CHALLENGES
Updates to the guidelines provide food for thought for managers

COMPETITION
The AIFMD’s debut brings new options in onshore fund structures

FUTURE VARIANTS
Divisive plans for Ucits V and VI directives making steady progress
Leading the market for Irish funds.

Maples and Calder is the independently recognised market leader in the establishment of new funds in Ireland and has been the fastest-growing Irish funds practice over the past five years*.

We do more new Irish funds work than any other law firm in Ireland. This gives us real expertise in innovative product development, particularly in the areas of UCITS and AIFMD, whether related to mutual funds, hedge funds, real estate, private equity or managed account platform structuring.

Maples’ sustained growth has coincided with one of the most significant periods of global financial services reform where our lawyers’ extensive deal expertise in new fund launches, and access to our global network of offices, has delivered proven solutions for our clients.

* Source: Monterey Insight Ireland Fund Survey 2012.

For expert legal advice, please contact:

**Barry McGrath**  
Partner, Head of Investment Funds  
barry.mcgrath@maplesandcalder.com

**Peter Stapleton**  
Partner, Investment Funds  
peter.stapleton@maplesandcalder.com

**Paul Dobbyn**  
Partner, Investment Funds  
paul.dobbyn@maplesandcalder.com

**Stephen Carty**  
Partner, Investment Funds  
stephen.carty@maplesandcalder.com

**Carol Widger**  
Partner, Investment Funds  
carol.widger@maplesandcalder.com

**Adam Donoghue**  
Head of Irish Investment Funds desk  
Cayman Islands Office  
adam.donoghue@maplesandcalder.com
It has been another successful year for UCits, with inflows into the pan-EU initiative rising just above €200bn for 2012 and steady progress made with the Directive’s fifth and sixth iterations.

However, as various regulations rain down over the hedge fund industry, it has not necessarily been an easy ride for UCits fund managers. New Esma guidelines on the legislation, along with ETFs, released this year outlined important regulations which have challenged the way funds deploy their strategies.

Meanwhile, competition has been sparked by the enforcement of the AIFMD in July 2013, providing an alternative fund structure minus the UCits restrictions. Some observers have suggested fund managers may steer away from UCits towards the AIFs. However, talk of a ‘two brand’ system has also emerged, with expectations currently that both fund types will co-exist, catering for largely separate markets. The debate, of course, will rumble on.

UCits V, and even VI, are on the horizon. Attempts to align UCits and AIFMD requirements to create a harmonised framework for fund managers’ pay rules and strengthen investor protection will provide plenty of food for thought. Anticipated restrictions and constraints by the new iterations have, again, caused concern that alternative managers will be left with little room for manoeuvre.

So what is in store for the future of UCits? HFMWeek has gathered a number of industry professionals to discuss what lies ahead in this, the HFMWeek UCits Report 2013.

Karolina Kaminska
REPORT EDITOR

CONTENTS

04 LEGAL
WHAT NEXT FOR ALTERNATIVE UCITS?
Stephen Carty and Aoife Kemp of Maples and Calder consider the outlook for alternative UCits and assess the feasibility of the newly introduced retail investor alternative investment fund as another option for investors

07 UCITS PLATFORM
SCHRODER GAIA SIRIOS US EQUITY
John Brennan of Schroder GAIA Sirios US Equity and Andrew Dreaneen of Schroder GAIA discuss the launch of their new equity long/short strategy

11 CORPORATE SERVICES
CAN A LEOPARD CHANGE ITS SPOTS?
Dr Andrew Zammit and Dr Kurt Hyzler of CSB Group explore the shift from UCits to AIFs

13 LEGAL
PASSPORT INVALID: ENTRY DENIED
Dr David Borg-Carbott and Dr Christopher Mallia, of GANAD, discuss the future arrival of UCits V and the implications of passportsing depositary functions
WHAT NEXT FOR ALTERNATIVE UCITS?

