: Barclay BTOP 50 Index. Please note that the Barclay BTOP 50 Index data over the past may be subject to change. Please note that the March figures for Barclay BTOP 50 are based on estimates.
World stocks: MSCI World Net Total Return Index hedged to USD. Investment involves risks. There is no guarantee of trading performance and past or projected performance is not a reliable indicator of future performance. Returns may increase or decrease as a result of currency fluctuation.
Source: Bloomberg and MSCI.

continued ▸

the risk profile for momentum trading can be far less appealing. We think by diversifying both cross-sectionally and temporally – by trading a large number of markets and at a variety of 'trend frequencies' respectively – systematic momentum trading may provide compelling long- term performance, tail risk protection and diversification.

Works cited

Covel, Michael. 2009. 'The Complete TurtleTrader: How 23 Novice Investors Became Overnight Millionaires.' HarperBusiness. Edelman, Daniel, William Fung and David Hsieh. 2012. 'Exploring Uncharted Territories of the Hedge Fund Industry: Empirical

Characteristics of Mega Hedge Fund Firms.' Available at SSRN 2161123.

Hurst, Brian, Yao Hua Ooi and Lasse H. Pedersen. Fall 2012. 'A Century of Evidence on Trend-Following Investing.' AQR Capital

Management.

Kahneman, Daniel, and Amos Tversky. 1979. 'Prospect theory: An analysis of decision under risk.' Econometrica: Journal of the

Econometric Society: 263-291.

Kat, Harry. 2002. 'Managed futures and hedge funds: a match made in heaven.' Cass Business School Research Paper. Available at

SSRN 347580.

World's hedge funds face the future with confidence and flexibility

By George Sullivan, Executive Vice President, Global Head of Alternative Investment Solutions group, State Street

AIMA SPONSORING PARTNER

In the hedge fund industry, agility is crucial. In recent years, managers' well-known ability to respond quickly to market events has been put to the test. Following the global financial crisis, investors' appetites and their demands have changed — and regulations have hit in waves. Even so, hedge fund managers are optimistic about the future.

Our new survey of 235 hedge fund managers explores their outlook for the industry over the next five years.[1] They see growth on the horizon, expecting strong flows from institutional investors looking to boost performance and increase diversification.

And this positive view of the future also lines up with our 2014 survey of global asset owners, which found that one in four pension funds plans to invest in hedge funds for the first time. [2]

But our research also suggests the industry will require managers to invest in a sophisticated operating model so they can thrive in an environment where costs are scrutinised and stakeholder demands are rising. At the same time, hedge funds will need the right investment talent to drive results.

Capital flows support optimism

According to our survey of hedge fund managers, 65% of them expect increased flows from ultra-high-net-worth investors and 63% expect stronger flows from institutional investors. More than half (55%) of hedge fund managers think pension funds will increase their allocations to the industry.

Our respondents believe that two main factors will drive the inflows from pension funds: 53% believe investors are facing portfolio performance challenges, and 35% think investors are looking to improve diversification.

With sophisticated investors increasing their exposure to hedge funds, managers know they must adapt their business strategies to attract these new opportunities. Three out of five (60%) plan to broaden the suite of investment strategies they manage over the next five years. This partly reflects demand from institutional investors for a wider choice of investment strategies to tailor to their long-term objectives.

While a broader range of investment strategies can help hedge funds accelerate growth, it also brings challenges. Product portfolios with multiple investment strategies also require expanded capabilities and expertise. Hedge funds moving from a single commodity approach to a global macro strategy, for example, may need new talent to broaden their internal capability for trading these strategies.

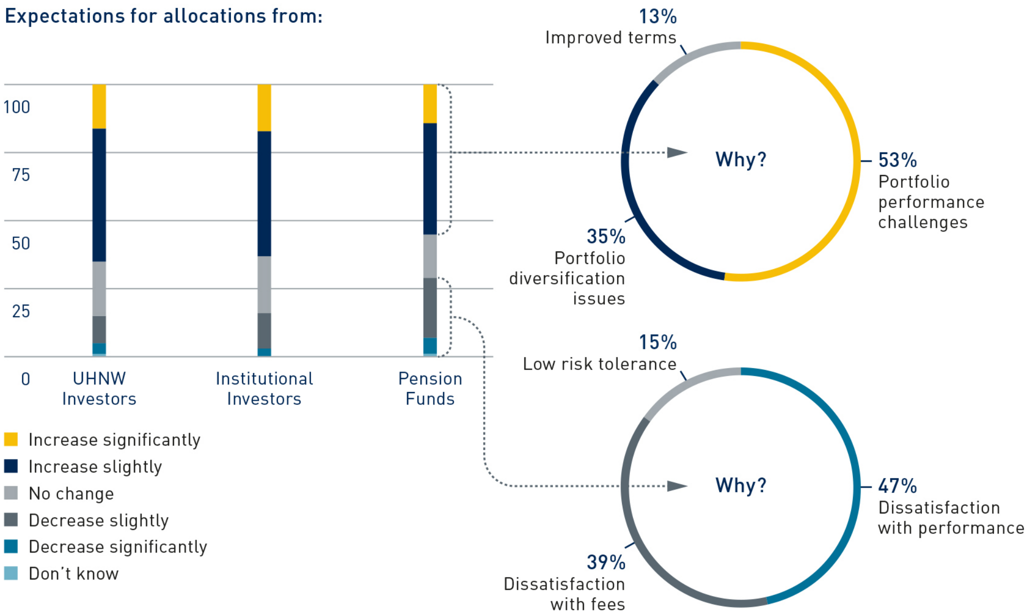
In addition, 37% intend to expand their global footprint to tap into growth opportunities in overseas markets. This also puts a strong focus on investing in the talent required to support an

continued ▸

1 State Street 2014 Hedge Fund survey, conducted by Citigate Dewe Rogerson. Conducted in October 2014, the survey received 235 responses from hedge fund managers across North America, EMEA and Asia Pacific. All data in this article relates to this survey unless otherwise noted

2 State Street 2014 Asset Owners survey, conducted by the Economist Intelligence Unit.

Outlook Points to Strong Flows



Source: State Street 2014 Hedge Fund Survey conducted by Citigate Dewe Rogerson.

increasingly global operation. They also recognise that they need to build closer relationships with investors to align their interests. More than nine out of 10 (91%) hedge fund managers say they need to more clearly demonstrate their value to prospective investors to attract new capital. The focus is on delivering better risk-adjusted performance, but they also need to communicate more effectively about how they achieve their goals. This means investment in technology and employees with the right skills to deliver new efficiencies, greater agility and higher-quality reporting.

