Reflections on 2015: Key developments shaping the global hedge fund industry

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Welcome to the inaugural edition of the Hedgeweek end of year editorial report: Reflections on 2015. We are excited to bring to you, our readers, what we hope will be the first of many such annual reports. In this first edition you will find a wide selection of some of the most important articles that Hedgeweek has put together throughout the year, which best serve to illustrate key developments shaping the global hedge fund industry; all neatly packaged and presented. Xmas has indeed come early!

The hedge fund industry has undergone an incredible transformation in recent years. Fund managers have embraced what were first felt as regulatory headwinds and used them as tailwinds to redefine the way they run their business activities. Not only has this vastly improved the level of transparency, compliance and overall operational infrastructure – satisfying investors and regulators alike – it has allowed hedge fund managers to branch out and bring regulated funds to market, in tandem with their offshore vehicles.

This has led to the incredible rise to prominence of liquid alternatives. Morningstar estimates that this segment of the market recorded an asset increase from USD27billion in 2008 to USD304billion in 2014, with the number of funds increasing over the same period from 482 to 1,569. Looking ahead, a report by PwC (Alternative Asset Management 2020: Fast Forward to Centre Stage - www.pwc.com/us/en/asset-management/investment-management/alternative-asset-management-2020.html) estimates that liquid alternative UCITS funds could see their AUM double to USD664 billion by 2020.

Regulation has also increasingly pushed hedge funds to consider offering AIFM-compliant funds to European investors. As such, the role of the Alternative Investment Fund Manager (‘AIFM’) has become vital, prompting an array of fund management groups and compliance firms to bring an outsourced AIFM solution, principally to support non-EU managers. This underscores the unique ability of this industry to continuously evolve and innovate in the face of what was, at the time, a burdensome piece of regulation.

Inside, readers will find an insightful piece from Fuchs Asset Management on the role of the AIFM, whilst under the ‘Risk Management’ section, Duff & Phelps’ Kinetic Partners outline how AIFMD has mutated risk management.

Indeed, regulation is a common thread throughout this report. From compliance and reporting, to building best workflow practices and developing an effective marketing and distribution strategy, regulatory considerations are never far away.

The issue of cybersecurity has been another important trend in 2015. The report features an excellent piece on this topic by Richard Fleischmann & Associates, a leading New York-headquartered technology firm. On 22nd April, the House of Representatives passed a new cybersecurity bill – the Protecting Cyber Networks Act (PCNA) – to allow file sharing between government intelligence agencies and private companies and raise the overall awareness of hacking.

With more hedge funds becoming the victims of social engineering, understanding some of the practical steps to stay cyber secure can no longer be overlooked.

So. Time to light the fire. Pour a glass of mulled wine. And see what’s inside.

Thank you readers, and have a prosperous 2016.

James Williams
Managing Editor, Hedgeweek
In this exclusive excerpt from Preqin’s forthcoming 2016 Global Hedge Fund Report, due out in January, we take a closer look at how the hedge fund industry has changed over the course of 2015. Drawing on data taken from Preqin’s award-winning Hedge Fund Analyst database, we examine in more detail fund launches and closures over the course of the year so far and which strategies and sectors have been successful, as well as those that have had a difficult 2015.

**Number of funds and industry capital**

In terms of the number of funds, equity strategies funds are the most prominent strategy in the single-manager hedge fund industry; 42% of all hedge funds utilise an equity-focused approach (Fig. 1). Although more than four in 10 hedge funds employ equity strategies, these funds hold only 25% of industry capital. A large proportion (65%) of equity strategies funds have assets of less than $100mn; equity fund managers often have a less scope for scaling their strategies, with greater footprints on trades and often operate in smaller or niche markets and are unable to grow beyond a certain level without compromising fund returns. This issue is less pronounced in other strategies where managers have access to more diverse and often deeper markets and can more effectively manage the vast quantities of capital possessed by the largest funds.

After equity strategies, all other core...
strategies command a fairly even distribution of funds. Macro strategies funds capture a larger proportion (29%) of industry capital than any other strategy. This is, in part, due to the two largest hedge funds in the industry utilising a macro strategy; combined, Bridgewater’s All Weather Strategy and Pure Alpha Strategy manage assets in excess of $168bn, representing more than 5% of all capital invested in hedge funds today.

**Fund launches and closures**

Fig. 2 shows the number of new hedge funds launched in each year and fund closures since 2012, and Fig. 3 depicts the breakdown of these funds by the core strategy they employ. A trend of steady growth within the industry occurred from the mid-1990s to 2012, when the industry hit a peak in terms of new funds entering the space. The period 2011-2013 represented three consecutive years when more than 1,200 new funds launched each year (Fig. 2). This spike in new funds entering the market came as the reality of the post-global financial crisis (GFC) world set in, when new regulations such as the Volcker Rule severely cut into prop-trading businesses and resulted in traders leaving banks to start hedge funds of their own.

However, the rate of new launches has fallen over the past two years. In 2014, 1,079 new funds were launched, the lowest number since 2009, and 666 funds formed in 2015. Although the number of funds launched in 2015 is expected to increase as more data becomes available in 2016, Preqin estimates that the final number of launches will be the lowest since 2008, when 891 funds were incepted.

Market uncertainty in 2015 – stemming from events such as the unpegging of the Swiss franc in January, falling commodity prices, volatility in Chinese markets and hesitancy by the US Federal Reserve – proved too challenging for some hedge funds and the industry saw over 560 fund closures over the course of the year. As more data becomes available in early 2016 this figure is likely to increase. The hedge fund industry has become increasingly crowded in recent years; this coupled with much of the capital inflows going to the largest funds has resulted in an increasingly competitive marketplace, especially for small funds. A drop in the number of funds being incepted in 2015, together with fund liquidations, meant the single-manager sector grew by a net increase of only 60 funds in 2015, compared with 343 in 2014. This decline in the growth of the industry by number of funds, coupled with continued net inflows into hedge funds, may help reduce the number of fund managers focusing on growing existing products in 2016.

**Macro strategies face difficulties while equity strategies preferred**

Macro strategies hit the headlines in 2015 with notable vehicles such as Fortress Investment Group’s flagship macro fund and Blackrock’s Global Ascent fund returning capital to investors. In fact, there were more fund liquidations (63) in the macro strategies
Equity strategies funds represent the largest share (44%) of funds incepted in 2015 (Fig. 4). This continued a trend of growth in equity strategies funds, which have seen a steady increase in the proportion of fund launches since 2009, when they hit a low following the GFC. Although big-name macro fund closures attracted the most attention, equity strategies funds accounted for the largest number of fund closures, largely as a result of the strategy’s existing prominence in the industry (Fig. 5). However, more funds launched in this sector than closed, and in 2015 the number of equity strategies funds grew by 46.

Second to equity strategies, credit strategies funds represent 12% of funds launched in 2015. Credit funds increased in prominence following the GFC, and this has been sustained, with the need for alternative lenders in the credit space still evident as banks continue to clean up their balance sheets. The credit strategies sector showed the largest net growth in terms of funds over 2015: 77 funds launched over the year compared with 29 funds liquidating, resulting in a net growth of 48 credit strategies funds. However, the landscape may change further for credit strategies funds over the next 12 months with the impending tightening of monetary policy by the major central banks.

Event driven launches form less than 10% of the industry in 2015

Launches of event driven strategies have fallen slightly in 2015 compared to 2014, representing 8% of new entrants over 2015 compared with 9% in 2014. In four of the five years between 2005 and 2010, event driven strategies represented more than 10% of all launches in each year. However, since 2010, event driven strategies have failed to exceed 9% of fund launches in any single year. Event driven strategies was the worst performing hedge fund strategy in both 2014 and 2015; fund managers in turn are seeing fewer opportunities in this space and we are seeing less new event driven strategies funds come into the market than in previous years. However, despite performance problems, relatively smaller numbers of event driven funds closed over 2015, resulting in a net growth by number of event driven strategies funds of 17, behind credit strategies (48) and equity strategies (46).

Even harder hit were relative value strategies funds and CTAs, with a net decline of 19 and 20 funds respectively as a result of closures of in each sector.
Over the last few years the FTSE 100 has gained 26 per cent, while the S&P 500 Index has gained approximately 65 per cent. The impact of quantitative easing has led to unparalleled growth in equity markets, to such an extent that hedge funds have largely lagged behind. This “raw” underperformance, in risk-adjusted terms, has led investors to question why they are invested in hedge funds.

“In our opinion it’s not just underperformance but a combination of underperformance and fees. This is leading investors to ask, “Why do I pay so much to receive so little?” says Nicolas Rousselet, Managing Director and Head of Hedge Funds at Unigestion.

This is slightly misguided however. Investors have to understand what their ultimate objectives are. If they are looking to beat a strongly performing market, they should not be looking at hedge funds, whose aim is to generate non-correlated returns without the long-term support of the markets, but rather ultra-risky speculative levered directional funds.

Today’s low rate environment has created a situation where hedge funds simply cannot expect to outrun the markets. Consequently, this magnifies the fees, creating a perfect storm of low performance and high costs.

“Back in ’05 and ’06, when risk premia contracted, people used excess leverage and when funds collapsed in ’08 investors were disappointed that they behaved like levered funds. Today, they don’t behave like levered funds and this too is causing disappointment. It’s quite ironic that even though investors learned their lessons from investing in levered funds the perception of hedge funds is still negative. Uncorrelated returns are harder to produce and this makes fees look bigger,” says Rousselet.

“To justify their fees, the manager has to have a demonstrable edge. Today, the proportion of truly talented managers is very small. They are rare, yet they are the ones who deserve the fees. Even if there were enough talented people, they would arbitrage themselves out so that only ultra-talented people would be able to have an edge.”

But it is far from doom and gloom for hedge fund investors. There are ways to deal with the above issues. Take fees. Firms like Unigestion, whose mission is to uncover talented managers, are making strides in negotiating fees that are more aligned to the investor and which incentivise the manager to perform, not just sit on the management fee and gather assets.

“The point is, the fee should be paid by investors when the performance is good, not all the time. Transformation of fees is something we increasingly see. Managers who operate in the true spirit of what a hedge fund is are happy to look at this,” says Rousselet.

Another key development is the emergence of factor investing and alternative beta products, which are helping investors better understand the true talent of a hedge fund manager. Some managers have, in the past, been no more than one-trick ponies says Rousselet. “Maybe they were a small-cap Japanese equity investor, shorting the Nikkei 225 and making large returns until the market turned. These were not uncorrelated hedge fund returns, it was a completely direction play. They were using a single factor (e.g. market capitalisation); that was the true driver of performance.”

