HOW TO START A HEDGE FUND IN THE EU 2011

DOMICILE SELECTION
The key factors managers should take into consideration

INVESTOR CONFIDENCE
How to attract and retain the right kind of investor

REGULATION
How the AIFMD will affect the European hedge fund space

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Although the alternative investments space is now showing strong signs of recovery, investor confidence is still shaken, and the demand for more regulated funds continues to grow.

With this shift in investor perceptions in mind, the EU is set to introduce its Alternative Investment Fund Managers (AIFM) Directive across the eurozone, allowing for increased transparency and regulatory rigour. Although the new requirements will impose additional stresses on start-up funds in particular, the high-value institutional and private investors they attract present an irresistible opportunity for fund managers looking to grow to the next level.

Beyond the restrictions of AIFM, increasing numbers of hedge fund managers will look to take advantage of the opportunities afforded by Ucits, a unique breed of fund structure which provides a guarantee of quality for uneasy investors. This HFMWeek special report examines the key challenges and benefits of complying with the AIFM Directive and moving into the Ucits space.

For start-up managers operating or looking to operate in the EU, these developments will mean deciding upon a domicile, the right fund structure and making the best staff hires.

Domiciling or re-domiciling to the EU will allow managers to ride a wave of buoyant investor confidence, but in order to target the right type of investor managers need to choose a jurisdiction that best suits their needs. This complex task involves considering a number of factors including tax, the regulatory framework, service infrastructure, workforce and proximity to investors. Structuring a fund in such a fashion that it can deliver sustained growth is no mean feat and, as we shall see, hiring the right staff and speaking to the service providers who can provide the level of support you need, can make all the difference.

Complying with the AIFM Directive’s stipulations and moving into Ucits will undoubtedly involve additional time and financial resources, but for those who do so, the increased demand from investors and the potential for open passporting rights across the eurozone could pay dividends in the year ahead.

Elizabeth Goodwin
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A QUESTION OF DOMICILE

Peter Astleford and Gus Black of Dechert discuss fund domiciles and the alternative investment fund managers directive

Given the diversity of needs and wants among global investors, structuring a fund is often an exercise in the art of compromise. Fund domicile is a key part of the equation.

The soon to be implemented Alternative Investment Fund Managers Directive (the Directive) brings the question of domicile into sharp focus by drawing a clear distinction, for the purposes of the new regulatory regime, between funds established outside the EU and those established within it. In this article we consider some of the issues that this gives rise to in the context of fund structuring.

INVESTOR PREFERENCE IS KEY
The Directive aside, some investors will require or prefer EU domiciled and regulated fund structures; just as others will prefer offshore, less regulated structures. Whether based on solid reasoning or unfounded perceptions, such preferences must be the starting point. So the first step in the domicile decision is to think hard about the target investors and their preferences, independent of any regulatory concerns.

THE REGULATORY OVERLAY
At present, each EU member state has its own approach to regulating private fund placements, resulting in a patchwork of different marketing restrictions. This creates a compliance headache but, barring a handful of problem jurisdictions that require special attention, in general it is possible to bring alternative investment opportunities to sophisticated European investors wherever the fund happens to be based.

HOW DOES THE DIRECTIVE CHANGE THE ANALYSIS?
The Directive will change alternative fund distribution in the EU as follows:

• Upon implementation of the Directive (which is expected to occur in 2013), EU domiciled alternative investment funds will benefit from a pan-European marketing ‘passport’ (similar to that which exists for Ucits at present).

• Two years following implementation (so, 2015 at the earliest), Esma (the newly created European Securities and Markets Authority) may opine on whether or not to extend the passport to non-EU domiciled funds. If the opinion is positive and following the required implementing legislation, non-EU funds will get their own passport. This delayed introduction was a political compromise: certain member states wanted to prevent the offshore fund passport altogether. Access to the passport will be dependent on the satisfaction of a number of pre-conditions on the part of the non-EU domicile, as well as Directive compliance.

• Three years after the introduction of the non-EU fund passport (so, 2018 at the earliest), Esma will be invited to opine on the termination of the private placement regimes. If it does so, and again following the requisite implementing legislation, such regimes will be terminated.

• Up to this point, Member States are permitted to retain private placement regimes for alternative funds. This does not necessarily mean that all such regimes will remain in force either at all or in their present form until that time.

• The Directive restricts active marketing, not investment in funds. Thankfully, the protectionist clauses, which would have restricted passive sales of non-EU funds (for example in response to an unsolicited request by a prospective investor), were negotiated out of the final text.

THE DIRECTIVE’S STRUCTURAL IMPACT
Aside from marketing considerations, the extent to which the Directive’s provisions must be complied with, and the impact these will have on the fund manager’s economics and day-to-day operations, is a somewhat complex jigsaw. In some cases the analysis will change.
depending on whether the funds concerned are EU-domiciled or not. Accordingly, the impact of Directive compliance on the fund manager (in short: is the Directive something that can be ‘lived with’, or is it a bigger problem?) is relevant to the domicile discussion.

Among the major areas of impact are:

- **Depository** – A new depositary regime will fundamentally change the prime brokerage / custody model for hedge funds. The extent to which costs will increase as a result remains to be seen.

- **Remuneration** – The Directive may restrict (subject to as yet undefined proportionality thresholds), among other things, the proportion of managers’ fixed and variable compensation; impose mandatory deferral periods; and require certain disclosures. The impact of the requirements on non-EU managers selling into the EU may be an issue.

- **Risk management** – Managers must separate their risk management function from portfolio management and other operating functions. Smaller managers in particular may need to reorganise.

- **Disclosures and transparency** – Managers will be required to make or procure increased disclosures to investors and regulators.

- **Capital requirements and leverage** – Managers will need to satisfy minimum capital requirements (of between €125,000 and €10m, depending on assets under management).

- **Leverage** – Reporting requirements will apply. The use of leverage by funds may, in certain circumstances, be restricted.

For many, particularly larger managers and international groups, the practical application of some of these issues will turn to a degree on which entity is the ‘AIFM’ (alternative investment fund manager) for the purposes of the new regime. There are a number of structural possibilities here. For example, could the fund itself be the AIFM and the European or other investment manager simply remain subject to its existing regulatory regime (for example MiFID in the UK) or?

WHERE DOES THAT LEAVE US?
Both onshore and offshore structures have their pros and cons, and the right solution for one manager will not necessarily be right for another. Determining the right domicile for a fund launch requires an objective look at the relevant factors (of which the Directive is but one).

Rumours of the death of the offshore funds industry have certainly been greatly exaggerated. Offshore fund launch figures for early 2011 look buoyant and offshore jurisdictions still have much to recommend them. Cost advantages; speed to market; flexibility; tried and tested structures; and zero-tax guarantees are among the reasons that jurisdictions such as the Cayman Islands have become familiar to, and favoured by, many sophisticated investors and managers – and these advantages still stand. Furthermore, there may even be certain structural or operational advantages in the context of the Directive (for example relaxation of the depositary requirements).

That said, interest in EU-domiciled hedge funds is steadily increasing. An EU domicile is already a firm requirement in certain quarters. An EU-domiciled fund, whether established alone or in tandem with an offshore fund, merits serious consideration by hedge fund managers looking to raise capital from certain EU investors, particularly in continental Europe. Furthermore, as the volume of alternative funds in EU domiciles increases, it becomes easier and faster to reproduce offshore functionality efficiently – and in some cases, depending on the strategy of the fund, perhaps with extra advantages or tax efficiencies. There are various advantages and disadvantages among the principal EU jurisdictions: look for an adviser who can offer an objective view.

CONCLUSION
There are no pat answers to the domicile question. A number of factors need to be weighed in the balance, first in terms of ‘EU’ versus ‘non-EU’ and then among the different competing jurisdictions. An open mind is generally the best starting point: if you need to broker a compromise, it helps to start from neutral.
WELCOMING REGULATORY CHANGES

PAUL NUNAN OF CAPITA FINANCIAL DISCUSSES HOW REGULATORY CHANGES AND RISING COSTS WILL LEAD TO A CLOSER RELATIONSHIP BETWEEN EU FUND MANAGERS AND ADMINISTRATORS IN THE YEAR AHEAD

Drawn in by a growing investor demand for well-regulated funds, Europe’s solid regulatory framework is set to attract growing numbers of redomiciliations in the year ahead. Investor perception is paramount, and a move towards transparency and disclosure will no doubt pay dividends. However, fund managers who ignore the costs involved in complying with the new, more stringent regulation do so at their peril. As Paul Nunan from Capita Financial explains, the biggest and most costly mistake can be choosing the wrong fund administrator.