STEPHEN CARTY AND AOIFE KEMP OF MAPLES AND CALDER CONSIDER THE OUTLOOK FOR ALTERNATIVE UCITS AND ASSESS THE FEASIBILITY OF THE NEWLY INTRODUCED RETAIL INVESTOR ALTERNATIVE INVESTMENT FUND AS ANOTHER OPTION FOR INVESTORS

The past 12 months have marked a welcome period of respite for managers of UCs that were fast becoming exasperated at the avalanche of regulatory changes in recent years. The main reason for this has been the long awaited arrival of the AIFMD – an entirely new area of pan-European regulation that has been keeping the European regulatory machine extremely busy. As a result, UCs essentially got bumped in priority in terms of new regulation – something which UC managers see as not a bad thing.

On the commercial side, it has been another extremely successful year for UCs and Irish UCs in particular. UCs pan-EU inflows were just above €200bn for 2012. The Irish UC market had an extremely strong 2012 (and first-half 2013) – both in net terms and relative to the pan-EU market. As at June 2013, there were 5,413 Irish domiciled funds, including sub-funds, with assets in excess of €1.3tn, the majority of which are authorised as UCs.

REGULATORY IMPACT

While it has been relatively calm, it has not been complete plain sailing for UCs from a regulatory perspective.

The first important regulation this year for UCs was the ESMA guidelines on ETFs and other UCITS issues (ESMA/2012/832EN) (the Guidelines). The Guidelines set out new regulatory requirements that apply to UCs in respect of a range of areas including index tracking funds, exchange traded funds, the use of efficient portfolio management techniques, the use of total return swaps and similar derivatives, collateral management and financial indices. They also reflect the consolidation of guidelines on repurchase and reverse repurchase of UCs issued by ESMA on 4 December 2012. Subject to certain conditions, existing UCs have until 18 February 2014 to ensure compliance with the Guidelines.

While the impact of the Guidelines has been relatively benign in some respects, there are some areas that have been significantly impacted. For example, in the case of index tracking funds, the Guidelines present significant challenges to certain index providers, most particularly regarding rebalancing frequency and methodology and composition disclosure. Certain index strategies will no longer be operable, while others may need to adapt and develop new solutions in order to comply with the Guidelines. Similarly, UCs will need to come to terms with the specific prospectus and accounts disclosure requirements in connection with securities lending arrangements, particularly regarding related parties, where relevant, while revenue sharing arrangements may need to be adapted to ensure that all “revenue” net of direct and indirect operational costs goes to the UCs.

In addition, UCs V and, more particularly, UCs VI are coming down the tracks.

“WHILE THE IMPACT OF THE GUIDELINES HAS BEEN RELATIVELY BENIGN IN SOME RESPECTS, THERE ARE SOME AREAS THAT HAVE BEEN SIGNIFICANTLY IMPACTED”

UCITS V

UCs V marks a further revision to the UCs regime and follows quickly in the footsteps of UCs IV. Notably, however, UCs IV was initiated prior to the 2008 financial crisis – an event that became a significant political driver in European financial services regulation.

UCs V covers three key elements, namely: the depositary role (eligibility criteria, liability, delegation and oversight functions relating to cash), manager remuneration and regulatory sanctions. The purpose of UCs V is to align these elements broadly with the corresponding elements now in effect under the AIFMD. While the general perception is that the AIFMD and UCs V (once finalised) will produce a consistent, harmonised framework in the area of pay rules for managers of alternative investment funds (AIF) and UCs, for example, there are subtle but significant differences between the remuneration rules in the AIFMD and the latest proposed rules in UCs V. This remains the case despite the fact that a proposal, introduced at an earlier stage of the UCs V process, to cap fund manager bonuses to 100% of fixed salary, was recently rejected.

UCITS VI

Arguably more significant is UCs VI which is being presented by the European Commission as an opportunity to assess the UCs product framework and ostensibly operate as an enhancement.
On 26 July 2012, the European Commission published a consultation paper entitled “Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-Term Investments” (the Consultation Paper). The Consultation Paper marked the start of a process for further Ucits regime changes that could take up to two years to come into effect and forms the basis of Ucits VI.

