



# Opalesque Roundtable Series '14

# FRANKFURT

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# Editor's Note

## Over 50% of German institutions to put more money into alternatives, offshore funds still attractive

The growth of alternatives in Germany is accelerating at the moment due to the absence of yield in the typically lower risk assets. While regulated investors' demand for UCITS is unabated, unregulated investors like corporates, family offices, etc. have found a renewed interest for offshore hedge funds - and funds of funds.

In a recent survey over 50% of the institutional German investors said that in 2014 they will put more money into alternative investments. A majority also said they would still go for infrastructure and other alternative investment classes, even they could have a 4% interest rate on government bonds. However with regards to solvency, people tend to hesitate making illiquid, long-term investments because it's not clear how these investments are treated regarding the institution's equity requirements.

Family offices in Germany especially like the asymmetric risk-return profile of hedge funds compared to equities and their ability to preserve capital in severe market environments. Some high net-worth who sold the asset classes after the 2008 experience are now starting to be interested again.

## AIFs versus UCITS funds: UCITS unbeatable selling point

Over the next two or three years, the AIF brand will get more established, and investors may increasingly use alternative investment funds (AIFs) while at the same time the UCITS framework may become more restricted for alternative investments. However, UCITS have an unbeatable selling point: they are not classified as a hedge fund. As long as an alternative investment fund is *classified as a hedge fund*, then institutional investors have to hold it in the hedge fund or alternatives bucket which is typically very restricted. Therefore, for regulated investors the discussion "do UCITS perform like offshore funds?" is irrelevant as many simply don't have other choices to get absolute return exposure: it is either UCITS or none.

But in the future, AIFs may be a good "middle ground" between the UCITS world where the funds are highly regulated, which may be a good format for less informed investors, and the unregulated offshore world. Over time also non-European managers will become more interested in either getting the AIFM license on their own, or in using platform type solutions offered by European licensed manager.

## One year of AIFMD - a reason to celebrate? Who benefits, who not? Why "reverse solicitation" isn't the answer...

While AIFs may become more established, challenges still loom on the taxation side. Many funds and German investors are not 100% sure about the impact of the new regulatory environment, especially on their after tax returns, and around the marketing of alternative investment funds.

Clear guidance exists with regard to the German "Spezialfonds": these are tailored for only one investor, and the discussion on setting up such a fund between a fund manager and the investor of such Spezialfonds is not regarded as marketing. If however you want to address the opportunities to unknown investors in Germany, marketing might be a tricky issue in the future.

This Roundtable, sponsored by Eurex and tax and legal consultant WTS, took place in Frankfurt on May 27th at the office of WTS with  
Vassiliki Veliou, [Eurex](#)  
Robert Welzel & Steffen Gnutzmann, [WTS](#)  
Frank Dornseifer, [BAI](#)  
Valentin Bohländer, [HQ Trust](#)  
Frank Umlauf, [Tajdo](#)  
Dr. Werner Goricki, [Prime Capital](#)  
Ahmet Peker, [Deka Investment](#)

This Roundtable also discussed:

- What alternative strategies are attractive for German investors now?
- Why has investor interest for Buxl, Eurex' 30-year instrument, gone through the roof?
- How is the industry moving from OTC towards a standardized world?
- What could the next financial crisis look like? How to prepare? How should risk management adapt?

Enjoy!

Matthias Kna, [Knab@Opalesque.com](mailto:Knab@Opalesque.com)

# Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Frank Umlauf, Ahmet Peker, Valentin Bohländer, Dr. Werner Goricki, Robert Welzel

Frank Dornseifer, Vassiliki Veliou, Steffen Gnutzmann



# Introduction

**Dr. Werner Goricki**  
Prime Capital

Werner Goricki from Prime Capital, an independent asset manager for alternative investments with 3.5 billion euros assets under management. We cover hedge funds, direct debt and infrastructure. We work exclusively with institutional investors and family offices and provide services in both content-related asset management as well as legal structuring and operational services.

**Frank Dornseifer**  
BAI

Frank Dornseifer. Managing Director at BAI, the German Alternative Investment Association. We currently have about 135 German and non-German members active in the alternative investment business (asset manager, custodians, prime broker and other service providers). We focus on hedge funds, private equity, infrastructure, debt and loan strategies, and finally commodities.

As a lobby association we advocate for an adequate and competitive regulatory framework here in Germany, not just for the industry, but also for institutional/professional investors. In fact, we understand ourselves as a catalyst between German institutional investors and best in class product suppliers and asset managers from the entire alternative investment universe.

**Frank Umlauf**  
Tajdo Consulting

Founder and Managing Partner at Tajdo Consulting. We are a classical investment consulting firm, mainly focused on institutional clients in the German market helping them along the regular and typical value chain; that means support with asset/liability studies, selecting managers, setting up risk management procedures for them.

Within the alternative space we are focused on liquid alternatives, which include onshore single strategies and offshore funds of funds. We are one of the first companies covering this UCITS absolute return market since it started in 2006.

**Valentin Bohländer**  
HQ Trust

Valentin Bohländer from HQ Trust. We are one of the oldest and largest independent multi-family offices in Germany based in Bad Homburg. We invest in all customary asset classes, from the liquids like equities, bonds and commodities, to private equity, real estate, hedge funds and other alternative investments. We have above 3 billion euros assets under management; I am responsible for the hedge fund investments at HQ Trust.

**Steffen Gnutzmann**  
WTS

Steffen Gnutzmann, I am a partner with WTS Germany. WTS is servicing all types of mutual, hedge funds or private equity funds with regard to German tax issues that they have. These issues may concern the fund investor tax reporting or take place on the fund's asset side when the funds invest into Germany.

We also consult regarding market entry for funds that do not have German investors at present, advising on what the funds need to do in order to have access to German money.

**Robert Welzel**  
WTS

My name is Robert Welzel, I am also a Partner of WTS. In addition to what my colleague Steffen Gnutzmann already outlined regarding German market entry service, we also offer European market entry services.

**Ahmet Peker**  
Deka Investment

My name is Ahmet Peker and I am working for Deka Investment, a subsidiary of DekaBank, the Wertpapierhaus of the German Savings Banks Finance Group. DekaBank offers the combined expertise of asset management, financing, issuing, structuring as well as liquidity platform, clearing partner and custodian bank.

With assets under management totaling approximately €170bn and around four million managed securities accounts, the Deka Group ranks among Germany's major securities service providers.