With alternative beta strategies, these one-trick ponies can be more readily identified and help investors become more selective; building a portfolio of pure hedge fund talent too.

“Depending on their objectives, investors can use alternative beta strategies, as well as accessing pure hedge fund talent too. There is a much wider continuum being created and that is a positive development,” concludes Rousselet.
Next stage of evolution in the ’40 Act marketplace

Interview with Bob Kern & Joe Redwine

Servicing approximately 113 liquid alternative funds that operate under the ’40 Act banner, U.S. Bancorp Fund Services (‘UBSFS’) is ideally positioned to understand the complexities of administration and compliance involved in with these vehicles. USBFS opened its doors in 1969 and since that time, the firm has been servicing these funds for over 20 years; although, back in the 1990s the term “liquid alternative” didn’t exist.

Still, with 878 funds and more than USD347 billion in assets (though Q1 2015, according to Morningstar), liquid alternatives represent an important growth driver for USBFS.

“Liquid alternatives revenue for us has ranged from 13 to 24 per cent in the last couple of years with respect to our overall ’40 Act new business. We’re dedicated to servicing funds in this space and building new relationships,” comments Bob Kern, Executive Vice President at U.S. Bancorp Fund Services.

Whilst the relative performance of liquid alternatives compared to hedge funds is reasonable, “the asset class loses lustre as it has underperformed the broader market on an absolute basis,” says Joe Redwine, CEO, U.S. Bancorp Fund Services. “We may very well be entering a period where traditional markets will come under greater stress, and when that inevitability occurs, the absolute performance of liquid alternatives will start to look more positive.”

In a recent presentation at the Brookings Institution in Washington DC, SEC Commissioner Kara M. Stein said that the liquid alternatives trend “should give everyone pause, and regulators and the public need to be asking questions about this development”.

Redwine believes this is an appropriate comment and that the biggest challenge is one of education: “Education of all associated with or overseeing liquid alternative funds – the regulators, distribution channels, and the investors. That education process is taking place but needs to ratchet up significantly.”

At USBFS, much time and focus is placed on educating advisors that have historically only ever operated in the unregistered private fund market. All aspects of compliance are covered, both with advisors and their investment boards.

“Hedge fund managers entering the ’40 Act space don’t necessarily understand all the rules and regulations, the onboarding and launch process, the compliance costs of running a ’40 Act fund, etc. We bring them up to speed in all these areas,” explains Kern.

“Furthermore, traditional fund houses who decide to launch a multi-manager liquid alternative also need support. The complexities and compliance issues apply not just at the fund level, but also at the asset level; especially with respect to more esoteric asset classes such as bank loans and derivative-based strategies, where the oversight and compliance demands ramp up quite significantly.”

Indeed, the more illiquid end of the spectrum is proving popular. Known as “interval funds”, they allow alternative fund managers to more closely mimic private fund strategies and typically use a monthly subscription, quarterly redemption model.

“Currently, we provide a full array of services to 18 interval funds. These include fund-of-funds, bank loan, peer-to-peer lending and CLO/CDO funds. One of the more interesting strategies is a fund that invests in reinsurance quota shares,” confirms Redwine.

This serves to illustrate how far the ’40 Act fund market has come in 75 years.

“We’re seeing more interval fund opportunities than ever before. At any point in time we’ve probably got half a dozen proposals outstanding,” concludes Kern.
There has been an extraordinary focus on and trend towards ‘split boards’ in the last few years. For most people the accepted definition of a ‘split board’ is having independent directors from different fiduciary firms. It is considered by some to be the best way to construct a board. In reality this is an overly simplistic definition and assessment of how to recruit and construct an effective and diverse board.

So how did this readily accepted definition come to be? In some respects there is merit and in other respects it is simply a sales pitch.

Governance is not a game. Unfortunately, in the past few years fundamental governance related issues such as board composition (split boards), capacity (numbers) and substance over form, (form over substance) have been used as marketing pitches.

These are fundamental governance issues yet the sales side of the issue is increasingly the focus of attention. Just as numbers were once perceived to be the key component in assessing a director’s ‘capacity’ the industry has now come to understand that numbers are only one factor.

Similarly, the concept of ‘split boards’ - engaging independent directors from different fiduciary firms, is often a material consideration and sometimes the key focus in assessing board composition. This narrow focus, for the most part, misses the fundamental objective of establishing an effective and diverse board.

The directors are individually and collectively responsible for leading and directing the fund’s affairs. Effective corporate governance is imperative, and recent issues, scenarios and outright collapses highlight this point.

As regulators and investors continuously increase their focus on corporate governance the requirement for the appointment of independent directors is essential. Investors in particular have recently become increasingly interested in board composition and appointing directors with complementary skillsets.

There is currently a trend to recruit some combination of an accountant, lawyer, ex-regulator, investment or risk expert from different shops to attain complementary skillsets. In response, there has been an influx of individuals into the industry whereby self-promotion of these skillsets, to make up an effective board composition, has become the latest marketing pitch.

One important skillset that is often overlooked is corporate governance in itself. Possessing one of the aforementioned technical attributes in isolation does not necessarily make someone a good director. Perhaps even more important than having a director with a specific skillset, expertise, or being from a different fiduciary firm is to select directors who have a broad range of experience, have the innate ability to ask intelligent and probing questions, and know when and where to find expert advice when needed.

It is often more effective to engage someone with specialised expertise when needed rather than recruit it on to the board. Ultimately, the aim is to have a board composition that is sufficiently diverse to have the necessary knowledge to provide effective leadership and direction.

There is certainly a greater depth of high quality directors in the space to choose from than there was a few years ago. The flood of new entrants into the fiduciary space can be partially attributed to a supply shortage as long standing individuals are reaching capacity.
Some newcomers are simply being opportunistic as they are looking for a career transition. Most are senior people who have excellent experience, qualifications, pedigree, etc, and are able to seamlessly make the transition from being an administrator, lawyer, auditor, regulator, risk or investment professional, etc, to being a director.

Others, however, have difficulty making the transition, as although they have impressive technical skills, they are unable to transition into a leadership and oversight role that goes beyond their area of expertise.

Individual personalities can come into play as well. For example, some are too passive, lack the intellectual curiosity, or gravitas to effectively and appropriately challenge management or their fellow directors, while others have domineering and controlling personalities or simply lack the aptitude to participate in a collective approach.

As it is for many things in life, the right balance of individualism and collectivity is also paramount to an effectively functioning board.

Additionally, the ability to put issues into the appropriate context is imperative - sometimes the board has to provide high level oversight and other times a more detailed approach is required, but without becoming a micro-manager.

Effective and experienced directors will be able to maintain perspective and context in such situations, regardless of their specific skillset.

The focus in constructing an effective and diverse board must go beyond just looking at attaining a ‘split board’ and consider each potential director’s attributes as mentioned above. It is disingenuous to suggest that real independence and diversity cannot be obtained via having multiple directors from the same provider.

This really depends on how each fiduciary provider is structured, in combination with the individual’s own attributes, and perhaps more importantly how they perceive their role and conduct themselves as an independent director. With that said, there is an argument that retaining individuals from different providers eliminates the risk of potential ‘groupthink’. If this is indeed the case it is good reason for a change.

Do keep in mind though, that groupthink or deferring to a more dominant director still happens in ‘split board’ scenarios as well. Therefore, ‘split boards’ may be more perception than reality as many fiduciary firms have engaged professionals, with complementary skillsets, and have the freedom to make independent decisions. As such, there may already be an effective board in place.

Serving as a director is a personal appointment and there is corresponding personal liability. In today’s post-Weavering environment passive directors are, for the most part, a thing of the past regardless of whether they serve alongside a colleague or someone from a different fiduciary firm.

An effective and diverse board requires competent individuals with complementary skillsets who can work collectively irrespective of whether they come from the same shop or not.

The collaborative aspect is equally as important as the individual expertise. There should ultimately be synergies gained so that the board’s collective value equates to more than the sum of its individual members.

Conclusion
Looking for an independent director and constructing an effective and diverse board does not have to be an arduous, time-consuming process, however, the decision should not be taken lightly.

Remember, the directors are accountable for leading and directing the fund’s affairs. Effective corporate governance is critical and therefore the appointment of experienced and qualified independent directors who collectively provide a diverse and complementary board composition is essential.

The influx of individuals with varying skillsets into the fiduciary space is a positive development, however, the industry needs to ensure the focus remains on the underlying fundamentals of good governance. So go beyond the ‘split board’ sales pitch – have a thoughtful, measured approach and give all aspects due consideration.

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Helping hedge funds build best workflow practices

Interview with Erol Dusi

New York-based Imagineer Technology Group offers award-winning solutions to help hedge fund managers address the transparency and workflow demands necessary to stand out and succeed in today’s marketplace.

These solutions, which include an industry specific client relationship management (CRM) software, a web reporting portal and a fund research and due diligence platform, have been designed to help managers build workflow efficiency and communicate more effectively with investors and prospects.

Imagineer is probably best known for its flagship CRM platform, Clienteer.

“Although Clienteer is often categorised as a CRM tool, it goes far beyond that,” explains Erol Dusi, founder and president of Imagineer. “There’s a great deal of functionality to assist with the specific business workflows required by an asset manager. Whether its business development/marketing, investor relations, transaction processing, compliance tracking and reporting, or group document distributions – our clients appreciate the breadth and depth of our offerings to help them manage their day-to-day business.”

“Clienteer is used by a firm’s Investor Relations team as the primary hub for all of the information that asset managers increasingly have to track on their investors and prospects as well as seamlessly pulling in account and transactional data from the fund’s administrator. Having this data centralised and well organised helps our clients easily deal with informational flows required by their “know your customer” (KYC) policies or their compliance reporting like ERISA levels, FATCA, or Form PF,” says Dusi.

Another key solution Imagineer offers is a web portal called WebVision that handles all aspects of online reporting at both fund and investor levels from within a manager’s own corporate website, maintaining the firm’s branding throughout the site. WebVision can be implemented either stand-alone or in-line with Clienteer for an end-to-end solution.

“Our clients can easily leverage a single data source from Clienteer to manage their online content and access control to that content, eliminating many unnecessary steps in the process,” says Dusi.

As a communication channel, WebVision not only addresses the transparency demands on managers by providing investors and prospects easy access to fund information, it also allows managers to gain insight on them in the process. “Since our clients can granularly track all website activity, the platform enables them to know more about their investors and prospects’ interests on an ongoing basis,” adds Dusi.

