

# The changing fund environment



**Customisation  
key to meeting  
servicing needs**

**Independent  
model appeals for  
alternative Ucits**

**Crisis legacy lingers  
as managers eye  
new opportunities**

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# Flexibility key for service providers in new fund climate

By Simon Gray

The impact of the global financial crisis and economic downturn upon the alternative fund industry is reflected in a more difficult fundraising environment and new challenges for managers such as greater regulation and increased investor demands for transparency, according to leading providers of administration, legal and brokerage services to funds and their managers.

These developments have led to a shift from standardised products and industrialised processes toward greater service flexibility and customisation, the firms say. Off-the-shelf structures are frequently giving way to individualised investment solutions; service providers are moving away from centralised, often 'offshored' operations in favour of smaller units that are closer to the client both geographically and in the way they work.

These changes are particularly pertinent in the fund administration sector, according to Peter Hughes, managing director of Apex Fund Services, who says his firm's focus on establishing offices and delivering services in the jurisdictions where fund managers are

located improves the level of service Apex can provide, through better understanding of the clients' business, problems and needs.

"Over the past three or four years we have been travelling the world to find out what fund managers are looking for," Hughes says. "We have more than 20 offices around the globe wherever there are fund management communities. Being close to clients enables us to receive feedback at first hand and to adapt to managers' requirements. No matter where they are, how big their fund is or what their strategy is, we can provide appropriate solutions and do so locally."

The human factor is vital in delivering highly personalised services to clients. "It comes back to having good people in our offices that can deliver the work locally and understand our clients' business," he says. "For example, the managing director of our Shanghai office knows how to route money into and out of China in legal ways that we can share with potential clients. That kind of local expertise is not something you ▶ 6



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# Customisation instead of commoditisation

By Peter Hughes

In the wake of the financial crisis, the global alternative fund industry finds itself in a changed environment characterised by increased regulation and new investor demands in areas such as liquidity. As a result, the way in which managers operate and the kinds of domicile and investment structure they favour is evolving to enable them to flourish in this new climate – and service providers are having to adapt too.

One of the key changes is a shift from commoditised, industrialised administration services that placed a premium on economies of scale and operations in low-cost jurisdictions toward greater flexibility and personalisation, which requires a much closer ongoing relationship and the ability of the service provider to determine and respond to the manager's needs, rather than presenting them with a fixed menu of services.

With more than 20 offices around the world – the latest in Australia – Apex Fund Services has long made it a priority to establish a presence wherever fund managers cluster together. Proximity to the client facilitates feedback and makes it easier to adapt to an individual manager's characteristics such as size, strategy, reporting needs and investor base. This customised service helps managers in their efforts to grow their business, which in turn benefits the administrator.

The past few years have been tough for the industry in financial terms, and the fund-raising environment remains difficult, especially for new entrants to the market. One way in which service providers can assist managers is in developing lower-cost solutions for setting up their funds, helping them to create a track record and build a business platform that will stand them in good stead when market conditions improve. Bigger fund managers can also benefit significantly from the white-labelling by Apex of services such as real-time risk



**Peter Hughes is managing director of Apex Fund Services**

management and P&L reporting, enabling them to provide a better service to their investors at a lower cost.

The growth in oversight of the industry worldwide and a greater preference among many types of investors for regulated fund domiciles and products is prompting managers to set up funds in onshore European Union jurisdictions such as Malta, Luxembourg and Ireland. They are also embracing the Ucits regime, which offers greater security for individual investors, greater flexibility for institutions and increased distribution opportunities, but also more restrictive and onerous investment, liquidity and transparency rules.

Managers fear that increased regulation will automatically add to their costs, stifle entrepreneurialism and raise entry barriers to the industry. The task – and opportunity – facing administrators such as Apex is to provide systems that enable managers to meet the new requirements without a crippling increase in costs. Outsourcing of IT-led functions such as regulatory compliance, risk management and reporting can save clients from having to invest in staff and system development, enabling them to focus on the core activities of attracting capital and delivering investment performance.

