Reflections on 2016: Key developments shaping the global hedge fund industry

Brexit: UK economy in concussion

Upside potential in US stock buyback programmes

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INTRODUCTION

As William Samuel Johnson, one of the US founding fathers once said: "He knows not his own strength who hath not met adversity."

Well, it's fair to say that adversity has been a common trait in the hedge fund industry over the last couple of years as managers have struggled in their alchemical quest to turn base ideas into investment gold.

Performance has lagged broader market indices, trades have become crowded, investors have become more astute and cutthroat in their allocation process, cybersecurity threats have risen exponentially, whilst the weight of regulatory compliance has continued to build.

2016 was, in many ways, the embodiment of uncertainty and adversity (in a broader, global macro sense). According to Eurekahedge, during the first nine months 566 closed versus 518 start-ups.

Fat tail events such as Brexit and the Trump US Presidential victory, threw the established order into chaos. The third quarter of 2016 saw an estimated USD28 billion of hedge fund net outflows - the highest since 2009. Investors, it seems, were getting the jitters, questioning the value of hedge funds which had returned a modest +3.22%, on average, over a 12-month period (based on the HFRI Fund Weighted Composite Index).

This brought year-to-date redemptions to USD61.5 billion. Those suffering significant outflows included high-profile stalwarts of the industry such as Brevan Howard, which saw USD3 billion in redemptions in the first six months of 2016.

But against this backdrop, overall net assets rose 2.5 per cent to USD2.979 trillion through Q3 2016 according to Hedge Fund Research, marking a new high. Despite the trials and tribulations, hedge funds still found a way to thrive. Yes, there have been high-profile fund closures and large losses, but the wider media never champion the winners.

Quantedge Global, a Macro Systematic fund, was up 24.81% on the year through November, Jon Bauer’s USD2.3 billion Contrarian Capital Fund I, a distressed credit fund, was up 21.91% on the year, whilst in the global credit long/short space, the USD1.1 billion Saba Capital Offshore Fund managed by legendary credit trader Boaz Weinstein was up 14%.

It is precisely in these challenging times that those working in the hedge fund/alternative fund space – managers and service providers alike – who can prove their edge and deliver value are the ones who shine and enhance their reputations.

The 2016 Hedgeweek Editors’ Picks Report aims to do precisely that: to champion those in the industry who are working hard to make a difference, no matter how challenging the market conditions may get.

Within this report you will find a selection of articles that range from Toscafund’s appraisal of the Brexit decision for the UK economy, cybersecurity operational due diligence insights by Castle Hall, the evolution of risk management under AIFMD, through to cloud platform evolution, the heralding of Luxembourg’s RAIF regime and why special situation and stock buyback strategies are proving especially effective.

Every client and organisation that Hedgeweek has spoken with over the last 12 months has brought insight and commitment to furthering the growth of the hedge fund industry. We appreciate this and we hope that this compendium provides a snapshot of how the industry continues to thrive in the face of adversity.

I wish everyone who reads this a productive and prosperous 2017.

James Williams
Managing Editor, Hedgeweek
The UK economy might be momentarily concussed following Brexit, as witnessed by the decline in sterling, but with smelling salts it is set to recover and build on what is, broadly speaking, a strong set of economic fundamentals, according to Dr Savvas Savouri, Chief Economist and Partner at London-based Toscafund Asset Management LLP, a USD4 billion multi-asset hedge fund manager founded in 2002 by Martin Hughes and Johnny de la Hey.

Toscafund has a proven track record of challenging the wisdom of the crowd, having delivered positive forecasts for London, and the wider UK, over the last six or seven years. The current forecast, which Savouri refers to as “an objective assessment with a positive conclusion”, is that UK GDP will grow between 1.8 per cent to 2.2 per cent in 2017 and that the medium-term outlook for the UK is that it will benefit from the exit.

To draw an analogy, Savouri compares today’s situation to 1992, when the UK decided to leave the ERM. This led to a severe decline in sterling, an aggressive rate cut from 12 per cent to 6 per cent, but whereas GDP growth was approximately -1.1 per cent in 1991, by 1994 it had climbed to 4 per cent.

“It’s a transition mechanism. When you deliver stimulus to an economy it will have a favourable impact. A positive stimulus cannot make an economy worse off. The economy was very sickly at the time, it had suffered a housing crisis in 1989/90. It needed access to cheap money and it wasn’t getting it,” says Savouri.

Compare and contrast that with today, he urges. The currency devaluation is only half
that witnessed in 1992, the Bank of England decided this month not to cut the base rate – although some think the MPC will cut rates in August when it publishes its quarterly inflation report – and the yield on 10-year gifts is, at the time of writing, 0.82 per cent.

Leaving the ERM, as Savouri illustrated in his 30 June research note, “1992 – it will be déjà vu all over again” – eventually led to a surge in employment (again, starting from a position of weakness), as well as a surge in the FTSE 100 when it more than doubled between 1992 and 1997.

Some in the industry are keen to stress the negatives of Brexit. Indeed, the latest PMI figures (47.7) show that the UK economy has contracted at its steepest pace since 2009. But Savouri is keen to point out that most of the partners at Toscafund were working in finance back in 1992, unlike the crop of younger fund managers and economists, and “we know what comes next”.

“All of those who claimed that it would be difficult for us to interact with non-EU markets weren’t telling the truth. We are not a small open economy, we are a large open economy.”

Dr Savvas Savouri, Toscafund Asset Management

A third example is Wells Fargo, one of the world’s biggest banks, which has reacted to Brexit by deciding to buy a GBP300 million building on King William Street in Central London in which it will house its own staff. Factor in that Derwent London, a well-performing UK property company, has announced that it has four new leases, three of which have been signed post-Brexit, for the White Chapel Building in East London, and there are encouraging signs.

Not only that, but Australia has signalled its intention to strike a free trade deal with the UK. Savouri is keen to point out that most of the partners at Toscafund were working in finance back in 1992, unlike the crop of younger fund managers and economists, and “we know what comes next”.

“Anyone under 40 should recuse themselves from any public engagement. Just sit back, watch and learn. I wish I had kept my mouth shut in 1992. At that time I was saying the exit from the ERM was a disaster. We all started calling it Black Wednesday. It ended up being White Wednesday,” recalls Savouri.

“The key contrast between today and 1992 is that the day before the Brexit referendum the UK economy was enjoying the strongest labour market it has ever experienced. It has, therefore, been stimulated from a very strong level. That competitive boost to the currency has meant that UK exporters have become more competitive,” Savouri says.

To see the potential positives of Brexit, one only has to look at developments over the last seven days, he says. Cambridge-based ARM Holdings has become the target of a potential GBP24.3 billion takeover by Japanese group Softbank; Ineos, the USD50 billion petrochemical company owned by Jim Ratcliffe, plans to open new headquarters in London and accelerate its shale gas exploration activities in the UK. Not only that, but Ineos is also looking to buy the rights to build the Landrover Defender in the UK; which will then lead to more factories being built and more jobs for UK workers.

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it sees is a really healthy single market. If it were so healthy, why is the ECB frantically pumping money into it?” argues Savouri.

From an inflation perspective, equity markets like a degree of inflation because it means they can raise prices. The UK went in to the referendum with the CPI at 0.3 per cent year-on-year growth. The Bank of England was mandated to have CPI no lower than 1 per cent and no higher than 3 per cent so the BoE went into the referendum failing to achieve the UK’s monetary inflation target.

Savouri thinks that “in our reasoned and seasoned expectation, consumer price inflation will settle nicely within the range 1-3 per cent, which the Bank of England is mandated to achieve”.

“CPI is now 0.5 per cent. If that goes to 0.9 per cent, then 1 per cent and 2 per cent over the coming months, that’s exactly where it should be,” says Savouri, who has been far from impressed by the actions of BoE Governor, Mark Carney.

“When the MPC convened he looked at the votes that were being cast and noticed that it was 7:1 in favour of not introducing a rate cut. He didn’t want to be on the losing side so he voted to keep the base rate where it is (0.5 per cent), even though a week earlier he told us he would cut rates.

“The currency today is pricing in a rate cut in August. Personally, I don’t see a rate cut happening so you could see a bounce in sterling as a result.”

He believes that Carney should fall on his sword for even suggesting a rate cut on 30 June. A rate cut would, in Savouri’s view, have led to too much stimulus.

“Quite frankly, I don’t think the UK has ever experienced so many positive stimuli as it has in the last month; fiscal and monetary. Monetary across different channels – bank lending, gilt yields and currency – fiscal by no longer being constrained to create a budget surplus by 2020,” he adds.

Savouri believes that it is in everyone’s interests that the UK’s access to the EU single market is maintained, even though Brexit gives the country a unique opportunity to spread its wings and forge international trade relations. In his view, the UK will get all the privileges of membership without having to write a cheque.

“You might say, ‘How can that possibly happen?’ Think of these six German companies: Aldi and Lidl (both privately owned supermarket chains), Volkswagen and BMW, and RWE and E.ON (energy companies).

“The fastest growing market for Lidl is the UK. Both VW and BMW export cars to the UK (a market that is still growing), and make cars in the UK under different brands, mainly Bentley and Rolls Royce, which they duly export and channel those revenues back to Germany. E.ON and RWE equally remit profits from the UK to Germany.

“Those are just six companies across three sectors whose boards in Stuttgart, Munich and Frankfurt earn money from UK imports and exports. They will put pressure on the German government not to hurt the UK (i.e. with tariffs), else it will impact their earnings and, by default, their tax payments,” explains Savouri.

