AIFMD Fund Services 2016

How to select the right AIFM provider in Europe
Platforms provide pathway to AIFM status
What to consider when selecting an AIF depositary
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Two of the most important considerations for any hedge fund manager under AIFMD are deciding on who to appoint as an external AIFM (or “Management Company”) and also who to appoint as a depositary; the latter of which is discussed later in this report.

As registered AIFMs, European hedge fund managers are required to separate out their portfolio management and risk management functions. That is fine for established managers with well-developed front to back teams.

But for smaller managers, who only just qualify as AIFMs by exceeding the EUR100m, they may not have sufficient capital and may not be able to adequately separate key management functions to ensure good governance is in place.

Show me the way
This is why the third party AIFM solution has become such a vital solution; not just for start-ups but also for non-EU managers looking for the most cost- and operationally-efficient route into Europe. Often they need guidance on the most appropriate fund structure, whether to set the fund up themselves or establish a sub-fund on a platform, and so on.

“For us, the starting point is determining where the divisions are going to lie,” says David Hammond, General Counsel at ML Capital, who operate the MontLake UCITS Platform and MontLake QIAIF Platform out of Dublin. “Let’s assume they want to go down the full outsourcing route. The manager would need to design the product, and depending on the strategy decide whether it would best work under a UCITS wrapper or an AIFMD wrapper. We would check to see whether there is investor appetite for the product, which could depend on pricing, fee structures, etc.

*Then you’ve got to consider the...
distribution framework: what kind of investors is the manager hoping to attract with the fund? Which EU markets will they be targeting? This is a key consideration because you could spend a lot of time on the operational side of the fund, getting it launched, but if you overlook the marketing considerations, all that work in the early stages might be wasted."

Deciding on whether to use an AIFM’s fund platform, or to set up a standalone fund depends on the will of the individual manager. “It may depend on factors such as branding, what the expected fund AUM will be, whether the manager wants to benefit from economies of scale by running a sub-fund on the platform. The point is, we can cater for managers in all scenarios,” says Cyril Delamare, CEO of ML Capital.

The AIFM’s track record
Andrew Frost is Director, Investment Solutions at Lawson Conner, a London-based specialist fund manager platform providing FCA license coverage as well as AIFM hosting services. He says that a key criteria when selecting an external AIFM is that they are tried and tested and have a demonstrable track record; one that has made a meaningful impact for its clients.

“In my view, one needs to look at the type of managers and strategies the AIFM has hosted, which in turn should dictate whether they have the right operational infrastructure in place to effectively carry out the role of a third party ManCo.

“I think it’s prudent to look for an AIFM with a four- or five-year track record of outsourced compliance and regulatory umbrella services. Lawson Conner has a team of 26 people including legal and regulatory experts, structuring experts, compliance experts. That’s all we do, 24/7.

“Finally, one point that is advantageous is to look for an AIFM whose teams have practitioner experience. Our team has worked previously for hedge funds, custodians and administrators so we have an innate knowledge of what our clients are looking to achieve and how we can provide that.

“Operational infrastructure, track record, experience of the senior management team: these are all extremely important aspects that need to be considered,” outlines Frost.

“I think it’s prudent to look for an AIFM with a four- or five-year track record of outsourced compliance and regulatory umbrella services.”

Andrew Frost, Lawson Conner

Other less obvious considerations might include: Can the AIFM provide capital introduction support? Can they assist on tax/VAT, staff payroll and accounting? Are they able to provide premises for the investment manager to run their fund? These can all help sway the manager one way or the other when it comes to narrowing down their short list.

Cost considerations
One of the biggest fears that new managers have is the cost of getting to market given the breadth and complexity within the hedge fund industry. New talent is vital; it is the lifeblood. To help break down the perceived cost barriers to entry, Cordium provides a unique pathway to becoming, should the manager wish, their own AIFM, without having to wait months on end to receive their regulatory license.

“Our customer base tends to be people who are looking for an institutional quality product. They want to make sure they can pass institutional investor due diligence, and that the firm providing the regulatory and AIFM hosting service has a strong reputation; not financial skin in the game but reputational risk in the game. We do this by providing a flat monthly fee. Some UCITS ManCos which have evolved to become ‘Super ManCos’ under AIFMD have continued to use a basis point fee model, which doesn’t necessarily make sense within the AIFM world,” explains Joe Vittoria, Chief Executive Officer, Mirabella Financial Services. Mirabella is a regulatory hosting platform that enables managers to get their strategies up and running in quick time, by availing of Mirabella’s FCA license.

Managers then have the choice to remain on Mirabella for as long as they feel...
Regulatory reporting remains a pertinent issue for a lot of fund managers under AIFMD. One of the attractions of going with a fully outsourced AIFM, which can also provide sub-fund capabilities for those dipping their toe into Europe, is that the reporting and operational compliance function is taken care of.

But for those managers who wish to continue to privately place their offshore funds into Europe, the regulatory reporting requirement under Annex IV is a key operational task; and one that they increasingly rely on their fund administrator to help with.

