OPALESQUE

Opalesque Round Table Series '09

GENEVA

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Editors' Note

Dear Reader,

Welcome to the Opalesque 2009 Geneva Roundtable. On 26 pages, you will find valuable intelligence from some of the leading Swiss hedge fund investors, experts and hedge fund managers on some of the most important developments around hedge funds globally and within Switzerland.

Over the last two years, an increasing number of hedge funds started to **move their operational base into Switzerland**. As we discussed at this Roundtable, the companies involved are not just coming out of the U.K. alone – there are significant moves also from other parts of the world into Switzerland. Swiss-domiciled hedge funds (set up by Swiss) explain some of the **little known actual advantages Switzerland offers for hedge funds** run from there.

The Roundtable highlights some of the drivers and motivations of these firms, but also the hurdles they face. In addition, you will learn about:

- **European Alternative Investment Directive:** Opportunities & challenges
- **Managed Accounts:** Aspects the general discussion has missed so far
- **Fees & Valuations:** How large investors successfully press hedge funds to revise fees, valuations, corporate governance
- **Hedge Fund Replicators:** When and why are they actually used?
- **Due Diligence:** When "yes/no" answers don't get the point
- **Back to normal?-** One year ago, some investors used to get up at 3:30 am to see how Asia was doing. But today, some veterans are still worried about stability issues – learn how they position themselves over such concerns
- **Disintermediating banks and prime brokers:** How sophisticated hedge fund investors are quietly revolutionizing hedge fund operations

This Roundtable was sponsored by Taussig Capital and took place late October 2009 at the Geneva headquarters of UBP. We thank Taussig Capital, UBP and all participants for their support of this Opalesque Roundtable.

- **Bertrand Bricheux,** Head of marketing and Business Development, UBP
- **Anne Simond,** Member of Management, UBP
- **Dr. Michel Dominicé,** Founder, Dominicé & Co
- **Glen Millar,** Director, Kinetic Partners (Switzerland)
- **Louis de Pfyffer,** Partner, Banque Heritage
- **Joe Taussig,** Founder, Taussig Capital
- **Michael Clark,** Head of Hedge Fund Research, Lombard Odier
- **Pascal Engel,** Director, Templar Group
- **Peter Fletcher,** Managing Director, Parly Family Office
- **Luc Estenne,** CEO, Partners Advisors

Enjoy "listening in" to the new Opalesque Geneva Roundtable!

Matthias Knab
Director Opalesque Ltd.

Knab@opalesque.com

Cover Photo: Geneva with Montblanc massif

Participant Profiles

Standing left to right: Joe Taussig, Michael Clark, Pascal Engel, Peter Fletcher, Luc Estenne, Matthias Knab

Seated: Dr. Michel Dominicé, Anne Simond, Glen Millar, Bertrand Bricheux, Louis de Pfyffer

Introduction

Louis de Pfyffer

My name is Louis de Pfyffer, I am an original partner of Heritage Bank, which has been involved in structuring and managing alternative investment products for its client base for over 20 years.

Peter Fletcher

Peter Fletcher, I manage a family office here in Geneva. We are an advisory company and have invested in hedge funds and private equity for about 20 years.

Michael Clark

My name is Mike Clark, and I am the Head of Hedge Fund Research at Lombard Odier. Our firm, a private bank founded in 1796, was a pioneer in hedge fund investing, having launched its first fund of funds vehicle in 1991, and thus benefits from strong and long-lasting relationships with leading hedge fund managers around the world. Lombard Odier currently has over 4.5 billion USD in hedge fund investments.

Our team manages a family of fund of hedge fund products, including Global Equity Long/Short, Global Trading, and a new liquid multi-strategy vehicle. In addition, we also offer customized services to the bank's private clients, including the construction and management of bespoke hedge fund portfolios.

My personal background includes trading and portfolio management in credit and fixed income, and I was previously the Portfolio Manager of a large multi-strategy credit hedge fund.

Pascal Engel

My name is Pascal Engel and I represent the Templar Group. Our head office is in Chiasso on the border of Italy. We have representative offices through associated parties here in the old town of Geneva and also in Lugano. We run our own fund of funds with an emphasis on commodities. We have also developed a managed account platform called Patronus.

Joe Taussig

My name is Joe Taussig. I am the founder of Taussig Capital, which is based in Zurich. We partner with hedge fund managers to create insurance companies and banks, where the managers will then run all the investable assets.

Our most visible company is called Greenlight Capital Re. Here, we partnered with David Einhorn. Greenlight Re has outperformed the Greenlight hedge fund by 6% per year since inception. One of the investors is present at this Roundtable. Investors can own their shares in the vehicle to the extent and length as they choose, but the manager has over a billion dollars in it which is permanent capital - a stable asset base he otherwise would not be able to secure.

I am the corporate sponsor of the 2009 Opalesque Geneva Roundtable, thank you all for participating.

Dr. Michel Dominicé

My name is Michel Dominicé; I am the founding partner of a company called Dominicé & Co. We are a hedge fund manager based in Geneva. Our main product is the Cassiopeia Fund, which is a volatility arbitrage fund. More exactly we could say it's an applied behavioral-finance fund in the sense that we arbitrage a permanent irrational behavior of equity market. We call this behavioral bias "shortsightedness of equity market". It is linked to the fact that people invest in the long-duration asset class like equity with a short-term focus on risk.

The fund has been very successful over the last six years with an annual return of 14%. We were also positive in 2008, in fact we have had only positive years.

Glen Millar My name is Glen Millar, I head the Swiss office of Kinetic Partners. Kinetic Partners is an advisory firm to the asset management industry which was formed four years ago.

Since we started out, we have served around 800 customers, of which two-thirds are in the alternative investment space. We provide audit and assurance, tax, structuring and consulting services, but we also have been quite active with moving hedge funds into Switzerland and helping both the incumbent hedge fund and alternative investment companies with adaptation to the regulatory changes.

Luc Estenne I am Luc Estenne from Partners Advisers. Partners Advisers was started in 1998 as a family office and gradually evolved into a professional asset management company. Partners Advisers focuses on the management of allocations to hedge fund managers on behalf of family offices, financial intermediaries, and institutions.

