October 2015

globalfundmedia special report

www.globalfundmedia.com

Luxembourg Fund Services 2015

Development of innovative solutions for AIFMs

EU fund distribution and the benefits of a strong network

Upholding hallmark of quality under AIFMD

ADVENT®

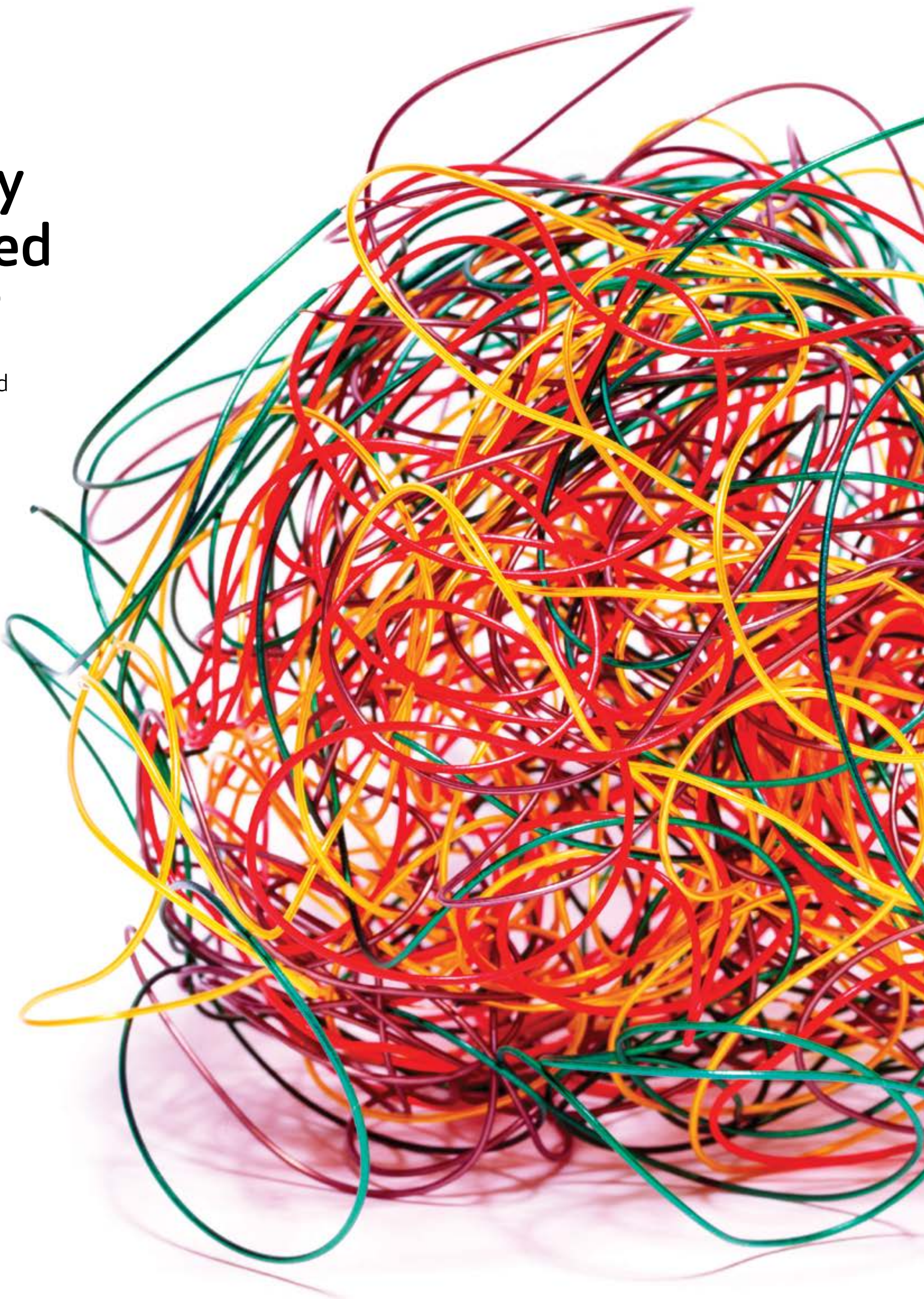
Aren’t you lucky to be surrounded by complexity?

Businesses are constantly being pressed to deliver more value with lower costs. But the complexity of new regulations, new regions and new products makes that virtually impossible.

Believe it or not, that’s very good news.

Advent software can turn this complexity to your advantage by providing you with a single platform that can not only support your business today, but enable you to take advantage of new opportunities in the future - faster than your competitors.

Visit www.advent.com and find out how lucky you can be.