Within Deka Investment I am responsible for managing the fund of hedge funds, which we run in mutual fund and segregated account formats. Additionally, I am a member of the Asset Allocation portfolio management team. The team works with different investment processes, like trend following and fundamental asset allocation.

**Vassiliki Veliou**  
Eurex

My name is Vassiliki Veliou, Vicky for short. I am from Eurex, one of the largest derivatives exchanges globally. I am responsible for all kind of regulatory topics within the trading scope for Eurex Exchange, in the Market Structure team. So everything that is relevant for us from a regulatory perspective passes my desk. As you can imagine, we are currently very heavily involved in analyzing all kinds of regulatory topics.

A lot of changes in fact do not only impact us as an exchange, but also the funds industry, and this is where we probably have a number of similar concerns about how we are going to address all these challenges in a joint effort.



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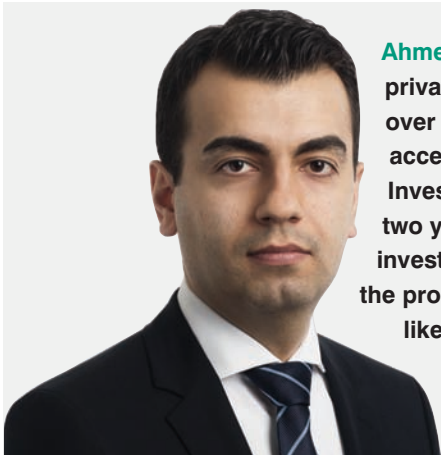
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**Ahmet Peker:** When I look at the asset allocation of institutional investors and also private banking clients, we can well say that the role of alternatives has been growing over the last two decades. Actually, I think the growth of alternatives in Germany is accelerating at the moment due to the absence of yield in the typically lower risk assets. Investors are therefore looking for alternatives, and my experience is that over the last two years, especially the last one, this has gained some momentum. Institutional investors that need to earn a certain minimum yield are more or less starting to realize the problems of not getting it through assets that were considered as low risk in the past, like government bonds. So they are looking at hedge funds, private equity, commodities, and real estate. Especially infrastructure and leveraged loans are in their focus currently.

**Frank Umlauf:** My observations seem to be a bit different, as across the institutional base we really can't talk about a strong pick up in the allocation to alternatives. Instead, we see a steady increase but allocations are still in low single digit figures. But I agree that there is interest, also regarding infrastructure investments. However, it is hard to figure out how much action has followed the talk, because for investors it is generally a challenge to find the appropriate investment vehicle.

Also with regards to solvency, people tend to hesitate making illiquid, long-term investments because it's not clear how these investments are treated regarding the institution's equity requirements.

In our view, commodities are totally out of favor, but again, there is interest for infrastructure and private equity, and maybe a little pick up in offshore hedge fund demand coming mainly from the unregulated investors, so corporates, family offices, and so on.

For regulated investors, we mainly see a shift to the UCITS absolute return world. Of course, interest rates are low, but I believe as long as rates are falling and credit spreads are tightening, there is no real pressure yet. We believe that only when credit and interest spreads are widening and interest rates stay flat for a certain time, then that is the real moment of truth about a major pick up in alternatives.



**Frank Dornseifer:** I think there is a fundamental difference if you look at global trends versus our national trends here in Germany. If you look at the fund raising figures on the global level there is still an increasing interest with regard to various alternative investment classes and strategies. However, the picture is different here in Germany. Insurance companies still have little exposure to hedge funds or private equity. Correspondingly there are few fund launches here in Germany. Nevertheless, I am still optimistic that things will change.

In the recent annual BAI investor survey we asked institutional investors if they would still invest in infrastructure and other alternative investment classes in a scenario where government bonds deliver again an interest rate above 4%.

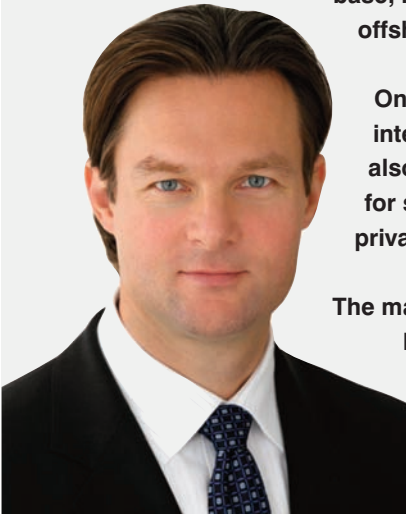
We wanted to find out if it is just the lack of investment opportunities that turns investors to alternative investments? Interestingly, the majority said that they would still would go for infrastructure and other alternative investment classes, even they could have a 4% interest rate on government bonds. Diversification has become one of the most important criteria for investment decisions of institutional investors.

So, I think we're looking at a shift in investor behavior, although it's of course happening very slowly. One thing investors but also BAI as an association are still complaining about is that the European and national regulations still leave room for a lot of uncertainty, for example regarding the changes of Solvency II, the German Investment Ordinance – Anlageverordnung - for the insurance industry, AIFMD, etc. Thus many investors are still holding back on their investments.

Still, the interest for alternative investments has been confirmed in our survey where over 50% of the institutional German investors said that in 2014 they will put more money into alternative investments. Nevertheless we are really concerned about the current draft of the afore-mentioned Investment Ordinance for insurance companies as it limits investments in numerous non-EU funds, especially if they are not in line with AIFMD.



**Dr. Werner Goricki:** We have seen mandates and investments on the hedge funds side picking up amongst our client base, mainly from family offices where interest has come back, largely for the unregulated, offshore side.



On the institutional side, we have implemented mandates for infrastructure. So yes, interest for this asset class is just starting here in Germany, and interestingly we have also seen that the fund of funds concept is making a comeback – this may be a surprise for some. And there is interest in the loan or credit space, the sector people now call private debt or direct lending.

The mandates that we have implemented are quite large and customized, and we agree with Mr Dornseifer that some investors hesitate a bit because of uncertainties around the structure. In Germany, the way of implementing such strategies is absolutely critical to people making the move towards an investment and is the decisive factor in turning interest into action..

**Valentin Bohländer:** For us at HQ Trust, alternative investments are strategic investments since the mid-90s for the founding family and some of our larger clients. Under alternative investments we understand most and foremost private equity, hedge funds and real estate. The exposure varies depending on the clients' risk preferences and investment guidelines.

