2017 Guide to setting up an Alternative Investment Fund in Europe

Choosing the right European domicile for an AIF
Self-managed AIFM versus outsourced AIFM
Regulation, fundraising and distribution
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Welcome to the 2017 edition of GFM’s Guide to setting up an Alternative Investment Fund in Europe. It is the first of a two-part series, the second part will focus on setting up an AIF in the USA, and will be published later this year.

This edition is published as the UK finally begins the all-important process of negotiating the precise trade terms under which it will conduct its Brexit from the EU, terms which will clarify how investment funds outside the UK are regulated and structured for marketing and distribution purposes within the UK, and how UK investment managers will access the EU markets.

This is a hybrid Guide, meaning that it follows a live day-long series of panel discussions held in London, which featured alternative investment fund experts from across the world and focused on the following five key topics:

1) Choosing the AIF’s European Domicile
2) Regulation and Compliance
3) Self-managed AIFM versus Outsourced AIFM
4) Selecting the AIF’s service providers
5) Fundraising and Distribution.

The results of each of these panel discussion are covered and summarised by James Williams, Managing Editorial of Hedgeweek, in his Overview on Pages 5-10.

This Guide also features expert articles on a comprehensive range of topics, from the individual merits of various jurisdictions to issues around prime broker selection, structuring, regulatory reporting and AIFM platforms.

We thank the following firms for their expert contributions and support of this keynote Guide to setting up an Alternative Investment Fund in Europe:

- Guernsey Investment Fund Association
- Maitland
- Chetcuti Cauchi Advocates
- PwC Luxembourg
- Circle Partners
- Cowen Prime Services
- Quintillion
- Management Plus Group
- Lawson Conner.

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1. Choosing the Fund’s European Domicile

One of the hardest decisions for any start-up or established manager wishing to launch a European Alternative Investment Fund is picking the most suitable jurisdiction. Europe has multiple fund centres, including Luxembourg, Ireland, Malta and The Netherlands, each of which offers something slightly different. Due care and consideration of all the options is therefore vital before the manager engages with legal counsel to commence the fund set-up phase.

Europe’s largest onshore funds domicile is Luxembourg, home to approximately 14,400 funds, including sub-funds, representing just short of EUR4 trillion in AUM, of which one third are held in alternative assets.

In terms of legal vehicles, since 2004 Luxembourg has offered the SICAR, the Société d’investissement en capital à risqué (SICAR), which has primarily been used as a vehicle to support private equity and venture capital investments. Up until 2013, Luxembourg operated quite an antiquated limited partnership regime - the société en commandite simple (SCS), which was based on the 1915 company law.

Cognisant of this, in 2013, at the time the AIFM Directive was introduced, Luxembourg’s authorities created the Luxembourg Limited Partnership Regime, allowing for Luxembourg AIFs to be treated as Luxembourg limited partnerships, which are not necessarily subject to direct supervision by the CSSF.

At the same time, a new structure in the form of a Special Limited Partnership (SCSp)
Unlike the Irish Plc structure, if the manager wants to change the memorandum and articles of association they don’t need a shareholder vote. They can also dispense of their AGM on 60 days notice and, unlike the investment company, there is no legislative requirement to spread investment risk within the ICAV.

Malta has been a leading jurisdiction of choice for smaller fund managers over the last 10 years. The island’s regulator, the MFSA, is very approachable to small start-ups and offers appropriate guidance where necessary to make sure everything with the fund is properly up and running.

The island offers a number of options with respect to the legal structure of the fund: the investment company with variable share capital (SICAV), the investment company with fixed share capital, limited partnerships that can be divided into shares or not divided into shares, unit trusts and the common contractual fund. The SICAV is the most common legal structure and can be used for single fund structures and umbrella fund structures, depending on the manager’s preference.

And then there is the Netherlands, which operates a light regime under AIFMD, making attractive to start-up managers based inside or outside the Netherlands, due to the lower costs involved. In case of a foreign manager, a management company should be incorporated in the Netherlands which will act as the Dutch AIFM.

One is able to choose between corporate and non-corporate entities. A corporate entity takes the form of either private limited liability company (BV) or a public limited company (NV). A non-corporate entity takes the form of a limited partnership called a CV structure (commanditaire vennootschap), or a fund for joint accounts (FGR).

The CV structure is most commonly used for closed-ended private equity and real estate vehicles, whereas the FGR is most commonly used for daily trading open-ended investment vehicles. An FGR can either be tax transparent, where there’s full look-through and no Dutch tax concerns on investors, or, if necessary, it can be tax opaque. In this case, it is not subject to corporate, income or dividend withholding tax.

Ireland’s reputation as a leading funds domicile has gone from strength to strength over the years. There were approximately 6,470 funds domiciled in Ireland through 2016 - 2,000 of which are alternative funds - with around EUR2.1 trillion in AUM.

The two primary legal structures in Ireland are the Irish investment company (Irish Plc) – which can be used for open-ended or closed-ended funds – and the Irish Collective Asset Management Vehicle, or ICAV. Up until March 2015, the Irish Plc, also known as a Part XIII Company, was the most popular vehicle.

This has since been superseded by the hugely popular Irish Collective Asset Management Vehicle (ICAV). This is a bespoke regime and has been quite successful since it was introduced in March 2015. At the end of April 2017, there were 314 ICAVs registered with the Central Bank of Ireland.

The ICAV is a bespoke piece of funds legislation so general Irish Company Law doesn’t apply. In addition, the ICAV is a corporate ‘check-the-box’ entity, which is beneficial for those wishing to market to US taxable investors and umbrella ICAVs can prepare separate audited financial statements for individual sub-funds. From a marketing and tax point of view, the ICAV is an enhanced version of the Irish Plc.

Key features of the ICAV:
• Authorisation and supervision by the Central Bank;
• Establishment as a UCITS fund or an AIF;
• If established as an AIF, it may be structured as open-ended, closed ended or with limited liquidity;
• Possible establishment as an umbrella fund with segregated liability between sub-funds;
• Multiple share classes;
• The assets of the ICAV must be entrusted to a depositary;
• Registered office in Ireland;
• Board of directors and a minimum of two directors.
OVERVIEW

One of the most common misconceptions among start-ups is that they think just because they are operating with a small AUM – say EUR5 million or less – they somehow fall outside of the purview of the FCA. This is not true. Even if the manager starts off with a managed account running his own capital, the moment they start promoting what they are doing to friends and family, for example, this is technically viewed as providing investment advise.

As soon as someone does this, they have to be a regulated entity; either directly, or by using a MiFID regulatory platform and operating as an Appointed Representative. This is the easiest way to operate within the FCA’s rules. As long as one is on a regulatory platform, one can invite as many people as they want into the managed account, allowing them to build their track record before potentially spinning off to set up a standalone fund structure.

