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SOUTH AFRICA

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Editor's Note

Overseas investors often not prepared for high returns, high alpha from South African hedge funds

When attending a Cap Intro event in South Africa, which I have been doing each year for many years now, I can see first hand that attendees and investors from overseas are often not prepared for the high level of returns when local hedge fund managers are coming up with 20%, 30% or 35% cumulative annual returns that can easily extend over periods of ten years or longer. The first assumption is sometimes that derivatives would play a big role in achieving those returns, when in fact they are a result of the skill-based exploitation of idiosyncratic opportunities offered by the South African equity market.

One is the growth opportunity, which is accessing not only the growth of the South African market, but also the rest of Africa, as a lot of South Africa listed stocks actual expand into the African continent and access that growth. The other is a **relative value opportunity, which is still strong and persistent.** South Africa's equity **market capitalisation is two times the GDP of South Africa.** The only other country in the world where the equity market is larger than GDP is Switzerland. In every other market, developed or emerging market, the capital markets are more representative of GDP.

South Africa's capital markets are large, well developed and well regulated. Already since about 2006 or 2007, South African hedge funds have offered daily position-level transparency, third party administrators, valuation agents, and third party risk managers.The World Economic Forum's Competitiveness Study has found that **South Africa's regulation of markets, the efficacy of boards, accounting and reporting standards are word class and actually rank among the top three in the world.** The unit trust industry in South Africa has now over R1 trillion in assets while local hedge funds reached ca. R60 billion and are poised for further growth.

New regulatory framework heralds new era for South African hedge funds

In 2015, the South African Ministry of Finance declared hedge funds collective investment schemes under the Collective Investment Schemes Control Act (CISCA). All existing South African hedge funds were requested to register with the Registrar of Collective Investment Schemes (CIS) before the end of September. Now, Retail Investor Hedge Funds (RIHFs) and Qualified Investor Hedge Funds (QIHFs) portfolios can either be housed in traditional Trust format, or in En Commandite Partnership format, both under a CISCA approved Management Company (ManCo). **The product is regulated, the managers are regulated, and the ManCos are regulated:** South African managers now have a product that they can widely distribute.

This Roundtable, which includes Udesh Naicker, the head of the hedge fund departments for the FSB (Financial Services Board, the South African regulator of the non-banking financial services industry) examines the growth perspectives, challenges and opportunities of alternative investments in South Africa.

The Opalesque 2016 South Africa Roundtable, sponsored by IDS Fund Services and Eurex, took place in November 2015 in Cape Town with:

1. Udesh Naicker, Financial Services Board
2. Nelia de Beer, Trustee Services, Rand Merchant Bank
3. Bradley Anthony, Fairtree Capital
4. Lee Dalley, Skybound Capital
5. Holly Rudman, Skybound Capital
6. Eugene Visagie, Novare Investments
7. Jamie Kent, Steyn Capital
8. Andy Pfaff, MitonOptimal Commodities
9. Markus-Alexander Flesch, Eurex
10. Tony Christien, IDS Fund Services

The group also discussed:

- Why, despite of their outperformance, is the South African (SA) hedge fund industry already relatively conservative compared to hedge funds abroad?
- The history and path to regulation of hedge funds in South Africa. Why the timing for this change in regulations couldn't be better.
- What's the difference between a Qualified Investor Hedge fund and a Retail Investor Hedge Fund? Why will the characterisation of a hedge fund as retail or qualified *not* necessarily define the risk profile of a fund?

- How will the future SA hedge fund industry look like? Will many smaller funds open, or will a number of funds just get very big?
- What if the “CIA” (large financial services groups like Coronation, Investec, Allan Gray) will enter the market? Which advantages do the current operators have?
- How will SA managers deal with capacity going forward? Will SA hedge funds have different payoff profiles?
- Which protection mechanisms are built into the new regulations?
- How will South African managers tackle the educational challenge?
- How will typical SA retail hedge funds look like? And how to market them?
- What is the role and value of a Trustee in the new hedge fund regulations?

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles

(LEFT TO RIGHT)

Matthias Knab, Tony Christien, Eugene Visagie, Bradley Anthony, Russel Julie (observer), Markus Flesch, Andy Pfaff, Lee Dalley
Holly Rudman, Nelia de Beer, Jamie Kent, Udesh Naicker.

Cover photo: Evening Mood at Cape Town's Waterfront

Introduction

Andy Pfaff
MitonOptimal Commodities

I work at MitonOptimal Commodities. We run a range of specialist commodities funds, from index trackers through to hedge funds, both onshore and offshore.

Eugene Visagie
Novare Investments

I am the head of Novare's fund of hedge of funds business. The group also operates a Management Company or ManCo, which operates in the traditional unit trust environment but will also be used for the hedge funds regulation.

Nelia de Beer
Rand Merchant Bank

I am the Head of Trustee Services for Rand Merchant Bank, a division of FirstRand Bank Limited. I have been in the position for 10 years. We currently perform an oversight function for Collective Investment Schemes in Securities (long positions) and Property Unit Trust. Hedge funds will be a new sector with its own challenges

Tony Christien
IDS Fund Services

Deputy CEO of IDS Fund Services, a specialist Fund Administrator here in Cape Town. We are primarily administrators in the alternative space as well as private equity and unit trust. We also have a ManCo which is operating in the unit trust and hedge fund domains.

Udesh Naicker
Financial Services Board

I head the Hedge Fund departments for the FSB (Financial Services Board), the South African regulator of the non-banking financial services industry. As of the 30th September 2015, my office has been inundated with applications for hedge fund scheme approvals. September 30th was the deadline for hedge funds to register as collective investment schemes with the FSB.

Jamie Kent
Steyn Capital

I am the Chief Operating Officer of Steyn Capital. We manage more than R7.5 billion across South African (SA) equity long/short funds, as well as SA long-only and Pan-African long-only equity funds

Holly Rudman
Skybound Capital

I work at Skybound Capital as an IFA and Client Liaison. Skybound Capital is a fund management business, providing investment products for family offices, private clients, advisors and institutions with a proven track record for preserving capital in tough market conditions while achieving strong growth in more favourable climates. We pride ourselves on our intellectual capital, risk management systems and an ability to do things differently. We have a global footprint with offices in South Africa, London, Mauritius, Australia, Bermuda and Hong Kong. We are also currently expanding our presence in Africa and Luxembourg.

Lee Dalley
Skybound Capital

I am currently a director at Skybound Capital. I have been involved in the South African hedge fund industry since 2001 when I managed a suite of local fund of funds. I am now involved in the business development side of our business.

Skybound Capital has a global presence through it's Cape Town, London, Hong Kong and Mauritius offices from where we manage a range of local and offshore alternative funds as well as some traditional long only Multi managed unit trusts.

Markus-Alexander Flesch
Eurex

I represent Eurex Exchange, the biggest derivatives exchange in Europe. Before that, I was for 10 years a proprietary trader in the derivatives business. Since South Africa belongs to my universe of derivatives clients, I am happy to join this Roundtable and get the latest insights and information on how the hedge fund industry or especially the derivatives industry is evolving over here.

Bradley Anthony
Fairtree Capital

I am the CIO at Fairtree Capital. Fairtree is a R21 billion asset management business, running hedge fund and long-only portfolios across multiple asset classes, including equities, agricultural and soft commodities, and fixed income. I have been in the investment industry since 1996, and been involved in the hedge fund industry for over a decade. Before joining Fairtree, I was the CIO of Momentum Alternative Investments.

Matthias Knab Much has happened in South Africa in the last couple of years, within financial regulation for the alternatives investment space.

This year for example, *the South African Ministry of Finance declared hedge funds collective investment schemes under the Collective Investment Schemes Control Act (CISCA) as from 1st April, 2015. All existing South African hedge funds were requested to register with the Registrar of Collective Investment Schemes (CIS) before the end of September. Now, Retail Investor Hedge Funds (RIHFs) and Qualified Investor Hedge Funds (QIHFs) portfolios can either be housed in traditional Trust format, or in En Commandite Partnership format, both under a CISCA approved Management Company (ManCo).*

How are you embracing those regulatory changes?

Tony Christien: At IDS, we have been involved in the alternative space since 2003. Since that time, the alternatives industry has developed and has always looked to become part of the mainstream financial services industry in South Africa. As an administrator, we have been in a very unique position in that we have been able to administer offshore funds from the regulated side, together with unregulated funds in South Africa. We have also contributed to the move towards the regulated space which has happened, in fits and starts, over the last 10 years.