HFMWeek (HFM): What are the main risks to which funds looking to start up in Europe are exposed, and what strategies can be employed to manage them?

Paul Nunan (PN): Part of the attraction of setting up in Europe, and one of the main reasons for the significant increase in the number of managers setting up or re-domiciling their funds to Europe, is the strong regulatory framework that persists in each European jurisdiction. The domicile of the fund and the regulatory framework in place in those domiciles has become increasingly important to the funds underlying investors when deciding where to invest their money. Consequently, fund managers need to understand what impact these increased regulatory requirements will have on both them and their fund. Gaining an understanding of the regulations in place and also appointing service providers with a proven track record will ultimately help mitigate the increased regulatory workload. It is worthwhile for the investment manager to understand that although there is an increase in regulation, this has typically not proven too onerous on either the fund or the fund manager.

An understanding of the initial and ongoing running costs for the fund is obviously important and an investment manager should spend some time ensuring that the running costs do not significantly affect the funds performance. Appointing service providers with proven track records in running European funds who can also be cost effective is important.

HFM: What are the common pitfalls involved in setting up small and large hedge funds in the EU?

PN: Irrespective of size, it is important that the underlying strategy of the fund matches the proposed regulatory structure. Many European jurisdictions have different fund structures. Some structures allow for greater flexibility but will typically have a larger investment minimum than more regulated funds such as UCits. Therefore the strategy of the fund needs to be matched to the actual underlying fund framework that exists within the relevant jurisdiction as well as matching the requirement of the targeted investor base. There has been at least one notable case where the investment manager was not able to replicate the performance of their non-European fund. For most jurisdictions in Europe the flexibility is however available to give investment managers the ability to match what they may have done outside of Europe previously in terms of fund structures and strategies.

HFM: How can fund managers best respond and adapt to regulatory changes?

PN: Firstly, it is important to consider not just the challenges that these new regulations are bringing to the fund space but also the opportunities they will create. Investment managers need to understand how the changes are likely to affect their existing funds and whether the
changes will have implications for their existing or future investors. The changes may lead to opportunities to increase the targeted investor base or lead to increased efficiencies for the fund. Secondly, it is key that the fund’s service providers (the legal adviser, the administrator and the depository) also understand how the regulatory changes are likely to impact the fund. Furthermore, the investment manager should ensure that those service providers can demonstrate that they have a programme in place in relation to the upcoming changes.

**HFM:** What key factors should a fund manager look for in a fund administrator? What should he avoid?

**PN:** There are a number of aspects that should be considered when choosing who you want to administer your fund. Firstly, a proven track record in servicing regulated European funds is essential. In addition, the administrator should be able to demonstrate that they service similar funds with other clients and can demonstrate a high level of service by being able to refer the investment manager to existing clients that they are currently servicing. Secondly, the investment manager should ensure that the administrator has the appropriate systems in place to maintain the books and records of the funds and generate any regulatory reporting that is required. Where managers have funds in several domiciles, including non-European domiciles, it may be beneficial to appoint an administrator that can service all the clients’ funds irrespective of the domicile. Thirdly, a sensible cost structure is obviously important. Increased regulatory requirements can add to cost but most administrators should still be able to offer a cost structure that benefits the fund, both in the initial start-up stages and on an ongoing basis. Finally, more and more investors are looking at the strength and track record of the fund’s underlying service providers. Large institutional investors in particular now see visits to the funds administrator as a core part of their due diligence process. Administrators who do not have any relevant experience in the domicile, and who are not used to dealing with regulators and regulatory requirements, should be avoided.

**HFM:** How important is finding the right fund administrator when it comes to re-domiciliation?

**PN:** Dealing with service providers that have exposure and experience in re-domiciliation can significantly aid the process. The last thing that any investment manager wants is for the process to be held up due to inexperienced service providers. Investment managers should look for administrators, custodians and law firms that can demonstrate they have this experience and that they have carried out migrations from other domiciles and large transfers from other administrators before deciding to appoint that administrator.

**HFM:** How do you believe the relationship between fund managers and fund administrators will develop in 2011?

**PN:** I believe that across the industry there will be a greater emphasis on partnership, not just between investment manager and administrator but also with the other service providers to the fund. The changes in regulation coming forward over the next couple of years will offer both challenges and opportunities for the administrator and the funds they service. Understanding the changes and the impacts of those changes will be crucial for fund managers in the next couple of years. I think the ability to work together to actually affect those changes or take advantage of other opportunities that arise in those changes is going to be very important.

It is worthwhile to highlight that European funds have been around for many years and the process of setting up and running a fund in Europe has certainly been well embedded. It is also notable that the service providers have effectively been running these funds for a long time. The increased regulatory requirements in running a European fund are viewed by many investors as a positive, and as investment managers continue to search for capital this needs to be understood. As a result, I do not think investment managers need to be scared of starting up funds in Europe. In conjunction with their service providers, it is certainly a very manageable structure and something that investment managers should actively consider as part of their fund range.
Even small funds deserve affordable, institutional middle & back office solutions

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PHILLIP CHAPPLE OF KB ASSOCIATES TAKES A CLOSER LOOK AT THE CHALLENGE OF SETTING UP A HEDGE FUND INFRASTRUCTURE, AND THE KEY REQUIREMENTS INVESTORS LOOK FOR

Once the decision has been made to take the plunge and set up your own hedge fund, the world you enter can be an extremely confusing place. The sheer variety of options available coupled with the wealth of different views and advice from different service providers, can create the feel of a Moroccan market bazaar.

The challenge of building a hedge fund infrastructure, while simultaneously managing potential investors, is not for the faint-hearted.

Investor demands have grown exponentially over the last few years, with memories of both the collapse of Lehman Bros and Bernard Madoff’s empire still fresh in people’s minds. It is hard to think of a single area of hedge fund infrastructure which has not faced increased scrutiny, forcing an ‘institutionalisation’ of the industry.

It is a common misconception that start-up managers do not need to worry about many of these developments as they are not initially ‘targeting institutional investors’. The reality is that nearly all hedge fund investors have raised their due diligence standards, taking the lead from the institutional investors.

The heart of the task is to match your fund and manager infrastructure with the needs of your target investor base. This can be difficult as the majority of hedge fund investors will not provide advice or feedback on their requirements. When managers reach the end of an investor due diligence process they often receive a standard rejection along the lines of: “We really like your fund, but it is not quite right for our strategy at the moment so we will keep you under review.” The truth can be anything from the complete due diligence failure with multiple ‘red flags’.

Many established funds have difficulty in meeting investors’ due diligence requirements. Satisfying these demands can seem almost impossible or, at best, very expensive for a start-up manager when looking at the variety of solutions available for problems you are not even sure you have.

There are two key requirements that all potential investors are looking for in any hedge fund:

a) A well defined alpha proposition: how the fund will generate a return on investment.

b) The correct identification, quantification and, where possible, mitigation of all potential risks. Another common phrase used is that ‘avoidable operational risks are avoided’. Investors are looking to take risk on the investment strategy, not on the manager or infrastructure of the fund.

Investors must feel assured that the manager understands all of the risk points in the strategy and operational infrastructure, and that the appropriate measures are in place for these risks. This requirement does not necessarily entail a complex and expensive risk system for a start-up manager; for many strategies, clear and demonstrable procedures can provide sufficient comfort for investors on many of the risks, if combined with a plan to migrate to a more ‘institutional’ product at a future point.

Another common misconception is that there is one defined path to investor comfort. Fund infrastructure will vary depending on the strategy, size, potential investor base and manager. A provider with a recognisable name is not always sufficient to ensure investor comfort; different providers have different models and product expertise and, in many cases, investors will have carried out their own analysis of this.

Extensive research and communication with a wide variety of potential investors is key to gaining a clear understanding of exactly what such investors require. Larger, established funds have developed relationships with their investors to ensure they are continually meeting growing requirements. It is extremely important to try and build constructive open relationships with your investor base, keep them well informed and check they
Setting up a hedge fund can appear to be a daunting journey but can be extremely rewarding.

The good and the bad

The bad news for a start-up manager is that the barriers to entry have grown over the last few years (as demonstrated above) and that due to a high level of competition for investors, there are no guarantees of large inflows, even with the right infrastructure and performance.

The good news is that for the first time in several years, there appears to be a new flow of investment money into the start-up hedge fund arena. The main source of funds is new money flowing to the hedge fund market from institutional investors, increasing their allocations to alternative investments. This inflow is combined with the desire of these investors to gain exposure to the alpha propositions offered by the smaller and mid-sized funds. Their view is that such funds can possibly generate higher returns by being able to trade more stealthily than their larger counterparts.