To clarify, MiFID (Markets in Financial Instruments Directive) applies to those who advise on trades in managed accounts or single investor accounts, whereas AIFMD applies to those who manage commingled funds with more than one investor.

Of course, one can opt to become directly FCA authorised. It is, however, important to take into account the costs of using legal advisers, FCA fees, putting up regulatory capital and also possibly having to make use of external compliance consultants. So it can be a costly route.

Three platforms

There are potentially three platform considerations for any new manager to consider under AIFMD – these relate to the AIFM, the investment advisor and the fund.

In Malta, the most popular choices are the Professional Investor Fund (PIF), the AIF and like Luxembourg, it has also introduced an unregulated fund: in this case the Notified AIF, where the AIFM is responsible for the running of said vehicle.

2. Regulation and Compliance

Understanding one’s regulatory obligations can be a minefield. Knowing what counts as regulated activities, or not, is vital if one is to stay out of trouble with the FCA.

Fund structuring options

Ireland and Luxembourg both have well-established regulated fund vehicles, referred to as Qualified Investor Alternative Investment Funds (QIAIFs) and Specialised Investment Funds (SIFs) respectively.

There are no investment restrictions on the QIAIF, no leverage limits and no diversification limits. It’s a broad structure that can be used by most alternative strategies. Speed to market is one of the key attractions. In order to get a QIAIF authorised, it takes two to three months but each application will be approved within 24 hours, once all the accompanying documentation is submitted to the Central Bank of Ireland.

A loan origination QIAIF is also available in Ireland. It can issue loans, participate in loans, participate in lending and it can also hold debt and equity securities, which are issued by the entities it is lending to.

Luxembourg offers both regulated products – namely the SIF and the société d’investissement de capital à risqué (‘SICAR’) as well as unregulated products – Luxembourg limited partnerships (SCS or SCSp) and the Reserved AIF (‘RAIF’).

The Reserved AIF can be managed by an authorised EU AIFM. It can be created in the form of a company or a contractual common fund (FCP). If it is established as an investment company with variable capital it will be called a SICAV. There, it can choose to operate as a partnership (SCS or SCSp), a limited liability company, or a limited company form; whatever suits the manager best.

In addition, there is the SOPARFI (Société de Participations Financières). This is still used for 60 to 70 per cent of private equity vehicles. It is a fully taxable Luxembourg company and can benefit from double taxation treaties signed by Luxembourg.

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As mentioned, a MiFID hosted solution allows a new manager to trade freely under FCA rules as an Appointed Representative to the platform, while they wait to become FCA authorised. Nowadays there are well funded, high quality fund managers using hosted regulatory umbrellas and, importantly, they are becoming accepted by institutional investors.

The MiFID hosted platform means that managers can focus 100 per cent on their investment strategy, while the platform has sole responsibility for compliance and the regulated activities of the fund.
3. Self-managed AIFM versus outsourced AIFM

Anyone that wishes to market their alternative investment fund (AIF) in Europe, regardless of whether it is an EU AIF or a Cayman AIF, must have an AIFM in place.

The third party AIFM will typically be involved in doing risk management and overseeing portfolio management, as well as delegating the day-to-day management of the fund to the investment manager.

One needs to allow at least a month to put together an AIFM application. The FCA is then likely to take an extended period of time reviewing it (nine months or more). Given the time involved to become a self-managed AIFM, oftentimes investment managers will appoint an outsourced AIFM to act in their interests. This is especially important for managers with seed capital in place from a cornerstone investor who needs to get to market quickly.

In this instance, the third party AIFM provides an ideal ‘stopgap’, while they wait for their FCA authorisation to come through.

There is no shortage of AIFMs to consider in Europe. In Ireland, for example, since AIFMD was introduced in 2013, the number of AIFM providers has grown from a handful to in excess of 30.

Key functions of the ManCo include delegated portfolio management, post-trade risk management, supervision of the AIF’s service providers, and maintaining valuation, compliance and liquidity policies. The quality of risk management expertise varies greatly. Some AIFMs have the technological capabilities to analyse clients’ portfolios and generate the necessary risk analytics required under AIFMD such as: liquidity analysis, VaR analysis, stress testing, etc.

Others will outsource it or ask the investment manager to provide the reports.

The initial capital requirements for an AIFM in Ireland are EUR125,000, as stipulated by the CBI.

The final step on the journey is for the investment manager to become an FCA-authorised MiFID regulated entity, or a fully authorised AIFM.
success and raise a lot of capital, the risk is that the AIFM suddenly finds itself unable to meet those additional capital requirements and goes out of business.

Therefore, before selecting an outsourced AIFM, see what other managers are on the platform. If there are a number of smaller managers, this is likely to present less of a risk than if there are one or two larger managers who have a greater chance of raising significant assets from investors.

Finally, the AIFM’s substance is key. Do they have general expertise in all areas to bring the various functions together that are required to support AIFs? What is the governance framework used by the AIFM? Do they have people within the management company that are capable of asking the right questions of investment managers?

If one decides to become an AIFM, it needs to be a full commitment. One cannot approach it half-heartedly or look to cut corners. Be realistic about the long-term prospects of the business. Are you hiring people? Are you looking for office space to grow into? Do you have the regulatory capital needed to operate as a standalone AIFM?

If not, and if it is likely to create bumps in the road, then going the outsourced AIFM route is likely to be the best option.

4. Selecting the AIF’s service providers

There are lots of factors involved in selecting the AIF’s service providers, which this report cannot detail in full, suffice to say that any service provider selected has to fully understand one’s business offering. People setting up hedge funds or private equity funds in the early stages experience ups and downs; investors committing capital and then pulling out for example.

Does the service provider have the flexibility and the willingness to work with you over the long term? If not, it can lead to problems and unnecessary costs further down the line if one has to change their fund administrator or prime broker.

Get a good understanding of what procedures each service provider has in place. Do they have good checks and balances internally? Are all the relevant procedures being followed and are people doing what they should be doing?

Getting the chemistry right is critical so during the fund set-up phase, ask to meet with the people that will be supporting the fund on a daily basis. Do you fit their business objectives? Equally, do they understand your strategy properly – for example, does your preferred fund administrator have experience in handling Level 3 illiquid assets? There’s nothing worse than a service provider who says, ‘Sorry, I can’t do that’.

Hedge fund start-ups often assume they have to have a blue chip prime broker in place to impress investors. While there is an obvious prestige to having Goldman Sachs appointed, the reality is that unless having formerly worked at the bank, or one is launching with EUR500 million in day one capital, they simply will not entertain the idea of doing business.