Ucits VI is aimed at strengthening investor protection and harmonising regulatory practice. However, it is feared by market participants and industry bodies alike that its introduction will spell bad news for managers running certain alternative strategies in Ucits.

A welcome aspect of this initiative is that the European Commission has framed this first phase of Ucits VI in the form of an industry consultation. However, while many market participants would welcome the extension of eligible assets to include commodities, real estate, loans and other types of instruments to provide more choice and better diversification to retail investors, reading between the lines (and based on strategic press pieces being released from European sources) the perception is that increased regulation and further investment constraint will be at the forefront of the proposals. Anticipated changes in terms of (i) restrictions on eligible assets; (ii) use of leverage; and (iii) constraint on derivatives usage, for example, may force alternative Ucits fund managers to rethink their strategies and could push certain strategies further towards AIFMD products.

RIAIF

In terms of AIFMD opportunities, one area of interest that could dovetail nicely and present a compelling alternative to Ucits (post Ucits IV) is the Irish retail investor alternative investment fund (RIAIF). This is the replacement product to the Irish non-Ucits retail fund (NURF), enhanced and re-structured.

The RIAIF is designed to be a balance between the Ucits and qualifying investor alternative investment fund (QIAIF) regimes, for products intended for retail investors but which cannot fully meet the onerous investment restrictions, leverage limits and diversification requirements of the Ucits framework. A RIAIF may be suitable, for example, in circumstances where a particular asset class or strategy cannot be accommodated within a Ucits structure.

A RIAIF may be marketed to retail investors (although this would be on an EU Member State by EU Member State basis, rather than via a marketing passport). It is not subject to any minimum subscription requirements. The trade-off is that the Central Bank imposes certain investment restrictions and diversification requirements, including a maximum 20% of net assets to be invested in unlisted securities in aggregate or in the securities of any one issuer or in unregulated funds (an increase from the previous limit of 10% under the NURF regime); a maximum of 30% of net assets to be invested in any one open-ended fund (an increase from the previous limit of 20% under the NURF regime); and a borrowing limit of 25% of its net assets. Similar to a Ucits, a RIAIF needs to disclose, in its prospectus documentation, the quantitative parameters on the extent of leverage which will be engaged in and is required to calculate its global exposure by using either the commitment method or the value-at-risk (VaR) methodology.

A number of strategies can be accommodated within the RIAIF that cannot be carried out in a Ucits structure. For example, a RIAIF may invest in physical gold, unregulated funds, real estate and China A securities (subject to appropriate disclosure requirements and investment conditions).

There is also greater flexibility in terms of dealing requirements. For example, a RIAIF which is open-ended must provide at least one dealing day per month (as opposed to at least one dealing day per fortnight for a Ucits) and ensure that the maximum interval between submission of a redemption request and payment of settlement proceeds does not exceed 30 calendar days (14 calendar days in the case of a Ucits).

The RIAIF represents a product that can be sold to retail investors as containing many of the key investor protections of a Ucits, but in a much more flexible product structure. Going forward, it is not unrealistic to venture that investors may be increasingly open to an allocation to the RIAIF rather than a Ucits, in particular, when one considers the wave of regulatory change on the horizon impacting the Ucits regime.

Fund custody is a core business for Sparkasse Bank Malta plc. Our experience and knowledge enables us to be nimble and flexible, allowing us to offer practical, workable solutions to our customers. By choosing not to provide other related fund services such as Fund Administration or Management, we avoid all potential conflicts of interest and focus entirely on what it is we do best – safekeeping, record keeping, monitoring and reporting.

We acknowledge the responsibilities and obligations bestowed upon us as custodians – for this reason, we are committed to making the necessary investment in IT, Human Resources and ongoing training in Legislation, Regulation and Compliance. Only in this manner can we guarantee a high and robust standard of service to our customer.

Tel: +356 2133 5705 • Fax: +356 2133 5710 • info@sparkasse-bank-malta.com • www.sparkasse-bank-malta.com

Sparkasse Bank Malta plc
101 Townsquare,
Ix-Xatt Ta’ Qui-Si-Sana,
Sliema, SLM 3112 – Malta

Sparkasse Bank Malta plc is authorised to conduct Banking business
and to conduct Investment Services business by the Malta Financial Services Authority (MFSA).

