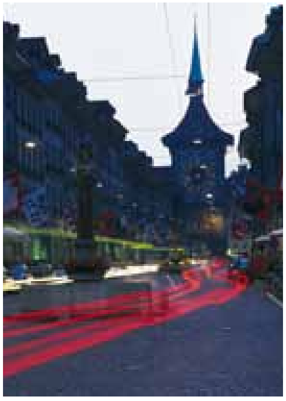
hedgeweek special report
www.hedgeweek.com
February 2015

Switzerland Hedge Fund Services 2015

Structural shift towards investing in liquid alternatives

The six steps towards Swiss funds distribution

Switzerland's first alternative and HFs platform



Publisher

Editor: James Williams, james.williams@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: Switzerland Tourism
Published by: GFM Ltd, Floor One, Liberation Station, St Helier, Jersey JE2 3AS, Channel Islands
Tel: +44 (0)1534 719780 **Website:** www.globalfundmedia.com

hedgeweek

Managers face Swiss Legal Representative requirement

By James Williams

The sands of time are running out for hedge fund managers wishing to continue distributing their funds to Swiss investors. As of 1 March 2015, any foreign hedge fund looking to raise assets in Switzerland from qualified investors will be required to appoint a Swiss legal representative and paying agent.

Qualified investors are defined under CISA (Collective Investment Scheme Act) as including pension funds, corporates and individuals with at least CHF5m in financial assets. Previously, only those funds that were registered for public offerings – which is now referred to as distribution to non-qualified investors – had to appoint a Swiss representative.

The good news for managers is that their foreign fund will not come under any regulatory oversight by FINMA; indeed, this is why the Swiss legal representative needs to be appointed, as they will effectively take responsibility for the fund and act as the point of contact with FINMA. The appointed legal representative's name will be included in any fund marketing materials and offering documents.

Managers still have the option of privately placing their fund(s) to regulated financial intermediaries such as private banks and insurance companies. However, the risk to this is that fund materials that should only ever reach the bank's qualified investors could inadvertently end up in the hands of retail investors; what this means is that banks will be very cautious about going down this road and potentially exposing themselves to regulatory risks under CISA-CISO.

"We are an alternative investment specialist. Our whole process is geared towards serving alternative managers, rather than coming at it from a long-only, retail perspective," comments Roman Pelka, founder of Montfort Funds, a specialist provider of Swiss fund representation services whose client base accounts for over USD400bn of hedge fund and private equity assets.

Appointing a paying agent is mandatory under the new rules, but it's up to the hedge fund investor to decide if they want to use the Swiss paying agent. "Our partner banks have so far not been involved in transactions involving qualified investor funds," says Gabriel Kurland, Montfort's COO.

Pelka notes that the average time it takes, from start to finish, to get the Swiss legal representative in place, is two to three weeks "so the reality is, the deadline will arrive and most managers simply will not be ready".

One thing is certain; if managers don't have the representative in place on 1 March 2015, any fund marketing activity, even if it involves sending a newsletter to existing Swiss investors, will be illegal and carry the threat of criminal charges.

"I'm not sure that managers outside of Switzerland are sufficiently aware of this. I think this is a point that needs to be emphasised. I know several London and NY-based managers who are rushing to find out what is required. This is not just for funds that are actively marketed, it's for all funds. Going forward, all fund documentation will need to go through a Swiss representative," comments Leila Khazaneh, general counsel at Jabre Capital Partners, one of Switzerland's most established hedge fund managers.

There is an important difference between the way FINMA describes "marketing" from other jurisdictions. In the UK, for example, handing over a fund prospectus is the point of sale. Beforehand, the manager can have discussions with investors etc. In Switzerland, however, it's more stringent. Any activity that promotes a CIS is considered distribution; a phone call, an email, a meeting.

There are essentially four options available to managers at the moment.

Option one is to rely on reverse solicitation, which really is becoming a foggy area, legally speaking. Option two is to work with private banks. Option three is to avoid Switzerland altogether, whilst option four is to take the safe bet and put in place the representative.

There is nothing in theory to stop Swiss investors reaching out to managers. That is genuine reverse solicitation. But the reality is quite different; it's very rare that a Swiss pension fund would pick up the phone to a manager and say 'Hey, we'd love to meet you'.

"Combine the low cost of compliance with the breadth and depth of the Swiss fundraising market and you will quickly understand why most managers pick Switzerland as one of the markets they want to focus on."

Roman Pelka, Montfort Funds

Most managers will, in all probability bite the bullet and choose option four. Not that getting compliant is a particularly costly exercise.

"The commercial argument is that the cost of compliance is covered by the management fee of USD1m raised from Switzerland. Combine the low cost of compliance with the breadth and depth of the Swiss fundraising market and you will quickly understand why most managers pick Switzerland as one of the markets they want to focus on," says Pelka.

"There are no grandfathering provisions – as of 1 March 2015, the shutters come down. Any foreign fund that wants to interact with qualified but unregulated Swiss investors will need to have the representative and paying agent in place. A lot of people are going to get caught out by this. If they market to those investors after the deadline without a representative in place they'll be breaking the law. The Swiss definition of "marketing" includes sending of fact sheets. It remains to be seen if managers decide to stop sending materials altogether."

Khazaneh confirms that Jabre Capital took careful consideration selecting their legal representative. What was important was that they could demonstrate first-class compliance and that the team had a strong legal and auditing background. There was no requirement at all to use the representative for distribution support.

"I wanted to separate that. We have a global distribution company in the Cayman Islands and they work with local distributors worldwide, including regulated distributors in Switzerland. I sought to keep that activity independent of our relationship with the

▶ 11

The key considerations when choosing a legal representative

Interview with Beat Blattner

As of 1 March 2015, it has become mandatory for fund managers distributing their products in Switzerland to commission a Swiss legal representative and paying agent. Regulatory compliance is the name of the game when it comes to the service provided by UBS.

"Our offering is designed to cover the current regulatory requirements, monitor distributors, contract with managers as well as distributors and guide them with respect to changes in the regulatory environment of distribution", says Beat Blattner, Head Representative Services at UBS Global Asset Management. "In addition, we support managers with market intelligence of the Swiss regulatory environment and the Swiss fund industry. We do not, however, raise capital for them as we see a potential conflict of interest with our duties as a representative. In our experience, managers want to have their own distribution team as they know their products best. For the majority of blue-chip managers we work with, regulatory compliance is their primary consideration, followed by confidentiality," says Blattner.

UBS has been in the representative services business for many years and it was thus a natural and logic step to expand its offering to alternative investment funds ("AIFs"). Therefore, the firm made the necessary preparations early and has now a very comprehensive offering in place. The services are offered to managers who already have an existing relationship with UBS. UBS aims to support clients with a one-stop solution and to keep the distribution market open for its clients or their funds from a regulatory compliance perspective.

