# AIFMD: HELPING TO REINFORCE THE UCITS BRAND

**JOHN LOWRY**, CO-FOUNDER OF **ML CAPITAL**, SPEAKS TO *HFMWEEK* ABOUT HOW THE AIFMD IS DRIVING HEDGE FUND MANAGERS RUNNING LIQUID ALTERNATIVE STRATEGIES TO EMBRACE UCITS

**John Lowry** is managing director of ML Capital, investment manager to the MontLake Ucits Platform. Prior to co-founding ML Capital in 2009, he was a partner at Tara Capital, a leading global distributor of hedge funds which helped money management clients attract over $3bn in new assets.

Following the introduction of the Alternative Investment Fund Managers Directive (AIFMD) in July 2014, it was clear from our discussions with managers that the general understanding within the alternative fund management industry was low. Even within some of the largest hedge fund groups, there was a clear lack of clarity in terms of how the Directive might impact their business.

Now that most of the initial kinks of the Directive have been ironed out, managers have a much clearer view in terms of their options and are seeing three main paths forward: launching an AIFMD-compliant product; launching a Ucits; or doing nothing and relying on so-called reverse solicitation. As of the last couple of months we would say that the majority are either in the 'do nothing' camp or have decided to go down the Ucits route for a number of clear reasons.

**HFMWeek (HFM): Why are managers choosing Ucits over AIFMD?**

**John Lowry (JL):** The debate between Ucits or AIFMD is somewhat misconceived in that they are different constructs and one is designed purely to govern a liquid regulated fund product while the other covers how a manager runs his business. The dust of AIFMD has now settled and US and Asian managers have realised that the two main options for European distribution in the long term will be to establish an AIFMD or Ucits-compliant product.

Given the inherent intricacies associated with AIFMD, such as the remuneration provisions and the reporting requirements, the gold standard that is Ucits has become the structure that many managers are now choosing.

The Ucits brand has grown over three decades making it a draw for a large portion of the global investor base, offering increased transparency, tax efficiency, attractive liquidity and regulatory oversight. The AIFMD is still in its relative infancy and is certainly overshadowed by the established brand of Ucits.

**HFM: Why is the AIFMD driving US and Asian managers to finally embrace Ucits?**

**JL:** By 2018 national private placement rules will be phased out and the clear consensus is that reverse solicitation is no longer an effective distribution strategy. If managers based outside the European Union are not willing to meet the obligations of the AIFMD, Europe should be avoided at all cost as opposed to relying on the risky strategy of reverse solicitation and waiting for the phone to ring. At best the legal complications of this strategy could be costly, and it could damage the reputation of a business very severely. While there still is some evidence in the marketplace that some non-European managers are intending to side-step the Directive's marketing restrictions by relying on this strategy, more and more are recognising the benefits of Ucits and committing to launching a European regulated structure that offers the flexibility of cross-market distribution.

There is a well-documented tale of the lack of non-European domiciled managers within Ucits and that the space is dominated by European based managers, however as the market has begun to diversify and the AIFMD has reinforced the strength of the Ucits brand for managers running liquid strategies, there are a growing number of both US and Asian strategies now available and this is a clear trend that we feel is set to continue.

**HFM: Tell me about the alternative Ucits investor base and some recent key trends?**

**JL:** The rapid rise of alternative Ucits assets has been relatively well documented, however less well reported have been the reasons behind the numbers and where the real growth has come from. While the strongest support to date has come from the private banking and FoFs sector, a considerable number of European wealth managers and an increasing number of larger institutional investors (pension and insurance groups) have moved capital from long only to long/short strategies and are certainly contributing to the growth in Ucits AUM.

Ucits is increasingly the product of choice for the institutional world and the reasons for this are varied. Ucits offer a more tax efficient structure than their offshore counterparts and are certainly more acceptable structures from a Solvency II perspective. Interestingly, recent research conducted by Preqin revealed that of the increasing number of Institutional investors attracted to Ucits, almost half of those feel that greater transparency of Ucits is key.

In the dominant HNWI market, platforms in a number of countries such as Germany and Italy have embraced alternative Ucits and have taken action to encourage further investment. German tax authorities amongst others only request that investors pay taxes on their holdings when they decide to liquidate their full position, whilst Italy has increased the tax rate on offshore funds. Enhancing the attractiveness of Ucits has certainly supported asset raising potential throughout Europe and helps broaden the potential investor base.

**HFM: Having made the decision to launch an alternative Ucits fund, how do you go about building an effective distribution strategy?**

**JL:** Key to the success of any alternative Ucits launch is a well-developed and effective strategy for the distribution of your fund. You need to quickly figure when and where – and if at all, your fund will be well received and focus your attention on those early stage investors.

At ML Capital we have identified three main types of investors that allocate to alternative Ucits. While the biggest support to date has come from the private banking and FoFs sectors, the most interesting development over the past 18 months that we have seen has been the rise in allocations from large institutional investors.

The largest investor in terms of numbers is within the mid-net-worth marketplace dominated by a variety of banking channels, investment advisor networks, fund platforms and insurance groups fund linked product lines. This segment requires in-depth knowledge and a large on the ground sales force promoting the products on an active basis as well as taking care of the negotiations and paying of rebate commissions. This is a time intensive process.

At the other end of the scale is the institutional investor base. Clearly far less numerous and dominated by European names, it does include an increasing number of non-European institutions, mainly Asian based groups but also a growing number of Latin American, Middle Eastern and Canadian institutions. This is where the largest tickets are sourced. These tend to be pension funds, treasury management companies and insurance companies and while they tend to be longer term investors they also can take a considerable time to commit. They also are usually advised by an independent consultant.

The HNWI, private banking and FOFs were early adopters to the alternative Ucits brand and have helped many managers get to scale in order to attract larger investors. This segment is the key part of the traditional offshore hedge fund client base and covering these investors is all about getting the fund on the approved list of the banks, roadshows with the manager and personal relationships.

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## Conclusion

The strong growth in popularity of alternative Ucits witnessed over the past decade, particularly following the global financial crisis, is set to continue. This upward trajectory combined with the introduction of the AIFMD has influenced a growing number of US and Asian managers to launch a Ucits product. Managers are now making the strategic decision to enter the market and if running a liquid alternative strategy – Ucits is the only logical choice to effectively raise significant assets in Europe.

At ML Capital we are witnessing a growing number of leading managers who have decided to embrace everything Ucits can offer, with a raft of launches on the runway set to change the competitive landscape of the industry.

The opportunity set for alternative Ucits is evident, however it is key that non-European managers find the right partner with local knowledge, and a genuine understanding of the complexities of cross-border distribution. ■