

# AIFM ManCo Platforms & Fund Structuring:

## The View of Alternative Managers

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IFI Global Research 2016



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# Introduction

This research project was planned in the early spring of 2016, before the Referendum campaign on the UK's membership of the EU had begun. The aim of the study was to focus on alternative fund managers' views of fund structuring questions looming on the horizon in Europe, with a particular look at third party ManCo platforms.

No one involved in putting this study together anticipated that the UK would vote to leave the EU on June 23. Fieldwork had just begun when the Referendum result became known. (87% of the interviews were done post June 23.)

Whilst Brexit made little to no difference to the US research findings it has undoubtedly had a significant impact on the European results. We believe that the level of interest UK based managers expressed in joining ManCo platforms in jurisdictions like Ireland and Luxembourg has something to do with the country's decision to leave the EU.

In effect Brexit has turbo-boosted London managers' interest in ManCo platforms. If the UK had voted Remain we would still have anticipated an increase in interest in comparison with research IFI Global has done in this area in previous years, but it probably wouldn't have been as pronounced.

Aside from the impact of Brexit the findings of this study suggest that there is a growing gulf between the US and Europe in several areas covered by this research. This is caused by AIFMD. The survey found that the Directive is now forcing real executive functionality on the AIF in the jurisdiction where it is domiciled. This



has begun to have a real impact on the structure of the European fund industry – and is probably the survey finding of most long term significance for this industry.

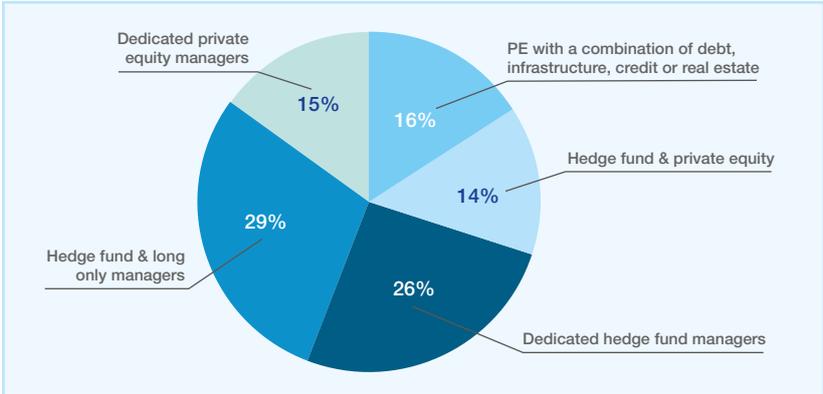
IFI Global would like to thank all those that agreed to give up their time to answer these survey questions – particularly given the fact many were preoccupied with the implications of Brexit for their businesses when the fieldwork was conducted. Alternative managers with a combined AUM of \$489 bn were interviewed by IFI Global researchers.

We would also like to thank Crestbridge and Fuchs Asset Management, the two sponsors of this project.

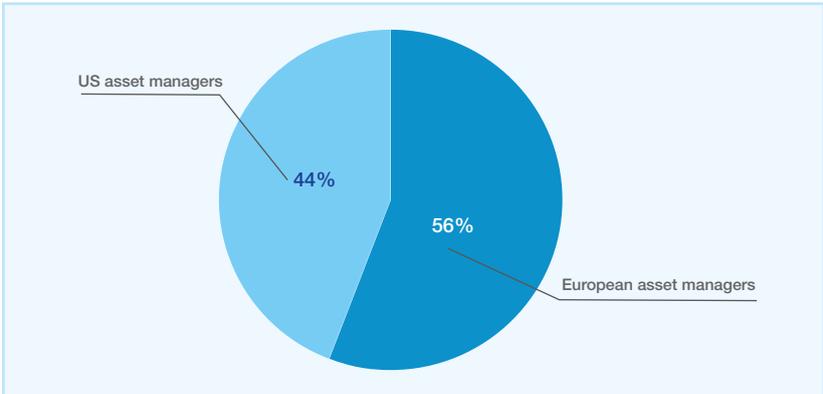
# Breakdown of survey respondents

Alternative managers with a combined AUM of \$489 bn in Europe (mainly UK) and the US were interviewed. The breakdown is as follows:

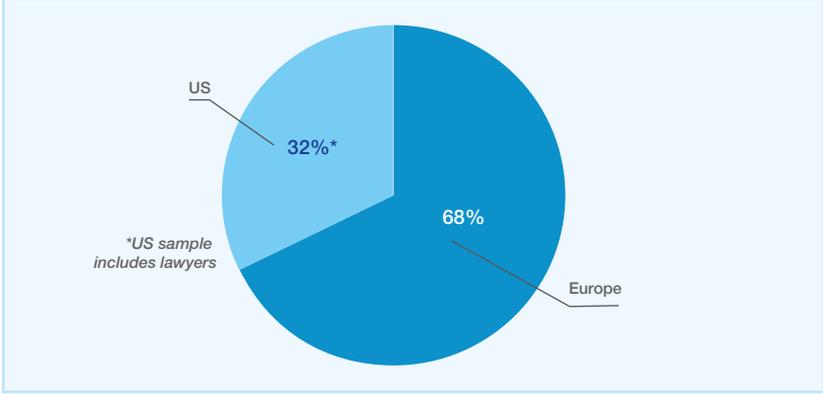
## Category breakdown



## Interviews conducted with:



## Interviews conducted with those based in:



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# Overall summary and conclusions

- Brexit will have a major impact on the structuring decisions of UK managers who want distribution in the EU. In particular this survey found a marked increase of interest from UK based managers in joining ManCo platforms (partly but not exclusively because of Brexit).
- In contrast to the European results this survey found that interest in ManCo platforms in the US was at the same level as in 2015 (when IFI Global conducted a similar that included questions on this subject). However the survey included interviews with US lawyers, in both 2015 and 2016, and it appears that they are becoming more comfortable with the ManCo platform concept.
- Processes and costs of AIFMD have largely been absorbed by the industry. Many survey respondents said implementation of the Directive hasn't been as onerous as they had been led to believe, in the run-up to AIFMD's introduction. But very few see much benefit from this measure – particularly for their investors.
- Many UK managers interviewed have heard of RAIFs, a new structure in Luxembourg. But no one surveyed had plans to use them, although the RAIF only became law in Luxembourg when the fieldwork for this study was well advanced. But a number of survey respondents made the point that they prefer it if others go first when new structures such as this are introduced to the market.
- ICAVs, which were introduced in Ireland in 2015, are popular and gaining considerable traction, particularly in the US. Two US managers interviewed have switched from offshore into Irish ICAV structures.
- The survey uncovered a growing concern for the future of private placement, particularly as the UK has left decision making bodies in Brussels in the wake of the Referendum result. Some survey respondents made the point it is already difficult to use private placement in key EU markets like Germany.



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## Overall summary and conclusions

- A number of interviewees commented on what is a key, but possibly previously under-estimated, AIFMD requirement: risk supervision. Some respondents said that this matter is now being taken seriously by regulators. This appears to be new. It was not picked up in previous studies that IFI Global as done in this series.
- Another new finding this year: there is concern that AIFMD is forcing real executive functionality on the AIF in the jurisdiction where it is domiciled (ie role of the Designated Person in Ireland and Luxembourg's Conducting Officer). The concern is that the portfolio management organisation is being reduced to not much more than another service provider to the fund. Some managers interviewed do not like giving up this amount of control. Prior to AIFMD the organisation that made the investment decisions was also in charge of how the business was run. The Directive is changing that.



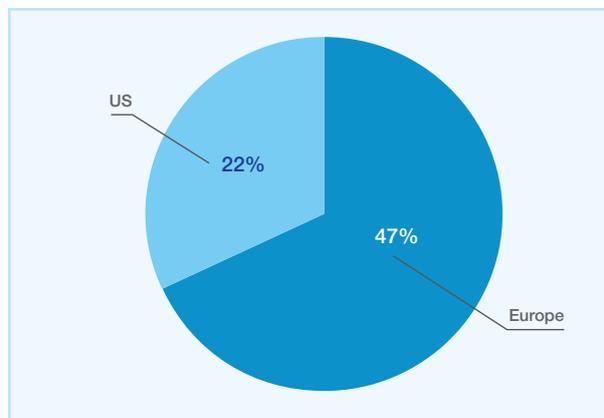
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# ManCo Platforms

## Survey Breakdown

**1) Are you using or are you considering using a third party external Management Company (ManCo platform) for your funds?**

Europe	47%
US	22%



**2) What do you see as the benefits and drawbacks of using a ManCo platform for your funds, vis-à-vis alternative options (for accessing the EU market)?**

**Benefits**

Costs (vis-à-vis the other options)

Expertise (particularly in ensuring AIFMD compliance)