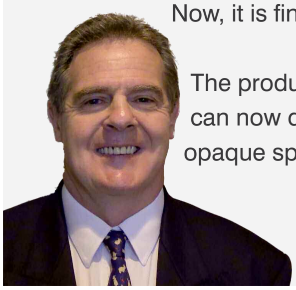
The hedge fund sector here has always had a desire for the product to be regulated. Over time, the hedge fund managers in South Africa have become regulated already, so by now all the different players in the market, the administrators, the prime brokers, and managers, all are regulated.

But the product, in other words, the hedge fund itself, has not yet been regulated, and that has delayed the growth of the industry to a certain degree. It has also prevented investors from taking advantage of the benefits hedge fund can offer in terms of broadening their investment styles and adding downside protection, depending on the type of strategies that they look at.

In the last two to three years, a number of regulatory initiatives have come to the fore and things slowly crescendoed towards the end of last year.

We are very excited that the product regulations have arrived now. Udesh may not be as excited, because he is going to do all the work, but we are definitely excited that we are getting to the point where we will fit into the mainstream and provide those extra benefits and choices for our investors, something slightly different from the standard investments that are out there.

Andy Pfaff: To put it in less technical terms, the South African hedge fund industry has had a very protracted adolescence. Now, it is finally all grown up and ready to sit at the adult table.



The product is regulated, the managers are regulated, the ManCo's are regulated. So we have a product that we can now distribute, and we can go out there as responsible adults instead of sneaking around marketing opaque speculative trading funds to sophisticated investors. It is all on the table, so let's get started...!

Holly Rudman: At Skybound Capital we welcome the new regulations and believe they provide a massive opportunity for the alternative investment space. **The unit trust industry in South Africa is colossal, with over R1 trillion in assets; compared to that of the hedge fund industry, roughly only around R57 billion.** We believe the new regulations will give the hedge fund industry the opportunity to grow and tap into a new market and investor base that previously believed they weren't eligible for such investments, or didn't understand the industry, and so rather avoided alternative investments.

At Skybound we believe that the new regulations are promoting the integrity of the hedge fund industry, and we're all for this! We're excited to interact with new IFA's and clients and to educate them on the wide variety of strategies which encompass the (sometimes misleading) blanket term "hedge fund".

Nelia de Beer In my opinion it is not only institutions that couldn't invest in hedge funds that would be attracted to the regulated hedge fund portfolios. It could also potentially be the pension funds that currently have an approved allocation for investment in hedge funds that would be more interested in investing in a regulated hedge fund product than a non regulated product.

Holly Rudman: Absolutely. This means that the investment gains from hedge funds will now be able to help grow the pensions of ordinary South African citizens and can even help stimulate the coffers of universities and charities across South Africa.

The ability of hedge funds to actively manage their funds in a way that other asset managers possibly can't means that socially important investments can also be protected from market drawdowns. It's an exciting opportunity!

Eugene Visagie: The lack of hedge fund regulation has historically been one of the biggest obstacles for new investors into the market. You come to investors with a product, they are very interested when they understand it, but if you're offering them a debenture trust or a partnership, then people immediately take a step back. We will have a more level playing field as now with hedge funds we have service providers like trustees, administrators, etc., who are regulated entities and investors are familiar with these service providers since they play an integral part in the traditional unit trust environment.

As Andy alluded to, hedge funds were at times in the past equalled to black-box investing – even though we're transparent – or worse, we have been thrown in with the Ponzi schemes out there. So there is a lot of education that still needs to happen around hedge fund investments. When you approach people, they still say, 'we don't understand what you guys are doing, we don't understand how you extract alpha.'

Even though we have to make an effort to really explain the different strategies, at the end of the day we mostly invest in equity or fixed income, which are in the end instruments that people are familiar with. So I think it is everyone's responsibility in this room to assist with that education, and to make a clear distinction of the benefits of including a hedge fund in an overall portfolio.

Matthias Knab What is the difference between a Qualified Investor Hedge fund and a Retail Investor Hedge Fund in the new regulation?

Udesh Naicker: Qualified Investor Hedge Funds are only allowed to accept eligible investors, that is, those investors who have a good understanding of hedge funds and the risks that such an investment may present. There is also a minimum investment of R1 million, although some managers may increase that level. In addition, the regulation is slightly less intrusive. For example, we allow the manager to set the exposure limits for each portfolio, provided that these limits are declared in the founding documents. We are also less likely to restrict the leverage, the sectors of investment or counterparty exposures.

By stark contrast, you have the Retail Investor Hedge Funds. They were created to allow access to the alternative investment space for the 'man in the street,' that is, the less-informed investor who would like to benefit from exposure to alternative investments as well.

Here we are a lot more restrictive in terms of what a retail hedge fund can do. We specify, for example, the legal structure. Retail funds must always have a trustee. They may perform their own administration, but then they would have to utilise an independent valuator. We specify certain checks and controls in the entire structure. Similarly, we specify exposure limits to both derivatives and individual counterparties. For example, a retail fund investing in other portfolios may not invest in excess of 75% of the market value of any single portfolio. There are various other limits of course. Importantly, the regulation for retail hedge funds also distinguishes between bank and non-bank prime brokers. All of these checks and balances are intended to limit potential loss to the investor. The major part of the regulation is also the level of mandatory disclosure, not just to the registrar but to the investor as well. We have comprehensively specified what must be disclosed to the investor. We want to make sure that the investors are fully cognisant of what it is they are buying into.

Matthias Knab Are you going to offer retail hedge funds?

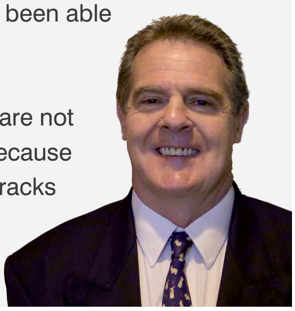
Eugene Visagie: Following up on what Udesh said about risk limits for retail investor hedge funds, the interesting thing is, **the South African hedge fund industry as it stands now is already relatively conservative compared to hedge funds abroad**, if you just take into account gearing and general exposure levels to name a few.

We have done extensive work looking into this, and found that most South African hedge funds already fit into the new retail framework, without changing their investment style or strategy. So, due to the conservative nature of the local industry, most of them do fit into the retail investor hedge fund profile. They will be able to manage the money within this framework quite easily just as they have been doing since they have started. They would just have that additional oversight and additional reporting to the regulator.

Markus-Alexander Flesch: I wonder to what extent will the use of derivatives be a differentiating factor for the industry? The use of derivatives, i.e. the results of using them has been a influential "sales-factor", which is measured in the European market, but as well in the US markets. It became apparent that the appropriate use of derivatives generates the "alpha" which is requested by the retail investor as much as it is by the institutional investor, therefore product and funds could easily differentiate by making use of derivatives, in any form.

To rephrase my question, do you believe that the industry is able to encompass derivatives in different hedge fund styles, though it does not seem a highly developed market segment, although the knowledge about derivative is available?

Andy Pfaff: In some ways, it is a loaded question and some ways, it is a non-issue. Generally, it is a non-issue. South African hedge funds have been trading derivatives forever and they can broadly continue to do what they have been able to do so far.



There however are some very specific issues for me since I manage commodities funds. Commodities are not permitted at all in retail hedge funds, so actually it is not a derivatives issue, it is a commodities issue because the only way you can trade listed commodities is via derivatives. This particular issue fell between the cracks during the drafting phase and it doesn't do my business model any good. But generally I don't think derivatives are an issue.

Bradley Anthony: I would agree with Andy. I don't think that the use of derivatives is going to increase or decrease relative to what hedge funds were doing in the past.

I'd like to add an interesting point from our perspective: we run somewhere in the region of 15 different hedge funds strategies at Fairtree, and our major consideration as to whether we launch them as retail hedge funds or qualified hedge funds is their remaining capacity, and not their risk profile.

In our experience, **the characterisation of a hedge fund as retail or as qualified is not necessarily going to define the risk profile of a fund.** This is because, within the current regulations, we could construct retail hedge funds which are far riskier than our existing qualified hedge funds, simply because we have limited risk capacity and/or appetite in our current funds.

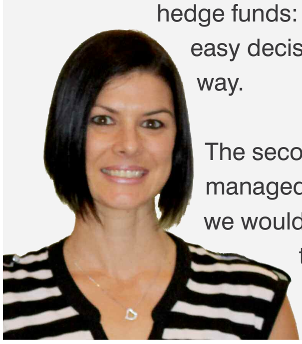
I have heard the view that qualified hedge funds will make greater use of derivatives, and I think it is a red herring. The use of derivatives has been extensive in the industry, and the way derivatives are applied is well-monitored by fund of funds, by risk managers, and by the administrators. So I don't think there is excessive risk within the use of derivatives.

Lee Dalley: An important point there is capacity. At Skybound, we have run funds of hedge funds since 2001, when the industry was in its infancy. One of the key factors that managers have always referred to has been their capacity.