In this issue...

globalfundmedia

Publisher

Editor: James Williams, james.williams@globalfundmedia.com
Managing Editor (Wealth Adviser, etfexpress & AlphaQ): Beverly Chandler, beverly.chandler@globalfundmedia.com; **Online News Editor:** Mark Kitchen, mark.kitchen@globalfundmedia.com
Deputy Online News Editor: Leah Cunningham, leah.cunningham@globalfundmedia.com
Graphic Design: Siobhan Brownlow, siobhan.brownlow@globalfundmedia.com
Sales Managers: Simon Broch, simon.broch@globalfundmedia.com; Malcolm Dunn, malcolm.dunn@globalfundmedia.com
Marketing Administrator: Marion Fullerton, marion.fullerton@globalfundmedia.com
Head of Events: Katie Gopal, katie.gopal@globalfundmedia.com
Head of Awards Research: Mary Gopalan, mary.gopalan@globalfundmedia.com
Chief Operating Officer: Oliver Bradley, oliver.bradley@globalfundmedia.com
Chairman & Publisher: Sunil Gopalan, sunil.gopalan@globalfundmedia.com
Photographs: Visit Luxembourg
Published by: GFM Ltd, Floor One, Liberation Station, St Helier, Jersey JE2 3AS, Channel Islands
Tel: +44 (0)1534 719780 **Website:** www.globalfundmedia.com

Luxembourg upholds its hallmark of quality under AIFMD

By James Williams

Luxembourg's funds industry is marching ahead as Europe's leading funds domicile if figures released by the Association of the Luxembourg Funds Industry (ALFI) are anything to go by. According to ALFI, March saw the Grand Duchy enjoy record net sales and a growth of AUM.

Total assets now total EUR3.53 trillion, a 3.55 per cent increase for the month and a 13.89 per cent increase since the start of the year. In addition, net sales topped EUR49.92 billion.

Over the last 12 months, Lux-domiciled funds have seen their net assets grow more than 30 per cent. The low interest rate environment has been a decisive factor, according to former ALFI Chairman, Marc Saluzzi, "in the sustained growth of assets under management by the investment fund industry". Saluzzi notes that the "diversified geographical origin of fund promoters" in Luxembourg demonstrates that it remains the domicile of choice for the international asset management community.

Saluzzi was replaced by Denise Voss as Chairperson of the Associated Luxembourg Funds Industry (ALFI), which helps to promote Luxembourg's funds industry to the global investment community, in June this year. Reflecting on this year's growth, Voss says: "Through July we have seen net growth of EUR500 billion, over half of which has been net inflows into Luxembourg funds. The amount of new money coming in reflects, I think, the diversification of Luxembourg in terms of asset classes, and the markets in which Luxembourg funds are investing in. UCITS funds, for example, are sold to investors in over 70 countries worldwide.

▶ 7

A future centre of substance for AIFMs

Interview with Alan Picone

Luxembourg has carved out a significant position as Europe's leading onshore fund domicile over the last 20 years. This has largely been based on the popularity of UCITS funds, and the fact that the UCITS brand is now one with genuine global investor appeal.

According to the Association of the Luxembourg Fund Industry (ALFI), Luxembourg funds (including AIFs as well as UCITS) have grown 23 per cent over the last 12 months to EUR3.58 trillion. The jurisdiction is home to nearly 4,000 funds and 14,000 fund units.

More than 75 per cent of UCITS funds distributed globally are based in Luxembourg; testament to the hard work put in by the CSSF, ALFI and other authorities to make it the go-to market for establishing a regulated fund. This achievement is not to be underestimated given that fund promoters can choose any European country from which to set up a UCITS for cross-border distribution.

The question now is, what must Luxembourg do to make the next transition, under the AIFM Directive, from being merely a funds centre to a management company (AIFM) centre of substance?

"Luxembourg has been driven to replicate the success it has had with UCITS funds under AIFMD," comments Alan Picone, global head of risk consulting services at Duff & Phelps' Kinetic Partners division and managing director of the firm's Luxembourg Management Company.

"To some degree, there might be a temptation to recycle some of the ingredients that fuelled the success of Luxembourg as a UCITS fund domicile. But the reality is, when you look at AIFMD, whilst you might be initially tempted to see it as an adjunct to the UCITS world, the factors of success should not and cannot be taken for granted."

Alan Picone, global head of risk consulting services at Duff & Phelps' Kinetic Partners division

For the Grand Duchy to carve out a leading reputation for management activities under AIFMD the landscape will need to change. It will be more than a simple adaptation. AIFMD is a multi-dimensional and complex piece of regulation and cannot be viewed as just an extension of the UCITS framework; the two are distinctly different.

A priori, Luxembourg has a number of advantages; thanks to UCITS, it has built a strong operational infrastructure, 42,000 professionals, some 190 UCITS management companies, 149 banks, etc. It has many of the key ingredients in place, but not all.

"I think it actually does have a competitive advantage, because of the quality on the ground, the infrastructure and so on, but it should not be viewed as being self-sufficient. What I mean here is it shouldn't be a matter of 'case closed'. It can't rest on its laurels. Luxembourg has concluded that, actually, implementing AIFMD requires a lot of innovation, in particular for key functions such as risk management, which requires a shift in culture – you need real substance to support a far wider range of risk requirements. And by substance, I mean showing depth across all dimensions such as operations on the ground, expertise, systems, processes, staff, etc," says Picone.

There is, of course, a fundamental difference between the AIFMD and the UCITS IV directive. Whereas the AIFMD regulates the manager, the UCITS IV directive regulates the fund domiciled in Luxembourg. Therefore, Luxembourg needs to ensure that it becomes the default choice for AIFMs to register there and demonstrate its legitimacy; it cannot merely rely on managers coming there by relying on its reputation, which has, until recently, been that of an investment funds centre. Now it needs to attract more talent to write the next chapter of its legacy. To reinvent itself, even.