Beat Blattner, Head Representative Services at UBS Global Asset Management

UBS has been managing its on-boarding over the last 12 months, opening up internal channels to inform managers regarding the changes in regulations ahead of the 1 March 2015 deadline to avoid any potential gaps or compliance issues in their Swiss distribution activities.

"We've been very busy over the last couple of months, providing our clients with a reliable onboarding process and working through the different steps in a structured fashion", says Blattner. The quality of service, providing early communication, getting a structured pipeline in place ahead of the deadline: these have all been important considerations. "The closer we got to the deadline, it was key to be very transparent with regard to our capacity as we do not make compromises in terms of quality. We are glad to say that our pipeline is very good at the moment. Our team is committed to the onboarding process to meet clients' expectations. We are very conservative with our planning to avoid any disappointments."

UBS takes a holistic approach, assessing the complexity of the funds, the quality of the fund manager and its service providers. From there the team goes into detail to identify any potential operational risks because, as Blattner points out, "you need to know exactly whom you are contracting with, especially for the ongoing monitoring component with respect to the requirements on the distribution side according to the Collective Investment Schemes Act "CISA".

One frequent question according to Blattner is about distribution rules. If a manager relies on reverse solicitation, execution-only, discretionary mandates then he doesn't need to appoint a representative. But "for AIFs, the question is not to focus on active versus passive distribution, but

on distribution according to CISA versus private placement, which is qualified as non-distribution," Blattner explains.

Under the so called private placement regime ("non-distribution") without legal regulation, it is possible to rely on exemptions from the term *distribution* and thus from the requirement to appoint a Swiss representative and paying agent. This is possible if the activity is solely addressing regulated financial intermediaries such as banks, securities traders, fund management companies and asset managers of collective investment schemes, as well as central banks and regulated insurance institutions.

Other options under the private placement regime are activities carried out based on unambiguously documented reverse solicitation, a written investment advisory agreement concluded between the placing entity and the investor or a written discretionary investment management agreement.

"When understanding the full context of the regulation, documentation requirements and remaining uncertainties to rely on such exclusions, most of the managers want to avoid doubts on compliance and will rather appoint the representative than try to work through the narrow exclusion scenarios," says Blattner.

When a manager appoints UBS, they are provided with a single point of contact. This keeps the process streamlined and allows the relevant representative services specialist to establish a clearly defined workflow over all on-boarding streams.

"We will coordinate the whole process. We don't want managers to have to deal with a broad range of different contacts." Blattner says that when managers approach UBS, the focus is:

- To clearly understand whether their activities are in scope (for example with respect to qualification of their investors, transition period, classification of closed end funds)
- To give the client an accurate understanding of the level of interaction with the representative (on an ongoing basis) and
- To determine whether we have a bundled offering, including both the representative and the paying agent function.

"Our goal is to help managers work in a proactive, rather than reactive fashion, when distributing their funds in Switzerland. Neither our clients nor we want to make compromises when it comes to regulatory compliance. Before contacting a potential Swiss representative, fund managers should define their Swiss distribution strategy, assess with their internal compliance team whether their products and activities are in scope of the new legislation, which level of support they need and what service quality is expected. Then they should get in touch with a legal representative in Switzerland to review the assessment and define the way forward," concludes Blattner. ■

WHY DO FINANCE IN TICINO?

TICINO
SWISS
TAILOR
MADE
FINANCE

Ticino Swiss tailor made finance

Is the institutional platform created by Ticino for Finance to promote the establishment of high value added financial activities in the Canton of Ticino at your complete disposal to all your questions.

Swiss-made

The stability of the Swiss administrative system as well as the moderate tax burden to promote business firms in the Canton Ticino jurisdiction, guarantee constant economic development and allowed Lugano to become the third financial place within Switzerland and a multicultural city.. on a human scale.

Simple setup

Productive interaction with the canton's authorities and direct negotiations with cantonal government makes it easy to quickly and effectively find ad hoc relocation solutions that simplify any possible critical issues.

The perfect location in the very center of Europe

With its unmistakable touch of Italy and sunny climate, Canton Ticino represents the southernmost area of Switzerland perfectly connected to major European capitals.

Are you interested in moving your business to Ticino or do you need more information?

www.ticinoforfinance.ch
ask@ticinoforfinance.ch
Tel. +41 91 961 65 55

Assessing the evolution of the Swiss funds industry

Interview from Lugano, Switzerland's third financial centre with Gian Luigi Trucco, Swiss Association of Asset Managers

With revised CISA in place and the introduction of the Swiss legal representative, how do you assess the current climate in the Swiss funds industry?
For the different actors, including the smaller ones, the implementation of the new rules and the establishment of a Swiss legal representative, in case of distribution, has turned out to be a relatively easy and fairly tolerable cost. Particularly if compared to heavier burdens and expenses that other rules and accomplishments, both domestic and international, imply for them, at a time of decreasing operational margins.


Gian Luigi Trucco, Swiss Association of Asset Managers (SAAM)

How is the Swiss funds industry likely to evolve under CISA (Collective Investment Scheme Act)?
Switzerland is already one of the most liberal and transparent fund markets in Europe. With the implementation of CISA – evolving the concept of 'qualified investor', simplified prospectus regimes, approval processes and time-to-market rules – this position is further reinforced. It will open new operational opportunities for different actors, including independent asset managers who combine private wealth management with fund management and advisory.

The introduction of limited liability partnership structures and SICAVs in Switzerland, too, is relevant for both traditional and alternative collective investment vehicles. The fund and institutional asset management industries are well integrated in a wealth management sector in which Switzerland still ranks first worldwide with a share of about 28 per cent, followed by the Caribbean and Luxembourg, each with about 15 per cent. This is despite the growing competition of centres such as Panama, Dubai, Hong Kong and Singapore. However, a number of questions of detail remain to be resolved about CISA, as with respect to the detailed documentation which has to be submitted to the supervision authority for its approval procedure.

How important is it that Switzerland is viewed as a level playing field to that of the EU under AIFMD?
It is very important that the European Union recognises the Swiss industry not just in general legal terms but also in providing cross-border access via the expected "European passport" for our products and marketing activities.

Switzerland is home to some 4,998 UHNW individuals according to the latest Research and Markets report. This number is forecast to rise by 24 per cent to 6,847 in 2018. Do managers need to accept the regulatory changes and look at the bigger picture?
We fully accept the new regulations. The UHNW segment is important for both the wealth management and the fund industries and is also a stimulus for the creation of more innovative and custom-tailored vehicles for such demanding clients. In Ticino, we are looking to the new trend of HNW individuals who delocalise from Italy and other countries for different reasons, beyond merely tax considerations.

