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Opalesque Round Table Series '13

FRANKFURT

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Editor's Note

German institutions: Much deeper understanding of hedge funds and sub-strategies

Since the financial crisis, the learning curve of German institutions about hedge funds and their many sub-strategies has been impressive, and investors demand a much more in-depth discussion of hedge fund strategies. Another factor that helps bringing more alternative knowledge into Germany is that many successful and well known offshore hedge funds have launched UCITS hedge funds. Offshore hedge fund knowledge and strategies are now distributed through UCITS into continental Europe. This is very beneficial to the German market as it provides additional hedge fund expertise to the investors.

Every hedge fund can become "tax transparent" for German investors

I remember when German Investment Act (Investmentgesetz) went into effect in 2004, every investor and manager was backing off saying, "oh, I would like to invest (or have German clients), but to deliver this tax transparency just seems pretty impossible to do...". Today, every fund can become tax transparent through the cooperation between the tax advisor and the fund administrator. The prices have come down significantly since 2004 and can range between €4,000 per annum for a derivatives driven fund to around €12,000 to €15,000 per annum for tax compliance for a long/short debt fund with large volume and many different assets.

The 2013 Opalesque Germany Roundtable took place June 12 at the office of tax, legal and consulting firm WTS in Frankfurt with:

1. **Marcus Storr, Head of Hedge Funds, Feri**
2. **Frank Huttel, Head of Portfolio Management, FiNet Asset Management**
3. **Alexander Adsay, Portfolio Manager, Antecedo**
4. **Carsten Straush, CEO, German Asset Managers Group**
5. **Dr. Randolf Roth, Head of Market Structure, Eurex**
6. **Steffen Gnutzmann, Partner, WTS**
7. **Robert Welzel, Partner, WTS**

This Roundtable was sponsored by Eurex, WTS and Taussig Capital. The group also discussed the following topics:

- **How long can non-AIFMD compliant international asset managers still sell to European clients?**
- **Which UCITS funds have on average an annual consistent negative tracking error of sometimes several hundred basis points? Why?**
- **What burned the word "hedge fund" in Germany and how to appropriately rename your fund when selling it into Germany?**
- **What are German institutions and retail investors looking for?**
- **What is THE big time bomb in bonds?**
- **How can investors prepare for the markets' worst nightmare: reliving the 1994 scenario when interest rates shot up**
- **How the Eurex Repo market helps asset managers managing their variation margins**

Enjoy!

Matthias Knab
Knab@Opalesque.com

Cover Photo: Römer, Medieval building in Frankfurt

Participant Profiles

(LEFT TO RIGHT)

Matthias Knab, Frank Huttel, Robert Welzel, Marcus Storr, Alexander Adsay, Steffen Gnutzmann

Dr. Randolf Roth, Carsten Straush

Introduction

Carsten Straush
German Asset Managers Group

My name is Carsten Straush. I am the President of German Asset Managers Group, a German hedge fund, fund of funds and single strategy management group, based in Frankfurt and Zurich and in business since 1999. We developed after the big long run in equities in the '90s strategies, setting ourselves up for the anticipated downturn in the markets based on volatility. In 2001, we added a relative directional long/short product, the Black+White fund for which we are mostly known in the industry. At first we were long/short in technology versus old economy. This was the famous trade of 2000 to 2002, when we made 20% plus while the markets were plunging. After that phase, we switched further into credit and loan related strategies.

We see ourselves as entrepreneurial first - mandated to change in order to adapt to the markets, and that is what we are looking to do in the future too. For us, investing is about "where do you get the next better alpha?"

Alexander Adsay
Antecedo Asset Management

I am Alexander Adsay, and I am a Portfolio Manager with Antecedo Asset Management, located in Bad Homburg. The company was founded in 2006 with the goal of providing strategies to protect equity investments from losses while still offering a decent return. In order to manage this task, we developed complex strategies that rely on exchange traded derivatives.

In 2009 we launched a mutual fund based on a highly developed options strategy. In this strategy, we buy and sell options of different maturities to benefit from different rates of decay over time, as options with a shorter time to maturity lose value relatively faster than options with longer maturities.

The fund itself was designed to achieve an annual return of 6% above the money market rate, while maintaining full compliance with the UCITS regulations framework.

The initial fund was so successful, that we decided to launch three further mutual funds derived from this core strategy. The first fund follows the same concept but is structured to accept a higher volatility. This leads therefore to a target return of 8% above the money market rate. The second fund follows this concept with the goal of achieving outperformance relative to the EuroStoxx 50 Performance index, which is built out of 50 eurozone Blue-Chips. So here you can participate in the options strategy and the performance as well as the dividends of some of Europe's leading companies.

In December of 2012, we launched our youngest fund which aims to yield outperformance relative to the bond market, namely the iBoxx Euro Overall AAA-AA Total Return Index, which contains only euro-denominated bonds of top-notch quality.

I joined Antecedo after graduating from Goethe University in Frankfurt, having studied in Bamberg and Oklahoma before. And today, I am responsible for our equity index linked mutual fund as well as our largest capital protection mandate.

Marcus Storr
Feri's asset management

My name is Marcus Storr and I'm responsible for the Hedge Fund Department within Feri's asset management division. I joined Feri in 2005. Feri AG is based in Bad Homburg and has three business lines, one which is consulting/family office business, one for its rating and research business and the third and most important business line is asset management. We run €21 billion in discretionary assets for institutional clients and ultra-high net worth individuals across the entire capital market spectrum. For each client, we manage a bespoke portfolio.

I joined the investment banking industry in London in 1998 and worked for JPMorgan and Dresdner

Kleinwort Benson in London within their equity research departments. During that period I serviced a lot of hedge funds with research ideas.

Feri runs a billion euros in assets under management in hedge funds, mainly offshore allocations, but also UCITS hedge funds. The remainders of AuM are run across all asset classes, including private equity, equities, fixed income and real estate. Each asset class has its own allocation/research team within Feri.

We are the largest hedge fund team in Germany when it comes to single managed due diligence and the number of analysts. Our department follows a very stringent and detailed approach when analyzing hedge funds. From the quantitative analysis, you can do a lot of thing by just using statistic models and academic research. But on the qualitative beside a structured due diligence process we spend a lot of money on very detailed and bespoke background checks on the managers we intent to invest in. We talk for example to the manager's professors, to former employers, business partners and so on. Doing this nitty-gritty stuff beside the quantitative work is a necessity to find not only the best performing managers but also to control certain risk parameters.

As we all know, it used to be that German investors were not all that well educated with regard to hedge funds, but I believe this is constantly changing positively as we currently see quite a significant interest when it comes to hedge fund allocation. Some of the current allocations go into UCITS hedge funds, but in fact when I look at the allocation of the first half of 2013, German institutional investors are also allocating to offshore hedge fund managers due to a better risk/return profile.

Dr. Randolf Roth
Eurex

I am the Head of Market Structure at Eurex, one of the largest derivative exchanges in the world. Eurex's headquarters are located here in Frankfurt. I am also a member of the supervisory board of the European Energy Exchange in Leipzig. The European Energy Exchange is a major exchange for power derivatives, power, gas and EUAs in Europe.

Frank Huttel
FiNet Asset Management AG

My name is Frank Huttel. I'm working with FiNet Asset Management AG in Marburg, located a little bit outside and North of Frankfurt. I'm responsible for macro research and selecting funds. We are a subsidiary of FiNet AG, which is a broker pool and an insurance service provider. Our company has been founded in 2007 and is regulated by BaFin. We have four core business areas: advising IFAs and helping them with their investment business, discretionary portfolio management for individual clients, fund management and "Haftungsdach", i.e. linking tied agents. I have direct contacts to our IFAs and to some extent to their clients, who are mostly private clients. Talking to both is advantageous to get an impression of the market mood.

One main emphasis of research is on "liquid alternative" funds. This has evolved as I used to manage a Managed Futures Fund (CTA) from 2005 to 2008. Before I was a derivatives portfolio manager trading on Eurex and other exchanges. I've changed sides in 2008 – leaving fund management and starting in fund selection. It makes it sometimes easier if you have done portfolio management before, if you talk to a portfolio manager because it is harder for them to tell you something which is totally nonsense. I also do hedge fund research, but as my clients are private clients, I have to concentrate on UCITS funds. So, unfortunately, I can't invest in offshore products which, if we can believe the data, are ´unfortunately´ better in performance than UCITS. This is often a matter of costs. I think we can talk about that later, the structure of UCITS. It's safer but it's more costly and I think that won't change over time.