One of the casualties of the crisis has been the one-size-fits-all approach to fund services that formerly prevailed among some providers, coupled with an obsession with cost-savings and efficiency at the expense of customer service. Today that is evidently a false economy. Whatever the manager's requirement – Luxembourg or Cayman domicile, unregulated fund or Ucits – administrators must have a thorough understanding of their clients' needs and the flexibility to meet them, wherever in the world they are located. Helping the manager achieve success will bring success for the service provider, too. ■

3 ► can expect from an administrator of Chinese funds based in Ireland.”

Hughes adds: “Our strategy is to obtain a better understanding of managers’ business and what they need to grow. It’s no good just churning out NAVs without considering clients’ situation and their particular needs. We are trying to add more value in the services we provide, because that is how we develop our own business. If the funds get bigger, we get paid more. Everybody’s interests are aligned.”

This is particularly important, he argues, because of the difficulties faced by many managers, especially new businesses, in an environment where fundraising remains long and arduous. “When there isn’t much liquidity around, as has been the case over the past couple of years, it’s about finding the lowest cost ways for people to set up funds, create a track record and start building a business,” he says.

Ultimately, Hughes believes, finding ways to help the asset management industry to thrive in the new environment is a more productive approach for administrators than cost-saving strategies that may entail trade-offs in terms of service quality. “Some of our competitors are more focused on ways to save costs and make their business more efficient than on giving good client service,” he says. “Staff working out of a low-cost centre in India will probably not be aware of what clients are looking for. Such firms may not be interested in providing out-of-the-box solutions; instead clients have to fit into the box that they offer.”

Increasing regulation is an added complication. “That’s inevitable, and it’s what shareholders are insisting on after their experience over the past few years,” Hughes says. “They are the ones with the capital to invest, so fund managers have to respond by delivering what they are asking for. That may mean products in more regulated jurisdictions such as Malta, Luxembourg and Ireland, and more retail-friendly types of fund such as Ucits, which tick most regulatory boxes but are the most onerous to operate.”

According to Hughes, the biggest fear of the asset management industry is that the wave of new regulation will stifle growth and innovation by creating insuperable barriers to new entrants, but he believes administrators can mitigate the risk by helping managers



to adapt to the changes at a cost they can afford. “We are examining ways to provide systems that enable our clients to meet those requirements without incurring huge costs, which is what they are afraid of,” he says.

The increased take-up of Ucits structures as a vehicle for hedge fund strategies has been boosted by uncertainty over the eventual implementation of the European Union’s Alternative Investment Fund Managers Directive, which will take effect from around mid-2013. Although the framework of the directive was agreed last November after more than 18 months of at times heated debate between EU member states, industry members are still uncertain about the shape of the detailed subsidiary legislation and regulation that will spell out how the directive will work in practice.

“The full impact of the AIFM directive is not yet clear because it still has to be interpreted by different jurisdictions,” says Andrew Dollery, who is responsible for origination and structuring at prime broker Newedge. “Up to last November offshore managers were concerned about whether they might be shut out of the EU market, and what would happen to US managers marketing into Europe. Some of those questions have been answered, but Ucits structures continue to attract plenty of demand.”

Dollery believes that the comfort managers and investors have with the long-established and highly successful Ucits brand will ensure continued robust demand from the hedge fund community, despite the introduction of

the European 'passporting' facility under the AIFM Directive. "There is more than EUR6trn in Ucits funds today, which has built up over the past 25 years," he says. "Hedge funds have been dipping their toe into the water for the past two or three years, and there is now quite a lot of momentum behind the structure within the community. It will continue to grow, it's not a fad."

Paul Farrell, a Dublin-based partner in the global investment funds group of law firm Walkers, says that investors and managers are more keen to go down the Ucits route, despite its greater investment constraints, than into regulated onshore alternative fund products such as the Irish QIF or Luxembourg SIF. "If they can fit their strategy within the Ucits regime, they will do so," he says.

"The most important driver is that Ucits offers huge distribution opportunities. Not only does it bring a European passport, but Ucits funds can now be registered for public sale in up to 70 jurisdictions across the world. It is a truly global mutual fund that works almost everywhere but the US. Another driver is that Ucits is a settled regime. People are unsure as to how the AIFM Directive will work out, but if they can fit their strategy within Ucits, they do not have to worry about that."

An example of how the industry is becoming less commoditised and more bespoke is that start-up managers have become much more open-minded about the jurisdictions and structures they use, according to Farrell's London-based colleague from Walkers' global investment funds group, Deborah Poole.