Risk supervisory & reporting capabilities

**Drawbacks**

Loss of control\*

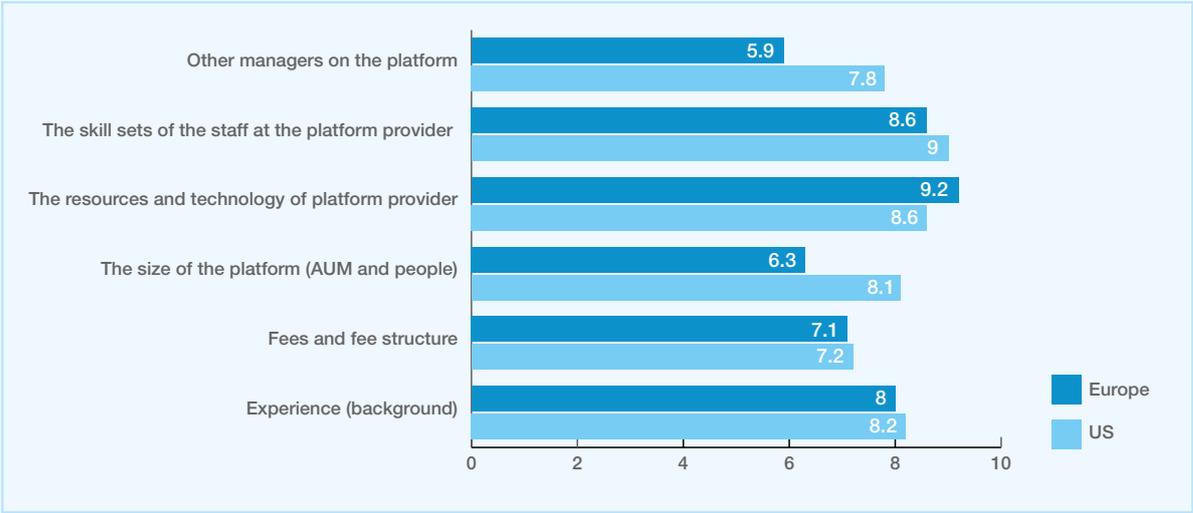
Potential conflicts between the manager & platform provider (particularly if something goes wrong)

Concern that these platforms may not be appropriate for complex strategies

*\*US alternative managers are used to partnership structures; the concept of a ManCo platform is foreign to them*

# ManCo Platforms

### 3) How important are the following to your organisation when looking to find a ManCo platform provider?



### 4) How important is a ManCo platform provider’s risk management capability to you? Please outline your views on this subject.

The position has changed in Europe but not in the US. Growing numbers of European survey respondents are becoming aware that risk supervision matters are being taken more seriously by regulators in the jurisdictions where their funds are domiciled. This appears to be a recent phenomenon. It is not something previous research studies in this series have come across.

US based interviewees, on the other hand, are not aware of the growing emphasis on risk that the survey found in Europe. The extent to which that AIFMD puts real emphasis on risk supervisory functions being carried out in the jurisdiction where the fund is domiciled is not something that US based survey respondents were familiar with.

However in Europe these survey results suggest that something of significance is taking place at present. As a result of the growing emphasis on risk the capabilities of ManCo platform providers in this area has become more important (for managers as well as investors). The situation appears to have changed considerably from when AIFMD was first introduced, and platforms compliant with the Directive were launched.

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# ManCo Platforms

Hedge fund managers surveyed generally take risk matters more seriously than those from other categories such as private equity. But managers surveyed across all asset classes want a robust risk reporting and supervisory capability from their ManCo platform provider.

However managers are not looking for risk management functionality that duplicates what their own portfolio or risk managers are doing. On top of which a number of survey respondents said that they doubt there are enough people with risk management experience, in EU fund jurisdictions, to add much value anyway. The view is that risk supervisory activity at the ManCo platform level should complement the portfolio manager's risk team, not compete with it. The key requirement, as far as managers are concerned, is risk reporting.

**5) Do you have a preference for a ManCo provider with a background from a particular industry sector (for example one that also offers administration, fiduciary, wealth management or consulting services)? Or do you prefer one that is an independent provider? Or is background immaterial?**

Ranking in order of number of mentions:

Doesn't matter

Administration

Wealth management

Independent

Fiduciary

Brokerage

Consulting



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# ManCo Platforms

## 6) What due diligence do you do on ManCo platforms and do you seek outside advice?

Survey respondents cited the following in their answers to this question: staffing levels, staffing experience and skills, infrastructure, technology used, types of assets covered, areas of expertise and specialisation, market knowledge, capabilities (including in risk and portfolio management), other managers on the platform, AUM, background on the organisation and its history, examples of how disputes are resolved, robustness of the business and future plans.