Robert Welzel
WTS

My name is Robert Welzel. I have joined today's event together with my colleague **Steffen Gnutzmann**. Steffen and I both are lawyers with a focus on fund tax and fund regulatory law; we are Partners with WTS.

WTS is a tax, legal and consulting firm in Germany with 350 employees, plus an international network. We represent the Financial Services Asset Management team which has five partners, 35 team members. What is our primary interest and service offering? We service funds, hedge funds, mutual funds to gain German tax transparency, all tax issues from a German, but also from an

Austrian and Swiss perspective. We have quite a wide range of international clients, but we don't only serve the fund industry as such, we also advise especially German investors who invest in non-German fund products.

At this time, we see a significant interest, really three-digit millions of new investments into offshore hedge funds. We conduct tax and regulatory due diligence and also advise on structuring issues on whether these products are eligible for German regulated and non-regulated investors, such as corporates and family offices.

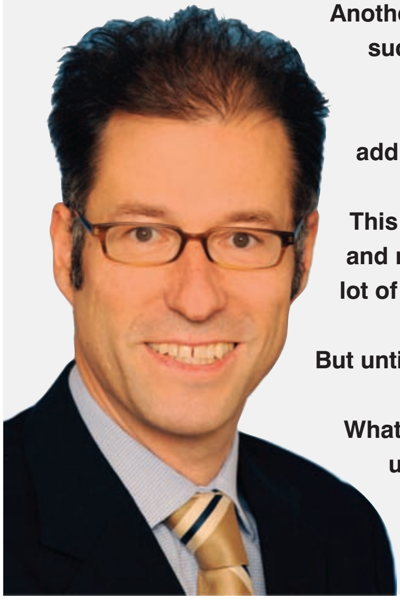
Matthias Knab Let's analyze in a bit more in detail the current interest from German institutions, family offices and retail investors for hedge funds or alternative investment products.

Marcus Storr: Let me briefly start by going back a couple of years to give you a very personal reflection. In 2005 to 2007, there was a big demand for hedge funds worldwide because people intended to diversify their portfolios. However, this did not really happen in Germany. There were some positive changes to the German regulation on hedge funds in 2004, so we all expected a certain run into hedge funds. That did not materialize due to two main factors: first of all, we didn't really see the launch of high quality hedge funds in Germany with some exemptions like AGI's European Discovery hedge fund. Secondly, the knowledge of institutional, and to some extent family office investors, was limited. However, traditionally family offices have been very much ahead in terms of knowledge. There are a number of large family offices staffed with a managing director and two graduates in their mid-twenties who are smart and hungry, who want to travel, and meet hedge fund managers personally. Interested German institutional investors were looking at fund of hedge funds, keenly watching what was happening in that space, particularly in Switzerland. Single manager allocation however did almost not exist.

The learning curve since the crisis has been very, very steep. For example, I find myself often in discussions with treasurers of large pension funds in Germany and I am surprised at the level of knowledge developed and understanding they display today. I remember discussions I had with the same people three or four years ago where they often had no idea about underlying hedge fund sub-strategies. The discussions are now much more substantial, and that helps because as we all know, people only allocate if they understand or they believe they understand what they are investing in.

The discussion about and the benefits of hedge fund sub-strategies is much more detailed now than the previous "I am invested [or not] in hedge funds" comment implied. Instead, people ask, "What do you think about Merger Arbitrage right now? How can current diversification benefit CTAs, or is the Distressed Debt cycle still attractive?" They want a much more in-depth discussion of these sub-strategies. Understanding Merger Arbitrage or CTAs is not rocket science, but you have to start somewhere, and subsequently to the built-up of knowledge and confidence, people will invest.

The second important element in fostering this trend is obviously the low interest yield environment in developed countries. But that factor won't put an investor necessarily into hedge funds; he may as well buy real estate or invest in private equity or other alternative assets with a higher yield potential.



Another factor that helps bringing more alternative knowledge into Germany is that lots very successful and well known offshore hedge funds have launched UCITS hedge funds. Offshore hedge fund knowledge and strategies are now distributed through UCITS into continental Europe. This is very beneficial to the German market as it provides additional hedge fund expertise to the investors.

This move into alternatives is quite dynamic at the moment, in particular in Private Equity and real estate. But if bond yields would go back up to 5-6% again, I think that in a minute a lot of that allocations in alternatives would be reallocated to the "safe" fixed income world.

But until that happens, there will be further allocations into alternatives.

What has also changed is that today, investors actively approach and contact us. Before, we used to contact them saying: "Can we help you in your portfolio? You are running 90% bonds; we think it makes sense to add some alternative strategies in your portfolio..." Now, people call us up and ask "can you come around? Can we discuss?"

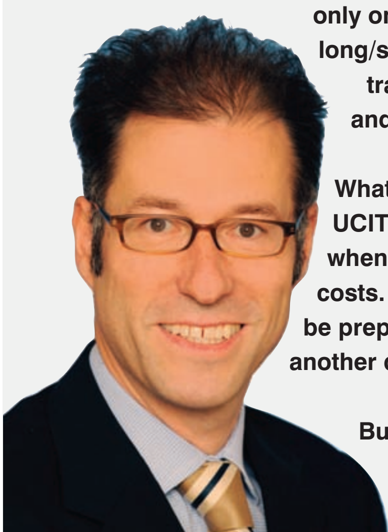
Carsten Straush: That is a great development, but I am still wondering how deep the investors' understanding has really developed. I am afraid some may assume that UCITS are "safe" because they are regulated. Moreover, what we have found analyzing UCITS is that the regulatory restrictions in running such a fund do in fact cost a lot of money. If I compare the typical hedge fund or say the HFRI or other indices and compare them to UCITS, the latter yield 3% to 4% per annum less. So a lot of the performance attributes of hedge funds are diminished or at times it is even impossible to reproduce a strategy in the UCITS way. This is a bad thing.

My second concern is the crowding of funds into those strategies that are "UCITS-able". We as managers are in fact looking for some more sophisticated or niche strategies that you can't replicate in an UCITS, e.g. buying oil in the ground and selling the future short. You just have to pump the oil out and of course deal with some variation in the drilling costs, but it is possible to set up a secured income stream of 8% to 10% p.a. through special vehicles, but not in a UCITS type fund because this strategy involves commodity risk, even though it's a sensible strategy.

Another sensible strategy involves freight rates. We have had a collapse in the shipping industry and similar kinds of sectors, so there are a lot of viable economic commercial ideas which really long for capital that the markets struggle providing. And now, the industry or the regulator are taking this conduit away saying "okay, we have to make hedge funds function like UCITS funds." That to a certain extent is one of the drivers behind the AIFMD, to regulate hedge funds like UCITS, but that is an error. From the beginning, hedge funds were entrepreneurial vehicles where people have special knowledge of some situations and wanted to do something different. Maintaining an alpha-driven industry rather than pushing each and everyone into the same approach by indexing and compliance would have kept the alpha and stabilized markets. Going down the route now in place will in the end result in big losses to the investor communities and to society.

Carsten Straush So my question would be then, do your people really understand already what they are doing, or are they going the wrong way, using the wrong vehicles?

Marcus Storr: I agree 100%, which in a discussion like ours is usually a bad thing to say – smile - but I agree 100% that investing in UCITS is not straight forward. We just published a paper in a book called ***'Reconsidering Funds of Hedge Funds'*** published in the United States. We conducted an empirical analysis of both the offshore and UCITS hedge fund universes. As a start we weren't taking a UCITS fund strategy at its face value based on the manager's description, we in fact looked at each single UCITS fund and defined the strategy according to what we think it is. We at Feri have hedge fund analysts for each sub-strategy, so conducting an empirical analysis strategy by strategy, we have found only one strategy where we think a UCITS wrapper makes sense. This strategy is equity long/short. All the other sub-strategies on average have an annual consistent negative tracking error of sometimes several hundred basis points between the UCITS hedge fund and the offshore version.



What drives the tracking error isn't the "official" management fee but the fact that within UCITS, you will have to use swaps, which means that you will be "charged" a bid-ask spread whenever traded. Hence the UCITS manager could end up with a lot of additional implied costs. Most of these UCITS funds also hold 15%, 20% or sometimes 25% cash, as they want to be prepared for potential redemptions due to a daily tradability of the fund. That is certainly another drag on the fund return, in particular in the current environment.