She says: "We're seeing a steady increase in single-investor products used by family offices to manage the family wealth where different members are in different jurisdictions around the world, and they need a mutual, flexible structure to hold their assets. In addition, trustees are using single-investor fund structures in an effort to minimise their fiduciary risk when they bring in third-party experts to manage particular assets."

Hughes insists that service providers must be ready to accommodate the needs of managers whatever their preferences. "We are completely agnostic about which jurisdiction they use to because we cover all jurisdictions," he says. "We are not trying

to force them down a particular path. A firm that only had operations in Cayman and Luxembourg might say that Luxembourg is the best place to go in Europe whereas Cayman is best if you're going offshore. By contrast, we can give completely objective advice designed to help the manager become as successful as possible."

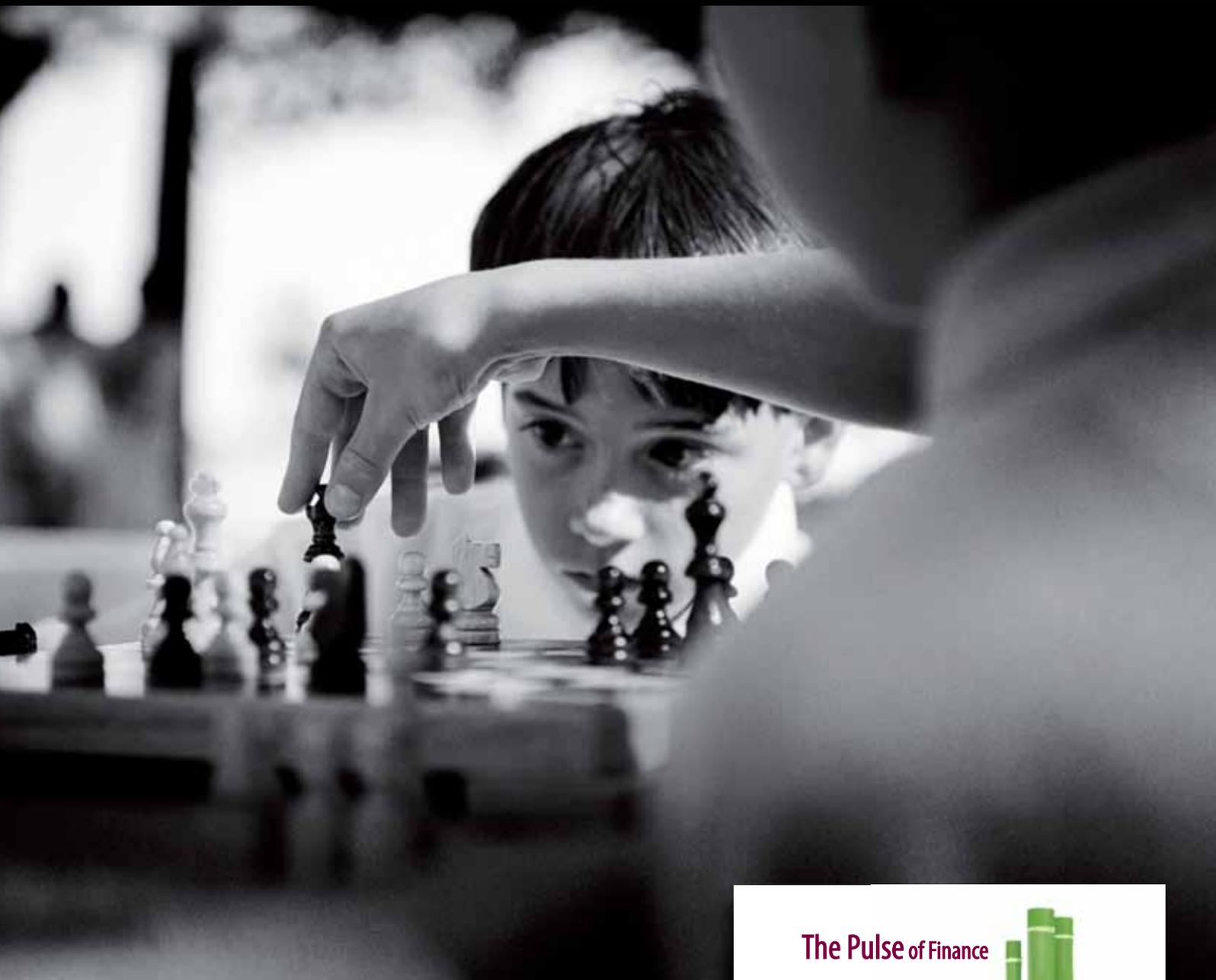
A further complication for the industry is the new rules on the role and responsibilities of a fund's depository that will be brought in by the AIFM Directive (and are set to be replicated in Ucits V, the next iteration of the directive). However, Farrell argues that the situation could have been even worse had the proposals suggested in early drafts of the directive been adopted.