ConceptONE, LLC, which specialises in regulatory reporting and risk and portfolio analytics, has developed a regulatory enterprise risk management solution - RegERMTM - to meet the regulatory reporting challenge. A holistic solution, it arms managers with the tools needed to meet today’s myriad reporting needs: not just Annex IV, but Form PF, CPO-PQR under Dodd Frank and EMIR.

"ManCo or no ManCo, our technology can support either scenario," says Ethan Wishnick, Associate General Counsel & Vice President, ConceptONE, LLC. "We work closely with the funds' administrators and other service providers to take as much of the reporting process into our own hands as possible. We find that this works particularly well when managers are going through their first Annex IV filing."

By aggregating the fund data directly from the administrator, outsourced risk provider etc., into the ConceptONE system, it provides a single interface to easily review all of the regulatory information prior to filing.

This is especially helpful for third party AIFMs looking to attract business from non-EU managers as it helps reassure them that the process of running an EU AIF need not be an operational nightmare. "It takes a significant workload off the fund, knowing that the AIFM only has to review the filing that we put together for them.

“That said, we only have a small number of managers currently using an outsourced AIFM. When we speak to new managers, many often decide that the ManCo option is not right for them. By choosing a ManCo you give up a significant amount of control of your business to someone else and I think that is the biggest concern that we are hearing among clients, particularly in the US,” says Wishnick.

This is a cultural shift that will take time to establish. It is a new concept for private funds and private fund managers to go with the outsourced AIFM option, "but it will be a growing business in Europe based on the success of the external ManCo under UCITS," adds Wishnick. He notes that the level of dialogue is increasing with ManCos to provide them with regulatory reporting, risk and portfolio analytics reporting, so that they can provide a more complete package to managers who join their platforms and launch funds in Europe.

"We’ve spoken to a few AIFMs recently who are looking for something like our RegERM solution. But, the majority of interest we are fielding is coming from mid-sized and smaller fund administrators who want to provide this service to their fund manager clients. Especially as US managers are choosing to continue either with reverse solicitation or to market their fund(s) into selective European markets under the NPPRs.

“It would be interesting to know whether the ManCos are pushing their fund administrators to have such capabilities in place rather than take on the burden themselves," concludes Wishnick.
comfortable once they have received their FCA license, and avail of its AIFM services, or take the next step forward and establish their own AIFM. This is made possible using the Cordium Total AIFM Solution (‘CTAS’), where the manager owns the AIFM outright and Cordium operates it on their behalf, in full compliance with AIFMD.

“We work in some respects like an octopus where the tentacles cover everything, giving us control so we can see what’s going on. But the minute the manager becomes licensed, we can disappear without causing disruption. It’s important to us that that transition is done as smoothly as possible. Using CTAS, Cordium can then maintain all of the risk and operational processes, governance processes, on an ongoing basis,” says Vittoria.

“Clients can start with Mirabella, set up their own AIFM with CTAS and everything they’ve enjoyed, operationally speaking, under Mirabella continues as normal. It is a proper partnership approach,” emphasises Adam de Domenico, Chief Executive Officer, Cordium (Malta).

**Taking control**

The above arrangement helps to address another concern that managers have - moreso established managers - and that is the issue of control. In Europe, under the UCITS regime, EU-based managers have long had time to understand the concept of appointing an external ManCo. But in the US, the concept of handing over control of the management entity is anathema. It just doesn’t happen.

“There is an optical consideration among SWFs and big pension schemes who may like someone’s strategy but need them to be fully authorised in their own right, and have their own AIFM. We have onboarded numerous clients who, at the same time, have asked us to help them get authorised as their own AIFM. We can provide a lot of efficiencies with our technology in terms of helping the manager get licensed by the FCA. If we can onboard someone, get them up and running, and then six or seven months later they become fully authorised, that’s a great result,” says Frost.

He confirms that Lawson Conner has in excess of 50 fund manager relationships, of which it acts as the appointed AIFM to approximately 30 of them.

**Risk management**

Risk management is one of the most important roles of the AIFM under AIFMD and this ties in closely with the issue of control. Again, for those established managers that are considering an EU AIF, the last thing they want is for the appointed AIFM to interfere with their risk processes and procedures. As one administration specialist points out, it is a case of the AIFM understanding what the fund manager’s risk processes are “to ensure we can properly segregate the risk management function from the portfolio management function under AIFMD. For some it might even be an enhanced risk management process, depending on the amount they’ve spent internally, so this is potential value-add that we can offer as the AIFM.”

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Joe Vittoria, Cordium
UCITS and AIFMD platforms provide gateway into Europe

Interview with Cyril Delamare & David Hammond

For EU and non-EU managers, the ability to choose between AIFMD or UCITS regimes to bring a regulated fund product to market with minimal fuss is a compelling one. With its unique business model, ML Capital has proven to the marketplace that there are many ways to scale the walls of so-called “Fortress Europe”.

ML Capital operates two Dublin-domiciled platforms that between them are capable of supporting a wide range of alternative investment strategies, from the most liquid end of the scale to the most illiquid end. The MontLake UCITS Platform was established in October 2010, while the MontLake QIAIF Platform, the AIFMD compliant solution, was established in December 2014, providing a dual-pronged route to access European investors.