"UCITS involved exporting the trademark to the four corners of the earth, given that it has become a gold standard for regulated funds. Now, in the AIFMD world, it's about importing talent to build local substance; not to act as AIFMs per se, but to do the necessary work of substance to support AIFMs; and risk management is key to that," stresses Picone.

Clearly, with any challenge comes an opportunity. At Duff & Phelps' Kinetic Partners division, that opportunity involves providing precisely the sufficient level of substance to act as the AIFM on behalf of the investment manager. As Picone points out, AIFMD is multi-dimensional and will continue to be a challenge for managers to implement internally, irrespective of their size.

"What our firm has done to accommodate that opportunity is to act as a conduit between the asset manager and the regulator in order to fully comply with the Directive. Managers are used to thinking in terms of risk premium. What is the risk premium to absorbing the extra substance responsibilities as an AIFM? There isn't one. They take the added risks and at the same time pay for doing so," explains Picone.

To take advantage of the opportunity set on offer under AIFMD, Duff & Phelps' Kinetic Partners division has needed to adapt to the new paradigm from merely supporting the organisation of the fund, which was for so long the case under UCITS, to supporting the organisation of the AIFM.

"Luxembourg can no longer be seen purely as an organisational centre for UCITS funds, it has to also be seen as an organisational centre of substance to support AIFM activities," adds Picone.

Should they establish the AIFM in Luxembourg – either independently or by outsourcing it – investment managers are still free to choose where they domicile their fund(s). This will depend on their marketing and distribution strategy, and the investors they aim to attract but having a fund domiciled in Luxembourg alongside the AIFM will bring various synergistic advantages; the AIFM will be close to the fund's operations and key service providers, it will be in close proximity to the regulator and so on.

"We don't mind where the manager's fund is located but we recommend to clients to have their substance domiciled in Luxembourg. Over the years, the jurisdiction has developed a solid knowledge of regulations, of risk management capabilities, and remains, in my opinion, the primary centre to set up the AIFM. The corollary to this is to then say, let's offer a facility for asset managers who can be located anywhere in the world and who can appoint us as the Luxembourg-domiciled AIFM instead of having to establish their own substance on the ground. We can perform that role, and in turn sub-delegate the portfolio management function back to the investment manager.

"It's a pure outsourcing model under the AIFMD. The challenge is to make sure that you are able to provide the substance and risk management framework commensurate with the investment strategy; the same for PERE funds as it would be for hedge funds, the same operational controls etc. That is the challenge for Luxembourg: to effectively get these experts on the ground that can tick all the boxes required for regulatory compliance under the AIFMD," explains Picone.

In many ways, it makes sense for investment managers to appoint a third party AIFM in a well-established jurisdiction; one that already has a solid infrastructure and a lot of the necessary cogs in the wheel. "We have people on the ground, many of who have previously worked for the CSSF, fund administrators, and have experience across the value chain," states Picone.

The reality is that Ireland and Luxembourg, Europe's two leading fund centres, will in all likelihood become Europe's two leading AIFM centres. The more that fund managers choose Luxembourg to set up their AIFs, the more it should benefit from building out its AIFM capabilities for providing solid regulatory oversight and risk management – indeed all primary functions under the AIFMD aside from portfolio management.

"It's not always clear to understand why this assimilation has happened between fund centres and substance centres. That said, it is certainly part of Luxembourg's vision to become a leading centre for both funds and for AIFMs," concludes Picone. ■

3 ▶

"With respect to the alternatives fund industry, we see the AIFM Directive as helping further diversify Luxembourg's fund industry."

Indeed, whilst Luxembourg has long established itself as Europe's leading onshore fund domicile for regulated funds, there is still a lot of work to do to attract global alternative fund managers to set up AIFs in the Grand Duchy. Many non-EU managers are still grappling to comprehend AIFMD, and whilst there are signs that real estate funds are growing in number, they still only make up around 1 per cent of all funds in Luxembourg.

There are currently around 380 regulated real estate funds in Luxembourg.

"It's developing quickly but is still small," says Frederic Perard, Managing Director, Luxembourg, BNP Paribas Securities Services. "For some of our global managers who have such funds, which have become more global in their reach rather than domestic, there is a growing need to avail of depositary lite services to comply with AIFMD."

An AIFM hub as well as a fund hub

It is important that ALFI, and other Luxembourg institutions, don't sit back and expect the money to keep flooding in. Whilst there are nearly 4,000 funds domiciled in Luxembourg, the vast majority are UCITS. The next challenge is to make Luxembourg a hub for both AIFs and AIFMs.

"We have to continue to make Luxembourg attractive as an international funds centre. We communicate often with the Luxembourg government since the fund industry is such an important part of Luxembourg's economy, representing some 8 per cent of its GDP. With respect to AIFMD, it is still going through a bedding-in phase as it was only formerly introduced in July 2014.

"The next phase will be on new products and distribution under AIFMD – I think it's still early days but we are seeing alternative umbrella funds under AIFMD being established, using that promise of AIFMD to offer regulated alternative funds to institutional investors who want alternative strategies in a regulated format," comments Voss.

Asked whether Luxembourg can indeed become a global hub, not just for funds

"Through July we have seen net growth EUR500 billion, over half of which has been net inflows into Luxembourg funds."

