MARKETING INTO EUROPE 2016

LIQUIDITY
Diversification is key

TECHNOLOGY
An increasingly vital factor

OPPORTUNITY
Innovators look to alternative Ucits

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*Source: TOP 10 UCITS Platform by HFM Week (Jan. 2016); Figures as of December 31st, 2015.

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imply put, marketing a fund in Europe is anything but straightforward. Reporting obligations and the increasing availability and scrutiny of the disclosure of data dissuade managers from the space, while Ucits and AIFMD continue to play integral parts in any ultimate decision.

Technology remains central to the process. The incoming Mifid II and its requirement for a substantial increase in transparency highlights the need for technological solutions. Partnering with third-party vendors could become a necessity, and, for the innovative asset manager, digital technology presents a competitive edge.

Despite misconceptions, liquid alternative strategies are an opportunity. A broad range of traditional hedge fund investors are turning to liquid alternatives in a search for diversification to withstand a variety of market conditions.

The industry-leading figures who have contributed to this HFMWeek Marketing into Europe Report 2016 investigate the importance of understanding the devil in the detail. This report seeks to provide a thorough and insightful examination of critical legislation and regulation.

Tom Simpson
Report editor
INVESTMENT BANKING
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MEETING REPORTING OBLIGATIONS
Nick Baldwin, director at Arkk Compliance, highlights the importance of meeting reporting obligations and the potential consequences for those who don’t
HFMWeek (HFM): What are the challenges in marketing an alternative fund to European investors?

Neha Jain (NJ): While alternative assets in Europe are growing twice as fast as the broader hedge fund industry since 2008, post-crisis regulatory changes have significantly altered the marketing of these alternative funds. Depending on the asset class, liquidity profile and types of instruments traded, a fund can be marketed as a registered Ucits fund, non-registered Ucits fund, a European AIF or a non-EU AIF.

Each of these regulatory wrappers come with additional service providers, governance structures and risk management requirements. Ucits funds require a custody arrangement, and short exposures to be taken via swap, hence counterparty arrangements are important to understand and set-up correctly. Under AIFMD for instance, safekeeping, cash management and oversight have come to the fore, which necessitates the appointment of a depository. The picture is further impacted by the demand-supply dynamic, which can differ dramatically depending on the jurisdiction and the client type within Europe.

Laura Elliott (LE): Our hedge fund clients have been keen to participate in this growth story and gather assets from Europe. In many cases they are looking for a partner who can manage the launch process for a regulated fund, and assist them in asset-raising. We view our platform as a collaboration with our hedge fund clients and hence give the manager control over the brand and growth of the fund, while offering template documentations and functioning fund structure which enables quicker time to market. On the distribution side, our key focus is generating direct, strong, long-term relationships between the manager and underlying investors.

HFM: How has your alternatives offering evolved in response to the changing regulatory landscape in Europe?

NJ: We have aspired to be a best-in-class provider of alternative solutions, since our inception in 2004. This was in response to our clients demanding high-quality, cost-efficient investments implemented in transparent, liquid and appropriately regulated wrappers. The platform has evolved significantly over the last decade.

“We have aspired to be a best-in-class provider of alternative solutions, since our inception in 2004.”
decade and currently offers a broad spectrum of investable products ranging from internally developed rule based strategies and external hedge fund content offered in multiple formats; Ucits, AIFMD compliant SIFs and QAIFs and Cayman funds.

LE: Our aim is to build a broad, cross-asset alternatives platform that allows access to hedge fund managers, systematic strategies, managed risk premia and other illiquid alternative investments in a transparent, liquid and cost-efficient format. We believe that by having a broad and flexible product range we can create the right mix of investment opportunities to meet the diverse needs of the clients that we service. As the race for returns intensified, we are cognisant of the ever-changing regulatory landscape and pressure on costs and fees. Our key focus is efficient implementation, varied access and targeted cross-border distribution.

HFM: How has investor interaction informed your response to these regulatory changes?
NJ: Our approach to investors in the alternatives market is solution-driven. We are looking to investors for guidance on what they would like to see in a regulated format and work towards creating products that fit client portfolios. We believe that the sustained success of the platform will be driven by the quality of the products we offer: the calibre of the hedge fund managers we can attract, and the merit of our systematic strategies. This is where we aim to differentiate ourselves.