Moreover, courting a big name can lead to unintended consequences. If a tier one prime reviews the fund and decides not to proceed, word will quickly spread. Other brokers will find out and will start to wonder why the fund wasn’t taken on. This can also unsettle seed investors.

The message here is, ‘be careful what you wish for’. Also, if one is looking to get on to a distribution platform, be careful of strategy bias. The funds industry is very cyclical. Strategies fall in and out of favour with investors. It is important to be aware of this before paying to appoint a distribution partner.

5. Fundraising & Distribution
Based on Preqin data, private capital funds (private equity, real estate and infrastructure) secured USD669 billion as of June 2016, the latest data available, which shows...
that institutional demand for alternatives remains robust. Indeed, this is playing into the hands of smaller GPs. Large groups are oversubscribed and this has made it easier for first time funds to get to market as LPs are forced to look beyond the upper quartile of top performing fund managers.

However, start-up managers bringing regulated AIFs to the European market need a healthy dose of reality; no matter what the calibre of the manager, or the efficacy of the investment strategy, if they do not have a clearly thought out marketing and distribution strategy, it will count for nothing if they approach the wrong type of investor.

In Europe, an increasing number of bank-owned and independent fund platforms are emerging to host funds and provide active and passive distribution support, whilst placement agents and distribution partners can prove highly effective at introducing managers to the right investors.

Broadly speaking, successful managers are those who have a clear understanding of what investors are looking for, where the appetite is, and work backwards to build a strategy; a kind of reverse engineering process.

The following steps can help one to develop an effective approach to raising assets and building brand reputation:

Firstly, try and secure cornerstone investors. You’re not going to get a first-time fund off the ground unless you’ve got a backer. If they can give you seed capital, this could be used to make investments and build an early track record.

Secondly, get the timing right. You don’t want to launch too early because you might find that during the first round of fund raising your fund lingers in the market. That can reduce momentum in the fund raising process. Check that other similar products are not already being presented to institutions. If not, they will find it difficult to tell the difference between one strategy and the next.

Thirdly, good news is great for fund raising. If you are an existing manager about to embark on launching your first onshore regulated AIF, communicate any successful exits in previous fund vintages, any updates in the deal pipeline, your overall track record.

Fourth, try, if possible, to create scarcity around the fund raising process – i.e. if investors don’t allocate now they might miss out; that can also be an effective tool within the marketing strategy.

And finally, do your research. Can you compete? And if so, where can you compete and how? If you can’t compete on performance, for example, maybe you can compete on price.

Indeed, one area that managers typically trip up on is appropriate pricing. It’s all well and good having the right fund structure but it means nothing if the wrong price tag is on the product with respect to fees. This is something that investors will look at through a microscope so.

Will you offer a founder share class? Will you offer a seeder share class, and if so will this be offered without a management fee? Will you increase the fee structure once you go beyond, for example, EUR150 million? Don’t put boots on the ground and then think about how you are going to sell your product. Think about who is likely going to buy your product; in which geographies are they likely to be located?

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Whether one is to run a fully compliant AIFMD fund and avail of passporting, or simply target a handful of EU Member States using national private placement regimes, it is important to plan ahead and try to put together a roadshow three to six months before the expected launch date.

This will go some way towards identifying potential seed investors and validate the price tag on the fund’s different share classes. Knowing one’s investors is the lynchpin to any successful distribution strategy. The more preparation and planning there is the greater level of potential assets one can attract into the fund.
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Raising funds in Europe: Private placement still works

What does the future hold for the raising of funds in Europe?
Wayne Atkinson of Collas Crill, on behalf of the Guernsey Investment Fund Association, takes a closer look

With the arrival of the Alternative Investment Fund Managers Directive (AIFMD), many were quick to bemoan what they saw as the inevitable loss of their favoured route to market; the use of national private placement regimes in the key European markets to raise capital for a Guernsey fund vehicle. With the passing of a few more years, a Brexit referendum and more than a little regulatory delay, it is becoming increasingly clear that not only does this route still work, it is becoming increasingly advantageous when compared to the alternatives.

At the time of its introduction, Guernsey’s dual AIFM regime was expected to provide great flexibility for fund promoters working from the island; those Guernsey managers marketing into Europe would ultimately enjoy the benefits of the EU-wide passport through the equivalence regime, those marketing entirely outside of Europe would have the flexibility to operate under Guernsey’s existing rules without the need to comply unnecessarily with the AIFMD regime.

Whilst Guernsey’s regime has been approved as having deemed equivalence the passport has not yet been extended to third countries due at least in part to the effects of the Brexit referendum. With negotiations now underway in light of the UK triggering the Article 50 process, the failure to extend the passport to third countries has meant that the use of the applicable national private placement regimes for third country funds must continue. From a Guernsey perspective, this cloud has turned out to have a definitively silver lining.

Nicholas Hofgren, director of Guernsey-based manager GFG Limited, notes that for him the issue of jurisdictional choice remains unchanged by recent events saying: “GFG analysed five EU jurisdictions and the Channel Islands when AIFMD was initiated. We considered Guernsey the optimal home state for cost, security and transparency. If we had to make the choice today, we would still choose Guernsey.”

Whilst political delay is always frustrating to those looking to move forward, this delay in itself has created an additional flexibility for managers seeking options around marketing into Europe. Managing using an EU entity allows, and indeed ordinarily requires one to use, the AIFMD passport. Managing from Guernsey by contrast still allows managers to use the existing and familiar private placement regime.

Martin Scott, Director of IAG Private Equity Limited, commented: “Whilst the Brexit vote has undoubtedly created uncertainty in the investment fund sector, the likely continuation of the popular and straightforward national private placement regimes provides an opportunity for fundraising by reducing the marketing costs and easing the reporting burden for GPs until an agreement on financial services is in place between the UK and the EU.”

The key markets in the EU... or “every” market
For many managers, the passport has brought with it the realisation that in reality they have never needed to market EU-wide and never will. Most managers are focussed on a few major economies and the benefits
of the passport in allowing marketing beyond their targeted investor base are an irrelevance at best. Diverting marketing spend beyond familiar targets like London, Frankfurt and Amsterdam is likely an unwelcome distraction at best.

Additionally, there are several logistical issues around the passport arising out of the way in which the directive has been implemented into the various national laws. Several Member States for example impose additional host fees and charges on AIFMD-authorised fund managers not based in their country. Others have gold-plated or mis-transposed the AIFMD wording resulting in additional documentary requirements or processes. So much for that universal ‘passport’.