Denise Voss, ALFI

but managers as well, Alan Picone, global head of risk consulting services at Duff & Phelps' Kinetic Partners division and managing director of the firm's Luxembourg Management Company, is unequivocal.

"Absolutely. There's no AIF product trademark as we see with UCITS. Under AIFMD, only the manager is regulated. The fund can be anything: a Cayman fund, a Luxembourg SIF. This is what Luxembourg's challenge is: to not only build substance in terms of managers establishing operations and staff on the ground, but to also encourage investment managers to choose Luxembourg to establish new funds under the Directive," says Picone.

"Not only AIFMs, but also AIFs, are increasingly finding a suitable home here in Luxembourg for a wide range of alternative fund management activities thanks to the opportunities that AIFMD offers. However, this does not mean that a migration of portfolio management function and competence centre can be realistically expected of course. Whilst AIFMs are based in Luxembourg, the vast majority of them typically sub-delegate portfolio management to the entity where the actual trading/portfolio management activities are conducted."

With respect to fund structuring activity in 2015, Perard observes that much of the work has focused on private equity and real estate funds, particularly the latter.

"Whereas before, real estate funds were very domestic we see an increasing trend towards global investment. Luxembourg is very well placed because of its historical trend in supporting cross-border assets. Also, just as we are seeing in the hedge fund and private equity space, we see real estate loan funds being created. They have been a clear trend so far this year," confirms Perard.

▶ 11

Key areas of support for alternative fund managers

Interview with Cindyrella Amistadi

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

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

"There were lots of concerns over regulatory changes in light of the introduction of AIFMD. We seized upon this as an opportunity and we have invested heavily to support fund managers to stay in line with AIFMD requirements," says Amistadi. "By obtaining an AIFM license we have strengthened a dedicated risk management team in Luxembourg to allow MultiConcept's clients to focus on running their funds, while we focus on all the necessary regulatory and risk management requirements."

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

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

Cindyrella Amistadi, CEO of MultiConcept, Credit Suisse

Risk management

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

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

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

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

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

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

Set up of the fund structure

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

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

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

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

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

Marketing and registration

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

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

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

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

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

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

7 ▶

RQFII funds

He notes that another structuring trend is the establishment of RQFII funds, which give managers the ability to invest directly into China's A-shares equity market as well as trade interbank bonds. China managers are looking closely at Luxembourg to establish funds as well, to attract global investors. The recent introduction of the Shanghai Hong Kong StockConnect programme in November 2014 has also provided a catalyst and prompted further interest to avail of Luxembourg's RQFII quota.

"Whereas previously we saw Bank of China being used, now we are seeing ICBC, China Construction Bank, as well as HSBC and Citibank being used. Our approach has therefore been to develop sub-custody arrangements with these names as more RQFII funds get launched in Luxembourg," says Perard.

On the one hand, Luxembourg is able to sell funds to investors in China and Asia Pacific more broadly, and on the other hand, give global investors access to fund products that invest directly in to China and the Asia Pacific region.

This is helping to further reinforce Luxembourg's international reputation.

"Many Chinese banks have chosen Luxembourg as their European headquarters and are now showing interest in offering products that give exposure to China. It is putting Luxembourg at the forefront of international fund product development," says Paul van den Abeele, Partner at Clifford Chance (Luxembourg). "We are also seeing interest from investors in Shariah-compliant funds that give them exposure to Sukuk bonds, for example. Indeed, on the capital markets side, Luxembourg tries to lead the way with respect to RMB-denominated bonds, Sukuk bonds; it is always looking to drive innovation."

Part of that innovation, in recent times, has been to update Luxembourg's legal regime for private equity and real estate managers. Alongside the existing SCS regime, which has a legal personality, managers can now choose to avail of the Special Limited Partnership (SCSp) with no legal personality. The SCSp regime brings greater flexibility to help attract managers used to the UK LP regime, by allowing them to come to

"Many Chinese banks have chosen Luxembourg as their European headquarters and are now showing interest in offering products that give exposure to China."

Paul van den Abeele, Clifford Chance

Luxembourg to leverage the cross-border expertise of the domicile as a hub for fund distribution under AIFMD.

"Nowadays, close to three quarters of private equity funds are structured as an SCS or an SCSp and we are seeing demand both for regulated and unregulated funds," says Van den Abeele. "With the SCSp, fund promoters are more willing to consider Luxembourg to structure PE funds as they can readily transpose their Limited Partnership Agreement and fund terms into a Luxembourg partnership structure.

"German investors, for example, have always been more comfortable investing in Luxembourg structures than UK partnerships. Now, Anglo-Saxon managers can benefit from using the same key terms in the fund as they would use in a typical UK partnership arrangement. Providing a structure that more broadly appeals to continental European investors creates a perfect world, where the PE manager can use Luxembourg to combine different groups of investors.

"That's why we are seeing interest build in the SCSp partnership structure. We've structured quite a few this year, for real estate assets, private equity assets, debt assets, both for open-ended funds and closed-ended funds."

The RIF – a new fund innovation

The next proposed fund vehicle development in Luxembourg is the restricted investment fund or 'RIF', for which a Bill of Law is being introduced. The idea is to create a framework to capture unregulated AIFs that operate in less traditional asset classes.

There are some fairly exotic strategies in Luxembourg: wine funds, art funds, aviation funds etc.

