ROUNDTABLE

SPONSORED EDITORIAL

FOCUS ON: Ucits IV

As the hedge fund sector adapts to the arrival of Ucits IV, four industry experts share their thoughts on how regulation is playing a bigger part in fund management

PROFESSOR JOE V BANNISTER is chairman of the Malta Financial Services Authority

ROBERT VAN KERKHOFF is head of product management, Asset & Fund Services Spain, BNP Paribas Securities Services

JOHN BOHAN is managing director and group operations manager at Apex Fund Services (Ireland)

DAVID CLAUS is head of offshore, BNY Mellon Asset Servicing

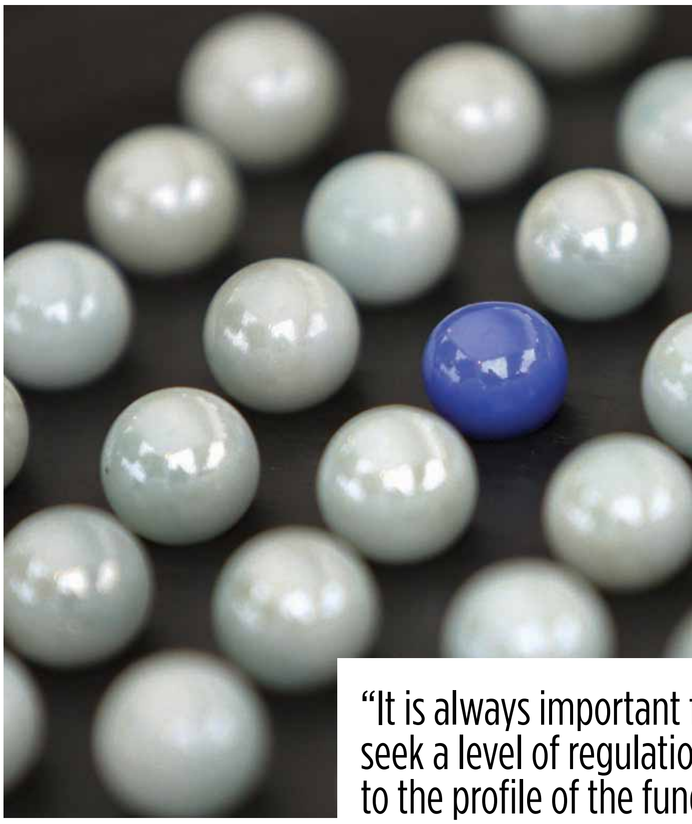
LatAm FM (LFM): Investors are increasingly interested in regulated funds. What options are available to a fund manager in Latin America when considering a European regulated product?
Joe V Bannister (JVB): The options are basically two. Undertakings for Collective Investment in Transferable Securities (Ucits) funds authorised in Malta come with a European passport and may be marketed to the general public across the European Union. Although they may also be offered by private placement, the regulation that comes with Ucits is highly protective of the ordinary consumer. On the other hand, funds that are intended to be sold on a private placement basis only may opt to apply for a Professional Investor Fund (PIF) licence. PIFs are an alternative regime regulated under Maltese law, under a more flexible legal framework that is particularly suited for alternative investment strategies.
Robert Van Kerkhoff (RVK): Obviously, the Ucits is a highly appreciated and well-known brand in the European fund market. What initially started as a way to standardise and harmonise the distribution among the state members in Europe has nowadays grown out to a truly global investment fund product. Ucits have become an increasingly popular investment in countries outside the EU.
John Bohan (JB): The Ucits product is deemed to be one of the most regulated products available, but whether the structure will fit the strategy is a key consideration for any investment manager. Whilst the central bank does not impose any minimum capital requirements on the investment manager, there is a minimum capital requirement of €635,000 required for the promoter of the fund. With Ucits IV now in place since 1 July it is also imperative to give full consideration to the implications of the management company passport, and the many options available for master feeder structures as well as the Key Investor Information document, simplification of regulatory communication and approval processes and how all of these new rules impact on the decision making process for an investment manager.
David Claus (DC): Ucits funds are the 'gold' standard in Europe today. The Ucits regulations were originally designed for European retail investors, some 25 years ago, and have not only proven a great success in terms of asset gathering, but also in terms of reliability. Fast forward to today, and the Ucits brand has become extremely well regarded across the world. It's a case of, if it is Ucits, you can trust it. It is also worth noting that the non-Ucits industry in Europe will be re-shaped next year when the Alternative Investment Fund Managers (AIFM) Directive kicks in. This will create another strong European brand, catering for asset classes/investment policies that are not available under Ucits.