Operational and regulatory challenges persist

In common with their peers across the financial services industry, hedge fund managers see no let-up in operational and regulatory pressures. An overwhelming 83% in our survey expect regulatory scrutiny to increase in their sector, including 31% who anticipate the increase will be "significant".

As hedge funds look to adapt to this new regulatory landscape, the task of complying with the new rules is massive. Eighty-nine percent of managers expect operational complexity will increase over the next five years, and 32% of those expect the increase to be "significant."

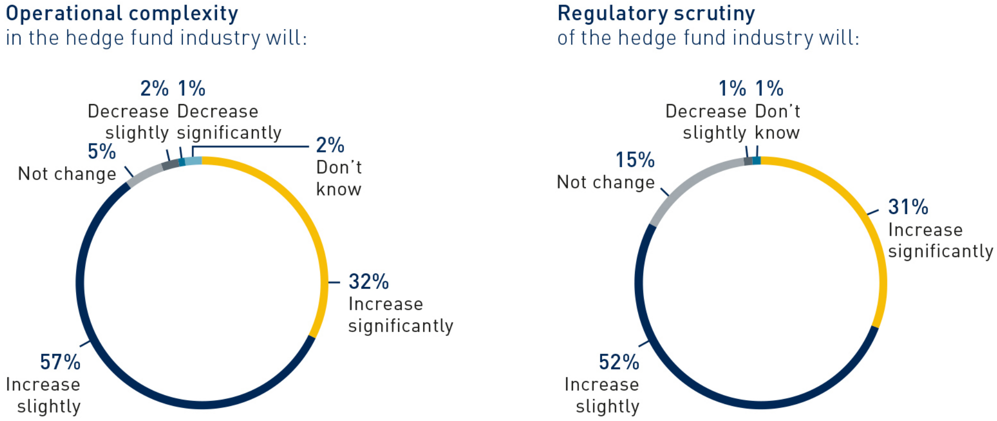
One consequence of this complexity is that the role of the chief operating officer (COO) is becoming more important in determining the success of the overall business model. As investors focus on due diligence, they spend a great deal of time looking at the operations team. The COO therefore plays a pivotal role in attracting investment while making sure the front office has the tools required to deliver performance. This suggests that hedge funds of the future will focus on their operations as a source of competitive advantage. They'll roll out advanced and highly integrated data architectures. They'll need operational systems that can cope with a broader range of stresses and risks, and an infrastructure that links front, middle and back office functions seamlessly. Ultimately, hedge funds will need to bring in leadership and talent to make sure their operations have the same standards of innovation and excellence typically found in their front office investment teams.

Navigating uncertain regulatory impacts

There is one impending global regulation, however,

continued ▸

Increased Operational and Regulatory Burden



Source: State Street 2014 Hedge Fund Survey conducted by Citigate Dewe Rogerson.

whose impact remains an unknown for our survey respondents. We asked hedge fund managers about Basel III, which would impose new standards around capital adequacy and market liquidity risk. Overall, while hedge funds may find it more difficult to gain their necessary funding under Basel III, many of them are uncertain at this stage about the regulation's potential implications.

Only 29% believe Basel III will significantly increase their firm's costs of financing, while a further 29% say they do not know what the effects will be. And while only 13% expect Basel III to require significant changes to their business models, one in four (25%) say that at this stage they do not know if, or what, changes will be necessary.

Respondents are slightly more definitive about Basel III's impact on their relationships with external partners: 37% say they expect significant changes to the way their firm manages its service providers, including prime brokers. Even so, the uncertainty persists — 26% say they don't know if they'll make changes to these relationships.

Product trends are also a disruptive influence in the sector. The past year has seen significant interest emerging in liquid alternatives. These offer some of the characteristics of hedge funds, but within a mutual fund vehicle, which usually offers a higher degree of liquidity. They have the characteristics of traditional alternatives, but follow the reporting and compliance standards of 40 Act funds and UCITS.

Opinions about liquid alternatives were divided in our survey. Half (50%) of hedge funds managers predict that alternative mutual funds will seize share from traditional hedge fund strategies over the next five years, while 35% disagree. A further 15% are undecided.

The next five years and beyond

Hedge fund managers have every reason to be optimistic as they face growth opportunities over the next five years. However, they can't afford to be complacent. They must be prepared to meet increasing operational and regulatory burdens — and unknown factors like liquid alternatives and Basel III. They also must partner with investors who have high demands for transparency and performance. But as they approach the new environment with a spirit of innovation and flexibility, they'll be positioned to succeed over the next five years and beyond.

www.statestreet.com

For public use only
Hedge funds are typically unregulated private investment pools made available to only sophisticated investors who are able to bear the risk of the loss of their entire investment. An investment in a hedge fund should be

continued ▸

viewed as illiquid and interests in hedge funds are generally not readily marketable and are generally not transferable. Investors should be prepared to bear the financial risks of an investment in a hedge fund for an indefinite period of time. An investment in a hedge fund is not intended to be a complete investment program, but rather is intended for investment as part of a diversified investment portfolio Investing involves risk including the risk of loss of principal. Diversification does not ensure a profit or guarantee against loss. There can be no assurance that a liquid market will be maintained for ETF shares.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without State Street's express written consent. The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor.

All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information.

AIFMD: How has the insurance market responded?

By Matthew Hughes, Divisional Director, Financial & Professional Risks, Arthur J. Gallagher

The insurance landscape for alternative investment fund managers (AIFMs) has had an unparalleled 12 months – with market and regulatory forces combining to create a positive risk transfer environment few may have predicted when the shift in capital requirements first came. In the London insurance market, we have witnessed an increase in the number of insurers keen to participate in the hedge fund and wider AIFM space, and this heightened competition, coupled with a relatively benign claims environment, has had a direct impact on the rates insurers charge and the scope of cover afforded by the insurance contract.

Understandably, much of the market talk over the last couple of years has been wholly focused on the implementation of the Alternative Investment Fund Management Directive (AIFMD) and what impact this would have. Three key questions repeatedly sprang to the fore:

1. Would insurers agree to offer contracts that cover the perils as prescribed by Article 12 of the directive?
2. Would firms decide to adopt the 'additional own funds' route rather than using professional indemnity insurance as the mechanism to meet the capital requirements of the directive?
3. And if insurers were to see an uptick in the levels of limit purchased in the professional indemnity insurance (PII) space, would they look to secure increased rate as their product becomes of greater value?

The first question has been answered emphatically by London market insurers: all the major players have accepted the addition of language into the contract which confirms cover is extended to include the perils prescribed. The addition of this language provides AIFMs with a welcome, straightforward, black-&-white answer to the question 'does your professional indemnity insurance provide cover to the scope required by the directive'?