There is the basis of a similar argument in France. Renault, for example, exports to the UK, it has a 45 per cent share of Nissan, and Nissan has a considerable manufacturing presence in the UK. The cars that Nissan produce are making generous profits for Renault who, as a key stakeholder, uses those profits to pay its corporate taxes to the French government.

When Article 50 is finally invoked in two years’ time (or thereabouts), neither Chancellor Merkel nor President Hollande will likely be in government, Savouri points out.

“If Hollande wants to express his thoughts on our perceived hubris for leaving the EU he won’t be around long enough to implement those thoughts. The walls of the EU are falling down without us pushing against them,” suggests Savouri.

In conclusion, Savouri believes the rationale for delivering a forecast on any economy, not just the UK, is based on the consideration of a number of components; notably exports and imports, consumer consumption, investment and government spending.

Savouri justifies his 2017 forecast by stating: “UK exports are going up, imports will go down because we will use more of what we make domestically. Consumption is currently concussed, as is investment, but that will end. The idea that we are going to be concussed through the second of 2016 and into 2017 is absurd. There’s nothing distressed, fundamentally, with the UK economy.”

BREXIT
Richard Fleischman & Associates Inc. (‘RFA’) have launched the RFA Multi-Cloud platform to enable RFA clients to more efficiently scale up and scale down their cloud platform requirements in line with their business needs. And, importantly, in full compliance with regulation.

The new cloud solution builds upon the success of RFA’s private cloud – an infrastructure-as-a-service (IaaS) offering – which sees RFA partnering with Amazon and Microsoft, giving clients the flexibility to use public cloud services in tandem with private cloud services with the same guaranteed level of performance and security.

This latest development marks an important stage in the continued adoption of the cloud by fund managers as they look to streamline their IT costs whilst still maintaining the highest level of enterprise-grade operations. Regardless of how many public cloud services clients use, they will, says Mike Asher, CIO at RFA, notice no difference in the level of security as public cloud data is subject to the same cyber protections that RFA uses in its private cloud.

“When we talk about private cloud infrastructure, it's one of the more widely adopted infrastructure-as-a-service models within the asset management community.
because it provides a high degree of security. In the last three years, this has been the most popular model for clients because they are confident in our ability to meet all of the regulatory requirements as a leader in the space,” says Asher, adding:

“Over the last year or two, what we’ve noticed is that some large, established funds have been exploring ways to future-proof their technology by leveraging the public cloud. The idea for RFA Multi-Cloud originated, therefore, not as a cost saving factor for smaller start-ups, but rather to help larger funds look five, seven years ahead.”

**Best of both worlds**

To be clear, RFA’s established clients are not about to jump wholeheartedly into public cloud adoption. Indeed, there are some applications such as data warehousing that are yet to be optimised for the public cloud. But what the RFA Multi-Cloud platform now offers is the ability for RFA to extend its IaaS (it has 8 data centres across the globe) by leveraging Amazon Web Services and Microsoft Azure, in so doing allowing financial institutions to reduce IT costs and build a more elastic IT infrastructure that optimises their business model.

As Yohan Kim, Chief Operating Officer at RFA, said when the firm unveiled the Multi-Cloud platform on 31st August 2016: “The release of the Multi-Cloud platform will provide clients at all stages—from start-ups to established, global firms—with the best of both worlds when it comes to the cloud: lowered costs and increased flexibility, while still providing the highest level of security and control.”

**A clear path for the future**

Both large fund managers and start-ups are embracing the potential of the cloud and understand the benefit to having access to data and applications in an instant, whilst on the move. Asher says that the Multi-Cloud gives larger institutions “a clear transition into the future”.

“At some point, public cloud adoption will reach critical mass in the alternative asset management space and we see that as the future. As such, the RFA Multi-Cloud offers a clear path to get there, in terms of not only technology but also budget,” says Asher.

For smaller fund managers, they are trying to run leaner and meaner businesses, building a performance track record using the least amount of technology expenditure. Asher says that the public cloud component works well “as we are able to leverage the cost advantages of large-scale resource pooling offered by vendors like Amazon and Microsoft; the model enables substantial storage capacity expansion for a fee that no medium sized service provider can compete with.

“At the same time, what was missing with the public cloud was a security tier that ensures the cloud solutions being considered were compliant with SEC regulation, UK and European regulation and so on,” explains Asher.

The ability to scale cloud services in line with one’s business needs is an attractive proposition for any financial institution. If a fund manager has operations in Europe and Asia where RFA might not have data centres, RFA will now be able to extend the cloud platform by launching a secure data centre on say AWS, and connect it with the same level of security provided in the RFA private cloud.

**Quality of service**

Asher says that one of the key items that RFA addressed before rolling out the Multi-Cloud offering was quality of service in respect to user experience. People don’t think about where the servers are, or what’s running the cloud. All they care about is connectivity and the end user experience.

As such it was vital that clients experienced no difference in that experience, regardless of whether they were on the private or public cloud.

“To this day, the reason that public cloud adoption for enterprises is slower than anticipated is because the end user experience – or the performance of connectivity to the public cloud – could not be guaranteed. We have fixed that problem,” says Asher.

“We already had a significant data centre presence in the US and the UK. We have since established private lines to public cloud data centres, which enables RFA to guarantee low-latency, high-speed connectivity. We’ve effectively alleviated the
uncertainty that users might experience a degradation in service quality should they connect over a normal internet connection alone. This change allows us to monitor, inspect, and report on all traffic and guarantee performance without the need for additional hardware on the client’s premises.*

The Multi-Cloud platform extends to iPads, to Android devices, and is completely seamless, regardless of whether the cloud application is running on the RFA private platform, or is running on Amazon or Microsoft in the public domain.

Multi-layered data encryption
Up until now, the problem with public cloud adoption was the security aspect. But as technology improves so does the ability to encrypt client data.

“On our cloud we use multiple layers of encryption and operating systems running on Azure or AWS are even encrypted separately. Were something to happen and Amazon wanted to access your information, it would not be possible because we escrow the encryption keys, which are then held either by RFA or the client,” affirms Asher.

Indeed, one of the key features of the RFA private cloud is that it does not build multi-tenanted environments. RFA creates virtual private environments where there is no commingling of data meaning each client is treated as a single tenant.

“For the public cloud we took the same approach,” confirms Asher. “We felt that clients would refuse to adopt the Multi-Cloud platform unless we could demonstrate that the public cloud is secure, and how we secure it. There are several components that we put in place.

Private RFA connection line
“One is how clients connect to the Multi-Cloud. Connectivity is established through RFA to the public cloud using a point-to-point line that RFA owns and operates. What this means is that you cannot access the Amazon infrastructure, for instance, unless you go through the RFA line. Because of this, we can then monitor and manage traffic security. We have a number of prevention systems running, we have a 24/7 security operations centre, and this allows us to guarantee that network security to the public cloud environment is as robust as possible.”

Data storage security
The second issue is data storage on the public cloud. Microsoft, Google and others have all been in situations where they’ve had to disclose information without necessarily being able to notify the end users.

In this situation, Asher says that RFA encrypts all the information that is stored on the public cloud, in addition to the encryption security provided by the vendor.

“We felt that it was important to provide an additional layer of security that guarantees for our clients that any data stored on the public cloud is only able to be made accessible by them specifically and no one else,” he says.

Performance levels guaranteed
The third issue relates to the level of performance. A service level agreement on response times is critical for a hedge fund. If they choose to use the private cloud on a standalone this cannot necessarily be guaranteed given that the mix of end users on the cloud will vary; if a media company is working with huge HD video files, for example, this could compromise response times. However, because of the way that RFA has built the Multi-Cloud, the level of performance is guaranteed.

“In addition, we provide software-defined WAN acceleration devices, which allow us to cut telecommunication requirements by 50%. These devices are in all our data centres and we have virtual devices running on the public cloud for the client. If telecommunications options are limited in the client's building, we can simply install one of these devices to ensure that connectivity is no longer a barrier to adopting the cloud,” adds Asher.

Looking ahead, Asher is confident that public cloud adoption will gain traction as it grows and develops.

“Going forward, with the compliance and security aspect that RFA can provide, we expect the public cloud will become more widely accepted across the entire manager stack, from those starting up through to those at larger, more established funds,” concludes Asher.
Data management is Mount Everest challenge

Interview with Todd Moyer

“One of the things we see across our organisation is that data management is becoming a much bigger priority and focus among asset managers,” asserts Todd Moyer, Executive Vice President of Global Business Development, Confluence. “The complexities related both to institutional investor reporting and regulatory reporting are making data management a significant challenge. With Form-PF alone, managers might be looking at 30 to 35 different data sources across a dozen systems in order to meet the transparency requirements.”

Confluence is a leader in data management and automation for the global asset management industry. To address the data management and regulatory reporting challenge – both for traditional and alternative fund managers – Confluence has just unveiled the Unity NXT™ Regulatory Reporting platform.

“It’s not the end reports that are the problem, it’s more the ability to take data and turn it into knowledge; whether that’s taking data from Confluence or external sources and being able to normalise that data for reuse across a variety of regulatory, financial and institutional reporting requirements. We will be using the platform for June 30th filings that some of our larger clients need to prepare for,” says Moyer.

Before the financial crisis, hedge funds could get away with producing straightforward quarterly or annual reports for investors. Both managers and fund administrators used technology systems that weren’t designed to cope with complex regulations.