It will therefore be very interesting to see how the large, traditional South African asset management institutions will enter this space, with capacity in mind. They have typically been asset gathers, something which the local hedge fund industry has not been due to capacity reasons, both from a strategy and performance point of view. Yet newly regularised mandates do not seem that different, so you would presume the managers should hold the same capacity views as they have for the last 12 years and limit the size of their funds.

Does that mean we will see many smaller funds opening, or will we just have some funds that get very big? How will our future look like?

Jamie Kent: Capacity was definitely one of our considerations in deciding between retail or qualified funds. We have two hedge funds: one is an all-cap fund which has been hard-closed for a couple of years already, so it was quite an easy decision to register that one as a qualified fund since all our investors are happy for it to be structured that way.



The second fund is a larger cap version of that fund, which has got far more capacity and which has been managed in-line with the retail regulations since inception. But we also needed to consider how much capacity we would be sacrificing by changing our current 60 day liquidity terms to 30 days. We ran the numbers and feel that we will still have sufficient capacity for this strategy under the retail structure's liquidity requirements - and it is on the short-side that the capacity constraints come in first.

Lee Dalley It is interesting about how such a potential growth of funds and volumes will affect the short side. Does the large plethora of funds potentially coming to market not introduce a different level of volatility to our market?

Eugene Visagie: I hear what your concerns are. However, we already have significant international players that participate locally, and they bring in a lot more volatility to the local financial market. To measure that is very difficult. But with the current size of the hedge fund industry of R62 billion combined with its conservative nature, even if the AUM were to double within the next year, this will not in my opinion introduce much more volatility to the local market.

I would also like to add to the topic of capacity. When we did the Novare survey in June, of the managers that participated said they would easily be able to take another R60 billion worth of assets.

I am fairly confident that the large asset managers will very quickly bring products to market if they see that there is an opportunity.

Bradley Anthony: Just to agree with Eugene, from our perspective at Fairtree Capital, what we foresee is that, as you roll out more scalable products in the retail hedge fund space, the typical payoff profile characteristics of hedge funds will morph slightly as well.

In the early days, when we started talking about the hedge fund regulation, we referred to two categories; hedge fund and hedge fund-lite. That might be not the right terminology to be using nowadays, but maybe we need to think about it the same way UCITS funds are viewed in Europe. These funds provide a variant of what is available in typical global hedge fund structures, but do not totally capture the nature of their traditional hedge fund counterparts.

Therefore I believe that, as a business, we will introduce products with payoff profiles that are different to the existing hedge fund products, which will be more scalable. Retail investors may not be able to enjoy the type of payoff profiles which we can produce from our traditional hedge fund products, but we will produce something similar, if not slightly more market-related in risks.

Andy Pfaff It may be exactly what the regulator wants: to have large, low volatility funds that never blow up and that don't hurt the retail industry. There is a lot of win-win throughout the industry in that. Those are all the pros.

The cons are, as Bradley says, that historical track records may not be accessible at any scale to the future investors.

Holly Rudman: Regarding Bradley's point about payoff profiles, I believe it all also depends on the client. Our current clients are very happy with the "traditional hedge fund" space, and as such they will remain in our qualified funds. It is our new clients that we will need to work hard at educating.

It will be interesting to see how all the retail funds perform given the limitations being placed on the various strategies. Skybound have worked very hard in preparing for our retail funds and have done various quantitative and qualitative modelling to ensure that our new clients will enjoy similar rewards to those of our qualified investors, despite the restrictions of liquidity, borrowing and derivatives to name a few.

Finally, the education of our IFAs and brokers is going to be paramount. We want our partners to understand how the funds work and the benefits they can offer our clients. They will be instrumental in the move forward into the retail space. We want our IFAs to come on this journey with us.

Lee Dalley

Hedge funds have received their fair share of bad press over the years when expectations were perhaps misaligned to actual outcomes. With retail hedge funds set to take centre stage, they really need to deliver the expected returns, non-correlations and diversification, so as to hold the image of the industry.

As mentioned earlier, the qualified investor funds may well be able to provide a better risk managed solution through their allowed mandate and a truer hedge fund type performance, but this may not go unnoticed.

Matthias Knab

What do you think the South African alternative investments industry will look like in, say, five years' time? What are some of the scenarios? Who will be making the cut?

Bradley Anthony: To start with, the industry has been very well-structured. Long before we embraced the move towards regulation, we had this idea of self-regulation, where independent service providers where used for valuation, administration and reporting.

So I think most hedge fund managers now have the opportunity to use these regulations as a platform to grow their businesses. We have great administrators like IDS who can help us out with things like the increased reporting requirements within the new regulation, as an example.

Most of the South African hedge fund industry has been very conservative, as Eugene has pointed out, so there are opportunities for South African hedge fund managers to grow their businesses.

However, **the one thing we have not focused on, as hedge fund managers, is our distribution capability.** If you look at the long-only industry, most of the assets are clustered around those houses who have fairly decent distribution capabilities. So, a strong brand coupled with distribution capability could determine where the real growth in the industry comes from in the future.

One of my concerns for the industry as a whole is that, if we turn the clock forward by five or ten years, the C.I.A. has taken over the industry. The C.I.A. being the likes of Coronation, Investec and Allan Gray in the South African context of course. So, I'm really talking generically about the big long-only managers who have established distribution capability, a loyal following and the brand recognition.

That is not a bad thing for investors, or for the industry as a whole, which will grow. But it is probably not a great thing for us hedge fund managers who have been in the industry for a while, toiling for as long as we have, working alongside ASISA and the regulators to try to bring regulation to market, but who don't have that distribution capability.

Who we are and what we do?

The IDS Group is an independent fund administration group which was founded in 2002. We specialize in providing back office services to alternative asset managers including hedge funds, funds of hedge funds, private equity and property funds. We are the largest fund administrator in Africa with assets under administration of approximately $6bn and international offices in London, Malta and Mauritius. Our clients trade all investment strategies and we pride ourselves on providing a tailored solution to meet their differing requirements.

What sets us apart?

Understanding your business is our business. Our clients vary in terms of size, location and complexity but we treat every client as an important client. One size does not fit all. Our experienced team works with our clients to ensure complete understanding of their requirements and provide detailed and bespoke solutions as well as ongoing advice, assistance and support. We continually review our processes and integrated range of products and services to ensure we maintain the high service levels that our clients expect from IDS.

When should you consider using IDS Group services?

Whether you're looking to launch a new fund, make a transition to a new administrator or simply wish to outsource some of your processes, we have a solution to suit your needs.

Tony Christien: Bradley, I think that is a really important point there.

One of the issues that we as an administrator have always tried to cover over the years is to look for the new manager and assist those guys coming out of the big houses to help them get started, even if it was with R5 million or R10 million only. Now, in spite of all the positive aspects of the regulations, we do have the concern that we get a situation where it will be almost impossible for the new managers to come to market. And if that does happen, we believe that the hedge fund industry will to an extent atrophy.

We are really adamant about trying to ensure that new managers continue coming the market going forward. And as Bradley mentioned, there is a problem with distribution. In the past, funds of funds actually helped in that sense; they assisted new managers, taking them on, providing them with some cash and help them grow. If we don't do that going forward, we will end up almost in a loop.

Udesh Naicker

I would like to ask Bradley a question. One of the things that we have always anticipated is that down the line, let's say five years, a greater percentage of the pension fund allocation will flow through to hedge funds.

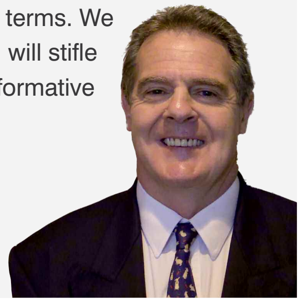
Do you not see that as one of the sources of growth for the boutique houses like yourselves rather than allocations flowing to the traditional managers?

Bradley Anthony: We would hope so, Udesh. We would certainly hope that the institutional market starts to allocate to the more boutique hedge fund managers.

However, even in our long-only business, we have a similar experience in that we fight the challenge day in and day out, dealing with those brand names, and the inertia of trustees and the larger investors. There is a reluctance to move away from those larger asset managers and what is essentially seen a safe bet. So that makes it difficult for a boutique firm like ourselves to grow.

But I don't want to be too downbeat about it. At the same time, it creates massive opportunity for those of us who want to invest into that distribution capability. My point is that, to date, we haven't, simply because as hedge fund providers, we haven't been permitted to solicit under South Africa legislation.

Andy Pfaff: There is an old saying about business - stay small or get huge... It is the same the financial sector. Either you be huge, you be one of the "CIA" or a large financial services group such as Old Mutual or a Sanlam; or you stay small. In the latter case, you will have to set up strategic alliances or partnerships with distribution channels or with other managers to attain a critical mass.