Will a stronger Swiss franc help or hinder its hedge funds industry?
The impact of the franc's rate of exchange may not be excessive. It should not act as a deterrent to doing business in and from Switzerland. Obviously local operators get most of their income in euros, much less in USD, and the prominent share of their costs, as well as their consolidated accounts, are in Swiss Francs, thus making the operator's returns lower. Nevertheless, in Lugano its proximity to the Italian border and big

centres such as Milan makes hiring EU skilled nationals easier, thus mitigating the high labour costs to some extent.

What would you categorise as the most attractive features of the Swiss funds market?

There are many attractive features in Switzerland. These include: the presence of potential seed capital from private banks, foundations, insurance companies and other financial entities, not to mention the tradition of private banking, trade finance and commodity trading. The funds industry is characterised by multiculturalism, fluency in foreign languages, providing fertile ground for investment professionals. The quality of life is good, as well as the level of public and private services. Also a favourable tax environment helps, despite the gaps between the Cantons and the property tax in place in Switzerland.

Where does Switzerland need to strengthen to continue attracting global alternative managers?

Possible solutions could come from reforming the wealth tax when applied to companies with uncertain and highly variable values, mostly linked to persons, such as hedge funds and their managers. Also the creation of new ways for local managers to access seeding from local pots of money, such as foundations and so on, could help. Particularly for Lugano, it would be great to improve air connections with major centres, especially London.

How do you foresee regulatory changes impacting the three main financial cities of Switzerland – Zurich, Geneva and Lugano?

The most important upcoming regulations are the Italian "voluntary disclosure" for assets held in Switzerland and not fiscally disclosed, and the automatic exchange of information to be implemented by Switzerland in 2018. We think most disclosed funds will stay in Switzerland due to better investment opportunities and growing country risks around Europe.

The three major financial centres, Lugano, Geneva and Zurich, have different features. Lugano is traditionally more devoted to the Italian clientele, whilst the other two have more international financial targets. However, the new rules are going to change the environment dramatically, as the focus shifts from secrecy to the quality of advice, cost-performance ratios and level of services; as well as the creation of new appealing and rewarding vehicles, for both the promotor and the investor. A favourable trend could also be the integration of advice and management for personal and corporate assets.

What are the tax considerations for managers when choosing between these different locations?

There are many factors which may be evaluated in selecting a location, such as environmental, cultural and infrastructure features. A major subject is taxation, but higher taxations in some cities or Cantons are usually balanced by lower operational costs and housing rents. Such is the case for Lugano in relation to Zug and other areas.

How is Ticino for Finance able to help managers that decide upon Lugano as a place to do business?

Ticino for Finance helps in many ways. It lobbies at both the domestic and international level with targeted communication programs and selected events, in order to inform and attract perspective new operators aiming to relocate to Switzerland. Moreover, it fosters contact with public and private institutions in order to facilitate such decisions, via a network of expert professionals. Ticino for Finance takes advantage from the mix of its promoters, namely the Canton, the Municipalities, together with associations and highly representative financial entities.

Finally, what are your expectations for Switzerland's funds industry over the next two years?

Expectations are positive. Much will depend on the attitude of the European Union and how the negotiations play out, particularly in terms of opening the European markets to Swiss managers and granting the "European passport" to our products. Otherwise, it would be necessary to change our business models and look beyond European borders.

Under the most attractive scenario, the industry may enter a new phase of growth, taking advantage of the huge assets that are deposited here. We will then be able to manage those ourselves directly instead of having them managed externally. ■

5 ▶ Swiss representative of our funds," confirms Khazaneh.

By extending the requirement for all funds to appoint the representative, FINMA's aim is simply to regulate fund distribution activities at the point of sale, just as it has done historically with UCITS.

The representative has to ensure that the fund is relevant for distribution under the new rules and has two key roles to play:

Firstly, ongoing compliance and regulatory support. That is, focusing on the monitoring side, making sure the relevant fund information is being distributed and that it adheres to Swiss law. Secondly, to act as the appointed representative to Swiss investors and the point of contact with FINMA.

Costs will obviously vary depending on the fund manager and the number of funds they intend to market into Switzerland. According to Khazaneh, the cost structure being used by Jabre Capital involves a fixed cost for the first fund – which is usually between CHF3-4,000 per annum – and an additional cost for each subsequent fund thereafter, which is less than CHF1,000.

"A number of smaller funds may decide that the cost is not justified and will avoid marketing into Switzerland but at the same time I think legislators might actually welcome that; the trend they like to see in distribution, as well as in asset management, is that the market is composed of larger managers and fund platforms. That may mean some of the smaller platforms and managers exit the market altogether, but it would deepen the quality of managers and ensure the remaining players can afford the higher cost of compliance. It will be interesting to see how this will impact the diversity of products available to investors."

"We would welcome that development," states Khazaneh.

There's no doubt that the introduction of hedge fund registration and regulatory oversight under the revised CISA is a welcome development for Switzerland; indeed, a necessary one given the state of development in Europe and the US under Dodd-Frank and AIFMD.

Whether the representative and paying agent requirement is needed is up for debate.

"FINMA recognised the need to strengthen regulation of the Swiss financial sector to be

considered an equivalent 3rd country under AIFMD. The Swiss representative and paying agent system is used widely in the Swiss long-only space, where the representative submits documents to FINMA and the paying agent handles subscriptions and redemptions.

"For hedge funds, this is not the case. The distributor is usually the fund manager itself, the Swiss legal representative doesn't send fund documents to FINMA or publish information – as the information is confidential and for qualified investors only – and subscriptions and redemptions are handled by the fund's administrator rather than the paying agent," says Pelka.

Khazaneh questions whether the cost and increased burden are necessary considering that hedge funds are intended only for sophisticated professional investors.

"If you look at our investors – HNW individuals, pension funds, family offices, wealth advisers – I think they are adequately protected and are unlikely to request a local paying agent, for example. Regardless, our funds have to incur the cost and offer the service on an annual basis irrespective of whether investors request to use the paying agent or not. When I speak to people offering paying agent services, they don't foresee their services being used by professional investors. I wouldn't be surprised if the requirement is eventually dropped, together with the same requirement in the UCITS Directive," opines Khazaneh.

One firm that is pushing the envelope to help global hedge fund managers distribute their products to Swiss (and indeed global) ▶ 13

Harmonisation with EU standards is crucial

Interview with Leila Khazaneh

“One of the most important considerations for us when choosing the legal representative was that they had a strong compliance structure,” affirms Leila Khazaneh, general counsel at Jabre Capital Partners, one of Switzerland’s most established hedge fund managers.

Khazaneh says that the service provider they settled on was an independent specialist whose team have a legal and auditing background, as opposed to a firm with more of a marketing and fund distribution bias.

“When the new rules were published by FINMA, some companies viewed it as a new commercial opportunity; all funds distributed in Switzerland would have to appoint a Swiss representative and there weren’t many service providers in the market. We were very careful with our selection,” confirms Khazaneh.