“ML Capital is unique in what we offer,” says CEO Cyril Delamare. “We cater for any type of European fund structure and position ourselves as the one-stop shop from a structuring perspective and distribution in Europe from our headquarters in Dublin.”

David Hammond is General Counsel at ML Capital. He highlights that the direction of the market has become clear – whether it is from a regulator’s viewpoint or an investor’s, “it is around more substance and more quality. If you want to present an investment opportunity to investors it has to tick as many boxes as possible e.g. that it delivers returns in the right sleeve from a tax perspective and that it is fully onshore and regulated. From a manager’s perspective, they want reassurance that the route for setting up a regulated fund is user-friendly. They want to know that the regulatory and operational considerations needed for a regulated fund to work well are all taken care of.”

Running a regulated fund – UCITS or AIF – is potentially daunting for any manager and comes with a myriad of operational considerations. As Hammond articulates, “we like to think of ourselves as the glue that holds everything together and makes the operation work in such a way that it allows the fund manager to concentrate on generating performance and marketing the fund to potential investors.”

ML Capital helps fund managers “by carefully project managing every fund launch, taking into account the requirement of the regulator and service providers whilst making the product attractive to investors in a time efficient manner,” notes Delamare.

Managers can choose to work with ML Capital by joining its platform offering, where they elect to set up a sub-fund, or by using them for standalone fund services. With respect to the former, this is a fully outsourced solution where the manager joins either the MontLake UCITS or MontLake QIAIF platform and ML Capital’s management company, MLC Management Ltd., acts as the external AIFM. If the manager prefers to launch their own standalone fund, ML Capital will do all of the operational heavy lifting and ensure that the fund runs smoothly; alleviating the pressure on the manager.

“We’ve built a team that has years of experience in the fund industry coming from a wide range of backgrounds including legal, distribution, risk and fund allocators giving us the ability to support multiple fund strategies and understand their requirements. ML’s view is that the fund managers manage and we operate the funds,” concludes Hammond.
the point that they simply police the risk management rules that the fund manager has written. “We do not unilaterally dictate how they risk manage their fund. It is a partnership methodology,” says Vittoria.

“The way we integrate our risk management sets us apart and ensures that we can do everything we need to from a regulatory and governance perspective. Our risk team can see everything they need to see, without significant intrusion into the client’s way of running their business. Most clients will put language in the fund documentation along the lines that Mirabella will be the initial AIFM to the fund until such date that their own firm gets its own appropriate regulatory license. In other words, the documentation is written such that the day they get regulated, we disappear.”

**Distribution support**

Some managers will want help from a distribution perspective when launching their fund into Europe, others less so. As such, it is worth considering whether the hosted AIFM is able to support distribution activities. At ML Capital, for example, the team offers both active and passive distribution. According to Delamare, active distribution will be offered for one of the three QIAIFs it is currently launching. Typically, this applies to managers who do not have a well-established distribution network of their own in place in Europe.

“We work with high-profile fund managers who have their own sales teams and often don’t need help with distribution. However, what they really like is our passive distribution service where we make sure that for every market into which their funds are marketed, they are fully compliant, they are visible on the relevant databases in each EU market, and we make sure they are open for investment through different platforms and that investors can efficiently allocate to them,” confirms Delamare.

To conclude, the seeding environment has started to pick up again with a major US seeder expected to make a big splash. In Vittoria’s view, this could result in a number of large hedge fund managers losing some of their star performers as the carrot is dangled for them to run their own hedge funds.

“There’s a perceived barrier to entry and an actual barrier to entry. The perceived barrier to entry is that traders sit around and think they’ll never be able to afford to run their own hedge fund business. When they go out and actually meet with service providers, the actual barriers to entry come down. Platforms like Mirabella are making it easier for new talent,” concludes Vittoria.
One of the primary reasons for investment managers choosing to use regulatory hosted services such as those provided by Mirabella, part of the Cordium group, is because of the time it takes regulators to approve manager applications; sometimes up to nine months in the UK.

For start-up managers entering the market for the first time, or existing managers outside of Europe who are looking for an AIFMD solution, the Mirabella platform, either alone or in tandem with the Cordium Total AIFM Solution (CTAS) provides a clear, cost-effective pathway.

Where CTAS differs from the usual outsourced AIFM solution is that the manager retains full ownership of the AIFM; in Malta. Cordium, meanwhile, takes care of all the operational headaches to set it up and ongoing compliance demands. This allows firms to save considerable time, effort and cost involved in manually setting up a firm in Malta and applying to the MFSA for AIFM status and ongoing aspects of managing various service providers.

“People like the benefits of a hosted platform when compared to direct authorisation. In the UCITS world having the name of the outsourced ManCo in your offering documentation is familiar to managers, but in the AIFM world we noticed that there was a feeling that managers wanted branding consistency throughout their product. CTAS offers the best of both worlds. Managers retain full ownership and branding of the AIFM, whilst at the same time benefiting from the reduced workload associated with the outsourced solution of a hosted AIFM,” explains Joe Vittoria, Chief Executive Officer, Mirabella.