Also from our side we see a pickup in the demand for alternative investments and the comeback of interest in hedge funds during the recent months. In our strategic asset allocation we recommend 15% hedge fund allocation to our clients, but the actual allocation of course depends on the client; as I mentioned some clients have come to see hedge funds as a strategic asset class and are invested in this asset class since 15 or 20 years.

There are also clients who sold the asset classes after the 2008 experience and all the public discussion that hit this sector, but are now starting to be interested again.



In our asset allocation, we analyze hedge funds within the overall portfolio context of the client. The portfolio of a typical investor may include equities, bonds, maybe high yield credit, private equity, hedge funds and real estate. The fixed income part of portfolio has had a terrific run over the last thirty years with 8% real returns p.a., but we don't see that type of return in the future.

If you look at the current 10 year yield and take it as an estimate for the next 10 years, then you'll get 2% or 2.5% nominal from fixed income. Going forward we expect hedge funds as an asset class should give us returns similar to fixed income in the past. Therefore we use hedge funds as a fixed income replacement in the portfolios of our clients.

We especially like the asymmetric risk-return profile of hedge funds compared to equities and the ability to preserve capital in severe market environments. For example, during the two big bear markets in the 2000s hedge funds lost significantly less than traditional long-only investments and recovered much quicker. So an investment in this asset class dampened the volatility of the overall portfolio. That is in a nutshell how we think about hedge funds at HQ Trust.

Let me also add that we as a family office are more interested in the offshore vehicles than in the regulated UCITS funds. The main concern or the main uncertainty we see in the market relates to the regulatory and also the tax environment. For example how will the new tax law impact our hedge fund investments?



**Robert Welzel:** Myself being an advisor, may I directly comment to your last statement. WTS also experiences that the funds, but also the investors, are not 100% sure on what is the new regulatory environment and what will be the impact on their business, especially on their after tax returns.

For example, from a fund perspective, existing funds have been granted a tax grandfathering until the end of 2016. Therefore, they are in a position to add on new investors based on the old tax regulations.

But funds which are currently newly established – especially in the hedge fund arena or alternative investment arena – are not grandfathered, and many of them face a less favorable tax law. We see that investors are much more hesitant to invest, especially private investors, when they understand how the after tax return is getting worse.

This is especially true with family offices. Private investors who face an after tax return decrease triggered by an increase of the tax rate from 25% to 45% in the case of alternative hedge funds are very hesitant at the moment to invest in new fund vehicles.

Also in the institutional investor arena, more and more funds will not any longer be in scope of what we call the tax privileged or the typical investment tax law. They might fall under the new CFC/PFIC like tax regime, and especially German insurance companies often have significant problems to invest into such non-distributing funds, which very often is the case in the hedge fund or the alternative investment sphere.

From a product promoter perspective, due to the above analysis of the German fund taxation and fund marketing environment and the current uncertainty of the future development, it seems that a “first aid kit” for the short term is needed.

The time frame, however, is different, as follows. Private placement is replaced by Reverse Solicitation by July 2014; whereas the German tax law changes, at least for



existing funds come into effect only at the end of 2016. Thus, the new marketing tool kit has to be evaluated and implemented now, along the line that the initiative must not come from the fund promoter but from the investor. Also, repackaging / securitization may be a feasible solution to avoid the new – quite stringent - distribution regulations for AIFs.

From a tax perspective, there is more time. Sophisticated German investors are monitoring their existing investments more closely. The market starts to discuss wrapper funds, specifically set up feeder funds, repackaging and securitization. But please note that the new rules are still under discussion and the interpretation of the new wording of the law is significantly influenced by guidance that the German Ministry of Finance has recently and will issue in the future; this guidance seems to ease the situation somewhat.

In a nutshell, solutions for marketing and tax may overlap, there may be synergies. Unfortunately, the situation will not be easier than in the past...and an approach that would be suitable for all of the European market has not yet emerged.

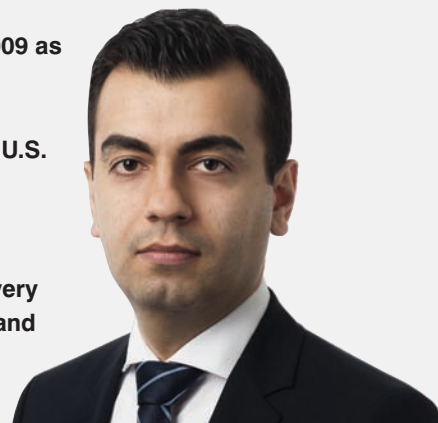
#### **Steffen Gnutzmann**

We also see, just like some of you already mentioned, significant investor interest in funds that invest in loans, bank debt, leveraged loans, senior loans – higher yielding debt assets. Now, the interesting thing that we learned is that apparently these funds do not exist as German vehicles. It seems that there are very few German loan funds. It seems that such fund vehicles are not usually set up in Germany – at least those loan funds that we service all are non-German funds, as if the German industry didn't know how to administer or set up such funds.

**Ahmet Peker:** We do run a loan fund: “Deka Realkredit Klassik” was launched in 2009 as the first loan fund under German law.

But if you look at the history of debt funds, you see that loan funds were run in the U.S. for decades already, so they probably have also set the standard for the industry. I mean, offshore vehicles lend themselves to these kinds of strategies.

When it comes to current investments of such funds in Europe, they are currently very active in Spain and Italy. There are a lot of interesting things happening in Europe and also in Germany.



**Frank Dornseifer:** There is a specific reason why there are no or almost no credit funds set up in Germany at the moment. Of course Luxembourg is ahead of fund structuring anyway, but there is a specific criterion at play: Luxembourg banking regulations allow investment funds themselves to provide credit. In Germany only the open-ended real estate fund is allowed to provide credit, so under German law no other fund type is allowed to provide credit.

So for the time being this is a significant competitive disadvantage for German funds, and hence another reason to choose Luxembourg or another domicile outside Germany.

That might change in the near future with the upcoming ELTIF regulation that explicitly stipulates that the ELTIF funds are able to provide loans or credit.



#### **Robert Welzel**

Yes, I fully agree with your analysis that it is more appropriate to set up these structures in Ireland or Luxembourg than in Germany. This is probably due to the fact that such German funds would operate in a somewhat grey area, especially tax law wise, plus the tax law is quite often changing.

Thus, the fund promoter might face the risk that ultimately the German fund vehicle might become taxable itself.

Nobody wants the risk of operating a fund vehicle, which itself suffers taxation. It would be a grave mistake of any advisor if such a thing would happen. It is not advisable to set up these more sophisticated structures in Germany.