Bertrand Bricheux My name is Bertrand Bricheux. I am the head of marketing and business development at UBP which includes, obviously, alternative investments. UBP has today $23 billion of hedge fund investments in a mix of fund of funds portfolios, bespoke portfolios and advisory clients. We have a 23-year track record investing in hedge funds. UBP has a diversified client mix ranging from institutional investors to high net worth individuals on a global basis.

Anne Simond I am Anne Simond, and I work with Bertrand in the marketing and business development department of UBP. Essentially, I focus on product development, since I have a legal background.

Matthias Knab **One of the hot topics which is currently being discussed is the move of hedge fund managers to Switzerland. Glen, your firm is helping funds to relocated. Is this a sustained trend?**

Glen Millar It's real. We have moved a number of managers here over the last couple of years. This dynamic was one of the factors behind Kinetic Partners choosing Switzerland and Geneva within Switzerland as its next office after the New York office was opened.

A couple of developments have recently contributed to the increased interest of managers to move their business. For example, the U.K. has steadily chipped away the non-dom benefits of the hedge fund community that work and live in the UK. We are obviously making our way through the financial crisis, and one of the labor government's reaction to that was raising the top marginal rate of tax to over 51.5%, which is higher than the most expensive Canton in Switzerland.

We also have the uncertainty of the E.U. Directive, and how U.K hedge fund managers – who until now have had a better regulatory framework than let's say managers in France, Germany or elsewhere in continental Europe – will be affected. Some of these U.K. managers are concerned and have begun to look at other jurisdictions. Many of them are looking, but that does not mean they will all be moving at once.

A key date to have in mind will be April 5 of 2010, when many of these tax changes that have been announced will become applicable.

Glen Millar

While we can't say it is a flood of managers moving, it is a steady trickle of managers that have relocated here. Let me also add that our company's investment in opening an office here is not predicated on hedge fund managers moving to Switzerland, but to be able to better serve the evolving hedge fund community in Switzerland better.

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A key date to have in mind will be April 5 of 2010, when many of these tax changes that have been announced will become applicable. I believe that at Kinetic Partners, we may see more interest from managers and that some will actually make the decision to move. But I don't think that we will see hundreds of fund managers moving here.

Luc Estenne As hedge fund allocators, the relocation process (mostly from the UK to Switzerland) has been minuscule. The significant press coverage in the UK and Switzerland seems in consequence oversized compared to the reality we have been confronted with and could potentially be attributed to a lobbying initiative.

Bertrand Bricheux UBP does not have anymore hedge fund research analysts located in Geneva - a couple of years ago, we moved them all to London and New York. If there would be a flood of managers coming to Switzerland, of course we would reposition our research team accordingly. But so far I can confirm that in absolute numbers, the amount of managers moving back here has not really reached a meaningful level.

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However, any initiative or relocation of managers, which will bring or raise the skill level of the Geneva financial place, would be considered of course as a positive thing for all parties. The choices, education and opportunities for young people and service providers that surround the alternative business will greatly benefit everyone including the Canton in terms of direct and indirect revenues.

Michael Clark I think that brings up a really good point, because human capital is so important to the hedge fund industry. Even though we are not talking big numbers at the moment, that constant trickle of firms and experts into the Geneva community has the potential to eventually reach a critical threshold, after which the talent pool may be large enough and deep enough to make Geneva an increasingly attractive place for more and more hedge funds. This is a huge opportunity for Switzerland – and for Geneva in particular.

Anne Simond Switzerland and Geneva, as well as other parts of Switzerland, succeeded in attracting some hedge fund managers, essentially because of the better tax treatment. There are not many large hedge funds operating in Switzerland - I mean full hedge fund operations with investment management, not only parts of the business like investor relations, or a bit of research or risk management.

When Jabre Capital moved here, they came with 30 people out of UK to start their operation. They did not find an adequate talent pool here, so they just brought everyone with them.

Louis de Pfyffer

I think there is a desire to move, but the execution is very difficult because you don't find the necessary talents here. This means you may end up moving the whole group (sometimes tens of families), which are British geared and not always willing to relocate in continental Europe. There are also failures after the move– not every body wants to stay. It is a big endeavor.

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But in general, the industry may have other concerns and preoccupations at the moment. Even if you are in a position to move, the successful execution of the transfer is a big question mark. You have to solve things like lodging, schools, talents for your business. So in my view if it happens, it will be a case by case story, and may be things will gather momentum but only in the medium term.

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Peter Fletcher

We haven't seen that many moves here. We did see Asian funds which set up operations here to cover the European and maybe US time zones. UK funds are also considering Singapore as a possible option when moving.

But, as Louis said there is an issue here. I have had three kids going through the international school – they have a huge waiting list, and housing is very difficult to find. Not sure where all these mangers are going to live.

Matthias Knab

We recently covered at Opalesque that Kinetic Partners helped moving 23 hedge funds to Switzerland. While the trend may be ongoing, the numbers are not big as we are discussing, but also have in mind that just a few years back, none of these firms may have considered to ever move their base.

Joe Taussig

We are here in Geneva and I live in Zurich – I actually believe that there may be a lot more movement on the German-speaking part of Switzerland. Randomly we had dinner the other night with an U.S.-based fund manager of a good size and high visibility who moved to Zurich two months ago, there are a couple of them who actually moved to Zurich.

I don't know if it's true or not, but Zurich is perceived by them as more English speaking friendly than Geneva. Also, the international schools are easier to get into. They have two of fair size on both sides of the Zurich lake, and none of them has a super-long waiting list to get in.

We are in contact with managers both from the U.K. and the U.S. and U.S. managers are not running for a tax benefit, but for lifestyle. Switzerland is a great place to raise children.

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If as a hedge fund manager, you are heavily weighted toward offshore funds you are having another problem if you are based in the US. This year the deferred comp is gone. The vast majority of personal wealth for hedge fund managers based in the US is in their offshore deferred comp. There are many hedge fund managers who don't even have domestic funds like George Soros for example. He could build all of his fee income tax free, Mr. Soros is one of the lowest tax-payers in America, as only when he repatriates the money does he have to pay taxes.