Part of the Austrian Savings Banks - Banking since 1872
SCHRODER GAIA SIRIOS US EQUITY

JOHN BRENNAN OF SCHRODER GAIA SIRIOS US EQUITY AND ANDREW DREANEEN OF SCHRODER GAIA DISCUSS THE LAUNCH OF THEIR NEW EQUITY LONG/SHORT STRATEGY

S

chroders has teamed up with Sirios Capital Management to launch a US equity long/short strategy. HFMWeek speaks with John Brennan, fund manager of Schroder GAIA Sirios US Equity and Andrew Dreaneen, head of Schroder GAIA product & business development, to find out more about the investment strategy and proposition to clients.

HFMWeek (HFM): Why has Schroders launched a US equity long/short fund?
Andrew Dreaneen (AD): This decision was driven by demand from our existing client base. We, together with many of our clients, felt this was an underrepresented asset class in the alternative Ucits space. We believe now is a great time to invest in a US equity long/short strategy. After an extended period of high correlation and minimal stock dispersion following the 2008 crisis, the environment is beginning to change. Lower stock correlation and more stock-price dispersion tied to company-specific fundamental trends began to develop in the fourth quarter of 2011 and have carried on through 2012 to 2013. As company-specific fundamentals are now on a very different path, depending on the geography and sector, this presents a great opportunity for US stock pickers like Sirios.

HFM: Why did Schroders select Sirios as the investment manager?
AD: Schroders is very selective of who we are prepared to partner with, ultimately we are seeking to find the best managers for each strategy on the Schroder GAIA platform. Sirios was selected as our preferred investment manager based on a number of criteria including their reputation, experience, integrity and consistent risk-adjusted track record over a long period of time with proven downside protection which can be seen in Figures 1 and 2.

HFM: Can you tell us about Sirios and the team behind the fund?
John Brennan (JB): Sirios was founded in July 1999 and is based in Boston, Massachusetts. We currently have two investment strategies: a US-oriented long/short fund and a concentrated long-only fund. The team comprises of 19 employees including ten investment professionals who have an average of 13 years’ investment experience. Research is divided into five broad sectors: consumer, energy/industrials, financials, healthcare and technology/telecoms. Each of our research analysts is a specialist in their individual field. We do not use a generalist model nor rotate analysts from one sector to another. In addition, we cover three broad geographies: US, Europe and Asia.

HFM: What is your investment philosophy?
JB: Our investment philosophy is to identify companies with significant long-term earnings-growth potential and to buy them when we believe the long-term prospects are not reflected in the current valuation. We put growth first and use valuation as a secondary filter. Through our sector-focused research we aim to identify the impact of changing dynamics on each company and select the best combination of growth and valuation. We size our long positions according to the level of long-term earnings upside (relative to consensus) and our degree of confidence in our expectations. Agents of change that we tend to focus on are new products or markets, changes in pricing trends, changes in organic volume growth, acquisition-driven economics, cost reduction initiatives, restructuring opportunities, and changes in management incentives.

HFM: What is the fund’s investment universe?
JB: The fund will invest primarily in very liquid securities with a market capitalisation in excess of $1bn and will focus on the US, although there will be some exposure to Europe and Asia. Our exposure to the US is typically greater than 75% and has averaged 85% since inception. While our focus is typically equities, given our expertise in capital structure, we will opportunistically only have exposure to fixed income as well. This exposure is most likely to occur during, or post, periods of market stress, such as 2002 and 2008. During these periods, our fixed income exposure increased as we found equity-like upside with better downside protection. For example, in 2009 we increased fixed income exposure to 25%.

HFM: How do you generate ideas?
JB: New ideas are generated on a company-by-company, bottom-up basis. Each sector has a well-defined universe of mid to large cap companies, and we constantly review our long-term earnings expectations with consensus. Those with the greatest positive variance are potential long ideas. Next, we review valuation to assess which ideas present the best risk-adjusted upside. All ideas are written-up and extensively modelled before purchase. These documents are electronically filed in our research database for future reference and periodic updates.