Such tools improve the workflow automation process for most hedge funds. Moreover, what Imagineer and other technology specialists are doing is helping managers migrate away from having to rely on multiple systems or to support complex IT architectures.

To illustrate, Clienteer for example, can calculate all of the performance statistics and benchmark comparisons required to generate custom branded fund factsheets. This alone could help the manager save thousands of dollars by not having to buy a separate performance analytics system.

“This is certainly another advantage that solutions like Clienteer and WebVision can provide as a way for managers to save time and money by reducing the number of systems in their operational infrastructure,” explains Dusi.

“The platforms we offer help firms establish their workflow best practices which can scale with the firm as they grow. For fund managers, being able to do more for less capital outlay is a clear benefit, and that’s exactly what our technology is designed to do – deal with the burden of regulatory and reporting requirements that are getting more onerous all the time.”

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HEDGeweek Review: Hedgeweek Special Report Dec 2015

www.hedgeweek.com
A fully hosted and customisable risk solution

Interview with Ittai Korin

The RiskAPI service, developed by PortfolioScience, is a fully hosted and customisable risk solution that integrates seamlessly with existing applications and programming frameworks to generate risk calculations for multi-asset, multi-currency portfolios and individual positions. It is available as both an Enterprise software API and an Excel Add-In.

Rather than being a risk calculator, per se, it is a complete end-to-end solution.

“Our system has all the underlying data, and all the necessary analytics, connections and external data feeds within the infrastructure; everything needed to generate a full spectrum of risk calculations,” explains Ittai Korin, President, PortfolioScience. “If they want, managers can come to us with nothing more than a description of their portfolio.”

**Short integration time**

The fact that the solution is delivered as an API is quite unique in the marketplace.

Korin notes that one of the biggest disadvantages that clients of its competitors face is that it can often take several months before they see any system output due to the time it takes to integrate with in-house systems. “Because of the lightweight nature of our API interface, customers can get up and running and start generating results in a matter of days,” says Korin.

**High degree of customisation**

In addition, because it is an API and is highly customisable, users are able to generate results according to how they work, and how they view the world. The idea is that users are not getting a standard off-the-shelf risk report that somebody else has built. They have full control over what parameters to use, which calculations to perform, and how to present the data.

Another important feature of RiskAPI is that it is offered “on demand”. Once a trade is placed in a manager’s execution management system, a request is automatically sent to RiskAPI, at which point all the risk calculations are instantly populated and conveyed to the end-user.

“Our philosophy is to provide clients with the same level of control that they would have if they were to build an in-house risk solution from scratch. Our hosted solution does exactly that, without the overhead of the manager having to build it and maintain it going forward. Every day there are changes to valuations, pricing etc. That ongoing monitoring and management can use up a tremendous amount of bandwidth. Clients can offload that to us and still maintain a high level of control,” says Korin.

Broadly speaking, RiskAPI provides dynamic multi-model VaR, valuation, and stress-testing capabilities, whereby users can select and specify a variety of inputs.

“This provides a more sophisticated way to interact with our system. We have larger clients with in-house development teams using this solution to build their own enterprise risk systems. Larger funds, for example, will have an internal data warehouse. They use RiskAPI Enterprise in conjunction with their data warehouse, which contains portfolio position data, to run risk calculations and render reports when needed,” explains Korin.

PortfolioScience also has connections to various data vendors covering different assets and markets to help ensure that the quality of data produces as accurate a picture of risk, at any given moment, as possible.

“We know how important data is to risk management. Ours is a very thorough and extensive database. Managers are getting accurate risk calculations generated off the back of the data we have at our disposal,” concludes Korin.
AIFMD and the mutation of risk management

Interview with Alan Picone

Risk managers are making a more conscious effort to not only understand the virtues, but also the limitations, to risk models as they adjust to life under greater regulatory scrutiny, in particular the AIFM Directive in Europe.

Indeed, such is the impact of regulation that it has in effect transformed the risk management function from something that was previously confined to portfolio management into something altogether more holistic.

Alan Picone is a managing director at Duff & Phelps’ Kinetic Partners division. He has a broad range of expertise on risk management and given that Kinetic Partners was one of the first firms to obtain a third party AIFM license in Luxembourg, Picone is well versed in understanding the changing dynamics of risk management that hedge funds now face under the Directive.

“We are acting as an AIFM on behalf of external hedge fund managers to help them meet the risk management and compliance challenges of AIFMD and as such are well placed to see what the impact of AIFMD is having on managers. One of the things that we are seeing is a fairly profound mutation of the risk management function,” says Picone.

The upshot to AIFMD is that managers are increasingly relying on more systems, processes and procedures, and indeed staff, to remain compliant. The role of risk management must now embrace all dimensions of the fund’s value chain: portfolio risk management, operational risk management, liquidity risk as well as the management of risks that have been delegated to third party providers; this is the risk oversight function, which has become an integral part of a manager’s aggregate risk framework.

As Picone points out, this requires understanding the processes and risks of the brokers, custodians, administrators and any other companies that support a hedge fund’s operations.

“When you look at risk management from this perspective, and you add to that such things as liquidity management rules, concentration risk rules under the Directive, you can see that the risk management function has become very far reaching as opposed to what it was in the past,” says Picone, who adds: “Another key observation is that risk management in the past was viewed as an ex post control, meaning that decisions were taken and then risk management was applied afterwards to measure the potential impact of those trading decisions.

“The AIFMD changes this fundamentally, such that ex ante risk management becomes critical. We see more interaction of the risk management function with the portfolio management function; these have always been embedded to some extent in hedge funds but not to the degree that risk management becomes, so to say, intrusive. It requires a number of critical tasks such as risk attribution, margin-at-risk impact and so on.”

In other words, ex ante risk has become more systematic. Some of the larger hedge funds have long had in place robust processes to embed risk management as much as possible into the portfolio decision making process at the pre-trade level. Under AIFMD, all managers are required to adopt this mindset; it is a cultural shift.

A good example of where ex ante risk management has become a major focus would be systematic CTAs. Given that these strategies employ sophisticated trading algorithms to detect market signals and put on positions in the portfolio, there is less involvement by risk teams in the decision making process. However, where risk teams
get more deeply involved is in validating the risk models used by the algorithms.

"I’m generalising here but what we’ve seen is that the role of risk managers in terms of validating trading models has become much more important. There is more caution being applied to test the resilience of trading models," says Picone.

Caution is no bad thing when it comes to risk management. Nobody is naïve enough to expect risk models to provide a crystal ball into future volatility and whilst AIFMD has amplified the risk function, expectations need to be kept in check. One element of this caution is by being more attuned to the limits of risk models; that is to say, understanding the qualitative risks and trying to avoid being reliant on models that are too simplistic to measure risk.

“The Black-Scholes formula for pricing options was a major breakthrough but it was qualitative and mathematically driven and as such it was viewed as a Golden Rule. It became almost Holy Grail-like," remarks Picone. “All risk modelers now understand that it is far from reality. Models come with limitations as they try to describe the complexities of reality.

“Whereas in the past, such models would have been seen as the ultimate weapon to describing reality, today they are viewed more as a starting point. Models are more prone to be reviewed and critiqued. I think risk managers are more inclined to understand the limitations of their models, and the risks attached, as opposed to believing that their model is a fair description of the world. This is a change in philosophy. Risk management has to work within limits and I think everyone now recognises those limits; risk managers are applying more rigorous governance to their risk models, which you wouldn’t have seen 10 or 20 years ago.”

Regardless of whether the risk model is ex ante or ex post, the implied assumptions mean that it can only ever produce a risk estimate. In that sense, risk management is like trying to predict the weather; some may say it is even harder, given the true complexity of financial markets. Risk managers are required to somehow quantify the level of risk the fund portfolio is exposed to, without having a complete understanding of the nature of the market.

It is a fantastic challenge.

“Risk managers know that whenever they develop a risk model it is only ever likely to describe some element of reality, but not the full reality. In the past, this acknowledgement of the limitations to risk models was not communicated; the classic example being Black-Scholes. When you look at the underlying assumptions they are completely outside the realm of empirical reality and you have to wonder why this model has been used for so long. The assumptions have nothing to do with reality. The reason it has been used so extensively is precisely because the model is simple.

“My point is that there is now a more conscious attitude towards acknowledging not only the virtues but also the limits of risk models. Risk managers are increasingly mindful when using models to understand, first and foremost, what they don’t do rather than what they actually do. And that’s an important paradigm shift,” posits Picone.

In some respects, the AIFMD has helped push forward the cultural adoption of risk management and broaden its application. Model risk is an important evolution precisely because risk managers do not want to get blinded by the VaR number; nobody wants another Long Term Capital Management event to occur.

“There’s now a need to more accurately capture the specific features of financial markets. If you want to benefit from market inefficiencies you need to look at numerous factors and lots of data. For quantitative and systematic strategies, the detection of inefficiencies and the decision making programs are becoming increasingly influenced by risk managers.

“For other strategies, such as equity long/short, risk managers will have a growing influence in guiding the portfolio manager(s) during the investment process. They will provide additional insights and tools to help the front office with respect to risk allocation, risk attribution etc. Portfolio managers want to better understand the risk budget,” concludes Picone.

With greater scrutiny of the risk numbers and a willingness to question the limitations of risk models, hedge funds are working harder than ever to operate safely in today’s financial markets.
The art of orchestration as a European AIFM
Interview with Timothé Fuchs & Pierre-Yves Augsburger

Luxembourg-based Fuchs Asset Management is not your typical AIFM provider. Its heritage is firmly rooted in wealth management. Having now grown into a team exceeding 100 people, it took the decision to diversify its offering and set up an AIFMD-compliant management company, receiving its license from the CSSF last June.

"With the substance needed to run an AIF today, a lot of mid-sized managers are now thinking: are we going to take on the burden of running our own AIFM, or are we going to use a third party?"

"We now have the size and scale to consider such an AIFM hosting business," says Pierre-Yves Augsburger, Director of Fuchs Asset Management.

With its ManCo service, FAM provides the substance and the knowledge (from a compliance, risk distribution and monitoring perspective) for asset managers, private banks, fund managers and family offices, or simply entrepreneurs who want to create their vehicle to comply with the directive, but are frankly overawed.

"We are able to offer them a tailor-made solution and bring a family office approach to small and medium-sized institutional clients. As the AIFM, we propose the structure, the licenses and the regulatory knowledge. There is a clear separation of tasks and responsibilities but it has to be done as a close partnership in the best interests of the managers and their investors."

"We like to think of ourselves as the conductor of an orchestra. That’s what a hosted AIFM should be in our view," explains CEO Timothé Fuchs.

