SEPTEMBER 2022

The Hedge

A look back at the month's news, views and a little more

High inflation, rising rates and slowing growth, spicy ingredients for the macro manager.

Performance
News
Private Equity
Crypto
Regulatory updates

Featuring guest articles from George Godsal of REKT Partners on the need for a clearer regulatory crypto path; Sarah Crabb from Simmons & Simmons on the rise of digital asset funds; and Alastair Crabbe on the return of global macro, likening it to the phoenix rising from the ashes.

A Brodie Consulting publication in conjunction with RQC Group and Capricorn Fund Managers.

#15

MACRO AGAIN TAKES TOP HONOURS

For large parts of August, investor risk appetite was relatively muted as many players stayed out of the market waiting on what Fed Chair *Jerome Powell* had to say on 26 August. As it transpired, it was a hawkish end to the month, as markets braced for a 75bps US rate rise in September. Equities generally fell on the news, oil prices dropped on recessionary and slowdown concerns and the USD strengthened. See the latest Market Review.

In this environment, managers had a decent month, with the **HFRI Fund Weighted Composite** up 0.5%, taking the year-to-date figure to -4.0%.

Equity focused managers were marginally in negative territory, with the **HFRI Equity Hedge (Total) Index** down 0.2%. This was a reasonable result given where equities closed the month. The winners in this space were perhaps not surprisingly focused on energy/ basic materials, with this index up 3.3% for the month. Healthcare managers also had a solid month, up 1.2%, but are still down 14.0% for the year. On the other end of the performance spectrum, quant directional and tech managers struggled, with the indices down 3.2% and 2.2% respectively.

This was a better month for the Event Driven managers, with the **HFRI Event Driven (Total) Index** up 0.8%. Although there were no particular stand-out sub-strategies, encouragingly they were all in positive territory, ranging from 0.3% at the lower end for Special Situations to 1.6% for Multi-Strategy.

Macro was again the overall winner in August, with the **HFRI Macro (Total) Index** up 1.6%. For once this year, commodities played second fiddle, with the **HFRI Macro: Commodity Index** up 1.1%, but leading this pack was the **HFRI Macro: Currency Index**, up 3.5%. Thematic Discretionary was up 0.8%, but was outperformed by the Systematic Index, which was up 1.8%. Year-to-date Systematic Diversified and Systematic Directional are up 14.6% apiece.

Fund of funds were also up 0.9% in August, led by the Strategic Index, up 1.0%.

Regionally, there was no stand-out market. The best performing was HFRI Western/ Pan Europe, up 2.6%, and the worst India, with the **HFRI Emerging Markets: India Index** down 0.7%. China continues to be the worst performing market this year, down 19.2%.

INDUSTRY EVENTS

14 September 2022
HFM European Operational Leaders Summit 2022

15 September 2022
SPS Alternative and Sustainable Investment Solutions

20 September
Prestel & Partners Family Office Forum

27-28 September 2022
Battle of the Quants

Click here to see future events

$3bn

Size of Bridgewater's latest European equity short positions

Source: Bloomberg

$1.3tn

Est. additional Middle Eastern SWF revenue generated from recent oil prices.

Source: IMF

LARGE FUNDS OUTPERFORM SECTOR IN COMMODITIES

A comparison of the largest hedge fund performances **(HFRI 500)** against the industry (**HFRI**) shows that in the first six months of the year the greatest disparity has been in the macro space and in particular commodities.

In equities, performances were virtually identical with the HFRI Equity index down 9.5% and HFRI 500 Equity down 10.0% through to end of July. It was a similar picture in Event Driven, where the HFRI 500 fell 6.7% and HFRI 5.1%. Interestingly, both equity and event driven show overall industry outperformance against the larger funds. But it was in macro where there was a material gap, with the HFRI up 7.6% and HFRI 500 11.8%.

Delving deeper into the macro strategy and it is evident that the real differentiator has been in commodities, with the HFRI Commodity Index up a highly respectable 11.7%, whilst the HFRI 500 Commodity index rose a staggering 36.6%.

CALPERS DISAPPOINTS

CalPERS has recently reported its worst performance in a decade. For the 12-month period to 30 June, the public pension fund lost 6.1%, a number it attributed to the *'tumultuous… [and] 'volatile' global markets.'* Compared to many other funds, this is commendable performance given market conditions, but CalPERS has exceptionally high standards and a tremendous track record. For the same period the previous year, the fund was up 21.3%.

Breaking the returns down, it is clear that these losses would have been significantly worse if they hadn't been offset by the fund's exposure to real assets and private equity. These particular allocations were up 24.1% and 21.3% respectively, while the public equity investments were down 13.1% and fixed income down 14.5%.