When Udesh asked Bradley about the growth prospects of his firm, we should also keep in mind that while a R20 billion shop is certainly small compared to the CIA-type of companies, it is very big in local hedge fund terms. We don't regard that as a small start-up business. But on that side, Tony is correct in saying that regulation will stifle the creation of small managers in the future, but perhaps the industry has already moved beyond that formative stage now.

The pro is we have got regulated product; the con is there is no space for the young upstart with the proverbial two men and a Bloomberg and a dog in the garage. That era is over. That is the price that we are paying for having a regulated product.

Yesterday, I sat through another CAT IIA (Category IIA licencing, for hedge fund managers) application, where I was the applicant. I had done it already around 2006, and this was second time around. It was very interesting to see how the business model has been forced to progress, in terms of RDR (Retail Distribution Review), Treating Customers Fairly, and policies like this. There is no way the small business can do that. The industry had to grow up, and it has, and that has been a fantastic thing about the regulations, because the industry is now very well prepared to go forward.

From now on, I don't think that we are going to see operational hiccups, we are not going to see the typical business risk issues. The industry is over that. But the price is that we lose some of that entrepreneurial edge. But the industry also has had 10 to 15 years to get there. We are now in maturing phase where the growth is different now.

The growth is in the distribution, the strategic alliances, not in just launching another fund. So we have got to move on and embrace it, and it takes strategic alliances, which the proverbial entrepreneurial independent hedge fund manager doesn't do well, or hasn't done well in the past. So there are going to be some interesting business models going forward.

Udesh Naicker: Bradley, just to go back a little to what you were saying about the retail fund industry. One of the characteristics of the South African hedge fund industry is that it is largely made up of long/short exposure. There is very little in terms of some of the more exotic strategies.

There are reasons for it; market maturity, liquidity, perhaps a lack of depth in the market and many more. But as a regulator, one of the things that we would always keep our eye on is the day that somebody comes in with some investment strategy that we haven't seen before.

Right now, it is a very professional market, where managers do things pretty much as hedge fund professionals will normally do it. What might happen is that from a strategies perspective, the industry may also gradually morph over the next five, ten years or so, into an even more entrepreneurial market, where managers are forced to differentiate their product offering. If you are going to grow your business on the retail side, you can't offer more of the same, because at some point everybody's products become homogenous.

My question to you is, how do you differentiate yourself, and how do you generate that alpha? How are you actually able to accept a new player in the market with 200,000 rand to invest into a retail fund?

Eugene Visagie: Initially for the next two years, one advantage that the current operators have is their track records. Fast forward two, three years down the line, then you will start seeing other sorts of strategies coming in. But as you rightly said Udesh, it is also related to market maturity, the type of instruments that are available out there, and the sort of strategies that can be implemented in the local market. And due to capital controls, we will probably see some hybrid strategies incorporating offshore as well, but then we could run into problems with regulations 28.

So there are many ways this can go, but I think for the next two to three years, our track record will speak for itself.

Bradley Anthony: We are very keen to embrace education of investors and capital allocators, and to work alongside our fund of fund partners, administrators, and other service providers to help investors through the education process.

Regarding the strategies, I think that as a business we are privileged and have been blessed in the sense that we have attained a degree of scale, and the ability to do a few more esoteric things already.

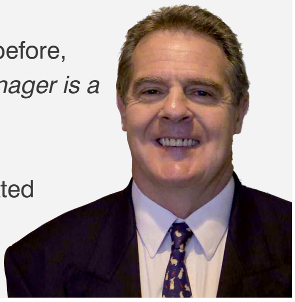
For example, in our current hedge fund product range, you will not only find the typical long/short equity strategy, but a range of other strategies which are less common in the South African market. However, we have also not been able to garner critical mass in those strategies, either because of a lack of understanding or perspective.

The key thing around new innovative strategies going forward is that **investors first need to realise that hedge funds are not a homogenous group.** It is a very segmented, let's call it, asset class, for lack of a better expression. Investors must also realise that they need to unpack every single hedge fund strategy to understand the mechanics of it and how it derives alpha, and hence the application of that alpha in a broader investment portfolio. And once they do that, then you can move on to stage two in the maturation of the industry and introduce new products.

Andy Pfaff: I think, like Eugene, there will be an initial phase where not much changes. It will be about more of the same, but it is the branding that will count for the distribution. Because if you think of a lower volatility / low risk product in the retail space, how will you really sell that low risk theme? You do it via the branding. So in my view, the branding differentiation or the loyal following will be the critical differentiator going forward.

And if you are going to a new asset class with a new product and a manager you have never heard of before, that also is a double risk for the agent who is selling it. *But a new product from a mainstream asset manager is a lot safer sell.*

But you are right, Udesh, the current hedge fund products aren't that differentiated yet. We haven't created demand for different products, it has been more like doing more of what has been working.



Matthias Knab Many of you spoke about the need for education, and this is part of a mid to long-term plan. So let's start right here at this Roundable. What do you think are the key messages about hedge funds that investors should understand? And what are the most misunderstood or the most missed points about hedge funds?

Andy Pfaff We can start with an easy one: how do we ask the press to stop referring to the hedge fund industry as opaque, when hedge fund managers provide complete transparency of their whole portfolios to investors on a daily basis?

Eugene Visagie I am not going to defend the press, but it does feel like they have softened over the last couple of months. They are not as harsh as they have been in the past toward hedge funds, and most of them are aware of the regulation. But you are spot on, Andy. And also, as soon as they, the press, don't understand an investment strategy, it is a hedge fund. But it seems they are getting better at it. But then also, maybe I am the eternal optimist...

Holly Rudman: The timing for this change in regulations couldn't be better. The Johannesburg Stock Exchange has been rising since about 2009, we've have had almost six years of bull market, and as such, equity funds and unit trusts have done really well.

It is the right time for hedge fund regulations because hedge funds can offer a credible alternative for investors as we enter a volatile bear market. So it's again a matter of educating investors as to what hedge funds can do in market downturns,
and the expansive toolset we are able to utilise to protect client's wealth even in market downturns. For example, the average man on the street doesn't currently understand short selling.

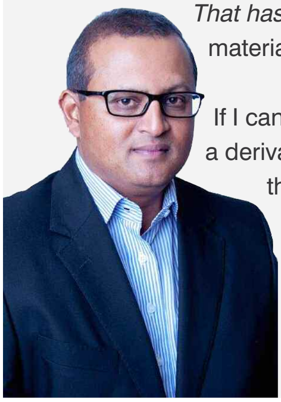
Lee Dalley: Education is paramount for the success of raising assets in the retail space. This remains our challenge. Most investors have a limited understanding even of the long-only space, let alone the hedge fund space. The man on the street must first understand the risks associated with traditional investing, before he can understand there is a way to protect against it.

Obviously, in the qualified investor space, it is slightly different. But there remain some challenges there as well.

Udesh Naicker: Just to add to what Lee has said, the education to me is a combination of awareness and understanding on the investor side.

Matthias had asked what should people know or understand about hedge funds, and back in the day you would have heard things like "a hedge fund would generate alpha or in general, positive returns, irrespective of the direction that the market took". But actually in a downturn, right now, the expectation would be that a hedge fund actually loses less than the market; and with that return profile, the investor is still ahead of the game.

The problem is that the man in the street doesn't understand that. Also, in some of the material that I have seen, *there is this implied promise of endlessly increasing returns that the fund is going to generate irrespective of what happens in the market. That has to stop.* We have actually started specifying what and how you should present material or marketing material to your clients.



If I can't understand some of the promotional material, how would a person who has no understanding of what a derivative really is or what it does or what its potential for profit or loss is, ever going to understand the risk or the return profile of the investment, or for that matter some of the fees structured around performance?

My point is that the education has to start with the managers. They have to equip themselves to best present what they are offering, in a manner that is the clear and understandable to all. That is going to be the challenge: how do you not confuse the guy who is ultimately buying your product?

Jamie Kent: Investors should be educated on the perception that has been created by the media who report on financial companies that weren't really hedge funds, but pretended to be, and blew-up.

The industry has done really well over the past couple of years in regulating itself. We now have the CISCA compliant structures, but most of us have had segregated and independent prime brokers, administrators and auditors for a long time. I think if regulation could help adjust the perception of hedge funds, then that would be a good starting point.

Bradley Anthony: We shouldn't fool ourselves to think that all of a sudden, the press and the world at large, are going to have positive views about hedge fund managers. We are still the 'Wolf of Wall Street,' we remain the poster child for the group that 'took down the Bank of England', and that sort of thing.