In Fuchs’ view, the core focus of a fund’s portfolio management team should remain portfolio management and building/maintaining client relations.

"That’s why it is important for the market to offer the third party AIFM solution, which is more an administrative, legal, risk management and compliance solution. Portfolio managers may not be comfortable or have any experience or particular interest in that side of things," adds Fuchs.

The firm wanted to be in a position to offer a high-level of service from day one and took pains to hire a raft of risk and compliance specialists while setting up the ManCo; constructing each section of the orchestra as it were.

"The right hand has to know what the left hand is doing. If a client has a specific request, we are ready to provide a full and prompt response. It doesn’t go through a committee of 25 different people," adds Augustsburger.

There are three solutions available to managers who partner with FAM:

- To launch a UCITS-compliant sub-fund
- To launch an AIFMD-compliant sub-fund
- To launch a dedicated fund and appoint Fuchs Asset Management as the AIFM.

“Our AIFM solution is open architecture. We know most of the main service providers in Luxembourg and Europe. Large banks might insist on only working with funds with at least EUR100m in assets, in which case the manager needs other options,” says Augsburger.

This is where a hosted AIFM can bring added value to managers. By leveraging their network, they can help to ensure that any new AIF launched by a client appoints the most suitable service providers.

“For a private equity client of a certain size, we’ll offer one set of recommendations, while for a real estate fund we’ll offer a different set of recommendations. We continue to search for the right universe of counterparties to meet our clients’ needs,” concludes Fuchs.
The gateway of choice for emerging investment managers

Interview with Derek Adler

The emergence of complex rules and regulations such as AIFMD and FATCA means that any new manager with visions of running their own hedge fund business must think carefully about the best route to market.

For managers who wish to market outside of Europe, then all of the current well established jurisdictions are fine. However, should they wish to market within the EU, then the choice becomes more limited. Luxembourg and Dublin do a fine job of regulating funds but they are predominantly retail and tend to be managed by large institutions.

Malta, by contrast, offers a well regulated choice of jurisdiction that fully supports the AIFMD passport for marketing purposes and is, crucially, a cost-effective option for the aspiring fund managers of this world.

The Maltese speak both Maltese and English despite the fact that it is a sovereign state within the EU, making it the gateway of choice for those emerging investment managers wishing to promote their funds across Europe.

Derek Adler is a director and founder member of International Financial Administration Group (‘Ifina’) - a firm that provides turnkey fund services to managers via its Primary European Fund SICAV in Malta and its Primary Development Fund in Cayman.

“We are still championing the smaller managers. As of September 2015, we are offering to set up a fund, within our umbrella structure, for under USD10,000, fully inclusive. On an ongoing basis, our minimum annual costs will stay the same at USD26,500 but we are now offering a fee of USD20,000 for the first year. We are really trying to help start-ups get up and running,” states Adler.

Like Ifina’s Primary Development Fund in Cayman, the Primary European Fund SICAV provides a turnkey solution for managers wishing to launch in Europe and build a track record without the burden of establishing a standalone fund. Ifina takes care of everything, from setting up corporate bank accounts, dealing with lawyers, appointing service providers, getting service level agreements in place; basically all the heavy lifting.

“We can help an emerging manager get up and running at very competitive pricing. This is a good thing and ensures that there is still a place for innovative and entrepreneurial talent to develop, despite the initial barriers that appeared to be in place,” says Adler.

In terms of the structure, the Primary European Fund SICAV is effectively a holding company composed of multiple sub-companies. Each sub-fund that sits beneath the umbrella structure is a separate legal entity. If there were 10 funds on the structure and one imploded, it would not impact the other nine funds at all. Each manager on the platform has full control of the fund’s name, branding, and track record.

“Our umbrella structure helps to accommodate the little guy that would ordinarily find it difficult to get off the ground in Europe. We’ve now got a few sub-funds up and running in Malta. It really doesn’t need to cost the earth to establish a fund and will help to build interest and grow the pipeline even further,” concludes Adler.
Becoming the EU’s leading securitisation centre

Interview with Paul Mifsud

Despite Malta introducing a legal framework for securitisation in 2006, the financial crash meant that it was rarely used until around 2012. But there are signs that securitisation is gaining some momentum locally. This is being helped by a dedicated regulated market for wholesale securities, the European Wholesale Securities Market (‘EWSM’); a joint venture between the Irish Stock Exchange and Malta Stock Exchange established in 2012 that allows the listing of wholesale-denominated debt securities to trade on an EU-regulated market.

“The revival of securitisation in the EU is now considered to be one of the priorities of the Capital Markets Union, in particular for the refinancing of SME loans and to reduce reliance on bank funding,” comments Paul Mifsud, Managing Director, Sparkasse Bank Malta. “We believe that securitisation as well as private placements of bonds through Maltese vehicles could fit well within the scope of the European Commission’s initiatives in this regard, and that Malta is well placed to offer cost-effective solutions for companies to raise non-bank financing.”

The Maltese Securitisation Act covers three main types of securitisation: asset securitisation, synthetic securitisation and whole business securitisation. A securitisation vehicle set up as a Maltese company has to appoint a local auditor; otherwise, the appointment of external service providers is optional. “The securitisation vehicle may delegate the day-to-day administration function to a third party, including the originator of the securitisation assets,” explains Mifsud.

To further strengthen Malta’s position, an innovative piece of legislation – the Securitisation Cell Companies Regulations – was enacted on 28th November 2014. This improves investor protection by formally recognising the segregation and protection of assets allocated to segregated accounts, compartments or units within the same company. A securitisation cell company (‘SCC’) may be established for the purpose of either entering into securitisation transactions or assuming risks as a reinsurance special purpose vehicle.

“The SCC is a company that creates one or more segregated cells by means of a board resolution. The cells do not have separate legal personality – only the SCC does – but do have separate patrimony status: the assets and liabilities of one cell are treated as being separate from the assets and liabilities of any other cell within the SCC, and from the assets and liabilities of the SCC itself. Assets attributable to a cell are only available to the creditors of that cell and are ring-fenced from other creditors,” explains Mifsud.

Mifsud notes that in terms of financing the securitisation transactions for each cell, the SCC would issue financial instruments in respect of the relevant cell, in one or more tranches: “Typically, these would be debt securities but it is also possible to issue shares in respect of a particular cell. Debt securities may be listed and admitted to trading on a regulated market such as the EWSM, or can be offered on a private placement basis.

With the legal and regulatory framework in place, Sparkasse Bank is starting to see interest build among asset managers for tailor-made solutions in alternative asset classes such as real estate and corporate loans.

Mifsud concludes, “While it is possible to set up so-called "loan funds" in Malta, investment in asset backed securities, issued by a securitisation vehicle, may be a more appropriate and efficient means for asset managers or their clients to take advantage of credit opportunities, depending on the circumstances.”
Funds of hedge funds bring bargaining power

By Ilario Scasascia

A well-diversified portfolio should include investments that offer alternative sources of returns, which can be found outside the world of conventional, long-only, bond and equity strategies. Sophisticated investors know this and understand, that when it comes to investing in non-traditional assets, hedge funds represent an important building block.

Hedge funds will therefore remain a staple in institutional investors’ portfolios. In fact, after the financial crisis of 2008, hedge fund assets have been growing at an annual rate of 10% and this growth is estimated to continue*. Growth has been supported by increased transparency and improvements in fee structure. So what is it that hedge fund investors want? The answer is straightforward enough: The main objective for hedge fund investors is to achieve its targeted return by allocating to a balanced portfolio, which benefits from the most significant alternative source of returns across different strategies. Simply put: Hedge fund investors seek absolute returns which exhibit lower correlations to traditional markets. Therefore, the prime question should not be what investors want, but rather how they can go about getting it.

As the world of hedge funds encompasses a myriad of different strategies, the conclusion that most investors come to is that they need a portfolio of hedge funds, not just a single hedge fund. This will lead them to three possible options: building their own team of experts, using consultants and advisors or investing via a fund of hedge funds. Building your own team might be feasible for very large investors, but for most this is not an effective use of capital. Accessing the knowledge of advisors and consultants is a popular option, but tends to be time intensive. Then there is the fund of hedge funds route, where the investor gets access to a diversified portfolio of hedge funds, managed by a team of experts. However, investors are understandably concerned about fees. But with the right kind of fund of hedge funds, this need not be a concern. A fund of hedge funds can and should use its size and experience to negotiate preferential fees and pass on these savings to its investors.

It’s not just lower fees that a capable fund of hedge funds can provide, it is also access to the best performing funds. This includes both the smaller, harder to find hedge funds – often the ones making the better returns – and the larger funds that many investors don’t have access to, due to investment size limitations.

Harcourt, the alternative investment boutique of Vontobel Asset Management, has been at the forefront in putting its expertise in hedge fund advisory to use for its clients by building fund of hedge fund portfolios, negotiating preferential access and fees to hedge funds. By providing the pension fund with Harcourt’s selection skills, combined with preferential access and fees to hedge funds, the strategy has provided stable returns averaging over 5% annually since inception, and beating its respective benchmark by a cumulative 44%. In order to provide investors with simplified access to this successful strategy, it has been made available in a Sicav-SIF structure as a Harcourt Alternative Leaders strategy, offering institutional investors easy access to a proven and solid fund of hedge funds strategy.


Please contact for further questions or information: Hubert de Froberville, Vontobel Asset Management S.A., London Branch, 22 Sackville Street, London W1S 3DN. Tel: +44 (0)20 7255 8323. Email: hubert.defroberville@harcourt-am.com.
Publishing has undergone a significant metamorphosis since the turn of the century. As the power of the internet has grown year-after-year, with Google’s search engine shaping the way we navigate it, publishing companies have needed to evolve their business models accordingly.

Global Fund Media (‘GFM’), which publishes Hedgeweek and was established in 2002 by digital media entrepreneurs Sunil Gopalan, Chairman and Publisher, and Oliver Bradley, Chief Operating Officer, has always been a pure-play digital publisher. Over the last 18 months, the firm has evolved significantly to forge greater alignments of interests between its clients and readers across its seven titles spanning all investment fund classes including private equity, ETFs and property funds (see www.globalfundmedia.com).

A new model has emerged: Straight-Through Marketing or ‘STM’ for short.

“Over the last 13 years we have learnt an enormous amount about digital publishing. About how to supply the right information to the right constituents, but also making sure that those different constituents i.e. buyers and sellers, are being informed with the right information,” says Gopalan.

“The fundamental lesson that we’ve learnt is how best to unravel the different strands of DNA to understand exactly who our readership is in order to deliver a more focused content strategy for our clients.”