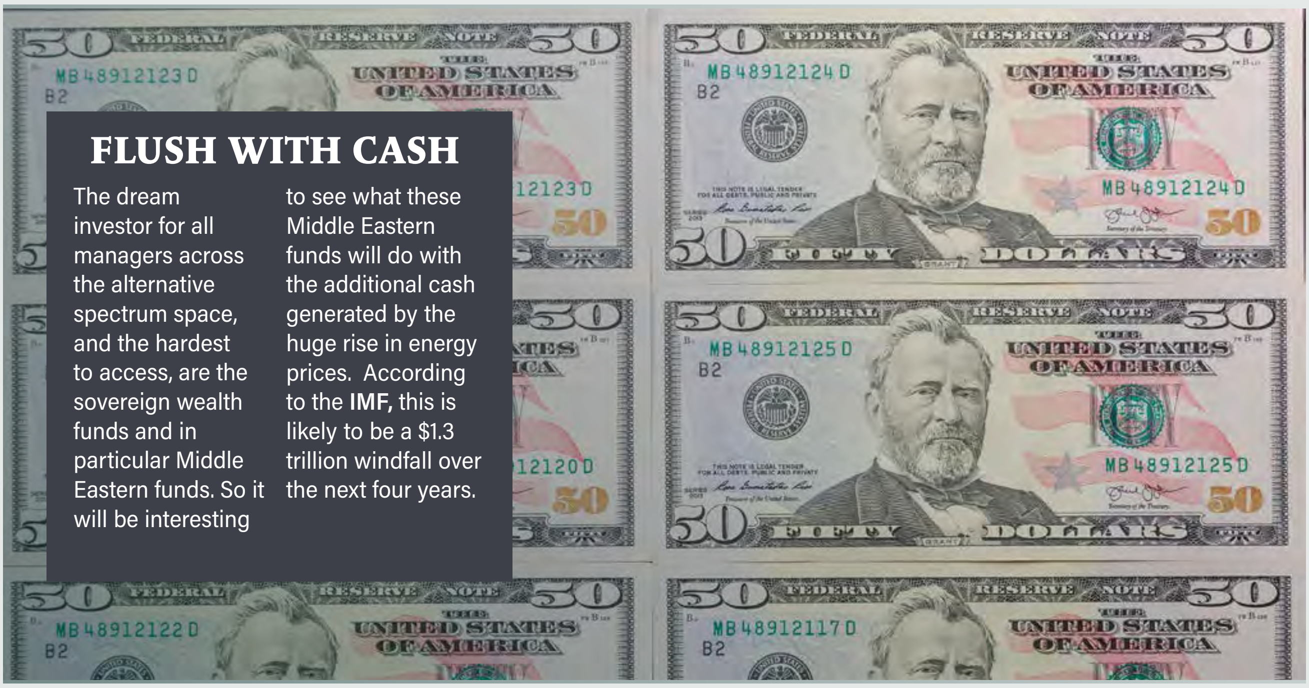
MAN GROUP ALTS PERFORM AND SEES NET INFLOWS

A litmus test in the hedge fund world is invariably **Man Group's** results. These were out in early August with their half year numbers and although overall assets under management declined, brought down by a $7 billion loss in the long only funds, there was $2.1 billion in positive performance from alternatives and $3.2 billion of net inflows. This took total managed assets to $142.3 billion and although it was the first drop in assets in two years, the net flows go to show the robustness of their diversified business model.

A large part of these positive flows went to the absolute return portfolios and in particular **AHL Evolution,** which had very strong performance in the first half, up 10.9%, and is where the bulk of Man's fees are generated ($187 million).

This is still plenty of dry power with $628 million set aside for seeding programmes. The share price dropped just over 4% on the results news, but is still up around 9% year-to-date at the time of writing.

NEWS (CONT.)



FLUSH WITH CASH

The dream investor for all managers across the alternative spectrum space, and the hardest to access, are the sovereign wealth funds and in particular Middle Eastern funds. So it will be interesting to see what these Middle Eastern funds will do with the additional cash generated by the huge rise in energy prices. According to the **IMF,** this is likely to be a $1.3 trillion windfall over the next four years.

NBIM HURT BY ENERGY DIVESTMENT

Not all sovereign wealth funds have been making money in these markets. The largest in the world, Norway's Norges Bank Investment Management, has just reported losses of $174 billion, or 14.4%, in the first half of this year. Its equity investments were down 7%, and fixed income and renewables down 9.3% and 13.3%. Back in 2019 the fund was more focused on energy, but made the decision to shift away to protect the economy should the oil price plummet, a move that saw the fund divest from firms that explore for oil and gas, although it has continued to hold stakes in firms that have renewable energy. This move looked smart during Covid, but has proved very painful this year.

BREVAN TO LIST?

A story that has done the rounds, which may or may not be true, is news that Brevan Howard is searching for a US chair. Such a move could well mean a future listing. This story originates from *Mark Kleinman*, Sky News business editor, who has a habit of breaking such stories. Watch this space.

BRIDGEWATER TAKES AIM AT EUROPE

Having aggressively cut back its European shorts, **Bridgewater Associates** has once more built them back up to around $3 billion, according to **Bloomberg** research.

This follows a story in August, which was reported widely, about the firm cutting back these positions. The August data came from **Breakout Point**, which trawled through public disclosures. According to their figures, Bridgewater's European short positions at the time stood at around €475 million in two financial services firms, **Banco Santander SA** and **ING Groep**. This was significantly below the €10 billion reported in mid-July, when it was betting against around 50 companies. There has been no public comment from Bridgewater as to why these positions were reduced, although some commentators speculated it was a squeeze.

In other parts of the Bridgewater universe, according to 13F filings, the second quarter saw the firm adjust their Chinese holdings, liquidating stakes in **Alibaba** and **JD.com**, but adding to their positions in China's electric vehicle start-ups, notably **Nio Inc** and **XPeng Inc.**

NEWS (CONT.)

EUROPE IS THE ACTIVIST HOTSPOT IN FIRST HALF

Given these market conditions, you could be forgiven for thinking that investor activism may well be rather more muted this year, but you'd be wrong.

According to the **Lazard H1 2022 Review of Shareholder Activism** report, there were 35 European activist campaigns in the first six months of the year, a 67% increase on the same period in 2021, with the UK being the location of choice for much of this activity. Tech and industrials were the sectors being most commonly targeted, with tech in particular in the second quarter as stock prices plummeted.

Another trend in Q2, as economic conditions deteriorated, was for activists to increasingly focus in on a company's strategy and operations.

There were similar figures in a separate report from **Harvard Law School**, which describes Q2 activism globally as being slower than Q1 although it continued to be *'robust.'*

While European activism has been a busy place to be, the US has seen a material decline in activities.

A new trend worth noted from these numbers is the rise of the first-time activists, with Harvard reporting that these accounted for 37% of all campaigns during the half, marking the highest level in recent years.