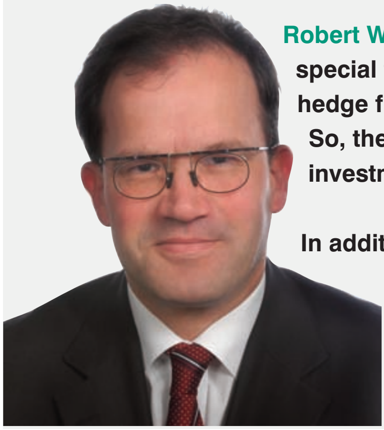
But – and this is a big "but" – there is on average less operational risk in a UCITS. The regulator looks at all UCITS funds and hence uncontrolled activity is rather limited, if not impossible. Compared to offshore funds, some qualitative elements are just as risky, like team stability and service providers, etc. However, there are a lot of hedge fund strategies in UCITS which shouldn't be in UCITS funds. Looking at equity long/short funds and CTAs or any security which is very liquid makes sense for UCITS. In fact we are investing in several UCITS funds applying these strategies.

So our study, which took a couple of months, showed that UCITS funds in general have a negative tracking error versus offshore hedge funds in addition to a higher risk profile measured using annualized volatility.

Robert Welzel: I think it is remarkable that we see a lot of interest from investors at this point in time to invest into offshore hedge funds. This happens at a time when regulations like the AIFMD implementation, plus additional German gold plating provisions click in, which will not only make the distribution or the marketing of hedge funds much more complicated in the future but will also prohibit certain regulated investors who currently can invest in hedge funds.

It will be interesting to learn how hedge fund managers prepare for these new regulatory and tax constraints in Germany and, on the other side, what will the reaction of the more sophisticated investors be if they see additional hurdles raised to invest into hedge funds.

Matthias Knab What are the increased regulatory areas?



Robert Welzel: For example, so called "other funds" can be set up as a retail product or as a special fund only for institutional investors. Currently, the "other fund" is entitled to invest into hedge funds. As from 22 July 2013, the "other fund" cannot invest into hedge funds any longer. So, the existing investments will be grandfathered, but from a regulatory perspective new investments will not be possible.

In addition, Germany has at present a very liberal private placement regime; a hedge fund on a private placement basis can be sold to everybody. After a one-year transitional period, after July 2014, there will be very strict marketing regulations. For example, private investors will not be able to invest into hedge funds any longer and also, the private placement regime to attract institutional investors will be significantly curtailed.

Frank Huttel: It is still possible to wrap any unregulated hedge fund into a certificate in Germany and sell it to private clients.

While it is correct that UCITS funds' performance can lag compared to offshore funds, a positive factor for European investors in general is that more U.S. managers are coming to Europe and setting up UCITS funds. The universe is getting larger, and hopefully we'll get some very good new fund managers who have proven their skills with their offshore funds. As an allocator, I appreciate having more choices, and possibly the 400 basis points performance differential will narrow over time.

But it is a pity that as ´onshore investors,´ we won't get the full offshore spectrum and performance. One way to get this performance is to invest in funds of funds which invest in offshore funds. It is often the only way to invest in attractive asset classes like commodities, real estate, private equity, infrastructure, etc. Unfortunately, the number of such funds of funds operating in Germany has come down for a number of reasons.

Marcus Storr Let's look for a moment at the issue that German institutions can only invest into funds that are providing German tax transparency. How are the industry and the service providers addressing this issue? How easy or how difficult is it for a hedge fund to comply with this tax requirement? Are more offshore funds providing this to be able to accommodate German institutions?

Robert Welzel: **We have seen a very steep learning curve on the part of the administrators and the tax advisors in the last years regarding the provision of German tax transparency. Today it is possible to establish tax transparency – whether it's fund tax transparency or any other form of required tax reporting – for every fund out there. If sufficient data is delivered, every fund can become tax transparent.**

Steffen Gnutzmann: **As Robert just explained, providing tax transparency is not really a problem any longer. So what we see is German money actively approaching foreign funds, or asset managers looking for ways to get German money, often pension fund money, often from large taxable companies, into offshore hedge funds. Right now, and for the last two to three months, we get a call almost every week, mostly from New York based fund promoters. They ask, "There is German money knocking on the door. What do I need to do to make my fund tax-attractive for the German investor?" The German investor in these cases is not a life insurance or endowment or tax-free entity but usually a big German industry group that intends to invest pension fund assets.**

The German investor community has comprehended that they will only have access to these funds for approximately one more year in the known way. In the future, as Robert already discussed, it will be much more burdensome and difficult to get to each other, the investor and the fund, and also the after-tax returns will be different in the future. So, it seems like German money wants to get into offshore hedge funds now and for the next year or so.

Matthias Knab That is wonderful news. I remember when German tax laws came out first, every investor and manager was backing off saying, "oh, I would like to invest (or have German clients), but to deliver this tax transparency just seems pretty impossible to do..." What you are saying now it's absolutely possible to do, so could you please add more information about the procedure and the costs involved?

Steffen Gnutzmann: **Usually, this is done in cooperation between the tax advisor and the fund administrator. The asset manager does not need to be involved in the day-to-day business of this tax work. There are different types of tax transparency, but if we talk about the once annual business year-end transparency that every German investor will want from the hedge fund, then the cost can be around €4,000 per annum for a derivatives driven fund (which is simple from a German perspective, maybe not from a fund accounting or from an asset managing perspective), and around €12,000 to €15,000 per annum for tax compliance for a long/short debt fund with large volume and many different assets.**

The prices have come down significantly since 2004, this is really not a show stopper.

Robert Welzel: As Matthias indicated, in 2004 and 2005 this tax transparency reporting was regarded as not possible, not only from a tax but especially from a regulatory perspective. What has changed is that by now, fund investors are anyway asking their managers and fund administrators for much more detailed data than before, so the tax data is just an additional data delivery issue together with other investor reporting and regulatory reporting.

Marcus Storr: Just as a small anecdote, I remember talking to a New York based hedge fund and asking them, "Would you be willing to provide German Tax Transparency?" It took me another hour to convince the manager that the German regulator neither wants to charge taxes on the fund nor wants to see the current portfolio positions... By now, all the global fund administrators are aware of the German tax transparency. So if you talk to hedge fund managers today, they say "yes, but you are the only investor, do you pick up the costs for it?" That is really the only question now, whereas five years ago, managers said "what requirements are you talking about?"

Carsten Straush: I have a question regarding the private placement rules. Recently a sales representative of one of the German banks started the conversation with me saying "Carsten, I wasn't even clear if I could approach you again, because the private placement regulations are changing and I am totally unclear about the issue." So my question is if the private placement is really secured or possible for another year?

Secondly, with regards to tax transparency, clearly, if a manager only invests into simple exchange based instruments like Eurex contracts, obviously, it's marked to market and there will be nothing to discuss about what prices to use and how they should be treated tax wise. But things become more complex if you have distressed investments, real estate or if you are doing more entrepreneurial deals. I believe things then get more complex and more costly. So just when the strategies become more interesting and could potentially provide more alpha, I would see that as a problem for the managers and investors.

Robert Welzel: I can confirm that the transitional period for private placement runs for another year, so until July 2014. The re-solicitation from investors to hedge funds or passive marketing will be possible in the future, but not for private investors.

The key point to have in mind is that tax usually is established upon realized income and capital gains. We are not talking about valuation. So this accounting related issue which might often trigger a lot of problems, what is the correct NAV etc., is not really an issue from a tax perspective. If the income and capital gain components are realized, this usually triggers tax. To extract these realized components is not too difficult.

Carsten Straush In a normal UCITS these days, the administrator has to account for gains made but not yet realized (market price appreciation of assets), and you have to provide the investor with numbers he has to pay tax on. How is that treated with regards to these offshore funds? Because that's the interesting point, not the gains realized, but accounting for gains not yet made and the valuation for that prospective investment returns.

Robert Welzel As long as we talk about investment tax law, it is quite easy because non-realized gains and losses will not be recognized.