"The change in depository liability in the directive was very important," he says. "Otherwise depositories would have almost been in the position of insurers to the funds for which they provide custody, and the cost of setting up funds in Ireland or Luxembourg would have gone up considerably. As it is, Irish-based custodians are lobbying to ensure that the detailed rules contained in Level 2 measures will not affect the industry too significantly."

The revised directive will still see custodians take on greater responsibility for losses incurred by alternative funds through fraud or negligence, but they will not be subject to strict liability irrespective of how they have performed their safekeeping duties. Farrell notes that in part the initial draft of the directive appeared to have been a reflex response to the issues highlighted by EU-based feeder funds that channelled investors' capital to Bernard Madoff's massive Ponzi scheme: "It was a reaction to the situation where Madoff was appointed as a sub-custodian to funds in Luxembourg and Ireland and investors lost out.

"Custodians must do proper due diligence on entities they are proposing to appoint as sub-custodians, and if they fail to do so, they may be liable. But it's going much too far to hold a depository responsible for all the actions of a sub-custodian; insurance-type arrangement are not appropriate for these types of fund. That would force a lot of players out of the market and make it more difficult for managers of small and start-up funds." ■

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# Ucits solutions in an evolving environment

By Andrew Dollery and Sophie Bentley

The proliferation of alternative Ucits funds has become a key feature of the fund industry landscape as investors demand more regulated, transparent and liquid products. Newedge has responded to this demand by taking an open architecture approach to servicing Ucits-compliant strategies.

Some funds have chosen to launch through integrated Ucits platforms that offer an established legal entity and operational infrastructure. However, for many the benefits of launching a Ucits fund independently, despite the cost and work involved, outweigh the advantages of a platform. From a branding, control and cost perspective, we believe this is often the most efficient long-term solution.

Newedge's Ucits service offers a comprehensive solution to support managers looking to launch regulated products. An open-architecture approach to working with other service providers, in multiple domiciles and structures, gives clients the flexibility to create products that suit their own business model. This natural extension of Newedge's non-conflicting, agency-based, brokerage model provides various clear benefits.

**Branding:** Continuity of branding represents a key element in any manager's marketing strategy. Where managers set up their own fund, they maintain control of the branding associated with a new product. This may prove optimal in the long run compared with 'leasing' a sub-fund from a platform.

**Flexibility:** By launching their own fund managers can select their preferred service providers such as administrator, custodian and clearing/financing counterparties. This minimises disruption to middle and back office operations through the replication of existing relationships and set-ups.

**Jurisdiction and structure:** Clients can select their preferred domicile and legal structure, according to investor or manager preferences. Margin/collateral arrangements



Andrew Dollery and Sophie Bentley are responsible for origination and structuring at Newedge Group

can be tailored to specific requirements.

**Distribution:** By creating their own structure, managers can tailor and control the distribution strategy. For example, Newedge works with Ucits clients through its Capital Introductions team to help source potential investors. This added-value service complements in-house sales teams and third-party distribution channels.

**Total return swap:** With a commanding position as prime broker to CTA and global macro strategies, it has been important for Newedge to expand its offering to include a Ucits-compliant solution for these managers, allowing them to gain commodities exposure equivalent to their futures trading programmes.

Since Ucits funds cannot hold commodity futures contracts directly, Newedge has developed a total return swap product, enabling funds to take synthetic exposure to a financial index whose underlying consists of a diversified range of liquid contracts, including commodities. Clients seek regulatory approval to create this Ucits-compliant index and, once authorised, the manager can systematically trade the index constituents via a Newedge account.