From what we have seen over the last 12-18 months, the answer to question two is somewhat less clear cut, and generally depends upon the size of the AIFM. For larger investment managers with broader balance sheets, using PII to protect investors from damage and meet the requirements of the directive does not make sense – with the limit deemed appropriate set at 0.9% of AUM for claims in aggregate per year and 0.7% per individual claim, versus the 0.01% of AUM deemed appropriate if using additional own funds. But for smaller firms, with lower AUM and limited spare cash, the insurance risk transfer route works for them.

There are some important elements to consider when pursuing the insurance route, however. For example, the requirement to hold the value of your self-insured retentions (also known as excess of deductible) separately on your balance sheet, and reload this provision in the event of a claim. Other key questions include:

- Do we have sufficient 'wriggle room' within the PII limit to allow for increase in AUM?
- What if our limit is eroded or exhausted – would that automatically put us in breach of the requirements of the directive?
- What if we have AIF assets and non-AIF assets covered under the same policy and the limit is eroded or exhausted by a non-AIF claim – would this lead to us being in breach of directive?
- Similarly, if we buy a PII policy and share this limit with crime cover, and the limit is eroded or exhausted by a crime loss, would that put us in breach of the requirements?

continued ▸

The good news is that some of these considerations and concerns, which may have deterred AIFMs from opting for the insurance route, may warrant reconsideration now that the market has responded and adjusted to the implementation of the directive. With regards to the latter three points above, we have seen insurers agree to add reinstatement provisions at relatively modest additional premiums — and, in some instances, no additional premium at all. This provides AIFMs with the comfort that, in the event a loss is suffered, they are not in breach of the requirements of the directive.

As for the last of the three initial questions — whether insurers have looked to get increased rate as a result of uptick in PII levels purchased — the answer is ‘no’. Whilst we have previously stated that many larger firms are not using PII to meet the capital requirements of the directive, this does not mean they are failing to buy PI insurance — merely not buying it to the levels prescribed. Feedback that we have received from clients is that investors do still ask if you carry PI insurance, and answering no to that question can prompt them to walk away, even if you hold additional own funds to cover any potential liability risks arising from professional negligence.

This continued demand for PII is thus helping maintain a healthy level of competition and prevent rate increases from a client perspective. Furthermore, following the global financial crisis, a number of insurers who previously had a large exposure to global financial institutions, banks in particular, have looked to diversify their portfolio. One of the ways they have done this is by entering the investment management sector, which is seen as a logical next step with the added benefit of a relatively benign claims environment in comparison to other industry sectors within FI market.

In fact this movement of existing insurers into the AIFM space, accompanied as it has been by the introduction of new insurers looking to underwrite risk in this space, has created one of the most competitive environments in London for many years. London-based insurers are also beginning to look at US-domiciled investment managers — a market they have been out of for a number of years — because competition has led to a decrease in the value of their portfolios and this income needs to be replaced.

What this convergence of various market forces means is that not only is the commercial insurance market for investment managers extremely competitive at the present time but it can also meet the requirements of AIFMD. And unless there is a systemic claims scenario affecting all investment managers, or a sudden reduction in the market capacity available for this sector, we do not anticipate this changing in the short term. All of which spells good news for insurance buyers.

Matthew_hughes@ajg.com
www.ajginternational.com

The above information is intended for general guidance only.

Reverse enquiry in the EEA – Beware of the pitfalls

By Serena McMullen, Senior Associate, and Jenny Ljunghammar, Senior Associate, Allen & Overy LLP

Of all the available routes for accessing investor capital in Europe in the new Alternative Investment Fund Managers Directive (AIFMD) world, reverse enquiry is probably the one receiving the most interest. Reverse enquiry (also known as passive marketing or reverse solicitation) is where an investor, who has not had any previous contact with an investment manager/distributor, contacts that investment manager/distributor in respect of a potential investment in a fund. At first glance, reverse enquiry appears appealing as it allows parties to raise funds without falling within the onerous scope of the AIFMD, but the reality is more complex.

What we are seeing is a major risk of market participants seeing reverse enquiry as a panacea for avoiding the more tricky aspects of the AIFMD and failing to consider the range of problems and pitfalls that can apply when using reverse enquiry as a capital-raising tool. In this article we hope to explain a little more about those pitfalls and offer some thoughts on best practice and risk management.

AIFMD background

- AIFMD has introduced a marketing passport for alternative investment managers (AIFMs) to access European investors in relation to AIFs (essentially most funds that are not UCITS).
- The AIFMD marketing passport is applicable to professional investors only and is subject to staggered implementation across the EEA.
- The passport is currently only applicable to EEA AIFs with EEA AIFMs. ESMA is currently considering whether to extend the passporting regime to countries outside the EEA.
- Where a marketing passport is not available, it may be possible to actively market to investors via a jurisdiction's private placement regime (PPR).
- When an EEA AIFM is marketing an EEA AIF via the marketing passport, compliance with the entire AIFMD is required.
- When marketing an AIF via the PPRs, compliance with certain provisions only of the AIFMD is required. The PPRs vary considerably from country to country. Jurisdictions may impose additional requirements on entities seeking to access investors in an EEA jurisdiction beyond those set out in the AIFMD.
- The AIFMD defines 'marketing' as "a direct or indirect offering or placement at the initiative of the AIFM, or on behalf of the AIFM of units or shares of an AIF it manages to, or with, investors domiciled or with a registered office in the Union" (emphasis added).
- It may be possible to undertake 'pre-marketing' (active marketing that falls outside the AIFMD definition of marketing) if it is recognised by a jurisdiction. Not all jurisdictions recognise this concept.
- Recital 70 of the AIFMD states that the directive is not intended to affect professional investors who are investing in funds "on [their] own initiative".

Pitfall 1 - High regulatory scrutiny

Contrary to what may people believe, reverse enquiry is not an official exemption from the AIFMD marketing provisions. It is more of a tolerated practice. In fact, the first draft of the AIFMD proposed a prohibition on reverse enquiry

continued ▸

although this was ultimately removed from the AIFMD on the basis that regulators recognised that professional investors, such as large pension funds, need the ability to invest in a wide range of investments. To date there have been far fewer registrations of AIFMs than regulators were expecting and market participants have shown far greater focus on reverse enquiry as a method of reaching European investors than had been expected. As a result, regulatory scrutiny of reverse enquiry is likely to be very high. Managers and distributors will need compliance procedures in place to ensure that records are kept proving that any such investment was made as a result of a reverse enquiry. We will suggest some best practice guidelines below.