This benefit is lost from 2009 onwards, so a lot of them are trying to restructure their affairs to the extent they can. I see a lot of a moving because Switzerland has a very advantageous corporate tax regime that most people don't understand or realize.

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This benefit is lost from 2009 onwards, so a lot of them are trying to restructure their affairs to the extent they can. I see a lot of a moving because Switzerland has a very advantageous corporate tax regime that most people don't understand or realize. There is no such thing as what they call a control for incorporation tax here. So it can be based here, have non-Swiss subsidiaries, and the way the Swiss look at it that, there is no look for taxation as there is in the US, the UK, Germany, France, places like that.

I am not even in Kinetic's business, but I believe there will be a lot more managers coming to Switzerland than what we have so far seen.

Pascal Engel What I found networking with the hedge fund community is that they like to cluster together. This is what we have seen in Mayfair, St. James and Manhattan, and this is what needs to happen in Lausanne-Geneva and in Zug-Zurich-Pfäffikon in order to gather critical mass. Ticino has the opportunity to make a case with Italian speaking traders living abroad who wish to return to an Italian culture without subjecting themselves to the Italian authorities. But we are not there yet.

Glen Millar I think this is one of the factors behind the move to Switzerland which remember still has maybe 25-30% of the global fund of funds market on the investor side.

Dr. Michel Dominicé

I am a hedge fund manager based in Geneva. I launched my company in Geneva not because Geneva was a good place to launch hedge funds, but simply because I am Genevan. I wanted to do business where I was and where my family is.

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I must say, it was difficult at the beginning. People regularly asked me if I wanted to move to London or New York. There was a lot of lack of credibility with Geneva being a hedge fund location. Things are changing now, but it has been quite a process until the mentality changes and people understand that Geneva is not only a place for private bankers, but that can be a good hedge fund and based in Geneva.

There are many advantages to the Geneva and in fact the entire Swiss market place for launching a hedge fund.

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There are many advantages to Geneva and in fact the entire Swiss market place for launching a hedge fund. The financial rules are very manageable - I could launch my own company alone. I think that is unique in Europe. As a small fund, you can easily launch here. Taxes are relatively good, and you have a good infrastructure.

Don't forget the fact that capital gain is not taxed. This makes a huge difference. You're not just looking at the tax levels, but also what is and what is not taxed. Not taxing capital gains makes a huge difference for many.

Another advantage of being here is that you can be close to your clients. Slowly Switzerland and Geneva will become real hedge fund centers, but it will be a slow process.

Dr. Michel Dominicé

One of the issues that I perceive is that academia and business are not working together in a lot of places. For example, I did a post graduate diploma in statistics at the Polytechnic (ETH) in Zurich, and most people there don't really care about finance.

I find it very refreshing to talk to scientists about how glaciers are moving and the routes birds are choosing when flying to Africa. For someone who is in finance all day, that can be refreshing. But if other students and assistant professors start telling you that "you are a nice guy, but somehow you ended up in finance" – it shows a certain stereotype thinking and small mindedness! If academia is all left-wing and speculation necessarily criminal, that's not really helpful for developing a hedge fund center.

I know there are exceptions and efforts have been made to build bridges between business and academia such as the newly created Masters in Finance at ETH; and there are other schools such as the IMD Lausanne or the HEC in Paris, which have been trying to fill that gap for years. Generally, I feel that a lot of the resources in Swiss academia are not used very well at all. One of the reasons is that banks and businesses in Switzerland are often run by people who have never gotten close to

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Pascal Engel

a University. Therefore they distrust anyone wearing spectacles. The crazy quant guy in the corner is shut out from investment management decisions and sometimes rightfully so, for his obvious lack of any relevant investing or trading experience.

Joe Taussig

A couple of years ago there was an initiative here in Switzerland to encourage the hedge fund business to migrate. I think Peter Mierbo was trying to spearhead that. I am not sure what happened to the initiative, because for a while it had a lot of support and could have developed into something very good for the country. I believe the perspective he was trying to get across is the Swiss are great in distribution, but lack in their ability to manufacture content – that is products like for example single manager hedge funds - to maintain the competitiveness.

We agree that the Swiss private banks are very good at what we call wealth administration, as opposed to true wealth management. Some Swiss bankers are wringing their hands how they could become good at wealth management. I am not sure they have to, I think they have to become good at portfolio management, which affords a much different skill set.

We talked about the clustering effect, and I believe you are going to have a hard time moving the bulk of the industry out of places like London, New York, or Fairfield County in Connecticut. The clustering is too strong and too attractive, very much like Silicon Valley or Bermuda's insurance industry. But I do think we develop the skills of portfolio management and expertise.

You can initiate large shifts through a strategic focus within a generation. I was in Bermuda in 1985 and helped starting the dabbling insurance industry. Peter was there at that time too, and if you remember, it wasn't much of an industry then. Today Bermuda is the second largest in the world.

Personally, I think there is a tremendous opportunity on a global scale in commercial banking, as opposed to private or investment banking. The big countries are going to drive the commercial banks into the retail business and out of commercial banking.

We are certainly seeing some of this happening right now. We are becoming active in Malta, which is a country you should be looking at right now. And they are doing some things very right. But let me add that if Switzerland ever got its energies focused, Malta couldn't be as competitive.

Peter Fletcher

At this Roundtable, I think we should be talking about hedge fund fees. Everything is two and twenty – I'd really like to figure out at one point who started this two and twenty scheme. And in a lot of cases now you are dealing with five and twenty. When you add everything up, those are huge numbers in this market environment.

Given that so many managers failed to protect assets from the macro forces over the last few years and many more that just provided beta there is a major review of what is paid in fees. Even at a 2% management fee level, this is a big number, I can hire a lot of people for the money these days.

If I want to do it or not is a different question, but in the end we keep pumping money into managers, and these guys are flying around in helicopters or on their boats and telling us about the tough life they have, and that now they got to move to Switzerland, because the tax rate is too high in the UK.