So therefore in Germany, we usually discuss under what circumstances German investors from a regulatory perspective can invest into these non-German structures, what are the tax consequence for the German investors and what are the marketing issues for non-German funds or fund promoters to access the German market.

**Matthias Knab**

Vicki, what do you see from an exchanges perspective regarding alternative investments?

**Vassiliki Veliou:** As a derivatives exchange our standardized products are attractive investment and hedging tools for banks and for funds. The volumes of our instruments can sometimes point to interesting developments. For example, while the fixed income derivatives volumes have declined in Q1 2014 versus 2013, we have noticed that volumes of the Buxl, the 30-year instrument, have gone up substantially.

When we started to consult with some market participants on this phenomenon, the answer was quite simple. Most people told us, “well, I used to hedge with my 30 years interest rate swaps, but I have problems with it now, because of all the regulatory impact that is coming on OTC products. So now I choose to use the standardized product and use that as a hedge tool.”

A major trend in the markets is that as a consequence of regulation people shift towards more standardized products in a way that can be very visible from one quarter to another. It was very intriguing to see how the banks and traders have changed their behavior coping with the new regulations. If you look back, this all started when a G-20 meeting some time ago agreed that there should be more transfer to standardized products, central infrastructures, and this is the first phenomena where you can actually see that this route is voluntarily taken.

We thought that was an interesting shift. If you look at the instrument, the Buxl was already an established product; we did not invent it now to cover a gap. We did other things to adapt to market needs, but this one was already a prevailing instrument. You could have traded it years ago, but this time it got picked up quite quickly and could be a good example of the shifts going on from OTC towards a standardized world.



**Matthias Knab**

Another major regulatory framework is AIFMD – we're approaching now one year of AIFMD, anybody wish to comment on that?

**Frank Dornseifer:** Well, the deadline for implementation of the KAGB, the German Act executing AIFMD, will end on July 22 2014. So currently the German asset managers and service providers are on their way to comply with the directive and German addenda. Fund managers are on the way to apply for authorization or registration under KAGB. Service providers, like depositories and so on, are shaping their services for the new AIFMs.

One very important observation is that so far we have only about 30-40 managers who are authorized under German



law, i.e. a large number of applications with BaFin is pending. And even worse, so far there are only few funds licensed. Looking at the numbers of so-called special funds (Spezialfonds) – almost 4.000 - the question arises when their notification will happen in the short remaining period until July 22? Furthermore, will BaFin be able to handle these notifications and what will it mean for marketing and distribution if they are not approved by BaFin before the deadline?

So there is really a bottleneck coming to us in the near future, and my main criticism is that legislator and regulators didn't really convey a clear picture of what this implementation process means, not just for the funds regulated so far, but also the unregulated funds who will come now the first time under this new regime. And this is not just a problem for the industry but also for investors!



So looking again at the implementation deadline there is still much work to be done, even though we have very positive examples, including some of you here at the table. But there are a lot of asset managers who will get into trouble, and that's of course also not for the benefit of the investors and really worries me.

Outside Germany, the FCA in London already issued guidance on these scenarios if FCA cannot handle all notifications and applications in due course and time. They are well aware of these problems and therefore we hope that there will also be a pragmatic way forward here in Germany. That's really in brief one observation regarding one year AIFMD; I guess there will be one or the other surprise in the next weeks and months.

**Matthias Knab**

Werner, Prime Capital is AIFM licensed, what was your experience?

**Dr. Werner Goricki:** It's a lot of hassle to do, but it can be done. I think the main reason why part of the industry is still a bit short of meeting the deadline is the fact that the impact of AIFMD for the industry was widely underestimated.

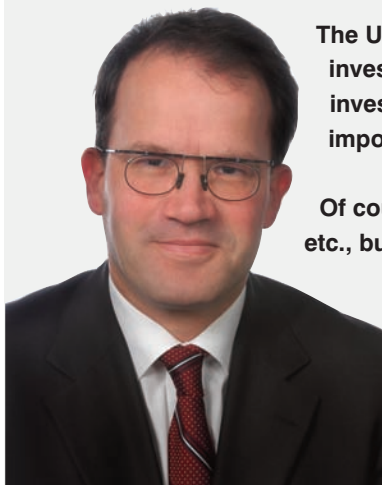
AIFMD is a regime shift from regulating funds to regulating the managers. Previously we only had the tightly regulated UCITS funds as vehicles for alternatives. Now with AIFMD, the alternatives space has been made a regulated segment right next to UCITS with more freedom to act and to manage a portfolio.

Many people didn't really take it seriously that this kind of paradigm change will come. For example, "reverse solicitation" is one of the buzzwords for AIFMD, and some folks may have thought "well, we just ask the clients to send us an email, and everything will be good..." But it turned out that AIFMD is a bit more than that.



**Robert Welzel:** Exactly! Regarding the implementation of the AIFMD, we have a one year regulatory grandfathering until July 2014, especially in respect of non-German domiciled funds, to go on with private placement. Then, the old private placement regime will elapse.

Originally, with the first drafts of the AIFMD implementation, there was the understanding that Germany might opt for a three year grandfathering of the private placement regime. Ultimately, this was shortened to one year. With this now ending in July 2014, non-German or non-European funds are much concerned with how to deal with the elapsing private placement regime.



The UK is more relaxed in this respect, just like Switzerland. We see that some sophisticated investors are already more or less asking funds they may invest in to inform them about their investment opportunities in the future, probably in the light of the restrictions which might be imposed by the new marketing regulation.

Of course, very often the industry has discussed about reverse solicitation, pre-marketing, etc., but also here to a certain degree the market is in a gray area.

Clear guidance exists with regard to Spezialfonds: these are tailored for only one investor, and the discussion on setting up such a fund between a fund manager and the investor of such Spezialfonds is not regarded as marketing. If however you want to address the opportunities to unknown investors in Germany, marketing might be a tricky issue in the future.

**Matthias Knab**

Valentin, from the investor's side, I believe what investors want is unrestricted access to global talent. What is your view on AIFMD?

**Valentin Bohländer:** Well, as Werner referred to, for me as investor one of the things I had to do was in fact to send a lot of emails to U.S. based fund managers saying that I want to get their information after the deadline.