Such investors will usually have to use some form of investment conduit, such as a hedge fund of fund, consultant or seeding platform, to gain exposure to smaller funds. It is important to ensure a fund meets the requirements of investors of this type to benefit from these inflows.

If a fund has a strong alpha proposition (or a negative correlation to other major strategies), there is the possibility of raising capital through this route. The starting place for most start-up funds is the ‘friends and family’ route or, if lucky, a seed investor. Beware that although due diligence standards for friends and family may appear lower, the infrastructure must be able to meet the needs of more sophisticated investors in the future. Many managers have found that corners cut at launch come back to haunt them further down the track.

The industry has changed aggressively in the past few years and, by indications, will continue to change. The best advice is for managers to stay connected with fund investors, service providers, colleagues at other managers and the hedge fund media to ensure they are up to date with the latest industry trends and that they stay in compliance with increasing investor requirements. This will put a manager in the best position to both retain existing investors and gain new investment.

Setting up a hedge fund can appear to be a daunting journey but can be extremely rewarding. Many have successfully trodden this path and been well compensated, both financially and in the satisfaction of owning and growing their own business. My advice is to ensure you have a defined alpha proposition for potential investors, then to maximise your chances of success by seeking advice and being open to suggestions.
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COVERING ALL BASES

DELOITTE PROVIDES HFMWEEK WITH UNIQUE INSIGHT INTO THREE KEY ISSUES FACING EU HEDGE FUND MANAGERS: REGULATION, TAX AND VALUATION

REGULATION: HOW MANAGERS AND FIRMS CAN PREPARE FOR LEVEL II OF THE AIFMD

ALTHOUGH LEVEL II IS likely to be implemented in mid 2013, the European Security and Marketing Authority (Esma) is still in the process of writing the finer details of its advice to the Commission. The debate is very much still open, and in this piece I will discuss firstly what managers can do in order to best position themselves, and secondly what action firms can take now, before the finer details are ironed out.

Managers across Europe should ensure that they stay up-to-date with the process. This really is a European directive and all the main players are involved in writing the law. Four Esma task forces have been set up: the UK FSA is chairing the group on transparency and risk and liquidity management; the German BaFin are chairing the organisational requirements group, which includes valuation; the French AMP are chairing the depositary group, and the Irish are chairing the fourth group which relates to the scope of the AIFMD and other matters. These task forces will be writing up the specifics of Level II, and with this Directive the devil really is in the detail. Esma will consult on the advice it is giving the Commission in April/May this year, and so firms should earmark time around that period to respond to the consultation, or arrange for trade associations to respond on their behalf. The key point to stress is that action must be taken now, managers across Europe need to find out exactly who is holding the pen on Level II within their jurisdiction and get involved now, before the ink dries.

Although a lot of the actions that firms will need to take will not come to light until the details are decided upon, preparations should begin now. Firms need to engage with the boards of their funds, and renegotiate roles and responsibilities. The provisions in the Directive do not say ‘the board/fund must’ but ‘the manager must ensure/appoint/provide/’ or ‘the manager is responsible for’. This shift in responsibilities will prove to be particularly challenging for firms in which boards and administrators where historically responsible for valuation. The Directive represents a departure from existing practices in that under it the manager is responsible for the valuation of the fund assets, and the calculation and publication of the NAV. Managers need to open the dialogue with their directors now; there is no need for them to wait for the detail to be finalised. Beginning the preparations now will stand them in excellent stead when the Directive’s finer details are finalised, and it comes into full force.

TAX: THE IMPACT OF FIN 48 AND SECURITIES ON THE INVESTMENT INDUSTRY

TAX HAS BEEN AN issue which has steadily moved up fund board’s agendas over recent years, and has come to shape the structures adopted by funds. One of the main reasons for this is due to the introduction of the accounting interpretation Fin 48, which applies not only to US GAAP funds, but also to IFRS funds who should consider the issues from a corporate governance perspective. This is particularly relevant given the current industry-wide awareness of tax risk at the fund level.

Although significant work has been done by funds in the first year of implementation of Fin 48, not all have adopted the best practice approach of creating controls and processes which continually monitor potential WHT and CGT issues on investments. Although it would make processes more manageable, such monitoring would involve significant initial outlay costs, and would require more sophisticated investment decisions, particularly since tax laws in most jurisdictions change on a regular basis.

Alternative solutions include incorporating an onshore fund vehicle within the current Master/Feeder structure. If set up correctly, this would provide access to double tax treaties in investee countries and, at a small tax cost, mitigate WHT and CGT on investments. Deloitte has a wealth of experience in assisting clients with monitoring of WHT and CGT on investments, and have been doing so even before Fin 48’s introduction. As well as assisting clients to implement controls and processes to monitor tax issues at the fund level, we also work with fund clients to assess whether it is beneficial for them to adopt onshore fund structures.

Today’s institutional and funds-of-funds investors are highly discerning, and request significantly more disclosure from funds as part of the due diligence process, including details of the processes funds undergo to mitigate any potential tax liabilities. Investors should also be aware of other tax risks such as residence of funds, permanent establishment issues and developments such as Fatca. Here at Deloitte we pride ourselves on engendering investor confidence, and aim to provide the transparency and reliability that new tax regulations require, and investors demand.
Andrew Robinson

is a Corporate Finance advisory partner at Deloitte. He leads the specialist Valuation Group and advises and provides expert evidence on all aspects of valuing businesses, funds, securities, and intangible assets both in the UK and internationally.

**Valuation: The Question of ‘Difficult-to-Value’ Assets**

Valuation can be a particularly difficult science to master, but in a turbulent market in which investors are looking for increasingly frequent and higher-quality valuations, providing reliable data has come to be a key differentiator for Deloitte.

Certain funds are more difficult to value than others. Valuations for UCITS funds, for example, which look at daily pricing, often feature anomalies. Looking at the markets on a global level, data fed into trading exchanges can be problematic as positions are not necessarily traded every day, and corporate actions can lead to mispricing. Although we do not specialise in UCITS funds, and focus on bespoke funds, we have become specialists in providing valuations of ‘difficult-to-value’ assets. Increasing numbers of hedge funds are branching out into these assets, which include pseudo or semi equity type positions, or semi-infrastructure type positions including holdings in a particular type of instrument or security, such as: equity, mezzanine debt, and senior debt. These assets will not necessarily be traded on a regular basis, and are notoriously difficult to value. However, Deloitte has positioned itself to provide reliable valuations of such ‘difficult-to-value’ assets. We value unquoted investments using a variety of recognised techniques such as comparable transaction analysis and discounted cash flow analysis, and indeed a number of our clients are now asking us for more frequent valuations – we have responded to this by rolling forward quarterly, semi-annual and annual valuations upon request. Our work is bespoke, and our key focus is reliability.

The AIFMD aims to introduce greater transparency and reliability to valuations, and as a professional, reputable services provider we predict that in the coming months our business will increase as more and more investors look to a highly regarded, respected firm for reliable valuations of assets.
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TO EU OR NON EU?
10 KEY CONSIDERATIONS IN CHOOSING A FUND DOMICILE

KENNETH FARRUGIA OF VALLETA FUND SERVICES EXPLAINS HOW WHEN IT COMES TO CHOOSING THE RIGHT DOMICILE, MALTA MEETS ALL THE REQUIREMENTS

Kenneth Farrugia, chief officer of Valletta Fund Services, joined Bank of Valletta plc in October 1985 and has occupied various roles within the BNV Group. A director on the Board of Valletta Fund Management Limited, Farrugia also serves as chief officer on the executive committee of Bank of Valletta plc.

With 75 countries positioned, or positioning themselves as international financial centres across the world, deciding on the most appropriate domicile to establish a fund is one of the biggest challenges facing fund managers today.

To compound matters, in November of last year the European Parliament approved the EU’s Directive on Alternative Investment Fund Managers (AIFM) with the majority of the Directive’s rules scheduled to become effective by 2013. This new Directive has changed the playing field and brought with it new rules applicable to all fund management companies which will also have an impact on non-EU funds and fund managers.

Consequently, choosing a fund domicile has become a highly challenging task as the ultimate decision needs to be taken following an in-depth evaluation of a number of considerations, the key ones of which are listed below:

1. JURISDICTION LOCATION AND TIME ZONE. The geographic location of the domicile has multiple ramifications on various other business and operational considerations such as: the location of the end investors; the ease of access to the jurisdiction in terms of flight connections; and the time zone of the domicile and its implications on the valuation of the investments held by the fund and its service providers.