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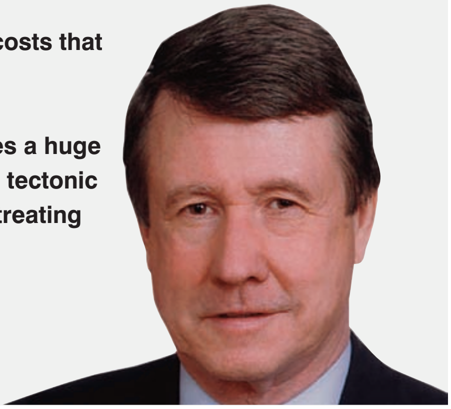
So again, I think we pay too much fees in this industry. There are so many hidden costs that we have found out since last year.

We have negotiated a lot of fees to performance fees on realized profits. This makes a huge difference and the start of a broader change in the industry. I think there is a whole tectonic shift, and managers are now also judged as to how they work with their investors, treating them like owners, not their own fiefdom.

Peter Fletcher



So again, I think we pay too much in fees in this industry. There are so many hidden costs that we have found out since last year. It's horrendous and I think a lot of the behavior by managers during that period was just disgusting. I don't have a better word for it. Some went through 2008 fine, we are still with them, and others disappointed us.

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Matthias Knab **Going forward, can you elaborate what is important for you in this respect in order to invest in a hedge fund? What are you now looking for?**

Peter Fletcher Well last year, one of the main things that came out was control. I guess we made a few mistakes ourselves, because I could see some of the events coming, we all could. I did get out of a lot of managers and strategies, but I didn't get out enough. A lot of these managers had too much faith in themselves. I never want to hear from a manager what a great company they are invested in and the P/E is 7 or whatever, while the world is crumbling around them. So, the control of assets was most important.

2008 changed the game dramatically – we are not in the same environment any more. We have been using managed accounts since 2000, and we are doing a lot more now. It's very easy to say "let do managed accounts", but they are very difficult to set up and structure. They change your whole operations because you have to add a lot on the operations and risk side. There are a lot of legal aspects that need to be covered, and sometimes it seems lawyers are the only people making

money.
We also set up bespoke funds, and we are doing more of those too, sometimes in cooperation with other family groups. In such a bespoke fund, we work with the manager, but we are on the board, it's our fund, we control it.

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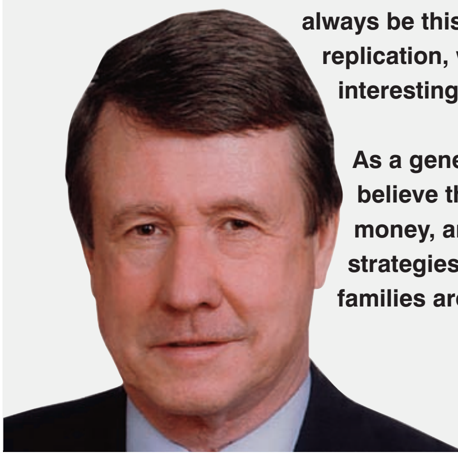
I used to say back in the mid 1990's that probably 96% of hedge funds were crap. I guess lateron in 2000 I said that 99.6% are. But we keep looking for that small percentage that are worth investing in. There will always be this superior type of hedge fund. However, there is another trend called hedge fund replication, which we have also started to use. There are also a number of mutual funds with interesting strategies, which weren't there before.



As a general observation, I believe that a lot of people forgot about asset allocation. We believe that investors need to identify the right asset allocations where to make your money, and then go out and find the right manager or implementation of the right strategies. This is what we are doing and we find that more and more ultra high networth families are doing that.

Peter Fletcher

The manager likes it because it entails an exchange of ideas. We do quite a few bespoke funds and feel comfortable with them. Managed accounts are great, but very difficult to set up and not suitable for some have very complex strategies.

I used to say back in the mid 1990's that probably 96% of hedge funds were crap. I guess later on in 2000 I said that 99.6% are. But we keep looking for that small percentage that are worth investing in. There will always be this superior type of hedge fund. However, there is another trend called hedge fund replication, which we have also started to use. There are also a number of mutual funds with interesting strategies, which weren't there before.

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Matthias Knab **Are you using managed account platforms or do you set up your own accounts with a manager?**

Peter Fletcher We do our own managed accounts. We have been doing this for quite some time, but it gets complex as after a while you end up with all this data.

Michael Clark

At Lombard Odier, we make very extensive use of the managed account platforms. Part of our due diligence process now includes both the platform as well as the managers themselves. We have selected a range of approved managed account platforms, and each of them tends to have different strengths and weaknesses. To begin with, we don't invest on platforms which face any identifiable conflicts of interest.

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Michael Clark

On the issue of the control of assets, managed account platforms don't necessarily transfer control to us, but rather what is important is that a significant degree of control over the assets is taken out of the manager's hands and put into the hands of a third party who will act in the best interest of the investors. The role played by the platform gives us and our investors a lot more confidence, particularly in avoiding cases of fraud. We firmly expect to see a sustained trend towards managed accounts, both on and off platforms, going forward.

I agree with Peter on the fee issue. While I have certainly seen a big change in managers' behavior following 2008 with respect to liquidity terms and addressing any potential liquidity mismatches, a lot less has been done on fees.

Moreover, it is very clear that funds are now a lot more focused on managing their relationships with investors and are more aware of, shall we say, the quality of their investors. Funds also tend to offer more transparency now, particularly in this post-Madoff world, and at least some degree of transparency is something upon which we insist.

So in summary, while we have not witnessed a lot of flexibility on fee levels, I would say that if I can solve the control issue, if I can get the transparency I require, and if I can achieve an open and productive relationship with the fund manager, those issues are actually more important than fees. Assuming the investment returns are satisfactory, of course, I can swallow the fees if the other issues have been dealt with.

Peter Fletcher

There is another thing that greatly worried us, which is valuations and fees taken from what we think improperly valued assets. For certain assets, how do you mark them if there is no buyer?

There is another thing that greatly worried us, which is valuations and fees taken from what we think improperly valued assets. For certain assets, how do you mark them if there is no buyer? Should we keep on paying fees on model prices? That is fees are taken on valuation bids, not liquidity bids where the assets can actually be sold at.

Peter Fletcher

Should we keep on paying fees on model prices? That is fees are taken on valuation bids, not liquidity bids where the assets can actually be sold at. In addition, too many mangers are stuck with the same huge positions, with no possibility of liquidating these.