Currently, Jabre Capital is at the stage of reviewing the legal documentation so there are no concerns over meeting the 1 March 2015 deadline. “Speaking to some US and UK-based fund managers, this has certainly crept up on them,” notes Khazaneh who, when asked the importance of mitigating reputational risk when appointing the representative, continues:

“If you look at it, the main task of the representative is to help the fund comply with Swiss disclosure obligations and ensure that relevant Swiss legal requirements are incorporated into the fund’s offering documentation and marketing materials.

“As the corollary to that, the Swiss representative has to keep up with the Swiss legal and regulatory obligations of the funds. These are evolving. The representative needs to ensure they have the resources in place to monitor this on an ongoing basis and keep the funds up-to-date. We are very sensitive about the reputation of the JABCAP fund platform. In deciding who to appoint, our priority was to ensure the firm had the requisite skill and resources for the task at hand.”

Leila Khazaneh, general counsel at Jabre Capital Partners

That Switzerland is now proactively introducing a regulatory framework for alternative fund managers is a key development in Khazaneh’s view, noting that with CISA, harmonisation with EU standards is “crucial for the Swiss funds industry”.

Jabre Capital has always embraced best practices. Back in 2007, there was only a “voluntary authorisation regime”, where a manager could choose to opt-in and be regulated by FINMA. This is precisely what Jabre Capital did.

“Getting regulated back in 2009 allowed us to launch the JABCAP UCITS platform and to enter into joint ventures with Swiss banks and other financial institutions. That there is now an obligation under CISA for all Swiss managers to become regulated, we see as a welcome development,” comments Khazaneh.

The need to appoint a Swiss paying agent, however, is less welcome. Hedge fund managers like Jabre Capital wonder whether it is not just an extra cost to the fund, for a service that will rarely, if ever, be used. “All our Swiss-based investors are highly sophisticated”, notes Khazaneh, “with established banking relationships. We don’t foresee them using the paying agent our funds appoint.”

Given the extra costs associated with new levels of regulation, many local managers anticipate that only the bigger firms will survive. Many smaller fund managers are looking to merge or relocate. In Khazaneh’s view, “Swiss legislators are probably quite happy about that. The trend they seem to be encouraging – in distribution as with asset management – is the market evolving towards larger, more sophisticated fund platforms that have the resources to quickly adapt to the new regime.” ■

11 ▶ investors is Fundbase Fund Services: the first FINMA-regulated online platform to offer full representation services for the alternative funds market in Switzerland.

"We are trying to overcome investors missing out on investment opportunities simply because they don't know the manager exists. Swiss pension funds are poorly advised. We are providing that gateway for these investors," says Michael Appenzeller, the founder of Fundbase.

"The longer-term strategy is to do things differently to everyone else: to bring investors forward that are willing to share their ideas and concerns on funds with the investor community we are looking to build on Fundbase. We are talking to Swiss family offices, New York seeding platforms that are willing to bring their manager selections forward. Our aim is to create a community. It's one thing for us to tell investors, "Hey, we've got these great funds". It's quite another if other investors are saying that too."

What Fundbase can offer managers is the ability to appoint Fundbase Fund Services AG as the legal representative as well as use the platform as a way to showcase their funds to potential investors. Within a Swiss context, this could potentially get around some of the confusion of reverse solicitation.

"There's uncertainty among managers as to who they can and can't work with. How would investors find you without breaching the rules? By putting your fund on Fundbase you can overcome this uncertainty," says Appenzeller.

Much the same as LinkedIn, an investor whose interest is piqued by a particular manager on Fundbase can send a connection request. At that point, the manager in question can decide whether they wish to share more fund information or not.

Appenzeller says that the goal is to have between 2,000 and 3,000 funds on Fundbase by the end of Q1 2015.

"We are seeing demand picking up in the hedge fund industry, generally speaking. It starts with the big banks allocating more to discretionary mandates. They have to allocate a lot of capital that they sometimes don't know where to go with it. What we are doing should definitely close the gap and allow people to look at the alternatives asset class more efficiently and more securely."

"Hedge fund managers can easily find institutional investors in Switzerland and send them emails, provided they've got the legal representative in place. We've set Fundbase up for qualified investors, with smart capabilities for managers to actively reach out," concludes Lilian Klose-La Scalea, managing director at Fundbase Fund Services.

The legal representative is a necessary evil for global hedge fund managers. To put things into perspective, Switzerland is home to some 4,998 UHNW individuals according to the latest Research and Markets report. This number is forecast to rise by 24 per cent to 6,847 in 2018.

It might be a nuisance having to comply with yet more regulation, but for managers who are still in active capital raising mode, Switzerland is too lucrative a market to turn their backs on. ■

Alternative beta strategies can enhance HF allocations

Interview with Nicolas Rousselet

Over the last few years the S&P 500 Index has gained approximately 65 per cent, while the Nikkei 225 has gained 113 per cent. The impact of quantitative easing has led to unparalleled growth in equity markets, to such an extent that hedge funds have largely lagged behind.

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

Nicolas Rousselet, Managing Director and Head of Hedge Funds at Unigestion

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

"Back in '05/'06, and indeed in '08, when risk premia contracted, people used excess leverage and low and behold, when funds blew up following the financial crisis investors were disappointed that they behaved like levered funds. Today, they don't behave like levered funds and this too is causing disappointment. So it's quite ironic that even though investors learned their lessons from investing in levered funds the perception of hedge funds is still negative," says Rousselet. "Uncorrelated returns are harder to produce and this makes fees look bigger."

Hedge fund managers are meant to have an edge, based on their unique research capabilities and risk management expertise. Back in the 90s, when financial markets were evolving with the creation of new products like options and other derivatives, talented managers could manufacture an edge and generate massive returns. That's no longer the case today.

"To justify their fees, the manager has to have a demonstrable edge. Today, the proportion of talented managers is small. They are rare, yet they are the ones who deserve the fees," explains Rousselet.

But it is far from doom and gloom. There are ways to deal with the above issues.

Take fees. Firms like Unigestion, whose mission is to uncover talented managers, are making strides in negotiating fees that are more aligned to the investor and which incentivise the manager to perform, not just sit on the management fee and gather assets.

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

Another key development is the emergence of factor investing and alternative beta products, which are helping investors better understand the true talent of a hedge fund manager. Some managers have, in the past, been no more than one-trick ponies, says Rousselet.

"Maybe they were a small-cap Japanese equity investor, shorting the Nikkei 225 and making large returns until the market turned. Point being, these were not uncorrelated returns, it was a completely directional play. They were using a single factor (e.g. market capitalisation); that was the true driver of performance."

With alternative beta strategies, such managers can be more readily identified and help investors build a portfolio of pure hedge funds and more cost-effective alternative beta funds.