**The cost of doing business...?**

Going beyond the efficiency or otherwise of the passport, the increased regulation arising out of the AIFMD regime has led to an increased costs base and many EU-domiciled funds are finding their service provider and transaction costs significantly exceed those of their Guernsey counterparts. It may go without saying but for a fund manager seeking to achieve growth in a fund’s value of a quantum significant enough to trigger a performance fee, spending on service providers or regulatory requirements will be unwelcome if a cheaper and equally viable (yet retaining regulatory substance) alternative is on offer.

Guernsey represents that alternative for many managers. For those seeking to target limited jurisdictions, and particularly those in the private equity space for whom the AIFMD regime is particularly ill-suited, the Guernsey regime is likely cheaper and quicker than launching through a European domicile.

**A well-trodden path**

Additionally, using a Guernsey vehicle and the private placement regimes allows the continued use of a structure the funds marketplace is familiar with and has always liked. Guernsey’s in-depth service providers, infrastructure, quality boards and simple pragmatic regulation continue to be attractive for the same reasons they always were attractive. Having access to capital through a simpler, more cost-effective route is simply a bonus.

Peter Miller, an Executive Director at Ernst & Young LLP, notes: “We continue to see a positive attitude from asset managers towards Guernsey as a jurisdiction, with the key drivers for jurisdictional selection being the strength of the regulatory environment, competitive structural running costs and the quality of the offering from local service providers. These factors still appear to outweigh any perceived uncertainty Brexit may bring to the investment sector in Guernsey.”

 Arbitraging the Guernsey regime and the use of private placement into Europe against that offered by European domiciles and the passport will always be a case of ‘horses for courses’. The exact requirements and workability of private placement are dependent entirely on a fund’s target marketplace(s). Private placement of Guernsey vehicles has been successfully used however to raise funds in amongst others:

- The UK
- Netherlands
- Germany
- Finland
- Norway
- Sweden
- Belgium
- Denmark
- Ireland
- Luxembourg

With any major decision, it is always worth running a cost-benefit analysis, the costs of launching in Europe and using the AIFMD passport are becoming increasingly clear, the benefits for those operating in the traditional fundraising arenas are perhaps less obvious. Meanwhile Guernsey continues to offer exactly what is has always offered; a cheap, effective, respected route to market.
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There’s a place for both RAIFs and SIFs

Interview with Kavitha Ramachandran

Traditionally, Luxembourg’s fund industry has always been based on the products being regulated. Both UCITS funds, and Specialised Investment Funds (SIFs) under AIFMD, work on this premise. However, the Grand Duchy was quick to realise that given AIFMD is manager regulation, it created a double layer of regulation for alternative investment fund managers (AIFMs) wishing to run alternative investment fund (AIF) products.

As Kavitha Ramachandran, Senior Manager Business Development & Client Management at Maitland, explains, this was a potential problem where time to market was essential. “This is what led to the creation of the Reserved Alternative Investment Fund (RAIF), which enables the manager to launch a fund product without having to go through the regulatory process with the CSSF. The key requirement is that the RAIF appoints an authorised AIFM, based in the EU,” says Ramachandran.

As the RAIF is a Luxembourg product it needs a Luxembourg administrator, depositary and auditor. Also, the AIFM is expected to apply to the CSSF to passport the RAIF across Europe with respect to capital raising. This means that the CSSF has full knowledge of the RAIF’s activities, as all marketing notifications must go through it.

“The RAIF legislation was passed through quite quickly and a number of RAIFs have been launched since last July,” confirms Ramachandran, adding: “As the AIFM is responsible for launching a RAIF, there’s a whole legal process in terms of getting the agreements together, making sure due diligence is done on all the key parties to the RAIF, such as the portfolio manager and distribution partners, and that the right people are appointed to the board.

“It is, therefore, important that the AIFM has the proper checks and balances in place.”

From a governance perspective, Maitland is uniquely positioned. Conducting all the compliance and oversight functions of an AIFM ideally requires an integrated process, especially when dealing with investment managers in the PERE space where complex structuring and tax elements need to be taken into consideration. Maitland is more than a fund administrator. It is a global advisory group, with its roots in Luxembourg dating back to 1976.

“The fact that we can run the product as an authorised AIFM is important but also, it helps us to work with legal firms as we understand the legal process, how to review the documentation and so on.

“If a fund manager comes to us to set up a RAIF, we can carry this out as an end to end service. There are, though, instances where the fund manager wants to work with certain law firms because they have an existing relationship with them and we have no problems linking through them,” explains Ramachandran.

She says that the profile of investors looking for a RAIF is different to those looking for a SIF. “Certain investors want both the product as well as the manager regulation and will opt for the SIF; whereas others have more flexibility in their investment allocation criteria and are happy with the RAIF because it offers quicker time to market.”

She confirms that Maitland has completed a few RAIFs and the pipeline is growing, mostly for PERE strategies.

“We can delegate portfolio management to the investment manager if it is a liquid strategy but for a PERE strategy we may not be able to fully delegate. In this case we would retain the portfolio management function as the AIFM, which we would run within an investment committee. The manager would then be invited to sit on that investment committee,” concludes Ramachandran.
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Dr Maria Chetcuti Cauchi
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Malta hosts a wide range of service providers, all of whom are well versed in structuring and supporting alternative investment funds, fund administration, risk management and so on. According to the MFSA’s statistics for Q1 2017, Malta had 26 recognised fund administrators, 115 Category 2 investment services groups, and 153 Company Service Providers.

From a fund launch perspective, a total of 21 Professional Investment Funds (PIFs) were licensed and three Notified Alternative Investment Funds (NAIFs).

“Overall, for the past 12 months fund formations in Malta have been strong,” says Nicholas Warren, Manager, Corporate Services, Chetcuti Cauchi Advocates. “We’ve seen our share of redemptions, however, these have been surpassed by the overall number of new funds.

“We have seen a number of different AIFs launch, including even a wine fund, and there are quite a few still going through the approval phase.”

For those considering Malta, they have a variety of options, both regulated and unregulated. The PIF and the AIF are both regulated products, whereas the NAIF, which can only be established by an authorised AIFM, is unregulated and offers managers a faster route to market.

As Warren explains: “The NAIF is certainly starting to gain traction among fund managers and law firms. It has a lot of potential and room for growth. That said, I think more needs to be done to raise awareness and explain that one can get to market within 10 business days after submitting the NAIF application to the MFSA. That is a big advantage.”

Whether a fund sponsor opts for the PIF or AIF product will largely depend on the asset class and the starting NAV, in Warren’s opinion, as well as the long-term marketing objectives and target investor profile.

“For example, we are in discussions with a potential client who wants to set up a small long-short fund. Initially, we thought the best choice would be to establish a PIF. But when learning that the strategy would be using leverage, and the overall exposure was going to move the fund beyond EUR100 million, we advised the fund manager that they would need an AIF.