Pitfall 2 – Varying implementation across the EEA

The AIFMD provides no further guidance as to when it deems an investor to be ‘acting on their own initiative’ and each member state is left to clarify how reverse enquiries will be treated in their jurisdiction. This makes the practical application of the use of reverse enquiry complex and varied across the EEA especially as little practical guidance has been given by regulators to date. Some jurisdictions have applied very stringent conditions to be met if using the reverse enquiry route. For example, in certain jurisdictions, the conduct of any active marketing activities will preclude an entity from later relying on the reverse enquiry route.

Pitfall 3 – The reality of fund raising

The classic example of reverse enquiry is where an investor, who has had no previous contact with the manager, approaches the manager or distributor about investing in a fund. In reality this scenario does not reflect the way that managers often raise funds in practice. Many managers will have links with investors who are either invested in other funds or who have a long-term relationship with the manager. However, approaching these existing investors about a new proposition will unlikely fall within the ambit of permitted reverse enquiry. In addition, proving that the investor acted on their own initiative will be easier for a large fund manager whose brand is well-known but harder for smaller managers.

Pitfall 4 – Which funds can be ‘marketed’?

A similar concept of ‘exclusive own initiative’ is used in respect of reverse enquiries under MIFiD II. This has been interpreted to indicate that a firm should restrict itself to providing only the services which the investor approached them about. So where an investor contacts a fund manager about Fund A, but the fund manager then wants to pitch Fund B, this may very well no longer constitute a reverse enquiry under the AIFMD. In certain jurisdictions it may also not be possible for a manager to approach an existing investor who invested on the basis of a reverse enquiry about topping-up their investment in a fund.

Pitfall 5- Use of third parties

The definition of “marketing” under the AIFMD includes marketing on behalf of the AIFM. This means that external consultants/distributors/data providers could unknowingly exclude the manager from being able to receive reverse enquiries from investors by conducting active marketing activities in that jurisdiction.

Pitfall 6 – Open access websites

Open websites with free access to information about a fund or application forms and offering documents may prejudice reliance on reverse enquiry. Design of websites needs to carefully consider the rules in each jurisdiction where funds are to be offered.

Pitfall 7 – Capital introduction

Capital introductions throw up specific issues. There is a concern that a regulator may make an argument that a manager using capital introduction services is actively marketing which would mean

continued ▸

that any enquiries made as a result of capital introduction cannot then be treated as made by way of reverse enquiry. The position varies across the EEA.

Pitfall 8- What about all the other EEA and local laws!

Any investment that is made by a permitted reverse enquiry may mean that a manager is outside of the AIFMD. But that manager will still need to consider applicable requirements under MIFID and the Prospectus Directive plus additional local requirements which may be complex and onerous.

Pitfall 9 - The impact of getting it wrong

The risks of getting it wrong can be severe. As well as possible criminal and regulatory sanctions (depending on the jurisdiction), there is the risk that investors might try, at a later date, to rescind their investments on the basis that they were sold them in breach of law/regulation. They may be entitled to recover any money invested as well as seeking compensation for any loss sustained by the investment.

Guidelines

Below we have set out some thoughts on best practice guidelines for use of reverse enquiry.

- Investigate – seek a thorough understanding of the law and practice in each jurisdiction where you seek to attract investors is required prior to marketing. Don't assume the rules are the same across Europe.
- Proof – check what evidence will be required in each jurisdiction to rely on reverse enquiry.
- Audit trail/document retention – retain all emails, letters or other evidence from an EEA investor to indicate the marketing relationship was a result of reverse enquiry.
- Timing – consider how long a reverse enquiry can last in each jurisdiction and "refresh" existing requests.
- Monitor content of investor communications and calls – don't mention other fund products or invite investors to increase their existing investments in those jurisdictions where each separate transaction requires a separate reverse enquiry.
- Use of third parties – exercise caution when using external consultants/distributors/data providers.

Conclusion

For larger asset managers who want to achieve or maintain a significant European presence, "marketing" by way of reverse enquiry is probably not the best option as reverse enquiry is risky and such managers typically have the resources to consider ensuring compliance with the AIFMD. For those fund managers who want the flexibility to accept European investors but don't necessarily have the resources for full AIFMD compliance, the reverse enquiry route may be an option, but each reverse enquiry should be a genuinely unsolicited contact and comply with any jurisdictional specific requirements. In short, reverse enquiry should not be seen as a quick fix to avoid the application of the AIFMD and those using it should take care to proceed with caution.

www.allenovery.com/online-services
serena.mcmullen@allenovery.com
jenny.ljunghammar@allenovery.com

Disclaimer:
Nothing in this article is intended to provide legal or other professional advice and Allen & Overy LLP, aosphere LLP and its affiliates do not accept any responsibility for any loss which may arise from reliance on the information contained in this article.

Small hedge funds complement large ones

By Michael Weinberg, Senior Managing Director, Chief Investment Strategist, Protégé Partners

What is the next step for institutional investors who have already embraced investing in established large hedge fund managers? What are the benefits of embracing smaller emerging hedge fund managers?

Small manager funds are an institution's next step in hedge fund investing

Institutional investors have mostly disintermediated the large manager-focused fund of funds to go direct. The rationale is that they no longer need the largest funds of funds to find the largest hedge fund managers. This is sensible, cost effective, and true. As the large established hedge fund world has matured and become relatively more efficient, the value of paying a specialist an additional layer of fees is far diminished and the cost is far higher, both relatively and absolutely. Although returns have compressed dramatically for the largest hedge funds, the dispersion of returns has remained wider among the smaller managers, allowing for a potentially greater value proposition in allocating to these smaller funds.[1]

In this article, my contentions are twofold:

1. Institutional investors that have successfully allocated to large established managers now need small managers to achieve true diversification.
2. The optimal way to achieve this small manager diversification is through small manager-focused solutions providers in order to complement institutional investors' large manager direct allocations.

Institutional investors such as pension plans (both corporate and public) plans, endowments and foundations, and sovereign wealth plans can be scarcely resourced. At the end of the day, they are divisions of organisations (or even governments) with other organisational goals far broader than more narrowly focused investment organizations. They are also unlike investment firms in that these divisions are often cost centres rather than profit centres.

Institutions are not sufficiently resourced to evaluate all opportunities

Between 2007 and 2014, institutional investors went from an average allocation of $500 million in two to three funds of funds to an average allocation of $2 billion to $3 billion directly to 10-25 hedge funds, having disintermediated the largest funds of funds focused on large, established managers.[2] Although it is relatively easy for one of these institutional investors to invest in one of the 367 largest hedge funds, defined as having assets of more than $1 billion, it is almost impossible to have the resources to evaluate the other 7,500 smaller hedge funds, with assets less than $1 billion. For perspective, this implies that 95% of the hedge funds by number have only 13% of the assets. This raises the question that if we agree that the largest established hedge funds are generally superior investments at least to long-only investments, why would one want to complement these with smaller emerging hedge fund managers?