A number of managers also go into detail on the ownership structure of the ManCo platform (particularly in Luxembourg where there has been some M&A activity in this sector, with more expected to come).

US managers interviewed all seek outside advice on ManCo platform selection especially from their lawyers. Europeans tend not to do so (other than asking friends, contacts and service providers for their views).



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# Fund Structuring

## Survey Breakdown

### 1) Please describe how AIFMD has affected your business. In particular:

#### a. Please outline any benefits or drawbacks of the Directive

The passport was frequently mentioned as a benefit. But many of those that participated in this study are not looking to use it at present.

A small number of interviewees also said that there is a level of investor protection in the Directive that will be of benefit to less sophisticated alternative investors. (The focus on risk management and AIFMD's depositary function were cited as examples of this.)

But the majority of respondents said that there had been no real tangible benefits from AIFMD to either their investors or their firms.

The drawbacks are costs, time and the resources firms have had to devote to become AIFMD compliant. But most said that these costs had now been absorbed and that AIFMD compliance has now become "part of the daily routine," as one interviewee put it. The general view was that AIFMD compliance has not been as much of a burden as was feared it would be in the period prior to the Directive's implementation.

Another drawback that was mentioned was, to aggregate many similar points made by numerous interviewees, is that AIFMD has made the European alternative fund industry considerably more bureaucratic and, allied to this, is altering the structure of the industry in a negative way.

For example a number of survey respondents made the point that they have only recently come to realise that AIFMD forces "real executive functionality", as one interviewee put it, on the AIF in the jurisdiction where the fund is domiciled. If the AIFM is in control of the process then it means that the portfolio manager organisation is relegated in importance. This means that AIFMD is diminishing the role of the portfolio manager organisation to that of just another service provider to the fund.

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# Fund Structuring

## **b) Is distribution in Europe now a more, or less, interesting proposition (as a result of AIFMD)?**

No one interviewed said that they are stepping up their distribution as a result of AIFMD.

Many made the point that decisions on distribution are based upon investor interest. AIFMD has not altered investor interest in alternatives (either positively or negatively).

The general view is that fund managers do not use regulatory developments, such as AIFMD, to develop their marketing – with the possible exception of a few of the largest managers surveyed.

These are the mainstream fund management houses with well established distribution channels in the EU, which have alternative fund departments as subsidiaries. These large multi-billion managers that were surveyed, that also have UCITS funds, do welcome the passporting opportunities offered by AIFMD. (But Brexit has complicated responses to this question.)

## **2) How would you describe the benefit AIFMD has had for your investors?**

Most respondents said that AIFMD has not brought their investors any real tangible benefits – although the depositary function and emphasis on risk supervision are seen as useful safeguards for investors by a minority of interviewees.

## **3) Are you currently managing offshore structures? If so do you have any plans regarding re-domiciliation of these structures?**

89% are managing offshore structures (primarily in Cayman, Guernsey and Jersey). 54% of this amount also have funds domiciled in the EU (most hedge fund managers have funds for this market in Ireland whereas the majority of private equity and real estate managers have picked Luxembourg).

Just one survey respondent is contemplating re-domiciliation (to an ICAV in Ireland). The overwhelming majority intend to keep their offshore funds for the rest of the world and launch new funds in EU fund jurisdictions just for the EU market. Additionally, managers of Guernsey

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# Fund Structuring

and Jersey structures said that these jurisdictions have been approved for AIFMD passport extension so redomiciliation is not necessary anyway.

One interviewee said this would be a decision driven by investors. His organisation would only contemplate launching a fund in the EU if their European based investors developed a problem with Guernsey, which he thinks is very unlikely to happen.

## **4) Have you assessed the pros & cons of offshore and AIFM structures? What factors would lead you to pick one over another?**

It is clear from the responses to this question that a decision to pick offshore or AIFM structures comes down to investor preference. Respondents are extremely reluctant to look into changing their fund domiciliation arrangements unless they are forced into doing so by investors or regulators.

## **5) Please outline the benefits and drawbacks for your firm of using the following options for accessing EU alternative fund investors:**

### **AIFM Passport**

The passport is seen as being the only reliable means of guaranteeing access to EU markets in the long term given concerns about the future of private placement and questions over reverse solicitation (see below). Its drawback is the commitment as well as cost in time and resources of setting up one's own AIFM or the issues that have to be addressed if joining a third party ManCo platform.