“With the convergence of fund investment strategies, today’s hedge fund managers are increasingly managing “mutual fund-like” products. Fund administrators are taking a hybrid approach to the opportunity by servicing multiple fund types, including mutual funds, UCITS, private equity and real estate funds. As a result, retail investors are expecting them to administer all of their funds with mutual fund-like efficiency, accuracy and reporting frequency,” observes Moyer.

In his view, the fact that hedge funds increasingly resemble traditional mutual funds in the way they report and provide transparency to satisfy institutional investors is a trend that is likely to continue.

“Institutional investors are demanding heightened levels of transparency into their hedge fund investments. They are requiring higher levels of operational efficiency and cost savings through outsourcing and back-office automation,” adds Moyer.

Those managers running multiple versions of their strategy face a rising summit of data management and filing obligations. This can bring about altitude sickness if the right technology is not in place to handle different data sets and reporting formats, across different jurisdictions.

“If you look at what’s being proposed with traditional ’40 Act funds with SEC Modernisation, there is quite a bit of data re-use between the traditional and long-only world, but hedge funds were not originally set up to share data and re-use data across different jurisdictions and regulators,” says Moyer. He thinks the burden will be placed firmly on the administrators and technology companies, “which sit in a strong position to help normalise large volumes of data for re-use”.

“Our data hub is centred on the ability to take data in its native format without additional manipulation. That is going to be key because not only is it hard to source data, but then when you get it, being able to tag it in a reusable format will become increasingly important. We’ve positioned ourselves today such that we can support both administrators and fund managers directly, to help them deal with their day-to-day data management challenges,” concludes Moyer.
Invast Global is a premium, multi-asset prime services brokerage serving the needs of hedge funds, retail brokerages, high frequency trading firms and sophisticated clients. The company provides access to industry-leading OTC FX and Commodities liquidity, along with synthetic DMA access to over 30 global stock and futures exchanges. The Invast Global PurePrime facility, with optimised liquidity streams and connectivity options is designed specifically to meet the needs of small and mid-sized trading firms.

The company has experienced rapid expansion over recent years as demand for prime services grows strongly amidst a regulatory-driven retreat from prime services by the Tier 1 banks.

What makes Invast Global a superior alternative to traditional prime brokers?
We focus on being responsive and flexible. That is definitely our niche. We are squarely aimed at meeting the needs of small and medium-sized firms that are being overlooked by the large Prime Brokers, as regulatory reforms begin to take effect.

If a trading firm is lucky enough to be accepted by a Tier 1 PB, they are increasingly being hit with prohibitive minimum commission hurdles and other requirements and constraints. All of this is the outcome of the post-GFC regulatory reforms aimed at reigning in the banks. These reforms will continue and are planned to be increasingly restrictive over time. They are shaping the prime services landscape for decades to come.

Invast provides an alternative for clients who are struggling to remain relevant to their Prime Broker. Being a specialised brokerage allows us to be more agile. We can provide prime services with the same integrity as the top-tier Investment Banks, but with more responsiveness and attentiveness to the needs of individual clients.

We have an overall philosophy of transparency and innovation at Invast Global – that is, we want to keep offering our clients more and more innovative solutions to meet their trading needs. And we want to give clients the information and control to allow them to shape their own trading environment. Our recently announced partnerships with the world’s leading non-bank market-makers, XTX, GTS and Citadel are examples of how we are thinking ahead on behalf of our clients and giving clients access to liquidity sources which are not normally available to the small/medium end of the industry.

What makes PurePrime a unique offering in an increasingly saturated market of non-bank PoP providers?
We named our premium multi-asset prime services facility PurePrime because it is the most transparent form of prime services a client can access without a Tier 1 prime broker. As part of PurePrime, we offer optimised liquidity streams aggregated from over 20 unique bank, non-bank and ECN liquidity providers. Clients can structure their liquidity in real-time, with full pre and post-trade disclosure to live streams from our liquidity providers. Backed by two Tier 1 prime brokers, we have designed a suite of bespoke collateral solutions and leverage arrangements customisable to the requirements of each client. Our six-decade Japanese heritage translates into industry-leading connectivity solutions, encompassing servers in NY4 and LD4 for ultra-low latency via multiple GUIs or API.

The offering is supported by a highly skilled team with deep Prime Broking experience and a responsive culture. Our focus is on giving clients control, so that they can customise the offering to meet their specific needs. PurePrime offers an opportunity to access the world from one account. The large Investment Bank PB’s are stepping back and nimble, innovative Prime Services firms like Invast are filling the void.
You speak of transparency and control as distinct advantages of PurePrime. Could you expand on this further?

We offer a number of platforms depending on the asset class the client is focusing on. We have a comprehensive synthetic equities and synthetic futures platform, which gives our clients long/short DMA access to 30 equities and futures exchanges across the globe. The beauty of the synthetic nature of the trade is that multiple exchanges and asset classes can be traded from the one account and one pool of collateral.

We have an extensive borrow inventory sourced from our PBs, which is loaded pre-market, allowing for easy one-touch shorting. Client orders interact instantaneously with the underlying exchange’s Order Book. Clients can see where they are in the exchange queue and know immediately when their order is filled.

All trades are reflected in the official “Course of Sales” of the underlying exchange. It is the most transparent and accountable way of trading synthetic equity and futures - which is why PurePrime is so popular amongst hedge funds and HFT firms.

Our OTC FX/Commodities offering is especially unique and has experienced amazing growth over the past few years. It is certainly shaking up the FX prime services industry. This is because we give our clients a level of control and degree of transparency that is unprecedented in the FX prime space. For example, we give clients access to more than 20 bank and non-bank FX Liquidity Providers ("LPs") and allow clients to structure their own liquidity mix in real time, with analysis and advice from our expert liquidity team. Clients are able to see the real LPs within their aggregated feed, both pre-trade and post-trade. This is revolutionary transparency for FX prime clients.

What assets does Invast Global have that distinguishes it as a premium PoP provider, compared to smaller firms that are expected to gradually disappear?

Staff, technology, prime broker relationships and balance sheet. We know the FX and Commodity LPs intimately. Most of our staff have worked at the Investment Banks who are streaming us prices. Our Head of FX Liquidity, Geoff Last, is arguably the longest serving (and most respected) institutional FX dealer in Asia Pacific.

We utilise numerous institutional systems to provide a wide range of connectivity choices for our FX and Commodities trading clients. We have servers in two Equinix locations - LD4 and NY4. We offer the highest quality API connectivity to industry leading aggregators and bridges, such as FlexTrade, Integral, PrimeXM, etc, with cross connection and co-location options.

Invast is backed by two Tier 1 prime brokers – Barclays and Deutsche Bank. The stability of relationships with Tier 1 FX prime brokers and liquidity providers will only become more important as regulations tighten and access to Tier 1 PBs becomes tougher. We also offer fully disclosed, aggregated bank and non-bank liquidity from over 20 liquidity providers. We have announced partnerships with XTX Markets, GTS and Citadel Securities, illustrating how Invast Global is pioneering access to the powerhouses of non-bank liquidity.

The fact that our parent company, Invast Securities Japan, is a 60-year old, highly capitalised listed entity is definitely helpful in securing a good deal with our PBs and LPs. These firms know we represent a solid counterparty. In addition, we STP everything straight through to the LPs, which means we do huge volumes with our LPs and represent a valuable relationship to them. We have no mandate to take on market risk ourselves and pride ourselves on always aligning our interests with our clients.

The client mix of Invast Global is primarily institutional clients – brokerages, hedge funds and sophisticated traders. How does Invast Global provide research capabilities to support the buy side community?

Research is important, particularly as many of our clients are not of a size where they can efficiently develop multi-asset research capabilities in-house. So we have invested in a top-tier research team, staffed by some of the most experienced analysts in the industry. Their focus is on providing high conviction, actionable advice.

Around the clock, the team is constantly monitoring global markets and debating trade ideas. Our clients benefit from daily access to the “live” discussions amongst the analysts via the client-only “Hot Notes”. Separate research teams cover the various equities markets across geographic regions, as well as the macro asset classes of FX and commodities.

What is your vision for Invast Global?

We recognised early on that there was growing global demand for a non-bank firm offering professional, transparent prime services for multiple asset classes with the same integrity as the top-tier Investment Banks, but with more responsiveness and attentiveness to the needs of different clients - particularly the smaller firms.

Since recognising this gap and setting about building a transparent Prime Services firm, there has been an industry-wide contraction in the Prime Broking industry due to regulatory reforms aimed at restraining the too-big-to-fail top tier banks. This has meant a lot of clients have needed an alternative. For Invast Global, it’s been a case of being in the right place at the right time, with the right offering. Considering the continued transformation of the industry, the future is full of opportunities for us.
Lawson Conner operates a specialist fund manager platform providing FCA license coverage as well as compliance and regulatory oversight on behalf of alternative fund managers. Over the last few years, the firm has seen a dramatic shift to ManCo structures as new managers, and, more importantly, institutional investors, appreciate the virtues of using an outsourced AIFM solution. By working with an established AIFM platform, emerging managers can focus on producing returns and managing their trading strategy.

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

As non-EU managers become more comfortable considering Europe to market their funds, third party management companies are likewise becoming easier to conceptualise. Frost says that having launched a number of managers under AIFMD, “we are experts in how to handle the marketing requirements. US managers appreciate there are USD20tn of investable dollars in Europe and are looking for the most effective way to capture those dollars.”

