ISSUE 39 JULY 2015

HFM COMPLIANCE

YOUR DEFINITIVE HEDGE FUND REGULATION ROUND-UP

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JUNE 2015

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SHORT SELLING

EU REGULATORS CRACK DOWN ON LATE FILINGS

Managers that fail to file short selling reports and cover shorts in time are now being increasingly hit with widely diverging fines, as EU regulators seek to enforce the Short Selling Regulation (SSR), which came into effect in November 2012.

AQR Capital Management is facing over $600,000 in fines for missing deadlines to report short positions in the Netherlands and Sweden, and Noster Capital was fined €15,000 ($16,475) by Finland.

"It's something we have become aware of recently, that there are a fair few number of fines being imposed against US and UK hedge fund managers," said John Young, associate at Ropes & Gray in London.

He added: "These regulators have – mainly – not disclosed any logic or method in how they assess these fines, but we are going to take steps to warn clients. They may need to disclose these fines to current and potential investors."

"In the past year, we have seen quite a few fines for naked short selling [Greece] and missing the deadline [Sweden]," said a London lawyer. "I have also heard reports that the Spanish regulator (CNMV) frequently calls up managers who have filed to make sure that they do subsequent filings when they modify or close the position."

$13bn York Capital Management was also hit with a €100,000 ($113,900) fine on 26 January by the CNMV for failing to cover a short position "in a timely manner", which it disclosed in SEC filings.

"One reason behind the different amount of fines might be the dimension of the different positions, or just very different national law," a spokesperson at EU regulator Esma told *HFMWeek*.

She noted consecutive regulation has introduced parameters on penalties and administrative sanctions. "The Market Abuse Regulation already includes in the Level 1 text some parameter/criteria."

Other European regulators declined or could not be reached for comment.

SEC

REGULATOR TO REQUIRE NEW ADV INFO

Hedge funds will have to provide new ADV information on managed account assets, social media and performance communications under SEC proposals.

The SEC may also introduce a leverage limit on 40 Act funds' use of derivatives and will require such funds to provide more regular information on certain holdings, such as derivatives and stock lending.

Under the amendments proposed on 21 May, hedge funds will have to provide aggregate information related to assets held and the use of borrowing and derivatives in separately managed accounts.

Firms will also be required to maintain records of the calculation of performance information distributed to any person. Currently, advisers are required to maintain performance information that is distributed to 10 or more persons.

A record of communications related to performance or rate of return of accounts and securities recommendations will also need to be kept.

The proposals were announced alongside reforms to the mutual fund and ETF sector, which will require funds to provide more information about the derivatives they are using and securities lending they are involved in. Separately, the SEC may introduce a leverage limit on derivatives in such funds.

New proposals require monthly reporting of the fund's investments, including data related to the pricing of portfolio securities, information regarding repurchase agreements, securities lending activities, counterparty exposures, the terms of derivatives contracts and discrete portfolio level and position level risk measures to better understand fund exposure to changes in market conditions.

Information contained on reports for the last month of each fund's fiscal quarter would be available to the public. An annual Form N-Cen would also need to be reported.

REGULATOR WATCH

By Sam Dale

For operations professionals at hedge funds, the burden of new reporting requirements is well-documented, but perhaps less so is the burden for the regulatory bodies.

On 31 May, many UK managers classified as 'Foreign Financial Institutions' under US anti-tax evasion law Fatca failed to file their first reports to the UK tax authority due to technical issues with the HMRC system.

Aware of concerns, HMRC circulated a letter on 29 May advising that there would be no penalties for any foreign financial institution that failed to meet the Fatca deadline provided they had a "reasonable excuse".

Problems with the tax system followed major issues with meeting the deadline for the first Annex IV reporting under AIFMD, with the UK joining major nations such as Norway, Germany and Sweden in failing to introduce working reporting systems on time.

The UK was beset by problems as thousands of managers were hit with technical issues when filing under the FCA's Gabriel system ahead of this year's 31 January deadline. The FCA took a relaxed view of the deadline as a result.

And it is not just Europe: the US Department for Commerce's Bureau of Economic Analysis has delayed the filing deadline for its BE-10 benchmark surveys until the end of June following a wave of concern over filing.

When regulators are overwhelmed by the volume of information being demanded on numerous fronts then you know it is significant.

IN THIS ISSUE

AIFMD PASSPORT

BY MAIYA KEIDAN

Cayman regulator Cima has urged the hedge fund industry to ignore "baseless rumours" on the AIFMD passport as the Ministry of Finance confirms talks with Esma and that a Directive-compliant regime is in its final stages.

Several lawyers and operations professionals at hedge fund managers have told *HFMCompliance* that they had heard Cayman was definitely not included in a 'priority list' of countries favoured for the possible AIFMD passport extension. But Cima and the Ministry of Finance are adamantly denying that Esma has drawn up a final list excluding the island.

"We are aware of some concern in the financial industry as to whether Cayman funds will be allowed to continue being marketed in EU countries under a passporting regime for non-EU funds and fund managers if this is recommended by Esma," Cima said in a statement in May.