"There is a much wider continuum being created and that is a positive development," concludes Rousselet. ■

Focus heavily weighted to US equities markets

Interview with Steven Bulko

Equity markets are close to or at their historic highs. How do you see the big picture for equity investors?

Steven Bulko, CIO, 1798 Fundamental Strategies, Lombard Odier Investment Managers

While developed economies have been recovering since the 2008 – 2009 global recession, the pace of that recovery has been varied. The US economy has improved but growth in Europe and Japan has stagnated, leading to a divergence in monetary policy – the Fed is progressively moving out of its accommodative monetary policy while the ECB and BOJ are embracing new strategies involving Quantitative Easing to provide stimulus.

These differences are reflected in domestic equity markets. Our focus is heavily weighted towards the US markets where Quantitative Easing has helped improve business and consumer confidence, driving stock markets higher with lower levels of volatility. Additionally, as much of the market's growth has come via multiple expansion, we think the opportunity exists for companies to differentiate on the "E" in the P/E ratio. This could lead to opportunities for active managers, but it's our expectation that such opportunities will be accompanied by heightened volatility and lower returns versus what we've experienced in recent years. So opportunity exists, but we need to be mindful of the potential market impact of heightened volatility.

The story is different for Europe and Japan, where economic growth is challenged but central banks have been slower to implement programs to support financial markets and bolster economic activity. Therefore, we expect the equity markets in these regions to be driven more by the macroeconomic environment than companies' fundamentals.

Can you describe the investment approach of your fund?

We launched our flagship hedged strategy in 2007 and it has USD1.2bn AUM as of January 2015. In July of 2014, we launched a fund with a very similar process under a UCITS format.

Our UCITS fund pursues an equity L/S strategy via a multi-portfolio manager approach. We have five portfolio managers specialised by sectors targeting Consumer, Healthcare, Industrials, Energy and TMT (Technology, Media, Telecom). Capital is allocated monthly by the CIO and the Portfolio Managers are responsible for initiating positions and managing their sub-strategy within a defined set of risk limits.

Our teams share a similar investment philosophy, which centres on a bottom up stock picking approach with deep fundamental analysis. The fund is focused on alpha generation within a low net environment, where single name shorting is favoured over portfolio hedging. Additionally, we are not a rapid trading fund looking to monetise small pricing inefficiencies but, rather, focus on longer term performance trends that will play out over several quarters.

What dimension has risk management within the investment process?

The risk management team sits alongside the investment team while our real-time risk system aids our Chief Risk Officer in monitoring limits at the fund and investment strategy levels, as well as keeping portfolio managers informed about their overall positioning and risks.

We view risk management not simply as an oversight function but as a guide toward enhanced portfolio optimisation: advising our investment teams on position selection and portfolio construction, in order to eliminate any significant, unintended risks to their portfolios.

What have the results of the fund been so far in terms of return and volatility?

Performance in 2014 was +2.87% with a volatility of 4.4%. Over the same period, the S&P500 T.R. returned +4.88% with a volatility of 12.4%. The fund was up +1.94% in January vs. the S&P500 T.R. down -3.15% (as of January 15th 2015), demonstrating a strong ability to protect on the downside. Since inception, the fund is up +4.86% versus +1.58% for the S&P500 T.R. ■

Disclaimer:
FOR PROFESSIONAL INVESTOR USE ONLY. This is for information purposes only and does not constitute an offer or a recommendation to purchase or sell any security or service. It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful. This document does not contain personalised recommendations or advice and is not intended to substitute any professional advice on investment in financial products. Before entering into any transaction, an investor should consider carefully the suitability of a transaction to his/her particular circumstances and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences. This document is the property of LOIM and is addressed to its recipient exclusively for their personal use. It may not be reproduced (in whole or in part), transmitted, modified, or used for any other purpose without the prior written permission of LOIM. This document contains the opinions of LOIM, as at the date of issue.

Neither this document nor any copy thereof may be sent, taken into, or distributed in the United States of America, any of its territories or possessions or areas subject to its jurisdiction, or to or for the benefit of a United States Person. For this purpose, the term „United States Person" shall mean any citizen, national or resident of the United States of America, partnership organised or existing in any state, territory or possession of the United States of America, a corporation organised under the laws of the United States or of any state, territory or possession thereof, or any estate or trust that is subject to United States Federal income tax regardless of the source of its income.

If the funds are denominated in a currency other than that in which the majority of the investors assets are held, the investor should be aware that changes in rates of exchange may affect the value of the strategy's underlying assets. The risk management process includes an effort to monitor and manage risk, but does not imply low risk.

The strategy may include the use of derivatives. Derivatives often involve a high degree of financial risk because a relatively small movement in the price of the underlying security or benchmark may result in a disproportionately large movement in the price of the derivative and are not suitable for all investors. No representation regarding the suitability of these instruments and strategies for a particular investor is made.

Issued by Lombard Odier Asset management (Europe) Limited which is authorised and regulated by the Financial Conduct Authority.

Swiss managers' 2015 outlook for hedge fund investments

By James Williams

Overall, last year was a positive year for hedge funds in the sense that assets continued to grow, to the point where the industry reached USD2.8trn in total AuM. However, from a performance perspective it certainly wasn't an easy one.

There are three aspects to explaining this. First, the beginning of 2014 saw quite strong market rotation. There were sector rotations in equity markets in March and April, leading to losses in long/short equity funds to the tune of -0.63 per cent and -0.89 per cent according to Barclayhedge.

Second, on the macro side, fundamental macro traders were positioned in expectation of rate normalisation, in particular in the US, which didn't materialise. And third, a dramatic development in the second half of the year was the collapse in oil prices, which caught many hedge funds off guard.

On the other hand, 2014 did display some improvements that were already present in 2013, notably stock dispersion which was high throughout the year. This proved beneficial to equity market neutral funds, for example, and multi-strategy funds. Trends also re-emerged in 2014.

"If you look at the managed futures space, trend followers were the bright stars of last year. Last year was also good for active managers, especially those trading in an uncorrelated fashion and who benefit from stock dispersion. On the niche side, commodity managers saw their environment improve dramatically. A lot of commodities became totally unrelated to the macro environment. As well as oil, there were strong price movements in grains," comments Alexandre Rampa, co-head of alternative investments at Syz Asset Management.

Stock dispersion is a welcome development for active managers. The divergence of monetary policy around the world will create trends, which long/short equity managers and global macro managers should be able to benefit from. Moreover, in the event-driven space, the fall in oil price is creating opportunities in distressed credit in 2015.

"At Lombard Odier, we construct a diversified equity long/short portfolio with low market directionality, with the aim of delivering attractive absolute returns while mitigating market volatility and lowering downside correlation," comments Steven Bulko, CIO of 1798 Fundamental Strategies at Lombard Odier Investment Managers. "Historically, we have delivered our returns with half the volatility of the US equity market as we manage our portfolio with the objective of protecting assets during market sell-offs."