Entering the Ucits market in 2007 was a natural evolution of our offering, and in line with our long-term vision for the alternative investment market. Our early Ucits products were entirely systematic (i.e. rule-based) as our clients looked to capture risk premia across asset classes in a transparent and low-cost implementation. More recently, we are developing a range of externally managed risk premia strategies in the Ucits wrapper, as clients are seeking increasing fiduciary oversight in the kind of products they choose to invest in.

LE: Furthermore, as AIFMD begins to take hold across Europe, we are seeing managers of illiquid assets struggling with cross-border distribution issues in Europe. We expect a greater proportion of US and Asian hedge fund, private equity/debt managers to shift towards launching AIFMD-compliant vehicles to tap this investor base. Having provided an AIFMD compliant solution to our existing investors, we are familiar with the various service providers and requirements around governance, reporting and cross-border distribution of these funds.

HFM: What key industry trends will be of the most significance to the process of marketing an alternative fund to Europe over the next 24 months?
LE: Propelled by regulatory requirements and a rising demand for liquid alternatives, we believe that the industry is at the threshold of expansion – across styles, geographies and investor types. We are increasingly seeing more US and Asian managers asking about Ucits. While this market has been dominated by equity long/short strategies so far, we expect to see strategies such as discretionary macro and credit enter the Ucits market in the next year.

We believe that AIFMD and Ucits are complementary brands, which have the ability to co-exist in the European marketplace, as they serve different needs. The AIFMD offering is likely to lean much more towards classic alternatives products – less liquid hedge funds, private equity/credit, and real estate funds, while the Ucits offering will grow to accommodate liquid strategies from alternative and traditional asset classes.

NJ: We are also seeing many more of institutional investors gravitating towards investing in a regulated format and we expect this trend to continue over the coming years. With changes in regulations for distributors across Europe, we expect a renewed focus on Ucits funds from this client base as well. We think that Ucits is well-poised to be a bigger and more credible brand for liquid alternatives, as more quality managers and diversified strategies enter this space.

Laura Elliott is an executive director in Goldman Sachs’ Global Fund Solutions business and is responsible for the development and management of the Ucits HF platform, which includes product strategy, manager selection and due diligence. Prior to this, she was responsible for managing the third-party manager platform, across onshore (Ucits) and offshore funds. She joined Goldman Sachs in 2004 and has over 10 years of experience in a variety of roles within the hedge fund industry.
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A CHANGING MALTA

DANIÈLE COP OF SPARKASSE BANK MALTA DISCUSSES THE IMPLEMENTATION OF UCITS V AND THE AMENDMENTS TO THE RULES GOVERNING CUSTODIANS IN MALTA

UCITS V – THE DEVILISH DETAILS

One of the objectives of UCITS V was to align the provisions regarding depositaries of UCITS with those of AIFMD. At first glance, the new depositary rules for UCITS appear quite similar to those of AIFMD, but there are a number of important differences. One of the most obvious departures from AIFMD is that the depositary of a UCITS cannot transfer the liability for loss of financial instruments to the sub-custodian. However, some of the divergences are less obvious and may lie in subtle variances in wording. To use the same example of the depositary’s liability: while AIFMD states that the depositary is liable to the AIF or to the investors of the AIF, UCITS V stipulates that the depositary is liable to the UCITS, and to the unit-holders of the UCITS, for the loss or financial instruments and other losses resulting from the depositary’s negligent or intentional failure to properly fulfil its obligations under the Directive. This seems to have been a deliberate decision of the EU legislator, since it is indicated that every investor in a UCITS should be able to invoke claims relating to the liability of the depositary directly or indirectly through the management company or the UCITS. This is irrespective of the legal form of the UCITS (corporate or contractual) or the legal nature of the relationship between the depositary, the management company and the unit-holders, but the right of unit-holders to invoke depositary liability should not lead to a duplication of redress or to unequal treatment of the unit-holders.

While the AIFM is ultimately responsible for compliance with AIFMD rules, it is the UCITS (if it takes the form of an investment company), which is subject to the obligations regarding depositaries under the UCITS Directive. Possibly, this might explain why certain provisions of the AIFMD concerning AIFMs were not replicated in UCITS V for management companies, such as, for instance, the detailed rules on valuation policies and procedures. Nevertheless, valuation is a function of portfolio management and the depositary still has to verify that valuation policies and procedures are established, implemented and reviewed.