Speaking to the **Financial Times**, *Mary Ann Deignan*, MD and Head of Capital Markets Advisory at Lazard, commented that *"activist investors love value stories and Europe has been operating at relatively lower valuations."*

SKY HIGH GAS SEES SKYLAR LOOK TO LONDON

With energy markets, particularly gas, at new highs over the past few weeks, there is an interesting player setting up shop in the London market. This is a colourful US energy trader *Bill Perkins*, who is also known as the *'Last Cowboy'* and is the founder of Houston based **Skylar Capital**. According to the **Financial Times,** Perkins generated $1 billion profits when he was at **Centaurus Energy Advisors** before launching Skylar ten years ago.

His London arm, which has around 12 investment professionals, includes an ex-**Glencore** natural gas and LNG team.

Perkins is more than just an energy trader, with a successful poker playing track record and has even been a film producer.

At the moment, the potential profits from trading LNG are extraordinary, with **The Times** writing that an LNG shipment at the start of August would have doubled in value by the time it reached its destination at the end of the month. And now with **Nord Stream** 1 closed, the LNG market is only likely to go one way.

LONE PINE DISAPPOINTS

Steve Mandel's **Lone Pine Capital** is another Tiger Cub to be struggling in these markets. In a letter to investors, Mandel wrote that performance has been *"deeply disappointing."*

According to **Bloomberg**, Lone Pine's hedge and long only funds are down more than 30% this year and assets are down 42% at $16.7 billion.

COLTRANE HITS IT OUT OF THE PARK

There have been some big losses this year, but there have also been some big winners. One of the best performers away from systematic strategies and commodities has been **Coltrane Asset Management,** a New York activist fund run by *Mandeep Manku*, who was previously at **Deutsche Bank** and **Third Point**. According to one report, his fund is up 223% from shorting tech stocks, including **Netflix**, and has been turning his attention to Europe. This is a good comeback for a fund that was hit hard by Covid.

As an aside, Coltrane's website is one of the briefest in the market, with a wonderful picture of the NYC skyline, a title and no more...

NEWS (CONT.)

BREACHING THE FORT

While many of the large quant funds have been making proverbial hay, such as **Graham Capital**, it has not been the same across the board. One of these is **Fort Investment Management**, a Washington based systematic manager with almost 30 years under its belt. Citing numbers from the **Financial Times,** which has seen investor documents, the firm's losses are in the region of 20 to 40% across its funds. While its assets under management are down from $6.2. billion in January 2022 to $1.9 billion in early January.

GOODBYE MR ROBERTSON

A word on legendary manager ***Julian Robertson***, who recently died aged 90. He was a name that we all knew so well in the industry.

From his legendary firm, **Tiger Management**, through to his Tiger Cubs, his legacy will live on and it is well worth rereading *More Money than God* by *Sebastian Mallaby.*

Robertson launched Tiger Management in 1980 and closed in 2000, during which he mentored an entire generation of future managers, with over 200 tracing their roots back to their time with Tiger Management.

These were the Tiger Cubs, many of whom were financially backed by Robertson.

Robertson's average annual return over the 20 years was more than 25% net fees, but eventually he came unstuck on the Japanese yen, having largely avoided the dot.com hype, which at the time irked investors.

He was more than just a manager, he was an industry icon. In 1996 he founded the **Robertson Foundation** that makes large grants to education, environmental and medical research.

PRIVATE EQUITY

A TIGER MAULING

Tiger Global has continued to be mauled by markets and the media, with the **Financial Times** describing recent numbers as an *'omnishambles.'*

Having been heralded in what now appears to be a past life as the greatest tech investors, even by some of today's detractors, *Chase Coleman's* firm is today somewhat less bullish having sold down some of its core listed vehicles.

The Financial Times has been keeping close tabs on the firm's recent fortunes and has taken a look at the firm's 13F filings, which at the end of last year stood at $46 billion but is now $11.9 billion. Some of these 'fire sales' included the likes of **Carvana**, which unfortunately for Tiger meant that they missed out on the July stock rebound.

SOFTBANK FOLLOWS SUIT

Tiger Global is not the only tech fund to have been heavily underperforming in these markets, but it happens to be, or was, one of the biggest. **SoftBank** is another to have reported dire numbers, with a $23.3 billion loss for the quarter. This was its largest loss since the fourth quarter and follows a string of under performances from its investments.

These numbers were perhaps the final straw that saw **Elliott** finally close its SoftBank investment, which at one point was worth over $2 billion. Elliott did however time its **Twitter** exit rather better, pressing the eject button shortly before *Elon Musk* decided to do the same.

This summer the **Money Maze Podcast** completed its 7-part private equity miniseries, featuring interviewees from firms such as **KKR, Bain Capital, CD&R, Permira, Schroders Capital** and **Vista Equity Partners.** With global private assets under management growing by over $4 trillion over the last decade, this series is a recommended resource to help you build your knowledge of this fast-growing and exciting sector.

The final episode of the miniseries was released earlier this month, featuring ***Philipp Freise***, Co-Head of European Private Equity at KKR. In the episode, he shares his career story and reveals how KKR approach the market. Countering suggestions of continued Eurosclerosis, he highlights some key investment opportunities, explaining that it's *'never been more interesting to invest in Europe'*. He then describes how *'entrepreneurial capital'* is needed, the unique private equity opportunity set and some specific examples of companies they've invested in (such as into e-biking and supply chain software). The episode is available now for free on all major podcast apps, including **Apple Podcasts** and **Spotify**. It's also available to watch on the **Money Maze Podcast YouTube** channel.

Established in 2020 by two industry veterans (***Simon Brewer*** and ***Will Campion***), the Money Maze Podcast features interviews with some of the biggest names in business and finance. Through direct, entertaining and insightful interviews with masters of the real life money maze, it aims to help listeners learn about the different approaches to allocating capital and to better navigate the pitfalls that line the path to prosperity. The podcast has won numerous industry awards and reaches over 2 million people per year, with lots more interesting episodes planned for this autumn!

The Money Maze Podcast is kindly sponsored by **Schroders, Bremont Watches, LiveTrade** (from **Bordeaux Index**) and **Mintus**.