1 Preqin, "Hedge Fund Spotlight," monthly report (May 2013); David Swensen, "Pioneering Portfolio Management: An Unconventional Approach to Institutional Investment," AllAboutAlpha (18 February 2013): http://allaboutalpha.com/blog/2013/02/18/smaller-hedge-fund-managers-outperform-a-study-of-nearly-3000-equity-longshort-hedge-funds.

2 Preqin, "2013 Preqin Global Hedge Fund Report."

continued ▸

Larger hedge funds have constrained opportunity sets

The answer to that question is as follows. Although there is a minority of hedge funds that launch with large assets under management, this is the exception. Most hedge funds start with small assets under management. Funds that post outsized returns are more likely to be successful at asset raising, which, in turn, results in the funds becoming large. When hedge funds are small, they are able to invest in securities that larger funds may be precluded from investing in. For example, when I was a portfolio manager at one of the world's largest hedge funds, the goal was to find at least 1% positions (but, ideally, 2%-4% positions). On an asset base of $25 billion, that would imply $250 million for a 1% position and $1 billion for a 4% position. Now, let's look at a $1 billion market cap company with a 100% float; it's not a realistic assumption, but for simplicity, let's assume that is the case. That would imply 25%-100% of the company.

Never mind the fact that when a hedge fund holds a 5% position, or only $50 million of a $1 billion company, it would have to file an SEC Schedule 13D, and when it holds a 10% position, it is subject to more stringent regulatory laws, which are restrictive and often undesirable. For a $250 million position to be only 5% of a company, in which holding such a position would still require filing a 13D, the market cap of the company would have to be $5 billion. This eliminates micro, small, and part of the mid-cap universe from a large hedge fund's opportunity set. In fact, when we looked at the Goldman Sachs VIP List in the first quarter of 2015, the median market capitalisation of the top 50 hedge fund holdings is $44 billion, compared with $17 billion for the S&P 500 Index. Historically, academic studies have found a correlation between market capitalisation, analyst coverage, and market efficiency.

Small managers provide access to more opportunity sets

The least-followed securities, which are historically the least covered and most inefficient and which often result in higher returns and potentially outsized track records for small hedge funds, are no longer able to be part of the opportunity set for larger, established hedge funds. In addition, these relatively smaller market capitalisation securities, including portfolios of them, are often more uncorrelated or at least less correlated and, therefore, also confer diversification benefits to portfolios of larger, more established hedge funds.

Similarly, as a long-only investor, one is typically focused on investing across market capitalisations and styles, which is sensible. For example, one might want an allocation to growth, value, small-, mid-, and large-capitalisation securities, often in line with index or market weightings. I believe this analog holds for hedge fund investments, which are merely a different structure (i.e., in many cases limited partnerships with the ability to short in addition to going long), and would expect such investors to want a similar allocation across the market capitalisation spectrum. This is another reason that small managers complement large managers.

Small managers provide access to capacity-constrained opportunities

Smaller managers may also exploit opportunity sets that may be capacity constrained. For example, last year, we researched a manager with $100 million of assets under management that invests in exchange-traded fund (ETF) arbitrage, although not large ETFs, such as those tracking the S&P 500. The manager estimated $250 million of capacity at which it can effectively implement the strategy at high rates of return. This is a good example in that to exploit this market inefficiency, the manager must stay small and disciplined in terms of assets. Let's look at this in the context of the $25 billion hedge fund alluded to earlier. That would leave the entire ETF arbitrage strategy as a 1% position in such a larger fund. It is neither practical nor desirable to have a team of portfolio managers that is not scalable to only run 1% of assets. This is why a small manager, such as this ETF arbitrage example or a portfolio of them, complements larger managers.

continued ▸

Finally, small managers may focus on inefficiencies in highly specialised sectors and regions. For example, for the past year we have researched a $500m equity long-short manager that is focused on the burgeoning Southeast Asian consumer, excluding the heavily followed greater China region. The manager is capacity constrained because of the smaller capitalisation and relative illiquidity of its respective markets (i.e., the Philippines, Thailand, Malaysia, and Indonesia) and is able to exploit the commensurate inefficiencies in these markets that are often under-followed by the sell side and buy side.

These additional opportunities may expand an institution's efficient frontiers

In summary, I tip my hat to institutional investors that have learned to appreciate the importance of investing in hedge funds that generate returns from alpha, rather than beta, and unlike long-only strategies, are not dependent on rising markets to generate returns. Institutional investors have generally accomplished this through investments in the largest established hedge fund managers.

However, I believe the next step in the evolution of these investors is to complement these hedge fund allocations with small managers who are sector or regional specialists and in many cases can invest in capacity-constrained strategies. Small managers complement large managers because they are inherently focused on a different opportunity set of securities. There are potential diversification, correlation, and return benefits that enable institutional investors to improve their efficient frontier (i.e., higher return with similar risk or similar return with less risk). I believe the best way to achieve these benefits is to allocate to small manager solutions providers that are best resourced to extract the alpha from this opportunity set.

info@protegepartners.com
www.protegepartners.com

How do you get systems and organisations to work together post trade? Interoperability

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

Years of history and painstaking development — component by component, some proprietary and some purchased — have shaped the operational frameworks that distinguish midsize to large hedge fund managers from each other. These substantial investments in back- and middle-office technologies — including general ledger, data warehousing, and shadow books and records — result in a level of business intelligence unique to each manager.

Keep legacy systems

It is only natural after such time and effort that managers remain committed to their systems and processes. Nevertheless, as they reach their growth targets, their need for scalability drives them to seek ways to augment, consolidate, and remove obstructive redundancies from their systems and processes. To liberate their operations from certain cumbersome components, many turn to outsourcing. Outsourcing affords managers the freedom to reallocate resources to treasury, collateral, risk management, and business intelligence with little disruption. Keep in mind, outsourced providers are not all created equal, and appointing the one best matched to a manager's unique framework is essential to expanding the capacity utilisation of operations systems.

Such seamless integrations take managers to the next level of efficiency, and the resultant transfer of focus to other products and business lines enhances their ability to differentiate themselves from the competition.