“Another manager, based in the UK, wants to get a fund up and running relatively quickly. They are a full-scope AIFM so they have opted to set up a NAIF.”

From a legal entity perspective, he says the most common structure for hedge funds in Malta is the SICAV. This can be used for single fund structures and umbrella fund structures. In addition, promoters can choose to avail of the investment company with fixed share capital, limited partnerships, unit trusts, common contractual funds and one structure that is becoming increasingly popular: the Recognised Incorporated Cell Company (‘RICC’). The RICC does not require a CIS license, but will need to obtain a recognition certificate from the MFSA.

Warren says that the most recent regulatory update is that both the PIF regime and AIF regime have been consolidated. Previously, the PIF regime had Experienced, Qualifying and Extraordinary Investors. It now has one category: the Qualifying Investor Fund. The same is also true of the AIF.

Importantly, the MFSA is trying to reduce the licensing approval process for fund applications given that the time to market for fund sponsors is important.

“They are looking to introduce guidelines and ask the applicant to provide a breakdown of the prospectus in order to identify the fund’s key features, thus expediting the overall process,” concludes Warren.
Circle Partners is a global, independent fund administrator providing a comprehensive range of fund administration, corporate, legal and reporting services to investment funds.

www.circlepartners.com
Standing out from the crowd: The Netherlands

Interview with Peter Jakubicka

Across most EU jurisdictions, either the management company or the AIF needs to be licensed and requires some form of approval process. The Netherlands, however, is the exception to the rule. Under its light regime, neither needs to be licensed or supervised at all. This makes it a fast, efficient and cost-effective option for start-up managers.

Provided the manager runs an AIF with less than EUR100 million in AUM, he can avoid licensing and apply for an exemption, although he will be subject to certain registration and reporting obligations. For example, the manager must include a selling restriction in a prescribed form in all advertisements and documents announcing the offer of participations in their fund.

Taking this registration route, all the manager needs to do is register the management company with the Dutch regulator, the Authority for the Financial Markets (‘Autoriteit Financiële Markten’ or ‘AFM’) and pay a one-off fee of EUR1,500.

“There is no ongoing supervision by the AFM and the light regime offers a fair amount of flexibility,” says Peter Jakubicka, Business Development Manager at Circle Partners, an independent fund administrator that guides start-up managers through the process of bringing a new fund to market in all major fund jurisdictions. “The substance required is that the management company has a registered office in the Netherlands, which we can arrange for as part of our service package.”

The other option is to go through the licensing process and become a Dutch AIFM, even if the manager is de minimis, to avail of the passport under the full scope of AIFMD. This is mandatory once the AIF’s assets exceed EUR100 million (open ended), or EUR500 million (close ended).

“Once the threshold is exceeded the fund structure remains intact but the management company then faces two options: one is to go through the approval process to obtain its own Dutch AIFM license. The second is to appoint a third party AIFM, who offers its license to support the ongoing activities of the fund.

“A Dutch AIFM will then be subject to ongoing regulatory supervision by the regulator. Once the manager has obtained a license they are free to manage either a Dutch AIF, or an AIF domiciled in any other EU Member State, and benefit fully from the passporting regime. While remaining de minimis, once you know that your AUM is likely to exceed EUR100 million, you can commence the licensing process for the management company and continue to manage the AIF during the transition phase from sub-threshold to full AIFMD compliance,” explains Jakubicka.

Circle helps with all the paperwork and the licensing application for the management company, utilising its network of local law firms. In his perception, Jakubicka says that most managers, when they cross the threshold to become a full-scope AIFM, seek to appoint a third party AIFM.

“Some managers we know are in the process of obtaining their own license but it is quite an expensive and cumbersome process,” confirms Jakubicka.

In terms of structuring options, the most common option is to set up the AIF as an FGR, in the form of an open-ended fund structure. This would be the choice for hedge funds, whereas a Dutch limited partnership or commanditaire vennootschap (‘CV’) would ordinarily be used for real estate and private equity funds.

“The Netherlands is an attractive option because it has a stable economic and political climate, with excellent infrastructure. In addition, it has a good number of bilateral tax treaties with EU and non-EU countries and a deep pool of industry professionals working in financial services,” concludes Jakubicka.

Peter Jakubicka, Business Development Manager at Circle Partners
Choosing your prime broker

Interview with Jack Seibald

When setting up as a new hedge fund manager, one of the most important relationships to establish is that of the prime broker. With banks facing regulatory pressures in the form of Basel 3, many are re-appraising their client book to ensure that they are getting a suitable return on investment for the balance sheet they provide. Consequently, the first point for start-ups to focus on is to articulate what they will be doing with the fund they are planning to launch.

“Self-analysis is critical to defining what the service provider relationships will likely be. My advice to managers is that they talk with multiple service providers in each category, but only to do that once they’ve done the self-analysis part,” says Seibald.

What’s in a name?

Oftentimes, start-ups will blindly assume that they have to appoint Goldman Sachs to the fund because of the kudos that come with doing so. But as alluded to above, today is a completely different environment to a decade ago. Many of the bulge bracket firms have become far more discerning in who they do business with and have materially higher requirements (in terms of revenue threshold) when onboarding and engaging with new managers.

The start-up has to weigh what his true options are in the marketplace, rather than just assuming that by going to the biggest names they will a) get an account open and b) even if they do, that they will receive the same level of service as a billion dollar client.

Best of both worlds

Which is where the introducing broker model has its advantages.

Cowen runs a multi-clearing IB model and has clearing agreements in place with names including Goldman Sachs, Pershing (Bank of New York), Merrill Lynch (Bank of America). From a reputational and custody standpoint, this goes a long way to comforting institutional investors as it relates to asset protection and counterparty risk.

“Legally and technically, they are your prime broker and custodian. It’s an alternative way of getting a relationship in place with one of the bulge bracket names without having to deal with them directly as a standalone client,” says Seibald.

Cowen’s prime services unit, on the other hand, provides all the client-facing services as it assists with trade execution, trade break...
resolution and settlement, corporate action resolution, facilitating information flow to the manager’s other service providers (fund administrators, auditors), and more. Not only does it provide a route to working with bulge-bracket counterparties, it also means that the client benefits from a high-touch level of service and the types of solutions that only a large client might expect to receive from a bulge bracket firm.

Last fall, Cowen Prime Services extended its offering to London. Like in the US, Cowen Prime’s London platform offers European hedge fund managers securities lending and margin financing facilities, custody and trade execution services (both cash and synthetic), an outsourced trading solution, as well as aggregate portfolio reporting services.