The fund referred to above is LO Funds – Fundamental Equity Long/Short; a US-focused vehicle that invests in five portfolio managers targeting Consumer, Healthcare, Industrials, Energy and TMT (Technology, Media, Telecom). It launched in 2007 and has since grown to USD1.2bn in AuM through January 2015. A UCITS version of the fund launched last July.

Although improving employment conditions, access to credit, lower oil prices and strong equity markets have boosted consumer confidence, Bulko thinks it is too soon to tell how big an impact these factors will have on consumption.

"The US consumer is exiting a multi-year deleveraging process that we believe has significantly altered their behaviour. Additionally, the dual benefits of an improving wage environment and lower energy costs do not come without risks as wage growth may cut into profit margins at corporations and energy companies are already cutting investment budgets as the outlook for oil and gas weakens.

"Despite the near-term challenges, we still view the US as the best option for equity investors based on the relative strength of the economy, low yield on fixed income

"Traditional markets have performed well over the last five years and investors remain sceptical about the worthiness of investing in hedge funds. I think that's still the broad sentiment among institutional investors."

Pius Fritschi, LGT Capital Partners

securities and the high level of cash on balance sheets, which can be used to buy back stock or invest for future growth," explains Bulko.

With respect to the oil situation, this could present attractive near-term shorting opportunities in weaker E&P companies within the energy sector, says Bulko, as "oil at USD50/barrel calls into question their entire business model. Longer term, this "flushing out" of weaker competitors should present attractive long opportunities over the medium to longer term as we see oil prices recovering.

"Staying with oil, we see the drop as a medium-term tailwind for the consumer and TMT sectors. Our outlook on TMT suggests that growth in the sector will be more consumer than business driven. Semiconductors should continue to benefit as more devices and appliances get connected to the Internet with demand increasing alongside consumer confidence."

Hedge fund managers still have a lot of work to do to convince investors – especially those in Switzerland – of the merits of investing in this asset class. There is, according to Pius Fritschi, Managing Partner at LGT Capital Partners, still limited demand in Europe for hedge funds. "Traditional markets have performed well over the last five years and investors remain sceptical about the worthiness of investing in hedge funds. I think that's still the broad sentiment among institutional investors.

"What still exists, undoubtedly, is the need for investors to find strategies where they can generate uncorrelated returns. That need is not going away. We see a return to CTAs and trend-following strategies, driven last ▸ 23

Shift towards investing in liquid alternatives

Interview with Dr Jan Viebig

Liquid alternatives are one of the fastest growing areas of the asset management industry. In Europe, assets grew from EUR36bn to EUR236bn between 2008 and 2014, according to a Deutsche Bank report released last September (entitled *From Alternatives to Mainstream Part Two*).

By definition, liquid alternatives are dynamic trading strategies that combine the sophisticated, goal-driven strategies of the hedge fund universe with the daily liquidity, transparency and regulatory oversight of mutual funds.

At Harcourt, the alternative investments boutique of Vontobel Asset Management, the Research-Driven Strategies (RDS) team, headed up by Dr Jan Viebig, Head of Alternative Investments, has developed a series of liquid alternative funds. These vehicles are designed to give investors exposure to strategy-specific risk premiums as opposed to traditional risk premiums (e.g. equity risk).

The three Pure Strategy funds are:

- Vontobel Fund – Pure Momentum Strategy
- Vontobel Fund – Pure Dividend Strategy
- Vontobel Fund – Pure Premium Strategy.

"Right now, a lot of people shy away from hedge funds because they are too expensive, they aren't liquid enough or transparent enough. In the US and Europe, these circumstances have resulted in the growth of liquid alternatives as institutional investors no longer find traditional asset classes attractive. Moreover, investors are worried about a rise in volatility which could lead to the erosion of wealth," explains Viebig.

The RDS team analysed over 20 different strategy-specific risk premiums. The three strategies highlighted above were found to yield the most attractive and robust returns in benign market regimes as well as during periods of market stress.

As Viebig notes: "The strategy you follow determines the risk you take on. That is probably the most important point to make about liquid alternatives. They are only a solution for liquid hedge fund strategies that fit well into the UCITS framework."

Dr Jan Viebig, Head of Alternative Investments at Harcourt Investment Consulting

According to back-testing results, if an investor had held an equal one third allocation across all three Pure Strategy funds between 2003 and 2013, they would have enjoyed a 7.20 percent annualised return (net of fees) with a 4.35 percent volatility.

So how would investors use such a liquid alternative fund to complement their existing hedge fund allocations?

"We combine time-series momentum with cross-sectional momentum. The former tries to exploit trends in markets using a quantitative approach, creating a series of signals to determine whether the strategy should go long or short. That is not always effective in short-term choppy markets and requires an additional source of momentum returns. Cross-sectional momentum involves looking at a cross-section or universe of stocks, e.g. the S&P 500, to hone in on stocks that show positive (or negative) momentum.

"By combining these two strategies, over longer periods of time it is possible to create stable returns, even during choppy market conditions," explains Viebig.

Overall, investors are becoming more interested in liquid alternatives.

"For a typical long/short equity fund, they might be paying upwards of 4 percent in fees whereas a liquid alternatives fund will only charge about 1 percent in management fees and a 10 percent performance fee. That's a huge saving," notes Viebig.

"We feel there is a huge secular shift taking place whereby investors are shifting a significant amount of money from traditional asset classes, which are no longer cheap, to dynamic trading strategies that we call liquid alternatives." ■

Hedge funds as zero duration investments

Interview with Michaël Malquarti & Alexandre Rampa

Investors are becoming increasingly aware of the fact that global markets will, at some point, move towards a higher interest rate environment. This will happen at varying speeds depending on the region, with the US and the UK most likely to raise rates before continental Europe for example.

Over the last 30 years the yield on US 10-year Treasuries has declined by around 25 basis points annually. As Michaël Malquarti, co-head of alternative investments at Syz Asset Management points out, not only has this led to a massive boost in bond prices but at the same time equity prices have also rallied. "Cyclically-adjusted PEs in the US have moved from less than 10 to more than 25," says Malquarti.

The asset management industry has enjoyed an unprecedented period of falling yields, delivering healthy returns to investors' traditional bond and equity portfolios but the world is on the brink of a new paradigm; one where rising rates will impact duration-sensitive assets and lead to lower, not higher returns, than investors have historically enjoyed.

"Without wanting to sound too dramatic, over a longer horizon the performance of a balanced portfolio, not only in nominal terms but also in real terms, is likely to be lower than what we have gotten used to.

"We are not saying that rates will necessarily be higher at the end of 2015. At best, rates will stay where they are now, oscillating between 1 and 3 per cent. So you buy a 10-year bond, the rate goes up to 2.5% or 3% and then falls back to 1.5%; on average, you don't benefit from the movement in rates at all," explains Malquarti.