We must realise we are operating within that context. But what we can do is try to reinforce what each of us do individually. **I always tell investors that the image that they have of South African hedge fund managers being akin to George Soros taking down the Bank of England is incorrect.** I don't know any hedge funds in South Africa that actually have that kind of ambition or operate with the same kind of gall. Notwithstanding the fact that risk limits in our mandates would never accommodate such degrees of risk taking. But we each have our own unique DNA as hedge fund businesses. I am sure Andy is very different to ourselves at Fairtree Capital, and we express ourselves very differently.

When it comes to your point about clearly presenting our funds, Udesh, we indeed need to be able to go out into the marketplace and inform people as to who we are as fund managers. In the long-only world, we can point fingers at all sorts of people that have underperformed, or not, over recent years. But those long-only managers have very clearly defined who they are. So when investors buy, let's say, a value manager, they know exactly what they are buying, there is no opacity around that.

So we need to define, for ourselves, who we are and get that out into the marketplace. But we should never think for one second that we are going to be seen as the saviours of the investment world in the same way that low cost beta trackers are seen as a saviour.

Andy Pfaff To pick up on Bradley's comment, because we now are regulated and part of CISCA, does this mean we get a marketing budget out of ASISA? Any members of ASISA (the Association for Savings and Investment South Africa) here? No?

Markus-Alexander Flesch: I think what Bradley is saying about informing investors and defining ourselves is right, and that was my perception yesterday while I participated in a hedge fund conference here in Cape Town.

It seems to me we have a very equities "shaped and driven" hedge fund industry in South Africa, but we all know that the hedge fund industry is very heterogeneous and therefore could develop further, especially into styles which are currently not represented, but add value, be it from its diversification approach or even more simpler be it as a hedging tool. Yesterday I saw several great presentations by long/short and global macro hedge fund managers, but I have not heard of many event-driven, fixed income-driven strategies or even volatility arbitrage funds.

The world of hedge fund is really huge and represents many different ways to generate returns and/or reduce risk. The point is to help the end investors, be they retail, institutional, or pension funds, understand what kind of instrument and product they are going to buy in. This clearly is a topic of transparency; the fund manager or its company must deliver this information in a very detailed, reliable and trustworthy manner.

He must inform on the usage of pure cash instruments, structured or even plain derivative instruments, for example. This is what I have seen in the European market, and I think it is the only way for hedge funds to avoid being declared as risky or opaque, if not even toxic.

I believe that hedge funds per se, whether they be event-driven or fixed income arbitrage represent unique aspects, and offer huge opportunities for clients, as well as providers. And you are right, Holly and Udesh, when the market turns south, hedge funds belong into a strategic or tactical asset allocation. But eventually, the end investor needs to understand what he or she is buying into. Without a detailed and clear transparent prospect the end investor will not engage in a product he does not understand, even if he could diminish risk and increase his return profile.

However, the impact of hedge funds will sometimes be misperceived, because some specific hedge fund strategies are rather complex. For example, some CTAs, or managed futures funds through their leveraged futures exposure can under certain instances also accelerate movements in the cash market on the down side. While this is part of the normal working of futures derivatives, at certain crisis moments it also could lead to very negative misperceptions of the impact of some hedge fund strategies. That is also something which needs to be explained and therefore hedge fund managers need to be transparent about the instruments they use, as otherwise regulation will kick in.

Matthias Knab Andy mentioned the press, and of course we all hear of the many frauds coming out of the United States.

I would like us to talk about some of the structural strengths and safeguards that the South African hedge fund industry provides, and has been providing for a long time, because the industry here was really created as a response to institutional demand.

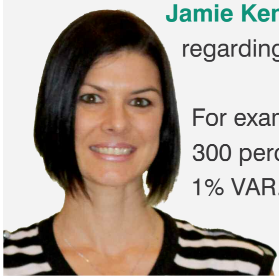
Udesh Naicker: One of the most basic protection mechanisms built into both the qualified and the retail categories is that the investor can't lose more than the value of the investment. That is something that we have been explicit about. So the investor's loss is limited.

That may seem trivial, but the fact is, many people believe that they are liable for losses in excess of their investment. Investors need clarity on this issue. Hedge funds are not a risk-free investment but you are not going down the tubes because your fund has lost money.

Markus-Alexander Flesch But this also means hedge fund managers are limited in their use of leverage, no?

Udesh Naicker: On the retail side, we do limit the leverage; that was the whole purpose of the retail category.

On the qualified side, the manager can pretty much do as it pleases. The manager will set the leverage levels upfront. But we have structured the legislation in such a way that the manager will have to disclose to the investors what it is they are buying into. We don't legislate how much the manager may lose but we do insist that the investor is fully informed of the risk they are assuming.



Jamie Kent: Udesh, the retail regulations limit the amount of leverage that can be used, but I have a question regarding the different approaches allowed to measure this risk.

For example, if you have a long/short fund that is purely cash equities running at gross exposure levels of 200 to 300 percent, it clearly doesn't fit within retail, but then you run it through a risk manager and it comes out with a 1% VAR. Do you think that a 20 percent VAR limit for retails funds is meaningful then?

Udesh Naicker: Somebody asked me about this exact same thing, and said the VAR limits that we prescribe in the legislation is too high and that it is a mathematical impossibility. My answer is that the VAR number isn't a target but rather the limit.

VAR is a cumulative number, so over the period that we specified, we have told you what the maximum is. As for the example that you are quoting, if the fund has to be classified as a Qualified Investor Hedge Fund, so be it. The fact that VAR is at 1% is an outcome of the risk profile. We don't try and stipulate what that profile must be. It may be as high or as low as the manager desires. The parameters must just be disclosed in the founding documents.

Lee Dalley: Another question that sometimes comes up is how we are structured.? I think it is also important to know where the hedge fund industry in South Africa has come from. We have been incredibly good at self-regulating this market to date, and a lot of people don't realise how conscientious and how aware the industry is about protecting itself and the investors whose money is being managed.

There is a misconception that hedge fund managers take large risks and it's a go big or go home mentality, when in fact it is the opposite.

The fund of hedge funds space are often the biggest investors into the single strategy funds, and with them comes a sophisticated level of risk management that monitors single strategy fund managers incredibly closely. Any mandate breaches or aggressive investing is frowned upon by these teams of analysts, and we have seen in the past how quickly invested capital can be withdrawn from managers based on unexpected returns, often leaving the managers no option but to close their funds. This serves as a big deterrent to managers trying to take on too much risk.

The self-regulation of the industry has been very thorough in its approach which has largely gone unnoticed. A classic point is transparency. We are still chastised about supposed lack of transparency, yet hedge funds are more transparent than traditional funds.

We have got independent administrators, independent risk managers, third party service providers, primer brokers, independent auditors, and then there is an additional level of this at a fund of funds level. The risk management processes in place at all levels is unparalleled.

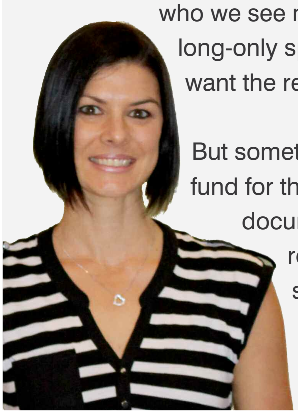
Bradley Anthony: I started investing in global hedge funds about a decade ago, and I remember clearly what we had to do back in those days when we built our risk models. We would take manager's monthly investor letter, which contained primarily their monthly returns and some high level historical holdings information, and we'd try to derive their current positioning in order to try to ascertain how the portfolio would perform over the following period. And that's the degree of transparency you got in the industry globally, probably until 2008; although it may have changed slightly since then.

However, in South Africa we very rarely have had that. **Since probably 2006 or 2007, we have had daily position-level transparency. We have had third party administrators and valuation agents, third party risk managers and prime brokers. A package which is still mostly uncommon globally.**

So the risk of an investor, even prior to this regulation, of losing more than they have invested into a hedge fund was exceptionally low, if a real risk at all. And the regulation goes a long way towards giving investors a sense of comfort about that fact, but I think the industry itself was already set up to that sort of standard.

Tony Christien I was wondering how the managers here think if and how the new South African regulations offer them opportunities to access offshore investors to come into the South African market?

Jamie Kent: I think something quite interesting that we have been hearing a lot of over the last year from offshore investors, who we see mostly through our Africa fund, is that they are starting to show an interest in South Africa, be it just the long-only space, and we are hearing that the big names in the industry don't want the institutions anymore, they want the retail space. So I think there is an opportunity for us to access the offshore institutional market.



But something else I find interesting, is that we had an offshore client who wanted us to launch a SA long-only fund for them so we started looking at a traditional CISCA compliant unit trust, but when I sent the legal documents to their lawyers, they said that they weren't comfortable with the SA unit trust structure and regulatory environment and rather wanted a segregated portfolio in the Cayman Islands. So it's not to say that all offshore institutional investors will automatically be comfortable with the regulated structure overnight as it may take some time for them to become familiar with the strength of the SA regulatory environment and the protection the structures provide.