Matthias had pointed to the issue, the main concern for me is that our investment opportunities will get constrained by AIFMD. Sure, most of the European asset manager will comply with it, because they are used to and required to comply with European regulation. But if I speak with asset managers in Asia or in the U.S., some managers will tell you that they won't talk with European investors at the moment because there are so many uncertainties around AIFMD and how this would impact their business, so they decided not to talk at all with the European investors.

Some of the larger hedge funds do have the infrastructure, the back office and the procedures to comply with AIFMD, or they may also rely on the somewhat gray zone of reverse solicitation.

It's a bit discomfoting that I as an investor don't really know what is right or what is wrong at the moment. But my main concern is really that the good managers tell you, "we get money from the U.S. and from Asia, why we should bother with European investors and regulations? We'd rather stay away from this market...", and that would be for us investors definitely the worst outcome of the regulation.



**Matthias Knab**

This negative effect of AIFM on investors has really been raised since the beginning of the discussions, so you can't really say this is just an unintended or unforeseen consequence of the regulation. Frank, what is your view, what should be done to help investors?

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**Frank Dornseifer:** Definitely this is an issue, however, we raised these concerns long time ago, even years ago under the former Investment Act. It had always been very difficult for new managers to set up their investment business here in Germany. To launch a hedge fund was almost impossible for young talents. Entrepreneurs and know-how moved to London, to Luxembourg or to Switzerland. This was a one-way road.



After asset management expertise left Germany it now seems that investors will leave too. If they don't find flexible and competitive ways to set up their funds in Germany, they look for better fund structures in Luxembourg and Ireland, wherever. And we know from a number of investors like insurance companies, occupational pension systems, etc., that they already have the plans prepared to move in the short term with their investment structures outside Germany because of uncertainties regarding regulation, taxation, etc. Investors need legal certainty and that's one thing that is sometimes hard to find in Germany, especially in the field of investment law.

Besides the amendment of the Investment Ordinance (Anlageverordnung) for insurance companies, there will be a revision of the Investment Taxation Act this year or in the early next year, and therefore a lot of investors put their investments on hold, or at least put their money not in alternative investment funds.

**Frank Umlauf:** My feeling is that over all these years it has been absolutely intended in Germany that this kind of industry should not be able to grow, maybe because regulation in Germany is set up as on a premise like "we don't want to have an accident in an area which seems to be a little bit too unconventional", or because politicians in charge don't understand this sector really, they confuse hedge funds as private equity, and because they don't understand it, they don't want it. They won't forbid the asset class, because that would be too obvious, but they do a lot to increase the barriers.

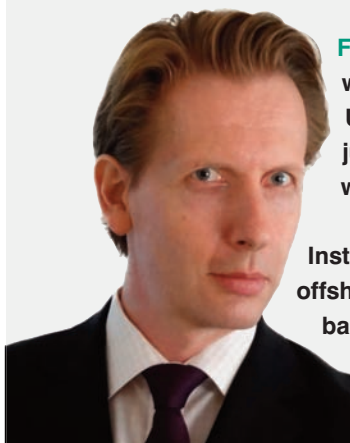
So the industry, and also the investors, will have to find new ways to get exposure to alternatives and uncorrelated investments. As a matter of fact, the way for the German institutional investor is UCITS. With UCITS you often hear the controversy that they are not performing like the offshore funds. That may be the case for some, but many investors don't have many other choices: it is either UCITS or none.

For those clients who have the possibility, we always advocate to invest offshore, because you have broader investment choices, but for many investors this is not possible. And don't forget, UCITS have an unbeatable selling point: they are not classified as a hedge fund. That is probably the main reason why UCITS funds have a certain appeal for regulated investors, simply because for them it's their only way to invest into some form of liquid absolute return strategies.



**Matthias Knab**

Your firm does a lot of work and analysis of UCITS funds. Are you in that respect comparable to a UCITS fund of funds?



**Frank Umlauf:** The typical UCITS fund of funds manager is really coming from the offshore world or offshore perspective. Often he is looking for his well-known managers from the U.S. who run an UCITS fund. For those U.S. based hedge fund managers, having a UCITS is just another form of distribution, they don't care so much about the UCITS per se, but they want to diversify their investor base.

Instead of just going after the already well known managers that are mostly coming from the offshore space, we are trying to have a combination between the European countries and U.S.-based managers. There are a lot of managers here in the German market, you can also spend two or three days in France to do manager visits. So for our use, we find that the UCITS space is different than the offshore space, and we like to take advantage of that.

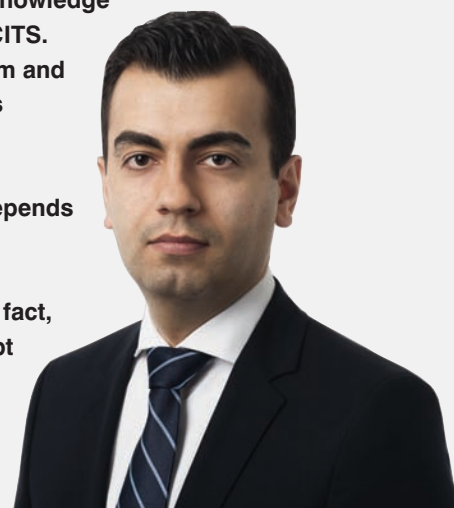
**Ahmet Peker:** We noticed that the strong growth UCITS funds have enjoyed the last couple of years has somewhat slowed down. The number of UCITS funds isn't growing that much currently, and in fact you can also see the some funds are closing down. But the aggregate AUM of hedge funds-strategies in UCITS-vehicles is still growing, that is very visible.

And there is probably still room for growth. If you look at the hedge fund universe, I reckon that you can implement around 80% of the global hedge fund assets in a UCITS format as well, with little restrictions. Of course, the very illiquid things like leveraged loans, distressed securities etc. will be difficult to do in a UCITS format, but that's accepted.

I also believe that UCITS generally targets a different investor group. I agree with Valentin that for sophisticated investors like HQ Trust the offshore world is still very important, I can fully understand that. But I think UCITS targets a somewhat different group, for example investors that don't have the resources, knowledge or experience to go into the offshore world feel more comfortable investing in UCITS. Even though they may be using fund of funds or an advisor to select funds for him and to do the due diligence, they are much more comfortable investing in alternatives through UCITS because they know there are certain regulations in place.

So now the question is, are UCITS-funds really of better quality? I would say it depends on what offshore fund you are comparing with what UCITS fund.