Pascal Engel

Managed accounts aren't the answer to everything; whether a managed account makes sense depends on the underlying instruments traded. We specialize in futures trading – CTA, Global Macro and therefore mostly listed or exchange cleared instruments - this is an area where it makes sense to use managed accounts, for other investment styles using less liquid instruments it may be not advisable, as managed accounts by themselves are not solving any problems related to liquidity.

Hedge fund managers in many cases have to make up their minds if they fall into our "liquid" camp or if they are more like private equity. Fee structures differ in private equity, as incentive fees are usually charged on realized profits and not on some fantastic model valuation. An event-driven fund which seeks to influence corporate management, control a majority of free float and hold a stock for a period of more than two years, why should this fund not adopt a fee structure like a private equity fund?

Luc Estenne

2008 was a stress test for the hedge fund industry and the global asset management industry. Control of assets and corporate governance came up as the main issues, together with the need for increased operational strength. The key lessons was the need for a reduced liquidity mismatches 1. between the assets managed by hedge funds and the liquidity provided by these hedge funds to investors 2. but also between the liquidity provided by hedge funds and the liquidity offered by fund of hedge funds.

There are solutions for all of these points. In some case, the solution could be a managed account, but managed accounts aren't necessarily the panacea. I believe managed accounts and hedge funds should be used in a complimentary fashion.

A key point for investors is to be more strict than in the past and recognize the importance of corporate governance, operations and extended due diligence. With structured guidelines that cover all these aspects, people investing into hedge funds will do well. I think that the industry is moving into this direction. We are seeing large hedge funds like D.E. Shaw moving to full third-party administration in reaction to investor pressure. We also see more independent boards of directors being set up. Partners Advisers would like to see the responsibility of custodians being upgraded. The current draft of the European regulation on alternative investments goes on many aspects in the right direction. Of course, at this point, the regulation has some weaknesses and the draft proposal has to be revised and improved, but the industry is reacting and moving in the right direction.

Bertrand Bricheux

I want to emphasize more on the subject of liquidity, which has been a wake-up call for the entire hedge fund industry. Asset liability mismatch seems to have been the name of the game for many participants. People have to understand that one of the drivers of performance in this business is the illiquidity premium. Few investors realize this, while too many funds have played that game, some of them have paid a dear price for this mismatch. If as an investor you want to be able to get out on a monthly basis, there is only a limited number of hedge fund strategies that can fit the bill. A parallel can be made also for fund of hedge funds and they all have to be transparent in terms underlying liquidity, underlying manager's portfolio liquidity.

As a fund of hedge fund we need to have a clear understanding for each underlying hedge fund manager what exactly is in their portfolio, how quickly can it be liquidated, even in difficult time, and minimize asset liability mismatch to the most possible extent.

Dr. Michel Dominicé

As a hedge fund manager, I hear a lot of critiques about fees, about investing in illiquid assets and that hedge funds are a pure beta play.

And true, when we measure the correlation of the HFR Global Index to the equity markets before 2008, the typical beta I could find was 0.7, which would confirm that hedge funds as a group may be more a beta than alpha play. I am kind of surprised that investors let this happen.

And guess what, this correlation went back down to much lower level at the beginning of 2009. But maybe not surprisingly, the correlation is again massively increasing. We may soon be back to the 0.7 correlation.

But it doesn't have to be that way. My own hedge fund has zero correlation with the S&P. However, I don't see floods of money coming into my fund today. I am not saying that all hedge fund managers are doing something wrong, but certainly, the hedge fund investor should fully understand strategies and correlations, and pick the funds that are appropriate for them.

Louis de Pfyffer

I fully agree with you. If we do our job well, we have to select the managers that are beta-driven from those that are alpha enhancers. That is a large part of the value-added you have to deliver when picking managers.

Generally I would say that managed accounts are a good solutions if you have the size. I am not sure about platforms, because platforms also mean traffic - traffic of different biotopes of investors in the same account. That traffic is extremely detrimental to the performance and a burden to the manager who has to constantly rebalance positions. The big lesson of last year was that there are very different biotopes or investor profiles that went into the same investment vehicles and when redemptions hit, everybody, whatever time horizon and risk profile, felt forced to redeem in order to avoid ending up holding the bad illiquid investments.

Louis de Pfyffer

Just like Peter, I don't like paying those fees, but at the end it is the net risk adjusted return that matters ,and I insist on risk adjusted.

If funds wants to keep their talent and attract the best people, it is their fee structure that will allow them to compensate the best individuals in a competitive manner. Funds with higher fee structures have more often than not succeeded in delivering above industry risk adjusted returns. A higher fee structure can work in your favor , if you are able to attract the talent that will help you deliver the better quality returns. And assets will come in!

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Traffic is very detrimental to the performance and often drives longer term money into redeemers, whereas in a separate account, you stay away from that traffic.

Pascal Engel

We operate a managed account platform, so I am obviously familiar with the others around. Just as a recommendation, I urge every platform investor to take a very close look at the segregation of assets. Traffic on the platform is one thing, but when it comes to the segregation of assets, many claim it and few have actually the structure in place to ensure that segregation can be upheld in times of trial.

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Pascal Engel

Use a lawyer or a structuring specialist to investigate this issue in-depth. We found that a lot of claims are not true, plus there are a lot of hidden fees such as kick backs on clearing fees, which are sometimes disclosed, sometimes not. So you do your work... as Michael said before, not just on the manager, but also on the platform.

Peter Fletcher

Just to clarify some things, we still have a lot of hedge fund investments. Some people did very well, and as you said, alpha is alpha, and there was a bulk that didn't perform that well last year. We, together with other family groups, also took managers "off the table". That is, they are now just working for us, quite similar to having an in house team and sharing ideas.

Anne Simond

Peter, you mentioned the need to structure and execute a proper asset allocation. At this point, managed account platforms are of limited help, as you only have strategies that can be, to a certain extent, controlled by the platform provider: liquid and transparent strategies like long-short, CTA, certain macro or event-driven managers. Talking about governance, some of these managed account platforms are full of conflicts of interest, by the way.

