Alternative providers look outside for management expertise

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Created *21/07/2008 - 17:46*

Foreign hedge fund managers may find themselves unable to access the fledgling Spanish market directly without going to the cost and trouble of setting up their own management company and funds inside the country, but there are plenty of other ways in which the expertise of seasoned industry professionals and firms can be tapped for the benefit of local institutional and retail investors.

In order to obtain authorisation from the country's securities and stock market regulator, the CNMV, hedge fund managers need to demonstrate experience and capability in the sector, which may not be difficult for large and diversified financial services groups with extensive international operations, like BBVA and Santander, but can pose problems for some of Spain's new breed of independent alternative asset managers.

'In the absence of in-house experience and capability in many fund management firms in Spain, most of them have been entering into agreements with foreign manager with the required expertise and track record,' says Juan Sosa Pons-Sorolla, a managing associate with law firm Simmons & Simmons Mochales & Palacios in Madrid. 'Unless they are able to recruit individuals with the necessary qualities, fund managers seeking to enter the hedge fund business are delegating investment management to companies abroad.'

Sosa reckons that as many 90 per cent of Spanish managers of hedge funds have entered into delegation agreements with foreign managers, although this includes Spanish-owned operations originally set up to serve international investors, such as Optimal Investment Services, a Geneva-based fund of hedge funds management business established by the Santander group nearly 20 years ago. 'Firms are calling in outside expertise not only because of regulatory requirements but because they see the benefits of accessing the experience and track record of a foreign partner,' he says.

Carlos Dexeis, managing partner of Madrid-based fund of hedge funds manager Altex Partners, notes: 'No big asset manager in the world will establish an investment management company just for one market. For them it is much better to make an agreement with people like us to achieve distribution in the market. We are opening doors for them, and they save on having to open an independent establishment in Spain, or having local staff.'

However, in a market where asset growth has been relatively sedate so far, foreign managers are not having it all their own way, according to Ander Lopez, head of alternative investments for Spain at Lyxor Asset Management, which provides due diligence and asset allocation for alternative investments to a number of medium-sized asset managers and also provides Ucits III funds to Spanish investors.

'While the biggest local asset management companies like Santander or BBVA already have their own hedge fund platforms or managers such as Altitude [a joint venture between BBVA and a subsidiary of Schroders] or Optimal, savings banks and other institutions without the resources to manage their own funds of funds have signed advisory agreements with external advisers,' he says.

'In 2004 and 2005 all the international managers were in Spain because they thought it would be El Dorado, but now some of them are less positive. They signed advisory agreements with local banks in order to gather as much as EUR50m or EUR100m, but they have realised that after one year the assets are quite small, EUR6m to EUR10m in some cases, and they don't really pay for the advisor's ticket to come to the local bank once a quarter.'

According to Lopez, there have also been differences between foreign managers and their local partners over levels of service and information, and also about the external manager's long-term plans in the market. 'Spanish banks are very demanding in terms of the service and information they require from the adviser,' he says.

'Sometimes the advisers cannot provide the level of information requested, or they don't want to because the client is really small. The relationship may also not be good because the bank thinks the international advisers have made contact with them only to learn, and that they will strike out on their own once they have the knowledge to launch their own funds.'

But other players in the market say that these relationships can work well. For example Altex Partners, which has four products registered in Spain and a total of more than USD300m in assets under management, including funds domiciled in Ireland, Luxembourg and the Cayman Islands, launched in March a fund that invests exclusively in single-manager products from GLG Partners.

'The fund of hedge funds has started with 12 GLG managers, with allocations to each manager of around 8 per cent, and the idea is to replicate more or less what GLG has been able to do in the hedge fund world for the Spanish market,' Dexeis says. 'It is a Ucits III product, which makes it eligible for many portfolios and enables us to sell it in the retail market in Spain, and it also enables investors to switch from other funds into our funds without paying capital gains tax on their profits.'

The firm's other Spanish-registered funds include Altex Global Vision, which was launched in April 2007 and expresses macro views through hedge funds, and Altex Low Risk, a conservative, low-volatility fund of funds introduced the following June; the latest product, Altex Arb & Quant, was registered with the CNMV in April. Its Luxembourg range, a Sicav umbrella structure with underlying funds of funds, is mainly aimed at institutional investors and Swiss private banks.