Adam de Domenico, Chief Executive Officer, Cordium (Malta), further explains the concept by adding: “Malta has a friendly regulatory environment. While they are waiting, the manager can use a plug and play option by joining the standard Mirabella platform, until their own AIFM license is approved by the MFSA; at which point they can then seamlessly move from Mirabella to their own AIFM. It is a seamless approach. CTAS delegates the portfolio management back to the fund manager, wherever they are based; London, New York, Hong Kong. That said, we have also seen an increase in fund managers moving to Malta for more frequent trading strategies and a significant increase in less traded strategies like PE and Real Estate.”

For US managers, the Mirabella/CTAS axis is an attractive proposition as they contemplate bringing AIFMD-compliant funds to market. Many, for the time being, are happy to utilise national private placement regimes to market their offshore funds to European investors, but as those rules eventually get phased out, they may have no choice but to establish an AIFM in Europe.

As such, managers can use Mirabella as a stopgap whilst the Cordium team in Malta set up the AIFM and take care of the regulatory process with the MFSA, or, if preferred, managers can remain on the Mirabella platform indefinitely and avail of its AIFM license and expertise.

Since 2001, Mirabella has hosted over 100 clients. It currently has 50 clients on the platform using its FCA & MFSA licenses, and the managers on the platforms have in excess of USD4bn in AuM.

“In the last couple of years, where
Moreover, this is important for European investors who seek access to high quality talent; the last thing they want is for non-EU managers to turn their backs on Europe.

“When it comes to fee structures what we offer is very similar to Mirabella – a one-line fee that captures everything,” explains de Domenico. “It is imperative for managers to manage the initial period of costs when becoming an AIFM. The single constant monthly CTAS fee includes external service providers, like auditors, regulators, and lawyers. Hence, knowing exactly what the costs will be to setting up the AIFM and running it is very important. Managers tend to forget the hassle involved with operating a ManCo once they have received a license. We remove that hassle. They can focus purely on managing the portfolio.

“Larger managers who are looking for a solution under AIFMD are attracted by the reputational name of Cordium. It helps to reassure their investors.”

For managers evaluating the easiest route into Europe, the Mirabella/CTAS offering eliminates the fear of the unknown. And that alone is priceless.

Mirabella has benefited (in addition to speed to market) has been institutional investors being attracted by the services we provide, such that we are now starting to see investors send us managers,” says Vittoria. Investors that are being approached by managers are insisting that they join regulatory hosting platforms such as Mirabella before they allocate any capital.

That in itself represents a clear shift in mindset among investors. As Vittoria recalls, 10 years ago institutional investors tended to look down on managers who sat on hosting platforms. Now, those same investors are stipulating it.

Oftentimes, people want to get their fund to market as quickly as possible because investors have come to them with capital ready to commit. If the manager then spends months getting the fund management entity licensed, the risk is that those investors will go elsewhere.

“Therefore, at Mirabella we take on the manager so that they can get to market with their fund, and then hand the manager over to the manager’s own manager entity (which includes the ones in the CTAS program) once they have been approved by the regulator. Some people choose to stay with Mirabella for longer if they feel they are not ready to spend the resources or time running their own business because they want to focus on building the track record; and doing anything else at that stage can be distracting to some,” explains Vittoria.

“It is a bit like having an indefinite call option. As soon as the time is right, they leave and become their own fund management entity but it is entirely up to them as to when to do that. In some cases a seeded manager will decide to start with us and only go down the registered AIFM route once they’ve got a certain number of investors in the fund.”

In Malta, de Domenico says that now Cordium has through its first cycle of onboarding CTAS clients, one of the key features of its success, to date, has been the fact that clients have an accurate handling of their costs. This is an important point because non-EU managers might feel overawed by the cost implications of setting up their own AIFM – offices, staff, regulatory fees and so on – have a viable alternative to consider.

Moreover, this is important for European investors who seek access to high quality talent; the last thing they want is for non-EU managers to turn their backs on Europe.

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Heritage Depositary
enjoying greater collaboration with AIFMs

Interview with Gerry Warwick & David Price

Heritage Depositary Company (UK) Limited ("Heritage Depositary") operates what the FCA refers to as a ‘PE Alternative Investment Fund (AIF) depositary’. Whilst it is able to provide full depositary services to most AIF structures, Heritage’s depositary services are focused on, but not limited to private equity, real estate, infrastructure, venture capital and esoteric alternative funds investing in both developed and emerging markets.

“The AIF’s we oversee invest in what are classed as non-financial assets. We do however have the capability to hold such ‘Financial Assets’ through our recognised and authorised global custodian,” explains Gerry Warwick, Director of Heritage Depositary.