LFM: How has the growth of regulated funds been? Which areas offer the greatest opportunities?
JVB: In recent years Malta has registered steady growth both in the Ucits and in the PIF sector. Both types of funds offer particular opportunities. Funds pursuing full alternative investment strategies find the PIF framework ideally suited for this purpose, since the level of regulation that is applied is inversely proportionate to the level of sophistication of the end investor. On the other hand, Ucits have become a global brand which, in a restricted kind of way, can also accommodate certain alternative investment strategies. Their real strength, however, lies in their potential for large-scale distribution.
RVK: Although Brazil and Mexico in size dominate the region, especially in smaller countries such as Chile, Peru and Colombia, there is an increasing appetite for cross-border Ucits fund distribution. Furthermore, local regulators especially in Chile and Colombia, are increasing their flexibility towards overseas investment in the pension market. For example, 70% of Chilean pension assets are currently allowed to be invested overseas. This will

3 6

ROUNDTABLE

SPONSORED EDITORIAL



LFM: Which type of investor tends to favour regulated products?

JVB: Regulated products are favoured by all types of investors, be they retail, institutional or professional. Investors feel more confident in putting their money where they are assured of the existence of certain standards of transparency, governance and some degree of regulatory oversight. Beyond that, it is always important for the promoter to seek a level of regulation that is proportionate to the profile of the fund as regulation does not have to be unduly burdensome on the business.

RVK: Basically, the institutional investors and private banking in Latin America are dominating the markets. Additionally it is also interesting to see that also small boutiques in Latin America show their interest mainly in the Luxembourg domicile to launch their Ucits fund in order to capture flows outside their local market.

JB: A Ucits fund that partakes in daily trading would attract a retail investor with a low appetite for risk. It is a highly regulated product, meaning they can take assurance that the local regulator is regulating the investment manager and the constraints which the funds must operate (Counterparty exposure/ Var analysis). Ucits IV employs a key investment information document (KIID), which is a simplified prospectus for investors to get transparency into the key elements of the fund. Of course, the Ucits product is very attractive to institutional investors, pension monies, trusts and family money. Ucits represent a low risk, highly regulated product that meets their investment criteria.

DC: Global investors are increasingly investing time and resources in the due diligence process when selecting a manager, looking into non-investment aspects of the managers including corporate governance, transparency and risk management. Whereas today, Latin

> "It is always important for the promoter to seek a level of regulation that is proportionate to the profile of the fund"

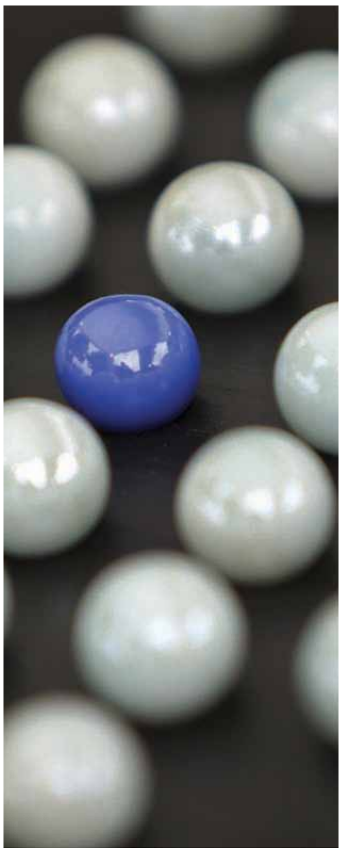
be increased in the third quarter this year to 80%. The latter in combination with the increasing flows to these emerging markets, clearly offer great opportunities to the sector.

JB: In 2010, sales of alternative Ucits funds increased by 70% on the previous year up to September, gaining €25bn, according to a survey by Strategic Insight. Most of those sales were represented by hedge fund-type strategies. Of that, €6bn was from newly launched alternative Ucits products – more than unregulated hedge fund launches. The distribution opportunities can be very attractive for a manager assuming steady track record and if the strategy is in vogue. By way of example, there are opportunities in life settlement funds where there are tax treaties in place between Ireland and the US that allow an efficient life settlement strategy to be employed. There has also been huge growth in Exchange Traded Funds and, through a Ucits vehicle it can tap into the distribution potential.