Dan McCausland, head of client services and marketing at Aspect Capital, says: "Launching a Ucits version of the Aspect Diversified Fund was a strategic priority. It was essential that we could rely on the counterparties we worked with to build the fund and that they could contribute to the construction process.

"We were well repaid by Newedge on both fronts. The fund depends on a swap provided by Newedge to access the returns of a Ucits-compliant index, which replicates Aspect's managed futures programme. The daily three-way process with the calculation agent for the index works smoothly, and USD250m raised in the first four months testifies to investors' approval of the product." ■



# Fund industry adapts to regulatory and investor scrutiny

By Simon Gray

Legislators, financial regulators and investors in alternative funds are examining how the informational deficiencies that did much to exacerbate the industry's problems over the past few years can best be remedied. Their efforts to address the problems have already resulted in substantial changes in approach and working practices not only for hedge fund managers but for the firms that provide services to the sector.

The need for greater transparency is resulting in new requirements for more frequent and more detailed reporting to regulators and to investors. It is also prompting the use of structures of which transparency is an inherent characteristic, notably Ucits funds, as opposed to classic offshore vehicles, not least because more highly regulated funds in general benefit from

a correspondingly greater scope in terms of distribution.

At the same time, investors are seeking – and in many cases receiving – the benefits of oversight and control offered by managed accounts and single investor funds. Although the bespoke quality inherent to a lesser or greater extent in such structures is liable to entail additional costs by comparison with traditional pooled funds, for many institutional investors in particular this is a price worth paying for peace of mind and protection against the unpleasant surprises that some experienced in 2007 and 2008.

This brings new challenges – but also opportunities – to industry players such as prime brokers, whose sector has been transformed by the disappearance or sale in 2008 of industry heavy hitters Bear Stearns

and Lehman Brothers, and the emergence of others. “A few prime brokers have exited the business or merged, and the US in particular has seen the phenomenon of mini-primes emerge,” says Andrew Dollery, who is responsible for origination and structuring at Newedge.

“That has been driven to some extent because the US market is homogenous, and there’s a very large asset base. In Europe, by contrast, we have not really seen the development of mini-primes, but a greater dispersion of market share among a group of eight or 10 large prime brokers. It is no longer the duopoly, relatively speaking, that you could say existed up to 2006 and 2007, but a much broader and more competitive market environment.”

Dollery says prime brokerage businesses have responded in different ways to the emergence of Ucits structures as an avenue to access both institutional and affluent investors in Europe. “Some have taken the platform approach,” he says. “They not only provide prime brokerage but offer their own legal structures to clients.”

Newedge, by contrast, has opted for an agency-only conflict-free business model. “We consciously decided not to move into the asset management space by offering clients our own structures for them to sub-advise, which set us apart a bit,” he says. “We remain a prime broker to Ucits funds as opposed to entering into what is almost a joint venture. There are obviously arguments for both approaches, but we believe that from a cost, flexibility and branding standpoint, having managers keep control of the structure is optimal in the long term.”

Setting up a Ucits fund is not something to be undertaken lightly, Dollery cautions. “A lot of work goes into it,” he says. “Whether managers join a platform or choose to do it on their own has an impact on a lot of things, notably the total expense ratio.” Platforms may not be the cheaper solution over the longer term, he says: “For maybe EUR50,000 you can have your own Irish or Luxembourg structure and avoid paying anywhere from 20 to 80 basis points to a banking group every year of the fund’s existence.

“Investment banking platforms may offer advantages in terms of time to market, but the manager is to some extent stuck with the



jurisdiction and service providers that the bank has chosen. From a branding point of view it’s effectively a joint venture that you can’t get out of without basically shutting the fund.

“By contrast, when we went live with Aspect Capital in December 2010, they set up their own Ucits-compliant CTA strategy in Ireland to which we are the swap counterparty. It allows them to be masters of their own destiny to a large extent, as they would be in the case of a Cayman fund. It’s been tremendously successful in terms of fund raising, with USD250 in the first four months. Investors seem to like a clean structure where the manager sets up its own structure and there aren’t multiple layers or fees.”