Interplay between domestic and offshore funds is becoming a growing feature of the market's development, according to Daniel Gonzalez, head of fund services for Spain with BNP Paribas, which provides custody and or administration to a large proportion of the hedge funds and funds of funds offered by independent managers.

'We have seen fund managers established to launch a Spanish-domiciled hedge fund, and to sell this fund abroad they have created an offshore clone,' he says. 'There are problems convincing investors in London or New York to invest in Spanish-domiciled single-manager hedge funds, so they create a Cayman fund with the same investment policy and the structure to sell it abroad.

'This is not a bad strategy for the Spanish industry because they maintain the asset management expertise locally but sell this know-how abroad through an offshore fund. This is in line with the desire of the regulator to see expertise being established in Spain. However, a contradictory trend is for international managers to set up Spanish vehicles that invest in offshore funds, because it's easier to sell these funds to Spanish clients through a locally-domiciled fund. This will not help to develop the Spanish market.'

BNP Paribas is one of the beneficiaries of increasing demand for sophisticated administration and custody services generated by alternative funds. Lopez, who covers the whole of the Iberian peninsula for Lyxor, says: 'Some very well known groups have been providing services to asset managers, but there is not a lot of experience in the local market in calculating NAVs for these vehicles. A number of big asset managers have signed sub-custody or administration contracts with external providers for their funds of funds.'

Gonzalez says BNP Paribas enjoys an advantage in offering its services to Spanish managers because it can offer depository banking and fund administration services for both offshore and onshore hedge funds, thanks to its substantial presence in international fund services hubs including Dublin, Luxembourg and Cayman.

He adds: 'We have seen big providers such as Citco marketing administration services to Spanish funds, but they don't have an office in Spain and have problems understanding the specific characteristics of the market, such as NAV calculation and certain accounting and regulatory reporting issues. We can serve onshore or offshore funds and by contrast, we have the local expertise.'

However, the conundrum for asset managers is how to speed market penetration of the new products. 'Demand is catching up slowly,' Dexeis says. 'The current turmoil in the market is helping us, because the Spanish market up to now has been dominated by fixed income and credit.

'The problem the industry is facing now is that people are reassessing their investments because of the very poor performance of the markets around the world. People are rethinking whether they should put their money into funds, or simply put it under the mattress. But those who want to stay invested are more and more receptive right now, because in absolute terms the value fixed income will deliver is small.'

Nevertheless, bank deposits remain the default option for many investors, Gonzalez says, because they offer high returns with no risk. 'It's funny that one of the most sophisticated investment vehicles sees as its competitor one of the simplest, but with interest rates as high as 5 per cent on deposit it's difficult to sell a product that targets 6 per cent with higher volatility.'

At least part of the problem lies in the country's distribution structure, with few independent intermediaries active in the domestic (as opposed to expatriate) market, where the big financial groups and savings banks continue to dominate. 'Even asset managers express scepticism about their ability to sell their own funds,' he says.

'The asset management entities in the banks may be launching hedge funds but they have problems selling to their own distribution networks, which are more used to bank deposits and may not want to take the risk of selling something that might not make money in the coming months. There may be problems with liquidity. People used to investing in products that offer liquidity on a daily basis have problems understanding that there is only monthly NAV that takes several weeks to calculate.'

Nevertheless, Gonzalez says: 'Managers have been complaining that in this environment it is more difficult to sell these products. I believe it should be the opposite, because hedge funds and funds of funds are selling absolute returns, so these should be the ideal conditions for alternative funds. I don't understand why the asset managers are complaining - it should be more difficult to sell hedge funds when traditional funds are gaining value.'

The coming year will be crucial for the market, according to Gonzalez's BNP colleague Elena Mesonero, head of coverage for institutional investors. 'We have seen many funds launched that don't yet have enough assets under management,' she says. 'By 2009 these funds will either have become bigger or will have closed. We also expect some managers and family offices to launch highly specialised single-manager hedge funds aimed at private clients. I don't expect many more funds to be created, as managers focus on the funds they had approved in 2007 and developing the track record they need to convince investors.'

Gonzalez adds: 'The market is waiting impatiently for assets to grow, because the average fund size remains very small, especially for a country like Spain. We need to increase the size of funds to make the industry profitable and attractive for asset managers and service providers alike.'

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