Under AIFMD, the depositary has four main functions: cash monitoring, asset verification, safekeeping, and oversight. “Initially there was some resistance to appointing a depositary but we find that the sentiment among managers has mellowed somewhat and they are now recognising the added value and comfort that an independent depositary brings to the AIFM, the AIF, its board and investors,” says Warwick. He adds “over the last couple of years, AIFMs have steadily adopted a more collaborative mindset to working with the depositary and Heritage Depositary offers tailored services that not only ensures compliance with its responsibilities under AIFMD but also minimises disruption to existing roles and relationships”.

Certain AIFM’s take the opportunity to avoid a potential conflict of interest and appoint depositaries independent to their other service providers while non-EU AIFs in particular are not required to appoint a single entity to carry out all of the functions required by AIFMD. This allows non EU AIFMs to maintain existing relationships with their appointed administrator and/or custodian by having them perform cash monitoring and verification of the AIF’s assets in an arrangement known as ‘Depositary Lite’. A depositary however is still appointed to carry out the oversight function.

While this arrangement may be referred to as Depo Lite, Warwick emphasises that such an arrangement should not be misconstrued: “It does not mean reduced oversight as all the functions required under the full depositary service still need to be carried out but with the option for the AIFM to use multiple providers, but, the work is effectively the same. We, as the depositary, must still perform the oversight function on those service providers looking at the processes and controls, stress testing etc., to ensure everything is robust.”

Heritage Depositary has clients that already use Heritage as their appointed administrator, those that retain a third party administration relationship and indeed those who perform their own administration function in-house.

“There are obvious benefits to appointing an Administrator and Depositary under the same roof although we have to emphasise that our Administration company and our Depositary are set up as independent companies with operational autonomy,” says David Price, Heritage Depositary Services Manager.

“It can be highly frustrating when waiting for information from an external third Party especially as our services have been tailored to ensure compliance with depositary
functions under AIFMD and in a way that minimises disruption to the AIFM."

Having easier access to all the required information and the ability to put in place an effective integrated operating model allows for reduced risk and a more efficient service to the AIFM. Given how sensitive costs are within the alternative funds industry, the more an AIFM can minimise them the better.

"However, if we are the administrator and the depositary we must avoid potential conflicts of interest. Heritage Depositary Services is a separate legal entity to Heritage Administration Services, and both have their own separate boards," explains Warwick.

"The risk component will influence the depositary fee but it will also be based on other factors such as volumes and access to necessary information. Heritage Depositary makes it clear from the outset that whether an administration function sits 'inside' or 'outside', this will not alter its own operating model. Its oversight duties therefore will not be compromised."

It should be noted that Heritage Group has an office located in Malta offering fund administration as well as the same depositary services described above.

Although managers are not going to necessarily appreciate the costs of having to appoint a depositary under AIFMD, Price is keen to stress that they are counteracted with the comfort the AIFM, its Board, and investors have from the added value that an independent depositary brings.

"Heritage Depositary provides depositary services to a number of funds that fall outside of the scope of AIFMD but have elected to be included within scope because it gives the manager extra credibility when talking to prospective investors," confirms Price.

As with any financial service function it can be difficult for Managers to find the 'right fit' when appointing a depositary. Heritage Depositary believes the other key aspects AIFM's should look for are:

• Knowledgeable, experienced professionals with a thorough understanding of the alternative fund industry who possess deep knowledge of the asset classes they service.
• Provision of flexible solutions and agile responses to meet the varying demands of each unique structure that add value not cost to the AIFM.
• Effective Systems and Controls with efficient reporting functions.
• An operating model which delivers a service that is compliant with AIFMD while ensuring that the needs and expectations of the client are met.
• A competitive fee that is proportional to the structure and complexity of the AIF.

To ensure compliance with AIFMD, it is essential that fund managers consider and address their depositary requirements particularly if they plan to market to investors in Europe. As an affiliate member of the Depositary and Trustee Association and chair of the Private Equity, Real Estate and Venture Capital Working Group, Heritage Depositary is well placed to offer assistance and added value to the AIFM.
Under Article 21 of the AIFMD, any AIFM running an EU-based AIF is required to appoint a single full scope depositary to carry out four core duties: cash monitoring, safekeeping and verification of assets and general oversight of the AIF. For EU managers with experience of running UCITS funds alongside their offshore Cayman fund(s), this arrangement is a familiar one, but for AIFMs marketing non-EU AIFs into Europe, the concept of appointing a depositary is unfamiliar.

This is made slightly easier in the sense that the AIFM of a non-EU AIF can, under article 36 of the Directive, avail of a “depositary lite” regime, where one or more entities can be contracted to carry out the three functions of the depositary. The benefit here is that it allows the AIFM to enter into service level agreements with their existing prime broker and administrator to undertake the asset safekeeping and/or verification, in addition to the cash monitoring roles required of the depositary, and then decide on who to provide the third, oversight function.

The obligations of a depositary lite are therefore broadly similar to a full depositary arrangement. However, one important point of difference is that there is no strict liability for the loss of any assets in the AIF. Instead, the liability standard is negligence for the depositary lite.