Dollery also notes that some platform providers charge fees on all assets raised for their Ucits funds, even if the manager’s own sales team has won the business. “If you do it yourself, our cap intro team will support the launch as a value-added service,” he says. “These are all debates that we have with clients when they’re looking at which structure to use. There is no single right answer – platforms will argue, for instance, that they take away the regulatory burden. But it’s an importance decision for managers when they come to launch their first fund.”

Managed accounts offer an alternative for investors with larger amounts of capital to invest, but Dollery argues that they represent the other side of the same coin to Ucits funds. “Many institutions prefer to ask for a managed account if they have enough capital to allocate to a particular manager or strategy, say USD20m, and if the manager can accommodate that,” he says.

# Regulatory changes and new opportunities

By Paul Farrell, Ingrid Pierce and Deborah Poole

With the impact of the global financial crisis on the performance of investment funds fading, managers' attention is increasingly focused on the evolving regulatory framework. However, the after-effects of the crisis linger on in issues related to managers' power to suspend redemptions and the ability of disgruntled investors to wind up solvent funds.

With final agreement on the EU's Alternative Investment Fund Managers Directive and the impending introduction of the Dodd-Frank Act in the US, 2011 represents perhaps the best capital-raising environment for some time, with hedge fund managers poised to take advantage of significant opportunities, particularly in Europe.

## Winding up of solvent funds

A persisting issue is whether investors can have a solvent fund wound up on the grounds of 'loss of substratum' - that the fund's underlying purpose is incapable of being achieved. This stems from the adoption by various managers in 2008 of liquidity/distressed techniques that resulted in their funds being placed in informal run-off.

More than two years on, some investors are applying to the Cayman Islands court to wind up funds on a solvent basis. In at least one case, the Cayman court has held that this type of orderly wind-down by the board of directors and its manager does not accord with the reasonable expectations of investors in a hedge fund and has exercised its discretion in favour of investors to wind up the fund on just and equitable grounds.

In other cases, where the court has been satisfied with how the manager and board of directors have handled the wind-down of the fund's business (including the regularity with which capital has been returned to investors), it has refused to make a winding-up order.

Having to defend applications of this type while seeking to close the fund on an orderly



Paul Farrell, Ingrid Pierce and Deborah Poole are partners within the global investment funds group at Walkers

basis can be both time-consuming and costly for the manager, potentially resulting in lower returns to investors. Regular communication with investors and transparency regarding fees and the run-off process generally can often avert investor action of this type.

## Redemption powers in fund articles

Some of the fund restructurings following the financial crisis have also raised important issues about the ability of funds to suspend redemptions, and relevant court decisions have been watched closely. In *Culross Global SPC Limited v Strategic Turnaround Master Partnership* [2010] UKPC 33, the Privy Council finally put to rest certain questions that had been hotly debated over the previous year.

Subject to specific provisions in a fund's articles, the general position is that redemption occurs on the intended redemption date, not on the date of payment of redemption proceeds. Thus an investor becomes a creditor on the redemption date even if the redemption proceeds to which it was entitled have yet to be determined and the due date for payment has not yet arrived. As a result, managers should ensure that administrators remove investors from the register of members as soon as legally possible.

Furthermore, where offering documents purport to grant redemption powers that exceed those in a fund's articles of association, they will be of no legal effect against investors. Managers launching new funds or undertaking updating exercises should ensure that the redemption provisions in the fund's articles either replicate or refer to those of the offering document.

## US regulation

The financial crisis has prompted the most significant regulatory shake-up the industry has ever witnessed. Although this primarily impacts managers, there are important

implications for offshore funds. In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act introduced sweeping changes affecting both US and non-US hedge fund and private equity managers and investment advisers, including those with Cayman funds.

Critical for managers is the elimination of the 'private advisor exemption' from registration with the Securities and Exchange Commission, previously available to investment advisers who satisfied certain criteria, notably having fewer than 15 clients. As a result, many investment managers currently exempt from registration with and regulation by the SEC will be required to register by July 21, 2011.

A change to the definition of an 'accredited investor' adjusts the individual net worth standard, with the threshold of USD1m henceforth excluding the value of the investor's primary residence. Funds have therefore had to update subscription documents and in some cases constitutional documents to reflect the new definition.

### **AIFM Directive**

Agreement in Europe on the future regulatory path took longer, but the final text of the directive was adopted by the European Parliament last November. Secondary rule-making is now being overseen by the new European Securities and Markets Authority, with member states required to enact domestic legislation to implement the terms of the directive by mid-2013.