The RIF would cater to these more esoteric types of strategies to create a proper framework rather than leave them completely unregulated.

One source who asked not to be disclosed, when discussing the possible introduction of the RIF, says: "If you are in a more exotic asset class, the liability of your valuations is more arbitrary than if you operate in an established framework where the standards have been in place for a longer time; as is the case for PERE funds and hedge funds that use the Luxembourg SIF."

"The RIF is something that will aim to hit the same objectives as other fund products; flexibility, accommodation and innovation. Luxembourg is very much aware that in order to attract asset managers, and grow as an AIFM centre, it must also offer attractive fund products," suggests Picone.

One firm that has been building substance in Luxembourg since 2011, to provide fund administration as well as, more recently, a SIF umbrella platform service, is Circle Partners. It now has five people on the ground and has a clear perspective on what it takes to do business in the Grand Duchy.

"I would stress that any manager who intends to have a fund in Luxembourg must visit the place to have a feeling of how business is done. It's a key requirement in my view. If not, you're just going to question everything that is expected of you in terms of documentation submission and so on," says Michel van Zanten, a Switzerland-based director of Circle Partners.

This sounds like an obvious point but what it shows is that everybody has a reputation to uphold in Luxembourg. It has one of the highest reputational standards and puts huge effort into putting Memoranda of Understanding in place with the rest of the world; hence why it was able to secure the RQFII programme with the Chinese authorities.

"The authorities take the same rigorous approach for every new business entity and every new fund that wants to set up in Luxembourg; it's all about maintaining a hallmark of quality. Due diligence is real and so is eye for detail. If you still think you can just call a few lawyers, banks and administrators, and bolt it together you'd be wrong. It's pretty much impossible if you haven't met the people.

"Every global player is in some way represented in Luxembourg so managers will always find a solution. But it isn't a domicile for everybody. People who need to get a strategy up and running within 10 weeks will find that a challenge, even if the manager is very well established. On the other hand, if you want a fund that is widely distributable, broadly accepted by investors, then Luxembourg is a fantastic domicile and it could justify the extra time to get it right," says van Zanten.

ALFI's Voss says that because Luxembourg has a small domestic market it has always had to look outside for its business opportunities.

"This is important because it means it is open to different business models and that is an enormous advantage. Even the small size of Luxembourg is an advantage because it means you can speak to a wide variety of industry professionals and government officials in a short amount of time.

"To illustrate how seriously Luxembourg safeguards its reputation, the CSSF recently created an inspection unit to focus on management companies (including AIFMs). Like the UK and Irish regulators, they had many AIFM licenses to review in the lead up to the introduction of the AIFMD. They want to ensure that they have been set up properly and are doing what they said at the time they applied for a license," concludes Voss. ■

IN A CHANGING WORLD, BY THE TIME YOU MASTER THE GAME, THE RULES HAVE CHANGED.

ANTICIPATING YOUR BUSINESS ENVIRONMENT

At Securities Services, we support your business in adapting to ever changing regulations. Our expertise across the globe ensures your assets are serviced effectively in over 100 markets.

www.securities.bnpparibas

BNP PARIBAS

The bank for a changing world

Distribution and the benefit of having a strong network

Interview with Frederic Perard

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

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

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

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

Frederic Perard, Managing Director BNP Paribas Securities Services, Luxembourg

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

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

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

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

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

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

"Globally, we look to support management companies for any kind of reporting they have to do. The final feature is to handle the fee attribution to a manager's fund distribution network to make sure the fees are properly distributed based on the level of assets they have in the fund. It is a full end-to-end solution for global fund distribution," says Perard.

Since BNP Paribas first established Fund Distribution Services in 2000, constant adaptations have been made based on client feedback and the evolution of the distribution and regulatory landscape. Further adaptations to the solution will be made if, for example, funds move to T2S (Target2-Securities) in 2017, which could result in changes to operating models. “Mifid II will require us to adapt as well,” adds Perard.

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

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

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

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

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

What makes Europe particularly complex is that it is such a fragmented market. Perard believes that fund managers looking to centralise their cross-border fund distribution activities in Europe will need to put in place a global contract with their service providers.

“What I mean here is that they will need a global contract that is valid for all countries in Europe under AIFMD. As an industry, we need to respond to convergence with a standard agreement on who would take control of the NAV calculation. The UK, German, Italian and French models are all different. The only thing they tend to have in common is that they have both local funds and Luxembourgish funds.

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

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

For managers looking to set up sub-funds to begin their European distribution activities, they can rent a compartment on one of two umbrella platforms operated by BNP Paribas: one for UCITS, and one for alternative funds.

“We work with a few different management companies in Luxembourg to provide the ManCo service. This enables managers to start small, focus on perhaps one or two countries for distribution in Europe and steadily establish their brand. This is important for fund managers from for example Latin America and China who ultimately want to sell their domestic class of assets and attract global investors”.

”They are using Luxembourg as a hub from which to expand their distribution network,” concludes Perard. ■

Luxembourg's service providers focus on AIFM solutions

By James Williams

One of the biggest challenges of AIFMD is that it directly impinges on investment activities at the manager level, as opposed to the fund level under the UCITS IV framework. This has required a shift in mindset, not just for managers, but also fund authorities in well-established fund jurisdictions such as Luxembourg.