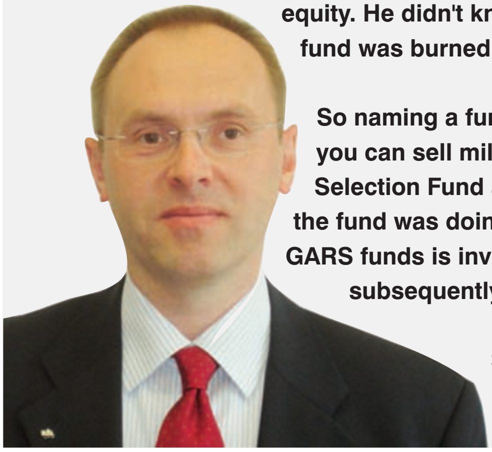
Carsten Straush So is there a different treatment for UCITS funds?

Robert Welzel No. If the hedge fund qualifies as an investment fund under the investment tax law, non-realized capital gains and non-realized losses will not be recognized at all. In case of realized capital gains, they can benefit from the so-called accumulation privilege. The accumulation privilege means: no taxation at the investor level as long as gains are accumulated. If, however, the hedge fund does not qualify as an investment fund, other taxation regimes will click in. But these tax regimes are very comparable to standard companies or standard enterprises. Therefore, from a tax advisory perspective, you have to understand the business, you have to understand what is going on, but you won't need a rocket scientist to come up with the tax figures.

Everyone who declares that fund tax law is so complicated that he has to charge enormous amounts of fees, I would look for a second offer, definitely.

Randolf Roth I have a question for Frank. You mentioned that funds of funds would be a way to get access to the offshore funds and at the same time, you said that this business is effectively dead in Germany. Why is that? Is it related to the costs or to poor performance or to some other reason?

Frank Huttel: I think there is a simple answer and a not so simple one. The simple one is that some years ago, there was a German politician who really killed the expression ´Hedge Fund´, when he talked about private equity. He didn't know what he was talking about, but from that point onwards, the word hedge fund was burned.



So naming a fund a ´hedge fund´ makes it unsellable here in Germany. If you name it UCITS, you can sell millions, even billions in the fund to investors. For example, the SEB Asset Selection Fund attracted more than €1 billion. I think most investors didn't really know what the fund was doing (it is a CTA). I also think most of the guys don't know what Standard Life's GARS funds is investing in, and GARS is even bigger. So, the name killed hedge funds and subsequently funds of hedge funds in Germany.

Secondly, maybe the performance wasn't that attractive for some, but I think funds of hedge funds had really no chance to show their advantages.

Carsten Straush: I began promoting funds of hedge funds as investments in 2001. At that time there was a racing car, the silver one, sponsored and featured by the bank with the big blue label presented in famous TV spots. And at that time, the emotion was very positive for hedge funds. This was further fueled by successes like ours where we netted a 20% positive return versus the 2000 to 2002 downturn in the equity markets where German equities dropped 70% at the peak. So that was a clear selling proposition. What happened next was a lot of banks jumping off the bandwagon, there were some blowups here and internationally, and then that ex-finance minister who wanted to become chancellor came to the funny conclusion that the main task of hedge funds was to destroy companies and put the people out of work, which is the most silly qualification I've ever heard about hedge funds. That is the problem Frank referred to, when the name of hedge funds got killed in Germany.

From there onward, public perception and participation was restrained. The other thing that wasn't really made clear in Germany is that hedge funds had nothing to do with the financial crisis. But it is a part of human psyche that you always have to have a scapegoat. Nobody wants to take the reality that the banks were over-leveraged, that some governments made silly decisions representing welfare actions and policies to their people that they will not be able to maintain. This is really behind what happened in Greece and the Southern European governments,

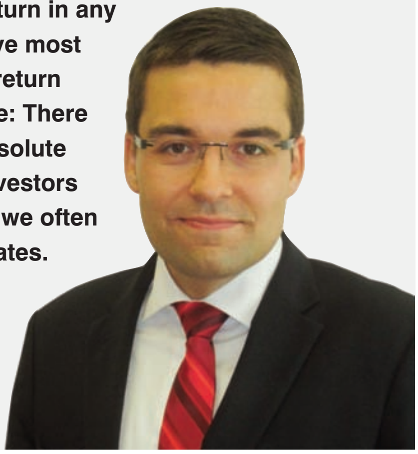
but nobody wants to name these things, so the attention has to go somewhere else. Like, "we have to do something about regulation of hedge funds because they were accelerating the crisis" Can you tell me even one occurrence where a hedge fund happened to be an accelerator? The only thing I know is that hedge funds at some point were not willing to sell their Greek bonds at 15% because they thought a fair payout would be rather at 35% or 40%. That possibly caused the politicians some problems, and maybe that also was a reason why they are fighting against hedge funds.

Another factor is that in some parts of Europe, there is a general negative feeling about people that are successful and made some money, like that has to be illegal because I didn't do it too. That has also been driving some of the negative sentiment since 2000. Before, during the tech bubble in the 90s, we all made money, so it was ok. But if you made money after 2002, it wasn't okay. Now, after the tech bubble and real estate bubble blowing up, some people say "it's the bad guys that cause all that, the markets are manipulated." Yes, they are manipulated, at least now, by the politicians, but not by the hedge funds. That's the problem now.

Marcus Storr: I am coming back to Randolf's question about funds of hedge funds. The main reason is that they are not anymore expected to provide any value added. This has to do with what I mentioned earlier, which is that investors have aggregated a lot more knowledge with regards to sub-strategies. Institutional investors and head treasurers of large pension funds are not willing to accept the old fund of funds approach of "trust me, we manage your investments" anymore. The reporting behavior of "I will tell you in a quarter which hedge funds you are invested in and in six months I will give you an exposure overview" is certainly not accepted anymore.

Rather, investors want to see on a monthly or even a weekly basis the underlying manager exposure. The real issue is that institutional investors are not willing to take the old approach "here is a fund of funds, I will let you know in the future which funds I select, so please trust me..."- this is gone. Today, investors want to know the entire hedge fund managers list from the very beginning. They probably don't need positional transparency at all the time, but they want to know the funds and the individual exposure. So if you have 20 single managers, you have to talk about the 20 single managers and not just about the portfolio level.

Matthias Knab Alexander, you are running UCITS funds. Can you tell us more about your experiences at the moment and the investor demand you are seeing?



Alexander Adsay: We see a lot of demand for absolute return products, and most of that demand comes with a longer time horizon. Most absolute return products these days are designed to give some return in any market situation – that might be nice, but usually, such returns are fairly small. I believe most investors understand that you need to accept some risk to achieve a return, and that return cannot be generated out of nothing - employing a phrase which is much older than me: There are no free lunches. So we try to incorporate this understanding in order to realize absolute returns over a year window, and in that window, allow some volatility. Sure – not all investors want to follow such an approach and many would prefer to avoid all market risks, but we often see an understanding that returns require risk, especially given the current risk free rates.

And as long as German 10 year rates and the monetary policies around the world are where they are now, there is barely any risk free return, but quite some return free risk.

As for the UCITS framework, we believe the benefit of reduced operational risk cannot be understated. The capital investment companies (Kapitalanlagegesellschaften) provide a neutral oversight, determining whether the mutual fund follows the legal framework, follows certain risk criteria such as a proper level of diversification and prohibits many kinds of fraud. And since we rely on listed derivatives and rarely use OTC products – now keeping Marcus' study about implied costs in UCITS funds in mind – we do not suffer such costs. We therefore do not have a disadvantage when we comply with the UCITS regulatory body but have the major benefit of the UCITS embedded oversight and quality controls.

Frank Huttel: We work a lot with IFAs, and I can confirm that their clients want absolute return. The outcome is clear, but at least on the level of the IFAs and their clients, the understanding of the strategies that will actually deliver them absolute returns is very limited. I had already mentioned that I was involved with managed futures, but after four years of trying to persuade IFAs about the benefits of this uncorrelated asset class, I gave up and changed my strategy. With some people, you cannot even talk about futures, it is not understood, or actually misunderstood.

Discretionary portfolio management on the other side allows me to allocate to managed futures strategies and other non-correlated, absolute return strategies. And the client will then actually see how those help in his portfolio. I have usually between 25% and 45% of my portfolios in alternative or absolute return strategies, whatever you want to call it. The clients want to have their money protected at first hand, so I buy the funds that can do or try to do that.

I like volatility funds, managed futures (even if the latter had their problems in the recent movement as they were long in some equity markets), market neutral, equity long/short or credit long/short funds. They all can control your risk and can prevent big drawdowns in periods of stress. These funds are supplemented by traditional long-only funds, which bring the extra performance during good times.