It's the same for equities. If the rates stay where they are now, it will require earnings growth to support higher equity prices or else P/E ratios will keep climbing to unsustainable levels.

Michaël Malquarti, co-head of alternative investments at Syz Asset Management

Alexandre Rampa, co-head of alternative investments at Syz Asset Management

"The whole asset management industry has to realise that we are coming to the end of a generation where bonds and equities enjoyed boosted returns. In that context, getting between 4 and 6 per cent by investing in hedge funds is becoming increasingly attractive," adds Alexandre Rampa, co-head of alternative investments at Syz Asset Management.

In this new paradigm, hedge funds, given that they are not a distinct asset class and aim to generate short-term alpha – thus making them in effect zero duration investments – are likely to become more important to investors' portfolios.

"Even if managers have a one-year outlook, that's still very short-term when it comes to duration. That means you are exposed to a different return stream. What made them unattractive to some investors in the last few years when equity markets doubled, will, for the same reason, make them more attractive going forward," says Rampa.

Moving forward, the best investors can hope for is that rates stay where they are. Even if that were to happen, bond and equity markets would not enjoy the boost in prices seen historically.

"Hedge funds will likely attract more capital as a result. Structurally, we are seeing a move towards passive investments so in a way the level of competition for hedge funds has decreased; the passive investment industry (e.g. ETFs) has grown significantly, and prop desk and bank trading activity has significantly decreased. This benefits active managers," concludes Malquarti. ■

19 year by a decrease in correlation between asset classes. I believe we'll see more demand for CTAs in 2015," says Fritschi.

LGT Partners currently invests in approximately 70 to 80 hedge funds, with CTAs and global macro managers featuring strongly.

"The collapsing oil price and currency movements are offering good trading opportunities. Global macro players should be able to profit in this environment. We are more neutral on long/short equities. Stock pickers should add value, we just don't believe the environment is completely favourable right now," adds Fritschi. "In addition, we see investment opportunities for illiquid credit, especially buying loan portfolios from European banks."

Any hedge fund investor wants to see an environment where multiple themes are developing, offering the opportunity to capture multiple uncorrelated return streams in the portfolio. This is the case today: in the US and Europe there is a clear divergence in monetary policy, with the ECB having finally bitten the bullet and introduced an asset purchasing programme worth USD1.3trn a full six years after the Fed introduced its own QQ programme. The same paper printing exercise is taking place in Japan as the US and the UK prepare – at some point – to introduce a rate hike. Factor in geopolitical tensions in Ukraine, and a large degree of differentiation within Emerging Markets as a result of lower oil prices and the opportunity set for hedge funds looks encouraging.

"We are more optimistic about investing in hedge funds in 2015 than we have been for the last few years for these very reasons," emphasises Rampa.

"As an investment, hedge funds make a lot of sense right now. A lot of markets are "toppish". It's difficult to call the end of the rally but equally it's difficult to see the US markets get much higher than they are now. The environment is moving away from one of holding long, in the wake of liquidity injections, to one where it will favour stock pickers and thematic allocators."

At Unigestion they've been expanding their cross-asset selection team over recent months to strengthen their expertise in bonds, FX, commodities to be in the best position to support clients in this evolving market environment.

Identifying bona fide hedge fund talent is one of the core activities at Unigestion and is spearheaded by Nicolas Rousselet, Managing Director and Head of Hedge Funds. Too many managers take huge directional bets, employ leverage, and consider themselves hedge funds, when in reality they aren't.

Take the recent decision on 15 January 2015 by the Swiss National Bank to unpeg the Swiss franc against the euro. The previous day one euro was worth 1.2 Swiss francs; 24 hours later, at one point, it was worth just 0.85 francs. The chaos that ensued hit some hedge funds hard but as Rousselet comments:

"None of our managers are losing money, despite what we've seen with the SNB and the appreciation of the Swiss franc. I'm satisfied on a relative basis that our hedge fund managers are doing well but I'm unhappy because the EUR/CHF is not a trade that managers should have got involved in. There were 5 basis points of monthly gains by holding this position before the carnage of mid-January. It was a classic case of picking up dimes in front of a steamroller."

For hedge funds to remain attractive, and indeed boost their PR image, something has to be done about the fee structure. The debate rages on, it's nothing new. But there needs to be more consistency within the industry. The fee structure should, unequivocally, reflect the level of returns a manager is generating.

Years ago, the management fee was merely pocket money. What mattered most 28

Swiss Representation done right

For Alternative Investment Funds

Contact Mont-Fort Funds AG:
Email: clientservice@montfortfunds.com
T. +41 22 508 15 47

The six steps to funds distribution in Switzerland

Interview with Roman Pelka

"This is not another AIFMD regulation. It is much simpler, much cheaper and fairly easy to implement," states Roman Pelka, founder of Montfort Funds, a specialist provider of Swiss fund representation services, when discussing the need to appoint a legal representative.

"The transition period provided to foreign funds to get compliant will end on the 1st of March. Thereafter there will be no way around it, except reverse solicitation but this is not really a viable option for most."

The role of the representative is first to review the fund to ensure it is fit for distribution to qualified investors and second to supervise the fund's distributor to ensure it complies with the new Swiss requirements. "This is critical" Pelka says. "We need to be confident that our clients have the appropriate procedures and controls in place to do things properly."

A fund marketed to qualified investors in Switzerland is not required to register with FINMA. There are no reporting requirements to FINMA and managers can continue to operate their own marketing teams just as they did previously, as long as they are authorised to carry out distribution activities in their home market.

The first stage of getting compliant is to understand the Swiss rules. "We are spending a lot of time educating the industry" emphasises Gabriel Kurland, Montfort's COO. In a second step, a formal service proposal is drawn up which outlines the service, the onboarding process and the terms. "Montfort proposes an all-inclusive package at a flat annual fee without hidden costs," stresses Kurland. Upon agreement, the third step – onboarding due diligence – begins, which Pelka says typically takes two to three days. "The quality of managers we

Roman Pelka, founder of Montfort Funds

represent is important to us so we take due diligence seriously," says Pelka.

"This is where we feel we have an edge as we do the work in-house. We don't send a due diligence questionnaire to clients, we simply request them to send their fund documentation and carry our own review, following a proprietary template specifically designed for that purpose. Each fund gets a score, based on our rating process. "We want to build a winning stable of managers rather than an industrial scale operation," adds Pelka.

"The next step is to execute the legal agreements. This is typically the critical path item in the onboarding process. Some managers receive the agreements and sign them within a week. Others might take a several weeks for an initial review. "We have seen the big international law firms in London and New York moving up the learning curve very quickly – good advisors help speed up the process.