The statement said Cima's managing director Cindy Scotland and general counsel-deputy managing director Langston Sibblies had met with Esma officials in Paris two weeks ago on the status of the passporting regime. It noted Cima did not think Esma had made a final decision on which countries passporting should be made available.

However, the Ministry of Financial Service also released a letter in May that said the compliance of a country's AIFMD regime will be a "material factor" in Esma's consideration of first-round jurisdictions. It confirmed that the government and Cima were finalising a new AIFMD-compliant regime.

In its statement, Cima said: "[We] urge industry members not to give credence to otherwise baseless rumours on the status of any supposed Esma listing of countries.

"Cima and the Ministry are working assiduously within the context of our respective remits to ensure that Cayman funds can continue to be marketed within the EU and elsewhere in the foreseeable future."

Esma must make its recommendation to the European Commission on whether the passport is extended to non-EU AIFs by 22 July.

Jersey and Guernsey operate a dual regulation regime whereby funds can be fully AIFMD-compliant or use the pre-existing regime for non-AIFMD funds. They are both said to have made the Esma list.

Guernsey's dual regulation setup was launched last January while Jersey's went live in late 2013.

MARKETING – CHINA/HONG KONG

REGULATORS SIGN MUTUAL AGREEMENT

An initiative to create a fund vehicle that can be passported between Hong Kong and China is set to go live on 1 July after regulators in both countries announced an agreement had been signed on 22 May.

KEY DATE
1 JUL 15

The China Securities Regulatory Commission (CSRC) and the Securities and Futures Commission (SFC) finally agreed on implementation and operational principles after first touting the mechanism two years ago.

The hedge fund industry had been "eagerly awaiting" the implementation of the Mutual Recognition of Funds (MRF) of funds between China and Hong Kong, market participants had told *HFMCompliance*.

The passport is expected to apply to retail funds at first with a hedge fund extension to follow.

The initial investment quota for the MRF will be RMB300bn ($49bn) for in and out fund flows each way.

Briefings will be held by the CSRC and the SFC on the application procedures and requirements under the MRF, which will be implemented on 1 July .

CAPITAL MARKETS UNION

ESMA DEMANDS NEW POWERS

Esma is demanding much greater powers in order to boost EU capital markets as it seeks to tighten its grip over national authorities.

In its response to the European Commission's Capital Markets Union (CMU) green paper published in May, the Paris-based regulator calls for the power to directly regulate firms if the member state has breached EU rules.

It also wants to charge specific levies to national authorities and is demanding national regulators be obligated to respond to Esma's requests for information.

The CMU is a multi-year project aiming to open up non-bank financing to businesses that has caught the attention of many credit-focused hedge funds.

"Esma considers that it needs additional powers in order to do its job more effectively, but I doubt the hedge fund community would necessarily welcome another regulator in the mix unless it meant that there was more consistency in pan-EU compliance," said Sidley Austin partner Leonard Ng.

"Right now a hedge fund is concerned that local regulators are taking different approaches such as on AIFMD passporting and the interpretation of the directive generally. Esma has been giving FAQs and they have been helpful, but at the end of the day a hedge fund still has to deal with regulatory enforcement risk at a local level."

Katten Muchin Rosenman partner Neil Robson said Esma has been seeking more powers for a number of years.

"If you're a pro-EU hedge fund then it makes perfect sense to have a pan-European regulator that dictates to each country what is going to happen," he said. " However, if you are more Eurosceptic then taking power away from each country reduces the ability to control your own capital markets. In this scenario, the UK would have little control over its own capital markets."

MARKETING – JAPAN

FSA PROPOSES RULES FOR FOREIGN FUNDS

Non-Japanese funds marketing into the Asia-Pacific country under the commonly-used Article 63 Exemption will need to appoint a local 'presence' under new rules before parliament.

Many hedge funds currently use the exemption for partnership funds under the Foreign Collective Investment Scheme, including Fortress, GoldenTree, Halcyon and Oaktree.

"Lots of clients are worried about this," said Yuki Sako, associate at K&L Gates.

Article 63 allows foreign funds to market into Japan without seeking an investment management license from the Financial Services Agency (FSA), as long as they have at least one qualified institutional investor, like a pension fund or an insurer, and no more than 49 such allocators.

But the Japanese parliament is currently considering a bill to require a local presence for new and pre-existing funds, with little guidance around what qualifies as presence.

"We need to see the rules on what having a representative means," said Sako. "Does it mean a branch? Or does it mean a subsidiary? Or a local accountant? This could be a big change and a drastically different approach."

The Japanese parliament is expected to pass the bill before July, with it set to be implemented one year later and applied to pre-existing funds six months following the initial deadline for compliance.

Japan has already been taking a stronger position on overseeing these non-domestic funds as it this year extended data collection for funds that use Article 63 to non-Japanese funds.

Managers had to file questionnaires, which detail information on their fund name, number or rights holders; total assets managed; short and long positions under futures trading; dividends and major investment targets by 2 June to their local financial bureau.

SWITZERLAND

FINMA SEEKS TO HALT STAFF DEPARTURES

The Swiss regulator has imposed new laws aimed at stemming the flow of regulatory staff to hedge funds and large financial institutions.