Also, notable for their absence are rules regarding prime brokers in UCITS V. The depositary rules of AIFMD forced a fundamental re-thinking of the relationship between the fund, the depositary and the prime broker. This will naturally also be the case for UCITS, even more so as UCITS V is more prescriptive than AIFMD when it comes to the “reuse” of assets. In fact, the “reuse” of assets by the depositary or a sub-custodian (which could be an entity providing prime brokerage services) for own account is prohibited, and subject to strict conditions if assets are “reused” for the account of the UCITS. The term “reuse” is widely defined as comprising any transaction of assets held in custody including, but not limited to, transferring, pledging, selling and lending.

Furthermore, the due diligence requirements in respect of delegates (and sub-delegates) under UCITS V go beyond those applicable under AIFMD. For example, if the depositary appoints a delegate for the performance of safekeeping functions outside the EEA, it has to obtain independent legal advice on the enforceability of the contractual arrangement with the delegate under the applicable insolvency law and case law of the country where the delegate is located. Curiously, the term “located” is used instead of “established”, which begs the question whether legal advice is required when the depositary deals with a third country branch of an EEA institution or an EEA branch of a third country institution, with the added complication that the insolvency laws of both the country of the branch and the head office could be triggered.

On the point of delegation, it is worth noting that UCITS V replicates the segregation obligation which was initially adopted under UCITS III and echoes the unfortunate use of the expression “mutatis mutandis” in rendering provisions related to delegation and segregation applicable to sub-delegation. In the meantime, the industry is still awaiting ESMA’s guidance on asset segregation under AIFMD, following a consultation launched back in December 2014. Whatever the outcome may be, the interpretational issues, operational difficulties and risks of opening and maintaining separate omnibus accounts for AIFs, UCITS and other types of clients for depositaries and their delegates are very real and it remains difficult to see how the segregation requirements are reasonably justified to achieve their aim: investor protection.

THE ELUSIVE “TRANSITIONAL ARRANGEMENTS”

In its Q&A on UCITS, ESMA indicated rather simplistically that, while UCITS depositary contracts should be revised promptly in accordance with any transitional arrangements...
outlined in the delegated acts, the provisions of a contract which set out the parties’ agreement on depositary liability, and which conflict with the Ucits V depositary liability provisions, will be void with effect from 18 March 2016 and the Ucits V depositary liability provisions will apply instead. This seems odd, considering that the Level 2 delegated regulation detailing the depositary obligations will only apply from 13 October 2016, and does not seem to set out any transitional arrangements.

From the Ucits’ perspective, KIIDs and prospectuses will need to be updated in due course. Fairly detailed information concerning the depositary will need to be given in the prospectus, including a description of any safekeeping functions delegated by the depositary, the list of delegates and sub-delegates and any conflicts of interest that may arise from such a delegation, and a statement to the effect that up-to-date information on this point will be made available to investors on request. Esma has indicated that the Ucits will be allowed to add the relevant information to the prospectus at the next occasion it is revised for another purpose or in any event by 18 March 2017 at the latest.

REGULATION OF CUSTODIANS IN MALTA

In Malta, custodians of collective investment schemes are licensed and regulated by the MFSA under the Investment Services Act. The provisions of Ucits V were transposed into Maltese subsidiary legislation, sticking to the wording used in the Directive quite faithfully. A new set of regulations was published at the beginning of April 2016, the Investment Services Act (Custodians of Collective Investment Scheme) Regulations, which concern all custodians of collective investment schemes and contain specific provisions that apply depending on the type of fund serviced by the custodian.

Understandably, the Maltese rules and regulations for the implementation of AIFMD and Ucits V do not address the interpretation issues posed by these Directives, some of which have been mentioned above. But it must be said that the Maltese legislator and the MFSA took the opportunity to clarify and improve some of the local rules regarding the holding and control of assets by custodians of collective investment schemes. For instance, the regulations include new provisions on the consequences of termination of the depositary or custody agreement, which seek to offer a solution to situations of deadlock, when the agreement is terminated but the fund’s assets cannot be transferred or no succeeding custodian is appointed.