### **Private placement**

Private placement is the preferred option for managers with AUMs below \$1 billion. Hardly any boutique asset management groups interviewed have ambitions to build their fund distribution across the EU at present. There is a widespread concern that private placement regimes might be turned off when the passport is extended. Private placement is already difficult to do in some major markets such as Germany. One interviewee was under the impression it had already been closed down there.

Many survey respondents have investors in just one or two EU markets, including the UK. When the UK leaves a number of these managers may not target the EU at all in future.

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# Fund Structuring

## **Reverse solicitation**

One interviewee called reverse solicitation a tactic, not a strategy. Survey respondents are aware of the dangers of using reverse solicitation. It is typically used in situations where investors know the asset management group and investment strategy well. It is generally not used as a means of finding new investors.

## **6) How is this choice (above) affected or influenced by remuneration and other disclosures?**

The cultural differences that exist between the US and European alternative businesses are highlighted by AIFMD's remuneration disclosure requirements.

Nobody interviewed in Europe said this matter has influenced their decision-making vis-à-vis the Directive. But it has had real impact in the US. One senior advisor to many US managers, that was interviewed, called AIFMD's remuneration requirements 'unAmerican'. He suggested AIFMD's remuneration requirements could "tip the balance" against becoming AIFMD compliant.

In addition to the remuneration issue GPs in the US are often considered masters of the universe so sharing responsibilities with a ManCo in the EU can cause them problems. They do not like giving up the level of control required by AIFMD and often won't do so unless absolutely necessary.

## **7) How aware are you on the recent introduction of the following fund structures and provide your views on them:**

ICAVs (in Ireland)

Notified AIF or nAIF (in Malta)

Reserved AIF or RAIF (in Luxembourg)

Many UK managers interviewed, including almost of them with a Luxembourg connection, had heard of the RAIF. But this measure only became law half way through the fieldwork for this study. No one interviewed has plans to use these structures, yet.

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# Fund Structuring

As a number of survey respondents said there is no competitive advantage to being an early adopter of new structures. They would often prefer to let others to go first. However the objective of the RAIF, to make it quicker and easier to launch funds in Luxembourg, is strongly welcomed.

ICAVs are well known by many interviewees. They are very popular and are gaining traction, particularly in the US. Lawyers in New York like them. Two US managers interviewed have switched from offshore into Irish ICAV structures

## **8) What are the main influencers on your fund domiciliation decisions and have developments in the structure of the alternative fund industry in the EU since the arrival of AIFMD (such as ManCo platforms) had any effect upon this?**

The results of this study show conclusively that domiciliation decisions are based on one factor above all others: investor acceptability. Domiciliation is not an area of the business in which managers wish to do anything different from their competitors. “You do not want to stand out from the crowd here,” said one interviewee.

The overwhelming majority of those that answered this question said that they would put up with being in an expensive jurisdiction, with slow set up times, if that was the price they had to pay to provide their investors with comfort on the domiciliation question.

## **9) Can you score the following jurisdictions for: 1) suitability of fund regimes, 2) quality of service standards, and 3) investor preference? (Please score out of 10 with 10 being the highest score.)**

Cayman	Guernsey
Ireland	Jersey
Luxembourg	Malta

Survey respondents see few if any differences in service standards across domiciles but some jurisdictions are recognised as being better for one area of the market over another. The Channel Islands and Luxembourg are recognised experts in private equity administration whilst Ireland is known for its hedge fund servicing capability.

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## Regulation and fund structuring

Luxembourg was the top jurisdiction for EU investor preference. In order to attract allocations from onshore EU investors it is considered to be the gold standard. Ireland is a close second. The survey found proponents for the Channel Islands, Cayman and Malta but none of these came close to Ireland or Luxembourg.

Several interviewees expressed concern that institutional investors are becoming ever more wary of allocating Caribbean domiciled funds. A surprise of this survey is how few of those that were interviewed with Cayman domiciled funds are planning to use these products for the European market.





IFI Global Ltd is a fund management research and media business, focusing primarily on the alternative side of the asset management industry. IFI Global conducts proprietary and syndicated research studies and publishes online media.

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A large, high-quality photograph of a single water drop falling into a pool of water, creating a series of concentric ripples. The drop is captured mid-fall, just above the surface, and the ripples are clearly visible, spreading outwards from the point of impact. The background is a soft, light blue gradient.