Finma has announced that employees with significant oversight roles will have to wait 12 months when leaving to join firms they were previously supervising.

The regulator said on 13 May as part of a review of its Personnel Ordinance, that rules requiring "cooling off periods" have been brought in to avoid conflicts of interest and follow a number of high profile regulatory departures to hedge funds and asset managers.

In April former Federal Reserve chairman Ben Bernanke announced he was to join hedge fund giant Citadel as an adviser and also took up a similar role with Pimco.

The FCA does not have specific rules around staff leaving to join companies in the financial sector.

UCITS V

DIRECTIVE MUST BETTER ALIGN WITH EMIR

Ucits V must more closely align with Emir, Esma said in advice to the European Commission, parliament and council.

The directive should no longer distinguish between exchange-traded derivatives and OTC derivatives, Esma said in an opinion published on 22 May.

There should also be separate counterparty exposure risk limits for exposure to central counterparties and clearing members. Esma added current risk limits of 5/10% should continue to apply to non-cleared derivatives.

"The clearing obligation under Emir has a significant impact on the calculation of counterparty risk of cleared OTC financial derivative transactions by Ucits, which cannot be appropriately resolved under the current Ucits directive," said Steven Maijoor, chair at Esma.

Esma highlighted that counterparty risk limits should be calculated based on the types of segregation arrangements, taking into account elements such as the portability of the position in the case of a default of the clearing member.

SECRET COO

The COO at a new London start-up says getting to the start line is tough for new managers

What is the biggest compliance challenge your firm currently faces?
Getting to the start line. It is hard and expensive.

If you were put in charge of the FCA for a day, what would be the first thing you'd change?
Improve transparency. The aggregation and manipulation of position-level data is a large problem for asset managers, their clients and now – courtesy of Annex IV – the FCA.

It is hard for COOs to garner all the position-level data on their funds and harder still for FoHF managers, so heaven knows how the FCA will deal with Annex IV.

But at the very least they should seek to return the aggregated and anonymised data back to the market place so we might learn something.

What do you think should be the primary focus of global regulators right now?
Fostering competition in asset management. There is very little sense of proportionality in the new regimes.

Asset managers are not systemically important, but the regulations give few breaks to the little guy.

A vibrant and diverse asset management sector is important for the financial services industry.

If you could scrap any piece of legislation and start again, what would it be? Why?
Short selling restrictions. There was never any evidence of systemic risks from short selling, and only rarely have there been settlement blockages.

Governments should be embarrassed that they feel they need extra protection from prohibiting net shorts in their own bonds. Man up.

What advice would you give to someone entering hedge fund operations?
Think beyond the role. Reducing cost is the best source of investment alpha going for the fund and an important driver of profitability for the manager.

CASE STUDY

STAFF HANDBOOK

BY PAUL QUAIN, PARTNER AT GQ EMPLOYMENT LAW

Q: Why should you create a staff handbook and what should be included?

A: Dealing with people requires systems in place and the recent Libor and pensions misselling scandals show that financial services are not immune from things going wrong.

The handbook doesn't just give a flavour of what you are about and what your values are; it can also help to protect the firm: of course, actions speak louder than words and it is crucial that the firm actually abides by the standards set out in the handbook, but if an employee goes 'off piste' and needs to be disciplined or exited, the firm can point to this to show how the employee should have behaved.

There are very few legal requirements. Information relating to disciplinary and grievance rules and procedures, sick leave and pensions must be included in the handbook (or other reasonably accessible document) if not in the contract itself. Businesses with more than four people must have a written health and safety policy that must be brought to the attention of its employees. Certain businesses, including some hedge funds, must have a written whistleblowing policy for regulatory reasons and many others choose to have one.

> Beyond the limited legal requirements, employers have a blank slate when it comes to what to include

It's usually best if the handbook is stated to be non-contractual. This generally allows you to amend policies as required while still requiring staff to abide by them.

Including additional policies can bring significant legal advantages for hedge funds. For example, an appropriately-worded anti-bribery policy will help show that the firm has implemented adequate procedures in those areas, which can protect the business from liability for breaches by its employees of UK and US anti-bribery legislation. Similarly, including an equal opportunities policy may reduce the likelihood of a business being found to have discriminated against job applicants.

Beyond the limited legal requirements, employers have a blank slate when it comes to what to include in the handbook. Commonly included policies are IT and communications; expenses; data protection; anti-harassment, anti-discrimination and bullying; anti-corruption and bribery.

While it may feel over the top, implementing a handbook is likely to be a good investment and may well help to protect your business from risk.

MARKET ABUSE – FRANCE

AMF WATERS DOWN SANCTIONS

French regulator the AMF is watering down penalties for market abuse by reserving criminal sanctions for the most serious violations in a major policy shift.

Findings from the group followed a review of 182 cases sent by the AMF to the public prosecutor since the regulator's inception to August 2014. Over the last 10 years, not a single market abuse violator has been sentenced to immediate custody, however suspended sentences were handed out in 13 cases.

The AMF released a proposal of reforms on 14 May, including writing into law the principle that criminal and administrative proceedings and sanctions may not be combined, and introducing objective criteria to draw a clear distinction between definitions used for administrative breaches and security violations.