I believe UCITS will continue to grow because they open new investor groups. In fact, many hedge fund salespeople I talk to are saying they cannot sell anything except for UCITS. Of course, the largest investors do have their own teams and their experts and can afford to go offshore, but for most others UCITS will be the dominant way of investing into these strategies.



**Frank Dornseifer:** I agree that at the moment UCITS funds are en vogue, but I think that might change in the next two or three years as the AIF brand gets more established. I believe that at some point many investors will really invest into those alternative investment funds (AIFs) .

I think there are a couple of reasons for such a development. First, you have the well-known restraints within the UCITS framework. And in fact, this UCITS format will also be reshaped further, ESMA will provide more guidelines, there will be more investment restrictions on securities lending and so on.

Therefore in the future, the investment opportunities under UCITS might be further restricted, because the EU Commission has an interest to have two regimes, UCITS and AIF. I think there is an intention to have separate regimes

with a clearer differentiation of the relevant investor types and regarding the strategies the funds invest in. We currently see that UCITS funds can have certain marketing limitations outside of Europe because of their wider investment opportunities. The EU Commission is scrutinizing this development and will respond, if necessary.

This is really my assumption for the next two or three years. Otherwise, if this will not happen, all the efforts to set up the AIF regime would be wasted.



And finally one argument for the prevalence of UCITS lies in the current German taxation regime for investment funds that in a way distinguishes “good” funds and “bad” funds. The good funds are the UCITS funds, they have a defined catalog of assets they are allowed to invest in, and they get preferential taxation treatment. And once you start to pick other assets or employ techniques that are typically found in the alternative investment universe like non-listed equities, real assets, short selling, leverage and so on, you are part of the “bad” fund universe – at least from the viewpoint of the German tax legislator – and you will fall under a detrimental taxation regime.

So we have to figure out the future investment fund taxation regime in Germany. Nevertheless my assumption is that once the AIF brand is established, there will be appetite by German investors going into AIFs as well.

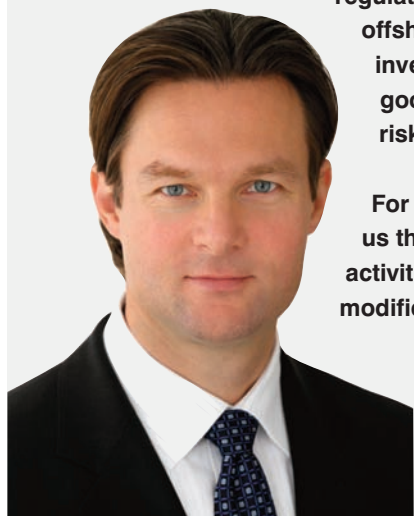
**Frank Umlauf:** For an institutional investor it’s not so much about taxation, it’s about classification, and as long as an AIF is classified as a hedge fund, then they have to hold it in the hedge fund or alternatives bucket. So again, for this very simple reason UCITS could be their preferred way to invest.



**Dr. Werner Goricki:** I agree with both of you: AIFMD is an opportunity, and at the same time a certain segment of institutional investors that are limited to UCITS are still not free or willing to move outside of the UCITS world at all.

If you take a closer look, there has always been a bit of a vacuum between the highly regulated UCITS space and the offshore space that by definition is not necessarily regulated, even though these days also in other places like the U.S. some managers are required to register, but there is no requirement for all of them.

In my view there is room to be filled in this middle ground between the UCITS world where the funds are highly regulated, which may be a good format for less informed investors, and the unregulated offshore world. For the reasonably informed investors it’s probably better to have an investment manager governed by the AIFMD framework that allows him to do whatever is good to create performance, but still has to obey to the AIFM standards in areas such as risk management and other procedures.



For active, professional managers, it is in fact not so difficult to get the AIFM license. For us the main challenge was to split the non-AIFMD activities from our AIFMD related activities. We were already a BaFin regulated asset manager, so we just had to do a few modifications.

Going forward, my take is that over time also non-European managers will become more interested in either getting the AIFM license on their own, or in using platform type solutions offered by European licensed managers like Prime Capital.



On the other hand, you could also argue that there are two reasons why managers outside of Europe may not be registering as AIFMs: first, Europe hasn't been the biggest hedge fund market recently anyway, so why jump into the hassle early in the process; and secondly, what we occasionally hear is that the compensation rules in AIFMD are an issue...

**Valentin Bohländer:** So we have offshore, UCITS and going forward more AIFs. But for me as an investor, the vehicle is only just one consideration; in the first place I am looking at the investment opportunity. We see that hedge funds surely give us different return streams than the other investments we have in our portfolio, like the equity long-only or fixed income investments. Especially the more illiquid assets, like loans, structured products, distressed investments etc. give us other return drivers that should be uncorrelated to the other investments.

Many of these strategies cannot be run in the UCITS format, and therefore we prefer definitely the offshore world where the managers can invest our money unconstrained in the most attractive opportunities. But we might look at UCITS from time to time. There are good managers in France or in Germany, who only run UCITS, so why shouldn't I give them money? I care first about the investment opportunity and how it works in our portfolio, then about the fund structure or the regulatory environment.



**Matthias Knab**

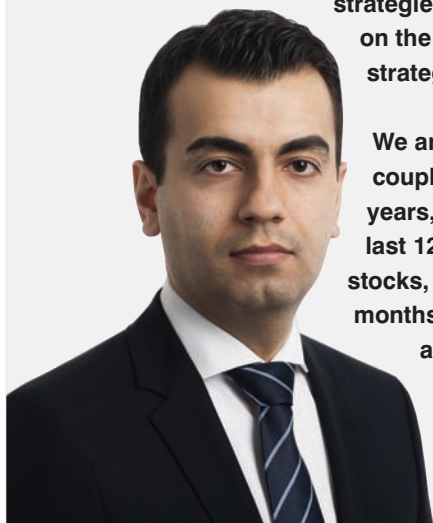
Valentin mentioned investment opportunities – which strategies and investment opportunities do you see at the moment?

**Ahmet Peker:** Let me first state that markets are going through a special phase: compared to their long-term averages, fixed income markets are currently priced higher than equity markets. Corporate bond spreads or yields in general, are very compressed. Equities on the other hand are moderately valued: not cheap from a historical perspective, but not expensive either, a phenomenon many haven't seen so far.

This is a very difficult environment for fixed income strategies in general. Some, like corporate bond selection strategies, can be interesting because they are market neutral. They are not that dependent on the direction of yields. But in general, we have reduced our exposure to these strategies.