While many unanswered questions continue to surround EU law related to depositaries, and national competent authorities such as the MFSA become increasingly dependent on guidance from Esma and the European Commission, one thing is certain: legal and compliance staff, practitioners and industry associations of funds and their service providers have their work cut out to find workable solutions in line with the exceedingly detailed and complex body of rules promulgated at national and EU level.

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Andrew Dreaneen is head of Schroder GAIA Product and Business Development and responsible for business development of the Schroder GAIA hedge fund platform. Previously, Andrew was head of Product Development for a number of Schroders Ucits and alternative fund ranges. His career commenced in 1998 in New Zealand in alternative investment boutique, FMG.

HFMWeek (HFM): What is the main role of liquid alternatives within investors’ portfolios?
Andrew Dreaneen (AD): Since liquid alternatives can cover a broad range of strategies and asset classes, the role they play can depend on how you define them. For example, broader definitions of liquid alternatives may include 130-30 funds, even though they aren’t really hedge fund strategies as such, while others may only include strategies more familiar to offshore hedge fund investors, such as long/short or absolute return. But, ultimately, it boils down to a fundamental thinking of the balance between risk and return. Offering diversified return streams, reduced volatility and decorrelation characteristics, investors are recognising the value of blending liquid alternatives within a balanced portfolio, with the aim of enhancing risk-adjusted returns.

Interestingly, although liquid alternatives, in large part, tend to cater for the retail investor market, we are now seeing growing interest from traditional hedge fund investors and institutional investors, provided that the liquid version’s underlying strategy is consistent with the offshore parent strategy. We are seeing a lot of institutional investors look at the Ucits version and in some cases, the Ucits version has proved an attractive proposition as they can be much larger than the offshore version.

If an institutional investor wants to write out a $100m or $200m ticket, they may often prefer to be in a $2bn fund rather than a $300m fund. So, the market is evolving and it’s playing into all types of investors today.

HFM: What do liquid alternatives offer in the current market environment?
AD: Given heightened volatility, low interest rates and elevated equity market valuations, we are seeing that a broad range of investors are turning to liquid alternatives in search of genuine diversification and the ability to mitigate the impact of large market corrections.

If we look at the S&P 500, for example, from 2009 to 2010 and 2012 to 2014, these periods saw roughly 75% to 91% of stocks in the S&P 500 go up. Those were great years to be in the market, but last year we saw a big reversal with only 45% of stocks higher. In January and February of this year, we had a very large number of stocks down and we still see little sign of a stable macroeconomic environment materialising.

Given this uncertainty, investors are recognising the need to avoid playing the beta game and are looking to alternative strategies to help build a well-diversified portfolio that is able to withstand a variety of market conditions.
HFM: What areas of liquid alternatives have seen growth in recent years? What are the reasons for this?
AD: As I’ve mentioned, the period between 2009 and 2014 were, for the most part, particularly bullish years. So liquid alternative strategies that were more highly correlated to the market or more directional in nature, such as long-biased equity or 130-30 strategies, proved particularly popular. These strategies looked to maximise participation in rising markets, providing a more equity-type return with perhaps less volatility.

However, given the current environment we have seen a shift in demand to more low-net, less directional strategies that don’t seek to provide a high beta or follow broader market directions. These types of strategies, such as market-neutral or relative value, aim to generate alpha based on the relative performance of one stock or market against another, or may even look to benefit from corporate actions like M&As. These strategies rely on the individual skill of the manager and their stock-picking ability rather than seeking to play a broad market rally. This is where we’ve seen growing demand and particularly when it comes to pricing. Many liquid alternative strategies have fees comparable to offshore hedge funds, although, investors are shying away from paying these types of costs for a strategy that is highly correlated to the market.

HFM: Are there any misconceptions of liquid alternatives?
AD: It’s often misconstrued that hedge fund strategies offered in a mutual fund format are designed to perform well in all environments. However, it’s important to understand that certain alternative strategies are more directional or seek to participate in rising markets and therefore go up when markets go up. On the flipside, this infers that they will also fall when markets fall, demonstrating a moderate to high correlation to the market. So investors should understand that liquid alternatives are not a homogenous asset class. Within long/short equity, for example, strategies such as long-biased, short-biased or market-neutral can have very different risk/return profiles. Similarly, the return expectations between a quantitative and fundamental approach can also differ greatly.