The regulator also proposed setting up a framework for civil action prior to co-ordinated action by the financial prosecutor and the AMF, and requiring the national financial prosecutor and the AMF to co-ordinate their work before instituting legal proceedings.

Since 2004, the AMF has imposed fines totalling €117m ($130m) and criminal sanctions of €2.9m ($3.m).

AML – SINGAPORE

MAS SETS OUT TOUGH NEW REGIME

The Monetary Authority of Singapore (MAS) has set out tough new rules to tackle money laundering and terrorist financing.

In early May, the authority set out a series of new requirements on financial crime for asset managers operating in the region.

Hedge fund managers, and other asset management firms, must now take greater steps to identify and verify beneficial ownership of companies, LLPs and trusts they invest in and take investment from.

The rules require much more comprehensive risk assessments of money laundering and terrorist financing as a whole, alongside risk assessments of individual customers.

Singapore will introduce a new category of Politically Exposed Persons (Peps) and impose new requirements on cross-border wire transfers exceeding S$1,500 ($1,126).

Managers were forced to comply by 24 May, apart from regarding the new guidance around assessing risks and applying a risk-based approach, new products, practices and technologies and group information-sharing requirements, in which case managers have until 24 July to implement.

PEOPLE MOVES

HFMCOMPLIANCE ROUNDS UP THE SECTOR'S LATEST LEGAL AND COMPLIANCE MOVES

Connecticut hedge fund **Contrarian Capital Management** has hired **Jennifer Diagonale** as its deputy compliance officer. She joined in May after holding roles at Arden Asset Management, Forester Capital and Silver Point Capital.

RiverRock European Capital Partners, the London-based alternatives manager, has hired **Decura's** general counsel and chief compliance officer **Sonia Bhasin-Woods** to take up the same role. She joined the firm in 2015.

Global compliance consultancy **Laven Partners** has promoted director **Tanja Ferri** as managing director of its Operations Consulting department. Ferri previously ran Laven's offshore consulting and corporate governance business in the Caribbean. Prior this, she was with the company in London providing regulatory compliance and due diligence services, having initially joined the group in 2007.

NEWS IN BRIEF

EU DELAY

Pan-European regulator Esma has postponed sending Mifid II draft regulatory technical standards (RTS) to the European Commission by two months.

Esma was scheduled to send the RTS to the European Commission by 2 July but have been approved for a new deadline in September, according to letters between chair Steven Maijoor and European Commission director general Jonathan Faull.

KYC FAILURES

Hong Kong regulator the Securities and Futures Commission (SFC) has hit out after a series of regulatory failings around KYC rules at regulated firms.

The SFC said it has identified "deficiencies" and "unsatisfactory practices" by licensed corporations during recent supervisory reviews of the KYC rules and account opening procedures.

On 12 May, it issued a stern warning to firms to take proper measures to effectively authenticate the client's identity and the client's execution of account opening documents.

WEAK LINK

Hedge funds and law firms are "weak links" in the effort to combat cyber-security threats, the US Department of Justice has warned.

The US assistant attorney general for national security John Carlin said hedge funds were being targeted for both proprietary trading information and theft of money held in fund accounts by cyber criminals.

EMIR GLITCHES

The Depositary Trust & Clearing Corporation (DTCC) has still not resolved issues with its Emir reporting service 15 months after the obligation was implemented by European regulators, *HFMCompliance* can reveal.

The DTCC admitted to continued issues with OTC interest rate client and reconciliation reports, temporarily disabled collateral reporting and Esma valuation warning reports in a recent letter to clients seen by *HFMCompliance*.

KEEP QUIET AND CARRY ON

Keeping quiet and taking time to research any potential allegations are the most important first steps if you get a call from the SEC, according to leading defence attorney Marc Powers.

Speaking at the Salt conference in Las Vegas in May, the chair, hedge fund industry and securities litigation practices at BakerHostetler warned strongly against speaking openly with the SEC when they first contact the firm.

DATA BREACH

Bridgewater Associates, Goldman Sachs and Citi are among the firms to have reported data breaches to the state of Connecticut since it introduced a notification law in 1 October 2012, an *HFMWeek* FOI revealed.

All individuals conducting business there must report any "breach of security involving computerised data", with 1,206 incidents reported so far.

ESMA COMMITMENT

Esma's chair Steven Maijoor is promising to make AIFMD and Ucits's rules "work better" as he vows there will no fresh wave of regulation for asset managers.

Speaking before the International Bar Association on the Globalisation of Investment Funds in Paris, Maijoor said the Capital Markets Union – an EU project designed to open up financing for smaller companies to entities other than banks – will see asset managers face fewer new rules but remain under close scrutiny.

"The European Commission made clear that new legislation would be developed only when necessary and that the focus should now be on how to make existing legislation, such as the Ucits directive or the AIFMD, work better," he said.

INDIA UNCERTAINTY

BY MAIYA KEIDAN

Foreign hedge fund managers marketing into India are facing uncertainty as the country is making a number of efforts to get to the bottom of a complex levy issue.