Michael Clark

Investors really need to understand how these managed account platforms are operated. You need to understand what investors are allowed to do or not, and most importantly, you need to understand the characteristics of the underlying collateral. In other words, some strategies are ideally suited to be offered via these platforms, and some aren't, but without a detailed understanding of the assets, the strategy, and the platform structure, you can't make that judgment.

I often find that among the hedge fund investor community there is just not enough expertise regarding the underlying asset classes. Not enough people who understand not just how the returns are generated, but also what can go wrong with these assets.

For example, let's just touch on a general concept like liquidity. It is a standard question in the due diligence process to ask how long would it take to liquidate a portfolio. I can tell you from having managed credit assets for many years that the answer today can be very different from the answer tomorrow, or next week. It is a very complex question, because liquidity is not a constant, and there is never going to be a single and simple answer to that question. So to be an effective investor you have to be able to tackle a question like this and understand the complexity and how environments and parameters change - whether we are talking about managed account platforms or otherwise. These questions can't be answered with a simple "yes" or "no" – but unfortunately many due-diligence processes assume otherwise.

Michael Clark

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I do hope that over time the level of expertise within the hedge fund investor community will go up. Alternatively, those firms that haven't had the requisite skills or foresight are now going out of business.

Joe Taussig

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The other aspect of managed accounts that is somewhat disturbing is that the manager will manage those assets differently. There have been studies claiming that managed accounts do not return as much as fund structures, because the manager will not make the next incremental investment, because he is looking at the redemption risk that exists, or the co-investor risk that you have inherent in the fund business.

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A quick word on the liquidity mismatches which theoretically are also addressed by lockups, but the problem is that once somebody exceeds the lockup period, they go to a much shorter term, but possibly the embedded asset liability mismatch remains. The industry must address this asset-liability mismatch. This also implies that if as an investor your liquidating horizon is rather short, you have to limit your choices.

Luc Estenne

Obviously liquidity comes at a cost. Most of the time investors are not ready to pay for it: they want the liquidity associated with traditional investments and the high return associated with hedge fund investments. Until last year, the industry was trying to deliver both to too many investors.

We see now investors opposing to mixing together different strategies with different liquidity profiles. These investors are not interested in getting an "averaged-down" liquidity. Rather, they want to have more distinct buckets with high liquidity and low liquidity being separated.

Luc Estenne

Where is the solution? Investment solutions should be structured towards the different liquidity preferences of investors and towards more reliable liquidity. The alternative investment solutions or offerings have to be much more granular and reliable regarding liquidity parameters.

We see now investors opposing to mixing together different strategies with different liquidity profiles. These investors are not interested in getting an "averaged-down" liquidity. Rather, they want to have more distinct buckets with high liquidity and low liquidity being separated. It is therefore important to better understand the liquidity profile of underlying funds of the different financial instruments they have exposure to.

Peter Fletcher

People forget how bad things where, and are maybe too optimistic that all has been solved by now. I remember last year at this time waking up at 3:30 every morning to see how Asia was doing, and now everybody seems to think that the world is okay again. We were moving cash around, because we did not know what bank to put it in. Has the situation really changed a lot? There is still a lot of risk out in the marketplace with counterparties, derivatives and some other instruments, and this worries me more than what hedge fund should I pick and what prime broker.

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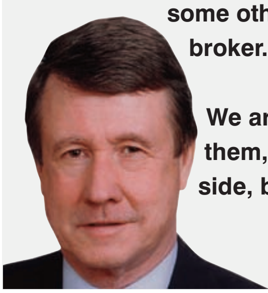
We are looking at disintermediating banks and prime brokers now, because you do not really need them, unless you are levering your assets. There are a lot of developments happening globally on this side, but again it kind of amazes me how everything seems back to normal.

Peter Fletcher



We are looking at disintermediating banks and prime brokers now, because you do not really need them, unless you are levering your assets. There are a lot of developments happening globally on this side, but again it kind of amazes me how everything seems back to normal. I travel a lot - in Asia for example, everybody is happy and excited, brokers say they are doing great while at the same time we have bizarre things happening like Royal Bank of Scotland hiring equity staff to expand throughout Asia – but they are in essence bankrupt and owned by the British taxpayers.

Joe Taussig

About a month ago, we met with the manager who runs the money market funds for Blackrock. In his mind, there are only 15 banks in the world that he will deposit with. I went through a list of five off the top of my head, and he said no to two of them.... well, at least I hit three....

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So Peter, you are right to be concerned. Let me give you another example. We are in discussions to set up a bank for a Forbes 100 family, one of the 100 richest families globally. They have two billion Euro trapped in the banking system any given point in time. And they are frightened that they will be in the wrong bank at the wrong time. The reason they want to have their own bank to run a global treasury operation which can deposit with central bank.

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Luc Estenne

True, there is one concern that we may face schizophrenic financial markets.

On one hand we have all the cyclical aspects. 1. the encouragement from of everything which has been done to support the functioning of the financial markets and the banking system - the quasi-nationalization of the banks, new lending practices implemented by central banks, etc. 2. the zero interest rate policy which obviously artificially supports risks assets, as everybody is desperate for yield.

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So technically everything is fine, but in terms of the structural issues, nothing is really solved.

On the other hand the key model of growth we have seen functioning over the last five to ten years was globalization, where the Chinese were the producer and the lender, and the U.S. consumer the consumer and the borrower. This model is broken.

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On the other hand the key model of growth we have seen functioning over the last five to ten years was globalization, where the Chinese were the producer and the lender, and the U.S. consumer the consumer and the borrower. This model is broken. What we are going to have to face sooner or later is what Bill Gross mentioned as DDR : de-leveraging, de-globalization and re-regulation. This will negatively impact the rate of growth you can get from the economies.

If your GDP in the US moves from an average of 6% growth annually for the last 30 years to maybe a maximum of 3% to 4%, then you cannot expect to make 15% in the stock market any more.

Where I am getting to is that I believe that we as investors have to readjust, and to lower our return expectations. This is going to be a painful exercise to the entire financial world. If your return expectations move down, it also means that potentially your commissions and fees of your services will have to move down as well. They can't be as high, if suddenly the returns provided are much lower.