2. ECONOMICAL AND POLITICAL STATUS OF THE JURISDICTION. The development of the jurisdiction’s fund industry is among other things highly dependent on the presence of a robust and resilient banking sector, which I consider as being the backbone of any developed or developing financial services jurisdiction.

3. LANGUAGE BARRIERS are often cited as a concern, as the day-to-day operational workflows linked to the services of a fund are to a significant extent dependent on the presence of a workforce where English (or any other language as for that) needs to be widely spoken (and written).

4. LEGAL AND REGULATORY FRAMEWORK. These must be both comprehensive and efficient. The recent interest in Ucits structures will, in my view, be beneficial for the European funds industry for this reason. Equally important, the introduction of the AIFM directive will possibly contribute to strengthen the growth of those fund managers that will fall within its remit. Likewise, it is clearly evident that both asset managers and end investors are seeking to ensure that their choice of jurisdiction operates within a legal framework that affords them all of the necessary legal protection and mechanism.

5. OPERATIONAL AND SERVICE FRAMEWORK. The presence of a highly developed operational and service infrastructure is also a critical decision-making factor. The quality of service providers is of key importance to investors and fund managers as is the availability of experienced/competent support services such as legal and accounting firms, fund administrators and the availability of skilled directors. The presence of a well-developed IT communications infrastructure should equally be given due importance.

6. WORKFORCE. A skilled and multi-lingual workforce is equally important, particularly as this will reflect on the quality of all the aforementioned services that will be delivered to the fund.

7. TYPE OF TARGETED INVESTORS AND THEIR DOMICILE. The type of investor being targeted and their domicile is of equal importance. A jurisdiction close to the investor target market may psychologically have an impact on the ultimate decision as to whether to invest in the fund or otherwise.

8. TIME TO MARKET. The speed of set-up as translated into the amount of time a fund takes from conception to launch is also significant. An understanding of the way the local Authority processes investment applications for investment services licences is necessary, as this will have an impact on the planned execution in a timely manner of the business plan for the fund and the fund management company.

9. SET-UP AND ONGOING COSTS. These critical factors will ultimately have a bearing on the expense ratio of a fund which will in turn impinge on its performance. This is particularly applicable to new fund set-ups particularly those that are launched with relatively low seed capital, say sub €30m.
10. TAX STATUS. The importance of structuring a fund in a tax-efficient way will always be paramount as this will bring with it the possibility to benefit from the domicile’s double-tax treaty network. Likewise, the jurisdiction will need to provide the most advantageous taxation scheme for the investors.

CHOOSING A DOMICILE - THE CASE FOR MALTA
Within the context of the above, Malta’s positioning as an international EU-based fund and fund management domicile presents a compelling proposition for fund managers either planning to set-up/re-domicile their fund/s in/to Europe or setting up/re-locating their fund management operation in/to Europe. The growth of Malta as a fund domicile has so far been spearheaded by the registration of various Professional Investor Funds (PIFs) falling under the PIF regulatory framework introduced by the Malta Financial Services Authority (MFSA), Malta’s single regulatory body, in the year 2000. Currently there are over 400 investment funds registered, primarily consisting of PIFs but also include Ucits III Schemes as well as retail non-Ucits schemes. The regulatory framework is supported with an equally comprehensive legal framework allowing such funds to be set up as Sicavs, Limited Partnerships, Trusts and Contractual Funds.

Malta is increasingly enjoying recognition as a fund domicile of repute because it fulfills all the aforementioned criteria. It has a comprehensive legal and regulatory framework falling under the auspices of a single regulator, the Malta Financial Services Authority. Malta’s geographic location right in the middle of the Mediterranean makes it a gateway to the EU for non EU financial services firms and, an open door to the financial services businesses of the Arab world. On the point of economical and political stability, Allianz SE, a Brussels-based consultancy firm singled out Malta and Germany as the only two EU member states which have boosted their competitiveness and fiscal stability in the last five years according to a scoreboard based on national debt, labour, productivity and trade indicators. Malta’s banking sector was also ranked as 10th soundest out of 139 countries by the World Economic Forum in its 2010/11 report.

The English language is widely spoken in Malta and is used in all business communications. Legislation is written in both English and Maltese with the former taking precedence in the case of any necessary legal interpretations. There are 15 fund administrators operating from Malta and its operational and service framework continues to grow. In fact, the fast-growing developments of the industry have brought with them the formation of an industry cluster consisting of not only alternative investment funds, but also the presence of global custody service providers such as the Bank of Valletta plc through JP Morgan, HSBC and Deutsche Bank. Notable is the strong presence of all the top four audit firms. Equally, Malta’s legal firms are multi-disciplinary providing advice across a broad range of financial services areas. Firms which are very well-connected with the major international networks are Lex Mundi, Lexis Nexis, Chambers and Martindale amongst others.

Our highly skilled workforce is driven by the presence of an excellent educational system in which students seeking to pursue tertiary education are paid a stipend by the Government. Malta also has a sophisticated telecommunications infrastructure, with large bandwidth networks providing high capacity communications to and from the island. Digital networks, satellite technology and high capacity fibre optics link Malta with Europe, and mobile telephone operators provide wireless internet connections based on GPRS technology. Voice-Over-Internet-Protocol Services (VOIP), WiMax and 3.5G are widely available, enabling companies to make substantial cost savings on telecommunication expenses. Malta also has two forms of broadband delivery technologies – DSL and Cable Modem Access. Lastly, Malta’s regulatory processing efficiency is becoming increasingly notable as are the highly competitive set-up and ongoing costs to operate a fund in Malta. Malta also has in place over 55 double tax treaties with both EU and non-EU countries which lend themselves to the possibility of setting up tax-efficient structures.

With the context of the above, Malta’s increasing popularity as an International Fund Domicile based in the EU is gaining strong traction as is evidenced by the increasing presence of funds, fund managers and fund administrators setting up their operation in Malta which truly augurs well for the future.
Mamo TCV Advocates is a tier-one law firm in Malta with a strong international practice and actively involved in all areas of commercial law, with a particular focus on financial services.

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RELOCATION MADE SIMPLE

DR ANDREW J ZAMMIT OF ZAMMIT AND ASSOCIATES – ADVOCATES OUTLINES THE HARD AND SOFT FACTORS INVOLVED IN RELOCATING TO A EUROPEAN DOMICILE

Investor demand for more regulated funds has never been stronger, but with a wide choice of European domiciles available, it can be difficult to know which jurisdiction will best suit investor needs. In this interview, Andrew J Zammit of Zammit and Associates talks to HFMWeek about the essential research fund managers need to conduct before they commit to a new domicile.

HFMWeek (HFM): Why has there been an upswing in funds establishing in an onshore domicile?
Andrew J Zammit (AJZ): I would primarily attribute the wave of both hedge funds and managers looking to establish themselves onshore to the financial crisis, as investors are now looking for increased supervision, transparency, governance and regulation. Investors increasingly feel that they want to put their money into carefully monitored and controlled structures in solidly regulated jurisdictions, and this is what onshore re-domiciliation can provide. Another primary consideration would be the Alternative Investment Fund Managers (AIFM) Directive, which, since its initial discussion in 2009, has put pressure on investment managers to carefully consider the structuring of their European-facing business.

HFM: Has re-domiciliation also increased? What are the advantages in relocating an offshore fund to an EU domicile?
AJZ: The EU offers the key advantages that investors are looking for: transparency, regulation and good governance. From our own experience the increasing attraction of Malta in particular is that a close relationship has been built with the regulator; people feel that not only has the fund been duly registered and regulated, but that there is actual ongoing monitoring of the fund and its performance. If any specific issues crop up at any point in the life of the fund, the regulator is very accessible, and they will make time to consider specific issues companies are facing and openly discuss possible alternative solutions.

There is an ongoing communication process between the regulator and the regulated, and this is a huge attraction for fund managers, who find that they do not simply steer the fund along blindly in the face of uncertainty, but have the regulator’s input and support on an ongoing basis. A key outcome of this process is that it provides invaluable peace of mind to both the fund manager and investors.