That said, staying with legacy systems removes the need to retrain on new systems and avoids the attendant increase in help desk inquiries during day-to-day operations. This is a strong argument against supplanting existing technology, as a provider's adaptivity must also extend to providing an excellent customer experience. Some managers prefer direct access to the provider's team, preferring not to deal with help desks. The decision to outsource ultimately depends on the size of the manager, and sometimes outsourcing can be more expensive than doing things internally. In some circumstances, having internal staff or systems dedicated to supporting the business does have advantages. This is because sometimes problems or issues can be fixed sooner internally rather than having to send an email to an outsourced provider or to go through to a help desk.

Boost rather than replace

Pragmatic operating officers seek adaptable providers that adjust their services to complement a fund's legacy systems and those who can pattern themselves after internal frameworks. In my view, COOs and their operations teams have a huge amount on their plate, be it dealing with multifarious global regulations or operational demands from institutional investors. In addition, many firms are adopting broader strategies and require outsourced technology on independent platforms to assist their existing infrastructure. Often, vendors push their own systems and are reluctant to build or adapt technology or services alongside those of their clients.

Although some managers may opt for a new framework, most are reluctant to convert wholesale to a new platform and supplant their legacy investment entirely. Some providers that lack interoperability capabilities insist that managers migrate to the providers' platforms. But even technology solutions from managed services may not provide a complete solution and may require significant amounts of data conversion,

continued ▸

retraining, and parallel reconciliation. Alone or in tandem, these are significant deterrents to moving away from legacy systems and onto an outsourced technology platform, as they distract from day-to-day operations. Offering the option to retain legacy systems indicates that a provider understands the manager's businesses, asset classes, and strategies and is sensitive to the immense task of migration. When choosing an outsourced provider it is essential to find service providers that have interoperability and can complement the existing systems of hedge fund clients.

Outsourcers offering complementary systems that enhance either legacy systems or upgraded components without the need to migrate are optimal. The best matched provider must exhibit interoperability on legacy systems or those chosen as a replacement. Their state of the art systems exist and work in partnership, thereby adding value to the manager's process. For those managers who do not have a choice of systems, can choose to migrate to the systems of the outsource provider, but should not be obligated to do so.

Full data history conversion

As investors demand transparency into historical performance and attribution, managers face the colossal task of converting their complete history to any new platform, a significant undertaking for managers running full, in-house books and records. Maintaining a record of this data is essential if managers are to solicit institutional capital. A challenge therein for managers is sourcing historical data, which may cover performance attribution or various risk calculations, particularly if their technology infrastructure has undergone enormous changes. Our sense is that this is one of the most important issues COOs have to confront when appointing a vendor. Historic data is difficult to move.

Admittedly, moving Excel or Word files is simple, and [these files are] easily replicated. But transferring data or replicating a directory from a PMS or OMS system can be challenging. Costs can be significant for an "inception to date" historical conversion, ranging from $300,000 to $600,000 to bring in five to 10 years of history. Additionally, it could take six to 12 months in elapsed time to migrate, reconcile, and load the data.

For these reasons, an outsourced provider should avoid remodelling or onboarding a hedge fund's entire internal infrastructure and technology. Instead, the provider needs to work alongside the fund manager to achieve better results than either would realize alone.

Interoperability unlocks value

Interoperability is the ability to make systems and organizations work together. The value proposition of the outsourced provider to improve upon a manager's framework necessitates both a cadre of skilled fund accountants and expertise on any platform a manager may operate, without any prescribed technology requirements.

The interoperability skills of outsourcing providers must accommodate the fund's unique business processes, its present operational needs, and its data warehousing. True outsourcing is far more than simply handing over responsibility for the technology. Genuine outsourcing is a strategic business solution for removing the cumbersome components of day-to-day operations. One CFO at a $9 billion US based hedge fund notes that it is essential for outsourced providers to work with managers to secure timely and seamless services and to help educate fund managers' teams on how to get the most out of their legacy systems. This partnership ultimately allows managers to leverage the expertise of outsourced providers to augment their own high internal standards as opposed to simply delegating the role to a third party. One of the benefits of appointing an external vendor is that the vendor often has the resources and breadth of talent to help managers. Such vendors are constantly up to date with the latest training, resources, technology, and best practices.

Freedom of choice

Outsourced multiplatform providers — those who know how to integrate a variety of technologies to work well together — understand the value inherent in a manager's business solutions and

continued ▸

offer the ability to service and adapt all back-office and middle-office software systems seamlessly so that funds have the choice to remain with their legacy systems by improving upon them. Offering a highly customised service to clients is essential. It is important for outsourcers to adopt a consultative approach with their clients. This can be achieved by sending their staff in to talk with hedge fund clients about their strategy and business, so they understand it in great detail. In this way, outsourced providers can complement the existing technology architecture rather than encouraging complete replacement.

Enhancing operations without disruption is a distinguishing characteristic of the skilled outsourcer. The beauty of employing a technology-independent provider is the freedom to choose whichever components or solutions the manager wants to incorporate. Since every fund is different, no single platform works for every fund. By enabling choice, funds can continue to improve their operations and position their frameworks as differentiators. No single solution, regardless of how comprehensive it is, can ever meet the needs of every fund, especially those that invest in a wide range of securities and work in multiple time zones. It ultimately comes down to finding the ideal blend of experience, technology, and processes for each manager.

Autonomous ownership

Outsourced providers that are independent of fund ownership are able to service all their customers equally. They gain no benefit from imposing specific business processes on their clients, since the service and supporting technology they provide are platform-independent. Employing a provider with strong interoperability capabilities ensures that the firm's processes and procedures remain consistent, with no upheaval during transition. This approach is about creating a synergy between the client and the outsourced provider, whereby the provider assists clients by injecting new ideas into their business processes to rationalize their operations, identify efficiencies, and ultimately help improve their business intelligence. By the same token, clients should not need to worry about their strategy or business secrets inadvertently leaking. Data security is absolutely essential, and it is something managers and their investors are increasingly alert to it. Security, permissioning, and control over data are among the most important issues at the moment for fund managers.

Since every fund is different, it stands to reason that the more clients a middle-office provider supports, the more interoperability expertise its team will have when it comes to best practices for the implementation and maintenance of multiple platforms and multiple investment types across those platforms. It is therefore essential to work with providers that have extensive experience and capabilities in reconciliations and net asset value calculations for a diverse range of asset and security types.

Flexibility to customise

To truly meet the needs of the modern hedge fund, the middle-office/in-house service must have flexible tools that complement any legacy system. Juggling the competing needs of meeting growing demand, being efficient, and being consistent, interoperable providers have developed best practices out of necessity. From their panoramic vantage point of servicing multiple managers, they have the advantage of seeing where customisations save time and effort for their clients. Thus, new clients benefit immediately from a provider's experience with similar frameworks and with all the usual requirements and enhanced automated processes that have been developed to deal with the activities of the post-trade life cycle. This is due in part to the provider's capacity for improved and detailed reporting, made possible by the automation of manual procedures as well as the implementation of processes that address consistent issues across clients.