Indian finance minister Arun Jaitley pledged that capital gains earned by Foreign Portfolio Investors (FPIs) would be excluded from India's minimum alternative tax (MAT) from 1 April. However, Indian tax authorities were still looking to collect MAT for capital gains tax from offshore derivative Instruments for previous years, until companies took up the issue in court, forcing the government to put all collections on hold until a decision was reached.

The basic MAT for Indian companies is 18%, but additional charges can take the rate as high as 21%. Some FPIs have taken the issue to court, with the Supreme Court due to deliver its verdict on one of the MAT cases.

> "The government has said please resolve this quickly"
> Daksha Baxi, Khaitan & Co

The Indian Government has simultaneously launched a review into the taxation of foreign hedge funds by setting up a three-person committee on 20 May to investigate how to apply India's MAT.

The newly unveiled panel, which comprises former chief justice of the Delhi High Court Ajit Prakash Shah, former chief economic adviser Ashok Lahiri and chartered accountant Girish Ahuja, must deliver a verdict on how the MAT applies to Foreign Institutional Investors (FIIs) retrospectively. They will have a year to do so, although Daksha Baxi, executive director at Mumbai law firm Khaitan & Co, said it is unlikely it will take a full year. "The government has said please resolve this quickly. The key thing here is that the government has taken the decision to put this on hold until the committee and the Supreme Court makes a decision."

Only time will tell at what decision the Supreme Court and panel will arrive, but if Jaitley's stance is anything to go by, it looks like the verdict could possibly favour foreign managers.

GO IT ALONE?

UCITS PLATFORMS VS. STANDALONE STRUCTURES

DO YOU NEED HELP? *HFMCOMPLIANCE* ROUNDS UP THE PROS AND CONS OF LAUNCHING A UCITS ON A PLATFORM VERSUS AS A STANDALONE VEHICLE

BY SAM MACDONALD

Ucits funds have enjoyed several successive years of strong growth, with assets swelling by $83bn during 2014. Assets in alternative Ucits hit around $390bn at the end of March 2015, according to various data firms.

This represents growth of around 34% YoY for European liquid alternatives as investors continue to allocate to the space and seek a combination of diversity and liquidity. But how much attention should traditional hedge fund managers be paying to the space?

Firms who are considering setting up a Ucits product are faced with a myriad of choices, particularly around whether to join a Ucits platform or set up on their own.

Overseas managers with little experience of European regulation can find this a particularly daunting challenge.

Firms have to go through feasibility assessments to see how their strategies can be applied to Ucits and how exposure to particular financial instruments such as commodity futures, can fit into a Ucits vehicle.

The main concerns for an alternative manager will be around how exotic assets fit into the Ucits wrapper and tough restrictions around leverage within a fund.

Ucits funds are permitted a maximum leverage of 200% of total market exposure of the fund's NAV although within a Ucits fund risk management obligations become more onerous as leverage increases.

So where managers have decided they want to access the Ucits space, what is the best route for them to take?

Some say a platform is the best way forward if it can significantly reduce the legal, regulatory and distribution burden.

Dillon Eustace partner Donnacha O'Connor says clients should be aware of the risks when setting up a Ucits structure, and of the contractual obligations when using a platform. "We tell clients to go in with open eyes when looking at Ucits platform offerings," he says. "They should bear in mind there can be difficulties if you want to get out of the platform. There could be tax issues, exit fees or conditionality. Some platforms, for example, say as long as you continue to use their bank as your administrator, there will be no fee, but if you change service providers you may have to pay an exit fee."

He adds that the performance of a fund and relationships with clients are also typically given up by the fund manager when signing over the duties to a platform.

"The control of a Ucits platform is with the platform board and principal investment managers who appoint a portfolio manager – firms are beholden to them as they are an agent of the platform. The firm who has used the platform to set up their Ucits is not in legal control and doesn't control the relationship with client from a legal point of view."

Other issues also arise where firms get to a certain size and want to leave a Ucits platform, O'Connor says. Firms who leave will be required to write to all existing clients invested in the fund in order for them to choose to make the move to any new fund set up by the manager. And, tax issues for clients can arise where investors could be seen to be making a capital gain when divesting from the old fund into an off-platform fund.

However, where new funds are merged with the old fund this can offset those tax liabilities if investors are from the UK. Yet in countries such as Italy, Switzerland and South Africa, mergers are still seen as taxable events.

"Leaving a platform can trigger a tax event if you move investors out of one fund and into another," says Debbie Anthony, tax partner at Deloitte. "You have to look at where each of your investors is based and be very careful. You have to look at reorganisation rules on a country-by-country basis. You will also need to make sure you do not trigger any additional tax exposures at the fund level"

Industry figures say managers who can get to a Ucits fund size of $100m or more generally have the size to be able to cover running costs of a fund themselves.

In order to set up a Ucits, firms must first decide what legal fund structure to use. These vary between European states. Ireland and Luxembourg are currently the preferred states for Ucits bases. Ireland, for example, offers a corporate fund, an Icav, a unit trust, or a common contractual fund, all which fit a Ucits vehicle.