To listen, simply search *'Money Maze Podcast'* on your preferred podcast app or on YouTube. You can also find out more and listen to the full podcast archive at www.moneymazepodcast.com.

PRIVATE EQUITY(CONT.)

APOLLO FLIES HIGHER

Alongside announcing growth in AUM, **Apollo Global Management** has also announced the launch of a secondary market business, with $4 billion of newly committed capital. This includes $829 million from the Abu Dhabi Investment Authority according to ***Jim Zeltzer***, co-President, on the earnings call.

The new business is called **S3**, or **Sponsor and Secondary Solution**s, which will provide financing to GPs and LPs across various asset classes, particularly private equity, private credit and real estate. At the time of this launch, according to the statement, Apollo has existing investments of more than $13 billion across second and fund finance solutions.

CHANGE AT CARLYLE

There is a big change at the **Carlyle** helm with ***Kewsong Lee***, the CEO, stepping down with immediate effect after two years as sole leader of the $376 billion group. This surprised markets with Lee, who had been previously the firm's co-CEO, very much evident in the run up to this news and a growing belief that the firm is heading in the right direction.

The share price dropped 6% on the news.

This news came as he was mid discussions on a revised contract with the group board.

In the interim, ***William Conway***, one of the co-founders of Carlyle, has stepped in as temporary CEO while the search is underway for a replacement.

WINDING UP PELTZ

In July we wrote about ***Nelson Peltz*** coming under fire from investors in his London listed vehicle, **Trian Investors 1,** accusing it of governance failings.

Since then, the Fund's board has decided to redeem 95% of each shareholder's holding by June of next year, at which point it will be wound up.

CRYPTO

BREVAN LAUNCHES DIGITAL FUND

Another crypto fund to launch in recent weeks has been **Brevan Howard's**, which has raised more than $1 billion for a flagship digital vehicle. This figure is a huge success story in today's trying times. As **Blockworks** rightly points out, this would be a stand-out figure for any strategy, let alone in the crypto space. According to reports, this is a multi-manager and multi-strategy fund, employing quantitative and relative value strategies to invest in venture capital investments and liquid crypto. This is managed by **BH Digital**, Brevan's digital arm, which has seen massive expansion this year, growing from 25 employees at the start of the year to 60 today, along with 20 external blockchain engineers.

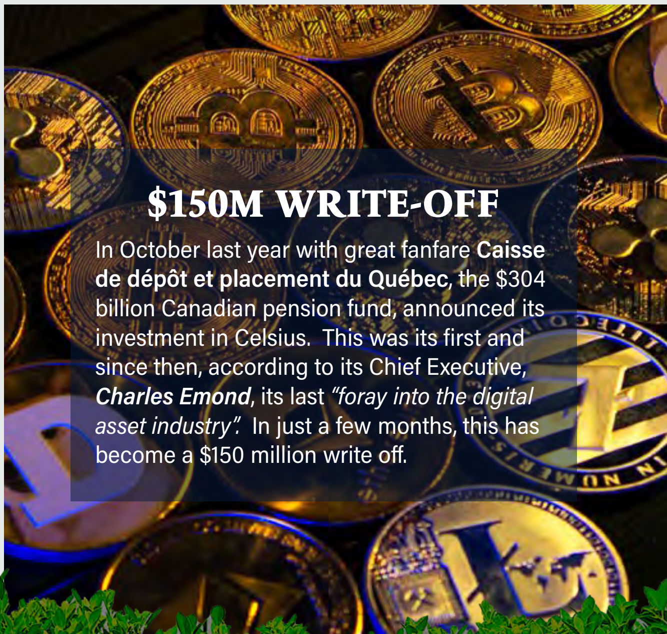
BLACKROCK LAUNCHES BITCOIN TRUST

Despite this year's crypto drawdown, we are continuing to see multiple products in the pipeline and there will be further big name launches before the end of the year. One of the latest is **BlackRock's** bitcoin private trust, which was announced mid-August. This new product connects their Aladdin portfolio digital platform to Coinbase Prime.

According to the statement, BlackRock said that *"despite the steep downturn… we are still seeing substantial interest from some institutional clients."* You can see the PR pushing to remove the word "some" from this press release, to give the story more clout, but quite rightly being pushed back by compliance given not every institution is sold on crypto…

AN EMPTY QUIVER

The reverberations from **Three Arrows** will be felt for many years to come as the liquidation events play out. According to the bankruptcy filing, the firm owes $3.5 billion to 27 different companies. This Singapore firm, which was once a leading light in this space, managing at its peak over $10 billion, came crashing down when poorly timed investments in **Luna** coin saw investors head for the door. This was a firm that was revered by commentators and journalists alike. The founders, ***Su Zhu*** and ***Kyle Davies***, are thought to still be in hiding and there is even a $50m unclaimed (and unused) yacht that is part of the liquidation proceedings. According to various observers, including ***Sam Bankman-Fried***, CEO of **FTX,** the firm's demise was largely, but not solely, responsible for the crypto contagion that has been rocking the crypto market this year.



$150M WRITE-OFF

In October last year with great fanfare **Caisse de dépôt et placement du Québec**, the $304 billion Canadian pension fund, announced its investment in Celsius. This was its first and since then, according to its Chief Executive, ***Charles Emond***, its last *"foray into the digital asset industry".* In just a few months, this has become a $150 million write off.

OPINION

MACRO RISES LIKE A PHOENIX FROM THE ASHES

We are now nine months into this extraordinary year and so far there doesn't appear to be any let up in the dire macro environment, Alastair Crabbe writes.

Geopolitically, Russia gets more entrenched and in August we had an aggressive China flexing its muscles over Taiwan.

Europe's winter looks desperate with sky high oil and gas prices, and the onset of a hideous stalemate in the Donbas.

The repercussions can only be increasingly high inflation and more aggressive rate hikes.