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

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

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

Not that this option is the preserve of start-up managers. A major asset management with billions in AUM recently spoke to Lawson Conner on appointing an external AIFM. That, says Maycock, speaks volumes about where the market is headed.

“They don’t want to spend several hundred thousand dollars setting up a structure if they don’t know exactly what the investor appetite will be for a particular strategy. Our AIFM solution gives them exposure to Europe without having to build out that entire infrastructure,” says Maycock.

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

Institutional investors support external ManCos

Interview with Andrew Frost & Daniel Maycock
A new white paper by Nasdaq Global Information Services reveals that US companies that engage in stock buybacks generally outperform the market on an annualized basis and also experience lower volatility; the Holy Grail of investing.

“This is helped by the fact that buybacks act as a bit of a floor during periods of heightened volatility, and act as additional price support for companies even when their share price might be falling,” says Cameron Lilja, Director of Product Development, Nasdaq Global Information Services and author of the Stock Buybacks white paper (http://q.nasdaq.com/StockBuybacksWhitepaper), which published last month.

Stock buybacks are nothing new but the main takeaway from Nasdaq’s white paper is that when people talk about companies doing stock buybacks, they typically focus on how much money the company is spending on buybacks. Last year, for example, S&P 500 companies spent USD569 billion buying their own stock, representing the second largest year for buybacks since the Great Recession.

But as Lilja explains, the white paper does not focus on dollars spent, but rather the actual reduction in the number of shares outstanding that the company achieves as a result of the buyback programme.

“When you look at how a company is buying back their shares, what we recommend to investors is to look at the bottom line. If they are buying back USD10 million of shares are they issuing USD5 million in new shares? Because if they are, you are only getting a net reduction of USD5 million.

“It’s a basic supply and demand story. If a company is still earning the same amount of dollars, but reducing the number of shares, then the share price will rise because there are fewer shares available. If instead of total shares outstanding we only considered total dollars spent on a buyback that’s really meaningless in terms of understanding the impact on share price,” explains Lilja.

Using data over a 13-year period provided by Ford Equity Research, whose equity universe database contains more than 4,000 US securities, Lilja and his team found that whilst the average annualized performance of stocks was +8.1 per cent, the performance of companies that had a net increase in total shares outstanding (‘TSO’) was +7.8 per cent compared to +10.4 per cent for companies that had a net decrease in TSO.

To extend the point further, companies that experienced a 5 per cent net decrease in TSO over the trailing 12-month period returned 11.6 per cent. It is these companies that qualify and go in to the Nasdaq U.S. Buyback Achievers Index (https://indexes.nasdaqomx.com/Index/Overview/DRBGT) and as Lilja points out, “this index has performed better than the Nasdaq U.S. Benchmark Index, particularly since late 2011, in addition to the S&P 500 Index.”

As buybacks tend to support a company’s stock price, this outperformance by the components of the Nasdaq U.S. Buyback Achievers Index is not surprising. The PowerShares Buyback Achievers ETF (PKW) is the leading product that tracks the performance of the Index and currently has USD1.6 billion in assets under management.

In contrast to the Nasdaq U.S. Buyback Achievers Index, the S&P 500 Buyback Index relies upon a methodology that does not take into account the overall reduction in...
total shares outstanding. Rather, it is based on a "buyback ratio" of dollars spent divided by market capitalization. The 100 securities with the highest buyback ratio are then equal-weighted to form the buyback index.

As Lilja points out in the white paper, there are two key differences to these indexes. Firstly, the Nasdaq Index uses the 2,700 stocks in the Nasdaq U.S. Benchmark as its starting universe. The S&P Index only looks at 500 stocks and thus skews it heavily towards large-cap companies.

Secondly, the Nasdaq U.S. Buyback Achievers Index requires a net reduction in total shares outstanding (TSO) of 5 per cent, even accounting for new share issuance, and allows for inclusion of all securities issued by a US company that meet this threshold. Lilja believes there are two main reasons why US companies are engaging in stock buybacks.

Firstly, there has been a steady bull market and economic recovery in the US, but the general sentiment among CEOs is that the recovery has developed on fragile ground. Ordinarily, one would expect over the course of a bull market that companies might start investing in riskier growth-related activities, in research and development, in acquisitions and so on. This simply hasn’t happened.

"In that case, they tend to return value to shareholders through stock buybacks rather than invest in these growth-related activities. Secondly, one has to consider the favourable interest rate environment. Companies are more willing to take on debt and finance buybacks because of how low rates have been, and continue to be.

"We’ve had a good recovery in the US stock market since ’08 but the economics of that recovery as it relates to rates has not played out; rates are still at historic lows and that has prompted companies to borrow cash and engage in this buyback activity,” says Lilja.

This ability to build exposure in one’s portfolio to companies engaged in significant stock buybacks is clearly beneficial. Although not an investment strategy that works year after year (what strategy is?), Lilja says that the Index does outperform the wider market for the majority of years, "which is in line with what we were expecting."

At a time when investors are concerned with increasing volatility in equity markets, finding companies that announce and actually follow through with their stock buyback programmes can provide a welcome buffer to stock price volatility. Lilja adds: "Just as putting a certain percentage of one’s portfolio allocation into companies that pay out dividends is important, so too is allocating to a certain number of companies that are buying back stock and actually reducing the number of shares outstanding in the market."

From a sector perspective, the information technology sector is the biggest spender when it comes to share buybacks although this is skewed slightly by Apple because of their massive buyback programme (USD6 billion in Q4 2015 alone).

Indeed, four of the 10 top companies in terms of dollars spent on buybacks come from the technology sector. In terms of growth, the number one sector is consumer discretionary.

Lilja believes that there is room for further growth in stock buybacks.

"When I wrote the first version of this paper in 2014 we had seen a record year for stock buybacks. At the time, I warned that with high stock prices it was possible if the economics stayed steady and stock markets continued to rise US companies might reduce their buyback programmes and engage in riskier growth-related activities but that has yet to happen. While buybacks to date are not on track to exceed 2015 by dollars spent, it is still possible for 2016 to top 2015 simply because buybacks are increasing in popularity as more companies enter the fray,” concludes Lilja.

For more information, please contact Nasdaq Global Information Services: http://q.nasdaq.com/GIG_SmartBeta_ContactUs

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Planning a hedge fund launch is a serious business. People need to decide whether they are truly ready, both financially and mentally, and be confident in their investment strategy. This may sound trite but all too often start-ups rush to get a hedge fund in place without clearly thinking everything through. “It is a significant undertaking and should not be treated lightly. From a financial perspective the first thing to do is to create a budget broken down into three categories: budgeting for fund expenses, budgeting for manager expenses and finally budgeting for personal expenses,” says Jeffrey I. Rosenthal, CPA, Partner-in-Charge of the Financial Services Group at Anchin Block & Anchin LLP, a full-service accounting, tax and advisory firm.

Fund expenses
With respect to budgeting for the fund, one needs to factor in the anticipated management fee and professional fees; audit, tax, legal and administration expenses. “The expenses are not radically different for a USD10 million fund versus a USD100 million fund but they will significantly impact the rate of return of a smaller fund,” says Rosenthal.

Manager expenses
“One of our roles is to educate the manager, not only from the fund perspective but also from the manager perspective. The Fund Manager also has to absorb a fair amount of expenses. The 1% or 2% management fee needs to cover business overheads: office rent, employee salaries, IT costs, insurance and so on,” adds Rosenthal.

The management fee is what the manager will survive on so factoring in all these costs at the pre-launch phase is vital as it will help determine how much Day One capital they will need to launch with.

“IT is therefore important to forecast what you anticipate the management fee income is going to be based on the assets raised, and calculate what the overhead expenses will be. Most start-ups are not likely to raise significant capital in the first year that the management company will be running a profit. So it’s important the manager knows what the overheads will be, deduct them from the expected management fee and have a clear idea of what the deficit is likely to be,” asserts Rosenthal.

Personal expenses
Given that a start-up manager will be putting a significant amount of his personal wealth into the fund, he needs to also make sure there is enough personal income to cover living expenses.

The majority of people who start up hedge funds know how to trade but don’t focus on all the associated costs of running a hedge fund business. The reality is they are going to be paid last, after their employees, so they need to know what will be left in the honey pot.

Start-ups would like to launch with USD100 million or more and be confident that the amounts remaining after expenses will leave them with plenty of ‘burn capital’ to grow the business. But raising capital remains a challenge. Rosenthal relates how, when he meets start-up managers they will often reveal that they are going to raise USD60 million or more. “At that point I always ask: ‘What happens if you only end up raising USD20 million?’

“Start-ups have to anticipate what the threshold needs to be before launching the fund. Adopt the mindset that you’re only going to raise half the target capital. You have one shot to do this so plan it out properly,” concludes Rosenthal.
Operation due diligence or “ODD” are arguably three of the most important words for any start-up manager hopeful of attracting new investors. Such is the level of expectation among institutional investors today that even if the manager only has USD20-30m in AUM and outsources the CFO function, operationally they still must look and act like a serious outfit.

As Frank Napolitani, Director, Financial Services at EisnerAmper LLP, comments: “You have to be buttoned up from a front-middle-back-office, legal, compliance and infrastructure standpoint and have answers to things; for example, on the outsourced CFO point, they might want to say, ‘I can’t afford a CFO currently, however I have outsourced the function to XYZ who have a great reputation and this is how they support my operation.”