Managers of funds that solicit investment in Europe are examining the impact on their operations and infrastructure and considering how to take advantage of the opportunities created by the AIFM Directive, as well as its associated costs. Significantly, a number of regulatory arbitrage opportunities are available during the transitional period.

For example, from 2013 all EU managers of funds covered by the directive will be required to comply with it in full, with certain carve-outs regarding the depositary provisions, but non-EU-managers can market their funds in Europe under national private placement regimes until at least 2018, subject only to compliance with the directive's transparency provisions. Non-EU managers of non-EU funds may be able to avoid compliance entirely even after 2018 if

they only accept investments from European investors passively.

This evolving regulatory framework has prompted managers to engage in jurisdiction shopping for the optimal location of both their funds and management operations. Offshore and onshore solutions are proving complementary for both start-up and established managers, and many fund jurisdictions are adapting their regulatory framework to remain competitive while meeting international co-operation standards.

### **The Irish perspective**

The financial regulator has introduced amendments to Ireland's regime to enhance its appeal to global investment managers and fund promoters. With Ucits funds garnering significant attention in Ireland as elsewhere in Europe, some key changes affect this regime, notably the naming convention in managed account platforms and dealing day requirements.

Managed account platforms are currently very popular in Ireland and promoters including Merrill Lynch, Morgan Stanley and UBS have establishing these platforms as Ucits products. However, one issue they faced was restrictions on a platform sub-fund being named solely after its investment manager. In the past, the Financial Regulator permitted this only where the promoter or its parent was majority owner of the investment manager. This prevented the proper branding of a manager's Ucits strategy within the platform and impeded the promoters' efforts to attract suitable investment managers.

Following submissions on this issue, the regulator – now part of the Central Bank of Ireland – has agreed to allow the sole name of the investment manager in the title of a sub-fund where the name of the umbrella fund contains the name or brand of the promoter. Where a supplement to the prospectus is published in respect of the sub-fund, the name of the promoter must be clearly stated on the supplement cover.

Another issue for promoters and investment managers of more complex Ucits funds was the requirement for funds' dealing days to occur at least fortnightly. Again following submissions from industry, the regulator moved positively to amend the requirement to twice per month at regular intervals. ■



- 11 ► “Both Ucits and managed accounts are currently seeing strong demand. Although they offer slightly different propositions – Ucits is more about distribution – they also answer some of the same questions regarding security, liquidity and transparency. A managed account holder legally owns and controls the assets; they can hire and fire the trading advisor as they wish, and redeem their money when they please. Although a Ucits fund is a commingled vehicle, it is a regulated product that offers frequent liquidity.”

Dollery says that most of Newedge’s hedge fund clients can comply with the Ucits framework without too much modification of their portfolios. “If you’re relatively well diversified and trading liquid instruments, or at least the majority of the portfolio is liquid, the exposures can be structured in a Ucits-compliant manner with relative ease,” he says. “My only caveat is that as a broker, Newedge tends to focus on relatively liquid strategies. We’ve never been involved with funds that invest in illiquid loans and credit strategies, so our book of business probably complements Ucits quite well.”

The firm has refined and to some extent built new service offerings to meet the demands of Ucits hedge funds, particularly for the CTA and systematic macro managers that currently make up the largest segment of the European industry. He says: “We have done some structuring work, because Ucits funds are unable to hold commodity futures directly. They can take synthetic exposure

to a financial index which itself consists of a range of underlying instruments including commodities contracts.

“Once the client receives regulatory approval for its index, it can then systematically trade the index constituents through a hedge account at Newedge. The P&L of the hedge account flows through to the index, and Newedge transfers the exposure to the Ucits fund through a total return swap.

“These three components – the hedge account at Newedge, the Ucits-compliant index and the swap – allow you to trade a CTA or systematic macro strategy in a Ucits-compliant manner. In the equity long/short space you may need to take the exposures synthetically through swaps and contracts for difference to gain long and short exposure, because you’re not allowed to leverage your positions directly.