I would buy more alternatives, were it not for the constraints of the UCITS framework. For example, I am looking for tail hedge funds right now, but you cannot run that in UCITS. So unfortunately onshore investors are prevented from buying tail hedge funds.

Marcus Storr: When we work with clients, it is always in a bespoke way. That means we don't build portfolios and then approach clients telling them "this is something you should invest in." This is not our business model. Rather, the institutional investor tells us what he wants to allocate to. Let's say 5% of the portfolio should be invested in alternative assets. What we do is matching that exposure to the existing overall allocations of the client's portfolio. So we ask the client, "Could you provide us your entire portfolio. You don't need to name your vehicles through which you invest. It's even enough for us to receive the individual benchmarks." Subsequently we run a detailed analysis and try to provide complimentary and diversifying hedge fund exposure to the overall portfolio allocation of our client.

Currently we are looking at distressed strategies, particularly in Europe. Funnily enough, you don't have that many high quality European distressed hedge funds. Most of the managers in the distressed space who we are invested in on behalf of our clients are in the U.S. They come over to Europe, which as we all know is different, there's a certain cultural mindset. I've lived on both worlds, the Anglo-Saxon world and Germany. It's surprising to me that you don't have much more dedicated European hedge funds trying to invest and benefit from a recovery of the periphery in Europe. There are a lot of distressed opportunities there.

We are always interested in equity long/short sector and dedicated country funds. When we allocate into the equity long/short space, we are not allocating to global equity long/short managers, sitting in London, trading Japanese equities, or sitting in Japan, trading U.S. equities. We try to find local equity long/short managers, not the multibillion dollar shops and more importantly, if possible, in different sectors. This comes back to the traditional diversification benefits in equities markets. If you invest into Japanese equities as well as German equities you have a very high correlations/beta, but it is not at once. Hence you have a small incremental diversification benefit if you invest in both markets and not into a single one. We have done a lot of analysis and believe that if you invested to sector long/short hedge funds, you receive this diversification benefit as well. The reason is that hedge funds do provide alpha from time to time but carry a consistent set of beta exposure as well. However, not only traditional beta like equity and fixed income exposure, but also what we call “alternative or smart beta”.

Beside sector funds and distressed debt, we have invested in emerging market hedge funds over the last six-and-a-half years. Thinking of emerging market hedge funds, people immediately think of weak regulation and accounting fraud. No, it's not. Take Brazil for example. The regulation in Brazil is the most stringent I've ever seen. The regulator can knock on the manager’s door without any advance notice and say, “Could you please provide me an office? We are staying for four weeks conducting a regulatory check on your firm/funds”. The fund can't do anything against it. Additionally, all managers have to report the entire portfolio.

Asian markets like China, Hong Kong are also attractive. You still see a lot of inefficiencies in those markets, which hedge funds could benefit from. However, market caps are not that big and the liquidity of these markets is also to be considered. On the other hand all these elements which investors are scared of like inefficiencies, illiquidity, small caps, etc., all these things provide risk premia, which can be harvested.

I just wanted to drop that word, “risk premia.” The way we read hedge funds returns is through the concept of collecting risk premia. As Carsten said at the very beginning, we are convinced that managers should collecting risk premia that is available in different markets out there.

In addition alpha comes around the corner from time to time but then it's gone again and you hunt it again, but you don’t know where it has gone, and then it comes back and then it's gone again. But you can find risk premia all over the place. You just have to have the will or the client perspective and knowledge to pick it up. Besides finding alpha opportunities, this is what hedge funds should do.

Matthias Knab Is there anything that worries you at the moment?

Carsten Straush: Well, the biggest issue we see, at least since May 22nd, is whether the biggest bubble on this planet will now burst, and how the people will react to that. I have just reviewed performance indices of five-year and ten-year bonds, and for the first time they are one year in the red. That means a lot of pressure on investors like insurance companies for example. They loose money and such pressure will mount; that is why we are seeing what we are seeing, people are getting out.

That is going to be a huge challenge. I am of the position like many bond managers that today´s moves are already a bit overextended, but it can be a wild ride because you do not know what the people will make out of that. What happened in our space is that yields in preferred vehicles and MLPs went up from 6% to 7% p.a to 8% to 9% p.a. So, that’s already pretty attractive. We are combining this with option strategies to further enhance the yields and further reduce the volatility for overall double digit yields.

So, this is a theme that we will ride through for the next two years and from which we expect to see good results. We

also see a lot of opportunities in value oriented investments in emerging markets. Some markets are in a really interesting situation right now. For example the sell-off that is hitting Brazil right now can almost be called catastrophic. Vale, the big iron-ore producer, it is trading down from the 40s to the 11 levels. This is the burst of the "we can sell everything to China" bubble, it is really hurting and something that will give long-term investors a second shot to play the BRIC story after the sellout has happened. There are some adjustments necessary, but growth will continue.

There is something that I love to play too, which is the smaller companies and smaller plays. But the problem is how do you communicate that to investors? Investors should realize that there are huge opportunities in under-researched small and mid-cap companies. The sell side is concentrating only on the big mega-caps. Even mid-caps are often left out. But the problem is that these names are left out now to such an extent that you have to be very careful. You easily have 20% or 30% daily moves in such a name, which you wouldn't have had three years ago. Now they happen because no intermediary is making markets anymore and all the computers, all the automated traders, are hopping in jamming the same side of a trade. That means you have extreme market inefficiencies. But that gives a firm like ours the opportunity to really excel. We have developed programs to get around such situations and use put options to reduce risk in these names and ride the long side protected.

With regards to the European credit problems, it's clear that there are few offers and few trades. Because, who should those European managers sell to? Everybody else they could sell to, especially the German banks and German insurers and portfolio managers, have that exposure already in their books, and they don't want it anymore.

Matthias Knab This is why these assets are so nicely dispersed. There used to be a joke around New York-based managers: "If you can't sell it, go to Düsseldorf!', which means WestLB.

Randolf Roth: **Carsten spoke earlier on regulations and hedge funds becoming a scapegoat for many things for which they are not responsible. I guess many of us, who are active in financial markets can relate to that. It is not only the hedge funds that are held responsible for something they did not cause, i.e. the financial crisis.**

There is a broad range of new regulations being forced on exchanges and clearing houses despite the fact that they were functioning throughout the various stages of the financial crisis and have nothing to do with the European sovereign debt crisis or the mortgage-related crisis in the U.S. Examples include the financial transaction tax or the German HFT act. While setting an appropriate regulatory framework is important, politically motivated regulatory initiatives such as the financial transaction tax are problematic. This kind of regulation is an attempt to divert attention and tension away from the real issues of the Eurozone such as the need for a common financial policy or a proper mechanism to prevent countries from violating the EU & Euro financial rules and policies. Obviously, from a political point of view, it is far easier to blame the financial industry rather than have a discussion about the current and past shortcomings and political compromises of the Eurozone.

Marcus Storr A lot of people don't know that offshore hedge funds running more than a $100m have to be registered with the SEC. Considering the large number of hedge funds out there, how many of them are already regulated by the SEC? The SEC staffed up enormously since the crisis and employed a lot more people, in particular, in the big financial centers in the U.S. We know that several funds get annual request from the SEC to provide details.

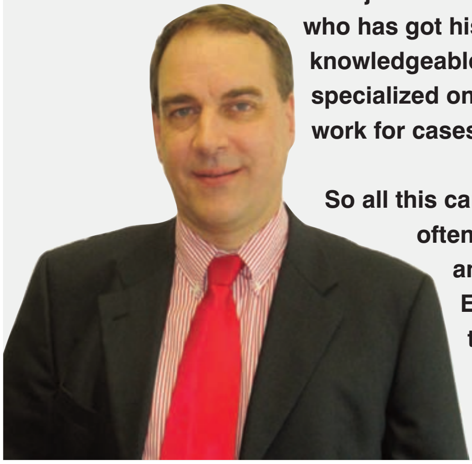
As an investor we are able to get the deficiency letter from several hedge fund managers. After a visit, the SEC writes a so-called "deficiency letter" where the officers evaluate and describe what they found while visiting the manager. This is a very important and "official" information of due diligence for us. Hence you have an official government agency looking at a large number of offshore hedge funds. We should not really talk about regulation within the context of offshore managers, but there is some oversight offshore as well. The smaller a manager is, the more they are under the radar because they're perceived as not being able to impact financial markets.