What we are all going through, globally, has been described as this generation's Cuban crisis, but it feels a lot more dangerous. The stakes are certainly massive, with Putin playing a very real game of Risk, by goading the West, playing with people's lives and weaponising energy.

Such a disconnected world continues to be fertile hunting ground for the macro manager, although positioning can at times be hazardous and less directional than it was earlier in the year. You saw this during the summer, with the bear market rally catching various managers out. But dig deeper and there was little substance behind it, beyond hope. As Isaac Souede mentioned in a previous edition of the The Hedge, bear markets are punctuated by rallies, but they are still bear markets.

Yet, it was not very long ago that commentators were reading the macro strategy its last rites after years of sub-optimal performance. Now their long-term performance looks absolutely stellar, particularly systematic and more commodity focused managers, and it is interesting to see US energy traders now looking to set up shop in Europe where they see the action.

Macro managers are firmly in the right place and even if Russia and China do step back from the brink, and it currently doesn't look likely, it is going to take many years to return to the status quo of yesteryear.

> ....not so long ago, commentators were reading the macro strategy its last rites after years of sub-optimal performance.
>
> Alastair Crabbe, Brodie Consulting

THERE'S NO STOPPING DIGITAL ASSET FUNDS...

Against the backdrop of the latest crypto winter, it might be fair to assume that new digital asset fund launches are few and far between. However the digital asset fund launch landscape remains buoyant as both new and established managers push forwards with digital asset fund launches. This suggests that the number of new digital asset fund launches is no longer inextricably linked to the value of Bitcoin where fund launches remain robust only when the value of Bitcoin is on the up and that manager and investor confidence in the asset class is continuing to grow. Digital assets are being viewed as a credible asset class that provides value. Signs are that the institutionalisation of digital asset funds and its investor base is materialising as established hedge fund managers continue to take steps to commence trading digital assets and/or launch bespoke digital asset funds.

Current trends for new fund launch structures include:

1. The continuation of the Cayman Islands as fund domicile of choice for digital asset funds in part due to an unhostile regulatory environment and wide choice of service providers. Note that for those seeking a European onshore launch, the European regulatory stance is shifting with the launch of Luxembourg domiciled reserved alternative investment funds ("RAIF") following crypto fund of funds strategies and the approval of qualifying investor alternative investment funds ("QIAIF") with a low level of exposure to CME Bitcoin futures by the Irish regulator.
2. The evolution in complexity of digital asset fund strategies. Market neutral strategies remain popular but certain digital asset fund structures are becoming more hybrid with portfolios combining liquid and illiquid digital assets and structures including corresponding liquidity mechanisms.
3. For new UK based managers, the use of an FCA authorised regulatory host. This is a tried and tested route for new managers regardless of asset class but the use is more widespread for managers managing digital asset funds as the involvement of digital assets significantly extends the time taken for approval.

Despite the continuing positive signs for new digital asset fund launches, recent market events have served as a reminder of the potential volatility of the asset class. Our clients have a renewed focus on:

1. Reviewing arrangements and agreements with custody service providers and counterparties to ensure it is clearly understood which party owns fund digital assets whilst held in custody accounts and any segregation thereof from other fund digital assets.
2. Strengthening risk disclosures in fund offering documentation, in particular regarding regulatory uncertainty and the treatment of assets held with custody services providers or other counterparties in an insolvency or bankruptcy situation.
3. Recruitment of risk management personnel with specialist focus on counterparty risk.

Although the digital asset fund launch environment remains positive in the face of this crypto winter, once launched the success of digital asset funds will depend on capital raising efforts which will really test investor sentiment in the current climate.

Sarah Crabb is a leading investment funds specialist and partner at international law firm Simmons & Simmons LLP. Her practice focuses on the establishment, structuring, maintenance and restructuring of alternative investment funds in a variety of jurisdictions. Sarah is an established digital assets funds expert, having advised managers investing in digital assets since 2017.

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>
> Sarah Crabb, Simmons & Simmons

OPINION (CONT.)

NEVER LET A GOOD CRYPTO WINTER GO TO WASTE

Whilst many of you will have been enjoying a searingly hot summer, crypto has been in the depths of winter. At the time of writing the two largest cryptocurrencies Bitcoin and Ethereum are both down over 50% YTD. However, volatility of crypto assets has not been the only story grabbing headlines. This year the crypto sector has seen seismic events with extraordinary frequency - even by the famously fast-paced standards of crypto. Just look at the collapse of the TerraUSD (UST) stablecoin, followed by a spectacular implosion of Three Arrows Capital, and the contagion from crypto lenders Celsius and Voyager filing for bankruptcy.

Crypto has always been a polarising asset class and these events provide ample fuel for crypto critics, as well as firmly testing the resolve of those of us invested in it. But just as the dotcom crash of the early 2000's did not mark the end of the internet, or the 2008 global financial crisis the end of traditional finance, the 2022 crypto crash is not the end of crypto.

As Winston Churchill once said, "Never let a good crisis go to waste". So as people observe the fallout from a(nother) tumultuous year in crypto, what needs to change?

In my view, the one thing that has to emerge is a much clearer regulatory framework for digital assets, and much more constructive dialogue between regulators and industry participants. Even the most hardened "no coiner" will recognise that crypto is at a size and scale that demands regulatory clarity, and yes, scrutiny too, but also has the capacity to inspire innovation in the financial industry for decades to come.

Let's be honest, crypto 'bros' haven't helped themselves with regulators over the years - in retrospect, those who turned up to a crypto conference in New York back in 2018 in a fleet of rented Lamborghinis might recognise - brand awareness aside - that they were inevitably inviting regulatory scrutiny. And regulators around the world have looked on at the crypto sector with an increasing sense of distrust and horror in recent times, exacerbated by the "catch me if you can" attitude of many crypto companies.

But uncertainty kills the game, and we need now a sensible (and grown-up) dialogue between authorities and industry to develop regulations that grow the game not kill it. On one side we need joined up thinking by regulators that stop the enormous risks taken by some crypto companies with customer funds (Three Arrows, Celsius, Voyager are good examples here). And on the other, the regulatory approach needs to be supportive and understanding of the digital assets space. Blunt laws enforced out of ignorance will not help anyone, least of all end-users.