This involved an extensive exercise in mid-2015 updating GFM’s database of more than 98,000 readers to ascertain who those readers are and where they are located. If there is a gmail address, that person is contacted so that GFM knows the company they work for, their job title, and the business function they are involved in: is it a sales & marketing function, an institutional asset management function, or a trading function?
The STM model is about crafting our service to suit our clients. To adapt and deliver according to their specific objectives and measure how well that approach has worked in meeting those objectives. We make sure that we measure its efficacy using the same quantum – or variable – as the client’s. That way, we are all speaking the same language,” explains Bradley.

For example, say a service provider has created a new product and wants to get a targeted message out to the industry. Once the mode of delivery has been determined – e.g. a bespoke report, a Q&A interview, an in-depth article – GFM will then disseminate that content to a specific portion of its readership (or indeed its entire global readership if appropriate), and over a predetermined timeframe measure the number of leads generated, which that client can convert into new business.

In other words, there’s a straight-through-digital-marketing line that shows what the client has spent, what content has been created – the INPUTS – and what the end result has been i.e. percentage of leads that have generated new business: the OUTPUTS.

This is the scientific approach that Bradley refers to earlier. In today’s marketplace, where clients face considerable challenges cutting through the ‘noise’ of the internet to get their voice heard correctly, having that rigorous front to back process in place means not only that that message is heard, it also means that GFM is closely aligned with the client’s objectives from the outset.

GFM recognises that there is no longer a single solution approach to servicing clients; each one is different and in today’s publishing environment, creating highly focused original content that resonates directly with the audience a client is looking to connect with has to be done in a carefully tailored fashion.

Today’s financial practitioners need customised solutions – primarily content – to meet their needs. In that respect, publishers are no different to FoHF managers, fund administrators, prime brokers or technology providers: everyone is working to deliver value for the end-user.

This is no longer the age of the cookie cutter model.

**A one-stop-shop for tailored marketing campaigns**

GFM can best be thought of as an amalgam of various processes that currently exist in various roles and departments within different companies. These include:

- The client’s marketing department;
- The media buyer;
- The copy writer;
- The advertising agency;
- The PR agency;
- The publisher.

“We offer all of this in one solution at a cost-effective rate with 100 per cent transparency; that is: no leads, no value.

Sunil Gopalan, Chairman and Publisher, GFM Ltd
Content is king
In the last couple of years, GFM has made strides to broaden its toolbox to give a client greater flexibility in how it controls and delivers its content. Traditional tools such as ad banner campaigns and press releases are still used, as are sponsored articles in a wide range of special reports that GFM’s flagship website, Hedgeweek, produces on a monthly basis.

But now there are other choices. One has been the creation of what GFM calls ‘Mini Reports’: rather than being part of a wider special report, these mini reports are 100 per cent owned by the client. Typically six to eight pages long, they provide a bite-size chunk of information that the client can showcase to GFM’s readership.

Some examples of recent reports that have done significantly well using this model include:
- **eVestment report**: The evolution of hedge fund investing & why institutions remain sanguine.
- **CME report**: Deliverable swap futures.
- **State Street Global Markets**: Fund Connect – A multi-sponsor ETF platform for the 21st Century.

Microsites
Then there are microsites. These are sites that sit within Hedgeweek that the client owns. The idea behind this is that it gives the client a unique opportunity to build a stable of original articles, based on editorial interviews with the GFM team, thereby reinforcing its market position and, crucially, allowing it to develop a strong digital identity; the more articles somebody writes on a specific subject, the more favourable they are viewed by Google.

GFM has developed successful microsites for the likes of Bloomberg, KPMG, SEI, Lyxor, Preqin, CBOE and Intralinks.

In addition to these mini reports and microsites, GFM’s team helps with industry surveys, compiles reports on the back of client-hosted events, and even contributes blogs to help reinforce a client’s message.

“More importantly, we can help our clients reach the right audience with this customised content. We then report directly back to the client with a stream of analytics on how many people looked at a particular article or report, who they work for and what their job title is – in other words qualified leads – in order for the client to capitalise on that information. The STM model is basically an end-to-end marketing communications solution for service providers.

“We have become incredibly active over the last 18 months creating microsites and mini reports for clients, which have proven to be hugely successful. It gives them an opportunity to shape and create content in close collaboration with our editorial team. Indeed, clients who choose to go down this path repeat the process: Lyxor Asset Management, SunGard, eVestment and several other companies have produced unique mini reports in recent times,” explains Gopalan.

The STM model is, in effect, the antithesis of a scattergun approach i.e. producing content and hoping for the best. What GFM does is ascertain who the client is looking to connect with and what topic or problem in the market are they attempting to address? That then facilitates the creation of thoughtful, intelligent marketing that has the best chance of resonating with GFM’s global readership.

“Because the internet is relatively intangible compared to print, a lot of metrics like numbers of unique views or impressions are by and large meaningless. We have always had that at the back of our minds as a digital publisher. In terms of how we deliver an advertising solution we aim to be as transparent as possible. Given that our model is 100 per cent supported by advertising, we have to take our clients’ advertising needs incredibly seriously. That has always been the case since day one.
and has enabled us to maintain an 80 to 90 per cent retention rate," says Bradley, who goes on to explain why GFM has evolved its business model.

"Firstly, we have a better latent understanding of how the digital marketplace works. Secondly, the internet has become a lot more sophisticated. We operate purely within the business-to-business community. We help connect the dots, putting our clients in front of GFM’s readers as efficiently as possible in terms of time, resources, and obviously cost."

**Google’s Penguin 3.0 algorithm**

The algorithms that Google and other search engines use is such that when you search for an answer you are confronted with 50 different options, all of which refer to the same data and contain the same content that you are looking for.

In a quest to bring the search engine user to the originator of that answer – and cut through the noise of the 49 other websites – publishers are going to suffer a bit with Penguin 3.0, the algorithm that Google updated last year. The whole point of Penguin is to fight against webspam in search results and black hat techniques to game the system, according to an article on entrepreneur.com (www.entrepreneur.com/article/239162).

Within a PR context, this is important. A PR agency wants to generate as much exposure for their client as possible by disseminating a press release far and wide. The search engine algorithm will, however, determine that the press release should only be attributed to one publication – first come, first served. All other companies who produce the press release will be penalised. On the one hand, this could impact Hedgeweek and other GFM titles that share press releases with the industry.

On the other hand, it could make the STM model even more powerful and compelling to GFM’s clients over the coming years, as they will be able to guarantee that by using GFM as their primary receptacle for distributing original content, their company will feature prominently in Google’s rankings.

“We are improving relevancy to both ends of the food chain – the advertisers, and our readers. People read Hedgeweek because they are in the industry, they have a vested interest. The content we create resonates with operations teams, front office traders, compliance teams, legal teams, asset allocators and so on. Having an article placed in front of you, that may lead you to contact the sponsor behind that content, is absolutely fair play.

“So we are well positioned to support clients even more strategically as the need rises for companies within the asset management sector to disseminate mission-critical information to the industry from a single reliable source: we are that source,” states Bradley.

Gopalan takes a slightly more cynical, editorially-driven view on machine algorithms. To his mind, GFM is using human intelligence to make the STM model work and deliver meaningful results. As such, getting over-obsessed over whether an article or press release should be used more than once is unnecessary. He makes an excellent point to illustrate this by referring to the emergence of PERE funds – investment vehicles that span both the private equity and real estate sectors.

“Let’s say a PE house wants to discuss their plans for expanding into the real estate space. It’s ridiculous to think that we shouldn’t then publish an article on both PE Wire and Property Funds World. That manager would want the exposure so as to appeal to both private equity and real estate investors. To suggest that an article becomes redundant when used on more than one website is missing the point entirely.

“We know how to disseminate that information to the correct audience; Google’s algorithm does not,” says Gopalan.

“Indeed, this is not like Amazon or eBay, which operate in the mass-market arena. GFM operates in a very niche industry. Our church is a small church.”

With STM, marketers can expect not to receive high volume, mediocre numbers but rather lower volume, high quality analytics and leads.

“As firms such as Bloomberg, Intralinks, State Street and SunGard have discovered, a focused strategy on content creation is allowing us to deliver quality leads that can be acted on. That’s the key to this,” says Gopalan in conclusion.
Distribution and the benefit of having a strong network

Interview with Frederic Perard

This summer, to further enhance the strength of its global network, BNP Paribas Securities Services (BNP Paribas) chose to integrate EY’s Global Fund Distribution (GFD) product into its wider Fund Distribution Services (FDS) offering. This gives clients access to a comprehensive range of information to help them determine which product to distribute, which jurisdiction(s) to choose, which investors to target and the most appropriate distribution channels.

As Jean Devambez, head of asset and fund solutions at BNP Paribas Securities Services said at the time, the partnership with EY gives clients “access to a wealth of information at the click of a button”.

For managers looking for guidance on how best to develop their cross-border fund distribution strategy, the GFD product is an invaluable resource given the depth and breadth of regulatory change in Europe. The GFD tool was made available to BNP Paribas’ clients on 1st July 2015.

Frederic Perard, Managing Director BNP Paribas Securities Services, Luxembourg, points out that the agreement with EY is just one part of the overall offering.

“The agreement we’ve put in place with EY gives clients access to a database describing the specifics of each European market in terms of registration and distribution; everything you need to know to establishing a foothold in Europe.

“We use the database globally and I like to refer to it like the Intel Inside concept; we are the computer, EY is the processor”, says Perard.

A second feature of the Global Fund Distribution solution is to support managers looking to register funds. The BNP Paribas team helps with everything from putting together the fund prospectus, filing the application with the Commission de Surveillance du Secteur Financier (CSSF) and so on. BNP Paribas refers to this as Legal Fund Engineering.

Many of today’s asset managers have different funds domiciled in various locations. To help with this, the third aspect of the GFD product is to offer regional tier services, which can support clients in two ways. The first is by providing the ability to centralise orders for an asset manager in a given region. BNP Paribas has centres in Singapore and Hong Kong to collect fund information during market hours in Asia, which then gets processed and sent to Luxembourg using a “follow the sun” approach.

“The second aspect is that for those managers who wish to sell their full range of funds to institutional investors, private banks etc., we centralise the orders for all their funds, even if we are not the primary administrator and custodian to all of those funds. This product is called Regional Transfer Agency – we are, in effect, a super TA, where we centralise all the subscription/redemption orders for all the funds of a given asset manager, regardless of where the funds are domiciled,” explains Perard.