Bradley Anthony: We have had experiences with trying to get external counterparties like prime brokers to face local South African partnerships and vehicles, but this is something that they haven't done in the common course of their business. They are unfamiliar with it, they are unfamiliar with partnership law in South Africa, and they are averse to it.

So I do think what the new regulations will do is give them a regulated vehicle. One in which I think they have certainty, from a regulatory point of view. One which they can face, and this will open up markets for South African managers. So if we want to take 20% of our portfolios and start trading global markets, I think we will have the counterparties to enable that.

Markus-Alexander Flesch: Bradley, I absolutely agree.

I perceive the level of regulation here has reached an equivalence criterion.

If more international investors believe that the regulation here is now equivalent to the U.S. or Europe that will clearly initiate new money inflows in S.A. However, the burden of imposed capital controls need to be overcome, as there will be no "one-way" street. If you want international money to flow to South Africa open up your own exposure to products being offered abroad. For a start I would say it is wise that fund industry should make use of this granted 20% level in foreign investments, since this would definitely seen as a first sign of bringing down investment hurdles.

Bradley Anthony: I think we have been talking to foreign investors for probably the better part of four years now, and the thing we always say to them is that there are **two opportunities to access in the South African equity market.** One is the growth opportunity, which is accessing the growth of the South African market, but also the rest of Africa, as a lot of our listed stocks actual expand into the African continent and access that growth.

But the other is a relative value opportunity, which is still strong and persistent. And what we mean by that is that you have a local equity market capitalisation which is two times the GDP of South Africa. The only other country in the world where the equity market is larger than that is Switzerland, but every other market, developed or emerging market, the capital markets are more representative of GDP.

So we have these massive capital markets here. If you take the World Economic Forum's Competitiveness Study and you look at regulation of markets, **the efficacy of our boards, accounting and reporting standards, they are world class and actually rank among the top three in the world.**

So you have efficient, well-capitalised financial markets, but then you have savings concentrated in probably about five investment houses, which in a way have also become large and cumbersome, like many of their peers in the developed world.

The takeaway for us users and investors is that **we have large, liquid, well regulated markets, with massive inefficiencies from which you can extract alpha.** And so the real opportunity in the South African market I think is not just the growth opportunity, but it actually still remains the relative value alpha opportunity. You can actually extrapolate that because of the dominance of the large four banks which spreads this inefficiency into fixed income markets. And Andy will attest to the fact that in commodity markets there is even more inefficiency, because financial market participants like us do not dominate those markets, but food producers and farmers and so on, so that also makes commodities a real, rich and unique relative value opportunity.

Matthias Knab Any other comment about the value or benefits of hedge funds for investors?

Lee Dalley: I think from our perspective as a fund of funds, our value offering to our clients is first and foremost **capital protection.** We also want to provide lower volatility as well as a diversification component to their portfolios.

I agree with Bradley's points about great opportunity to extract alpha in the South African market using the growth and relative value opportunities. We believe that it's possible to do so whilst protecting capital by using highly skilled hedge fund managers.

The alternative investment space is one of the few places where you can generate consistency of return ahead of cash with a low volatility.

Eugene Visagie: I would just like to add to what Holly said earlier, the current market environment presents a lot of opportunities, specifically for hedge fund managers following the strong bull market of the last five, six years. That's a great opportunity and also brings back, as Lee mentioned, the capital preservation part, and the need for consistent, absolute returns.

Let me also add a comment about fees, because people are always jumping up and down about our fees, but have in mind that our type of products are supposed to provide positive, consistent and low volatility returns over the longer term, investors will get a protection of their capital and should be able to sleep well at night and not whipped through the up and down swings. Actually, as Holly also alluded to, the current market environment should excite any investor into these products.

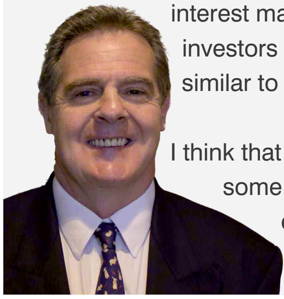
Andy Pfaff: Equity investors have been the beneficiaries of a six year bull market, bond investors are the beneficiaries of a 30 year bull market, and commodities are at 25 year low, so if anyone is looking for the value opportunity ...

But having said that, if you talk about opportunities more broadly, the commodities are a funny space; I have got to slice and dice from not only my product suite, but also between onshore and offshore, there are very different audiences.

Managing commodity product, I don't really offer a differentiator to an international investor coming into South Africa, because gold is gold; American, London, Hong Kong managers all trade the same gold, the same oil; of course, albeit on different exchanges and in different currencies.

So I have just got to go out like an adult into the big wide world and compete globally on performance. But while many other asset classes are probably well-priced, commodities are rather underpriced, so there is a tremendous opportunity for real returns, or diversified, non-correlated returns.

However if you look at the South African pension fund regulations, there is a substantial allocation it can go to commodities. That could take either a long-only route or a hedge funds route, and there are very real diversification and non-correlation benefits available from commodities. So South African managers can provide more than an asset class discussion; internationally we also compete well on competing on performance and risk-adjusted returns.



Regarding hedge fund inflows internationally, the hedge fund industry seems to be cannibalising assets from fixed interest managers. Fixed interest returns are terribly low, and everyone knows the bull market is very mature. So investors now are not looking for 30% returns but for bond proxies with the associated low volatility, and that's similar to what Lee has been expressing about his fund of funds proposition.

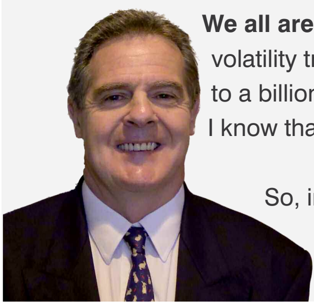
I think that **bond proxy might be the retail product that we have been talking about,** offering bond yields plus some upside, at bond-like volatility. That could be the diversification and the complimentary profiles that could also work well as a retail product.

Markus-Alexander Flesch: I think that's a very good point, but let me also add here that **I wasn't really prepared for the high level of returns South African hedge fund managers are making when I went to the Peregrine hedge fund conference yesterday.** Excuse my ignorance, but I was really stunned when one hedge fund manager after the other was coming up with 20%, 30% or 35% annual returns. I initially thought that derivatives would play a big role, but Bradley and the others pointed out here in this Roundtable some other factors like the African growth story and the relative value edge or inefficiencies allow your managers to capture that much return without even considering alpha as a differentiating factor.

So in my view, as long as the alternative industry is delivering 25%, 30%, 35%, there is no need to differentiate or change the approach. Differentiation is primarily happening in a commoditized market, where the investor is asking for additional return and lower risk premium. In Europe, for known reasons, the investor is less spoiled, as yields of LIBOR plus 300 basis points are acceptable, but this is probably different from the expectation levels of your local South African investors in a further boom market delivering exceptional results even on the pure beta level. However, there comes the point of "no return" and then the industry need be prepared.

In Europe as well in the US, a lot of studies have been done recently about the markets, styles, correlations and about the often quoted “diversification impact” of different hedge fund strategies and asset classes, including commodities. Although all these studies and portfolios are behaving great in normal circumstances and market environments, we all know that correlations tend to become positive even if these instruments have shown a negative correlation prior to the crash, like commodities. Across all strategies and products though there is only one style protecting investors interest, and this a “volatility”. I foresee this topic of volatility remains focal for some years to come, and especially in Europe and the US we have seen that volatility strategies in form of different hedge fund wrappers are now added permanently to the suite of hedge fund products, as ETNs, Black Swan products or other structured wrappers.

Andy Pfaff: Just to pick up on that volatility - as my former business partner Renault Kay used to say, we grew up in a rough neighbourhood. We are used to the volatility here. When you live in the emerging markets, your currency gets knocked around, your asset prices can move around substantially; it's not like you are trading in US bonds and a 5 point move is a big day.



We all are used to volatility in multiple areas simultaneously. There have been a lot of very, very good volatility traders here. A former colleague is managing a large volatility fund in London - he has probably close to a billion dollars under management now. I think that he had returns of 500% to 700% in the early 2000s, and I know that he made over 200% in 2008 and over 100% in 2011. That is why he is managing a lot of money.

So, in South Africa there are some very, very good volatility traders. Mostly ex-prop desk traders. It's not an uncommon strategy here, but it hasn't been one that's been well-invested in.

Markus-Alexander Flesch Why?

Andy Pfaff I am not sure. I get the sense that it is because most of the asset allocators, mostly funds of hedge funds in South Africa have come from the long only buy side of the industry rather than the prop trading side. They are very good equity analysts but not as familiar with trading strategies & CTA’s etc.