DC: Latin America and Asia have become significant sources of net inflows for the European Ucits industry and we foresee this to continue. Asian and Latin American funds have historically been hampered in their cross-border aspirations by the regional complications and the absence of a common framework for funds across multiple jurisdictions on both geographies. As a result, through Ucits, Europe's cross-border fund centres, particularly Ireland and Luxembourg, are playing a big role in reducing the cost and complexity of cross-border funds in both Latin America and Asia.

ROUNDTABLE

SPONSORED EDITORIAL



America is largely a pension funds market for Ucits, we hope retail investors in Latin America will be able to invest in Ucits going forward.

LFM: What distribution and marketing advantages does having a regulated fund offer managers within Latin America?

JVB: As already indicated, Ucits funds offer managers much wider possibilities when it comes to distribution and marketing. Originally developed to harmonise Europe's fund structures and promote fund distribution inside the European Union, Ucits have today become a "gold standard" recognised by many other countries worldwide. This is particularly true of Latin America, where Ucits are considered the foreign investment opportunity of choice for local pension funds in a growing number of South American countries. Chile and Peru have both permitted foreign funds to be authorised to certain institutional investors, while opportunities for distributing European based funds on a private placement or institutional basis also exist in other Latin American countries. Apart from all this, the popularity of Ucits in other parts of the world, such as Asia, also makes them the ideal vehicle to channel wealth into investment opportunities in emerging economies, such as those of Brazil and neighbouring countries.

RVK: The Ucits brand name is growing strongly in acceptance across many jurisdictions globally. Mainly the confidence of the local regulator in the Ucits brand is the most important driver for their success. In some countries, regulators only ask a simple notification procedure for the registration of these funds in their local market. Besides the only requirement under Ucits IV, the Key Investor Information Document is very similar to a document that is required in Chilean market.

> "The confidence of the local regulator in the Ucits brand is the most important driver for their success"

JB: The key advantage is that they have instant access to Europe. Ucits IV is bringing in a number of key changes; enhanced communication between regulators, increased response times which allows a Latin American investment manager to attain regulatory status in order to quickly tap into different EU markets. They can launch their fund in Ireland and distribute that fund in any EU state. The local regulator has a minimum period of 10 business days to authorise distribution; which means that within a couple of months, products can be distributed freely across Europe.

DC: As mentioned earlier, Ucits funds are the 'gold' standard in Europe and highly respected worldwide. The marketing advantage is therefore fully linked to the strength of the Ucits brand which scores highly on investor protection, risk diversification and governance. More specifically, while Ucits IV only kicks in on 1 July, and a number of countries in Europe are still translating these provisions in their local legal framework, Ucits V is already in preparation. Investor protection under Ucits V will be further strengthened by increasing the obligations for depositaries and trustees. In a nutshell this will give investors in Ucits products a level of certainty in terms of asset detention that would go beyond what retail and institutional investors would face if they were holding the underlying assets themselves.

LFM: What issues should a fund manager be aware of when considering regulated funds?

JVB: There are a number of regulatory, administrative and tax issues that should be carefully considered by the promoters of a fund seeking a regulated domicile. These conditions can be unduly onerous and time-consuming in some European domiciles relative to others. This is why the choice of domicile has to be carefully weighed to ensure that the fund may be brought to market in the least possible time and at the lowest possible cost. Other important issues to consider include the availability of the right infrastructure, an environment that is conducive to cross-border business and good distribution networks. However, the fact that some service providers have started to position themselves as intermediaries between distributors on one hand and promoters and management companies on the other, is making it even easier to distribute funds on a global scale from practically any European domicile.

RVK: When a fund manager considers regulated funds like Ucits, he must be aware that in a non-EU jurisdiction the

ROUNDTABLE

SPONSORED EDITORIAL

passporting regime is not available. A Ucits must therefore be registered under the local regime and comply with all local registration and compliance requirements. Consequently, the local regulator has the possibility to impose additional restrictions on a fund's ability to manage various kinds of assets. In Chile, for example, the regulator is using a kind of benchmark in the pension market to ensure that all six pension funds keep the same track. In case of being below this benchmark, the legislator is allowed to interfere. Consequently, this benchmark is an important variable to keep in mind when investing in assets.