Pascal Engel The share of financial services companies in the S&P in terms of market cap or of the overall wealth or income generation in the economy will most likely decline.

Michael Clark I would certainly agree that there remains a heightened level of risk and uncertainty in the macro environment. And of course, the rally we have had in the last six months has bailed out a lot of hedge fund managers who may have faced significant difficulties otherwise. And so it has perhaps just delayed the day of reckoning. Leaving that aside, this massive rally in risk assets is actually the strongest argument for why good quality, real alpha-generating hedge fund strategies should be more important to investors going forward, and not less. It is exactly why equity long-short strategies should be much more appealing than a traditional long-only fund in this kind of environment.

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Michael Clark

Luc Estenne

I agree. Within all the challenges, the irony is really that if you believe in the virtue of alternative investment and in absolute return versus relative return, this is one of the best times to invest in hedge funds.

Some hedge funds have disappeared, and you have less assets competing for significant opportunities. You have less leverage, you have less competition from investment banks who were partially responsible for the crisis and were the biggest competitor to hedge funds.

All the conditions have changed to the better for investors. All hedge funds that have been around through the last cycle went through their stress test and many have proven their abilities through a major crisis.

You have much more reasonable hedge fund managers eager for business, who offer more transparency, liquidity and are more open to discuss terms and better access.

Peter Fletcher

There is this intellectual war going on globally whether we'll have deflation or inflation, if they will come sequential or all at the same time. We may be in flat markets for a long time. This means you really have to find those managers or trading strategies that do something different.

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One thing that we actually do is buying companies. Companies can have a very long life. Even the family I work had a business, before it was sold, that went through many environments, depression, recession, wars, currency changes etc. and it survived all this, because it produced something.

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So there are those opportunities in the real economy, but also in other fields that are vital for our world going forward. There are not enough resources, not enough water, not enough agriculture to support the predicted population growth.

Louis de Pfyffer

One of the lessons for me is that there is a limit to which the hedge fund industry can be scaled up and commoditized. Hedge funds are a cottage industry business, and any attempt to industrialize it will fail. When you start having way too much money for too little talent, markets will reject the weak hands and make the industry consolidate and go back to its equilibrium.

One of the lessons for me is that there is a limit to which the hedge fund industry can be scaled up and commoditized. Hedge funds are a cottage industry business, and any attempt to industrialize it will fail. When you start having way too much money for too little talent, markets will reject the weak hands and make the industry consolidate and go back to its equilibrium.

Louis de Pfyffer

Michael Clark

As a general comment on the fund of funds industry, I believe strongly that if managers of funds of funds held themselves to the same standards which they demand from their underlying hedge fund managers, the industry would be in a lot healthier state right now.

For example – I would never invest in a hedge fund where their idea of investment research is a junior person going through a standardized set of questions ticking boxes “yes” or “no”. But that is considered acceptable, even standard, by many funds of funds managers with respect to their own due diligence. Research is, or should be, the very heart of fund of funds management. The standards have to be raised.

Peter Fletcher

I call those junior analysts JBTs that is Jargon Box Tickers. They know all the jargon, they tick boxes, and go out. The best question I had from one in Asia was “how do I get from Mumbai to Bombay?” By train, I’d say, it’s a long route.

I sit on the Board of a few hedge funds, so I get a lot of due diligence calls. I like to take those calls, also because I am also curious what they are asking about and what their level of expertise is. Remember, these people have to supposedly do due diligence on behalf of some pretty large fund of funds. Some are quite sharp, but others don’t really score by asking stupid questions like “do you like the manager?” Sometimes I don’t, but I still keep my money there.

Glen Millar

This is an important discussion, and let me just point out that none of the issues we are raising here will be solved by regulation.

Louis de Pfyffer

Nobody really wants overwhelming regulations like they are proposed. However there is a true need to improve the corporate governance of funds, for example when it comes to independent directors. Up until recently, a lot of board members of the hedge funds were people that had nothing to do with the business, they were just there for rubber-stamping.

You can make yourself a first opinion on a fund just by reading the few pages at the begining of the memorandum. Do they have a solid board of professional, independent directors who will take the heat when something goes wrong?

I am a Board member of a few funds, and I believe that good corporate governance is definitely a better route than regulatory overkill like the one that is being proposed!

Peter Fletcher

That is a very important point. We have seeded several funds, but even at such an early stage, the first thing I do is add an independent board.

We have seeded several funds, but even at such an early stage, the first thing I do is adding an independent board.

The next issue then are side letters. You have to look at this from the perspective how a fund evolves. When they start out, they want money, and they want the money quickly, even if they have been around for some time. So investors come knocking at the fund's door, but they want this and that side letter. As a director, I tell the manager not to sign anything, because if we change anything, it will be in the prospectus, and then it will be to the benefit of all investors.

I do see a lot of side letters that are irrelevant, because they are signed by the manager, and not the board. The manager has no authority to sign them – it's the board of the fund....

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Matthias Knab **Let's speak about regulations for a moment. Will Switzerland benefit from the new, coming regulations?**

Glen Millar I think that Switzerland is in a position to benefit, not just in terms of hedge fund managers that are locating here. Switzerland has the advantage of being outside of the EU, but it can, if the country positions itself well, also be an EU compliant location for the fund management industry. That means, some managers can keep their money offshore and not be affected by EU rules, while others may be within an EU-compliant onshore regime. This is a very interesting proposition for the investment community.

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Glen Millar

Dr. Michel Dominicé Also, the public is pressing the government or the authorities to change any hedge fund regulation here. As an industry, we could benefit from the developments in the banking sector, where organizations cut bonuses with the consequence that some talent will chose to set their own business and work for the own profit.

Some of the activities run by large banks in the past could in the future be run by hedge funds by exactly the same people. We may see credit hedge funds set up by people who in the past have worked for a big investment bank in London. I know some people are planning to move to Switzerland to launch a hedge fund for those reasons.

Pascal Engel We have a similar dynamic in Ticino. Some Italians work for prop desks in London chose to move out and be closer to home, but they do not want to be subject to Italian authorities. They come to Ticino, where they either trade for their own account, or they have someone who gives them 20 or 40 million, and they make a nice living. This could at some point develop into a hedge fund center. Right now, it's more people taking a break in their home culture, making some money trading their own capital, possibly running maybe two or three managed accounts from someone else, but it could develop into something more.