Bradley Anthony: I think the one message that I want to give to international investors is that the South African market is not homogenous. So you are going to find the guys churning out 25%, 30% and possibly higher; investors can find a wide spectrum of return profiles. Our firm runs very conservative market neutral funds that have absolutely no beta exposure, churning out 13% per annum for the past 11 years, and we run more volatile products that participate a bit in the beta, and are annualising at 27%, 28% per annum. We also run a volatility arbitrage fund, which hasn't garnered a lot of investment. And my only takeaway is that that locally investors and allocators, and maybe Eugene, you need to comment, have not embraced the application of these different hedge fund strategies in their overall portfolios.

The way we think about it from a business point of view and how we are trying to build our business is the same way we believe an investor should think about building their portfolios. You need to have sufficiently diversified, uncorrelated return streams blended together to give you a low volatility experience throughout your investing horizon.

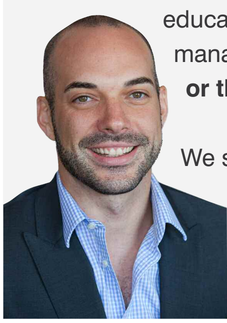
And so for that reason we think there is massive space for CTAs even. There is massive space for volatility arbitrage, for event-driven, for credit funds. We run all of those funds in our business, but we tend to do them as part of multi-strategy offerings because on a standalone basis they haven’t been able to attract the kind of flows that you would expect in the South African market.

Markus-Alexander Flesch Coming back to our previous discussion about investor education, if you really think about it, those products are not really difficult. The funds are easy to be constructed, the returns are fairly transparent, the products deliver what they usually promise and they are heterogeneous, so investors can make their choice. So it comes back to the distributions channels, you have to market these vehicles to increase the interest, and of course we know that this is very time-consuming and cost intense, but that's the only way to go.

Andy Pfaff Sure, we should have been educating and doing marketing, because these are Siamese twins, but as I said earlier, we also have to remember that we haven't been permitted to market hedge funds in the past because hedge funds were unregulated products. Now with regulated product that is a lot easier, we can now even go out and educate the press about opaqueness and transparency, or even about things like long volatility or short volatility, if they want to hear about that...

Lee Dalley This is where fund of funds can provide a broader solution to investors and the industry and possibly be the face of the industry.

With attractive annualised returns of between 12% to 15% since 2002 and with volatilities of around 5% this makes for a great retail focused investment. It is now for those skilled fund of hedge fund managers to understand the more complex strategies for possible inclusion into their funds, and size the allocation accordingly, rather than the volatility arbitrage manager trying present his fund to Joe Public.



Eugene Visagie: I 100% agree, there is a massive opportunity for the fund of funds. Like Lee, we also sit on the education side, and I also believe it doesn't help to go that granular, but initially we should rather focus on the risk management and the oversight, which a fund of fund offers to all its investors. **They want a hedge fund product, or the benefits of it. They don't want to be told about volatility and about structures and all the details.**

We should always at least start the conversation at a high level and focus on the oversight and all the protection that's offered to investor. That is also in line with the regulations, but we shouldn't overestimate the sophistication of some investors in the South African market, and I am even including institutional investors.

Bradley Anthony: One of the things that I would love to see going forward is that the regulation actually evolves in the sense that we embrace what is good in the regulation and also try to change where there are gaps. For example, one of the areas where there are gaps is the lack of distinction between fund of funds and hedge funds. I also agree with the others here that funds of funds do have a role to play.

And right now if Eugene wanted to use a commodity fund in his retail hedge fund, because it brings a particular payoff profile and diversification benefit, he is unable to, because you cannot run a retail commodity fund. So that's just one example. I think there are many examples where we need to work together and say, "well, how can we actually take the regulation, learn from where there are gaps and try to enhance it?"

Udesh Naicker: I am sure you all know that the current regulations are really the culmination of three years of on-going discussions and toing and froing between the industry and the regulator, and that most of that was before my tenure. I hear you and accept that you are probably right. There are always going to be shortcomings, because one can't legislate for every possible outcome; that's not going to be possible.

That being the case, there are a fair number of players in the industry that have complained to some extent, about some of the provisions in the regulations, which is something I don't understand, and quite frankly, find difficult to accept, largely because they have been given the opportunity to apply their minds and provide input into the legislation.

The point I want to make is that should that opportunity arise again, please apply yourselves carefully to what it is you ultimately would like the legislation to reflect, because we sit in an office and we try and draft it in a manner that we believe best balances the interests of the industry against our own objectives. You have a first-hand understanding of what is actually happening on the ground and you have to provide that input. If that input is presented too late, or if the industry has been too passive, then they have got to live with the final product.

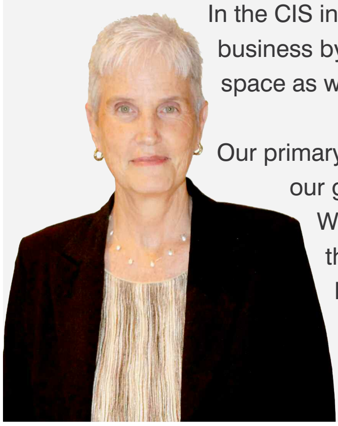
Bradley Anthony: I couldn't agree more, Udesh, I think a number of people around the table were actually involved in the process from the very beginning; in fact, within the CISA structures, we probably established the steering committees for hedge funds. *And through the process there were concessions that needed to be made in order to move forward, and I think a number of us were mature enough to concede, even when it was to the detriment of our own businesses in order to move forward, because we saw the benefit of promulgation of this legislation, and so we did that.* But my hope is just that this doesn't remain static from this point forward.

Tony Christien

That is correct, a number of people around the table have had the chance to chat and to bring forward their opinions. The regulator kindly graced us with his presence and added to that conversation.

I would like to bring the trustee, Nelia into this discussion to understand your issues and challenges from a trustee point of view when it comes to hedge funds, and how you think that you can add value to us as an industry?

Nelia de Beer: What value does the trustee bring?



In the CIS in securities space I am confident that the ManCos have experienced the value add brought to their business by the trustee. We definitely want to create the same perception and true value in the hedge fund space as well

Our primary role is that of investor protection and fulfilling a "watchdog" role for the regulator. Therefore it is our goal to ensure customers are treated fairly. **Our role is thus an oversight role of the portfolios.** We are not responsible for investment decisions but rather to ensure that the investment objective the investor has ultimately signed up for is adhered to within the limits imposed by the Collective Investment Scheme Control Act, subordinate legislation as well as the deed. We firmly believe that we need to engage as partners with the ManCo to ensure we promote a healthy and well regulated industry.

The trustees are typically banks which are regulated by the South African Reserve Bank and the Financial Services Board which impose strict compliance, governance and risk management. This is filtered down into the relevant businesses in the banks, and therefore the trustee has a wealth of experts within the bank to refer to, if in doubt on the legislation. Therefore the ManCo can take comfort from being associated with an institution that is reputable and the trustee knowledgeable and skilled.

What I have experienced is that the ManCo appreciates another party (the trustee) that they can bounce ideas off as well as interpretations of legislation.

I do have to agree that parts of the legislation need to have further clarification. We need to have clear principles, in clear English, and we need to make sure that there are no grey areas, which leads to much frustration on both the ManCo and trustee sides.

Tony Christien What is the grey area?

Nelia de Beer: The grey areas are mostly due to the differences in interpretations of legislation. We have identified a few and will at all times consult with the regulator to clarify the interpretation. Thereafter the trustee and the ManCo will consult to discuss the most prudent approach on these differences and ensure that these differences are addressed clearly in updates on the relevant regulations i.e. board notices.

In this way both the ManCo and trustee are protected which in turn protects the investor.

Tony Christien Thank you Nelia for contributing to the conversation, not so much to put you on the spot as to what you are doing, but more from the perspective that most of the hedge fund people here are not used to dealing with the trustee, so we lack that understanding as to what a trustee can bring to the table. Those managers who are in the long-only space do understand that, but in our space there are a lot of people out there that don't necessarily understand this.

Udesh Naicker: Nelia is right. The regulator does place reliance on the trustees but I also need to make clear that the manager is always going to be ultimately responsible. The buck stops with the manager, so the final question as to why things went wrong, and we hope that never happens, will always go to the manager.

The trustee really is the conscience of the manager, so to speak, because we do rely on them to tell us whether or not everything is actually running the way it should or at least running the way the manager said it would, because we as regulators are never going to have the resources to check on every last thing on a continuous basis as a manager can through the normal course of operations.