For many new managers, they often find themselves wearing multiple hats. They might be the CEO, portfolio manager and CFO rolled into one. For those that can afford to hire a CFO from day one, however, the pressure is far less. In Napolitani’s view, taking on the CFO role internally is a massive learning curve and one of the main challenges for new managers.

“These are smart people and it’s important not to let ego get in the way. The smartest guys are the ones who sit back, listen and talk to a number of different service providers and consultants in the space to formulate a plan. The heads of ODD that I speak to, who oversee approximately USD100 billion in hedge fund investments, say that it’s okay for a manager not to have the CFO in place, on Day One.

“However, if they say they plan to hire a CFO after they reach USD100 million, the heads of ODD are going to hold them to it. They will expect to see the addition of staff and systems that demonstrate the manager is institutionalising their business,” explains Napolitani, who heads up EisnerAmper’s new launch advisory business.

Launch AUM is a big driver towards how the organisation is set up on Day One. Napolitani says that for larger launches of USD100m plus, they will generally have a CIO (founder), two to four analysts, a CFO/CCO, Head of Operations, Controller and Executive Assistant. The will generally outsource their OMS, PMS/Middle Office and General Ledger and IT (hard/soft plus cloud, telephony).

For smaller launches of under USD100 million, it is acceptable to for the CIO to have up to two analysts and to outsource the CFO, as well as have a compliance consultant to help the manager operate their business with a “culture of compliance” as if they were already SEC registered. They would typically rely on the technology capabilities of their fund administrator and prime broker: EMS/OMS, real-time/T+1 reporting, etc.

When outsourcing any function, however, from an ODD perspective it is vital that someone in the firm takes responsibility for the oversight and delivery of that function internally.

Since the Madoff scandal, the ODD industry has grown dramatically. Prior to this, investors would focus their attention on the fund manager’s pedigree, investment process and performance. Today, those remain key characteristics, however, the quality of the front-middle-back-office operations, in addition to legal, compliance and infrastructure, play an equally important role.

Start-ups are minded to appreciate that ODD is not just a one-time exercise with prospective investors. It is a repeatable process with investors following up on ODD with managers on a quarterly, bi-annual
Cybersecurity: Outsource this function to your IT service provider; it is what they specialise in. Don’t try to do it on your own. You’re built to raise capital and manage capital.

A key element of any ODD questionnaire will be determining who the fund’s service providers are. Investors need total reassurance that there is sufficient independent oversight but also that the firms carrying out this independence – for example the PB or fund administrator – have robust operational processes in place, strong balance sheets etc. This really addresses the counterparty risk issue that any ODD team will want to get a handle on.

Name brand recognition is one of several key considerations when choosing service providers, says Napolitani.

“I talk to bulge bracket, middle market and boutique firms because managers come in all different shapes and sizes and strategies. A small manager might not be suitable for a bulge bracket prime broker but more suitable for a boutique prime and vice-versa. The institutional investor community knows who these providers are,” comments Napolitani.

Technology capabilities will also need to be considered. Also, what is the knowledge and experience that the service provider can bring to the table? Everyone on the planet can support long/short equity but do they have the expertise in supporting bank debt strategies for example; can they book the trades, value the assets and provide administration, audit and tax services to such complex strategies?

“Another factor is Partner Interaction/Employee turnover. Make sure the partner you are speaking to will be covering you going forward and try to find out what the firm’s employee turnover looks like? You don’t want to have a new team supporting you for auditing and tax purposes each year, requiring you to bring them up to speed on your investment strategy, organisational structure, etc.

“I would also recommend determining what the service provider’s client base is – how many funds do they support, what types of funds (strategies) are they, and how long have those fund clients been on their books – and finally, their breadth of services,” concludes Napolitani.
DMS Governance specialises in providing global fund governance with the firm best regarded for the provision of offshore independent directors in the Cayman Islands. The second core business line is its UCITS and AIFMD management company and platform based in Dublin and Luxembourg.

“The demand for our European range of solutions has exceed expectations to the degree that we have doubled out footprint in Ireland and just relocated a senior executive team to Luxembourg to support the growth. Whilst proud of the now 94 mandates secured, what pleases me more is our ability to adapt to our clients changing needs through provision of MIFID services, active trade execution, verification and settlement services and now distribution. Our range of products allows managers to focus singularly on alpha generation; a unique offering in the European Hedge Fund space.

“In addition, we have over 100 risk clients to whom we are providing a range of risk and reporting services,” comments CEO, Anne Storie.

“We’re listening to our clients and what the industry is facing in terms of regulation and we’re trying to find the right solutions. We have a duty to do so being governance experts.”

Storie confirms that interest in its European solution suite built momentum in 2016, be it for DMS’s AIFM platform, UCITS platform, Annex IV reporting solution or guiding clients to register their offshore funds on a private placement basis.

“Hedge funds can suffer from regulatory fatigue – it is our job is to help them as much as possible and due to recent regulatory changes we have been busy across the board,” says Storie.

Three years ago, DMS hired Jason Poonosamy to develop DMS’s proprietary risk system. This substantive approach to risk is a point of differentiation at DMS, having invested considerable time and money to ensure that its solutions are recognised as best in class.

Beyond regulatory services DMS Bank & Trust have identified and fulfilled another industry need; client friendly and responsive banking services providing clients with cash management solutions, active FX, trading and custody solutions.

The DMS group is increasingly recognised as providing ‘all-encompassing services’ thanks to the strength of its internal technology, and the breadth of its team, both in Cayman and in Europe.

“The banking services we are providing to hedge funds are also of tremendous interest to family offices and expanding further in to this group is one of our primary goals for the bank in 2016,” says Storie.

“The latest key growth area for us is the provision of bespoke solutions for the structured finance industry. We recently hired a new Global Head of Structured Finance, Murray McGregor. Murray has been in the industry for more than 20 years and we’re excited to have him on board.”

“All these services are underpinned by DMS’s 17-year track record – our Directors have literally watched all of the regulation as it’s evolved. This gives us a level of in-house governance expertise that we pass along to not only our clients, but the service providers we work alongside,” says Storie.

Looking ahead into 2017, Storie further notes: “We are excited and motivated for the year ahead with the continued growth of our firm and products in the areas of governance, risk, and compliance globally. Our robust and dedicated team and its relationship driven approach coupled with our track record of being solution focused allows us to move into 2017 as the clear industry leader.”
Maitland grows North America business

Interview with Scott Price

Maitland is one of the industry’s largest independent hedge fund administrators with USD280 billion in AuA. With more than 1,300 employees across 16 offices globally, Maitland is more than a fund administrator. It is a global advisory group, with its roots as an innovative law firm in Luxembourg in 1976 offering cross-border structuring solutions to corporates and some of the world’s wealthiest families.

This in-house legal and tax expertise, as well as Maitland’s independence, set it apart from most other fund administrators – and means that it is ahead of the game when it comes to administrators moving up the advisory services chain of added value.

“People like our ownership structure, the fact that we’ve been in the business for more than 40 years. As we continue to expand in North America we maintain an entrepreneurial mindset that we bring to every client meeting. We want each client to be a long-term partner,” says Scott Price, Head of Business Development and Client Management (North America).

“One of our mid-tier global macro managers middle office team was spending a lot of time preparing its daily reconciliation and end-of-day reports, so they decided to leverage our technology, staff and infrastructure, so as to focus on the outcomes of the reports as opposed to spending a lot of time producing them in the first place.”

Technology proficiency is important for any ambitious hedge fund administrator. Maitland’s technology group integrates each client’s workflow processes, from its OMS / PMS, to receive trade information as soon as possible.

“This means we can assist them with intra-day, end-of-day, customised reporting which really helps the management company leveraging our technology infrastructure so they don’t have to buy it themselves,” says Price.

Price is located in New York City, one of two client-facing offices including Miami. He and his team - including client relationship managers - work directly with Maitland’s operational centres in North America, one in Richmond, Virginia, the other being Halifax in Canada. Price says that 2016 was a ‘growth year’ with respect to Maitland’s North American business.

“A number of clients have launched new products and in terms of expansion and product development, we’ve stepped up our presence in New York and Miami and have more client-facing staff and business development staff. That has enabled us to get closer to our US clients and we’ve been successful at winning some nice mandates, not just in hedge funds but private equity as well.”

Price confirms that it is substantially increasing its middle-office capabilities, allowing clients to outsource more of the operational and regulatory/compliance work that would ordinarily have been handled internally.

“The pressure that fund managers have been under the last few years, from a performance perspective, has led to an increased need to generate operational alpha. Clients are leveraging our technology, infrastructure and headcount to do more work for them on a daily basis.

“One way to do that is to lean on service providers to perform tasks that historically they were not asked to perform. We’ve got great experience with outsourcing where we will work with management company staff and take on customised processes to support their business,” says Price.

Price says that what makes Maitland unique to alternative funds is the level of investment to technology and commitment to human capital it dedicates to clients to deliver a high quality service. “What that translates to is a relationship model that offers a daily and strategic partnership that is both flexible with our clients’ changing needs and nimble to support our clients’ growth.”
Evidencing risk management is music to institutions’ ears

Interview with Alan Picone

Risk management has mutated under AIFMD, causing risk managers to become more involved in the portfolio management process from an ex ante risk perspective. As investors become more educated on the risk function, managers who can demonstrate an independent, robust risk management environment have the potential to improve their capital raising capabilities.