For hedge funds and private equity funds that have never needed a custodian, there are understandably a lot of questions they need to consider, the most obvious being cost. As the depositary is only required to do the four core functions listed above, and nothing else, there is very little to differentiate among depositaries, as compared to when a fund manager appoints a fund administrator;
in this situation, they will look at the skillset of the administrator, its experience and expertise across different fund strategies to ensure that they are a good fit.

“That is still important when selecting the depositary because it makes the relationship easier to manage on both sides, but pricing is a major consideration undoubtedly,” says Gerry Warwick, Director of Heritage Depositary.

Cost versus risk profile
The cost of the depositary ultimately comes down to the risk profile of the AIF.

For an EU-based AIF, the full scope depositary will be on the hook for any liabilities suffered by the AIF as a result of asset misappropriation. This means that the depositary has to conduct a robust risk assessment of the AIF if the AIFM chooses to continue using an existing prime broker and administrator. Under this arrangement - referred to as an open architecture arrangement - the cost impact to the manager will be higher because the depositary will be required to enter into a discharge of liability arrangement with the prime broker and/or administrator.

Alternatively, by using an integrated model, a lot of the risk can be internalised and the cost impact to the manager is reduced. In this arrangement, a single counterparty acts as the administrator and depositary to carry out the cash monitoring, safekeeping and oversight functions.

As Mike Hughes, Global Head of Fund Services at Deutsche Bank explains, there are a number of benefits to this: “These include cost savings for the manager due to efficiencies in terms of system connectivity & data sharing, reduced burden on the manager to carry out due diligence and KYC on multiple entities, and generally having one point of contact from a relationship perspective.”

Warwick stresses that under this arrangement, the administrator and depositary, as part of the same group, must operate as independent companies to avoid potential conflicts of interest. He agrees with Hughes on the efficiency point, noting that it makes for a “relatively smooth interaction between the two ‘in house’ companies. It can be highly frustrating when waiting for information from an external 3rd Party, especially as our services have been tailored to ensure compliance with depositary functions under AIFMD and in a way that minimises disruption to the AIFM.

“Having easier access to all the required information and with the ability to put in place an effective integrated operating model allows for reduced risk and a more efficient service to the AIFM,” says Warwick.

For over 20 years, CACEIS has been Depositary bank to some of the most well respected asset managers in Europe. Its depositary service is tightly integrated into its technology and as Clara Dunne, CEO, Caceis Bank Luxembourg (London) comments: “Where we also act as Fund Administrator to our clients, there are advantages for reporting and access to information. However, we understand that it is not always easy or expeditious to change service providers. Consequently, we do offer Depositary as a stand-alone service and are confident that over time we will prove to be the preferred partner to our clients in other areas; for example, fund administration services, where we are number one in Europe with EUR1.4trn in AuA.”

PERE funds contribute to depositary growth
Indeed, for large established fund managers who decide to launch an AIF in Europe and need a full scope depositary, although the integrated model might make operational sense, it isn’t necessarily feasible to move lock, stock and barrel into a single counterparty relationship – one could even argue that the concentration risk that would create would be counterintuitive to the AIFMD’s aim of better protecting investors.

Nevertheless, there are clear signs that more PERE fund managers and hedge fund groups are exploring the benefits of
Ha ha or Aha?

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Considerations for appointing an external AIFM

Interview with Kavitha Ramachandran

One of the biggest decisions for fund managers under AIFMD is whether or not to appoint an external AIFM. But as management companies, many of whom have experience supporting traditional managers under the UCITS framework, continue to espouse the virtues of outsourcing the ManCo function, alternative fund managers in different geographies are beginning to understand the benefits of going down this path.

“In the US, especially, fund managers are getting to grips with the concept that someone else can take over and run the governance function and do all the necessary risk management without necessarily giving up too much control,” says Kavitha Ramachandran from Maitland.

“In terms of characteristics, they are looking for experience and expertise within the management company, and whether or not the AIFM can provide a one-stop-shop solution (by also hosting sub-funds on a platform) – there is a general view that managers prefer to go to one service provider and avail of a consolidated service rather than shopping around to choose multiple providers.”

Fund managers should also consider the size of the group providing the AIFM service, with respect to strength of balance sheet, given that any such undertaking is a long-term commitment. “Gone are the days when a small team of people can operate as a management company. Substance has become an important element under AIFMD. We have clients coming to visit us in person to make sure we have the right infrastructure, human resources and the like, so substance really matters,” says Ramachandran.

Then of course there’s the fee consideration. Launching an AIFMD-compliant fund and appointing an external AIFM comes with additional fees but Ramachandran says that managers understand that they are paying those fees “for clear value-added services”.

“I wouldn’t say there’s a race to zero as many appreciate the benefits to appointing an external AIFM to take care of all the heavy lifting under the Directive,” notes Ramachandran.

Maitland has been onboarding a number of sub-funds and there is a healthy pipeline for the platform although some are also choosing to establish their own standalone funds. In this situation, the manager appoints Maitland as the external AIFM to take care of the operational and governance duties under AIFMD, leaving the manager free to focus on portfolio management as a delegate.

Maitland has recently added private equity and real estate to its AIFM offering and since the beginning of 2016, Ramachandran says that “the majority of clients we’ve been speaking with have been PERE managers, specifically real estate managers.”