Carsten Straush: Hedge fund managers all over the world have to fill out SEC forms these days too. The challenge is to implement a sensible regulation.

I had a discussion with the Swiss regulators and I told them "you have in Switzerland extreme money laundering laws, where you have to be checked yearly for money laundering and for compliance with the money laundering laws. There is no need for further hedge fund regulation on that issue, because much that is intended with further regulation is already one way or the other covered by the money laundering checks."

Basic aspects of running an asset management company like "do you properly identify clients?" and "are the asset there and are they in the name of the client?", all of that is already checked in the money laundering procedures. So, the question now is whether you need to prove the same issues again and again via different, separate regulatory frameworks.

Also, nobody should think that this "Pirates of the Caribbean" image is a proper description of regulatory reality and that the judicial environment is insufficient in the Caribbean. You will typically deal with a judge who has got his education in London or in Australia there. Those guys are pretty knowledgeable these days from my experience. In the U.S. there are already some companies specialized on unwinding financial institutions, and we know of cases where those were put to work for cases where the offshore hedge fund was run by a U.S. based portfolio manager too.



So all this can and is already done, and thus the offshore world is not at all as unregulated as often portrayed. But the point is that the investors there typically take the initiative and say, "Okay, something has to be done," and then they start the proceeding. In Europe we are doing a lot of paperwork. The paperwork is then send down into the basement and sits there, and the real regulatory work that would help the investor is done by nobody. We are producing a lot of paper, but of nobody's use.

Matthias Knab What opportunities are you looking at the moment?

Frank Huttel: What I am really looking at right now is Japan. I think, whatever is going to happen, it will start in Japan. Abenomics right now is driving the markets, it is a game changer. If you take a look at the Yen, and if you know what the Yen is doing, you know what the other markets are doing. A continued weakening of the Yen is bullish for Japanese equities, but bearish for the JGB. The first look in the morning is at the JGB - for me, it's THE big time bomb in bonds. I think it's a bubble and everybody knows that it will burst. Well, it can take years before it bursts, but it will eventually burst.

Right now, we are approaching levels in the bond markets which are really dangerous. Even if Bernanke is saying, "Well, QE will go on further, we will still buy $85 billion every month," I don't know if the Federal Reserve can prevent rising yields (of T-Notes above 2.40%). If the market starts running, it will run. I have a little bit of grumbling in my stomach that we could get a 1994 scenario again.

So that's a big threat of what I'm seeing, and not only government bonds but also corporates. I think that the PE-ratio of U.S. investment grade bonds is about 55. There is no value in corporate bonds, from my perspective. There is an immense possibility of rising yields as well as defaults. The default rates are very low, historically, and if we go from 2% to 4%, 5%, we get a problem in the corporate bond markets. Liquidity is already drying up.

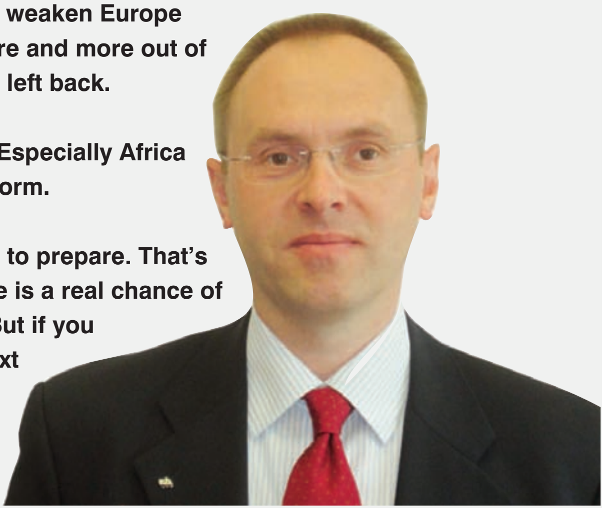
So, I'm looking right now for long/short corporate bond funds, which play the alpha, and can go short. It doesn't pay out right now, but I think it will in future. I think one has to look for funds which can go short in the JGB, in T-Bonds and Bunds.

Where I am positive, on the other hand, is China. Everybody is bearish on China. There are a lot of inefficiencies and the market is not homogeneous. So, investing in a long/short China equity fund would be quite interesting. There aren't so many out there, so it's a problem. A guy called me from Hong Kong to ask if I know somebody who can set up a fund, so maybe it will come as UCITS.

Sector funds are getting quite interesting as well. The reasons for investing in a long/short tech fund is the revolution in the tech sector. The ´old ones´ go bust. Maybe it's Apple which one day will be an old style company. Who knows? There are technologies which will boom the next years and some companies will diminish. So, long/short tech is quite interesting. Long/short energy is also highly interesting, and energy is driving the U.S. This whole shale gas story, I think is a long-term trend which will strengthen the United States and weaken Europe because we don't even think about this topic. We're maneuvering more and more out of the game. The U.S. and China will go further and we in Europe will be left back.

What's interesting as well on the long-only side are frontier markets. Especially Africa (Sub-Sahara) and the ASEAN region have a real possibility to outperform.

So to sum up, the big threat really is in the bond markets, so we have to prepare. That's the reason why I am really looking for a tail hedge fund because there is a real chance of making money on it. A good macro fund might also fix the problem. But if you have a macro UCITS fund, you can't short commodities. That's the next problem. So, a better or looser regulation for our sake would be better, but we don't seem to get that.



Randolf Roth: I have another question for you as buy side representatives. In Europe and in the U.S., there is quite a bit of OTC regulation emerging that will have a truly global impact. According to the regulation, standardized OTC derivatives should be cleared by CCPs and traded on multilateral venues such as Swap Execution Facilities (U.S.) and OTFs (Europe).

In this respect, I would like to raise one specific point. While all major clearing houses develop OTC clearing services, there are a couple of challenges, especially for the buy side. One of the greatest challenges results from the daily variation margin requirement covering the P/L of the existing position, which needs to be provided in cash. For example, a liability-driven investment firm that has government bonds in their portfolio and that uses derivatives such as swaps to manage the exposure and duration of their portfolio will experience difficulties. According to the clearing house rules, the buy-side firm needs to cover an initial and a variation margin with the clearing house. The provision of the initial margin is no issue, as the bonds can be used as collateral. However, if the swap position piles up losses,

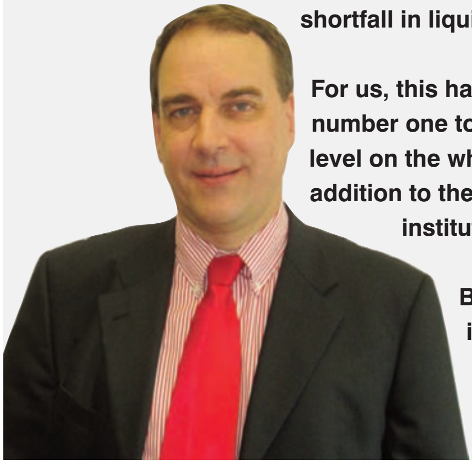
cash needs to be provided to the clearing house (variation margin) because the clearing house passes it on to the holder of the profiting side of the swap. The asset manager may not hold the required amount of cash, which creates an issue as the amount of cash needed to be paid could in some cases, like in the case of a ten-year swap, be a considerable amount of money.

So, the question is, how does the fund get the cash to pay to the clearing house if they only have bonds?

An elegant solution could be buy side firms getting access to our successful Eurex Repo market, our GC Pooling offering, that worked well throughout the crisis. That would allow buy side firms to get the cash required by the clearing house by borrowing cash against the bonds they held.

Do you see this as a problem and do you have a view on the proposed solution?

Carsten Straush: **First, as a hedge fund allocator, we have dollar exposure, and we are hedging this through exchange listed contracts. What happens now in the OTC world is that this world is facing the same requirements and the same problems we have already been solving for the last ten years. Your hedge fund performs well, but then the dollar goes from 148 to 123 and suddenly you have to come up with 12% in liquidity to cover your variation margin. Eurex provides us with a daily figure and we have to come up with that money at the day's end. You now have to have certain other investments aside from your hedge fund investments or loans with your banks to cover this shortfall in liquidity.**



For us, this has never been a problem. In our diversified portfolio – that would be answer number one to your question -- because we never went above the 15%-20% margin to equity level on the whole portfolio, lots of liquidity was always left to handle such currency margins in addition to the equity margins. This "problem" only occurs – from our point of view – if the institution is overleveraged. And then perhaps it should change its attitude to risk.