Historically, risk management has always been viewed as a tactical function within hedge funds and has tended to operate in the background. But AIFMD regulation and increased investor due diligence is making risk management a more strategic function, causing risk managers to become increasingly involved in the capital raising process.

This is the view of Alan Picone, Global Head of Risk and Management Company Solutions at Duff & Phelps.

"Broadly speaking, one of the main aspects of regulation is to make sure that there is an element of systemic risk preservation. We talk often about investor protection under AIFMD but what is the investor perception in all of this?" asks Picone.

"In my opinion, the role of the risk manager has become magnified under regulatory evolution. There needs to be independence under AIFMD, with risk management providing a counterbalance to the portfolio management function. There has always been good governance of risk processes in hedge funds, but what is different today is that it is written in black and white."

The fact that the risk process is codified in the regulatory tome that is AIFMD, has led to a mutation of risk management; one that requires fund managers to adopt a far wider, holistic approach to risk management. Those that can demonstrate this are going to be viewed more favourably by institutional investors, at a time when getting one’s investment strategy in front of institutional eyes is more challenging than ever.

Picone says that from a technical perspective, risk managers must not only rely on their fundamental expertise in managing risk, they also have to bring an element of gravitas to present the risk management process at the boardroom level.

Risk, in no uncertain terms, has become a multi-faceted and far-reaching role.

The combination of technical excellence plus being influential within the higher echelons of an asset management group, has become one of the main challenges that risk managers have had to confront, says Picone.

“Looking at risk is no longer confined to financial/market risk, it means having a more holistic view that encompasses every single source of risk that an asset manager is exposed to: operational risk, compliance risk, regulatory risk, liquidity risk, etc, that could ultimately affect not only the performance of the fund, but the perception among investors.

“The risk management paradigm, in my view, has changed. It has multiplied such that risk now touches upon every aspect of an asset manager’s business,” comments Picone.

Risk management influencing managers’ distribution prowess

One of the upshots to this supercharged risk management function is that it is becoming a more integral part of the capital raising process; a new cog in the distribution
Duff & Phelps management has to become more closely intertwined with portfolio management, meaning that risk managers must consider ex ante risk at the pre-trade, position building level in a portfolio, rather than merely focus on ex post risk.

The optics of risk management have therefore changed. It is no longer a case of applying risk measures afterwards to measure the potential impact of trading decisions; this rearview mirror approach to risk has now become a frontview mirror approach under AIFMD.

“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. Ex ante risk makes sure you remain on track and along the lines of the fund’s objectives,” says Picone.

In other words, says Picone, 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-

Ex ante not just ex post
In many respects, AIFMD has helped to push risk management to the next level. The regulation makes it quite clear that risk management has to become more closely intertwined with portfolio management, meaning that risk managers must consider ex ante risk at the pre-trade, position building level in a portfolio, rather than merely focus on ex post risk.

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In other words, says Picone, 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.

“When you actually look at the risk prescriptions under AIFMD, managers do not necessarily have every aspect of risk management in place. There will be gaps, and we help our clients to address those gaps when necessary. It would be a great pity to have a robust, sophisticated infrastructure on the ground yet overlook certain risk management functions,” adds Picone. The implication being that it could lead to the manager getting rejected by an institutional investor.

**Investors want evidence of independence**

Investors do not necessarily seek to understand the quantitative aspects of risk management given the complexity of the role but what they are doing is looking for several qualitative factors as part of their decision-making.

The first, and perhaps most important of these, is evidence that the fund manager is truly independent.

When investors realise that the risk management function is completely separate from the portfolio management function, with clear Chinese Walls in place, it is regarded as a big plus point for the manager.

“If you take 10 asset managers, chances are each one will have different operating models for managing the risk functions; (the level of independence will vary) but it has become a key element. When there is a suspicion that the risk manager is also the portfolio manager, it can create frustration with investors,” says Picone.

The second factor that investors consider is the presence of risk infrastructure and risk systems with technology. They want to see evidence that risk is being managed with robust technology and tools.

“The third factor that investors want to see before putting a large ticket on the table is that the risk management function meets their investment requirements: beyond technical points of calculating risk there may be requirements such as the ability for the strategy to invest only X per cent in a certain asset class, for exposure levels to remain within certain limits and so on. The end result of this is that investors can get risk reports that are tailored specifically to their needs, as opposed to standard risk reports,” explains Picone.

In other words, does the risk manager have the flexibility to be able to meet the idiosyncratic requirements of the investor that accurately reflect their risk appetite? To determine this, large institutions will often ask their own risk teams to engage with a fund manager’s risk team, again further illustrating the point that risk managers are becoming a key part of the capital raising process.

The above are all important factors that will go into an investor’s due diligence exercise before deciding on where to allocate capital.

**Equal pegging**

With global hedge funds beginning to embrace AIFMD, the role of the risk manager is set to become even more critical to a fund’s long-term success. As they move out of the shadows and more in to the front line, one could argue that risk managers are on an equal pegging to their portfolio manager colleagues.

“If not more so,” says Picone. “A portfolio manager who can demonstrate a good track record is a statement of fact, you would expect that when going out to raise capital. It’s a given, otherwise investors wouldn’t be meeting with them. What is a differentiating factor today is the extent to which the risk management function is evident within the fund strategy. When you talk to pension funds, that is music to their ears.

“As opposed to performance, managers are able to talk about risk-adjusted performance, about the risk-reward compromise within the strategy and so on. This is not fundamentally new, but I want to reiterate my belief that risk management has mutated from just a tactical exercise to a strategic exercise.”

Ultimately, what AIFMD has done is to extend the scope of risk management.

Risk used to be a technical exercise. That is no longer the case.

“It has become an important element of a fund manager’s distribution capability. It gives risk managers the possibility to be more influential in hedge fund groups,” concludes Picone.
Registered private funds offer greater leeway

Interview with Tony Fischer

Much is made of '40 Act alternative mutual funds but with their myriad investment restrictions and daily liquidity provisions, the lesser-known registered private fund could be a more compelling proposition for hedge fund managers.

This is the view held by Tony Fischer, President of UMB Fund Services, whose Registered Fund Services platform provides a full turnkey solution for establishing and running a registered hedge fund.

“We put the turnkey platform together over four years ago and there has been steady demand for these types of structures. Liquid alternatives haven’t exactly lived up to people’s expectations. The can only hold up to 15% illiquid securities, for example.

“The thinking among some hedge fund managers now is, if they could run their portfolios like they do their private funds, they would be better able to deliver returns as they feel they should be able to,” says Fischer.

Alternative mutual funds delivered -2.77% in 2015 (2016 Preqin Global Hedge Fund Report). As the Financial Times reported 27th November 2015, performance issues led to twenty alternative mutual fund closures (citing data provided by Preqin) last year, and a contraction to USD310 billion, having doubled to USD314.67 billion between 2010 and 2014.

Interest in registered private funds – also referred to as ‘interval funds’ – is building among wirehouses and independent broker-dealers, and as financial intermediaries begin to better understand the benefits of the structure, Fischer believes the next few years could see increased growth in fund formations.

“At the one end of the spectrum you’ve got US mutual funds and at the other end you have private funds; limited partnerships that are designed for a limited number of accredited investors and have limits in terms of how much money they can take in certain categories such as ERISA.

“In between is the interval fund. These registered private funds provide a lot of the benefits of a US mutual fund in terms of unlimited numbers of investors, the type of investments the fund can accept, but also allows the fund manager to hold high levels of semi-liquid or illiquid securities in the portfolio so that they can meet performance objectives.

“Also, rather than redeem every day managers redeem on a quarterly basis,” explains Fischer. “We continue to see reports of intermediaries planning to increase allocations to alternative products and I believe many will be open to understanding the interval structure and its benefits.”

Rather than being confined to liquid hedge fund strategies, the interval fund can be used for a wide range of strategies such as bank loans, peer-to-peer lending, CLO/CDO strategies, private equity, etc, and gives investment managers the opportunity to use leverage.

“Our turnkey solution lowers the barriers to entry through shared costs and service providers. We handle all of the regulatory and financial requirements. We understand what is needed to successfully run one of these products and can offer a more streamlined and centralised approach to launching these funds,” confirms Fischer.

An interval fund turnkey solution provides the full infrastructure to handle: administration, accounting, auditing, legal counsel, chief compliance officer support, and a board of directors to provide oversight.

“With more than 9,000 mutual funds it’s hard to differentiate yourself. The mutual fund structure can be challenging for hedge fund managers. In some cases, the strategy will be a better fit for the interval fund structure,” concludes Fischer.
Cybersecurity has rapidly become one of the most discussed issues in the alternative asset management industry. Regulators have provided multiple warnings around the need for investment managers to protect their businesses from cybersecurity risks. In response, both industry groups and tech consultants have published advice to help asset managers implement cybersecurity protections.

On the other side of the industry, asset owners are now acutely aware of their governance, risk and compliance obligations to evaluate the cybersecurity preparedness of external asset managers within their operational due diligence programmes. However, investors must bridge the gap between highly technical subject matter and more practical guidance as to how to approach cybersecurity during a real world operational diligence review. Earlier this year, Castle Hall Alternatives published *Evaluating an Asset Manager’s Cybersecurity Environment – A guide for the operational due diligence practitioner*, a white paper discussing cybersecurity in the context of operational due diligence.

**10 key risk categories**

The alternative industry comprises many thousand asset managers, varying enormously by assets under management, headcount, and overall quality of operational infrastructure. To provide a standardised evaluation framework across such a diverse landscape, Castle Hall has identified 10 cybersecurity diligence risk categories to support investor oversight and diligence.