HFM: What key factors should funds take into account when deciding on a European domicile?
AJZ: Statistics published recently in an IFI research report (The future of manager migration, fund servicing and domiciliation in the Mediterranean: The alternative to Ireland & Luxembourg?) distributed among UK-based fund managers clearly showed that tax was the largest single reason why people would relocate their funds or even their own operations from one jurisdiction to another. Of course, several jurisdictions exempt such structures from tax altogether, but when you compare an offshore jurisdiction that does not submit funds to tax and a tax-exempt onshore jurisdiction, other key factors, such as concerns over the AIFM Directive restrictions, come into play. Many managers are moving into Europe in order to comply with the Directive, be closer to prospective investors and to be within the same time zone.

The European investor market is a highly attractive one, and within this zone other ‘hard’ and ‘soft’ factors come into play. The hard factors are the pure business reasons such as tax and the AIFM Directive. The soft factors, on the other hand, are concerns such as geographical proximity to investors and language. In Malta, for example English is widely spoken, and this can be a great advantage for many funds and investors, but for those looking to do business in French or German, Luxembourg would be an attractive option. Swiss-based companies often look to this option to avoid the headache of translating supporting documentation.

Also, the number and quality of hedge funds registering in Malta is steadily increasing, and much of this business comes from places such as The Cayman Islands and the BVI. A small number of high-profile fund managers are also re-domiciling here, attracted by the excellent regulatory framework and the fact that English, Italian, French and (to a lesser extent) Spanish are widely spoken, our accessible geographical location and our mild Mediterranean climate.
**HFM:** Are there any risks in moving? How can these be mitigated?

**AJZ:** Business people don’t like surprises. Hedge fund managers like to work with what they are accustomed to, and change for change’s sake rarely proves to be a successful strategy. There may be compelling reasons to move, but these involve the risk of upsetting a formula that has worked for years or even decades. The way to mitigate this risk is to actively meet service providers in the new jurisdiction, taking the time to get to know the new location well, and getting to know the people they will be working with. Hedge fund managers are not the sort to make blind leaps of faith, and they must ensure that the re-domiciliation dovetails seamlessly from one jurisdiction to another by learning as much as possible about the process.

Another potential strategy, which many fund managers have adopted, is not to re-domicile funds, but to set up mirror structures in new jurisdictions. For example, many managers with Cayman structures set up a parallel operation in Malta, start raising capital within the Maltese structure, sometimes even by mirroring the strategies undertaken in the Cayman structure. Over a period of time the Cayman structure is then wound down and its funds are channelled into the Maltese structure. This strategy has been widely adopted by fund managers, and has avoided catapulting the number of re-domicilations per se. The Malta Financial Services Authority (MFSA) published figures at the end of November 2010 showing that only five funds re-domiciled from the Cayman Islands to Malta, but in terms of mirror funds, this number is significantly higher.

**HFM:** What resources and services should hedge fund managers draw upon to smooth their transition into the EU?

**AJZ:** Aside from taking advantage of the opportunities offered by the increasingly sophisticated and efficient telecommunications infrastructure that many jurisdictions now offer, hedge fund managers should draw heavily on service providers for accounting, outsourced legal work, administrative services and back-office work. Service providers can add a huge amount of value to a company’s infrastructure, especially as they know the jurisdiction well, and can really help to smooth the transition as much as possible. Malta’s financial services industry has grown tremendously in recent years, and our accounting and back-office support services, as well as flexible office space offerings, have made us an increasingly attractive location.

All of these considerations give hedge fund managers very efficient inroads to new jurisdictions like Malta, allowing them to set up skeletal operational offices in the space of mere months. The best strategy is to relocate a minimal amount of infrastructure to begin with, and then once the manager has a better feel of what the country and its industrial regulations have to offer, and the compliance burden involved, they are in a better position to identify where the weaknesses in their infrastructure are and what sort of resources they need to draw upon in that jurisdiction. Funds need to check which support services are available within the jurisdiction, and their quality, and check them against their own personal needs. Jurisdictions like Malta, which are looking to attract funds business, are constantly working to expand and improve service provisions to meet these needs. This includes administration, legal and compliance, among others.

**HFM:** Can moving to an EU jurisdiction help to attract investors and does it help to mitigate new regulation, like the AIFM Directive?

**AJZ:** The implementation of the AIFM Directive has heightened awareness of Malta’s offering and already spurred some offshore funds to relocate to Malta with a view to benefiting from the distribution possibilities under the Directive once it comes into force. I would not, however, attribute such trends to the mitigation of new regulation but to the fact that being in the EU would facilitate compliance with the said regulations when compared to the alternative of complying with such regulations from outside the EU. The silver lining of the AIFM Directive is that the marketing of AIFs to investors becomes much less ambiguous when compared to the current position – which is quite fragmented and fuzzy.

**HFM:** Which states do you think will benefit in particular from the trend for re-domiciliation into Europe?

**AJZ:** The IPI report indicates that the main jurisdictions to benefit from the re-domiciliation of fund managers will be Switzerland, Malta and Guernsey.
7 reasons why international financial institutions are dropping anchor in Malta:

- English as an official language;
- Cost competitive skilled workforce;
- EU member with euro as its currency;
- Consistently highly ranked quality of life;
- Meticulous yet accessible single regulator;
- Robust yet flexible legal and regulatory framework;
- Secure and stable business environment and a world class IT infrastructure.

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the choice of fund domicile is one of the first issues faced by a fund manager looking to establish an investment fund. The options available and the reasons behind those choices have changed dramatically in recent years. The days where fund managers blindly opted for the Caribbean locations of least regulatory resistance are gone, as the better-informed realise that the efficiencies and expertise offered there, along with additional benefits, can be found in equal measure far closer to home. Choosing the right home for a fund is vital not just in assisting in the investment process but also in ensuring that the fund can run efficiently following the subscription process.

The recent downturn in financial markets, the heightened emphasis on investor protection and the potential impact of the proposed Alternative Investment Fund Managers (AIFM) Directive has shifted the geopolitical landscape of global fund jurisdictions back towards mainland Europe. Investors’ demands for strong corporate governance, transparency and regulatory oversight have become a priority as the task of raising investment becomes increasingly challenging.

While the final wording of the AIFM Directive is unknown, what is clear is that the heightened requirements for non-EEA domiciled funds to market themselves to European investors will make those jurisdictions less attractive. Where jurisdictions within the EEA can offer the combination of efficiency, strong regulatory protection, European marketing passports either through AFIM for UCits as well as being in the same time zones as managers and investors, the question for managers setting up funds is no longer ‘onshore or off-shore’ but which European jurisdiction is right for them.

GIBRALTAR TO THE FORE

Ireland and Luxembourg have traditionally been Europe’s best known fund jurisdictions but in recent years they have been joined firstly by Malta and more recently by Gibraltar to create a shortlist of four from which to choose.

Gibraltar was not globally recognised as an investment funds jurisdiction until the birth of the Experienced Investor Fund (EIF) regime, which was launched in 2005. Since then, the growth of the Gibraltar fund industry has been exponential as its fund offering has become more widely known. That it is a more recent entrant into the funds arena has benefitted Gibraltar as it has managed to create a legislative regime that has married the strong regulatory elements of some jurisdictions with the efficiencies of others so that they overlap rather than compete as forces against each other.

Furthermore, Gibraltar has created an intelligent portfolio of different fund options designed to fit all requirements. The range starts with the private fund aimed at those marketing to a small identifiable group of investors (up to 50). The EIF regime offers a fully regulated option that can be marketed (within the private placement regime) to an unlimited group of experienced or sophisticated investors. With regards to retail funds, Gibraltar offers an Undertakings for Collective Investment in Transferable Securities (UCits) regime similar to other European jurisdictions as well as a non-UCits option that can be more tailored to meet a fund’s requirements.

Private Funds are not formally authorised by the Financial Services Commission (FSC) and as such are subject to light regulatory scrutiny. They have few legislative requirements (such as an administrator, custodian or local directors), and are quick and cost-effective to set up and to run. While there are limitations on the number of participants (capped at 50), such limitations do not constrict the fund – the freedom afforded elsewhere means that it is provided with an extremely efficient environment in which to flourish. Examples of such situations include: where an investor is backed by a few close friends; a fund is needed for pooling employee investments; a feeder system is used; and where a manager has some initial seed capital and is keen to establish a trading record within a collective
investment scheme at an absolute minimum expense ratio.

For those managers aiming to market at a wider audience or for those that actively require a higher form of regulation, there is the EIF. This has been the catalyst for the development of the fund industry in Gibraltar in recent years. The key to EIFs’ attractiveness is that they are fully regulated funds that are deed-authorised at their launch on the basis of a legal opinion as to compliance with all legislative requirements. EIFs offer the fastest track to launch and the commencement of investment activities of any regulated investment fund in the EEA.