Furthermore, investors shouldn’t automatically assume that the liquid version reflects the same as the offshore parent strategy. In some cases managers may create a strategy that is differentiated from the offshore version. Therefore you shouldn’t necessarily rely on the offshore strategy’s track record as a basis of how the liquid version may perform. Investors should analyse the offering carefully and understand what to expect from the strategy in different market environments.

I mentioned earlier that liquid alternative strategies can have fees comparable to offshore hedge funds. Investors should be mindful that they’re paying for genuine manager skill rather than for a manager who has ridden the wave of buoyant markets. Since alternative strategies are expected to derive a large component of, often promised, additional returns through active management, manager skill plays a crucial role. Investors should look for managers with a transparent, repeatable investment process and a long and proven track record of delivering consistent alpha across a variety of market conditions. A proven edge is vital.

HFM: What is Schroders’ experience in managing liquid alternatives?
AD: At Schroders, we manage a broad range of liquid alternative strategies across a variety of different asset classes, while our global Ucits platform, Schroder GAIA, provides investors with access to leading, externally-managed hedge funds, such as equity and credit long/short, event-driven, trend-following and catastrophe bonds. We’ve also recently extended this platform into the non-Ucits arena, through Schroder GAIA II. In doing so, we are able to offer investors a more diverse suite of liquid alternative strategies, some of which may not naturally fit within the Ucits format and are most effective outside of such a framework. For example, we recently launched a distressed securities strategy on the platform.

I’ve mentioned the importance of investors understanding exactly what they’re buying when it comes to alternatives and it’s no different for us. Manager selection is critical and at Schroders we are extremely vigilant with the managers we partner with and conduct deep due diligence. Only through this process are we able to find the most compelling strategies for our clients that can help them build robust portfolios fit to withstand a range of different market environments.

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MARKETING INTO EUROPE 2016

TECHNOLOGY IS THE KEY TO SUCCESS

Kieron O'Brien has spent almost 20 years in the financial markets. Prior to joining AQMetrics, he worked on market surveillance, data analytics and IR services projects at a leading European Exchange and ran the sales effort for an Irish and Canadian cloud and business intelligence boutique. Before his venture in RegTech, he was managing director of Rosenblatt Securities in Europe. During his tenure, he was responsible for developing the Rosenblatt in Europe where he consulted with money managers on topics including market structure, technology solutions and strategic trading assessments.

HFMWeek (HFM): How significant is technology to a fund manager looking to market into Europe? What areas are key?
Kieron O'Brien (KO): At AQMetrics, we believe that technology plays a critical role for fund managers looking to market into Europe in the future. Risk management is a key area in technological advancement. In the Ucits world, whether you are running VaR on a Ucits fund or screening for investment breaches pre-trade, it is only through the systematic approach with technology that you can be sure they know their risk and are compliant. In regards to AIFMD, technology is the key to ensuring that each nuance particular to individual jurisdictions is understood and applied at filing time. Furthermore, with MiFid II on the horizon, the specific requirements to each European country’s regulator can only be effectively met through the use of technology.

HFM: How do technology-related regulations impact funds looking to market into Europe?
KO: The Alternative Investment Fund Managers Directive (AIFMD), which came into effect in July 2014 across Europe, is already causing difficulties for asset managers. For each alternative fund, asset managers are required to submit more than 300 data fields, including the main instruments traded, investment strategies, markets where a fund traded, and principal exposures and concentrations. Additionally, certain jurisdictions require specific filing procedures, ranging from file encryption for BaFin in Germany, to Swedish and Dutch language versions of the reports for Dutch and Swedish regulators. It is truly only through technology that funds marketing in multiple jurisdictions in Europe can rest assured that they are ready to meet each jurisdictional requirement.

Furthermore, complying with MiFid II legislation will require a significant level of new streams of data to be produced in a variety of different reports to different agencies and/or divisions of such agencies. It goes without saying, technology is the only means to mitigate the risk of duplication of effort by asset managers and in turn reduce the human capital costs.

In addition to specific country and product-based regulations, funds marketing into Europe also need to be mindful of the cyber-security and data security laws in Europe.