We are positive for equity stock selection strategies, although they took a hit over the last couple of months. We think the market behavior we had observed over the last four, five years, where the markets would just be in risk-on or risk-off modus, has changed over the last 12 months. The markets are again differentiating more between good stocks and bad stocks, so we are optimistic for stock selection. Emerging markets got hit over the last 18 months and may offer an interesting entry point in some segments. That is may be a bit of a contrarian view.

We also have some interest in foreign exchange strategies. That sector was also very difficult over the last five years and hasn't delivered much return, but that could change now.



**Frank Umlauf:** At the moment we don't see any silver bullet across the traditional asset classes or the alternative asset classes. Therefore, I do have a recommendation that some are seeing as very unconventional, which is to keep in mind that cash could be an option for the time when risk premia will go up again.

But this is something institutional investors are not conditioned for – everyday they go against the carry, and it's another bad day for them. As long as they see that everybody else is positioned like themselves, they won't move.



**Matthias Knab**

So how will it end?

**Frank Umlauf**

I think we all know how it will end; it's a matter of when it will be, and that perhaps still could take years.

**Matthias Knab**

What do you think will happen?

**Frank Umlauf:** The coming crisis will be a bit different from the ones we have had so far. Over the years, we could see how the different asset classes were behaving in stress situations. In equities, we have seen this a couple of times, we know that they are falling and except for small caps retained a certain liquidity that allowed managers to act. We know that credits are not liquid, managers couldn't reposition the assets. And that's even more true now where all the investment banks' trading desks are gone. That is also true with convertibles. Therefore, everything that is not a pure government bond will have a certain form of disruption.

So the big question is what will happen with government bonds? I believe none of us has ever seen a real government bond crash, so we don't know how this will work out. That is a big question mark people should maybe look at.

Wherever you look in the traditional long-only world, you don't find attractive risk premia. Now may you say, "well, let's move then into alternatives," but if you take a closer look many alternative investments also have these kind of hidden betas. A lot of the performance last year was driven by equity beta or by a long bias to credits.

So also within alternatives we have to be very picky and focus on a liquid underlying. I agree with Ahmet that certain strategies that have been out of favor like currencies or also macro may become interesting again.

Long/short equities can suffer from rotations in the market, which we will see happening probably with a higher frequency. This makes it hard for managers who mainly invest on a fundamental basis and may give an advantage to managers with a more nimble, trading oriented approach.

We are also not so keen on infrastructure. In our view the investor is buying a cash flow stream like in a 30 year bond. Now, what will happen to your NAV when interest rates start rising? In general, infrastructure is less liquid and often comes with longer durations. Maybe private equity could be a more appropriate alternative for the long term time horizon.



**Valentin Bohländer:** The [General Motors' German car maker] Opel Slogan “Umparken im Kopf” or “rethink your assumptions” is a good phrase. I agree that a lot of investors are not prepared for what is coming in the fixed income market. As we said, we don't know when it will come, but it will come. Rates and default rates are so low, this it is not an environment which will stay forever. And if you compare equities and bond returns long-term, over the last 70 years back or so, equities have on average a relative premium of 3-4% versus fixed income investments, but at the moment the 30-year return of fixed income and equities are the same. That is not sustainable in our view. So we as long-term investors see equities as much more attractive than fixed income investments over the longer term.

Regarding investment opportunities, I already mentioned we have strategic investments in private equity where we still think we can get good returns going forward, and in hedge funds as well.

Unfortunately here in Germany and probable a few other places the perception of hedge funds is completely wrong. How many articles do we come across that say “S&P is up 30% and hedge funds are lagging with 10%...”. If I am up 10% with 3% volatility for my portfolio, I am quite happy with that. This represents a Sharpe ratio of 3, so it's one of the best investments I had last year.

We're back again to “rethinking your assumptions” where the industry must do more to educate investors and get the idea out of their head that hedge funds should give you 20% or 30%, that is not what we are looking for. We are looking for stable returns with low volatility in our hedge fund investments that will replace some of the returns investors earned from fixed income in the last 30 years making them 8%.

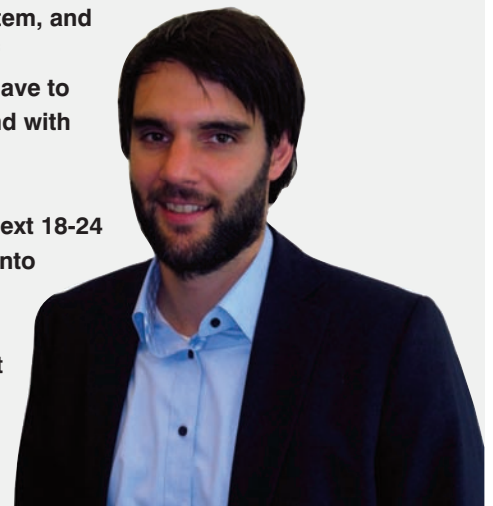
At the moment, some hedge fund strategies are interesting, like event-driven investments, mergers and acquisitions or other corporate activities like share buy backs also pick up, together with the whole activist segment. These strategies give me a different return stream and risk factors than what I get from my long-only equity investments.

But while a lot of people are looking at returns of certain hedge fund indices or sub-indices, we believe in good manager selection that will give you better results than the index. Manager selection is key in the hedge fund world.

Another area that is interesting but possibly getting a little crowded now is the whole European bank deleveraging. That strategy is done mostly in the offshore world, because here we are dealing with less liquid investments that you need to keep for a bit longer, like one or two years, you shouldn't go and sell them when there is some kind of volatility in the market.

We are looking at 300 billion Euro or more of debt in the European banking system, and banks have to sell it among other things due to the regulatory pressure. A lot of managers are coming now to Europe and pick this stuff up, and also here you have to choose again the right managers with a long established business in Europe and with the right network. Then you can get really attractive returns.

The third strategy that could offer attractive and uncorrelated returns over the next 18-24 months is global macro. Being short rates will also be interesting when we get into a rising interest rate environment. Global macro managers have the flexibility in their investment process to benefit from rising rates. They are at the moment positioned for rising rates in the U.S. and the UK and since it's not happening at the moment, they may suffer a little bit, but going forward should produce positive returns. Again the key is that they have the flexibility in their positioning to benefit from different market environments.