Multi-prime model...?
When asked whether start-up managers should adopt a multi-prime model, Seibald suggests that it depends largely on the fund’s AUM. Some primes do not think too highly of the concept unless the manager is running a multi-hundred million dollar fund and is able to provide each appointed PB with a substantial level of business.

“Splitting potential revenues across more than one PB is a risk diversifier, but it becomes difficult for smaller and mid-sized managers to do this as they lose the benefit of cross margining the portfolio. They have to meet a certain level of business for two, three, four prime brokers, whereas holding the portfolio at one prime broker means the prime can be better rewarded while the fund’s cross-margining capability becomes more efficient.

“We have the ability to open funds on the books of any one of our clearing firms, or all of them, in a seamless manner because we keep a set of investment books and records on each of our clients’ funds in Advent Geneva. If a client started with Pershing, for example, and their assets grew substantially, to the point where they wanted to add Goldman Sachs, they wouldn’t have to go and strike up that conversation. We could offer them that solution directly,” explains Seibald.

Aggregate reporting
Another benefit to using Cowen as a multi-clearing introducing broker is that, even if the manager is already established and wishes to appoint Cowen as their second prime brokerage relationship, Cowen will provide aggregate portfolio reporting; something that few, if any, primes will offer.

“We will take electronic data overnight from a variety of prime brokers and custody banks and aggregate that data for each of our clients. We will report the aggregated portfolio regardless of where the rest of the fund’s assets are held, not just on the part of the portfolio that is held with us,” states Seibald.

When asked what he believes are one or two red flag issues that managers should be aware of before entering into an agreement with a prime broker, Seibald offers the following advice in conclusion:

“The two red flags that we try to avoid at all costs is firstly the notion of establishing minimum revenue expectations. We want to understand a manager’s business at the outset and then decide whether to enter into a relationship or not. Establishing minimums, in our mind, potentially gets the new partnership off on the wrong foot. Or worse, it may establish the price at which the service is valued, thus limiting future revenue potential for the prime.

“The second red flag is overpromising on capital introduction. It’s the one thing that new hedge fund managers want most and is the one thing that prime brokers have the least control over. Regardless of how well their efforts, they don’t have the power to influence the outcome.”
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Getting to grips with regulatory reporting

Interview with Charles Gillanders & Alan Doyle

Regulatory reporting has become a critical component of running an alternative investment fund. This requires well-developed data sourcing and data management processes to help ensure that fund managers remain compliant.

Until a few years ago, there were no formal regulatory reporting requirements on the part of alternative investment managers. Following the financial crisis in 2008, the European Union tried to figure out a reporting mechanism to obtain a clear handle on the size of the alternative investments industry, and the degree of counterparty exposure that exists.

The European Union subsequently introduced the AIFM Directive, within which Annex IV reporting can be found.

Determining the frequency of reporting requires a decision tree methodology based on whether the manager is EU based or non-EU based. The total assets of the manager will be considered – referred to as regulatory AuM – as well as the size of the AIF, the manager’s status (EU or non-EU), whether they are employing leverage or not in the fund (invariably an AIF will be employing leverage) and the type of assets being held in the fund.

In most situations, the frequency of reporting can be broken down as follows:

- RAuM is EUR100 million – EUR500 million (unleveraged): Semi-annual
- RAuM is more than EUR1 billion: Quarterly
- Any single AIF exceeds RAuM EUR500 million – Quarterly

UK-based AIFMs are required to file Annex IV reports electronically via its GABRIEL system using ESMA’s Annex IV reporting template, which is implemented in an XML file format.

Whereas Annex IV, for most start-up managers, many of whom will have less than EUR100 million in AUM, will only be an annual filing, what is of more concern is the transaction level reporting, which is due to come into effect under MiFID II on 3rd January 2018.

Regardless of the size of the manager, they will be required to transaction report on a daily basis. The MiFID II requirements on transaction reporting are set out in article 26 of MiFIR.

“Many clients’ prime brokers already do filings on their behalf, under MiFID I, but there is a concern that this will not exist forever, and as such they are having to think about alternative options,” explains Charles Gillanders, chief technology officer at Quintillion Limited, a European-based affiliate of U.S. Bancorp Fund Services. “Under MiFID II, transaction reporting will contain much more detailed information, including personally identifiable information, which the sell-side will not necessarily be happy to report on.”

As a result, investment firms are more closely considering which Approved Reporting Mechanism (ARM) they work with to comply with their reporting obligations.

“We have just completed a comprehensive RFP process to select a regulatory reporting partner. We have selected someone who will, as an ARM, provide us with a robust MiFID II reporting solution for our clients,” confirms Gillanders.

For context, MiFID I has 30 reportable fields whereas MiFID II has close to 80 reportable fields.

Even if a prime broker were to continue doing transaction reporting for their clients, they would have to invest significantly in technology to extract the additional information.

Alan Doyle, head of strategy, alternative investment fund services at Quintillion, confirms that the fintech firm that Quintillion has selected as its trusted partner will combine the administration capabilities they...
have in identifying the data sources, with their ability to take all of that data, aggregate and file it on behalf of clients to the relevant regulatory authorities.

“Phase one of working with this partner will include providing a solution for Annex IV, Form-PF and CPO-PQR reporting. That is for the retrospective annual, semi-annual or quarterly reporting requirements. Phase two will support more detailed periodic reporting and end-of-day reporting: EMIR, Solvency II reporting, etc,” confirms Doyle.

“We’ve spoken to clients who have attempted to do regulatory filings themselves, or have been using an outsourced technology partner or fund administrator, and really there are pros and cons to every approach.”

Some managers find that they struggle with the onboarding process when getting set up with a technology provider. Regulatory technology, or ‘Regtech’, has quickly become a growth area and several technology providers are jumping on the gravy train. The problem with this is that they lack the knowledge that is needed to handle the nuances of regulatory filings.

“They need to meet particular file format demands and use different reporting systems. It quickly becomes quite a large undertaking for some technologists,” says Gillanders.

The other option is for managers to take on the reporting responsibilities in-house. Many soon find that while they might have the expertise and data management capabilities, they struggle to keep everything up-to-date.

“The regulators constantly update things, there are regular updates on filing requirements. It becomes a maintenance burden on managers,” says Doyle.

“We think we are able to help resolve the two problems simultaneously. We live and breathe the underlying information streams of our clients’ funds and know the data very well. We have the internal resources to conduct data mapping, make sure the data is going to the technology provider in the correct format and confirm everything works as it should.

“At the same time, the technology provider we have chosen is committed to remaining up-to-date at all times with the regulators; whether it be the latest Q&A released by the ESMA, the SEC or the NFA. They have that expertise to maintain the regulatory filings despite the ongoing changes that might occur. It is an effective, solution for our clients.”