Once a fund structure is decided upon firms then must appoint an admin and a custodian. The fund's lawyer will then be responsible for drafting a fund prospectus and service provider agreements within the firm's Key Investor Information Document while also liaising with the relevant regulator in order to have the fund manager approved.

Some fund types may also require a fund board of directors or fund promoters to be approved by the respective regulator. Once this is done the regulator will review the fund literature before it is then authorised to start taking in money. Regulatory approval on a fund's strategy can vary in timing depending on the complexity of the strategy, although on average, it takes between six and eight weeks for approval.

Industry sources indicate the initial cost of setting up such a fund can cost around $160,000.

Trium Capital CEO Gareth James says firms need to have a robust risk management team at a fund if they are to run their own Ucits, which can come at an expensive rate. He adds that distribution is another vital, but costly, element.

"I guess that for managers there's a question around how will they monitor rules, have they got the right trading infrastructure to be able to trade in a way that is consistent with Ucits requirements?

"Can your traders' procedures be sufficient – how do you monitor live trades with Ucits rules and how to ensure they trade consistently with those rules?" he says.

"The other thing that we can offer is that distribution element and the ability to market straight into 15 different states; that's something that most manager won't have the ability to do. Distribution into the retail space can also be very appealing to managers who are not used to the Ucits environment."

HSBC head of securities services, Ireland, Tony McDonnell says there are few platforms in the Ucits market who are genuinely able to offer a distribution strategy and managers should be clear between those admins who offer support and firms who can actively distribute products.

"Managers need to be fully aware of the difference between platforms offering distribution and administrators offering distribution support and thus to make decisions on their service providers with their eyes wide open. Managers also need to be clear on the question of 'why Ucits?"

McDonnell adds: "In recent years we have witnessed an increasing trend of managers launching Ucits vehicles in the belief that investors craved liquidity.

"While that may be part of the story, the reality is that those that launched Ucits without a credible marketing plan, generally struggled to raise capital. Many underestimate the extent of competition prevalent in the Ucits in-

Latest Iteration

The fifth iteration of Ucits (Ucits V) was originally published in August 2014, with member state given 18 months to implement required changes.

Key impacts of Ucits V include the implementation of new remuneration rules, the increase of shared information between fund managers and depositaries, increasing liability rules, which will see increased charges from depositaries and increased transparency from funds.

The rules also mean depositaries have to be registered credit institutions and also requires them to adhere to increased cash flow monitoring and restitution rules alongside minimum capital and asset ring-fencing and due diligence regulations.

dustry. The Ucits funds that do well are where the managers are committed to the strategy and have the right distribution support behind them and the right links in regions they are marketing into."

Dexion Capital is currently launching an alternative Ucits platform with a low fee dynamic beta offering managed by former Bank of England monetary policy committee member Sushil Wadhwani.

"The most important service offered by a platform is distribution," says Dexion head of asset management Magnus Spence. "It is difficult to grow new funds to a size of $100m at which level you can start to attract larger investors and significant allocations money."

Spence also highlights the possible risks of unsuitable strategies being launched under the Ucits umbrella.

"Ucits is not suitable for all alternative strategies, particularly where concentrated position taking is required or where the strategy invests in commodities," he says. "Managers may try to shoe-horn inappropriate strategies into a Ucits fund but the regulators will be looking out for obvious attempts to circumvent the rules."

Funds looking to be Ucits compliant may in some cases have to restructure to keep within the rules.

Esma rule updates in 2013 set out the extent to which the use of financial indices were permissible in Ucits.

Following the move, Deutsche Bank restructured its $1.2bn Winton Capital Ucits fund to comply with the guidelines.

It saw the DB Platfinum IVdbX Systematic Alpha Index fund switch from a swap-based structure referencing an index to a physical fund directly holding financial futures, FX forwards as well as transferable securities to retain its commodities exposure.

The Esma update made it tricky to fit hedge fund and CTA strategies with commodities exposure into Ucits, leading to several managers closing down their funds before the effective date in February 2014.

Alternative structuring solutions have been found using financial instruments to retain an exposure to commodities, with Société Générale and Morgan Stanley deploying such approaches.

Some hedge fund COOs have cast doubt over whether alternative managers should be looking at the space at all.

One hedge fund COO said that while the space is attracting assets, it seems at odds with the strategies and investment opportunities that hedge funds are trying to provide.

"You do wonder why there is a rush to start fitting illiquid, alternative strategies into liquid retail vehicles. It doesn't seem to make sense to me and I think where investors want a hedge fund strategy they should look to hedge funds, if they don't then look elsewhere. Otherwise you can end up with a halfway house that meets nobody's needs."

Another hedge fund COO said many Ucits platforms failed to deliver on their claims that they can offer distribution that the funds could not achieve outside of a platform.

"There is a danger that instead of firms trying to make the strategy fit the fund structure they are trying to squeeze the fund structure round a strategy which investors should be wary of. Also I think the whole marketing doesn't work and fund groups are paying quite expensive fees for little return on the distribution side."

As part of its annual managed accounts platform (MAP) study, sister title *HFMWeek* recently revealed that a number of changes had taken place in the MAP universe to cater to requests for Ucits-compliant options.