This interest could further strengthen following the approval of the reserved alternative investment fund (‘RAIF’) regime which is expected in the second quarter of this year.

“This will be a regulated fund product which will not come under the direct supervision of the CSSF but rather the AIFM and providing managers with the ability to market the fund in a short period of time. It’s early days but there is a lot of anticipation with this product, and we think it will really appeal to the PERE manager community,” says Ramachandran, who concludes:

“Alternative fund managers know that AIFMD is not going away. Many of them want to raise capital in the EU and are getting used to the fact that they are going to need the help of external parties. We think the trend of outsourcing the AIFM is set to continue.”
Choose the safer path, with Lawson Conner

Lawson Conner’s award-winning AIFMD solutions and our team of experts will help you navigate through the complex AIFMD regulatory landscape.
Lawson Conner operates a specialist fund manager platform providing FCA license coverage as well as compliance and regulatory oversight on behalf of alternative fund managers. Over the last few years, the firm has seen a dramatic shift to ManCo structures as new managers, and, more importantly, institutional investors, appreciate the virtues of using an outsourced AIFM solution. By working with an established AIFM platform, emerging managers can focus on producing returns and managing their trading strategy.

“Recently, the sentiment for launching new fund structures has been strong and there is clear interest among managers in using an AIFM structure with a hosting solution,” says Andrew Frost, Director, Investment Solutions at Lawson Conner. “It can take a long time for managers to set up all the agreements and relationships with various service providers and become a licensed AIFM. We can get a fund manager up and running in a regulatory and compliant way in three to four weeks and provide either an efficient fund structure via our fund platform, or simply provide AIFM capabilities for a fund vehicle that they bring to us. This saves on both time and cost.”

As non-EU managers become more comfortable considering Europe to market their funds, third party management companies are likewise becoming easier to conceptualise. Frost says that having launched a number of managers under AIFMD, “we are experts in how to handle the marketing requirements. US managers appreciate there are USD20trn of investable dollars in Europe and are looking for the most effective way to capture those dollars.”

Daniel Maycock, Director, Investment Management Services at Lawson Conner, confirms that previously, when start-up managers joined the regulatory platform – either to avail of Lawson Conner’s FCA license while they waited to become FCA-approved, or simply to remain on the platform as they built their track record and AUM – investors could see that there was an extra layer of governance and risk management in place. This was reassuring, even if they were writing small tickets.

“Now we are starting to see some of the biggest institutional investors encouraging fund managers to use third party ManCo structures because it is the better solution. We see this as huge support in how far the third party ManCo has come. It is definitely the future for fund management,” says Maycock, who continues:

“Pre-AIFMD an insurance company approached us. A group of traders had just left a hedge fund but lacked the operational expertise, or experience in running a business. We provided everything for them under our regulatory umbrella. At the time, the allocation was less than USD100m. Now we are seeing allocations of hundreds of millions to us, acting as the appointed AIFM to the manager.”

Not that this option is the preserve of start-up managers. A major asset management with billions in AUM recently spoke to Lawson Conner on appointing an external AIFM. That, says Maycock, speaks volumes about where the market is headed. “They don’t want to spend several hundred thousand dollars setting up a structure if they don’t know exactly what the investor appetite will be for a particular strategy. Our AIFM solution gives them exposure to Europe without having to build out that entire infrastructure,” says Maycock.

Frost concludes: “Having a third party AIFM take on the compliance and regulatory responsibility has universally become the best solution, provided the right counterparties are in place.”

Institutional investors support external ManCos

Interview with Andrew Frost & Daniel Maycock
provide depositary services to existing AIFM’s who utilise in-house administration and also fund managers with an established third party administrator relationship seeking a segregated depositary function.

• A flexible operating model that delivers a service that is compliant with the Directive while ensuring that the needs and expectations of the client are met.

Hughes adds that the ability to provide full Depositary services versus merely Depo Lite services, accountability of management and staff, and a global footprint with a ‘bricks and mortar’ presence in all key global markets “to sense check issues as they arrive” are also key considerations when selecting a depositary.

“Having a depositary with a sound balance sheet and good technology is an equally important selection criterion for AIFMs and their investors. This is an important point because administration groups that have a depositary lite license – which ultimately restricts them to providing safe keeping of financial assets if they are not also part of banking groups – may not necessarily have the fortress balance sheets of global custodians. “As there is doubt whether that can continue indefinitely, a consideration for any manager is the potential need to move service providers in the near future. We maintain that a depositary with great people, high-quality controls, and financial strength is increasingly important to a manager’s investors,” opines Dunne.

“A further consideration is the level of cooperation and shared technology platforms across different entities of the depositary, which is helpful to a manager who is...
PFS-PAXUS is a global technology solution for today's fund administration industry allowing you to automate fund administration accounting and reporting functions whilst maintaining control.