The fourth aspect of the product is to provide global reporting on fund data. This is called Data Navigation Analysis (DNA) and supports managers with respect to FATCA, AML/KYC, Annex IV reporting; all of which falls under the umbrella of “management reporting”.

“Globally, we look to support management companies for any kind of reporting they have to do. The final feature is to handle the fee attribution to a manager’s fund distribution network to make sure the fees are properly distributed based on the level of assets they have in the fund. It is a full end-to-end solution for global fund distribution,” says Perard.
Since BNP Paribas first established Fund Distribution Services in 2000, constant adaptations have been made based on client feedback and the evolution of the distribution and regulatory landscape. Further adaptations to the solution will be made if, for example, funds move to T2S (Target2-Securities) in 2017, which could result in changes to operating models. “MiFid II will require us to adapt as well,” adds Perard.

Within Luxembourg, a clear convergence is taking place between the alternative funds universe and the UCITS universe with respect to global fund distribution. Under AIFMD and UCITS regulation, European funds must appoint an independent depositary to provide the necessary oversight, safekeeping and cash monitoring functions. Given that BNP Paribas is the depositary bank of choice in Europe, and has a global network that few other European banks can match, Luxembourg is proving to be very beneficial.

Perard notes that with respect to UCITS V, the main change to current UCITS IV regulation relates to the restitution and safekeeping of assets: “That creates a bit of work for us but what matters is the strength of the network and this is where we can make a difference going forward. Approximately 90 per cent of our clients’ assets, on average, are held in our own network.”

One of the key aspects of UCITS V – which will share many attributes of the AIFM Directive – is that the depositary bank will be required to fully replicate a client’s fund portfolio on a daily basis; previously, this was an annual process. That presents a potentially significant challenge for funds that are using OTC derivatives.

“The depositary bank will need the capacity to justify, at any moment, all of the assets contained with a client’s fund including OTC derivatives, and collateral and securities lending. This has created a significant debate because in the context of EMIR, collateral and securities lending activity are still in their infancy for OTC derivatives. Depending on the outcome, this could have a major impact on depositary banks because for these assets they have historically used data coming from the fund administrators. Depending on the regulator’s view – ESMA Level II guidelines should be published in February 2016 - this could change what is currently being done and what will need to be done going forward,” outlines Perard.

Given that auditors will also be part of the process, banks will be under even more pressure to ensure that their operating model is sticking fully to the rules and in line with regulation. But as Perard mentions: “Being headquartered in France, UCITS V for us will be very much business as usual.”

What makes Europe particularly complex is that it is such a fragmented market. Perard believes that fund managers looking to centralise their cross-border fund distribution activities in Europe will need to put in place a global contract with their service providers. “What I mean here is that they will need a global contract that is valid for all countries in Europe under AIFMD. As an industry, we need to respond to convergence with a standard agreement on who would take control of the NAV calculation. The UK, German, Italian and French models are all different. The only thing they tend to have in common is that they have both local funds and Luxembourgish funds.

“If ESMA releases the Level II guidelines we might, come March, see a timeline for adaptation – maybe 6 to 12 months. But we will have to wait and see,” comments Perard.

This is precisely where the benefit of a strong network comes into play. BNP Paribas has a presence across Europe and operates in 34 major markets.

For managers looking to set up sub-funds to begin their European distribution activities, they can rent a compartment on one of two umbrella platforms operated by BNP Paribas: one for UCITS, and one for alternative funds. “We work with a few different management companies in Luxembourg to provide the ManCo service. This enables managers to start small, focus on perhaps one or two countries for distribution in Europe and steadily establish their brand. This is important for fund managers from for example Latin America and China who ultimately want to sell their domestic class of assets and attract global investors”.

“They are using Luxembourg as a hub from which to expand their distribution network,” concludes Perard.
The Portfolio Amalfi™ platform by Nedelma Inc. offers multi-asset, multi-language and multi-currency dynamic reporting and data visualisation and analysis capabilities to the asset management industry. The platform also offers data aggregation tools as well as portfolio management solutions and a calculation engine.

In addition to Portfolio Amalfi, Nedelma has an online investor document repository with document approval workflow and interactive reporting.

“The platform can be added to existing in-house and third-party products,” says CEO Michael Medvinsky, who founded Nedelma after previously holding senior technology positions at Goldman Sachs and UBS. “Integration is quick and requires minimal input from the user’s technology teams. Nedelma empowers end users to create reports on the fly and change almost anything dynamically, including formulas. We help users improve performance, increase assets, improve transparency, and reduce costs.”

Portfolio Amalfi™ seamlessly combines P&L, risk, exposure, third party and in-house data, making it available across numerous devices including the desktop, the iPad and other mobile devices. Users can tag positions with custom attributes, set up filtering rules, share reports, drill down to underlying information and aggregate data by any number of attributes.

“Our state-of-the-art reporting gives business users complete control of report creation with user defined attributes and data, and produces reports in most languages and currencies. The platform is delivered through either desktop or Apple-certified, iPad products. Our Apple certified mobile solutions are comparable to desktop applications and are far superior to web-based mobile reporting products.

Portfolio Amalfi™ provides portal functionality by securely delivering investment information, monthly investor reports, interactive dynamic charts and grids, custom reports and other data. Nedelma offers its products directly to clients and by partnering with other vendors. For example, IKONIC Fund Services has licensed Portfolio Amalfi to provide dynamic reporting to their clients based on data exported from their core fund accounting system.

The benefit to investment managers is that the latest fund data, including historical data, is seamlessly available in Portfolio Amalfi and they can run and build reports on the fly. As Medvinsky explains, Portfolio Amalfi reduces “I will get back to you” communication scenarios and enables managers to make investment decisions more efficiently, leading to more effective execution and improved performance.

“Additionally, flexible analysis of data both online and offline helps investment managers make decisions faster, reducing “down-time” when a user is on the go and needs rapid access to data. It also makes fundraising more effective by providing prompt and accurate feedback to investors with added transparency,” explains Medvinsky.

This can potentially lead to increased investments from investors and helps to retain existing investors and acquire new ones. One attractive feature of Portfolio Amalfi™ is that it can be used as a CEO dashboard to give senior executives a holistic view across their firms, anytime and anywhere. Additionally, multi-dimensional reports and other features enable CEOs and other users to analyze their data from multiple perspectives using a combination of attributes, formulas and values, with almost no limit to how they view data. “To provide a first-class reporting system we combine power and speed through ad-hoc flexibility in reporting, data aggregation, data visualisation, calculations and analysis,” explains Medvinsky.

Nedelma’s multi-asset, multi-purpose and multi-language platform, including Apple-certified iPad solutions, is a powerful differentiator and provides numerous benefits, including helping with marketing efforts. It turns clients’ data into actionable, profitable information and improves collaboration by users, anywhere and anytime, across the desktop and the iPad.

As fund managers face increasing regulation, Portfolio Amalfi delivers dynamic, ad-hoc reporting to meet the compliance and reporting challenge. As Medvinsky concludes, improving managers’ reporting efficiency “is one of the significant benefits of Portfolio Amalfi.”
DMS Offshore Investment Services (‘DMS’) Limited was established in the Cayman Islands by Don Seymour in 2000. Over the past 15 years it has grown into one of the industry’s leading fund governance firms with over 200 people.

One of the big focuses for the firm is ongoing regulation, in particular AIFMD and FATCA. With respect to FATCA, DMS stole a march on its competitors in 2014 by establishing a FATCA Responsible Officer (FRO) role.

“Our principal, Don Seymour, identified FATCA as an area to work on three years ago. We got the teams set up, the systems and the processes set up so that when managers came to us, we were ready from day one to support them in respect to FATCA compliance,” comments Derek Delaney, Managing Director of DMS Offshore Investment Services (Europe) Limited.

Whilst over half of DMS Group’s clients have decided to use its FRO service, an equal amount of uptake has been seen among non-DMS clients. Part of this growth has originated from legal firm referrals, as Delaney explains: “Law firms would tell managers that they needed an FRO in place, but when it came to internally deciding who would take on that role a lot of these law firms began referring clients to us. We have built a lot of law firm relationships on the back of their endorsements of our FATCA solution.”

The FATCA solution is delivered out of DMS’s Cayman, Ireland and Luxembourg offices and supports all global funds. Whilst other firms are still ironing out the creases of their US FATCA solution, DMS has already moved on and developed the necessary policies for UK FATCA and the OECD Common Reporting Standards.

DMS Group has also developed a suite of AIFMD solutions. Not only does it have an AIFMD-compliant platform and registered AIFM (DMS AIF Management Company) it also offers Annex IV reporting services. “Even when clients have decided not to go with a full European fund, they’ve still asked us to act as the Annex IV reporting party. During January 2015, we did 216 filings. Now, we are able to say to managers, ‘We’ve got the AIFM in place, the platform, we’ve gone through a successful round of reporting, so any uncertainties that existed with AIFMD are now in the past’. The only unanswered question is when the funds passport will be made available to non-European managers,” says Delaney.

Year-to-date the firm has won 57 mandates across AIFMD and UCITS, including one of the largest investment banks in the world. “In addition, we have over 78 clients for whom we’re doing Annex IV and other global risk reports on EMIR, OPERA, CPO, etc. I would estimate that we will have more than 100 AIFMD/UCITS clients by the end of the first quarter 2016,” adds Delaney.

“In addition to the mandates we’ve won, we’ve also taken on mandates to provide risk management support to other management companies; those where an investment manager has decided to set up their own entity in Luxembourg and they are putting one or two people on the ground but wish to delegate the risk management function,” states Nick Parkes, who heads up the AIFM business in Luxembourg.

“The other function that has become a focus in Luxembourg,” continues Parkes, “is more qualitative, i.e. can you identify a good trade. DMS can do this because we’ve been working with an 8-person strong investment management firm for a period of time. This means we are able to provide a real, qualitative oversight of how managers are performing. That type of substance is really resonating with the market.”
These are exciting times for the financial technology sector. In the last few years, market complexity has grown in response to increased regulatory demands, increased investor due diligence requirements, more complex fund strategies and even how hedge funds manage their balance sheets with their prime brokers.

These demands are in turn putting pressure on technology specialists to innovate. One firm that is helping pioneer the way that hedge funds streamline their operations is Eze Software Group. According to President Jeffrey Shoreman, “we feel we are driving innovation in this space by bringing together front, middle and back office functionality in ways that have never been done before.”

Eze Software Group was established in 2013 by bringing together three industry-leading platforms: Eze OMS, RealTick EMS and Tradar PMS. As such, integration lies at the heart of the firm, having knitted together these three solutions to create Eze Software Investment Suite. Users can choose to either use the three products in isolation, or altogether in a single offering that also includes Compliance, Data Management and Commission Management applications. This provides a consolidation solution to manage the investment lifecycle from portfolio analysis and modelling, through to trade execution, order management and reporting.