These included the Lyxor MAP losing 37.5% of its assets after the withdrawal of a large European insurance firm, while Permal set up a new Icav structure and moved $4bn assets across to the new proposition from its BVI operations.

Permal head of global business development Shane Clifford says this can be in part attributed to new Solvency II requirements that become active in January and force insurers to hold greater amounts of capital against their alternative allocations.

He adds that if you can provide a Solvency II-friendly offering through Ucits then you can avail of the money coming into the space from European insurance businesses.

He said: "For Solvency II and to be relevant in the insurance space you have to invest significantly in risk management and tech spend – that's a growing thing, life goes more and more onshore and with that comes a heightened level of regulation.

"In Europe you need to be offering onshore vehicles and that is why we opened an Icav in Dublin. We expect that it will surpass the BVI segment of our MAP in the future."

Lyxor is another well-known distributor in the space.

Head of managed account platform Daniele Spada says the firm has a relatively low number of funds on its Ucits platform compared to others in an attempt to ensure it gets a manager from each strategy.

Spada explains: "We stick to our approach in building our Ucits platform, we want to build a comprehensive and diversified investment universe – We are looking for managers in all strategies that you can find in the hedge fund world and particularly in the ones under-represented in the existing Ucits space – in each strategy we select a talented manager with the skills to be successful in liquid strategies and we are very careful to select managers which can perform well within the Ucits framework which is not necessarily what I see elsewhere. "

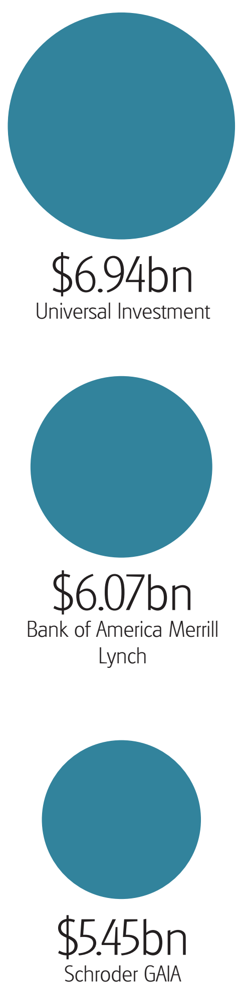
He adds: "We currently have seven funds on the platform. We don't want to have dozens of funds just to increase volumes of managers if we do not have great conviction on these funds.

"Sometimes we can also work with clients to select managers in specific sub-strategies, adapted to their investment needs."

Spada says by the end of the year Lyxor intends to have around 10 funds, representative of the different hedge fund strategies, and offering exposure to best-in-class managers who can strongly perform in the Ucits space.

TOP 3 UCITS PLATFORMS BY HEDGE FUND UCITS AUM

Source: *HFMWeek* Top 10 Ucits Platforms 2014 survey



AIFMD FCA FEE CHANGES

By Jon Wedgbury, Principal Consultant, ACA Compliance (Europe) Limited

With the FCA's implementation of AIFMD, alternative investment managers have seen changes to the way their regulatory fees are calculated. These changes are intended to enable the FCA to recover its costs associated with the implementation of AIFMD. However, there has been some ambiguity in relation to the new fee-blockA009 for managers of AIFs, particularly in relation to the calculation of gross income.

The total amount of fees charged by the FCA varies each year and reflects the regulator's annual funding requirement (AFR) for that period. The AFR incorporates the FCA's budget and also 'any additional scope change or regulatory costs', which it can seek to recover through fees, hence the charges associated with AIFMD implementation.

By way of background, the FCA publishes indicative fee rates to help firms budget for their final fee invoice, usually issued by the FCA from July.

Late last year, to cover the period from authorisation as an AIFM to the end of the FCA's fee year, and again in early 2015 for the forthcoming fee year, AIFMs received a request for fee tariff data on which the FCA will base its 2015/16 fee levy. In addition to paying fees to the FCA for their portfolio management activities (based on their total AuM, which is unchanged and includes assets from both AIF and non-AIF mandates), this request for fee tariff data required certain firms to complete fee block A009 for the first time.

Fee block A009 introduces a new element whereby AIFMs must calculate how much they need to pay the FCA based on the gross income attributable to them from the risk management and administrative activities performed on behalf of the AIFs they manage.

In practice, AIFMs do not tend to levy a discreet annual charge for risk management and AIF administration activities. However, based on our current understanding of the FCA's position, the regulator expect firms' A009 returns to include an estimate of the proportion of their annual charges that relate to the costs of discharging those functions. We believe this point remains somewhat ambiguous and the FCA may well seek to clarify the matter in a later policy statement.

In the meantime, many firms have sought to determine an appropriate methodology for their own calculation. Such methodologies should be reasonable and show an audit trail demonstrating that the methodology has been considered at an appropriate level within the firm.

We have seen a number of approaches. Some managers may have based their figures on the FCA's suggestion for internally managed AIFs (1% of AuM declared in the previous year). Others have considered how much of their appointed risk officer's time is spent on AIF risk management activities (as the role is often combined with other responsibilities, especially among smaller managers) or whether they can apply a proportion of the costs of a risk management system. Some firms have considered how much of their operations budget might be considered relevant to AIF administration activities. Whilst in each case these are costs to the firm, such costs are arguably recovered by the firm through its AIF management fees.