Our short selection process follows the same fundamental approach as we utilise on the long side: company-
by-company analysis where we focus on identifying the largest variances in expected fundamental deterioration relative to consensus. We also pay special attention to vulnerable balance sheets where high leverage could lead to potential bankruptcy or significant share dilution.

**HFM:** How do you construct your portfolio?

**JB:** The portfolio will be structured to have a net exposure typically in the range of 25% to 75%, with a long-term average expected to be around 50%. Gross exposure will be limited to 200%. We will generally be balanced across the five broad sectors with a larger exposure typically in two to three sectors at any given time. High-conviction long positions are generally 5% to 7% and the top ten long positions typically account for 45%-55%. Typically, we will hold 40 to 60 long positions. All positions will be selected on a company-by-company, bottom-up, fundamental basis. We are investment driven and as a result core long holdings are typically held for between three to five years. The short side of the fund is likely to comprise between 20% and 50% of net assets on a gross basis, which typically equates to between 50 to 70 positions. Shorts are typically (0.5%) to (1%) weightings, and company-specific, common equity shorts, are limited to 2% at market. Shorts are typically held for less than a year.

**HFM:** How do you manage risk in the fund?

**JB:** Risk is managed on four levels. First, financial risk is limited by our total gross exposure, which is limited to 200%. Next, market risk is limited by controls around the fund’s net exposure. Our flagship long/short fund has averaged 47% since inception. Third, we limit sector exposure on any one of the five broad sectors to 35% gross long and/or 35% gross short. This results in a balanced portfolio on both the long and short side and mitigates the risk of sector mismatch across the long/short exposure. Lastly, we limit company-specific common equity longs to 9% and shorts to 2% at market. The result of our risk management has been to mitigate risk beyond the company-specific factors we are focused on. This has resulted in virtually all of our return since inception, for our flagship long/short fund, being alpha generation while our beta risk has been kept to a low level (0.22).

**HFM:** What is your current outlook for US equities?

**JB:** We expect a continued moderate economic recovery led by a gradual improvement in housing and a renaissance in manufacturing to provide a positive economic backdrop for the US equity market over the next several years. The recent increase in long-term interest rates, given uncertainty surrounding the Federal Reserves System’s (Fed’s) exit from quantitative easing, has likely run its course with the ten year Treasury approaching a 3% interest rate. Further increases in long-term interest rates are less likely unless either inflation begins to accelerate or the Fed begins to increase short-term interest rates significantly, which we believe are both unlikely in the near-term. Given a positive economic backdrop and equity valuations that are extremely attractive relative to fixed-income alternatives, the market is underpinned by solid fundamentals and the potential for a significant asset reallocation toward equities.

**AD:** Schroder GAIA Sirios US Equity is a compelling offering within the UCits space:

- The fund launched on 27 February 2013 and is based on a very successful hedge fund with a proven track record since 1999;
- The Sirios investment team is led by veteran stock picker and portfolio manager John Brennan who has more than 28 years’ investment experience;
- The fund stands out amongst the peer group especially in terms of delivering equity type returns with lower volatility and less downside participation than the market;
- The fund is available exclusively on the leading Schroder GAIA UCits platform with a strong focus on manager selection, due diligence, risk oversight and client service.

**FIGURE 1: SIRIOS US EQUITY LONG/SHORT STRATEGY* VS. S&P 500 TR**

RESULT: SIGNIFICANT ALPHA SINCE INCEPTION

**FIGURE 2: DOWNSIDE PROTECTION**

RESULT: SIRIOS RETURNS IN 10 WORST MONTHS FOR S&P 500 SINCE INCEPTION

**SOURCE:** Schroders and Schroder GAIA as at 31 July 2013

*From July 1999 to February 2013 the Sirios offshore fund is used, from March 2013 onwards Schroder GAIA Sirios US Equity C ACC USD is used.*