**Cybersecurity ownership:** The maturity of a manager’s cybersecurity programme is directly correlated to the role and seniority of the individuals accountable for it.

**Cybersecurity framework:** Effective cybersecurity policies and procedures should follow a tailored framework that articulates a clear cybersecurity vision, based on regulatory and legal requirements, industry standards, the current threat landscape and the manager’s risk management strategy.

**Data classification:** All data that the manager handles should be assigned a formal sensitivity level and data category. A well-structured cybersecurity framework maps the flow of data through creation, access, processing and destruction points on both internal and third party infrastructure.

**User access:** Managers should limit user access to appropriate data, according to least-privilege and need-to-know principles. Access to the manager’s data and IT resources should be provided through roles that map job functions to data sensitivity levels and data categories.

**Data, network and hardware security:** Managers need to follow a “defense in depth”, layered approach, where multiple detective, preventive, corrective and recovery security controls are deployed between a potential attacker and the manager’s data. Security controls always have to travel with the data.

**Change management:** Managers must maintain an inventory of all their IT assets, follow standardised processes and procedures, and understand the implications of changes to the IT infrastructure before they are made.

**Personnel:** Managers should have a dedicated Information Security resource (individual or department) with the authorisation and means to assess, monitor and defend all of the manager’s data and information systems.

**Vulnerability and patch management:** The manager needs to proactively evaluate vulnerabilities and ensure that security patches are applied on a timely basis.

**Incident response:** Regardless of the nature of the incident, a timely response is essential. Having a tested plan helps ensure efficient and effective responses that limit the damage to a manager’s data and reputation.

**Security awareness and training:** Awareness of the importance of cybersecurity, familiarity with policies and procedures, and reinforcement of proper practices are essential for understanding and avoiding cybersecurity risks.
CVC Credit Partners is a global alternative investment manager focused on sub-investment grade debt capital markets in the US and Europe, managing USD14.4 billion of assets under management, as of the first quarter of 2016.

Recently, the firm completed the final closing of its Global Special Situations Fund. The fund, which focuses on stressed and distressed corporate credit, predominantly across Europe, secured EUR650 million of capital commitments from investors.

This brings total commitments across all of CVC Credit Partners’ Credit Opportunities vehicles to more than EUR2.5 billion and the scale of its business serves to illustrate the demand for special situations strategies.

Steve Hickey, Managing Partner and Chief Investment Officer of CVC Credit Partners, recently commented: “CVC’s local office network across the US and Europe provides us with broad access to a wide range of investment opportunities, as well as invaluable market insight and local relationships, as we continue to enhance CVC Credit Partners’ growing platform.”

Mark DeNatale is Partner and Global Head of Special Situations. He believes the structural changes across the European banking landscape, potentially impacted by the recent UK referendum result, have created “attractive investment opportunities for disciplined investors, like ourselves. We look forward to investing further in the space, delivering consistent value for our investors.”

The new fund will invest in bank loans, high yield bonds, mezzanine, structured products and, selectively, short positions, other derivative transactions or equity, often created through debt restructuring.

DeNatale says that in terms of the target assets being pursued in Europe: “We believe the market size of opportunity is greater than USD500 billion of non-performing loans.” One only has to look at Italian banks, which alone are estimated to hold EUR360 billion of NPLs, to appreciate the scale of the situation.

“We like to keep the investment philosophy simple,” says DeNatale. “What we are aligned with our LPs on is to deliver private equity-like returns, but in a much better risk-adjusted part of the capital structure. For example, more than 50 per cent of our investments are targeted for loans, which would make sense in so much as the assets coming out of European financial institutions are non-performing loans. Loans often have preferential terms like collateral and covenants that are drivers of recovery.”

Within CVC Partners’ Credit Opportunities and Special Situations strategies there are a number of segregated managed accounts and quarterly redeemable credit opportunity funds (for example CVC Credit Partners European Credit Opportunities Ltd has shares listed on the London Stock Exchange).

However, these have lower return hurdles and are more liquid products than the CVC Credit Partners Global Special Situations Fund; the only fund that offers a private equity lock-up, targeting 20 per cent gross returns. It has a six-year investment cycle with a three-year reinvestment

**Stressed and distressed opportunities**

Special situations strategies see value in European bank NPLs, writes James Williams.
“We see opportunities in renewables, infrastructure, power generation, as well as in corporates that have been impacted by the Brexit decision.”

Mark DeNatale, CVC Credit Partners

period.

Back in April, KKR, a global investment firm, announced the final closing of KKR Special Situations Fund II LP (KSSF II), a USD3.35 billion global fund primarily focused on credit-oriented, deep-value investing in distressed or event-driven situations.

That the number of credit assets trading at distressed levels has been increasing steadily for several months, coupled with the wave of redemptions in the distressed and opportunistic credit fund space, the pricing environment for risk is “meaningfully more attractive than in prior years,” according to Jamie Weinstein, Co-Head of Special Situations at KKR. “The size of the distressed opportunity is not the same as it was in 2008. The levels of stress were higher than they are now. The default rates are lower today than they were in 2008. We think there is a likelihood of an increase in distressed and credit opportunities in the next couple of years although the sourcing and executing of opportunities is actually harder today. That said, we are not as dependent on the liquid secondary market for distressed securities as other firms are.”

KSSF II is the successor fund to KKR Special Situations Fund (KSSF I), KKR’s first dedicated special situations vehicle, which completed fundraising in December 2013 with USD2 billion in capital commitments. KKR’s special situations strategy invests across the capital structure in both privately negotiated transactions and in the secondary markets, seeking to earn strong risk adjusted returns from market dislocations, complex situations and distressed assets.

Over at CVC Credit Partners, DeNatale explains that GSSF portfolio contains 20 to 30 of the best ideas on the CVC Credit Partners platform. “There are multiple factors involved in the team arriving at those best ideas that involves detailed bottom-up fundamental credit analysis. We are leveraging our European network of 13 offices and also leveraging our proprietary database that has been tracking credit metrics for a decade or more.

“In that sense, GSSF pursues a truly global mandate focused on the best opportunities across the CVC platform. DeNatale says: “We see opportunities in renewables, infrastructure, power generation, as well as in corporates that have been impacted by the Brexit decision due to large FX movements.

“European banks are, of course, the main source of the loans that are getting sold down. For example, we are currently analysing a USD2 billion-plus portfolio of impaired loans out of a UK bank. We believe this opportunity set will grow over the next 24 to 36 months.”

Weinstein says that KKR leverages its relationships and industry expertise to identify opportunities “where we think risk is mispriced”. Sometimes, he says, it comes in the form of buying securities in the secondary market at a steep discount to face value. “Other times it comes from a privately originated new money investment into a company where we get a more than adequate
return for stepping into a distressed company’s capital structure and providing a solution."

He says that while there are attractive opportunities in the market “they are not easy. Situations are complicated. Capital structures and business issues are complicated. QE is making it hard for investors to get paid right now.”

The European Central Bank’s Asset Quality Review programme is pushing European banks to sell impaired loans to the market, all of which plays to the advantage of specialist investors such as KKR and CVC Capital Partners. Weinstein confirms that KKR is active in the European NPL space and refers to a joint venture it has with European banks via its Pillarstone platform.

Pillarstone was established in 2015 by KKR Credit to partner with European banks to create value by managing their exposure to non-core and underperforming assets on their balance sheets. In May this year, KKR Credit further expanded the Pillarstone platform through the signing of a binding agreement with Alpha Bank and Eurobank in Greece.

Those who pursue special situations strategies are required to diversify the portfolio as much as possible. The Global Special Situations Fund is not expected to hold positions greater than 7 per cent of the total book value. The ability to source the right opportunities across the capital structure is something that CVC Credit Partners prides itself on. The team has been successfully managing returns since the Asia crisis in the late 90s and knows how to build and manage positions appropriately in strong risk-adjusted opportunities.

DeNatale does not believe there has yet been enough capital raised for the opportunity set in Special Situations over the next two to three years, but he caveats the point by saying: “We are raising what we think is an appropriate level of capital to be deployed in our strategy. You don’t want to be in a position where you raise so much capital that you are forced to put it to work in lower quality opportunities. That undervalues the proprietary database that we manage here and leverage.”

Of critical importance when purchasing impaired loans – or mezzanine tranches and high yield bonds for that matter – is focusing on what the recovery rate will be for the asset that is being purchased. For this reason, CVC Credit Partners uses a bottom-up approach.

“We are constantly balancing the expected asset recovery assumptions versus the offer price coming out of the selling institutions. The majority of the time we are sourcing directly from selling institutions.

“We could see loans priced at 40 cents on the dollar, or 80 cents on the dollar. An asset at 80 cents might not sound exciting but because of the equity stapled to that loan purchase you could be driving returns of 20 to 30 per cent. It’s not all about absolute price. It also comes down to your collateral and what else you are getting with that asset purchase,” explains DeNatale.

As European banks are being forced to sell their impaired loans, over 50 per cent of the GSSF portfolio will be loans. This will help CVC Capital Partners capture private equity-type returns in a more attractive risk-adjusted part of the capital structure as loans get paid before equity.

There is a carve-out of up to 20 per cent in GSSF for hedging purposes. DeNatale confirms that the team has already been active in terms of deploying capital in the fund. Like GSSF, KSSF II will have a three-year investment period. “It is structured as a long term vehicle so we have many years for value creation and to realise those returns,” says Weinstein.