Gillanders explains that with Annex IV reporting clients are required to report static and portfolio data. Some 38 questions relate to the AIFM, most of which require static data, while 295 questions relate to the AIF.

Static data includes information on the investment manager, the fund strategy, its risk profile and so on.

“One of the high-level objectives of the regulator is to pick up outliers or changes that indicate a change in the risk profile. Investor data also needs to be reported based on country, investor type (professional, retail) and the degree of investor concentration, or otherwise, as well as the redemption terms, notice period and exposure to side pockets where applicable.

“The regulators also want to look at month-end portfolio data, which outlines the market value of each of the fund’s open positions. If on any given quarterly basis there are found to be material movements compared to what was reported the previous quarter, it will get picked up. Exposure levels based on counterparties, currencies and countries are also reported,” explains Gillanders.

All of the funds overseen by the investment manager are reported on in one filing to the local regulator under the banner of the AIFM. If one is outsourcing this function, as several managers opt to do, it will be the responsibility of the third party AIFM.

Doyle does not think there is materially significant difference in regulatory filing requirements for European managers relative to US managers.

“There is quite a bit of crossover in terms of the questions being asked and the underlying data which will comprise the answers. Making sure that you know where the data is going to come from is vital. There are always going to be some firms that want to maintain everything in-house but it comes with maintenance requirements.

“If you are going to outsource at all, selecting the right partner who has both the data source responsibilities and the expertise to adapt to changing regulations is highly important.”
We offer a robust and extensive solution for UCITS and AIF’s, leveraging on unparalleled track record in fund governance, market leading technology as well as broad and deep expertise.

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The ‘Anti-ManCo’ ManCo

Interview with William Jones

MPL Management (Luxembourg) S.A. is a third-party ‘Super Management Company’ providing fund governance, operational support and oversight to both UCITS funds and AIFs. It is part of MPL Group, founded by William Jones in 2006, who has, over the past 26 years, helped set up more than 100 funds in his career.

In 2008, Jones decided upon Luxembourg as his preferred European base for directorship services. At the time, he had no specific interest in setting up a management company.

“The premise I operate from - and why I refer to MPL as the ‘anti-ManCo’ ManCo - is that the original UCITS ManCo didn’t do anything, operationally speaking,” explains Jones.

“As the UCITS ManCo model is fully delegated, their role is merely to ‘monitor, comply and report’. In reality, all they do is re-hash the data that investment managers provide them with; they move seats on the Titanic without doing anything to avoid hitting the iceberg.

“At the time of the financial crisis I was sitting on the board of various Luxembourg funds that used third party ManCos and said to myself, ‘These firms are not doing anything to solve the various problems affecting these funds’. At that point, I decided it was best to set up my own management company.”

The aim was clear: to offer a ManCo that adds true value to clients and effective independent oversight; in other words, a ManCo that actually does things for the client, not just pay lip service to corporate governance and operational oversight.

“One client that we onboarded had a Cayman fund and said that they wanted a Luxembourg fund and a US ‘40 Act fund. Yet they had a disjointed marketing strategy. We helped them redesign their whole marketing approach. That’s something that few, if any ManCos, are willing or able to do,” says Jones.

Another example Jones provides refers to a client who was using a fund administrator that was, in brutal terms, inept at performing the fund’s NAV calculation. The whole process was all over the place. Whereas a lot of ManCos will sit back and allow the administrator to own the process, MPL stepped in and remedied the situation.

“What I call an ‘anti-ManCo’ ManCo is, first and foremost, operationally adept, engaged with the client, and knowledgeable, particularly in terms of the underlying asset classes.

“Anecdotally, there are numerous ManCos operating in Luxembourg and Dublin that simply lack asset class knowledge. How can you review what’s in a fund portfolio if you don’t even know how it operates, how trades are settled, etc.? Our team has deep asset class knowledge. I built the business from the bottom up by identifying and hiring the right individuals whereas most ManCos are built top down,” explains Jones.

He says that one important question for managers to consider before selecting their AIFM is: Where does the third party ManCo end and the investment manager begin? What is it that the delegated ManCo has to do from a regulatory perspective? Can the local-based manager do any of those things? How do these two entities interact on a day-to-day basis?

“That is where the operational value comes into play when clients appoint MPL. We can deal with various operational breaks as and when they occur, so that by the time the COO of the locally-based investment manager gets the information, the first round of operational processing and analysis has already taken place. This helps avoid the duplication of tasks. And very few other ManCos do that,” concludes Jones.
Typically there are three options for managing external money: using managed accounts, setting up a dedicated fund structure or launching a fund on a regulated fund platform.

The latter is best thought of as a halfway house option and is particularly suitable to those launching with EUR10 to EUR30 million in AUM, or even less. The beauty of the fund platform is not only does it provide efficient speed to market, it allows fund managers to concentrate on what they are good at, operating with a lean team that helps to keep management company costs to a minimum.

The Lawson Conner Group runs the Discovery Investment Manager Platform. By leveraging its FCA license, managers can act as Appointed Representatives and take succour knowing that all the operational, regulatory and compliance infrastructure is in place to support the fund and their investors.

“Lawson Conner also acts as the AIFM to the Discovery Platform. This is a full scope AIFM called G10 Capital,” explains Andrew Frost, Director, Investment Management Solutions. “This means anyone launching a fund can avoid going through the process of selecting an AIFM as there is an award winning one already in place. G10 Capital also acts as the principal firm to the Appointed Representative. It is an all-encompassing solution.”

The sub-fund that one runs on Discovery is structured as a Cayman Islands Segregated Portfolio Company (SPC), with Frost confirming that later this year Lawson Conner will have an Irish ICAV in place, for those preferring onshore fund structures.

These fund platforms are best thought of as pre-structured ‘plug and play’ fund solutions. A lot goes into launching a fund: appointing independent directors, selecting the main service providers (auditor, fund administrator), paying for legal counsel representation.

“These are all costs related to the fund and it requires a lot of work. In most cases, start-up managers won’t have a COO to handle this. In the pure start-up space, therefore, establishing a standalone commingled fund is not always necessarily the most cost efficient option.

“The only consideration for the manager is to choose their preferred prime broker as this is not part of the pre-structured solution. G10 Capital, as the authorised AIFM, has agreements in place with most of the top tier prime brokers on the street.

PwC, Apex Fund Services and Harneys are the main service providers that work with Discovery. Discovery already has a private placement memorandum that has been signed off by offshore counsel. All the manager needs to do is write a supplement to the prospectus. This, says Frost, will include details on the manager’s investment strategy, the types of instruments it will be trading, performance fees and the backgrounds of the portfolio managers.