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• Response to change
Integrated platform brings order to chaos

Interview with Paul Kneen

Pacific Fund Systems is a global leader in supporting investment fund accounting and administration through its integrated share registry/fund accounting platform, PFS-PAXUS. With fund administrators under increasing pressure from AIFMs to provide a broader suite of regulatory reporting services – most notably Annex IV reporting under AIFMD – demand has grown for integrated systems that can house fund data on a single platform. This is precisely what PFS-PAXUS offers, avoiding the need for reliance on multiple systems by utilising a single database infrastructure to deliver greater workflow efficiencies, reduced risk, and more timely valuations.

Two years ago, to keep pace with regulatory change, Pacific Fund Systems built an automated Annex IV capability, in tandem with a FATCA reporting tool. Speaking with GFM, Paul Kneen, Chief Operating Officer, explains that the underlying philosophy behind developing the Annex IV solution was borne out of a realisation that some 70 per cent or more of the data required to be reported on in Annex IV, which contains 300 separate data fields, is already housed within PFS-PAXUS.

"Owing to the fact that it is fully integrated, this makes it particularly attractive to our clients, and prospects, as they look to comply with the Directive. Other global fund reporting requirements such as FATCA and Form-PF can all be handled within the system and we are currently working to introduce Common Reporting Standards functionality, which will build in order to support clients when they need to start reporting next year," says Kneen.

PFS-PAXUS generates the Annex IV report in the required XML file format, which the fund administrator then shares with its clients to be sent to the relevant national regulatory authority for onward submission to ESMA. Kneen says that the solution has been well received and generated a lot of interest among clients.

"There can be a huge cost associated with administrators developing 'in-house' regulatory reporting solutions," comments Kneen. "As a technology firm, we made a conscious decision from the outset to support global regulatory reporting within PFS-PAXUS. Annex IV may be amended, to some degree by the regulator as reporting requirements develop, which might require additional system developments on our side which will take the burden off the administrator."

For fund managers and administrators alike, the current regulatory reporting environment has become a spider web of complexity. This is why technology has become such an integral part of the financial system because without Annex IV solutions such as the one developed by Pacific Fund Services, the potential for mistakes through lack of system automation, and the time it would take to file reports and remain compliant, would rise exponentially.

"We take care of managing the myriad moving parts and simplify our clients' workflows thanks to the automated nature of PFS-PAXUS. We like to think that our Annex IV solution is a user-friendly component of PFS-PAXUS. In terms of coming up with the aggregation of data, we don’t have to collect it from multiple sources because the system effectively acts as a repository holding 70 per cent of the data needed for Annex IV. The administrator then only needs to collect the other 30 per cent from the AIFM, or their risk provider, to complete and generate the report in full, ready to be uploaded to the relevant regulatory body," says Kneen in conclusion.

Market regulation has caused waves of disruption, but with enhanced data aggregation and reporting capabilities powering them in the background, systems such as PFS-PAXUS have developed solutions which allow their clients to sail in calmer waters.
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The role of technology

Technology advancements in recent years have helped administrators and depositaries cope with the added responsibilities they face under AIFMD. For administrators in particular, the ability to provide comprehensive regulatory reporting solutions to AIFMs has become a key criterion. Paul Kneen is Chief Operating Officer at Pacific Fund Systems, a technology specialist that provides investment fund accounting and administration through its integrated share registry/fund accounting platform, PFS-PAXUS. He notes that as AIFMs rely more on their fund administrator to ease the regulatory burden, the more automated the administrator can handle the reporting requirements the better. “It can certainly help give administrators an extra edge,” says Kneen.

“We don’t charge separately for the production of Annex IV and other regulatory reports. It is inclusive and made freely available to our administration clients. Should our clients wish to charge their end clients for the production of regulatory reports, it gives them an ability to increase their revenue stream. If we weren’t providing this support, administrators would have to slice and dice a lot of this data using manual processes, spreadsheets etc., all of which would be time- and cost-intensive.”

The ability to perform asset safekeeping, verification, cash monitoring, and general oversight of the AIF’s activities necessarily involves a significant volume of data. As mentioned above, where these functions are performed within the same group, with the administrator and the depositary separated by Chinese walls, the transfer of data is more seamless than it would be when relying on data from multiple third parties. All of the data can reside in a central repository using systems such as PFS-PAXUS, giving the administrator significant granularity on the AIF, which it can then use to good effect for Annex IV reporting, FATCA reporting, Form-PF reporting and so on.

ConceptONE’s regulatory enterprise risk management solution – RegERMTM – meets the regulatory reporting challenge by providing a truly holistic view, which is making the lives of administrators and depositaries so much easier, from a data management perspective.

“Some AIFMs in the past wanted us to work directly with them but the realisation now is that if we are doing this already with the fund administrators, it’s just a more efficient system in general. The AIFM’s business is a bit different to the administrator, which at its most basic boils down to data management and running fund data through complicated calculation engine to create responses for the regulatory report, and then fill in the gaps by going to the AIFM or to their outsourced risk provider,” says Ethan Wishnick, Associate General Counsel & Vice President, ConceptONE.

The technology capabilities of the depositary must therefore be a final key consideration for any AIFM as they settle in to life under AIFMD.