“One of our major focuses has been integrating the execution management functionality and the compliance engine. This allows pre-trade compliance checks to run seamlessly at trade entry and throughout the trading lifecycle,” explains Shoreman.

“Data has to be synchronised for that to happen. In the past, an order would be generated in the OMS and then staged or re-keyed into the manager’s execution management system but that meant losing some of the compliance checks. If the order changed they would have to swivel back into the OMS and update it. What we’ve done by bringing the EMS and compliance functions together is to allow the compliance checks to run natively within the EMS. A manager might have a global disclosure rule that they have to file when the fund reaches a certain holding percentage. They can now see that directly in the EMS without having to swivel back to the OMS.”

There are plenty of technology providers who offer integrated EMS/OMS systems, but what makes Eze Software unique is this: because the systems both reside under one roof, they use synchronised data. In order to get a firm-wide view of compliance, “clients need to have all the transactions and positions in one place for the compliance system to evaluate them. This means the manager can track their exposure and risk more accurately,” adds Shoreman.

Another example of how Eze Software Group is building a single suite to help managers reduce their operational risks is by integrating the OMS and PMS functionality. As Shoreman explains: “Historically, order management systems were the intra-day book of records; one could manage all of the positions and transactions but then you’d have to shift them over to the accounting system, or the portfolio management system, to do shadow NAV and month-to-date and year-to-date P&L calculations. We are bringing the OMS and PMS functions together, so that when you would enter a trade into the OMS, it automatically would flow through into the PMS, allowing you to see updated positions.”

Investors want more timely updates on how their portfolios are performing and hedge funds are trying to become more efficient in doing this.

“We can offer one process where technology is driving efficiency front through back and reducing human error to streamline a hedge fund’s overall operation,” concludes Shoreman.
How hedge funds need to address cybersecurity threats

Interview with Mike Asher & Grigoriy Milis

The threat of cyberattacks is growing within the hedge fund community, requiring managers to put in place policies and procedures that address the cybersecurity risks unique to their firm. This goes beyond merely acquiring technology and hoping for the best.

“This year we see the emergence of Chief Information Security Officer (CISO) roles that will help hedge fund managers understand their risks and how the technology is aligned to mitigate those risks. It’s about making sure that network professionals are using the right tools applicable to the firm’s investment strategy,” explains Mike Asher, CIO at Richard Fleischman & Associates, a New York-headquartered technology firm that has been providing outsourced services to the hedge fund industry for more than twenty years.

The SEC’s Office of Compliance Inspections and Examinations (“OCIE”) issued a Cybersecurity Initiative Risk Alert highlighting the importance being placed on information and cybersecurity preparedness. In February they released a summary of their findings, on the back of which the guidelines for 2015 will be updated over the coming weeks. Contained within these guidelines are a series of questions covering everything from monitoring cybersecurity, business continuity plans, WiSP (Written Information Security Policy), physical security etc.

The SEC selected 50 firms, including broker-dealers and registered investment advisers, to see how they stack up in relation to these questions. The end objective is to prevent financial institutions from falling victim to cyber attacks. The fact that the SEC is now treating cybersecurity seriously shows the level of responsibility that technology providers have to their clients, especially those running billions of client assets.

“What the SEC exercise brought to light was that security is no longer just a checkmark on investor DDQs. There is now a new baseline standard for security, which alternative asset managers have to adhere to,” says Asher.

In response to the examinations, technology providers jumped to market with product offerings that were good but not, says Asher, “mature enough for enterprise-level consumption”. For example, providing penetration testing software, which has been around as long as network security. Problem being, many of these firms fail to define how their solution relates to financial firms. “The same sort of products and services that were being offered to the wider marketplace were simply being packaged and sold to the financial industry,” adds Asher.

The alternative asset management industry is unique and cannot be expected to use generic products of security configurations. Whilst everyone emphasised the need for security last year, nobody took a step back and said, ‘What is my current strategy and the potential risks associated with it? Once that has been analysed, risks highlighted and understood can we ask, Who’s the “right” person to guide me and help mitigate the risks of today, and tomorrow?’

“This is where we see the evolution,” states Asher. “The initial package of service offerings – penetration testing, intrusion detection and prevention systems – that were implemented last year, as part of that initial push to bring alternative asset managers to the baseline level of security, did not
answer the above question. That’s where providers like RFA come in. We can share our experience, not only when it comes to what technology, but also at the level of policies and procedures. We advise management firms on how they can create customised solutions that address their specific business needs.”

**Rise of targeted attacks on hedge funds**

Grigoriy Mills is chief technology officer at RFA and a 16-year IT veteran, holding various leadership positions covering all aspects of infrastructure design, R&D and evaluation and testing of new technologies.

The malware market has, over the years, focused on softer targets within global markets: namely stealing credit card information from individuals, which has, naturally, proved highly lucrative. Hedge funds, by contrast, were largely overlooked, much to the surprise of Mills. This could be because “hactivists” viewed them as secure tech-heavy institutions. As the sophistication of malware has improved, however, the number of targeted attacks on hedge funds has started to rise. Eldon Sprickerhoff, chief security strategist at cyber-protection firm eSentire, says he sees more than 10 phishing attacks every day on his 350 hedge fund clients.

“Hedge funds and Alternative Investment Funds control significant amounts of money, not to mention the sensitive personal information on the fund’s underlying investors, who are typically very wealthy individuals.

The intellectual property of the fund is also highly vulnerable. It’s really a perfect place for a cyber hacker to focus their attention,” says Mills.

Protecting the network, and fund data, is a challenge for smaller managers who simply don’t have the budgets to put in place sophisticated protection mechanisms.

“The big change is that hedge funds are now coming under direct attacks, it is no longer just the banks and wire houses being targeted. Managers realise that they have, in fact, have got to improve their cybersecurity levels. These are not wide-ranging malware attacks, they have been specifically created to breach internal networks with the intention of stealing or manipulating data such as fraudulent wire transfers, stealing social security numbers or even just to create damage.

“These targeted attacks are the most difficult to guard against. They are custom-made. Typical intrusion detection systems are not able to detect them. Outside of some emerging technologies, there is no silver bullet that can give hedge fund managers 100 per cent protection against a breach,” explains Mills.

Spear phising attacks, as referred to above by Sprickerhoff, have existed for quite a while and are one of the most commonly used network attack mechanisms. A piece of customised malware is created to acquire information through an email, which is made to look like it has come from a trusted source.

But there are far more sophisticated hacking tools being used. A recent example is where a hacker breached a hedge fund’s network and sat, watching activity within the fund. The hacker watched a substantial amount of money coming in to the fund’s bank corporate and created a fake wire transfer.

“What makes this case interesting is that, at the same time, in order to divert attention from the wire transfer fraud, they initiated a huge DDOS (distributed denial of service) attack on the client’s network. This affected the entire operation and the wire transfer almost went through undetected,” says Mills.

This is where managers need to ensure that the right policies and procedures are in place, so that they are able to respond quickly by knowing what steps to take. Without these, it doesn’t matter how sophisticated the cybersecurity technology might be. In the above example, the manager would have been fully compromised and the wire transfer would have gone through.

Employee education and training remain one of the core components to robust cybersecurity plan, and in this instance it paid off.

“It’s important to understand that people can do more damage than any piece of technology. To be as secure as possible requires a combination of policies and technology,” says Asher.

Of course technology is key. After all, a manager won’t know they’ve been breached unless they have a detection solution in place. In addition, people need to regularly audit their data access, and audit activity within their network. It is a system of checks and balances.

Auditing, monitoring and detection are becoming ‘must haves’ for any hedge fund manager, in Mills’ view.

“The second element to this is procedural. A manager needs to have policies and procedures in place in order to outline what they need to do if a breach occurs. As with any crime, the timeliness of the response is extremely important. The faster one can respond to a breach, the faster one can determine the extent of the breach and the better able one will be to mitigate the damage,” explains Mills.

Even more than the fast response, policies and procedures that are detailed, practiced and enforced can help mitigate breaches before they occur.

Certainly, WISPs are a big part of addressing these procedural issues. In addition, the manager’s compliance manual should include policies pertaining to technology, such as data usage, mobile devices, breach protocols, and disaster recovery. Each of these topics should be broken out as a separate set of policies and procedures as they relate to each area of business operations. Technology is part of the procedures and assists in enforcing the policy.
It’s a detailed process but that is exactly where RFA can step in, providing the specialist expertise to consult with managers, perform gap analysis on their existing cybersecurity policies and help them more clearly understand security risks. These procedures need to be written by industry professionals with experience in dealing with network breaches.

“It’s about tying together all critical components. If you look at security research firms, for example – eSentire, SecureWorks – they are big companies in this space. They look at security matrices, the latest threats, and are able to provide products and services on the infrastructure security front.

“In addition, managers need someone to analyse their environment, perform gap analysis, and create a cybersecurity breach policy. It’s not as simple as taking a cookie-cutter approach as one might with a disaster recovery policy. With cybersecurity it’s a specific protocol, it’s understanding what’s at risk and gathering information at the early stages; usually, smaller funds are not equipped to handle this. I don’t even know many large hedge funds who are equipped to handle this internally,” states Asher.

Each policy and procedure should be testable and quantifiable. To have a policy documented that can’t be enforced is worse than not having the policy.

**Vulnerability is a function of hedge fund size**

Within the hedge fund firmament there are many highly advanced, technologically superior managers that have built state-of-the-art infrastructures: firms like Citadel, Renaissance Technologies, and other quantitative hedge funds, have long been safeguarding their trading codes and intellectual property.

The same cannot be said for more traditional strategies, such as equity long/short, particularly as one moves further down the AuM scale. These managers have more to catch up on.

“Smaller funds certainly don’t have budgets to spend and historically have operated in a more relaxed environment. What I mean by that is if you look at large established hedge funds, they operate as you would expect a large company to operate: they have clear operational controls in place, user rights and so on. Smaller hedge funds tend to allow staff to have more freedom and senior management are less inclined to impose strict controls,” says Mills.

This is understandable in the sense that’s the reason many traders set up hedge funds is precisely to escape the confines of large-scale institutions and the myriad rules they have to abide by. That mindset however, when applied to network security and data access, is a potential danger in today’s environment.

“Now, it is clear there have to be technology-implemented rules in place that restrict freedom for all. It’s a slow change but I think managers across the board are starting to understand the importance of this and implementing change,” adds Asher.