For Luxembourg to take full advantage of AIFMD, it needs to build on its success as a UCITS hub by also becoming a manager hub. One where global investment managers use the Grand Duchy to establish management company operations, or appoint a third party AIFM, and run their global fund distribution strategy from a single, consolidated location.

That is one reason why ALFI spends a lot of time travelling the world to explain the basic concepts of AIFMD, and the benefits of doing cross-border fund activities out of Luxembourg, to non-EU fund managers.

"AIFMD is a challenge for hedge fund managers. One point we emphasise, however, is that there are plenty of solutions offered by third party AIFMs for those managers who don't necessarily want to come to Europe to set up their own management company, which can be costly for smaller managers," explains ALFI Chairperson, Denise Voss.

It is perhaps, therefore, no surprise that many of Luxembourg's service providers – administrators, universal banks – some

19

The importance of independent service provider integration

Interview with Michel van Zanten

Collaboration is extremely important for any service provider looking to do business in Luxembourg and in that respect, Circle Partners ('Circle'), an independent fund administrator, is no exception.

Having first established a footprint in the Grand Duchy in 2011, Circle has invested considerable time and money and is now beginning to see the fruits of its labours as it prepares to establish an umbrella SIF. The platform will act as an incubator for managers wishing to create a sub-fund as opposed to taking on the burden of establishing their own standalone fund structure.

Michel van Zanten is a Switzerland-based director of Circle Partners. He confirms that Circle is about to sign up its first manager to a sub-fund of the umbrella SIF.

"We will be able to support managers in the whole process of setting up and registering a sub-fund by working with a law firm to create the PPM. We are working with a couple of brokers who will be able to support a wide array of asset classes not only in mainstream European countries but internationally. The SIF will support managers of sub-funds with assets of less than EUR100 million," confirms van Zanten.

Fund platforms like Circle's can only establish the sub-fund if the request has come from the appointed and licensed fund management company (that isn't running their own umbrella platform) and ensured that the existing service providers fit with the strategy and management of the new sub-fund.

What makes this a challenge is that in order to receive the mandate, the investment manager needs to partner up with an AIFM, before Circle – or any other SIF (umbrella) platform – can take the next step.

Michel van Zanten, director at Circle Partners

"The AIFM isn't going to give a fee quote until they've done all the necessary fund due diligence. They have to decide between each other to do business and then the management company (the AIFM) would ordinarily go out and source quotes from the main service providers.

"In this situation, we as the introducing fund administrator might get asked but it's not guaranteed. There are many ways you could lose a fund proposal as an administrator because in this scenario you aren't in the driving seat; the AIFM is," says van Zanten.

"It's important to work together with many Luxembourg-based AIFMs but that alone is not a guaranteed road to success. If you work with an independent AIFM, they have to determine whether you are fit and proper to host their client's sub-fund. AIFMs are aware of how complicated it is when it comes to setting up new alliances without disgruntling their existing service providers or, potentially, the regulator."

As long as the fund structure falls out of the scope of the AIFMD, there is no requirement to appoint an AIFM. But as Circle builds its network of AIFMs, synergies should develop and lead to improved quality: Circle recommending the best AIFM if and when a sub-fund reaches EUR100 million, and the AIFM recommending Circle Partners' SIF platform to fund managers who wish to dip their toe in Europe.

"We are working closely with a handful of management companies that will allow us to select the right management company to support the right fund strategy. We will then be able to offer a full solution that includes the AIFM, fund administration, custody, trading, risk, etc," concludes van Zanten. ■

16 of which have long been operating UCITS management companies, are now actively creating AIFM solutions to attract global alternative fund managers.

After all, the last thing Luxembourg, or indeed Europe's institutional investor community wants, is for non-EU managers to turn their backs on Europe.

MultiConcept Fund Management S.A. ("MultiConcept") is a fully integrated AIFM and UCITS IV fund Management Company within Credit Suisse Group. As CEO Cindyrella Amistadi points out, managers today are far more fixated on cost savings and are thinking far more carefully about their distribution strategy from the get-go.

"We can help them think about where to register their funds. Ten years ago, managers took a wider approach to registering their funds in lots of markets. Now, it is a lot more targeted. It's more to do with identifying the right potential investors and keeping control of costs.

"We can have an open dialogue with clients to help guide them with this," says Amistadi. Until now, UCITS represented the largest percentage of assets on MultiConcept but going forward, under AIFMD, Amistadi believes that MultiConcept's growth trajectory will be in the private equity and real estate space.

"We had a discussion just recently with a large manager regarding the possible establishment of a real estate fund, and we are focussing all of our energy in this area right now. Credit Suisse has a large, dedicated team to support PERE funds. We have the internal knowledge and expertise to develop this area of the business.

"With MultiConcept, Credit Suisse now has a full product range. We can support clients throughout their lifecycle. Some banks still do not offer third party management company services under AIFMD. For us, it is a big point of differentiation," says Amistadi.

Deciding on when to opt for a UCITS fund versus an AIF under AIFMD will depend on many factors. Under the AIFMD regime, less liquid portfolios tend to be used whereas in the alternative UCITS space in Europe, the majority of strategies are those operating at the more liquid end of the spectrum.

More important than the investment strategy, though, is the marketing strategy.