HFM: Does technology hinder or aid funds looking to market into Europe? How?
KO: Without technology, European regulatory reporting becomes a mammoth task. For example, for the many alternative funds operating across various countries and jurisdictions in Europe, these funds may have up to 40 different reports to file on a quarterly basis, as compared to those domiciled in the US, where reports are consistent across states and therefore not differentiated.

Moreover, technology creates efficiencies, which, in turn, create better profit margins, thus making funds more attractive to investors. Technology aids funds to stand out from the crowd in Europe. We all know that investors, both retail and institutional are more risk savvy than ever before and the funds that can show robo-advisory, robo-risk and robo-compliance management are those that will attract the investors in Europe.

HFM: Are there any misconceptions about technology within the industry? Why do these exist?
KO: Technology changes the very nature of asset management transactions; however, this is already occurring with the dawn of robo-advisors. Although robo-advisors...
cause mistrust among traditional asset managers, it is proof that technology should not be feared and automation can bring great value in terms of efficiencies.

Asset management has historically been a very hands-on industry built on a foundation of relationships, networks and trust. Many firms have been cautious about investment in technology solutions because of cost and the uncertainty of future proofing any investment – the knock on effect is inevitable, i.e. vendors such as AQMetrics will find ways of alleviating these fears by offering on-demand pay as you go options, which ensure tight cost management and deliver future proofing through the very nature of their highly interactive, more transparent and low cost upfront investment models.

Technology complexity and cost are misconceptions within the industry. For years, consultants and specialists have been creating a myth of complexity around the delivery of software into the industry. We recognised this at AQMetrics on day one and decided to simplify the technology offerings to the industry by creating a one-stop shop that offers simple, effective and efficient software as a service, thus lessening the need for costly consultants and experts.

**HFM: Are many funds technology dependent, do they have a choice?**

**KO:** Funds are not technology dependent; technology is the new norm for funds. Funds don’t have a choice. With the emergency of robo-advisors, robo-risk and robo-compliance, the firms that don’t embrace technology will be facing a challenge to thrive in the future.

**HFM: What key industry trends will be of the most importance to funds marketing in Europe within the next 18 months?**

**KO:** MiFid II and the requirement for transparency leads to the greater need for technology solutions and a greater dependency on third-party data vendors. This will lead to a trend towards collaboration. Innovative asset managers partnering with software vendors to build digital capabilities into an existing platform, will gain an advantage over those that are not. For asset managers, digital technology is a competitive advantage to win market share across the various countries in Europe. It is simply not feasible to know your risk and always be compliant across Europe without embracing digital technology. The European regulatory nuances across countries means that computer-driven solutions using algorithmic risk assessments and automatic compliance reporting according to jurisdictions will continue to be one of the most important industry trends for funds marketing in Europe.
KNOWING ALTERNATIVE UCITS
HFMWeek (HFM): Can you provide a general update on the alternative UCITS industry?

Daniele Spada (DS): Firstly, and most importantly, there is a strong demand and an even stronger appetite for alternative UCITS. In terms of evidence, recent figures released by Morningstar highlight the success which the last two years have borne witness to and emphasises asset growth.

This year, despite a rather slow beginning, the figures suggest that an emerging positive trend looks set to continue. January and February of 2016 saw a relatively low number of inflows, but March certainly shook off any New Year fragilities and volatility. Initially, during this low ebb, investors were simply wondering what the next step would be and were retaining the level of cash before deciding what kind of investment to make in the volatile markets. With more than €3.5bn of assets in the UCITS space, March serves as confirmation that a strong interest for alternative UCITS remains. A change in investor attitude has birthed a hunt for UCITS alternatives that offer more volatility control and greater risk management.

At Lyxor, in terms of growth, we are in line with the industry, and in some respects, see even more. Take our UCITS platform for example, there was a growth rate in AuMs in 2015 that was slightly higher than the industry, which grew by roughly 30%. And, in terms of assets under management, we have now reached $2bn overall with our eight funds in the UCITS range.

The proof is evident and it is clear that a strong demand remains. In regards of the future, a correlation between our statistics and industry-wide figures indicate that the trend exists, and we expect it to continue.

HFM: The UCITS format was not created entirely for hedge funds and is more appropriate for less sophisticated investors. How do you explain such appetite for UCITS hedge funds when taking this into consideration?