The fund documentation is required to be filed with the FSC within 14 days of the launch. Where Gibraltar perhaps differs from many other jurisdictions is that the regulator not only has an opportunity in the authorisation process to review and scrutinise the structure and documentation of EIFs but also that the FSC actually does carry out such activities, is keen to understand the structure and nature of the funds it regulates and conducts its regulatory duties in a constructive and helpful manner, rather than merely creating regulatory red tape.

While Gibraltar’s fund industry has largely focused on the alternative investment fund industry below the €100-200m investment level, it also provides a UCITS option and with the implementation of UCITS IV by July this year is expecting significant growth in the retail market. The industry and regulator are working with the government to establish Gibraltar’s UCITS IV offering as a market leader.

Every fund jurisdiction will inhabit a different space within the spectrum between efficiencies pushing one way and regulation pulling the other and in the past most have opted toward deregulation. However, Gibraltar is unique in its ability to marry the two. While efficiency is one of its primary benefits, the regulatory environment in Gibraltar is also seen as a major advantage. The International Monetary Fund has recently praised Gibraltar as a well regulated jurisdiction, superior to many of its larger competitors.

Under statute, the FSC is required to at least match the UK FSA’s standard where EU legislation applies. The UK FSA conducts regular assessments to ensure that this is the case. Furthermore, the size of the jurisdiction is such that the regulator is able to understand and supervise the finance industry in a pragmatic manner in fulfilling its responsibilities to reduce systemic risk and protect the reputation of Gibraltar.

Gibraltar’s establishment as a mainstream European finance centre has been significantly fuelled by the attractiveness of its flexible and comprehensive fund offering. However, additional benefits including the legal structure being based on English common law, the business language being English and that it can be reached in just over two hours from London, help to make it a perfect match for UK fund managers.
evolving with regulatory changes and developments

Roma (Italy) office opening March 2011

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When it comes to the costs of starting up a hedge fund, making mistakes early on can seriously stifle future growth. Ambasuthan Jananayagam from Point Nine Financial Technologies talks to HFMWeek about the hidden costs that managers should look out for from day one, and provides insight into how the strategic use of operational infrastructure can help grow a fund to the next level.

**HFMWeek (HFM):** What are the trends you are seeing in the small hedge fund space?  
**Ambasuthan Jananayagam (AJ):** It is no secret that post-crisis regulatory barriers are going up. Both investor and regulatory demands for robust processes are increasing, and fulfilling these demands involves higher costs. Some vendors have withdrawn from the small fund manager space either because the infrastructure necessary to deal with these hurdles was too expensive, or margins were too small. Institutional investors are also increasingly attracted to the diversity that alternative investment strategies can offer. Encapsulating alternative strategies with robust processes will place further demands on small hedge funds’ infrastructure. Fund managers need to be smart about how they deal with these demands and costs do not have to be exorbitant; doing your homework will pay off. The changing environment means only the most automated and efficient vendors are able to cater to small funds in a cost-effective manner.

**HFM: What kind of operations infrastructure can start-up fund managers adopt in order to attract institutional investors?**  
**AJ:** Post-Lehman crisis everyone understands the importance of having a multi-prime platform, and with that comes additional operational needs. Funds will need to demonstrate: adequate risk management and reporting capabilities; T+0 trade reconciliation deliverables which capture any trade errors early; tried and tested disaster recovery procedures; and the ability to demonstrate their backup systems, locations and people. Start-up fund managers need to ensure that their vendors have a solid track record, are using current technology (such as web-delivered services and cloud computing, and so on), and can produce the reports required by the fund manager and the fund’s investors. Also highly prized is the ability to carry out independent valuations (including a shadow NAV), and ensuring that processes are automated and light on manual intervention. Finally, small fund managers should certainly seek vendors’ high-quality service support during the critical ‘launch’ phase. Ideally, a fund manager would ensure an operations solutions vendor ticks at least a few of these boxes, if not all of them.

**HFM: What advantages do ‘best of breed’ independent providers hold over larger ‘one-stop-shop’ operations?**  
**AJ:** One popular myth is that one-stop-shops are cheaper. ‘Best-of-breed’ packages compete on the headline costs but go further in addressing potential costs. Start-up clients need a really high quality of service both pre- and post-launch. Implementing an operations platform can create a myriad of operational process challenges which will need solutions. Some common examples are: integrating the different vendors a fund is using; creating the right reporting suites, particularly where the fund manager is trading a variety of asset classes; and finally eliminating as many manual processes as possible. Start-up fund managers frequently underestimate the number of changes to the original launch plan that may be required. Start-ups will find a nimble and flexible vendor invaluable during the launch phase. We consider the support our clients get from the managing partners during the launch phase as a key differentiating factor between Point Nine and our peers. We stay in close touch throughout the launch process and should the client need to change tack, we endeavour to minimise (if not eliminate) the extra charges. The concept that one size fits all just is not true. Funds have specific mandates, defined assets and target investors: you need flexible vendors; going down the best-of-breed route means that you can package together the correct set of vendors who can deal with your needs.

**THE CONCEPT THAT ONE SIZE FITS ALL JUST IS NOT TRUE. FUNDS HAVE SPECIFIC MANDATES, DEFINED ASSETS AND TARGET INVESTORS: YOU NEED FLEXIBLE VENDORS**
HFM: What risks are involved in choosing a provider?
AJ: Both the benefits of getting it right, and the costs of getting it wrong, are substantial. Obviously you have the headline figure, the price you get from all your vendors, but it is important to look further and to pay attention to hidden costs. Contracts frequently feature hidden costs for new interfaces, extra reports, new assets, and essential upgrades and maintenance which might become necessary in the future. As a start-up manager you need to know what those are. As your fund grows, your needs will change and you do not want to be penalised for growth with a hefty bill. The cost of errors is also an important factor. If your systems are not sufficiently robust and an error goes unnoticed you are liable to lose the money of the market movement during that period. In the big blue-chip funds the costs of such errors run into the millions.

Then there are the intangibles such as management time spent resolving operational problems. Any time that a fund manager does not spend managing his fund or raising money is precious time lost. Ideally fund managers, like any good business, should focus upon their core competencies.

Finally, the worst potential cost of all is that by failing to get infrastructure and operational platform right, you risk failing to draw the big institutional investors you need in order to grow your fund to the next level.

HFM: How can start-up managers mitigate these risks?
AJ: Speculate to accumulate. The key is to pay money for a little good advice early; many fund managers try to become experts on operational systems and services in a very short time and often get mired in the process. There are many affordable and well-informed consultants and it is worth engaging them early. As with any service, the best way to find a reputable company is to ask around.

Plan ahead. Lay out a full plan of where you want to go. Given the fund’s strategy, and assuming growth goes according to plan, what is the full spectrum of assets the fund would trade? Are there other services that will be necessary (for example, collateral management)? Try and choose vendors who have solutions for you now, and the capacity to serve you in the future. Upgrading vendors and infrastructure half way through could be a costly mistake.

Thirdly, stick to what you do best: don’t outsource and forget, but certainly outsource with oversight. Our advice is to demand that your vendors give you regular reports and internet or instant access to what they (your vendors) are doing, but let them do the heavy lifting while you carry on playing to your strengths and managing the assets.

Finally, take a fresh look at the market. Many fund managers make the mistake of coming out of a business and wanting to use exactly the same technology they used before, whereas there might be other options better suited to a smaller and lighter fund than their previous, larger institution. Start-up managers should scope out the costs of all the solutions. If, for example, you are going to get a new IT system, make sure you know the total cost, including: hosting costs, staffing costs and the costs involved in contingencies (staff leaving, trading a new asset class or creating a new process). Managers should endeavour to have a ‘cost tree’, which will allow for better cost planning in the different contingencies and allow the fund manager to be more prepared.

HFM: What qualities should start-up fund managers look for when outsourcing support?
AJ: Quality of service in terms of staff and the use of current technology are key. Point Nine is a full service, middle office shop and we really hold our clients’ hand all the way through the process. The management team has over five decades of experience of trading and managing trading businesses. It is the management team who scope out the clients’ needs and design the specific solution most suitable for our client. Post-launch we hand over to our operations team comprised of individuals who typically have over a decade of experience. The management team continues to work with clients in a relationship management capacity. We find that keeping up with our existing clients’ demands is the best way of maintaining our firm’s edge in this space. Our technology is current and completely proprietary (which means that we control our implementation deadlines). Our service is web-delivered, and deals with the full spectrum of asset classes (from vanilla equities to complex exotic derivatives). We are a nimble, solutions driven company. To date, no client has ever left Point Nine for another vendor and we strive to keep it that way.
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Launching a successful start-up hedge fund, like any new business venture, requires a combination of factors to come together. One key factor is having the right people in the right place at the right time. The failure rate for start-up hedge funds has always been notoriously high; figures from the European Central Bank state that between 1998 and 2005 more than 20% of hedge funds with assets of $50m or less failed within their first five years.