"We also organise the appointment of a paying agent for our clients. "We largely handle the setup of the paying agent relationship for our clients and have a range of paying agent partners who will rely on our due diligence," says Pelka.

The last step is the review of the fund documentation to ensure the appropriate references and Swiss disclaimers are included.

"We are specialists in this field and are fortunate to count some of the world's largest alternative asset managers as our clients. Fund Representation is a simple job but it needs to be done well. Our aim is to guide clients through the process in a minimal amount of time whilst ensuring high standards of compliance," concludes Pelka. ■

First regulated alternative and HF platform

Interview with Michael Appenzeller & Lilian Klose-La Scalea

An innovative new platform has emerged in Pfaffikon, Switzerland that could potentially revolutionise the way investors gain access to global hedge fund managers. The platform is called Fundbase and is the brainchild of Michael Appenzeller, its co-founder and president.

"Qualified investors will have to look for alternative investments in an unprecedented investment environment. Today they very poorly advised. We are providing a gateway for these investors. With Fundbase, we feel we are at the forefront of keeping the Swiss market open for global hedge funds," comments Appenzeller.

Fundbase Fund Services AG is the first FINMA regulated online platform to offer full representation services for the alternative funds market in Switzerland.

"Offering the legal representative service is just one element. We have built the technology for Fundbase to help managers increase their exposure, legally, and connect with Swiss investors; it's about making investors and managers' lives easier," says Appenzeller.

The aim is to have between 2-3,000 managers listed on the platform by the end of Q1. Some will, of course, choose to use the Swiss legal representative function. There is no cost to any manager who then chooses to list their fund on the platform. From Q2 2015 onwards, Fundbase will enable investors to use a plethora of investment tools to search for, and connect with, managers they find interesting.

Fundbase offers a range of functionality for investors, managers, and advisors. Take, for example, the "Investment Channel". Each channel can be branded according to the individual manager. A proprietary algorithm sits in the background, and what this does this is effectively compare a manager's portfolio of followers to all other investors on the platform before recommending it to the right set of investors.

Michael Appenzeller, co-founder and president of Fundbase Fund Services

Lilian Klose-La Scalea is managing director at Fundbase Fund Services

"It's a business development algorithm. It only costs USD500 per month and guarantees to the manager a certain number of new investor visitors. The platform is live but we are still building a lot of tools and features such as investment management tools, an investor network/community and so on," confirms Appenzeller.

There are only a small number of specialists providing the Swiss legal representative service to hedge funds. What Appenzeller has done with Fundbase, however, is identify a compelling opportunity to enhance the distribution component for global hedge funds. In that respect, it is a unique philosophy being offered to the market.

"We get asked a lot of questions by managers – How does it work? What are the contractual arrangements? If you're not a specialist, the representative onboarding process for the manager can be cumbersome. We are in the process of doing due diligence on dozens of managers right now so the pipeline is starting to build," states Appenzeller.

Lilian Klose-La Scalea is managing director at Fundbase Fund Services and views the changing regulatory environment in Switzerland as a positive.

"There's a huge demand for fund distribution. What differentiates us from the competition is our network – other organisations cover the legal aspect but they don't necessarily have a direct network of investors. We, on the other hand, have a network of qualified investors that we serve all day long. Once we understand their needs, we can connect them with managers quite easily."

"In this regard, we think the platform will prove to be very successful going forward," concludes Klose-La Scalea. ■

23 ▶ to managers was earning the 20 per cent performance fee. Today, some managers have grown so huge that they earn a fortune from the management fee alone. These "asset gatherers", it could be argued, do not have the same hunger and motivation to generate performance fees as a young start-up with sub-USD100m in assets.

"In theory, hedge funds should use a 0/20 fee structure. In reality, the zero management fee is a business issue for managers. They need to cover the costs of running the fund, but this fee should not be taken in addition to the performance fee. What we recommend, and have had some success in doing, is a fee structure that rewards managers when they do well, and doesn't reward them when they don't do well.

"Say a manager aims to deliver 15 per cent (20 per cent gross) – so five per cent for him, 15 per cent for his investors. Fine, they deserve to get paid five per cent if they generate those returns, which is effectively a 0/25 per cent fee structure. The manager will receive even more incentive fees if they return more than 20 per cent gross. To resolve running business costs, let's then give them an advance of 1 per cent in exchange of a hurdle rate of 4 per cent (25 per cent of 4 per cent). At least this puts the manager in closer alignment with the investors, which is the original point of hedge funds," explains Rousselet.

Another critical development, which is also putting hedge funds increasingly under the microscope, is the rise of liquid alternatives; UCITS-compliant hedge fund-like strategies that aim to replicate offshore flagship funds whilst offering enhanced liquidity, transparency, and lower fees.

"In the wake of increasing regulatory pressure and considerable demand for alternative sources of returns, the industry has developed liquid, transparent and cost-efficient strategies in a UCITS format that offer investors the possibility to access diversified sources of return, which in the past were only available via traditional hedge funds," comments Dr. Jan Viebig, Head of Alternative Investments at Vontobel Asset Management.

Harcourt currently offers three such funds, developed by its Research-Driven Strategies, along with a fourth absolute return fund – Vontobel Fund – Absolute Return Bond – which is designed to deliver performance in all weather conditions; in stable, inflationary as well as deflationary scenarios.

The three Pure Strategy funds, Vontobel Fund – Pure Momentum Strategy/Pure Dividend Strategy/Pure Premium Strategy, have been designed to benefit investors for the next decade or more says Viebig.

"Liquid Alternatives could be an excellent addition to a balanced portfolio due to their low correlation with traditional asset classes such as equities and bonds. They offer significant diversification benefits and the potential for steady returns in various market environments. Each of our three Pure Strategies offers a different risk/return profile. By combining them in a portfolio, one can create super stable return profiles over time; and that's what we recommend to our clients," confirms Viebig.

Coming back to the cost issue of hedge funds, Fritschi notes that Swiss investors are very focused on the TER of hedge funds and are searching for alternative solutions:

"For example, factor-based and rules-based strategies (alternative beta funds), that seek to filter out some of the risks of value trades, momentum trades, yield trades. They are more simplistic, rules-based strategies that seek to emulate hedge funds.

"We have seen significant inflows over the last 12 months, but not exclusively into hedge funds; more into multi-alternative solutions where we are trying to add alternative content to clients' portfolios: private debt, private equity and real estate, insurance-linked strategies combined with hedge funds. Investors are searching for different risk factors today."

Viebig believes that investors who diversified not only across different asset classes but also incorporate liquid alternatives in their portfolios, will be well prepared when equity markets, after a sharp increase in recent years, correct and interest rates, sooner or later, rise again.

"With the aim to minimise losses and stabilise portfolios especially in adverse market phases, investors increasingly see Liquid Alternatives as an opportunity to power their portfolios. This is a trend that will definitely intensify in the near future," concludes Viebig. ■