We are seeing change. Crypto by its very nature moves at lightning pace, and with very little physical infrastructure and typically young and nomadic employees, companies can make rapid decisions on where they chose to base themselves. What they are looking for is a supportive commercial environment combined with regulatory oversight that is respected globally. Crypto behemoth FTX's decision to base its headquarters in The Bahamas is a perfect example of this, and no doubt a loss to its original home of Hong Kong. The Bahamas has seen an influx of crypto companies as a result. The traditional powerhouse financial markets of New York, Hong Kong and London are all at risk of missing the boat as a new wave of crypto powerhouse markets emerge.

And if you're looking for a benefit of Brexit, perhaps frustrated by a summer of immigration queues when exiting or entering the UK, then maybe it will be some consolation that the UK does have an opportunity to be at the forefront of shaping global policy for digital assets given its new-found freedom from crypto-skeptic European neighbours. Let's not waste crypto's crisis.

George Godsal, Founder, REKT Partners - a specialist crypto reputation, issues and crisis communications consultancy

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>
> George Godsal, REKT Partners

REGULATION

Presented by RQC GROUP

UNINTENDED CONSEQUENCES? HOW THE FCA'S CONSUMER PROTECTION INITIATIVE AFFECTS HEDGE FUNDS?

The **FCA** has concluded that too often the retail public gets a *'raw deal'* when engaging with the financial services industry, including rip-off charges and fees, difficulties in switching products, poor customer support and insufficient or unclear information on products and services. This has prompted the FCA to enhance the protection afforded to retail, albeit the cynic may argue that this is also due to a number of scandals - including **London Capital and Finance, Blackmore Bond** (the subject of a recent Panorama documentary) and **Woodford Investment Management** – where the FCA has taken a reputational hit.

As frequently happens with regulatory change, there is a focus on firms that perform certain functions. However there are consequences – intended or unintended – for firms that are out of focus. In this instance, firms that engage with the retail public are in the bullseye, and firms that do not directly engage with the retail public or are on the periphery of such activities, are also affected – including some hedge funds and other types of alternative asset manager.

CONSUMER DUTY

A majority of the changes are set out in the new 'Consumer Duty' regulatory framework. This comprises a new overarching FCA principle plus requirements including having to act in good faith and avoid causing foreseeable harm. Specific requirements relate to governance arrangements over products and services, ensuring that the price and value of products and services are appropriate, and ensuring that frameworks with respect to consumer understanding and support are 'fit-for-purpose.'

Where a firm provides a product or service for retail customers, it is in scope, including where it is part of a distribution chain where end investors are retail customers and the firm can materially influence the outcomes for such customers, for example when designing a product and determining its distribution and fee arrangements.

Thankfully, the Consumer Duty is out of scope where the products and services are directed towards professional clients and eligible counterparties only, i.e. no retail customers. Furthermore, a product is out-of-scope where the minimum subscription is £50,000 or more.

In the first instance, this should cover a majority of alternative investment funds – albeit there is a question mark over funds where the minimum subscription can be waived and subscriptions of under £50,000 can be accepted – where the investors are a firm's employees or 'friends and family,' for example.

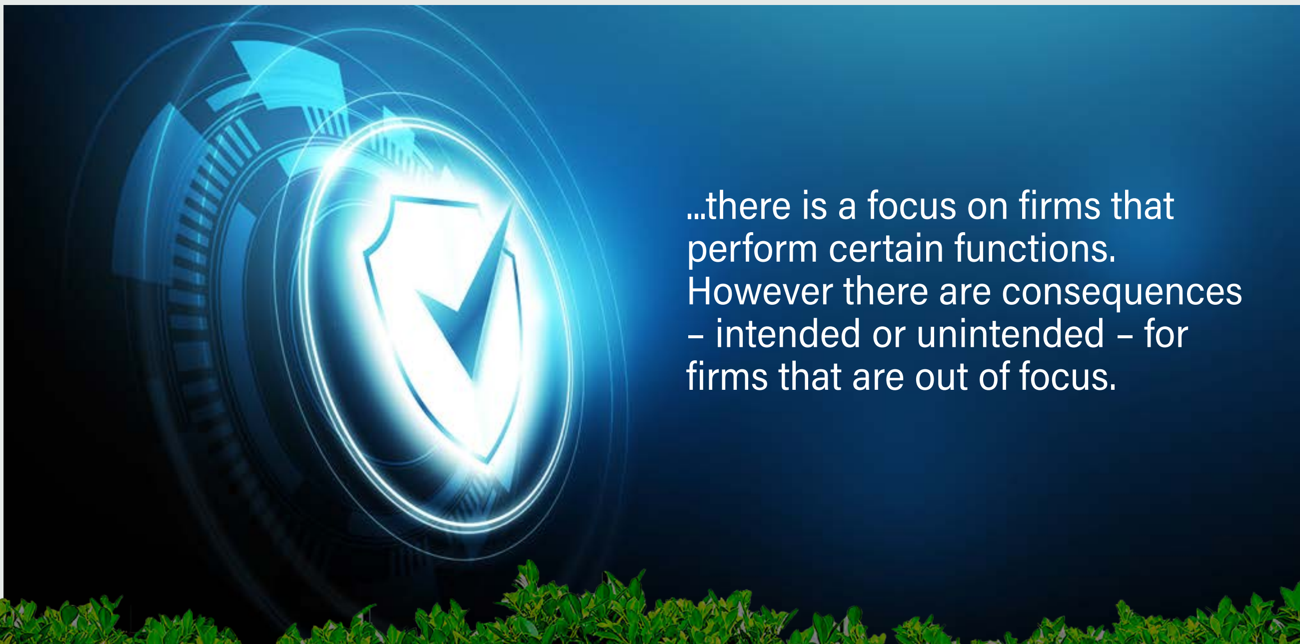
Other alternatives might be brought into the scope of the regime, for example where they manage a listed investment trust or a UCITS, that can be purchased by consumers.