In the wake of the financial crisis however, some estimates predict that this figure rocketed to an average of 30% in 2010. This worrying trend has been accelerated, in part, by a growing tendency amongst start-ups to fail to hire the staff they need to grow their business.

**THE NEED FOR FOCUS AND WHY**

In recent years I have spoken to numerous start-ups whose strategy is to generate sufficient alpha before even considering the need for bolstering their operational and marketing staff. Given that investor confidence has plummeted, and that operational mistakes and investor withdrawals are the principal causes of failure for start-ups in today’s turbulent market, this cart-before-the-horse approach is odds-on to have them fail at the first hurdle.

It is often said that those who fail to learn from history are doomed to repeat it, but this need not be the case for start-ups in the year ahead. To avoid the fate of their competitors, start-ups serious about achieving and sustaining growth in 2011 will need to recognise the need to re-think what hiring means for them.

TO AVOID THE FATE OF THEIR COMPETITORS, START-UPS SERIOUS ABOUT ACHIEVING AND SUSTAINING GROWTH IN 2011 WILL NEED TO RE-THINK WHAT HIRING MEANS FOR THEM

**INCREASED IMPORTANCE**

This trend of focus on just alpha in the earlier years of start-ups meant the hiring across the COO/operational hiring was not seen as crucial whereas today investors want to meet the COO before they have even met the portfolio manager.

For this reason, after identifying the front office hires the next most crucial hire is the COO. The gene pool of talent in this area is sometimes viewed with frustration and that is because at the start-up phase, the breath of skillsets demanded from this hire is so varied. The debate of what constitutes a good COO for a start-up can be a very long one as there is such a variety of individuals that find themselves being COOs of a hedge fund: qualified accountants or lawyers, technology and operational backgrounds. There is no definitive answer as to which background is better but in our experience, among many factors, the two key areas which define a good COO outside of specific requirements is their general attitude and passion for working in this industry and how detail-orientated they have been in previous roles.

After the COO hire, we are seeing an increase trend in the need to hire business development/marketing hires. Ultimately it could be argued until there is a track record there is no point of making these hires, but the early strategic positioning of a hedge fund strategy with the right investors can mean that the fund has the best chance to attract new capital during the early years of good performance – investing in the right talent with a long-term view.

**FINDING THE TALENT**

Despite the increased external scrutiny on the credibility of the individuals that work in a hedge fund, the industry’s talent pool, which has developed and matured
tremendously in the ten years since I became a specialist in the alternative space, is now populated with a wealth of experienced, talented individuals. These potential key hires have weathered the storms of the past, and are ready to steer those start-ups who can identify and utilise their talent toward a more successful and profitable future. Similar to buying a property, you often need to see a candidate several times to gather enough information with which to make an informed decision. For this reason, I recommend that the recruitment process for any size of company should feature at least three stages. The first viewing allows you to form an initial impression, the second to learn about the candidate in more detail, and the third allows the candidate to ask those searching questions which may not have been appropriate in the first two meetings.

This whole process can feel like traversing a minefield and be very time consuming. The benefits of working with specialist industry recruiters like One Ten Associates is that you are instantly tapping into a wide network of people in the hedge fund industry and our experience can then help you spot the differentiators needed in key hires which ultimately can save you a lot of invaluable time.

FINDING THE RIGHT MATCH
The hedge fund industry is unique, and the demand for exceptional individuals across all types of hires is now being demanded by the key stakeholder of the industry: the investors. Staff in smaller operations, even more so than in the larger, more established funds, have to possess unquestioned loyalty and commitment to the fund: they must live and breathe the organisation.

Identifying these attributes early on is not always easy. Hiring the right people is like buying a house; it is a significant investment in terms of both time and money, and takes time, care and expert advice.

Times have changed, and start-ups serious about building a profitable, solid hedge fund with a sound infrastructure must adapt their recruitment strategy accordingly. By seeking advice from specialist recruiters who have seen the alternative space grow in the past, start-ups can tap into the staffing resources they will need in the years ahead. We have built up a network of contacts, and know where to find the often elusive key hires that start-ups need. As the alternative space has developed so its talent pool has matured. This gradual increase in quality of the talent on offer over the past decade affords start-ups in 2011 an opportunity of which their predecessors, in their early days, did not have the benefit.

The wealth of talent now on offer is a huge opportunity for ambitious start-ups to become high-flyers in 2011, but for those who ignore the importance of senior operational and business development hires in particular, the dream could be short-lived.
Gibraltar’s prominence as a mainstream European finance centre is now well established.

With high regulatory standards, the funds industry has prospered and in recent years the introduction of the EIF regime has accelerated this sector.

At the forefront of this growth is Triay & Triay one of Gibraltar’s most respected and prestigious law firms.

With over 100 years experience, a visionary and practical approach to our clients’ needs has secured outstanding levels of client satisfaction.

So with a reputation for legal excellence that is second to none, why establish your funds anywhere else?
WHICH JURISDICTION FOR YOUR HEDGE FUNDS?

DOMINIQUE LECOCQ OF LECOCQASSOCIE CONSIDERS WHICH JURISDICTION – MALTA, SWITZERLAND OR LUXEMBOURG – IS RIGHT FOR YOUR HEDGE FUND

Each jurisdiction has its own unique attractions for a fund manager contemplating the launch of a fund. While Luxembourg is traditionally an attractive option due to its long-standing track record in the fund business, Malta and Switzerland have proved to be advantageous options for new collective investment schemes.

This article seeks to provide an outline of the differences between Maltese Professional Investor Funds, Swiss Alternative Funds and Luxembourg Specialised Investor Funds.

STRUCTURE AND CAPITAL CONTRIBUTION AT INCEPTION
A Malta Professional Investor Fund (PIF) can be incorporated as an investment company with variable share capital (SICAV), an investment company with fixed share capital, a limited partnership, a unit trust or a contractual mutual fund. There is no requisite minimum capital to inject by the manager/promoter and no notary is required for incorporation.

A Swiss Alternative Investment Fund (AIF) can be incorporated as a contractual mutual fund or a SICAV. There is no requisite minimum capital to inject by the promoter and no notary is required for incorporation of a contractual mutual fund, while a minimum of CHF250,000 shall be injected if structured as a SICAV.

A Luxembourg Specialised Investment Fund (SIF) can be structured as a contractual mutual fund or a corporate SICAV. The SICAV may be a joint-stock company (JSC), a limited liability company (LLC), a partnership limited by shares or a cooperative company. Should the SICAV be a LLC the manager/promoter will have to pay a minimum capital of €12,500 and if it is structured as a JSC, €31,000 at incorporation.

A Cayman fund is very similar to a PIF in terms of structure: no minimum capital and no notary are required for incorporation.

MINIMUM INVESTMENT PER INVESTOR
Swiss AIF can be either structured for retail investors and/or accredited investors. In both cases, no minimum investment per investor is required. This gives more flexibility to create ETF or ETC listed on an exchange and actively traded on the secondary market. Malta offers three different categories of PIF:
(i) A PIF for Experienced Investors, which requires a minimum investment and holding of €10,000 per investor;
(ii) a PIF for Qualifying Investors, requiring €75,000 per investor; and
(iii) a PIF for Extraordinary Investors, requiring €750,000 per investor.

Luxembourg offers one category of SIF which requires a minimum investment and holding of €125,000 per investor or less if the investor is an institutional investor or receives a certificate by a financial institution certifying the adequacy of experience in high risk investments. Based on experience however, banks are reluctant to issue such certificates.

ELIGIBLE ASSETS AND INVESTMENT RESTRICTIONS
The Maltese PIF opens up an extremely broad investment universe. No mandatory investment restrictions apply to PIFs targeting Qualifying or Extraordinary Investors. These two categories of PIF offer great investment flexibility. PIFs targeting Experienced Investors are however subject to some investment restrictions. In summary, a PIF for Experienced Investors may invest up to 20% of its total assets in securities, and up to 30% of its assets in money market instruments, from the same issuer. These limits may be increased to levels of 100%, 35% and 30% of its total assets, depending on the creditworthiness of the issuer. Investments in deposits held with a single body are capped at 35%. Direct borrowing for investment purposes and leverage via the use of derivatives is restricted to 100% of the net asset value. Some other specific rules also apply.