DS: Primarily, UCITS is not a regulation comprised only for hedge fund investments. UCITS and alternative UCITS have, and answer to, the same regulation. So, why are we experiencing such a big success?

The answer happens to be contained within the question. Investors are searching for true alternatives, but in a form which is both well-known and well-respected by their boards, risk managers and clients alike. Thus, proposing an “alternative” way of investing in the same asset classes than the UCITS long-only funds, but following the same regulation, is hugely reassuring for them. Moreover, this regulation and these type of funds are already validated and there is no requirement to gain specific internal approval to invest in alternative UCITS. This success explains why more and more hedge fund managers want to propose their strategies in a UCITS format, directly or via a platform like Lyxor. Recognisability is the key in the acceptance of this format by institutions and private clients.

HFM: How do you see the UCITS industry developing? What key industry trends will be of the most significance?

DS: Firstly, I believe that the industry is developing rather impressively. This is mainly due to the current market context and given the fact that, on the equity side, valuations are rich in the majority of the equity markets and that the current volatile market can last for a while.

In regards to fixed income, it is supremely difficult to anticipate that further profit can be made. Any decision maker will have to look beyond the standard long-only investments. Inevitably, there will be an increasing need for alternative sources of return and a search for less correlated and alpha-driven investments. And, for those who will be conducting this search, alternative UCITS will be the solution. Alternative UCITS is here to stay and we envisage it to remain for the foreseeable future.

At Lyxor, we scour the globe for talented managers with true “hedge fund” skills and spend a significant amount of internal resources to propose strategies that are underrepresented in the UCITS universe. We propose strategies and managers that are aligned with the current market context. The vast majority of meetings that we conduct with investors surround a small number of simple questions; i) how can I replace (usually partially) my long-only exposure in Europe or in the global equity markets with a long/short equity fund or ii) do you have specific long/short equity market neutral funds. There is a constant pursuit of talented managers that we would like to provide a platform for. Our analysts research specific skill sets throughout the hedge fund world and to date, we have a couple of advanced discussions that should enable us to welcome at least two additional managers by the end of the year. Investors are looking for strategies with less directionality, different sources of alpha, less volatile returns, all packaged in a regulated, transparent and risk controlled framework, the UCITS format.

In terms of remaining a market-leader, we pride ourselves on our history. Lyxor is widely acknowledged in uncovering talented managers in the offshore world and proposing them through transparent and risk controlled managed accounts. Behind the scenes, our powerful group of engineers and solution providers are able to convert hedge fund strategies, even some complex and innovative ones, into a UCITS format. From time to time, it is important to innovate in appeal to the masses, who, above all else, may just want to see something a little different.

Daniele Spada, of Lyxor, speaks to HFMWeek about the alternative UCITS market and what vital trends will have the most impact to its development.

“THERE IS A VAST AMOUNT OF ATTENTION PLACED ON TRUE ALTERNATIVES TO LONG-ONLY INVESTMENTS”

Daniele Spada

Is head of managed account platform at Lyxor, where he is in charge of the development and management of the platform, including hedge fund and mutual fund selection, due diligence, and customised infrastructure services. He joined Lyxor in 2007, is a director of a number of investment funds managed by Lyxor and was appointed to his current position in 2014.
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MEETING REPORTING OBLIGATIONS

NICK BALDWIN, DIRECTOR AT ARKK COMPLIANCE, HIGHLIGHTS THE IMPORTANCE OF MEETING REPORTING OBLIGATIONS AND THE POTENTIAL CONSEQUENCES FOR THOSE WHO DON’T

HFMWeek (HFM): Are enough fund managers prepared to meet reporting obligations?
Nick Baldwin (NB): So far, our experience in 2016 has been that few fund managers still struggle to meet their AIFMD submission deadlines. Filing periods remain tight and data sourcing can still be challenging – but these are not the new challenges they were in 2014 when we first helped filers make their Annex IV returns. Most compliance teams are used to their reporting cycles by now.

The most common issues that we encounter these days concern the quality of reporting. An Annex IV return can comfortably clear the validation checks of any national authority gateway and still contain glaring inaccuracies, inconsistencies and omissions. Towards the end of 2015 we started to hear of more direct communications from some regulators concerning accuracy and completeness of AIFMD returns, and in some cases, requests for resubmissions. HFMWeek revealed back in January that the UK FCA was investigating 67 AIFMs for regulatory breaches, and in terms of preparedness, it is this increased level of scrutiny for which fund managers may be less well-prepared.