**TABLE:**

<table>
<thead>
<tr>
<th>Period</th>
<th>S&amp;P 500</th>
<th>Sirios</th>
<th>Net Exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q-08</td>
<td>-16.79%</td>
<td>-5.41%</td>
<td>-8%</td>
</tr>
<tr>
<td>S-02</td>
<td>-10.87%</td>
<td>2.70%</td>
<td>9%</td>
</tr>
<tr>
<td>F-09</td>
<td>-10.65%</td>
<td>-2.59%</td>
<td>20%</td>
</tr>
<tr>
<td>F-01</td>
<td>-9.12%</td>
<td>1.00%</td>
<td>52%</td>
</tr>
<tr>
<td>S-08</td>
<td>-8.91%</td>
<td>-4.82%</td>
<td>31%</td>
</tr>
<tr>
<td>J-08</td>
<td>-8.43%</td>
<td>3.13%</td>
<td>9%</td>
</tr>
<tr>
<td>J-09</td>
<td>-8.08%</td>
<td>6.34%</td>
<td>44%</td>
</tr>
<tr>
<td>S-01</td>
<td>-7.99%</td>
<td>0.02%</td>
<td>32%</td>
</tr>
<tr>
<td>M-10</td>
<td>-7.83%</td>
<td>-4.15%</td>
<td>49%</td>
</tr>
<tr>
<td>N-00</td>
<td>-7.68%</td>
<td>-0.06%</td>
<td>27%</td>
</tr>
<tr>
<td>Cumulative</td>
<td>-97.15%</td>
<td>-3.44%</td>
<td>27%</td>
</tr>
</tbody>
</table>

**SOURCE:** Sirios as at 31 July 2013
WE’RE IN THIS TOGETHER
YOUR TEAM AND OURS

We pursue a philosophy which emphasises both study and pro-activity. We seek to identify trends in the international commercial and financial markets leading to opportunities for Malta once translated into tangible form. It is no surprise that we have been consistently at the forefront of local legislative initiatives and have provoked on several occasions over the years major legislative change in many fields, not least in maritime, ship finance, banking, aviation, trusts and investment services.

For more information on how we can help please contact us on:
171 & 176, OLD BAKERY STREET,
VALLETTA VLT 1455, MALTA
T. (+356) 2123 5406 F. (+356) 2122 5908
E. lawfirm@ganadoadvocates.com
www.ganadoadvocates.com
Orchestrating alternative investment strategies

Schroder GAIA gives you the opportunity to access a suite of leading hedge fund strategies, within a UCITS regulated structure.

The funds available for investment on the Schroder GAIA platform have been rigorously judged to be best in class by our highly experienced team of alternative investment specialists:

Schroder GAIA CQS Credit
Schroder GAIA Global Macro Bond
Schroder GAIA Sirios US Equity

Accessibility, liquidity, risk control, diversification and regulatory oversight are all part of the score.

The leading players are in place, so let the performance begin.

For professional investors or advisers only. Past performance is not a reliable indicator of future results, prices of shares and the income from them may fall as well as rise and investors may not get back the amount originally invested. Issued in September 2013 by Schroder Investment Management Limited, 31 Gresham Street, London EC2V 7QA. Registered number 1893220 England. Authorised and regulated by the Financial Conduct Authority. w44193
The European UCITS brand is a seal of quality recognised in financial centres the world over, spanning from Asia to the Americas. The widespread appeal of UCITS-compliant funds exists notwithstanding the significant additional compliance burden that is pinned onto UCITS-compliant managers. This is a success story that began in 1985 and has undergone three subsequent and significant amendments, with another one, possibly two, in the regulatory pipeline.

Each amending directive brought more flavour to the initial and somewhat restrictive UCITS framework. What initially started off as a framework for retail collective investment schemes pursuing plain-vanilla equity and bond strategies gradually evolved into a platform for the development of investment strategies that are more akin to those sought by hedge funds. The Product Directive (Directive 2001/108/EC of 21 January 2002) broadened the scope of “eligible assets” to include Financial Derivative Instruments, resulting in a corresponding widening of appeal to managers looking for more flexible investment parameters.