But, my question back to you is how netting of those contracts is done or intended to be done? In particular, if you have OTC contracts and exchange listed contracts, how do you and other clearers like Clearstream do the netting? Do they fully offset? That for me would be the more interesting part.

Randolf Roth: **Our approach is clearly that there is going to be netting between the contracts that we clear, i.e. between bund futures and interest rate swaps, for instance. Right now we are introducing a new risk matching system called PRISMA that will be a major tool allowing for netting across OTC and on- exchange positions. However, we can only create netting efficiencies between those products, which we clear in our clearing house Eurex Clearing.**

Marcus Storr One more comment from a hedge fund perspective. We had a couple of discussions in the U.S. with regards to OTC derivatives getting exchange traded and cleared through a clearing house but more importantly, about this netting aspect mentioned by Randolf. The issue we discussed with managers is that they actually don't want to throw up this entire margin cash with different brokers; they want to keep cash invested, hence netting of margin requirements is a benefit. The worst thing for a hedge fund manager is to keep cash unless it is part of their allocation / risk procedure. Managers are looking forward to be able to net margins of all credit derivatives with all others as well. From a performance point of view, a potential netting of margins across asset classes should increase expected returns for managers, because if you can hold a lower level of cash you should be able to increase your returns.

Matthias Knab We already spoke a bit about the AIFMD. What are the most important things that asset managers, both from within and without the EU, should prepare for?

Robert Welzel We already indicated that it will be an issue to sell the funds to clients, both retail and institutional investors, in the future. The taxation of hedge funds will change in the future, too, so the after tax return will be less favorable, especially for new products.

Matthias Knab Is there a date for that? What year?

Robert Welzel It's currently in the political hassle. Everyone is guessing what will be ultimately the outcome, due to the upcoming elections in the fall.

Robert Welzel: How investors will react to the future restrictions? Big institutional investors may be able to route their investments directly offshore, by not using any German or European intermediate vehicles. They don't have to. So, if they want to invest in, say Asia, they can invest via their Singapore or Hong Kong subsidiaries.

But the midsized institutional investors and regulated investors, who have to use investment vehicles which are domiciled and regulated in Europe, will be affected significantly. So, their investment horizon will probably be limited, and the same applies to those retail investors who will not be regarded as high trading MIFID eligible investors. They have problems investing in hedge funds in the future. To be precise, I think they can invest in hedge funds, but then the hedge funds and their managers would have to adapt their business to the AIFMD regulations. So, it is a question of whether the offshore hedge funds would adapt their business model.

Frank Huttel It seems that the choices for European investors are actually broadening. There is a chance to invest in products after 22nd of July in which you cannot invest right now. On the one hand your options will increase, but on the other hand the regulations will also drive up costs. If a manager is regulated, he incurs much higher costs. Right now you see no products coming around and the whole business is dead. There is no demand right now in the market. If you look at the sales figures from the German Association for closed ended funds VGF, they are down by 50%. The assets raised in the last quarter were just EUR 400m whereas before it was EUR 800m. Hopefully things will kick-start after this whole legislation is behind us.

Steffen Gnutzmann: Regarding the effects of the AIFMD, let me offer you a metaphor that in Germany everyone understands. If you propose a German politician to introduce a speed limit on the German Autobahn, everyone is going to say, "No, never." On the other hand, the AIFMD is just that for funds, to a certain extent. Of course, it is just a picture, but as a speed limit will affect cars traveling on the highway, with the AIMFD many German and European investors will more or less be excluded from investing into the high performance funds.

This is particularly schizophrenic if you consider that these non-regulated high performance funds are allowed to buy, say, German and European distressed assets and benefit from the deleveraging process, but our local investors are not allowed to invest in these funds.

Carsten Straush: I think there are also cultural and subsequently structural issues at play. When I heard Dragi saying three or four conferences back "well, what a pity. We don't have capital markets culture. The Americans can pump up their capital market and create a wealth effect and produce positive feelings within the societies, we cannot because we are loan-driven societies." This perfectly portrayed the situation.

The average German has his money in a money market account and then he has his life insurance and real estate. With the tech bubble in the 90s, he became a little bit interested in stocks and bought Deutsche Telecom stocks, because he thought that these famous actors who promoted them were nice guys, and when the stock went from 60 to 8, he vowed to never touch stocks again.

Steffen Gnutzmann

This is a real paradox. The average German who buys a car will be very diligent, they inform themselves, read reviews and talk to the experts. But when they buy financial market products, they can act like an-alphabets.

Carsten Straush

Yeah, that's a funny thing. If I were to advertise here in Frankfurt and say "Invest with 25% guaranteed yield!", some Germans would very likely call me up. If however I ran this ad in a Zurich newspaper, they would say, "you're insane", or they would ask me: "show me all figures, all about the investment and tell me three or four people who invested in that. Anyhow, I want to know who you are." In Switzerland as well as in the Anglo-Saxon world, nobody would give you money without an introduction.

I personally wouldn't invest with any hedge fund manager without personally knowing him, without making an on-site visit on his premises and investigating in depth his strategies. There is an acceptance that a partnership model is the way to do it. The Blackstones, the KKRs and Warren Buffetts and others, all are working the trust and partnership model. The LLP is a form to build a legal entity, and in the Anglo-Saxon world, you have lots of hedge funds that are run in the from of LLPs. Limited partnerships have been around for a long time, it is the same principle medieval captains who did the pepper trade in 1600 used when they looked around and asked themselves, "Which millionaire can we talk up to take the risk if our ship is sinking and we'll lose the whole freight?"

Somebody has to share the risks, together with the rewards. But some people are always looking for a world where there are no risks. Instead of picking the right risks at the right prices and making a good profit if the favorable side of the trade turns out, they are looking for the "guaranteed risk-free" investment. But that doesn't exist, and besides it's a frame of mind where you are probably most prone to become the victim of fraud.

Robert Welzel

Coming back to the AIFMD, what really struck us was that the regulator also introduced a lot of product regulation, which as a matter of fact was unnecessary given the AIFMD concept, which is a manager regulation, not a product regulation.

I also saw that the industry lobby in Germany didn't really argue against this additional product regulation. The only thing they were concerned about it was to save the open ended real estate funds, which as we all know has turned out to be a rather high risk product. That was all, no one asked, "What is the reasoning to implement very specific product regulation? Do the regulators have the knowledge? Have they been successful in regulating products in the past?"

So, it is very interesting that you are not allowed to invest in certain products which are – in the understanding of the regulator - being regarded as risky, while at the same time you can invest without restriction in Cyprus and Greek government bonds, even via UCITS funds, plus with a tax benefit.

So, there is not really, from my perspective, a concise concept of product regulation which can be argued or for which one can find positive arguments. It is, from a product regulation point of view, a very weird regulation which will cause a lot of arbitrage, misallocation or bubbles in the future. But no one in the industry, in my understanding, really tried to test the regulator or the politicians on this point.

Marcus Storr

First of all a general comment with regards to the AIFMD. Obviously everybody in the industry should have a task force working on this topic. Feri has dedicated people working on this topic to make sure that all alternative investment activity is compliant with the requirements.

Marcus Storr: The last comment from Robert however is very important: Regulation is always a reaction, which results from a negative financial market event as something unexpected has happened. Therefore the regulator is trying to do a good job. But you have to ask, "Do they have enough knowledge?" At this point in time, they have enough knowledge probably, as regulators worldwide are all heavily employing new staff.

And where does this end? The regulator is providing the financial community with a corset of safety and asset allocation restrictions. Germans are saving their money for example through insurance contracts and payments into pension funds. Insurance companies and treasurers of pension funds with a liability to pay futures pensioners have to generate a certain yield to be able to comply with the promises they made. Some regulatory elements however might be too strict to enable those market participants to generate the required yield. Hence, in a couple of years this might evolve into a liability problem for these market participants as the market risk taken to generate reasonable returns might be to low.

This kind of safeguarding by the regulator leads to a non-risk-taking environment. We all know what no risk in portfolios means from an academic point of view: no yield. No yield will be, not today and not in 2014 and 2015, but probably from 2016, 2017 or 2018 onwards, a significant problem. Either future pension payments/insurance payouts will have to be cut or more financial market risk will have to be taken. However, it is too easy to blame the regulator for what they do. This is their job and there are always opportunities to generate decent yield even in a strict regulatory environment, though it is much harder to do.

