Meeting the challenges of regulatory change

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The alternative fund industry may have experienced a difficult couple of years following the economic crisis and downturn, but HSBC believes that with market stabilisation, greater competitiveness in areas such as costs and international endorsement of its strong regulatory structure, Ireland is well placed to benefit from the upturn underway in the hedge fund sector.

At the height of the crisis in late 2008 and the first half of 2009, the industry saw many hedge fund and fund of funds clients hit by asset outflows. During that period HSBC worked closely to help its administration and custody clients preserve their businesses through restructuring and mechanisms such as the side-pocketing of assets and gating of redemptions.

The ability of funds to meet repayment and margin requirements became a key issue for some providers. HSBC's financial strength meant not only that it did not need to seek government funding, but that it retained the capacity to extend credit to its clients. Retaining open lines of communication and helping clients to pull through temporarily difficult times has strengthened relationships as the economic environment becomes more benign.

Today some of those managers are enjoying rapid growth – especially funds of funds, which are defying predictions that their business did not have a long-term future. In the past six months fund of funds managers with a loyal investor base and a robust due diligence process have been attracting money again, notably from institutions such as pension funds and charitable foundations that were not prominent investors in the past. They still offer institutional investors the best form of hedge fund diversification available.

The main challenge for service providers in 2010 and 2011 is increasing regulation ,, including a focus on increased transparency, independence in the valuation process and safety of assets in custody, plus an increase in capital requirements stemming from the 'strict liability' clause proposed in the European Union's Alternative Investment Fund Managers Directive. Providers will have to use their balance sheets to meet this obligation, unless an insurance-based liability solution becomes available.

Lack of balance sheet strength could eventually force out less robust administrators as business gravitates toward firms capable of standing behind the pricing of the funds they administer. Amid a shift from the offshore model to a more regulated environment, operating at current cost-income ratios may present a challenge if firms cannot bring in additional revenue by offering more services.

HSBC has responded by establishing a prime services business bringing together its existing custody and global markets activities. This combines the segregation of assets so important to hedge fund managers post-Lehman with the flexibility of prime brokers in using their assets to generate leverage. HSBC can now offer clients economies of scale through its ability to act as custodian, prime broker and administrator.

This one-stop shop approach may become more important in the coming years, especially as the implementation of Ucits IV presents the industry with challenges such as product complexity, cost pressures, new regulatory and disclosure requirements, and the need to handle larger and more intricate distribution channels.

The complexity of cross-border servicing requires systems and expertise to operate across diverse business environments. A provider with an unrivalled global presence, strong balance sheet and extensive experience in the fund services industry will be well placed to meet clients' needs.

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Please click here to read the full Hedgeweek special report on Ireland Hegde Fund Services 2010 [1]

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