A Swiss AIF must be diversified, but can leverage up to 600% of its net assets and enter into short selling arrangements. If the AIF is open to accredited investor only, the Swiss Financial Market Supervisory Authority (Finma) can grant additional flexibility.

In Luxembourg, the law of 13 February 2007 provides that a SIF must invest in assets ‘in order to spread the investment risks’. In principle, a SIF cannot invest more than...
30% of its net assets in similar securities issued by the same issuer unless the issuer is subject to equivalent diversification rules or is an OECD Member State or one of its public institutions. Short selling, derivatives and OTC transactions are subject to similar risk spreading rules.

SERVICE PROVIDERS
While a Luxembourg SIF and a Swiss AIF require the appointment of a local administrator, a local custodian and an approved auditor, PIFs are much more flexible. The PIF can appoint foreign administrators and custodians. A PIF for Qualifying Investors and a PIF for Extraordinary Investors do not need to appoint a custodian per se. The fund can directly appoint a prime broker and only use a banker to operate the cash account (subscription and redemption account) of the fund. This is very beneficial for specific strategies and has a positive impact on the total expense ratio of the fund. With the enactment of the AIFM Directive, these provisions of the law may be subject to amendment. A Swiss AIF can appoint foreign prime brokers.

LICENSING AND RUNNING COSTS
To issue the licence, the Maltese regulator charges €1,500 for an umbrella fund and €1,000 per sub-fund. In Luxembourg, the CSSF charges €3,000 to license an umbrella SIF. Finma’s fees amount to approximately CHF3,000-10,000.

TIMELINE AND REGULATORY OVERVIEW
Prior to launching the fund, an application must be submitted to Finma in Switzerland, which is deemed to be approved after four weeks of its receipt by the Finma for AIF. Finma may request amendments to the structure within 3 months as of the end of the deadline above. In practice, the overall timing takes approximately three months. The CSSF in Luxembourg takes four to six weeks depending on the structure, the strategy and the manager. A case officer is delegated to analyse the risk and viability of the strategy and to understand the entire scheme. While the manager does not need to be a licensed entity to manage a SIF, the CSSF will try to evaluate its experience in investment management. The CSSF will also review the experience of the directors of the scheme. The directors of a SIF must be of sufficiently good repute and have sufficient experience in relation to the strategy of the fund.

The MFSA in Malta does a full review of the fund documentation and a complete due diligence (fit and proper test) on the manager if it is not already a regulated entity. It also runs due diligence checks on the directors and holders of founder shares. This due diligence includes a background and experience check. The licensing of a PIF by the MFSA would usually take two months. This timeline may be shorter if all players in the fund are already MFSA-approved persons.

Each jurisdiction has its strengths and weaknesses. It is therefore important to conduct a careful evaluation of the following issues as some jurisdictions might offer a better solution, depending on the particular circumstances of the case: what investment strategy is sought to be employed? What investment restrictions? What level of leverage (by credit or inherent by derivatives)? What amount of assets? Where is the investment manager located? Is the manager regulated? Is the fund sought to be retail or non-retail? What minimum subscription amounts are envisaged? What redemption frequency? Is the scheme to be open-ended or close-ended? What liquidity is required for the fund and what frequency of calculation of the Net Asset Value? Where are the prospective investors located?

See table on page 34.
<table>
<thead>
<tr>
<th>** MALTA – REGULATED BY THE MFSA **</th>
<th>** SWITZERLAND – REGULATED BY FINMA **</th>
<th>** LUXEMBOURG – REGULATED BY THE CSSF **</th>
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</thead>
<tbody>
<tr>
<td><strong>Type of fund</strong></td>
<td>Fund for Alternative Investments.</td>
<td>Specialized Investors Fund (SIF).</td>
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<tr>
<td>Experienced Investor PIF: Qualifying</td>
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<td>Investor PIF: Extraordinary Investor PIF</td>
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<tr>
<td><strong>Type of investors</strong></td>
<td>Open to retail or accredited investors.</td>
<td>Open to accredited investors only.</td>
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<tr>
<td>Open to accredited investors only (Experienced, Qualifying or Extraordinary)</td>
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<tr>
<td><strong>Minimum investment per investor</strong></td>
<td>- Experienced Investor PIF: €10,000</td>
<td>€125,000 per investor or less if the</td>
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<td></td>
<td>- Qualifying Investor PIF: €75,000</td>
<td>investor is an intuitional inves-</td>
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<td></td>
<td>- Extraordinary Investor PIF: €750,000</td>
<td>tor or receives a certificate by a</td>
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<td>financial institution certifying the</td>
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<td>adequacy of experience in high risk</td>
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<td>investments.</td>
</tr>
<tr>
<td><strong>Eligible assets; investment restrictions</strong></td>
<td>Extreme flexibility in terms of eligible assets and no mandatory investment restrictions for PIFs targeting Qualifying or Extraordinary Investors. Some risks spreading, leverage and other restrictions apply to PIFs targeting Experienced Investors. The MFSA has the power to grant derogations from these restrictions.</td>
<td>Extreme flexibility in terms of eligible assets and investment strategies. Certain leverage and other restrictions apply. The fund can leverage up to 600% of its net assets. Finma has the power to grant derogations from the restrictions when the fund is opened to accredited investors only.</td>
</tr>
<tr>
<td><strong>Investment manager</strong></td>
<td>Must be based and licensed in Switzerland or in a recognised jurisdiction.</td>
<td>No need to be based in Luxembourg. No need of a license if home jurisdiction of the manager does not require the manager to be licensed.</td>
</tr>
<tr>
<td>No need to be based in Malta. No need for a licence if home jurisdiction of the manager does not require the manager to be licensed.</td>
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<tr>
<td><strong>Service providers</strong></td>
<td>The appointment of a local administrator, a local custodian and a Finma-approved auditor are required. The fund can appointed a foreign prime broker.</td>
<td>The appointment of a local administrator, a local custodian and a CSSF-approved auditor are required.</td>
</tr>
<tr>
<td>Highly flexible. The custodian and administrator do not need to be based in Malta. The auditor must be MFSA-approved. Foreign service providers can be appointed. Currently no custodian need be appointed for PIFs targeting Qualifying or Extraordinary Investors and alternative arrangements for custody can be made with a prime broker only. This has a very positive effect on the total expense ratio of the fund.</td>
<td></td>
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<tr>
<td><strong>Estimated timeline for launch; regulatory overview</strong></td>
<td>Prior to launching the fund, an application must be submitted to Finma which is deemed to be approved after four weeks of its receipt by the Finma for Hedge Funds. Finma may request amendments to the structure within three months as of the end of the deadlines above. In practice the overall timing take approximately three months.</td>
<td>Four to six weeks depending on the structure, strategy, and manager. The CSSF assesses the risk and viability of the scheme, the competence of the manager, whether licensed or not, and the experience and reputation of the directors. Directors must have experience in the underlying strategies.</td>
</tr>
<tr>
<td>Two months or less if persons who have already been approved by the MFSA are involved. The MFSA conducts a full review of the documentation presented, fit and proper tests to assess competency, solvency and integrity on the persons involved in the scheme as well as due diligence procedures on all the relevant persons.</td>
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<tr>
<td><strong>Licensing and running costs</strong></td>
<td>Regulators’ fees are estimated at CHF3,000-10,000 depending on the size of the fund and the time spent by Finma on the file. No need of founding capitalisation if structured as a mutual contractual fund. CHF250,000 initial investment is required if structured as a SICAV. Audit fee ranges between CHF10,000-15,000.</td>
<td>Regulator’s fees amount to €5,000 to license an umbrella SIF. Notary fees amount to approx €4,000. Minimum founding capitalization €12,500 (if LLC) or €31,000 (if joint-stock company). Audit fee ranges from between €15,000-25,000.</td>
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<td>Generally the most cost effective jurisdiction. Regulator fees are as follows: €1,500 for an umbrella fund; €1,000 per sub-fund; €1,750 (registry fee). Audit fee ranges from between €4,000-7,000.</td>
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</table>
Dechert has hedge fund work “down to a fine art.”
Chambers UK, 2011

“This firm has a peerless global footprint in the hedge funds space.”
Chambers Global, 2010

Praised for its “timing, quality and in-depth knowledge.”
The Legal 500 (UK), 2010

“An outstanding reputation as the premier law firm for hedge funds.”
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Chambers UK, 2010

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The Legal 500 (UK), 2009

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