Anne Simond One has to bear in mind the genesis of the directive. It was drafted without any consultation

One has to bear in mind the genesis of the directive. It was drafted without any consultation whatsoever from any hedge fund representative. AIMA was not involved, the Hedge Funds Standard Board was not involved, and the U.K. FSA was not involved.

It was drafted with a big push essentially from France and Germany to go after hedge funds and also find a way to get to some tax revenue, since most hedge funds currently operate in Cayman Islands. There are many underlying motivations which makes the draft directive pretty unworkable.

I think we all agree that although more transparency is necessary, when it comes to regulation, the best regulatory regime is set by the U.K. FSA. Most institutional investors actually want to see that hedge fund managers are properly registered and regulated.

Once the directive has been passed, it will be interesting to observe its implementation. Member states have a certain discretion on the implementation, the rules could end up being ultra-protectionist.

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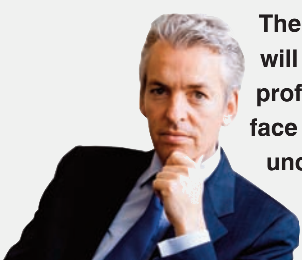
Once the directive has been passed, it will be interesting to observe its implementation. Member states have a certain discretion on the implementation, the rules could end up being ultra-protectionist. Today there are still too many open questions with respect of the draft directive, some lawyers actually do not advise their hedge fund manager to move. They say "stay in Cayman, until we have more visibility."

Glen Millar There is no such thing as a directive, for the time being it is a draft. By definition, a draft is subjective to revisions. Accordingly, the level of uncertainty is very high, and it is very difficult to comment specifically on what would be the impact of more regulation, because we do not know what regulation it will be. As a matter of principle, good regulation and clever regulation will serve the hedge funds, and frankly it is also needed in order to restore the confidence in hedge funds and fund of funds for many of their potential investors. But regulation needs to be balanced, fair and cost-effective.

Luc Estenne There is one bargain, one advantage that comes embedded with all those new rules. Hedge funds will receive the European passports and accordingly will be freely marketable to all European professional investors. In my view, that is a fair and good bargain, because one of the problems we face at the moment as fund of hedge funds when marketing into different parts of Europe is the uncoordinated regulation in each country. This is a very ineffective situation which makes things unclear, slow and cumbersome.



There is one bargain, one advantage that comes embedded with all those new rules. Hedge fund will receive the European passports and accordingly will be freely marketable to all European professional investors. In my view, that is a fair and good bargain, because one of the problems we face at the moment as fund of hedge funds when marketing into different parts of Europe is the uncoordinated regulation in each country. This is a very ineffective situation which makes things unclear, slow and cumbersome.

Luc Estenne

Louis de Pfyffer For me there is no doubt that this draft regulation was made as much to regulate hedge funds as to make sure that these people do not appear to make too much money in the future. So it is very political in a way, but the good thing about it is that we needed some regulation to regain a certain level of credibility.

If you really want to control hedge fund, it is very simple: just control their leverage. That is the only efficient way to do it.

In any case, I think we should pay a huge tribute to Andrew Baker from AIMA, who did a tremendous job in coordinating and organizing our industry lobbying and communication efforts around the E.U. directive. So you could say that the industry is getting a bit more organized, this is a very positive outcome!

Pascal Engel I wish that the regulators would also take a look at how the futures industry is regulated, particularly how the NFA (National Futures Association) operates. It is a good example of an efficient and effective regulation: It generates the transparency needed without increasing the burden on the regulated subjects beyond necessity; and it is also supportive to the due diligence process: A fund analyst can easily check any record by going on their website and search for the individual or the company and see if there have been any issues.

I want to reinforce what Louis said about controlling leverage. This is exactly the way it works in the futures industry, where an underlying can be very volatile and the future with its implied leverage quite a risky instrument. But in effect, futures trading has not posed any risk to the system in this financial crises, because the exchanges limit the amount of leverage by imposing speculative position limits and asking for adequate margin. The exchanges have done a good job assessing the risks involved in futures trading.

On the hedge fund side, this responsibility lies with the prime broker, or the bank who is lending against securities. The question is whether the prime broker is actually equipped and motivated to control the hedge fund leverage and positions in the same effective way as the exchanges.

Michael Clark

I think more than margining, which is a process applied in most derivatives transactions, the key consideration going forward, in terms of managing systemic risk, is centralized clearing, a key characteristic of futures markets. The migration of OTC derivatives transactions to a centrally-cleared model is a major step forward for the reduction of counterparty risk, and systemic risk generally.

Now we have talked a lot about the EU Directive, but of course, there is also the regulatory environment in Switzerland for us to consider.

Dr. Michel Dominicé

Generally I see two problems when it comes to a compulsory regulatory scheme. First, you raise a massive cost on the industry. But the second, real danger is that you give the impression of safety while there is no safety. A stamp of approval, or a regulated fund does not mean it is a safe investment.

Michael suggested to talk about the Swiss regulations for a moment. There is one feature that is quite unique and interesting. If I wanted, I could under Swiss regulations launch my hedge fund Cassiopeia, which is a Cayman Island fund, as a Swiss Registered Fund. The Swiss law is very flexible, I could do that without a problem.

If the investors want a regulated funds, they can go into the regulated fund. If an investor prefers to go into the Cayman fund, because he may feel there is more flexibility or more innovation or whatever advantage, he can pick the offshore funds. This seems a like a detail, but for a fund manager, it's big. All in all, I am quite happy to run my hedge fund out of Geneva, and by now, people have actually stopped suggesting that I'd move to London or New York...

Dr. Michel Dominicé

Further, I wonder what the authorities will do out of the huge flow of information with hedge funds and other regulated entities having to send their current positions all the time. I just do not know what they would do with that information. Even if they had the systems to manage the information, I am not sure if they have the right manpower or skills to extract real value or the right conclusions from that information. As I said, they could create an impression of safety, and it may in the end just end up to be a huge waste of resource and energy.

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