Along with interoperability skills that accommodate the client's business processes, an experienced team can accurately shadow the data feeds to ensure a pristine set of books. Interoperability also improves business continuity. After all, the outsourced provider ultimately supports the

continued ▶

licensed and proprietary technology used by the hedge fund. This independence can help hedge funds mitigate the fallout should a service provider undergo an ownership change or experience some other disruptive event, because the manager will still possess a substantial amount of the technology infrastructure in-house. This is a practice hedge funds and their institutional clientele are scrutinising in depth during operational due diligence proceedings.

Conclusion

The quest for alpha to some extent resides with the ability of managers to make their operations efficient. As firms seek growth from one level to the next, designing systems in an efficient and cost-sensitive manner is not a luxury but a necessity. For many managers, the task of migrating away from legacy systems entirely is daunting. In these instances, outsourced providers with an understanding of interoperability and expertise in accounting and technology are a viable alternative.

david.ross@viteos.com
www.viteos.com

Sponsoring Partners of AIMA

The following corporate members joined AIMA during the first quarter of 2015.

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.

1OAK CAPITAL LIMITED
Country: UK
Contact: Andrea Grillo
Telephone: +44 (0)20 7016 7979
Business activity: Hedge fund manager / adviser
Website: www.1oakgroup.com

ABSOLUTE RISK ADVISERS
Country: Australia
Contact: Oscar Martinis
Telephone: +61 4 1462 0324
Business activity: Insurance services
Website: www.absoluteriskadvisers.com.au

ADAMAS ASSET MANAGEMENT (HK) LIMITED
Country: Hong Kong
Contact: Alan Lau
Telephone: +852 3793 6200
Business activity: Hedge fund manager / adviser
Website: www.adamasam.com

ADVANCE GLOBAL CAPITAL LIMITED
Country: UK
Contact: Nathaniel Hartley
Telephone: +44 (0)20 3770 5600
Business activity: Hedge fund manager / adviser
Website: www.advanceglobalcap.com

ADVISORS & PARTNERS LLP
Country: UK
Contact: Vincent Tournant
Telephone: +44 (0)20 3205 7133
Business activity: Fund of hedge funds manager
Website: www.advisorsandpartners.co.uk

AIMCAPITAL AG
Country: Liechtenstein
Contact: Benjamin Albers
Telephone: +423 373 0044
Business activity: Hedge fund manager / adviser
Website: www.aim.li

ALBOURNE PARTNERS (CANADA) LIMITED
Country: Canada
Contact: Ryan Teal
Telephone: +1 416 848 4124
Business activity: Consultant (investment)

ALITHION CAPITAL MANAGEMENT PTE. LTD
Country: Singapore
Contact: Sera Kano
Telephone: +65 6220 6930
Business activity: Hedge fund manager / adviser
Website: www.alithion.com

APERIOS INVESTMENT MANAGEMENT LLP
Country: UK
Contact: Gordon Eichorst
Telephone: +44 (0)20 3145 1840
Business activity: Hedge fund manager / adviser
Website: www.aperiospartners.com

ARM SWISS REPRESENTATIVES SA
Country: Switzerland
Contact: Anne Simond
Telephone: +41 22 354 2533
Business activity: Consultant (other)

CAMBRIDGE ASSOCIATES LTD
Country: UK
Contact: Matthew Cutlan
Telephone: +44 (0)20 7592 2200
Business activity: Consultant (investment)
Website: www.cambridgeassociates.co.uk

CASH ASSET MANAGEMENT LIMITED
Country: Hong Kong
Contact: Lennix Lai
Telephone: +852 2287 8788
Business activity: Hedge fund manager / adviser
Website: www.cashon-line.com

CLEARFIELD CAPITAL MANAGEMENT LP
Country: USA
Contact: Aaron Tawil

continued ▸

Telephone: +1 212 468 5400
Business activity: Hedge fund manager / adviser
Website: www.clearfieldcap.com

CLIFFORD CHANCE BEIJING
Country: China
Contact: Yuxing Huang
Telephone: +86 10 6535 2288
Business activity: Legal services

DBS BANK LTD
Country: Singapore
Contact: Gan Shian
Telephone: +65 6222 2200
Business activity: Banking services (excl. pb)
Website: www.dbs.com.sg

EFFICIENT CAPITAL MANAGEMENT
Country: USA
Contact: Michael Marcey
Telephone: +1 630 657 6800
Business activity: Fund of hedge funds manager
Website: www.efficient.com

ELIAN FIDUCIARY SERVICES (CAYMAN) LIMITED
Country: Cayman Islands
Contact: Colin MacKay
Telephone: +1 345 949 9876
Business activity: Fund administration, accounting & custody services
Website: www.elian.com

EZE CASTLE INTEGRATION
Country: UK
Contact: Kulvinder Gill
Telephone: +44 (0)20 7071 6802
Business activity: It/systems/software services
Website: www.eci.com

EZE CASTLE SOFTWARE LLC
Country: USA
Contact: Jeffrey Shoreman
Telephone: +1 617 880 7405
Business activity: It/systems/software services
Website: www.eci.com

EZE CASTLE SOFTWARE SINGAPORE. PTE. LTD
Country: Singapore
Contact: Laura Ryan
Business activity: It/systems/software services

EZE SOFTWARE ASIA PACIFIC LIMITED
Country: Hong Kong
Contact: Rafael Manalac
Telephone: +852 3664 1106
Business activity: It/systems/software services
Website: www.ezesoft.com

EZE SOFTWARE EMEA LIMITED
Country: UK
Contact: Agata Allende
Telephone: +44 (0)20 7634 8507
Business activity: It/systems/software services
Website: www.ezesoft.com

EZE SOFTWARE GROUP PTY LIMITED
Country: Australia
Contact: Chris O'Connor
Business activity: It/systems/software services

FUND EVALUTION GROUP, LLC
Country: USA
Contact: David Mason
Telephone: +1 513 977 4400
Business activity: Consultant (investment)
Website: www.feg.com

FUNDBPO (HK) LIMITED
Country: Hong Kong
Contact: Clay Sullivan
Telephone: +852 3580 6551
Business activity: Fund administration, accounting & custody services
Website: www.fundbpo.com

GALENA ASSET MANAGEMENT SA
Country: Switzerland
Contact: Gerard Lynch
Business activity: Hedge fund manager / adviser
Website: www.galena-invest.com