KKR employs a partnership approach when working with companies and seeks unique opportunities to offer solutions to its various counterparties. The special situations strategy is dynamic and able to deploy capital in multiple ways in order to capture opportunities arising from market dislocation.

“KSSF II will do distressed for control, rescue financing and secondary opportunistic investments. Those can take the form of loans or bonds or potentially things that become equity investments after a restructuring,” adds Weinstein.

DeNatale concludes by stating that the stressed and distressed market is as interesting “as I’ve seen over the last five years.

“The credit market is twice the size it was before the financial crash in 2008 and there are significant impacts to the underlying corporates within the credit space. It’s a space where we feel we have the right network and team, and right capital base, to outperform over the next three years of the reinvestment period.”
Understanding the role of the depositary

Interview with Suryanshu Mishra

There are a number of important considerations for a fund manager, especially a start-up, when it comes to selecting an onshore depositary to an onshore AIF. But before these are explored, it is perhaps worthwhile explaining exactly what the role of the depositary is under AIFMD, given that alternative fund managers have never had to use one before.

**Safekeeping of the AIF’s assets**

There are two parts to this. Firstly, providing custody of financial assets that are held directly by the depositary (i.e. stocks and bonds, options and futures). Secondly, performing record keeping and ownership verification of an AIF’s assets, which are not required to be held in custody; i.e. private equity investments where the assets are owned and held in the manager’s name.

**General oversight of the AIF’s assets**

According to Suryanshu Mishra, Head of Hedge Fund Administration, Fund Services at Deutsche Bank, it is important that the depositary properly understands the AIF’s valuation policies in order to effectively monitor them. This ensures that the policies are enforced and adhered to, in line with AIFMD and the AIF’s governing documents (i.e. the Offering Memorandum).

“There is a thin line with this as a lot of fund administrators often carry out this role but they do so in a different capacity. At the end of the day, the administrator will tend to accept an instruction from the fund manager when it comes to any exceptions from the fund valuation policy, but the depositary can go a step further and actively question the valuation policy and enforce it.”

“The other piece to oversight is monitoring transactions on an ongoing basis to again make sure they are in line with AIFMD and with the fund’s governing documents. This might involve making sure that the AIF does not exceed leverage restrictions, for example, making sure settlement considerations for transactions are compliant with market standards, and finally, with regards to income for the fund, making sure dividend or accrual income is in line with regulation and the Offering Memorandum,” explains Mishra.

He says that the depositary has to understand every single facet of the fund strategy at the onboarding stage, ideally before the OM has even been finalised by the investment manager.

**Cash flow monitoring**

This is arguably the most important role of the depositary, according to Mishra. In summary, it involves having a regular line of sight into the cash flow of the AIF, ensuring that there is no deviation from the AIF’s primary activities, and ensuring that investors’ monies are paid into the fund’s bank account.

“That ties in with the two other primary duties of asset safekeeping and general oversight of the AIF. If the cash is consistent, and coming in and out of the correct bank accounts, that effectively offers an additional layer of oversight to protect the fund’s investors,” says Mishra.

Indeed, the premise of AIFMD is to uphold investor protection and avoid a repeat of the Madoff scandal. As such, the depositary has a fundamental role to play. It is, therefore, imperative that start-up managers – or indeed those managers who run existing offshore vehicles but wish to offer a regulated fund to continental European investors – understand what to look for in a depositary.

Firstly, it’s important to look at the authorised aspect. Is the depositary appropriately authorised and regulated by the local Member State regulator?
The next key criterion is financial strength. "I can’t emphasise how important this is," states Mishra. "The depositary needs to have a balance sheet that is strong enough (not withstanding regulatory capital), to cope if there is a strict liability call and the strict liability hasn’t been discharged to the AIF’s prime broker(s) or sub-custodian. The depositary must always have a safety net in place in case of this.

"Another important aspect is managing potential conflicts of interest. How does the depositary interact with the fund administrator with a level of objectivity?"

With the integrated model – where large financial institutions can act as both the fund administrator and depositary to the AIF – they have to functionally and hierarchically be segregated, from a data management point of view, so that the depositary really can provide objective oversight.

"The initial due diligence of speaking to a depositary that is part of the same organisation as the AIF’s fund administrator, understanding the processes, and doing a detailed walkthrough of how independence is maintained, is very important."

Managers are advised to also review the depositary’s operating model. What is the frequency and quality of review around investment guidelines? Make sure the depositary actually has a way of monitoring the evolution of the fund. The appointed depositary should be constantly enhancing its cash flow monitoring operation as part of its key role.

Another key consideration is cost: a worry for any new manager.

With an integrated model, whereby the depositary and fund administrator – and potentially even the prime broker – are part of the same broader firm, managers can benefit from economies of scale and get a total package cost that is likely going to cost less than appointing the fund administrator and depositary separately.

"I also believe that managers should check a depositary’s legal terms. Do they have up-to-date contractual arrangements as required under UCITS V Level 2 guidelines? And last but not least, future developments. Can the depositary keep up with the growth of new funds that it is elected to support? Can it keep up with regulatory developments? When selecting the depositary, managers need to think not only about what the depositary can do today, but what it can do over the next two or three years," comments Mishra.

One way to check this is to ask questions about the depositary’s views on future regulatory changes and how they plan to adapt to these changes. What is their level of engagement with local regulators? Make it an open dialogue not just a box ticking exercise.

**Strict liability & asset segregation**

There is still work to be done in terms of establishing what the best practice should be regarding asset segregation and remains the million dollar question.

Mishra says that at Deutsche Bank Fund Services the view is that ultimately the strict liability provisions of AIFMD will eventually require depositaries to work with prime brokers with a full discharge of liability; meaning the prime broker will be responsible for any loss of assets that they are responsible for safekeeping.

"That has to be the case and become the de facto model in terms of how depositaries interact with prime brokers. But this will involve a lot of detailed legal negotiations between the AIFM and the prime brokers and between the AIFM and the depositary in a tripartite arrangement. The AIFM needs to budget adequate time and effort to get this arrangement in place with the depositary and prime broker," says Mishra.

As for the asset segregation point, at present prime brokers can continue to pool all of the AIFs’ assets together into their omnibus account without individually segregating them. But Mishra believes that any parties to whom an AIF’s assets have been delegated for safekeeping should be subject to the same asset segregation requirements that apply at the depositary level.

"The standards of asset segregation for the depositary need to be applied to everybody in the value chain. That means the prime brokers will eventually be unable to operate traditional omnibus accounts and will need to provide full segregation, as is now the case for depositaries under UCITS V," says Mishra.
The recently introduced Reserved Alternative Investment Fund (‘RAIF’) is compelling to fund managers because although it is not subject to direct supervisory authority from the CSSF, it is still a fully AIFMD-compliant product, benefiting from the European passport for marketing to professional investors in Europe.

“The time to introduce an unregulated AIF is a strong message and part of the construction of a new alternative investment fund norm in Europe,” says Jean-Florent Richard, Head of Fund Engineering Services at BNP Paribas Securities Services, Luxembourg branch.

“The RAIF allows the bank to once again position itself as one of the European leaders of depositary bank services and administration services to these new types of investment vehicles.”

The timing of the RAIF’s introduction could be a masterstroke, helping to cement Luxembourg’s reputation as the jurisdiction of choice, not just for UCITS funds, but AIFs as well.

Until August 2016, qualified investors were able to invest in two types of vehicle - those not subject to such pre-authorisation from the CSSF or those subject to pre-authorisation, but that were unable to utilise structuring flexibilities available to Luxembourg investment funds, such as sub-funds/compartments or variability of capital.

“However, following the introduction of the AIFMD three years ago, there was a risk that some qualified investors, such as pension funds, would no longer view product supervision as a ‘must-have’,” adds Richard.

AIFMs in Europe are highly regulated under the AIFMD and as such, there were concerns that Luxembourg could appear overly protective as a fund domicile, suggests Richard.

“The RAIF helps address this concern head-on, instantly removing the dual layer of regulation that, while necessary when selling UCITS products to retail investors, but unnecessary when selling to a professional investor base under AIFMD.

“The RAIF is creating a buzz among fund managers because although Luxembourg is well known as a longstanding regulated product jurisdiction, the RAIF is not subject to any clearance by the CSSF. It is a revolution, but one that is perfectly in line with the AIFMD,” explains Richard, adding,

“The perception among some qualified investors is that product regulation may no longer be useful since the implementation of the AIFMD and the shift in European regulatory focus. Retail products need to be regulated under the UCITS Directive, but in the alternative investment fund world a double layer of supervision may be perceived as useless.”

He says that one important consideration for fund managers is that the RAIF allows them to better manage the expected time of launch because there is no reliance on CSSF approval.

“Another consideration is that there is no limitation or restriction on the type of assets that a RAIF may invest in,” Richard adds.

This means that, in theory, the RAIF could be used for investing in private equity, real estate, infrastructure or plain vanilla long-only portfolios.

“That said, we expect the RAIF to be primarily used by private equity, real estate or similar fund managers and hedge fund managers,” says Richard, who adds that the bank is already working on four RAIF projects.

“I think mindsets are changing about how to leverage the AIFMD, and the RAIF is a way of achieving this. Alternative fund managers now have an innovative, compliant and very flexible tool for structuring their products”, he concludes.


Jean-Florent Richard, Head of Fund Engineering Services at BNP Paribas Securities Services, Luxembourg