What is the manager looking to achieve? Are they hoping to raise assets across multiple EU countries or just one or two? Who will those investors be? What is their experience in allocating to alternative fund strategies?

Asking these questions is vital for fund managers to move forward and potentially establish an AIF in Luxembourg.

If you have a broad requirement to raise capital in the EU and you are looking at multiple jurisdictions it does make life a lot easier to avail of the marketing passport. However, if you are focusing on one or two markets it is best to use the private placement regime. The only problem with this is that the costs of placing in multiple jurisdictions can become costly.

"If you are a non-EU manager with a non-EU AIF raising capital in the EU, a more permanent solution would be to establish an EU AIF managed by an EU AIFM and mirror the strategy in Europe to avail of the marketing passport. You could have your own structure/s or adopt a partnership approach," explains Kavitha Ramachandran, Director of MS Management Services, a Luxembourg-based subsidiary of the Maitland group.

Taking the partnership approach would allow a non-EU manager to avail of an AIFM platform, such as Maitland's MS SICAV SIF, to initially establish a sub-fund, test investor sentiment, and maybe wait a couple of years before opting to have a standalone EU regulated fund running pari passu to the offshore fund.

"Something else we are seeing and implementing is passporting our AIFM to be able to manage AIFs in other jurisdictions. Maitland recently acquired Phoenix Fund Services – a UK-based fund administrator with its own Authorised Corporate Director (ACD) and AIFM license – so we are able to passport their UCITS administration and management capabilities for managing Luxembourg structures. We are now in a position to be able to manage both AIFs and UCITS in multiple locations," confirms Ramachandran.

Should a manager opt to establish an AIF in Luxembourg, it makes a lot of sense to also locate the AIFM in Luxembourg so as to ensure that all of the supervisory functions such as risk management are easy to put in 22

Attracting PE and RE managers to innovative AIFM platform

Interview with Kavitha Ramachandran

In May 2014, MS Management Services SA, a Luxembourg-based subsidiary of the Maitland group, a leading global fund administrator, received authorisation from the CSSF to act as a third-party AIFM to alternative investment funds. At the same time, it established its own umbrella fund platform, MS SICAV SIF, to support managers wishing to fast track the process of launching a readily passportable EU product.

Kavitha Ramachandran, Director of MS Management Services, notes that managers in Europe are increasingly aware that the AIFMD brand is becoming popular with investors. "Initially, people were trying to look for ways to avoid it or circumvent it but they increasingly see the benefits of being regulated under AIFMD. It gives them a marketing edge, especially in the eyes of institutional investors.

"As a result, we are getting a steady stream of enquiries. We see particular interest among fund managers operating in the private equity (PE) and real estate (RE) space," confirms Ramachandran.

Indeed, to capitalise on this trend, the firm has applied to the CSSF to extend its AIFM license to support PERE managers.

"We see this as a real growth area," adds Ramachandran. "It is going to be an integral part of the expansion plan for our AIFM solution. We'll follow a similar strategy to the existing one for hedge fund managers; that is, to have a platform product that will cater for these more illiquid asset classes, as well as offer outsourced AIFM services to managers running their own AIFs."

Ramachandran confirms that the firm has been speaking to managers wishing to set up structures in Europe.

"We've had conversations with US fund

Kavitha Ramachandran, Director of MS Management Services, Maitland

managers about mirroring their offshore fund strategies and establishing an EU AIF to avail of the AIFMD marketing passport. An EU feeder into a non-EU Master fund does not avail of the AIFMD passport, At the end of the day, if you're interested in raising capital in Europe, you need to have a solution in place."

That solution could be to join an umbrella fund structure such as MS SICAV SIF, where the investment manager creates a sub-fund and avails of Maitland's AIFM license to passport the fund in Europe. In such an arrangement, Maitland delegates the portfolio management back to the investment manager.

"We are talking about managers and countries, such as the US, where the passport is not going to be made available by the European Securities and Markets Authority (ESMA) on a Third Country basis for some time yet. What we are able to offer with our AIFM is a simplified solution for non-EU managers, so long as they feel they haven't lost too much control with a third party looking over what they are doing and providing full oversight," explains Ramachandran.

A strong pipeline means that the number of sub-funds is likely to grow over the coming months. In addition, Maitland is setting up individual client-owned entities, which then appoint Maitland as the delegated AIFM. This is typically done by EU managers setting up their own AIF, yet do not want the day-to-day burden of being their own AIFM.

"We see a combination of EU and non-EU managers wanting this solution. If you are a boutique manager, you really don't want the hassle of setting up your own management company, dealing with the local regulator and using up valuable resources. We can help overcome this," concludes Ramachandran. ■

19 ▶ place. Rather than spend time and money building substance on the ground by hiring operations staff, building infrastructure etc., the beauty of the outsourced AIFM model is that investment managers needn't worry about putting all the processes in place to remain compliant.

"We have people on the ground, many of who have previously worked for the CSSF, fund administrators, and have experience across the value chain," says Alan Picone, global head of risk consulting services at Duff & Phelps' Kinetic Partners division and managing director of the firm's Luxembourg Management Company.

One could then argue that if the AIF is not located in Luxembourg, why on earth appoint a local AIFM?

This is where the concept of substance – experienced personnel, systems, processes, etc – comes in to play. If the manager is based in London, and wants to outsource the AIFM role, there aren't many companies to turn to outside of Luxembourg and Ireland.