The UCITS brand continues to attract the interest of hedge fund managers who are eager to avail themselves of pan-European passporting and international recognition as a serious, solid vehicle affording high levels of investor protection which, in turn, attracts investors from across the world. Investors’ recognition in markets such as the Middle East, Asia and Latin America of the high level of investor protection afforded by the EU’s UCITS funds has gone a long way towards establishing this form of regulated retail fund as a staple offering by many managers.

The accommodating of hedge fund type strategies within the UCITS framework led to variants referred to as “Newcits”, “sophisticated UCITS”, and “complex UCITS”. UCITS IV has preserved this state of affairs and it is expected that this flexibility will not be materially affected by UCITS V.

However, with the current raging debate within the EU...
in respect of the appropriateness of selling complex investment strategies to retail investors, the European Commission has published a consultation on UCITS VI in July 2012 which, among other things, seeks to evaluate the appropriateness of retail funds adopting complex or highly sophisticated investment strategies.

This consultation process has been received by the industry with a mixed sensation of curiosity and consternation, primarily due to the fact that UCITS V hasn’t even rolled off the regulatory production line in Brussels. In any case, UCITS VI may mark the start of a process of change for the long-standing UCITS regime policymakers may seek to curtail the extent to which hedge fund strategies can be wrapped in UCITS packaging. If the AIFMD timelines are anything to go by, it may be anything between two and four years until the final cut of UCITS VI sees the light of day.

But does this mean that hedge fund managers would be denied from having access to the EU market and benefitting from the advantages of the UCITS brand distribution network?

Enter the AIFMD, the EU directive which has yet to win the favour of fund managers across the European continent and beyond, and which provides a pan-European market to fund managers having alternative strategies, underpinned by tighter monitoring of such managers’ risk management procedures.

The AIFMD is essentially a service-related directive, targeting the operations of investment managers. But it also indirectly has elements of a product-related directive to the extent that the rules imposed on the manager directly affect the structuring and operation of AIFs, the funds managed by AIFMD-compliant managers, or AIFMs.

This directive has created a dual regulatory regime in Europe for the management and marketing of investment funds, namely the UCITS funds on one hand and all other investment funds (referred to as “alternative investment funds” or “AIFs”) on the other. “AIF” is the new “non-UCITS” and is certain to become the vehicle of choice for all managers seeking a quality fund structure without UCITS restrictions. Hedge funds, private equity funds, real estate funds and venture capital funds, to name a few, would all fall within the scope of the AIFMD.

Against this backdrop, it is expected and logical that UCITS VI will push complex investment strategies towards the AIFMD fund framework, while on the demand side, non-retail investors seeking a combination of exciting investment strategies within structures affording high levels of investor protection within will find themselves suitably accommodated by AIFs. The investor’s peace of mind rests in the fact that AIFMs will be subject to various levels of disclosure to the relevant EU regulatory authorities, adding a much-desired level of transparency and oversight both on a micro level (the manager’s internal systems) and a macro level (ensuring the avoidance of build-up of systemic risk).

It is noteworthy that managers are permitted to operate as UCITS managers and AIF managers contemporaneously, giving managers the ability to reorganise their various strategies within the appropriate vehicles while retaining the pan-European distribution channels – UCITS for retail investors and AIFs for professional investors.

In light of these considerations, the development of the AIFMD as a regulatory framework for alternative investment fund managers represents a positive move for investors and will also prove valuable to managers in providing an attractive alternative to UCITS funds which were always intended to be retail in nature. The UCITS leopard will not change its spots – but it could certainly lose a few to AIF structures.

Dr Kurt Hyzler
Advocate
Advocates. Throughout the years he has been involved mainly in corporate law, privatisations, banking and financial services law.