Frank Huttel

I believe to a certain extent we are all responsible for the crisis. Maybe the regulator in his current run for regulation didn't ask us, the asset management lobbyists. Maybe they asked the insurance industry, because they are larger and traditional fixed income investors, but probably too few people from our side were involved. Therefore, some mistakes were made which should not have happened, in my view. Also, the whole multi billion sector of special funds (Spezialfonds) were almost included in the AIFMD regulations and have been taken out just in the last minute.

Robert Welzel

The AIFMD regulation intends to regulate collective investments. No regulation is necessary for a Spezialfonds, i.e. a fund which only one investor owns from the AIFMD perspective.

But what was the important thing, the German special fund industry is granted a very significant tax benefit and due to the fact that the taxation is linked to the regulation, it was necessary to implement a rule that the special funds, even though usually they only have one investor, is fully fledged regulated by the new regulation law to keep the tax benefits. Otherwise, the business model of special funds would have gone bust.

Randolf Roth: I would like to point out for the benefit of the readers of this Roundtable that the AIFMD, the Alternative Investment Fund Managers Directive, is a European directive and therefore most of the points discussed here apply to the European Union, and not only to Germany.

Robert Welzel: You are right in general, AIFMD is a manager regulation from a European perspective, but Germany specifically added some very tough product regulation, i.e. the “gold plating” which we mentioned earlier.

This very specific German regulatory part is now mixed together or entangled with the overall AIFMD implementation, plus an additional tax component. So, therefore, we have a fully fledged manager regulation, additional strength in product regulation on a standalone German basis, and we also have the national tax law rules. This makes the German landscape a bit different from, say, the UK. From 2004 and until now, Germany followed the Anglo-Saxon regulatory model. In the future, Germany will switch to a more Southern European model of regulation. I have my doubts whether this new approach will be successful.

Alexander Adsay: We haven't talked about macro risk at this Roundtable.

In my view, although there are currently a lot of sources of macro risk, it is extremely undervalued at the moment. As an example, implied volatility and volatility futures are currently close to their lowest levels and a lot equity markets are reaching their all-time highs. Meanwhile we have seen incredible debt levels in most developed countries. We see the banking sector in many developing countries in difficult situations, and a major housing bubble may develop in China. I could continue with such sources of risk for quite some time.

While expansionary monetary policies around the world helped the global economy and capital markets, taking this cheap money away won’t be easy. Even though we may keep expansionary monetary policies for some time, Bernanke’s statement regarding the reduction of quantitative easing was enough to spook world markets. When flanked by cash crunch in China with a significant surge in short term borrowing rates, no one can deny the current importance of monetary policies and the risks they can originate.

And even though we spoke a lot about regulation, and as important as regulation is, we should not forget that this industry is about managing money and more importantly: about managing risks. The regulator cannot take all the risk out of the markets and that’s why we have to prudently understand and manage the risks that we take and be aware of risks we can and we cannot avoid. While regulations demand a lot of time and energy – they are is no excuse for not using common-sense.

My impression from the markets right now, is a misunderstanding of the macro situation that we are in. While regulation might have made banks safer – and that’s a good thing – does that mean that banks will never fail again? Are all government bonds risk free now? Are there no bubbles developing due to cheap money? Obviously, affirming these questions would not be too sensible.

Just look at Japan’s economy which is currently moving erratically. Things like that should probably get far more attention from the whole industry. With implied volatility being so low and with the current levels of macro risk, I believe there are huge risks and obviously also huge opportunities. So buying volatility right now seems to be a very attractive idea whether you seek returns or you are looking for protection.

Marcus Storr: You are absolutely right; we haven’t talked about that, which comes down to rather how we judged the world in terms of risk. If bond markets were to really blow off with rising interest rates, a lot of institutional investors would have to report valuation declines. Soon institutional investors will ask “Can we invest in something else? We are completely at ‘risk’ here. Do you want us to buy additional government bonds in such an environment?” I am not sure how the regulatory environment might change if interest rates rose heavily with potential defaults of countries perceived of being safe.

Frank Huttel But we have to be careful that the regulator won't react too prescriptively, like he did in 2003, at the low point of the DAX, when he said, "Okay, throw your stocks out of your portfolio," because mostly the regulator gets it wrong.

Carsten Straush: Let me share with you my experiences how I found laws and regulations often come about. I have had some experiences with the lawmaking process in Berlin, and I am not sure things are too different in other capitals of the world. I was involved with some changes of the German banking law. So you have a representative from the Finance Ministry and someone from the German finance regulator BAFIN sitting on one side of the table and you have the representatives from the different industry groups; someone from the association of closed end funds, another one from the Association of Official Exchange Brokers and finally someone from the BDI, the association of the German manufacturing industry. Well, this is a power where everybody else crumbles immediately in Germany. If they heave up the word, then all the others instantly capitulate or stay mum. So when the BDI asked "well, are you going to change any law? Will that imply any changes for us?" Of course the officials were very quick to point out "Oh no, it's not for you, it's just for the financial companies." That is the way things are run.

So if we are not sufficiently represented there, it will not work. You can see how the banks are pushing through their agenda looking for solutions to their problems right now, like how to bail them out of Greece, how they can manage their debt. And the next sector, I assume, will be the insurance companies due to their dependence on fixed income yields and the negative real return the get these days.

But as Marcus said correctly, there is no way to resolve that problem because the solution to extremely high Bund prices would be a buying program to keep them even higher, and that of course is unsustainable.

So, it is highly necessary that these institutions invest into alternative strategies. That is nothing new; the Bible already says people should diversify and invest in different things. Everybody for the last 5,000 years has known these things, but for some reason a new paradigm came up that tries to restrict investors to something that is called riskless. But this is not riskless, but in fact the biggest risk at all if you look at the two possible outcomes. Either the interest rates stay low, but then the insurance companies and pensions won't make enough money to stay alive. The second scenario is what would happen to the amount of outstanding government liabilities if we only returned to a 2007 level of interest. Already now at 3% or 4% interest, you can hear the Southern EU countries crying that they feel they are not able to bear anymore. Well, I say that's a joke, just six year back in 2007, we had interests of 6%, and in 1990 I could invest in Bunds yielding 9%. Germany must have been in another universe at that time.

So if one day we will return to the norm, the current system simply won't survive. And if it happens sooner rather than later, we will have the biggest crash of all times. What could be some of the triggers? It could come from the government side with regards to taxes and liabilities that need to be suddenly refinanced, or it will come from the insurance and pension sector that may be hit with having to write off 20% to 30% on their long bonds.

The alternative industry and sensible economic strategies, which are underfunded now, would be a solution for insurance companies to diversify. And for the German private investor who is too invested in fixed income, this is a necessity too. But right now, the regulator is hindering the development of the solution, and the more regulation we get, the more problems we will therefore have in the future.

Alexander Adsay I agree with you and we already witnessed the first signs, when Ben Bernanke said that he is considering taking back a little bit of quantitative easing. Interest rates surged and markets fell immediately. Right now everyone seems to be afraid of rising yields, but everyone can see it will come sooner or later. We know that some day, either in the close or in the distant future, interest rates will return to higher levels. That way might be a very painful one.

Marcus Storr Everybody talks about the inevitable. It’s like somebody told you the devil will soon arrive, and you say, “You're right, and you know, and he knows and they know.”

The only thing that can somehow help to reduce this burden of worldwide debt is a controlled inflation, which on the other hand would be a disaster for investors with no inflation protection, like savings books and the majority of fixed income investments.

Carsten Straush That's what they're trying, but it's not picking up!

Marcus Storr That is correct, it is not picking up yet, but at some point we will see inflation expectation increase and this will be the final turning point for the bond market. For me, this kind of “yield less risk” as I would call in government bond market of the developed world is the biggest risk to liability-driven investment at this point in time.

Frank Huttel: And not only in Germany. If you look at the statistics about the real debt levels we have in Europe and elsewhere, maybe you should pack whatever you have and go to places with much less debt, maybe Canada. From a rational point of view, you may have to leave because with debt ratios – including liabilities or pensions – of 400% or 500%, there is no chance to pay back that debt, and I don't see inflation drying this up either.