GOODMAN & COMPANY, INVESTMENT COUNSEL LTD.
Country: Canada
Contact: Jonathan Aikman
Telephone: +1 416 363 5621

continued ▸

Business activity: Hedge fund manager / adviser
Website: goodmanandcompany.com

HFL ADVISORS LIMITED
Country: Hong Kong
Contact: Philip Tye
Telephone: +852 9031 6078
Business activity: Independent fund director

INDEA CAPITAL PTE. LTD
Country: Singapore
Contact: Peter Newing
Telephone: +65 6225 0400
Business activity: Hedge fund manager / adviser
Website: www.indeacapital.com

INDUS VALLEY PARTNERS (INDIA) PVT LTD
Country: India
Contact: M P Kaila
Business activity: It/systems/software services

INDUS VALLEY PARTNERS CORP
Country: USA
Contact: Gurvinder Singh
Telephone: +1 201 984 1044
Business activity: It/systems/software services
Website: www.indusvalleypartners.com

JWS ASIA LAW CORPORATION
Country: Singapore
Contact: Jek Aun Long
Telephone: +65 6831 5508
Business activity: Legal services
Website: www.jwsasialaw.com.sg

KESSION CAPITAL LIMITED
Country: UK
Contact: Dalisha Patel
Telephone: +44 (0)20 7558 8800
Business activity: Hedge fund manager / adviser
Website: www.kession.com

KILGOUR WILLIAMS CAPITAL
Country: Canada
Contact: Colin Kilgour
Telephone: +1 647 977 5803
Business activity: Hedge fund manager / adviser
Website: www.kilgourwilliams.com

LANSONS
Country: UK
Contact: Meglena Petkova
Telephone: +44 (0)20 7490 8828
Business activity: Public relations
Website: www.lansons.com

LOYENS & LOEFF LUXEMBOURG S.A.R.L
Country: Luxembourg
Contact: Marc Meyers
Telephone: +352 46 62 30
Business activity: Legal services
Website: www.loyensloeff.lu

MAXAM CAPITAL MANAGEMENT LTD
Country: Canada
Contact: Travis Dowle
Telephone: +1 604 678 6251
Business activity: Hedge fund manager / adviser
Website: www.maxamcm.com

MAYBANK KIM ENG SECURITIES PTE LTD
Country: Singapore
Contact: Mark Lange
Telephone: +65 6231 5000
Business activity: Broker
Website: www.maybank-ke.sg

MONT BLANC CONSULT SARL
Country: Luxembourg
Contact: Alain Guerard
Telephone: +352 26 76 9612
Business activity: Independent fund director

MORGAN LEWIS & BOCKIUS LLP
Country: Japan
Contact: Christopher Wells
Telephone: +813 6721 3111
Business activity: Legal services
Website: www.morganlewis.com

NIPUN CAPITAL, LLC
Country: USA
Contact: Anne Yip
Telephone: +1 650 425 9352
Business activity: Hedge fund manager / adviser
Website: www.nipuncapital.com

continued ▸

PELARGOS CAPITAL B.V
Country: The Netherlands
Contact: Richard Dingemans
Telephone: +31 70 757 8030
Business activity: Hedge fund manager / adviser
Website: www.pelargoscapital.com

PEMBERTON CAPITAL ADVISORS LLP
Country: UK
Contact: Chris Higgins
Telephone: +44 (0)20 7993 9300
Business activity: Hedge fund manager / adviser
Website: www.pembertonam.com

PIQUANT TECHNOLOGIES LLP
Country: UK
Contact: Roddy Orr
Telephone: +44 (0)20 8819 5287
Business activity: Hedge fund manager / adviser
Website: www.piquanttech.com

PRIMESTONE CAPITAL LLP
Country: UK
Contact: Martin Donnelly
Telephone: +44 (0)20 7072 3150
Business activity: Hedge fund manager / adviser
Website: www.primestonecapital.com

PYX ASSET MANAGEMENT LIMITED
Country: UK
Contact: Richard Hutchison
Telephone: +44 (0)20 3700 5426
Business activity: Hedge fund manager / adviser
Website: www.pyxam.co.uk

QUADRATURE CAPITAL LLP
Country: UK
Contact: Suneil Setiya
Telephone: +44 (0)20 3743 0400
Business activity: Hedge fund manager / adviser

REYL & CIE
Country: Switzerland
Contact: Nicholas Roth
Telephone: +41 22 816 80 00
Business activity: Hedge fund manager / adviser
Website: www.reyl.com

RICHMOND HILL INVESTMENT CO., LP
Country: USA
Contact: Catherine Wilkins
Telephone: +1 212 989 2700
Business activity: Hedge fund manager / adviser
Website: www.rhiclp.com

ROXBURY ASSET MANAGEMENT LIMITED
Country: UK
Contact: Douglas Shaw
Telephone:
Business activity: Hedge fund manager / adviser

SS&C TECHNOLOGIES HONG KONG LIMITED
Country: Hong Kong
Contact: Stewart Bent
Telephone: +852 3468 5016
Business activity: Fund administration, accounting & custody services
Website: www.sscglobeop.com

TEZA CAPITAL MANAGEMENT LLC
Country: USA
Contact: Seth Travis
Telephone: +1 312 768 1600
Business activity: Hedge fund manager / adviser
Website: www.teza.com

AIMA has more than 1,500 corporate members in over 50 countries and is present in all of the major financial centres globally

Track record
AIMA was founded in 1990 and over 25 years has grown into the only truly global hedge fund industry association, with more than 1,500 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. AIMA's manager members manage a combined $1.5 trillion in assets.

Regulatory updates
AIMA members receive comprehensive regulatory updates and tools.

Sound Practices and DDQs
AIMA members receive access to our full range of sound practices material, covering hedge fund management, valuation and asset pricing, administration, governance, business continuity, as well as DDQs for managers and service providers, offshore alternative fund directors and fund of hedge funds managers.

Loyal members
We consistently have a high membership renewal rate.

Insight
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*.

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.

Get involved
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.

Regular events
Our Annual Conference and Global Policy and Regulatory Forum, open to all AIMA members, attract leading speakers from the industry and among policymakers, and hundreds of delegates, from around the world. We also hold regular events globally, which provide intelligence and networking opportunities.

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

aima
Alternative Investment Management Association
www.aima.org

Registered in England & Wales at the above address Company No. 4437037 — VAT No. 577 5913 90

Contact us

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

AIMA in the USA
230 Park Avenue, 10th Floor, New York, NY 10169, USA
+1 646 397 8411
mnoyes@aima.org

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

AIMA Cayman
cayman@aima.org

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

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

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

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

aima

Alternative Investment
Management Association

www.aima.org