**Dr. Werner Goricki:** We are fairly advanced in the credit cycle in general – maybe with the exception of the Eurozone – and we have very low short-term interest rates. What typically happens when you advance in the credit cycle is that risk premia across asset classes converge, hence reducing expected returns, and that is exactly what we have been



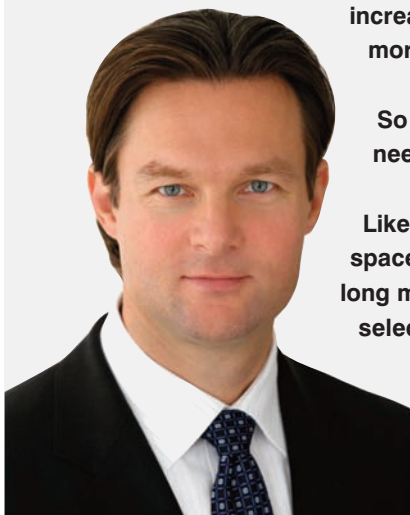
observing. While today's risk premia are below average levels, they are at levels which we have already seen before, and which can possibly stay like this for another few years. What is rather unusual about today's markets is the very low level of short term interest rates across major markets.

So the big question today, the elephant in the room, is about the direction of short-term interest rates. A rise in short-term rates could likely lead to a nominal re-pricing of risky assets across the board. For the time being let's assume that short-term rates would stay where they are for the near term, and let's look at spreads.

When you look at the size of the spreads, they are reasonable in many markets. Of course we are not in a particularly cheap environment, but in the past we already had similar times where spreads relative to short-term rates kept going down for many years. We see here and there some signs of over-heating, in particular in certain illiquid market segments like U.S. structured credit, but overall there is no reason from today's perspective why spreads can't stay where they are for a few more years.

Risk management is always important, but particularly in an environment like this one. It is now especially important to focus on capital preservation and avoid large losses. To help us achieve this we have been gradually increasing the liquidity and reducing the complexity of our investments so that we will be able to react when significant changes happen in the markets. We ensure this process does not only happen at our decision level, but also at the level of the managers we may be hiring.

I agree that event-driven strategies are interesting, but here we see two diverging trends. As structured credit performed well, you can see that some managers go into even more complex areas accepting more illiquidity and complexity to pick up a few additional basis points, which of course is also something that increases the danger of a sudden large loss. On the other hand, others are going into the more liquid space, which is the direction we prefer.



So in a nutshell, we see the relative return environment as okay, but there is an increased need to make sure we can avoid large losses once the markets turn.

Like Frank, we are quite critical about a lot of the activities we see in the infrastructure space, but we also see some sectors there that are clearly attractive, even considering the long maturity of the investment. There are ways to protect against rising interest rates by selecting such infrastructure investments where the profits are directly related to inflation.

This is important because you wouldn't expect rates to go up by a significant amount without any inflation over a horizon of several years. So rising interest rates in our view is not the right argument against infrastructure, but it is a warning to be careful when analyzing investments in that segment.

**Vassiliki Veliou:** One key discussion point we just mentioned is "crisis". The role that we as an exchange and clearing house play in times of crisis is valued by many market participants.

This role the exchanges have taken on addresses many of the G20 goals. For one, a standardized trading environment. Usually everybody tries to get on to the exchange because it is more liquid, so for a long time now we are trying to complement both the OTC world and the listed world and try to complement them in the sense of providing instruments that can be a possible solution in both a safe as well as turbulent market environments for users of derivatives.

In that respect we have seen a lot of interest in our work on new services and products on the fixed income side at the level of our working committees with our members. With the help of those discussions – as you can see from the history of Eurex – we have introduced in the past few years a lot of fixed income related products, like the OAT on the

French side or the BTB on the Italian side. And in the future we will probably try to further complement the OTC space, for example by introducing Euro denominated swap futures. In our committees we have found that this would be a relevant complement to the U.S. side.

Another concern around such crisis related themes where the regulator wanted to see improvements relates to cleared OTC derivatives and segregation. On the individual segregation side we can see that funds really take up this idea. It's not only a mandate by law, but funds actually really use segregation.

We have currently 33 clearing members for over 140 registered customers, of which the majority opted for individual segregation in our OTC offering. Thus the regulator can see the trend that the industry has learned its lesson from the 2008 crisis where Lehman has shown the deficiencies of accounts that are not segregated. This progress is in fact not only valued by the regulators and represents now also a way to mitigate potential side effects of a crisis. As Frank pointed out we can always expect crises, and the question remains how prepared are we?

EMIR set many standards to increase stabilizing elements, but EMIR hasn't unfolded entirely yet, we are still at the beginning. Eurex, for example, recently received our approval as a qualified CCP under EMIR, but others are still in their application process. Only after all regulatory efforts have widely been implemented will it be possible to assess the new market structure and its resilience in the next crisis.

Some of you had mentioned that you'll be looking at currencies again. Eurex will introduce FX futures and options on individual currencies and currency pairs. Since it is just being announced, I cannot provide any more details, but I felt I ought to tell you, since you just referred to this asset class.



**Matthias Knab** Any final comments?

**Frank Dornseifer:** Circling back for a moment to where we started our discussion today, on the level of our association we do get the impression that a lot of investors now really start a more thorough review of their portfolios. Our recent survey with German institutional investor confirmed that while of course return is really important for them, at the same time diversification has become even more relevant.

Over 50% of the surveyed investors said that they will not only allocate more money in alternative investments but also reduce their bond allocation for this purpose. This is from our point of view a very positive outcome that investors are now really concerned about having a balanced portfolio and therefore shift asset classes and strategies. To give you an idea, in last years' survey only 20% stated that they would decrease their bond allocation; so this is a significant change now.

Furthermore I can confirm that many German institutions have become more interested in illiquid strategies and assets as private equity, private equity real estate and of course infrastructure.

The recently published investment ordinance, which is currently under consultation, is not really meeting our expectations, but it does include some innovative aspects e.g. concerning infrastructure debt.

However, the quota announced for alternative investment funds – just 7,5 % – is far too low. Restrictions on non-EU private equity funds, especially fund of



**funds, are far too onerous. We do not believe that this a move toward Solvency II, but rather towards the opposite end with too much regulation and intervention by the German regulator and too little responsibility for the insurance companies.**

**We need a framework that enables insurance companies, pension funds, occupation pension schemes, etc. not just to prepare for Solvency II, but also to build balanced portfolios with asymmetrical risk-return-profiles. To reach this goal these investors must be able to invest to some extent into hedge funds, private equity, debt strategies or infrastructure. This piece of legislation has a strategic and long-lasting impact.**



# accurate

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