“Newedge’s role includes strategy-specific prime brokerage work, whether through index swaps or CFDs, but also other areas such as capital introduction. Ucits funds offer the ability to access an additional investor base, and we have worked hard through our cap intro team to reach out to wealth management platforms and other investors who have become interested in alternative Ucits funds over the past year or two.”

Paul Farrell, a Dublin-based partner in Walkers’ global investment funds group, says that in the wake of the crisis regulatory scrutiny of Ucits funds has increased in Ireland. “The Central Bank undertakes a full review of the documentation for Ucits vehicles, whereas Qualifying Investor Funds designed for sophisticated investors normally receive next-day authorisation,” he says. “The review of a fund’s management and investment policies is more involved.”

The volume of new Irish-domiciled funds following alternative strategies has increased significantly since the beginning of 2010, he says. “Investors, particularly in the European Union, are pushing for regulated products, and more alternative managers are seeking to determine whether their products are suitable for the Ucits regime. Often they are setting up parallel Irish structures to their existing offshore vehicles, designed to meet the requirements of European investors who no longer feel comfortable investing through Cayman funds.”

In an interesting counterpoint, however,

UK-based managers of offshore funds are examining whether having an offshore management company structure might enable them to escape the increased constraints – and costs – once the EU's Alternative Investment Fund Managers Directive takes effect in two years' time, according to Farrell's London-based colleague Deborah Poole.

"London-based managers are looking very closely at potential arbitrage opportunities where they could act as investment adviser to an offshore manager," she says. "They are hoping that when the directive's Level 2 measures are drawn up, the offshore company will be treated as the fund's investment manager, rather than the regulated entity in London. The aim is to minimise the impact of the directive, at least for the transition period over the next four or five years until all funds that want to market into Europe have to comply with the directive in full."

Another relatively new development, Poole says, is moves by managers to clarify the liquidity rules for their offshore funds, reflecting the difficulties that arose at the peak of the crisis when funds imposed liquidity restrictions on the basis of terms and conditions that were sometimes unclear and in most cases had not been previously tested.

"Amid the fallout from the global financial crisis, we expected significant changes to Cayman structures to make liquidity rules rather more bespoke than they had been previously," she says. "The typical boilerplate wording was tested by measures such as suspension of redemptions, gating and side-pockets. However, it is only relatively recently, with the resumption of start-up activity, that Cayman platform providers have moved to address these issues and tailor liquidity rules to a fund's strategy and investor base, and to what the product is intended to achieve."

There have been changes in other areas to the documentation drawn up for Cayman, she adds, notably affecting redemption proceeds paid in kind rather than in cash. "We now see more clarity in the documentation as to when and how 'in kind' assets are valued, for example where it has been defined how much investors are to be paid on the redemption day, but the assets decline in value before they are paid out," Poole says.

"Disclosures in the offering documentation

will often now address whether the obligation to pay the redemption proceeds will be satisfied by delivering those assets, or whether it requires delivery of something else that brings the cash value to the defined level on the redemption date."

Uncertainties over redemption issues have resulted in a number of Cayman court cases over the past year. "They have involved the redemption process itself, when the redemption actually happens, and whether or not you can impose a suspension after the redemption date but before the proceeds have been paid," she says. "It has made managers more conscious about ensuring transparency in the documentation about what they want to, or even can, achieve."

However, Poole argues that other recent cases in which investors have sought to have an external liquidator appointed rather than allowing the fund's manager to complete an orderly wind-down of the fund most likely reflect failures in communication with investors as much as uncertainty in the fund documentation.

"It's a signal to the managers that they simply can't neglect communication with their investors," she says. "In many cases it appears that the problem has been not that investors were unable to get their cash out, but that the investment managers had gone underground. Some managers have taken their eye off the ball and gone on to other things. They may not have seen the process through to the end and kept their investors informed. These cases are symptomatic of investors at the end of their tether. A little more communication and transparency might have resolved these issues without going to court."

In other cases investors in funds with distressed assets have been satisfied with innovative solutions designed to make the most of an unattractive economic environment. "We are seeing some rollover funds where investors are being partly cashed out and partly rolling over into a new structure," Poole says. "Often there is a new investment manager providing a different skill set that may be particularly appropriate to the illiquid assets previously held in side-pockets. New seed capital is used in part to pay out investors in the existing structure, but they keep a certain proportion of their investment in the new structure they have been rolled into." ■