HFM: Do reporting obligations deter prospective fund managers from marketing in Europe? Why?
NB: Cost of compliance will always be a factor when making the decision to market, but we don’t see a lot of evidence of the AIFMD transparency obligations being pivotal in this. Successful fund managers will naturally think strategy first and most compliance teams are fairly resilient to new reporting requirements.

The exceptions, as you might expect, are those non-EEA firms with lower AUMs wishing to market into the Union. We assist some firms from North America and Asia who don’t have large compliance teams and acknowledge that they would find it difficult to report under multiple National Private Placement Regimes without outsourcing some of the effort. These are the filers that are most excited about the proposed extensions of AIFMD porting to non-EEA financial centres since the relative compliance cost savings could make quite a difference.

HFM: What will happen to fund managers who do not meet reporting obligations?
NB: We know that what can happen is very serious indeed. At a supranational level, the Directive spells out the requirement for member states to impose penalties on responsible persons and allow public disclosure of punishments for infractions. At a national level different regimes are enshrined in law but the common message is that ultimately penalties can be very severe.

What managers really want to know, however, is what the short-term effects of poor-quality reporting look like. Competent authorities are consistent in their initial approach that it is preferable to correct and assist filers rather than hand down punishments. We have yet to encounter a filer that has been formally admonished for AIFMD non-compliance, but we have helped a number of fund managers make resubmissions of old Annex IV returns at the request of their regulator. For compliance teams that are under pressure to maximise efficiency this can be punishment in itself.

To date, the cases we have seen of regulators contacting filers directly are relatively sporadic, but the trend is that they are increasingly frequent and broadening in their requests. We are always keen to impress upon managers the benefits of addressing quality issues as early as possible – correcting inaccurate or incomplete returns becomes
harder the older they get, and regulators are more likely to accommodate filers that are pro-active in requesting revisions.

**HFM:** How can managers retain ownership of their reporting while outsourcing to a third-party provider?

**NB:** Outsourcing providers have a responsibility to ensure fund managers understand their disclosure and do not simply sign it off, but finding sufficient time during filing periods to ensure this always happens can be difficult. The best approach we have found for Annex IV reporting is to meet with the client during a quieter time at the start of an engagement and agree on the methodologies and assumptions to be employed in preparation of the live returns. This also allows time to address any regulatory knowledge gaps so the individual signing off the returns understands what they are reviewing.

Something else that we find important is accommodating filer preferences when it comes to making live Annex IV submissions. The electronic filing stage is where third-party specialists can add a lot of value to the reporting process, but the function needs to be undertaken within the rules and in a way that suits the filer. This could mean carrying out filings at the client premises, using shared online workspaces, or simply talking the filer through the process over the phone.

**HFM:** Over the next five years, what current industry reporting-related trends will be of the most importance to fund managers marketing in Europe?

**NB:** The most significant trend will be the increased availability and scrutiny of disclosure data. You may say this could be applied to most spheres of compliance, but our expectation is for AIFMD filers in particular to see a very clear upward trend in the level of transparency and interrogation of reported information over the next two to three years. We are already seeing the end of the soft-touch Annex IV phase in some authorities, and regulators that have invested heavily in electronic infrastructure will feel some pressure to demonstrate value. At a supranational level, the appetite for greater oversight of a purportedly light-regulation industry shows little sign of abating.

In response, we expect to see the continuation of another current trend over the next five years – increased outsourcing of specific compliance roles to specialist firms. AIFMD reporting is a very good example of where specialist knowledge, experience and technology can be applied effectively at key points in a reporting cycle to greatly improve the efficiency of a firm’s compliance function. This is particularly the case for firms required to comply with multiple regulatory authorities under National Private Placement Regimes.

The upward trends in regulation will not be welcomed by fund managers, but it should be possible to take some positives from the process of applying greater rigour to firms’ reporting processes. Many AIFMD filers have sharpened up their data infrastructure in response to the new requirements, and the Annex IV returns themselves often make filers look at their fund data from a different perspective. With greater efficiency of reporting and familiarity of the requirements, the next few years of AIFMD compliance need not be an uphill struggle.
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