"Fund centres tend to become substance centres," says Picone. "Counter-intuitively, AIFMs do not tend to establish themselves systematically in the same location as the portfolio management units. Rather, a significant proportion of the market players have opted for their AIFM physically residing in Luxembourg to ensure proximity with fund operations. This mechanically means the portfolio management being delegated so that risk management is retained in Luxembourg. This is a massive evolution which paves the way for Luxembourg to impose itself as a hub for risk management excellence."

Unlike Maitland, or Credit Suisse, Duff & Phelps' Kinetic Partners division specifically chose not to establish an AIFM umbrella platform in Luxembourg and sticks to offering ManCo services.

"If you have a platform, you need to have an umbrella fund that is sufficiently wide in terms of legal restrictions to accept any types of investment strategies, otherwise it's economically pointless. Running such a structure with so much flexibility, you need to find service providers who are willing to support small fund mandates, you need to take legal risks having a large offering memorandum, so we took the decision to

"We are able to provide a real, qualitative oversight of how managers are performing. That type of substance is really resonating with the market."

Nick Parkes, DMS Offshore Investment Services

refrain from setting up a fund platform.

"Rather, we encourage clients to establish their own funds and we can help them do this. This helps avoid dilution of a manager's brand, which might otherwise happen if they become one of many sub-funds in an umbrella structure," explains Picone.

One firm that is enjoying a good level of demand for its AIFM service is DMS Offshore Group. So far this year, it has picked up seven mandates for its outsourced AIFM solution, all from top-tier managers according to Derek Delaney, Managing Director of DMS Offshore Investment Services (Europe).

"They tend to have a pan-European reach and prefer Luxembourg given that a lot of continental European investors are familiar with the Luxembourg fund structure. Nick Parkes heads up the AIFM business in Luxembourg where he will look to replicate the size and success of our Dublin office," says Delaney.

The seven mandates are a mix; some are to appoint DMS as the AIFM and assist in establishing a standalone fund, some are to provide the investment manager with a sub-fund by availing of the DMS platform.

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

"The other function that has become a focus in Luxembourg is more qualitative, i.e. can you identify a good trade. DMS can do this because we've been working with an 8-person strong investment management firm for a period of time, which we have now acquired. This means we are able to provide a real, qualitative oversight of how managers are performing. That type of substance is really resonating with the market."

To underscore just how important AIFMD could be to managers, more than half the money in the fund mandates that DMS has worked on this year originate from four markets: Germany, Denmark, Sweden and Norway. There is clear pent-up demand for AIFMD-compliant funds from non-traditional markets, where investors have never been comfortable investing into offshore hedge funds in any significant volume. Now they can get access to these strategies in a European regulated format.

That is encouraging news, especially for non-EU managers. Indeed, Parkes says that many of the mandates attract large tickets: "What we find, in the main, is an institutional investor will favour a particular investment strategy and write a ticket sufficient to make it worthwhile for the manager to establish a European regulated fund structure."

One AIFM that is going a step further, and not merely sub-delegating the portfolio management function back to investment managers, is Crestbridge.

Under some scenarios, it is better to keep the portfolio management function internal and appoint the investment manager as an advisor. This is not something that would ordinarily be pursued for those running actively traded hedge fund strategies. As such, it is better suited to buy and hold, long-term asset classes such as private equity, real estate and debt funds. In this arrangement, where the investment manager operates in an advisory capacity, Crestbridge oversees an investment committee.

"We would play an active role within the investment committee, which would then appoint an advisor to run a particular mandate. We have appointed four or five advisors to run mandates, out of the 20 or so mandates that operate on our AIFM platform," says Daniela Klasen-Martin, Managing Director and Country Head, Crestbridge.

Crestbridge was one of the first AIFMs to use investment committees when it received its AIFM license in February 2014. As the number of regulated PERE funds is expected to continue to grow, it could be that more AIFMs use this as a further tool to support managers.

"Smaller managers might not be fully authorised as portfolio managers; they might be FCA-authorised, but as advisors, so there's not as much of an advantage for them to become fully authorised as an AIFM."

Daniela Klasen-Martin, Crestbridge

"Smaller managers might not be fully authorised as portfolio managers; they might be FCA-authorised, but as advisors, so there's not as much of an advantage for them to become fully authorised as an AIFM. That's why this solution can work well.

"It only works for portfolios that aren't turned over regularly and held over a longer period of time. The investment committee will set out the guidelines and approve the model for what the advisor can and cannot do," adds Klasen-Martin.

Typically, then, these will be newer managers with good track records that have recently launched a fund and are new to the whole regulatory regime, although as Klasen-Martin points out: "We have one exception which is a very large US manager. Generally speaking, it would be USD100million managers that explore this option, as opposed to USD1billion managers in terms of AUM."

Clearly, there are plenty of options for managers to consider when looking to comply with AIFMD. As the number of AIFMs in Luxembourg grows, and substance deepens, there's every reason to believe that it could become a leading AIFM hub, just as it has thrived as a funds hub over the last decade or more.

"What is clear is that the country has adapted quickly to regulatory changes and in my opinion it remains the leading domicile for investment fund managers. Luxembourg will remain a bastion of the funds industry. It really is the gateway to Europe," concludes Amistadi. ■