That being the case, I would actually encourage that the managers pressurize those trustees into up-skilling themselves so that they are able to understand what this business really entails. I think the trustees need to understand what their liability is, and they need to understand what their responsibilities are to discharge that liability. It's going to be a rather unfortunate eventuality if something does go wrong and we have to go through that entire circle of who did what and who said what and allocate responsibility. That's not something I relish.

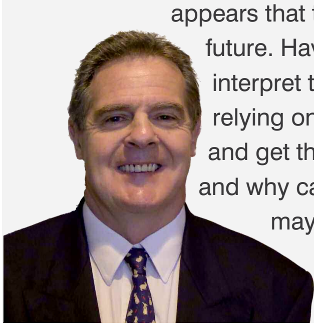
And it starts with the most basic things. To understand the legislation may seem trivial, but don't take it for granted. To understand how valuations and pricing work, to understand what risk management entails etcetera takes a huge amount of time and effort. There are a host of things that go into those processes, and I think the time is now appropriate for trustees to seriously consider whether they ought to enrich their skills to meet the challenge at hand.

I might as well point out that from an oversight perspective, I know that collective investment schemes have begun evaluating trustees as part of their oversight process, and that's bound to filter across to the hedge funds trustees as well. So we would start evaluating their expertise, their insight, et cetera, on various levels.

Nelia de Beer: The trustee is a party to the Collective Investment Scheme, and that implies that the trustee will require information that is related to the administration of the scheme which might not only be portfolio related such as reporting to the regulator etc

Therefore I do agree with Udesh that the ManCo should demand the knowledge and skills from the trustee as this will ensure that appropriate and relevant information is requested which will result in risk mitigation for both the ManCo and Investor.

Andy Pfaff: I think the trustee is the one role that the hedge fund community hasn’t dealt with in the previous structures. It appears that the reciprocal is also true, so I think we could see some interesting interactions in the immediate future. Having said that, I have also noted that trustees are apparently put in the role where you need to interpret the regulations and the regulator's requirements. It does make it quite tricky for the manager who is relying on your interpretation because we’ve only got one regulator, so we can all talk to the same regulator and get the same story. But now we are in a situation where we’ve got multiple trustees we are dealing with, and why can Bradley’s commodity fund do that and mine can't because we got different trustees? Managers may become subject to varying interpretations, and I think that it’s something that we need to be very wary of the practical implications at this early stage of new regulation.



Nelia de Beer: The CIS in securities have been in existence for a very long time and the ManCos and trustees still have differences in opinions with regards to the legislation. However the maturity in the relationships has ensured that we resolve these differences timely and in the most prudent way.

The trustees at all times have recourse to the regulator and in addition have scheduled quarterly meetings at the Financial Services Board’s offices. These meetings are beneficial to both the trustee and regulator. We bring items of concern or any questions we might have and address and debate these items to ensure consistency in interpretations.

Bradley Anthony: At the risk of being controversial, sort of looking at the big picture post 2008, I think it's clear that the pendulum has swung from a regulatory perspective, and I suppose as an industry participant we would not want to see the pendulum swing too far.

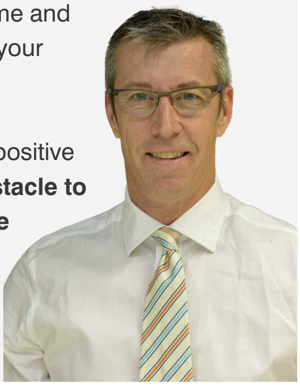
We have enabling regulation at the moment, and we would want it to remain enabling. And I suppose when you look at the

South African hedge fund industry, there are certain capacity constraints. There are limitations to the extent to which we can grow our individual funds while retaining the same DNA and sort of payoff profiles. And the hope is that the regulators are aware of this, and all the new participants in the industry acknowledge this, and that the pendulum doesn't swing so far that it starts to stifle the potential of the industry.

The kind of reaction that we see from foreigners around the alpha production in our market it's always one of positive surprise, and we could see that again today with Markus from Eurex. **The foreigners are mostly taken aback by the degree of alpha that we can generate.** This is an industry which represents an exportable skill-set, and I think there are massive opportunities for the industry to play a role from an export revenue perspective as well. And so, our wish is that regulation recognizes that and realizes that there is a point after which pendulum should probably not swing any further.

Markus-Alexander Flesch: I would agree that one of your issues is that you are running into capacity constraints. One option would be to open up the industry, you just learn how to position yourself in new products, I think here the new regulation even will pave the way for that. And secondly, you also have to enable investors to buy your products.

But then unfortunately, the whole global industry is dealing with this over-regulation, which has started with Dodd-Frank and just reached the European market with MiFID II. So when you try to open up your markets, you cannot insulate yourself from these global regulatory trends and just trying to come up with something that will be positive for South Africa, but oppose overall international regulation. So when you open up your markets, you will be part of the game and also this "over-regulation" which is affecting the global markets will then also have a strong impact on your market as well.



But it is my conviction that you are on a good path, and this global regulatory impact could also have positive effects locally in the end. **In general there are two ways to see regulation, either as a hurdle or obstacle to your business or you just acknowledge that there is nothing we can do about it, so let's make the best out of it.** Sure, the pendulum is swinging to both sides, if you are going about it and to open up you could end up on a level playing field towards international competition without being beaten by it.

Udesh Naicker: A number of you brought up specific issues that I am happy to respond to. So let's start at the beginning: Firstly, I think you must understand that it has always been our objective to enable the industry. We don't intend for the legislation to be an impediment to industry development.

From that perspective, I also wanted to address the question that was raised earlier about attracting foreign investors to South Africa. To use that as a case in point, I'd like to believe our legislation offers them a level of certainty, a framework of certainty rather than presenting an obstacle to foreign investment.

That said, I understand and accept that it's a complete mind set change for some of the managers who have not been previously regulated in the CIS space. It is true that if you are new to the regulated environment, you can find it quite onerous to comply.

In the end, there will always be a certain level of resistance to some of the requirements in the regulation, be it the monthly returns or quarterly returns, the type of risk management frameworks required or the kind of policies to be implemented. But these are all of the aspects that are required for the legislation to be effective, to create that environment that we all seek.

It’s difficult to achieve that in the absence of a formal framework. That is what the regulation provides us with – a framework.

So maybe some may think that the pendulum was pushed too far already, but on the other hand, let me recommend that you get over the compliance hurdle as quickly as possible. What we have implemented are really minimum requirements for a regulated industry, and you can verify that by looking into the other jurisdictions that were mentioned today. Compliance is not optional. There’s no way to avoid it.

I would like to use risk management as a simple case in point, because in our minds, that is arguably one of the most important aspects of the legislation. You have to manage the risk around the fund, its exposures, its leverage… whatever. That takes some serious effort. It’s going to have some cost implication too. It cannot be avoided. So I think we have to accept it, build the requirements into the business and operating models, and in two years time it’s history. Once you get used to it, it’s history. It’s done.

But I also understand if people perceive it as an initial hurdle. It’s like asking a schoolboy to come off the playing field and to do some homework. He doesn’t want to, but once it’s done, it’s done.

Bradley Anthony: Maybe I wasn’t clear enough. I don’t think the pendulum has swung too far at this point. While I do think there are some concessions, the regulation as it is I think is enabling, and your point is well made. There are additional aspects to one’s business that you have to introduce in order to ensure that you comply with reporting requirements and alike.

The concerns that I have is that, again, we have been blessed the sense that we have got a diversified business and we probably have a bit of scale and can absorb the additional costs. But, there is also a lot of discussion and fee compression on the hedge fund side, and my concern is that in the pendulum swing too far we are introducing new costs to small hedge fund firms, and at the same time we are considering fee caps and all sorts of regulations around reducing hedge fund fees in a market where capacity and therefore revenues are constrained.

So my thought was that we need to be aware of the point from where we would move from being enabling to stifling the industry to a certain extent, and that we need to find the right balance.

Andy Pfaff

I don't want to ‘shoot the breeze.’ In contrast I will put the cat amongst the pigeons and be very frank and very serious.

I think the reporting requirements in the regulations are remarkably light. The risk management provisions in the hedge fund regulations should be regarded as absolutely minimum criteria. *To continue the turn of phrase used a moment ago - I don’t think it's the ‘schoolboys’ that need to come off the playing field and do their homework. I think the ‘adults’ are unsupervised and irresponsible.*

What I mean is that I believe that the risk management requirements for the long-only space are naïvely light. They need to up their game. Bank prop traders and hedge fund managers have been managing risk-specified mandates for decades. With significantly more restrictive volatility & liquidity parameters. So, in that context, the hedge fund regulation is very light touch and enabling. It accommodates pretty much everyone (except the commodity traders in the retail space) and, in my view, it's the long-only industry that needs to up their game with regards risk management.