**Connecting to Prime Brokers – another area of vulnerability**

Aside from the hedge fund itself being vulnerable to potential cyber attacks, another source of vulnerability that could be targeted is the trading connection that exists with a fund’s designated prime broker(s).

According to Asher, the way primes are responding to this can be split it into two camps. Some are focused on mitigating any bad publicity and providing their clients with best industry practices and standards that they are advising all their clients on – not just alternative managers but all asset managers.

“They are producing their own templates of recommendations to serve as a minimum standard,” says Asher, who continues: “Then there’s the second camp of prime brokers who are taking the stand that it is such a complicated situation that they are better suited recommending vendors, taking a step back and leaving it for individual clients to come up with their own solutions.”

When it comes to addressing security concerns, it would appear that for some prime brokers it is a reputational issue, whilst for others it is a liability issue.

“At the end of the day, it will be part of the product offering that all prime brokers will have to provide as part of their IT service. Goldman Sachs is now working closely with security vendors and looking at what everyone is doing; it’s just a matter of time before they all offer a solution,” suggests Asher.

To conclude, it’s worth referring to the fall-out that is building on the back of the recent Sony hacking. Whilst the incident, which targeted Sony’s Playstation network, involved personal details from thousands of individuals being stolen was a clear embarrassment to the firm, of greater import is the number of lawsuits that are now being filed by individuals who were affected.

This is a stark warning to hedge fund managers who remain blasé about security.

“If private information is taken off site and you don’t do your due diligence to understand the extent of the breach that can be a greater threat to the existence of the fund than the original cyberattack,” says Mills.

The real harm does not come from the cyberattack itself, it comes from the downstream effect of having to inform your investors. The reputational damage could be irreversible.

“If managers don’t do anything, you can guarantee it’ll be the end of their fund,” concludes Asher in no uncertain terms.
Extending AIFM license to PE and real estate funds

Interview with Kavitha Ramachandran

Last May, MS Management Services SA, a Luxembourg-based subsidiary of the Maitland group, received authorisation from the CSSF to act as a third-party AIFM to alternative investment funds. At the same time, it established its own umbrella fund platform, MS SICAV SIF, to support managers wishing to fast track the process of launching an AIFMD-compliant fund in Europe.

Although less than a year in operation, there are already plans to extend the AIFM license capabilities to support private equity and real estate managers, in addition to hedge funds.

“We already provide administration services for PERE funds. Also, we have the accounting and administration infrastructure in our corporate services teams to handle the SPVs typically used in these vehicles,” explains Kavitha Ramachandran, Senior Manager, Business Development and Client Management, Maitland Luxembourg.

“We see this as a real growth area. We’ll follow a similar strategy to the existing one for hedge fund managers; that is, to have a platform product that will cater for these more illiquid asset classes, as well as offer outsourced AIFM services to managers running their own AIFs.”

Maitland’s platform has onboarded a number of clients with several more AIFs currently going through the approval process.

“When we get an enquiry, the client always asks for information on both the ManCo stand-alone services and the platform. However, I’d probably place greater weight on the product platform in terms of the level of future growth. The main factor that drives managers to use MS SICAV SIF is speed to market,” says Ramachandran.

One aspect that PERE managers who are looking to market in Europe need to be comfortable with when using a third party AIFM is just how important a role they will play. PERE funds have been lightly regulated structures; hedge funds have at least had a few years under Dodd-Frank and MiFID I to get used to regulation.

“Overall, the fund board is still responsible but suddenly they have to start dealing with an AIFM who has just as much authority to tell the manager what they need do as the board,” says Ramachandran, adding that the valuation model used by Maitland in respect of its hedge fund and FoHF clients would be robust enough to give comfort to PERE managers.

“Typically, with PERE funds you can’t really appoint an external valuer in the true sense of the Directive for liability reasons. The fact is that external valuers or property appraisers don’t value the structure up the entire chain; their only responsibility is providing a valuation of the ‘real’ assets but there might also be swaps and other instruments being used in a PERE fund. This requires a more comprehensive valuation function and solid technology infrastructure.”

In addition, any third party AIFM to a PERE fund will need to effectively monitor the entire structure, including any SPVs being used. That requires having the right processes and procedures in place and as Ramachandran notes: “The AIFM has to provide and demonstrate a more intensive level of governance to handle the additional risk involved.”

“Moving forward, we will continue to refine our processes in line with new developments under AIFMD. What we know about Annex IV reporting today, for example, is different to that of six months ago. We’ve also incorporated an integrated FATCA service into our AIFM solution which is a significant value add for our clients.”
Key areas of support for alternative fund managers

Interview with Cindyrella Amistadi

MultiConcept Fund Management SA ("MultiConcept") is an AIFM and UCITS IV fund Management Company. Established in Luxembourg in 2004, MultiConcept has approximately CHF10.7 billion in assets under administration. It currently has 20 umbrella structures with 89 sub-funds.

With the AIFM Directive now in full swing, the demand for management company services as well as the ability to get to market quickly with a new fund offering is growing exponentially among alternative fund managers of all shapes and sizes. Cindyrella Amistadi is the CEO of MultiConcept. In her view, the potential growth is particularly strong in the more illiquid market (i.e. private equity and real estate) as these managers seek to establish pan-European regulated funds.

“There were lots of concerns over regulatory changes in light of the introduction of AIFMD. We seized upon this as an opportunity and we have invested heavily to support fund managers to stay in line with AIFMD requirements,” says Amistadi.

“By obtaining an AIFM license we have strengthened a dedicated risk management team in Luxembourg to allow MultiConcept’s clients to focus on running their funds, while we focus on all the necessary regulatory and risk management requirements.”

MultiConcept is a fully integrated solution, within Credit Suisse Group. Each clients’ situation is assessed from a global perspective. “Investment managers can come to us if they are looking to develop a fund in Europe and need the support of a management company, respectively an AIFM. Moreover we can also support them from a global perspective with the full scope of services one would expect from a global banking group,” explains Amistadi.

MultiConcept addresses three key areas: risk management; set up of the fund structure; and registration and marketing.

Risk management
The day-to-day demands of remaining compliant as an AIFM are enough to put off most managers. Even those with a well-established presence in Europe are turning to outsourced ManCo/ AIFM solutions but one of the key considerations when assessing an AIFM is the quality of its risk management framework. AIFMD has a significant focus on this aspect and requires AIFMs to have a comprehensive view of a fund’s risk exposure, not to mention operational risks, conflicts of interest, asset valuation and provisions pertaining to remuneration.

Amistadi says that prior to AIFMD, there was a feeling in Luxembourg that “Luxembourg had lost substance because a couple of operational functions were being outsourced to low cost centres. By developing the role of the management companies, new functions were reinforced. MultiConcept used this as an opportunity to demonstrate to managers not only substance requirement but also our knowledge and expertise; especially with respect to risk management.”

This is particularly important for non-European managers who might be looking at Luxembourg for the first time to market a fund yet lack knowledge of the risk management requirements under the Directive. MultiConcept can provide that expertise and allow managers to establish and market their funds relying on MultiConcept to ensure compliance with the AIFM regulations.

“Within the Luxembourg ManCo we have two people who are dedicated to risk management, one of whom specialises in illiquid assets. We are also supported by risk managers out of Credit Suisse Zurich. Moreover, we have recently also expanded the team with an additional specialist who deals with illiquid AIF funds. In total, the overall fund risk management team comprises 11 people,” confirms Amistadi.
ONSHORE EUROPE

MultiConcept’s team takes care of all the necessary risk assessments and risk reports pertaining to an AIF. The most critical of these is the Annex IV report, which the majority of AIFMs must file on an annual basis; this increases to semi-annually for managers with over EUR500 million in AUM and quarterly for those with assets north of EUR1 billion.

“We generate all the information and support the client from the beginning when they submit their prospectus with the CSSF, all the way through to filing the Annex IV,” adds Amistadi.

Set up of the fund structure
Aside from the AIFM support role, a second key area where MultiConcept is able to support investment managers is with respect to offering a white label SICAV fund platform, registered with the CSSF. By acting as the AIFM, MultiConcept is able to help managers establish sub-funds on the platform and raise assets to test the market. The portfolio management function remains with the respective portfolio manager – be they in London, New York or Hong Kong. Alternatively, a manager is free to launch their own AIF and use MultiConcept purely as the AIFM.

“If the client chooses to use our white label SICAV, they will avoid most of the burden of having to comply with the Directive. They will not be under as much pressure to raise assets within a short space of time. They can establish a sub-fund on the platform and test the market without a lot of risk or pressure. And then decide on the future development of the fund. There are fewer risks to launching a standalone fund from a regulatory point of view,” comments Amistadi.

As with all things in investment management, the choice a manager makes ultimately comes down to how big they expect the fund to be, what its asset raising potential will be, and how aggressively they wish to market it; will they focus on one core market or a cluster?

“There is another option available for established European fund managers,” adds Amistadi. “We already have clients with an existing Management Company in Luxembourg who decided to appoint us for the AIFM function. What that means, by extension, is that if a client has their own management company, but perhaps does not have enough resources to cope with AIFMD, they can simply choose to appoint us as the third party AIFM to their standalone fund.

“We are able to offer this flexible fund structuring solution as part of MultiConcept to make life as easy as possible for our clients. We want to help them and take the pressure off of complying with AIFMD.”

Marketing and registration
The third area of added value with MultiConcept centres on helping clients to develop their marketing strategy and cross-border fund registration.

MultiConcept is supported by a dedicated team that is able to help clients make the link to a marketing channel across Europe and also to help with the fund registration process, both of which can be difficult undertakings. Clients are guided through every aspect of the registration process.

“The team will explain what the different requirements are in different European countries, as well as help clients to collect all the necessary information to ensure that registration goes as smoothly as possible,” says Amistadi.

What makes Europe particularly challenging to non-EU managers is that they are often not used to market their funds in a regulated environment. An AIFM benefits from a passport enabling it to market the AIF it manages to professional investors in EU/EEA Member States. A notification procedure must be followed to market each AIF in each Member State. Therefore MultiConcept proposes to support their clients in this area. Some countries may have a specific or additional local marketing requirements in place. From a timing perspective, it can be difficult getting a fund quickly to market when managers take on the fund formation role themselves.

“Now,” says Amistadi, “we are deliberating to develop marketing models to offer more targeted marketing support within Europe. Marketing support is one of the key areas of focus. We already have a marketing support solution that sits between the client and the global marketing but we still need to increase the support for our clients with respect to cross-border marketing.”

With solutions like MultiConcept, managers have a way of finding the best route to market in Europe.