By 31 July 2023, firms with 'open' products must have implemented the new requirements. There is also a deadline of 31 October 2022 for firm's board to agree an implementation plan.

MISLEADING ADVERTS AND HIGH-RISK PRODUCTS

The FCA is amending its rules to bolster the financial promotions regime for high-risk products. This is pursuant to research showing that too many consumers are investing in such products which are not aligned with their risk tolerance.

This focuses on consumers and as a result many products and services in the alternatives sector will be out-of-scope. However where a so-called non-mainstream pooled investment (which many AIFs fall into) is promoted to certain individuals (high net worth investments and sophisticated investors), there will be a requirement to state a risk warning, accompanied by a '2 minute read' risk summary. This might require a change to the content of marketing materials.



FCA SETS OUT MAIN RISKS OF HARM FOR 'ALTERNATIVES'

In a letter to the Chief Executives of alternative investment firms, the FCA has articulated what it considers to be the main risks of harm for such firms, their clients and the marketplaces in which they operate.

The FCA expects alternatives, including hedge funds, to consider which of these risks apply to their business and whether they have appropriate strategies in place to address these. The risks are grouped into three 'FCA Commitments':

1. Putting consumers' needs first

   This includes a focus on investment strategies that carry inappropriate levels of risk for the target client. Firms should have process in place to appropriately categorise clients and investors. The consumer duty and high-risk product advertisement (covered in the above article - *Unintended consequences? How the FCA's consumer protection initiative affects hedge funds?*) are also mentioned.

   In addition, there is a continued focus on the appropriate management of conflicts of interest.

2. Strengthening the UK's position in global wholesale markets

   This covers market integrity and description and the importance of risk controls, market abuse systems and controls and the importance of fostering a healthy culture within a firm including the influence of senior managers, diversity and inclusion and staff remuneration.

3. ESG, a strategy for positive change

   There has been a growth of ESG investment in the alternatives sector, and it is important that investors have confidence in the products being offered. For example, documentation promoting products labelled as being ESG focussed must be 'clear, fair and not misleading.'

NEW RULES TO IMPROVE OVERSIGHT OF AR'S

The **FCA** has confirmed that it is putting in place new rules to make authorised financial firms more responsible for their appointed representatives (ARs).

Principal firms are responsible for ensuring that their ARs, which conduct certain financial activities, comply with FCA rules.

Under the new requirements, Principal firms will need to:

- Apply enhanced oversight of their ARs, including ensuring they have adequate systems, controls and resources
- Assess and monitor the risk that their ARs pose to consumers and markets, providing similar oversight as they would to their own business
- Review information on their ARs' activities, business and senior management annually, and be clear on the circumstances when they should terminate an AR relationship
- Notify the FCA of future AR appointments 30 calendar days before it takes effect
- Provide complaints and revenue information for each AR to the FCA on an annual basis

The AR regime covers a wide range of sector types. For example, some IFA networks contain over 3,000 ARs, all attached to the same Principal firm. Within institutional asset management, the 'hosting model' has become a viable alternative to seeking full FCA authorisation. The new rules should provide additional comfort to businesses seeking to become an AR, that the host's systems and controls framework is sufficiently robust, and that in turn reduces the risks to the AR.

MARKET ABUSE FINES FOR CITIGROUP AND EX-VODAFONE CEO

The **FCA** has fined Citigroup Global Markets Limited ("CGML") £12,553,800 for failing to properly implement trade surveillance requirements relating to the detection of market abuse.

As a result, CGML – Citigroup's international broker-dealer - was unable to effectively monitor its trading activities for certain types of insider dealing and market manipulation.

The **Market Abuse Regulation**, introduced in 2016, expanded requirements to detect and report potential market abuse including a requirement to monitor both orders and trades to detect potential and attempted market abuse, across a broad range of markets and financial instruments.

The FCA found that CGML failed to properly implement this new requirement when it took effect and took 18 months to identify and assess the specific market abuse risks its business may have been exposed to and which it needed to detect. This flawed implementation resulted in significant gaps in its arrangements, systems and controls for additional trade surveillance.

CGML agreed to resolve the case and qualified for a 30% discount. Without this discount, the fine would have been £17,934,030.

Whilst this is a sanction against a large broker-dealer, buy-side firms of all sizes are also required to have appropriate market abuse surveillance systems.

Separately, the FCA fined *Sir Christopher Gent,* former non-executive Chairman of **ConvaTec Group Plc**, £80,000 for unlawfully disclosing inside information.

While Chairman, Sir Christopher disclosed inside information to individuals in senior positions at two of ConvaTec's major shareholders before this information had been announced properly to the market. The disclosures concerned an expected announcement by ConvaTec relating to a revision of its financial guidance and the CEO's plans for retirement.

REGULATION (CONT.) Presented by RQC GROUP

SEC'S MIFID II RESEARCH PAYMENTS NO-ACTION LETTER SET TO EXPIRE

The **SEC's** division of Investment Management recently announced that it would allow its October 2017 no-action letter related to **MiFID II** research payments to expire in July 2023. MiFID II refers to the European law that came into effect in January 2018 that, among other things, prevents asset managers in Europe from purchasing broker-dealer research with *"soft dollars".*

In the no-action letter, the SEC advised that it would not recommend enforcement action if a broker-dealer accepted cash payments for research from an investment manager that was required by MiFID II to pay for research. This letter was issued to allow time for the SEC to address questions about how broker-dealers would be able to receive compensation for research services after MiFID II went into effect.

The SEC has engaged extensively with market participants on this topic, including broker-dealers, investment advisers, service providers, and others. The SEC noted that firms have developed a variety of solutions to address the impact of MiFID II. Some broker-dealers have dually registered as investment advisers while others now utilize a registered adviser affiliate to provide certain research services.

