The Interview – Chris Day and George Cadbury, Merchant Capital: “There is a massive opportunity for high-calibre managers to raise money through a Ucits structure”

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Merchant Capital directors Chris Day (pictured) and George Cadbury say the firm, which last year launched the first Dublin-domiciled Ucits umbrella fund created specifically for Ucits absolute return funds, is looking to launch up to 10 funds over the course of 2010 following the debut of the long/short Merchant European Equity Fund in January.

GFM: What is the background to your company and funds?

CD/GC: Merchant Capital launched Merchant Funds, the first Ucits hedge fund-specific Dublin-domiciled Ucits umbrella fund, at the end of 2009, offering managers the opportunity to launch Ucits-compliant sub-funds under the umbrella. Merchant Capital acts as investment manager and offers the hedge fund manager either an advisory or sub-management role in managing the sub-fund. This reduces the barriers to entry in this relatively new environment for absolute return funds.

We used to run PCE Investors, one of the largest independent UK fund incubators and infrastructure providers to offshore hedge funds, which focused on providing operational, risk and compliance support to its managers. Transferring our experience to this new business model allows Merchant to develop and support the complex infrastructure inherent in Ucits funds.

Each of the sub-cells has a different strategy and investment procedure, which under Ucits rules are scripted and reviewed by the regulator. Each fund uses its own investment process and Merchant endeavours to create a diversity of strategies under the umbrella.

Merchant Capital works closely with PNC Global Investment Servicing, the firm’s administrator, and Kinetic Partners for risk management, to provide a seamless methodology for clients. This allows the manager to focus on asset management while this triumvirate of parties, overseen by Merchant Capital, guarantees adherence with the Ucits regulations. Our independence is ensured by working with Carne Group, which provides directorships and corporate services, and essentially providing independent financing to the directors.

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The Merchant European Equity Fund, a European equity long/short strategy managed by Robert Maxwell, began trading at the end of January as the first fund to launch under the umbrella. The fund is distributed by Tressis, a large wealth manager based in Spain.

GFM: What is the structure of your fund?

CD/GC: Merchant Funds is domiciled in Ireland and structured as a corporate entity under the regulation of the Irish Financial Services Regulatory Authority. Merchant Capital is the promoter and investment manager and is authorised and regulated by the Financial Services Authority in the UK. Via an advisory or sub-management agreement, Merchant Capital appoints managers to advise or sub-manage the underlying segregated cell, which can be branded in a format suitable to the client.

GFM: Who are your key service providers?

CD/GC: The administrator is PNC Global Investment Servicing and the custodian is PNC International Bank. Our auditor is Grant Thornton and our law firm is Maples & Calder.

GFM: How and where do you distribute the funds? What is the profile of your targeted client base?

CD/GC: We have signed up a number of distributors, allowing us global reach to investors of all categories. Over the next 12 months we will focus on building exposure to the private wealth and retail market, though this must be done within the European distribution guidelines. There is also huge demand for Ucits-compliant products emerging from investors in Asia and South America, where we are currently assessing numerous potential outlets.

GFM: How would you assess the impact of the recent global financial crisis and economic downturn on your business?

CD/GC: The financial crisis has been favourable to the Ucits concept because investors are now demanding transparency, liquidity and the reduction of counterparty risk, all of which fall comfortably within a properly structured Ucits III framework. Merchant Capital is being approached by a number of investors which, having identified investment targets, are asking us to provide appropriate Ucits versions of existing hedge funds.

GFM: What is your approach to managing risk?

CD/GC: Merchant Funds has a risk monitoring programme that has been reviewed by the regulator. Each fund must adhere to the general programme, and this is complemented by the adoption of fund-specific risk processes developed in conjunction with the manager and Kinetic Partners, our independent risk monitoring provider. The independence of the risk monitoring service is an integral part in ensuring our product works. It is led by Dr Christian Szylar at Kinetic, whom we are fortunate to have as part of our team.

The functions carried out by the risk monitoring programme are daily risk reports detailing value at risk analyses, stress testing, back testing and scenario testing, the generation of monthly summary reports and of quarterly board reports.

GFM: What opportunities are you looking at right now?

CD/GC: We are actively appointing high-quality managers who appreciate the opportunities presented by Ucits – increased transparency, liquidity and risk management for investors, and expanding distribution capabilities for managers. Merchant Funds is expanding its distribution channels as well as seeking new managers.

GFM: What events do you expect to see in your sector in the coming year?

CD/GC: One of the major events will be the introduction of Ucits IV in mid-2011, along with the implementation of the EU Alternative Investment Fund Managers Directive and the gathering

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momentum of alternative funds being launched. At present only an estimated USD35bn is dedicated to alternative funds out of an overall Ucits market of USD7trn. There will also be increasing interest in alternative Ucits funds from the retail sector, perhaps not directly but certainly from distributors of retail products, which represent an opportunity to increase assets under management.

GFM: What differentiates you from other managers in your sector?

CD/GC: There are very few other Ucits umbrella funds that can provide the flexibility, speed to market and expertise provided by Merchant. Using the extensive experience acquired in our previous positions, we are well versed in providing the support mechanisms for a competitive and viable business model.

GFM: How do you view the environment for fundraising over the coming 12 months?

CD/GC: There is clearly a massive opportunity for high-calibre managers to raise money through a Ucits structure. Investors want access to risk managers who can protect their capital regardless of market conditions, and if the right product is marketed to investors and private wealth managers who can fully understand the product, there is no reason why assets under management should not grow significantly.

GFM: Are you considering any mergers or acquisitions in the foreseeable future?

CD/GC: We are currently looking at purchasing distributors, but this will not be finalised until the end of the year. Until Ucits IV is implemented, there is no straightforward way of merging Ucits funds.

GFM: Do you have any firm plans for further product launches?

CD/GC: We are looking to launch in the region of 10 funds during the course of 2010.

- Absolute Return

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