“When they do a European roadshow it means they’ve already got a PPM that they can put in front of a prospect. This demonstrates that the fund is up and running, bank accounts are open and a subscription document is ready for investment,” states Frost.

Crucially, the investment manager has their name on the fund, it is their branding and marketing strategy with the Discovery providing the regulatory and compliance infrastructure to allow this.

Frost confirms that as well as hedge fund structures, a number of private equity clients are using the Discovery platform for co-investment opportunities.

“They can get the sub-fund set up within a matter of days and close on deals much quicker. We think it is a trend that will continue,” concludes Frost.
Luxembourg has the tools to support global distribution ambitions

Interview with Mike Delano & Begga Sigurdardottir

Luxembourg is one of the world’s leading onshore domiciles where, over the last 30 years, it has become the default option for managers wishing to establish UCITS funds. It is, by size, the world’s second largest fund centre after the US, and, from a funds expertise perspective, offers managers everything they need; not just for UCITS funds but also unregulated or regulated alternative fund structures under AIFMD.

Through February 2017, total Assets under Management (AuM) for Luxembourg funds had risen 13.6 per cent year-on-year to 3.86 trillion euros, according to the latest statistics by the Association of the Luxembourg Fund Industry. Back in 1985, when Luxembourg became the first jurisdiction to transpose the UCITS Directive into national law, total AuM stood at 58 billion euros.

“All of the largest service providers operate in Luxembourg. If you draw a circle of 500 kilometres around Luxembourg you can attract more than 40 per cent of the European wealth,” says Mike Delano, partner at PwC Luxembourg. “If you look at the size of Luxembourg’s financial services industry, relative to its wider economy, it is very substantial. The government is willing to work with the financial services industry to make sure it remains a viable part of the economy.” Luxembourg is famous for its long standing political stability and has one of the lowest debt to GDP ratio in the EU.

Luxembourg’s funds do not just have European investor appeal; they are sold in more than 72 countries worldwide. In Europe, a large part of the Grand Duchy’s appeal is that it is viewed neutrally by investors.

“There is a lot of flexibility with Luxembourg fund vehicles and in many ways reflects the legal and regulatory environment. It is neutral, it has been geared towards the asset management industry, and the services it offers are able to support the global asset management community. It makes Luxembourg a viable option for a lot of fund managers,” explains Begga Sigurdardottir, tax partner at PwC Luxembourg.

Part of that flexibility applies to Luxembourg’s tax regime; a key consideration for any fund manager. Luxembourg investment funds are generally tax neutral.

“Whether it’s a private equity fund, real estate fund or hedge fund, very often the manager needs holding companies and additional vehicles for legal ring fencing reasons, and in such situations you do not want those vehicles to be tax inefficient. This is where Luxembourg’s tax laws have allowed for enormous flexibility to make sure vehicles remain tax neutral and investors are not penalised,” states Sigurdardottir.

Before a start-up manager even thinks about setting up an AIF in Europe, there are a couple of key considerations. “Firstly, who will be the target investors and which EU countries will they be located in? Secondly, what is the fund’s asset class and where are the assets going to be located? It’s important that everything works from a tax perspective because unlike a UCITS fund, an AIF is very different. It may need to use holding vehicles in various jurisdictions, especially if it is a private equity or real estate structure,” says Delano.

Also, managers should think about the capability of the jurisdiction they are considering for the fund. Does it offer the service providers and level of expertise
needed to fully support the fund? Recently, several large alternative investment managers of Blackstone and Carlyle Group, have announced that they’ve chosen Luxembourg as their hub for Europe.

“Those are good names for the jurisdiction. It adds real credibility, from an AIF perspective,” adds Delano.

These announcements show the impact that Brexit is now having, as large established managers look to set up operations on the mainland - Luxembourg or otherwise - to fully benefit from the passporting rights offered by AIFMD; something that cannot be guaranteed for the UK unless an equivalence agreement is achieved.

In terms of fund structuring, Luxembourg offers a menu of options. These range from regulated AIFs, known as Specialised Investment Funds, which can be established as a Luxembourg Common Fund (FCP) that has no legal personality and managed by a management company, or as an investment company with variable capital (i.e. Luxembourg SICAV); two choices of limited partnerships, called a common limited partnership (i.e. société en commandite simple, or SCS) and a special limited partnership (société en commandite special, or SCSp), which can either be regulated or unregulated; and finally, the most recent product innovation called the Reserved AIF (“RAIF”), which is an unsupervised product.

“Luxembourg offers a wide range of vehicles that fit all investors. You may have investors that prefer a regulated vehicle, in which case you would opt for product regulation (SIF). Or, if the institutional investors being targeted are used to offshore unregulated products, you may want to offer them something similar in Europe. In this case, one could use either a RAIF or an unregulated SCS or SCSp. Unregulated limited partnerships are very popular in private equity, less so in real estate and credit. The difference between the two is that the SCSp has no legal personality,” explains Sigurdardottir.

As of now, Delano says that there are more than 110 RAIFs registered. It has proven to be a relatively successful product in a short space of time.

“I think alternative fund managers are excited about the opportunities the RAIF offers. One of the benefits of the RAIF that is worth pointing out is that it can, at a later date, be converted into a SIF if a large institutional wants to invest but only if it is a regulated vehicle.

“It can be launched and marketed as a RAIF in the early stages, and transformed into a SIF at a future point in time, which is advantageous,” observes Delano.

The RAIF can also be compartmentalised, meaning that the fund sponsor is able to incorporate different cell companies, which could be used to create a suite of fund strategies. The benefit of it is that it avoids the cost impact of setting up multiple funds. Sigurdardottir confirms that in principle a RAIF needs to adhere to risk diversification limits: this is typically a 30 per cent counterparty exposure limit based on the NAV.

Anyone who opts for Luxembourg knows that they will be getting access to a premier funds centre, which is fast becoming used as the focal point for global distribution among the world’s largest fund management groups.

“Many global service providers operate in Luxembourg with multi-national workforces that can interact with different regulators, investors, other service providers, etc in their native language - English, German, Italian, French and so on - and being able to do that is one of the country’s strengths. It is a truly international community here," says Delano.

He thinks that over time, AIFs have got the potential to become a brand like UCITS.

“We hope it turns into something that is recognised as a solid regulatory regime and accepted by global institutional investors, not just those based in Europe. In the past, managers might just have used a Cayman Master fund and a Delaware LP. That will still remain popular but I have, for example, a client who has set up a RAIF Master fund with an EU feeder, a Cayman feeder and a Delaware feeder to ensure they can continue to easily raise capital from European investors.

“They are taking one fund and achieving global reach by using Luxembourg as their European hub for distribution," says Delano in conclusion. ■