Separately, the FCA has reduced the scope of the MiFID II research payment requirements as applicable in the UK, for example by excluding certain asset classes and companies with an equity market capitalisation under a certain threshold.

The SEC does not expect to issue further assurances with respect to broker-dealers accepting compensation under MiFID II arrangements.

SEC FILES MULTIPLE INSIDER TRADING ACTIONS

The **SEC** filed insider trading charges against nine individuals in connection with three separate alleged schemes that together yielded ill-gotten gains of over $6.8 million.

All three actions originated from the SEC Enforcement Division's **Market Abuse Unit's Analysis and Detection Center**, which utilizes data analysis tools to detect suspicious trading patterns.

Chief Information Security Officer ("CISO") tipped friends

The SEC alleges that ***Amit Bhardwaj,*** the former CISO of **Lumentum Holdings Inc.,** and four of his friends traded ahead of two corporate acquisition announcements by Lumentum, generating more than $5.2 million in illicit profits.

The complaint alleges that Bhardwaj learned material non-public information **("MNPI")** about the company's plans to first acquire Coherent, Inc. and later acquire **NeoPhotonics Corporation**.

Based on this MNPI, Bhardwaj allegedly purchased Coherent securities ahead of Lumentum's announcement and tipped a friend with the understanding that he would later share some of the ill-gotten gains.

The SEC further alleges that, during October 2021, Bhardwaj shared MNPI about Lumentum's planned acquisition of NeoPhotonics with three other friends who then amassed large positions of NeoPhotonics based on those tips.

Investment banker tipped friend

The SEC alleges that investment banker ***Brijesh Goel*** and his friend ***Akshay Niranjan,*** who was a foreign exchange trader at a large financial institution at the time, made more than $275,000 by illegally trading ahead of four acquisition announcements in 2017.

The complaint alleges that Goel learned about the acquisitions through his employment. Niranjan purchased call options on the target companies, later wiring Goel $85,000 for Goel's share of the ill-gotten proceeds.

Former FBI trainee tipped friend

The SEC alleges that ***Seth Markin***, a former FBI trainee, and his friend ***Brandon Wong*** made approximately $82,000 and $1.3 million, respectively, from illegally trading ahead of the February 2021 announcement of a tender offer by **Merck & Co., Inc.**, to acquire **Pandion Therapeutics, Inc**.

The SEC's complaint alleges that Markin secretly reviewed a binder of deal documents about the planned tender offer belonging to his then-romantic partner, who worked as an associate for a law firm representing Merck on the deal, traded on the MNPI and tipped Wong.

The SEC's complaints charge all nine defendants with violating the antifraud provisions of the securities laws and seek permanent injunctive relief, disgorgement with prejudgment interest, and civil penalties.

SEC CHARGES FORMER INDIANA CONGRESSMAN

The SEC charged former Indiana Congressman ***Stephen Buyer*** with allegedly using inside information to buy $1.5 million in stocks.

According to the complaint, after leaving Congress in 2011, Buyer formed a consulting firm, the **Steve Buyer Group** which serviced, among other clients, **T-Mobile**. In March 2018, Buyer attended a golf outing with a T-Mobile executive, from whom he learned about the company's then non-public plan to acquire **Sprint**. Buyer began purchasing Sprint securities the next day, and by the time of the merger announcement, had acquired approximately $568,000 of Sprint common stock. After news of the merger leaked in April 2018, Buyer saw an immediate profit of more than $107,000.

The **SEC's** complaint alleges further that in 2019 Buyer purchased more than $1 million of **Navigant Consulting**, Inc. securities ahead of the public announcement that it would be acquired by another one of Buyer's consulting clients, **Guidehouse LLP**. After the public announcement of the Navigant acquisition, Buyer sold nearly all of the shares he had acquired and profited more than $227,000.

The complaint seeks disgorgement of

Continued over page

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ill-gotten gains plus interest, penalties, a permanent injunction, and an officer and director bar against Buyer. The complaint also seeks disgorgement from Buyer's wife, *Joni Lynn Buyer*, who profited when Buyer executed unlawful trades in her brokerage account.

VC FUND ADVISERS ON SEC RADAR

The **SEC** has made clear that venture capital fund advisers are on the radar of the Enforcement Division's **Asset Management Unit**, even those exempt from registration. Energy Innovation Capital Management LLC ("EIC"), a California-based exempt reporting adviser, was found to be charging excess management fees to two of the firm's venture capital funds.

Under the limited partnership agreements, EIC was allowed to charge management fees based on invested capital, but was to reduce fees to account for certain circumstances, such as write-downs on portfolio company securities. The SEC charged that EIC made a number of errors, in the firm's favour, when performing these calculations and thus overcharged the funds.

As the order sets out, the errors include:

- Failing to make adjustments to its management fee calculations for individual portfolio company securities subject to write-downs;
- Inaccurately calculating management fees based on aggregated invested capital at the portfolio company level instead of at the individual portfolio company security level;
- Incorrectly including accrued but unpaid interest as part of the basis of the calculation of management fees for certain investments; and
- Failing to begin the post-commitment management fee period at the correct date.

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Brodie Consulting Group is an international marketing and communications consultancy, focused largely on the financial services sector. Launched in 2019 by Alastair Crabbe, the former head of marketing and communications at Permal, the Brodie team has extensive experience advising funds on all aspects of their brand, marketing and communications.

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Capricorn Fund Managers Limited is an investment management and regulatory hosting business that provides regulatory infrastructure and institutional quality operational, compliance and risk oversight. CFM is part of the Capricorn Group, an international family office, which has been involved in alternative assets since 1995.

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Founded in London in 2007 and with a dedicated office in New York, **RQC Group** is an industry-leading cross-border compliance consultancy specializing in FCA, SEC and CFTC/NFA Compliance and Regulatory Hosting services, servicing clients with AUM in excess of $295 billion.

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