“THE UCITS LEOPARD WILL NOT CHANGE ITS SPOTS – BUT IT COULD CERTAINLY LOSE A FEW TO AIF STRUCTURES”
UCITS 2013

LEGAL

PASSPORT INVALID: ENTRY DENIED

DR. DAVID BORG-CARBOTT AND DR. CHRISTOPHER MALLIA, OF GANADO, DISCUSS THE FUTURE ARRIVAL OF UCITS V AND THE IMPLICATIONS OF PASSPORTING DEPOSITARY FUNCTIONS

Dr. David Borg-Carbott
is a senior associate within GANADO Advocates’ investment services and funds team with particular focus on safekeeping of assets and fund custody.

Dr. Christopher Mallia
is an advocate practising with the investment services and funds team at GANADO Advocates.

UCITS V aims to align the UCITS brand with the AIFMD rules and to further bolster the regulatory architecture for investors in mutuals, seeking to push the UCITS wrapper within Europe and capitalise on realised successes in Latin American and Asian markets.

Its proposed remuneration restrictions, set to cap bonuses for fund staff and cajoling them into getting their skin in the game, have sparked much interest. Perhaps eclipsed by the AIFMD’s depositary rules and liability implications generally, UCITS V’s provisions for depositaries did not garner the same level of attention.

Instead of focusing on what UCITS V does provide for, we would rather shed some light on one area where the Commission has persistently fallen short – allowing the passporting of depositary functions across the single market.

Currently, UCITS depositaries cannot avail from a European passport. The UCITS Directive prescribes that depositaries shall either have their registered office or be established in the UCITS’s home member state.

Undoubtedly, the passporting of depositary functions carries potential implications for myriad stakeholders and necessitates prudent and careful assessment. The Consultation Document of July 2012 on product rules, liquidity management, depositary, money market funds, and long-term investments (UCITS VI) expressly raised the issue, indicating willingness to acknowledge the implications of a cross-border passport for depository functions set out in the UCITS Directive for different stakeholders.

Industry players have long debated whether UCITS should be limited to using depositaries located in the same jurisdiction as the fund. Opponents have raised familiar arguments. From necessitating elevated levels of co-operation and co-ordination between competent authorities, to concerns about the viability of further extending ESMA’s oversight functions.

Talk of systemic risk and exacerbated contagion risk have also featured, but the fact that no EU fund has received state support over the course of the financial crises over the last five years makes these assertions sound hollow. Concerns on elevated costs – due to the need to report to a plurality of competent authorities depending on the nature and extent of passported activities – are admittedly not without merit.

These ‘issues’, however, should not impede the inevita-
PROMOTING THE FREEDOM OF MOVEMENT OF MARKET PLAYERS CANNOT BUT FOSTER A MORE COMPETITIVE MARKET, AND IMPORTANTLY, HAMMER A NAIL INTO THE COFFIN OF AN INCREASINGLY OUTDATED REQUIREMENT OF A “JURISDICTIONAL” ANCHOR
HAVE YOUR CAKE AND EAT IT.

Otherwise there is no point in baking.

The proof of the pudding is in the eating—ask any of our clients. When we start a job, we get it done from start to finish, providing all the ingredients to cover your business needs. Through our wide spectrum of specialised legal and commercial services we guarantee a complete turnkey solution for setting up or relocating your business to Malta. We aim high and exceed our clients’ service expectations through a sound, results-oriented approach.

After all, our objective is to help you have your cake. Your satisfaction just puts the cherry onto it.

SMARter BUSINESS STARTS HERE®

Corporate & Trust | Advisory | Legal | Tax | Accounting
Recruitment & HR | Credit Risk | Relocation & Real Estate
Merrill Lynch Investment Solutions
Your access to liquid, transparent alternative UCITS funds.
For further information visit www.invest.baml.com/funds or email investfunds@baml.com

For Professional investors only. This information is for discussion purposes and neither the information nor any opinions expressed constitutes a solicitation by us for the purchase or sale of any securities or other financial instruments. The value of funds on the platform can go down as well as up and you may get back less than you originally invested. For further details on the funds, including additional risks, please refer to the KIID documents and the prospectus, both of which are available from www.invest.baml.com/funds. Merrill Lynch International is Authorised and Regulated by the Financial Services Authority.