> "The FCA publishes indicative fee rates to help firms budget for their final fee invoice
> Jon Wedgbury, ACA Compliance (Europe) Limited

As to the effect the fee proposals have had on firms, much depends on how firms have calculated their gross income. For 2015/16, fees for A009 only start to apply once gross income reaches £1m (the FCA fee is £1,425 ($2,225) for every £1m ($1.6m) in gross income), but this may change in the future. Many smaller managers will therefore be unlikely to incur additional fees, as their income attributable to risk and AIF administration is likely to fall far below this amount.

Larger AIFMs may have seen an increase in fees following these changes and it is here that the FCA is likely to recover its AIFMD set-up and ongoing costs relating to its oversight of AIFMs.

Arguably, the significant change sitting behind this amendment to the fees regime is one viewed from the FCA's perspective. The application of this new fee block for AIFMs reflects the regulator's need to recover new costs incurred in its oversight of certain additional regulated activities that AIFMs are now responsible for. ■

HFMCOMPLIANCE PEER REVIEW UCITS

Every month *HFMCompliance* offers its readers the chance to answer questions on compliance, regulatory and operational matters, which are later benchmarked against your peers when we reveal the results in each issue. This month, we polled firms on how to structure a Ucits.

A slim majority of respondents (53%) said platforms significantly reduced the legal, regulatory and distribution burden of launching Ucits funds although 41% had some concerns about exit fees or conditionality clauses.

Almost half of market participants (47%) surveyed said they were currently considering whether or not to launch a Ucits fund and how to structure it, with one-quarter (24%) saying they have already launched a Ucits vehicle.

Only 6% of respondents said they had launched a Ucits fund as an independent structure while 23% said they had no interest in developing a Ucits product.

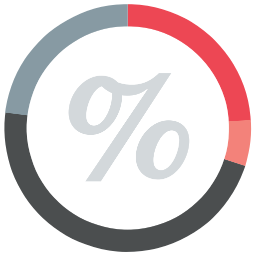
When asked if there were any concerns over leaving a Ucits platform, 35% cited exit fees as a possible problem alongside being required to stay with the platform's administrator.

Around a quarter (24%) said they had concerns over possible tax implications for investors when spinning out of a platform Ucits vehicle while 41% said the positive aspects of using a platform outweigh any potential concerns.

Global macro and credit were the strategies highlighted (33% each) as the least suitable for Ucits vehicles, closely followed by equity long/short (27%) and then multi-strategy (20%).

For more insight into the world of Ucits platforms read the *HFMCompliance* lowdown on the reasons for and against using Ucits platforms on pages 8-10.

Q1 HAVE YOU LAUNCHED A UCITS FUND ON A PLATFORM OR AS A STANDALONE VEHICLE?



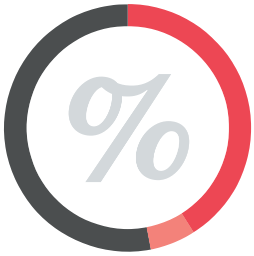
24% Yes, we launched a Ucits fund on a platform

6% Yes, we launched a Ucits fund as an independent structure

47% No, but we are considering whether or not to launch a fund and how to structure it

23% No, we have no interest in launching a Ucits product

Q2 DO/DID YOU HAVE ANY CONCERNS ABOUT LAUNCHING A UCITS ON A PLATFORM?

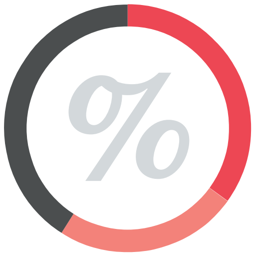


41% Yes, there could be tax issues, exit fees or conditionality clauses

6% Maybe, but we came to a good compromise on some of these issues with the provider

53% No, a platform significantly reduces the legal, regulatory and distribution burdens

Q3 DO/DID YOU HAVE CONCERNS ABOUT EXITING A PLATFORM?

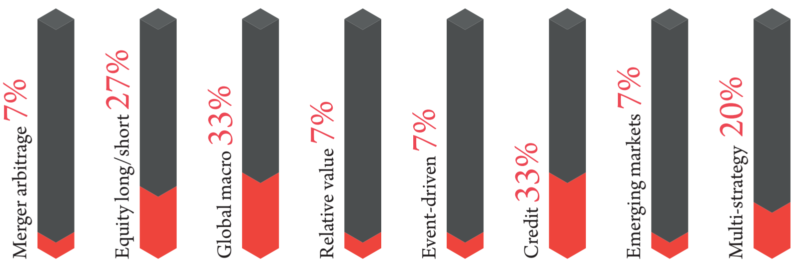


35% Yes, exit fees may be high and the fund may be forced to stay with the bank's admin

24% Maybe, but mostly around triggering a taxable event if you move investors out of one fund and into another

41% No, the positives of a platform outweigh any possible exit concerns

Q4 WHICH STRATEGIES ARE THE LEAST SUITABLE FOR UCITS? CHECK ALL THAT APPLY



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