JB: There has to be an appropriate fit for strategy, size, and market. Cost is a factor. It is certainly more expensive to launch and maintain a regulated product. Besides the legal aspects and regulatory applications, there is the ongoing maintenance of the fund. You must have a local custodian and you must have a local administrator, local directors and custodian fees. Most importantly, the regulator will require detailed infrastructure which carries a proper risk analysis of the strategy itself. The sophistication involved in managing a regulator product is far greater than that of an onshore product.

DC: There are indeed constraints in terms of fund structures, asset classes, concentration limits etc that they need to comply with. That is the trade-off.

LFM: Which domiciles are available to a fund manager when considering regulated funds and what advantages does each domicile offer?

JVB: Malta has established a reputation as one of the leading fund domiciles in Europe. The quality of service and all round cost-effectiveness of setting up a fund in Malta have been critical to its success and have turned it into the European domicile of choice for fund managers relocating onshore. As a regulator the MFSA considers it its duty to ensure that managers and fund promoters are fully aware of the regulatory implications and that they understand the various licensing frameworks available to them depending on their business model.

RVK: Currently Luxembourg as a domicile has a favourite position above the other domiciles mainly due to the stability and regulatory regime. Again Luxembourg as in 1988 when they were the first European Member to adapt its legislation, now again they are the first country in transposing Ucits IV in their legislation. Certain Latin American legislators impose investment restrictions, like for example in Chile where they oblige the pension funds to invest in AAA overseas assets. The recent crisis in this sense has positively affected Luxembourg in the selection of domiciled assets by Latin American fund managers. Ucits being a successful brand, most of the target funds are Luxembourg funds, then Irish funds, and to a lesser extent French funds, UK funds and German funds who do have a strong domestic market and asset management expertise.

JB: To a degree, it is a level playing field for each domicile within the EU. Ireland has key tax treaties with the US, which are advantageous for life settlement funds. There is also a Tax D'abonnement payable on funds in Luxembourg which is not payable on Irish funds. Despite being marginal it can have an impact for certain strategies such as money market funds. Ireland enjoys close links and synergies with US and 40% of the world's hedge funds are administered in Ireland. We are a proven jurisdiction from a service provider perspective. Ireland has a highly educated workforce, one that is in abundance and that has over 20 years' experience in dealing with every type of hedge fund and alternative investment strategy.

DC: From my vantage point, there are two key domiciles a fund manager should largely focus on and they are Luxembourg and Ireland. Over 90% of the cross-border funds industry is in the hands of these two domiciles – about 75% with Luxembourg and about 15% with Ireland. They also represent over 40% of the Ucits industry – largely a testimony to their success in the global arena since both domiciles have relatively limited local markets. While both domiciles operate their Ucits business under very similar frameworks, as one would expect, there have been a few differences historically in the type of business they attract.

LFM: How is the role of a service provider different where regulated funds are concerned in comparison to traditional offshore vehicles?

JVB: Regulated fund frameworks such as Malta's ensure that the fund service providers are pre-screened and that they are fit and proper to carry out the relevant activities. A rigorous due diligence process also ensures that proper controls are in place and that the service provider is capable of satisfying its on-going obligations vis-à-vis the fund in terms of the existing regulatory framework.

RVK: When working with Ucits the role of the service provider is even more important in terms of quality of the service to be delivered, operational effectiveness and cost efficiency. In this field, we do feel that there is room for a larger number of competitors and the provision of a wider range of services, which will inevitably improve and reinforce the current trend towards cross-border distribution.

JB: There are generally more demands from a timing and reporting perspective whether through reporting through to the investment manager themselves or through to the regulator. Given the level of regulation there is also a demand across clients for risk management reporting. Investment in front end systems can represent significant outlays and investment managers can avail of these services such as Apex Fund Services middle office and operational risk reporting solutions.

DC: Service providers, like our company, provide consistent core services across all types of products. So the basics are absolutely the same. Regulations will impact the role though – there will be a direct impact when regulations prescribe the way services need to be rendered to the client and their funds; and an indirect impact when regulations trigger new needs from clients, like the KIID under Ucits IV. The main issue affecting both managers and service providers across Europe continues to be simply keeping up with the volume of new laws and regulations.