



# Opalesque Roundtable Series '15 HONG KONG

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# Editor's Note

## Expert investors can generate higher returns in Asia than in more mature economies

While it was a volatile year in Asia, **2015 was actually pretty good for hedge fund investors. The biggest source of alpha returns has been China.** Asia-based multi managers like SAIL find they get about **two to three times the alpha generation with Asia long/short equity managers versus US long/short equity managers.** Even some of the highest returns of both start-up funds and larger US and European quant funds are generated in their Asian strategies and Asian allocations.

We all know that an equity bubble was forming earlier in 2015, and it popped in July. Hedge fund managers generally had a very heavy long bias from end of 2014 into 2015. So we knew that they would have strong performance if the equity markets would do well, but *the question was, how will they perform when the equity markets pull back?* The summer of 2015 was not a classical pull back, but rather a collapse within the Chinese equity market in particular. Still, those European and US investors who knew China well have not significantly pulled capital due to the recent market volatility.

What 2015 in particular has demonstrated once more is that being in Asia is very important, it gives you an edge if you invest in the region. There are a number of funds that are based out of London or the US that are investing from a distant perspective, and they perhaps don't invest in the same style or the same types of stocks that more local managers are investing with. Those foreign managers in general have had more difficulties in the sense that many were from July through September or October giving up all gains for the year.

On the other hand, **the more locally based managers tended to actually manage the volatility quite well.** Of course, most of them probably had one difficult month, whether it was August or September, that depends upon the manager. But since then, especially in October, we have seen a very large rebound in some of these managers, and for 2015 it looks like they will have quite a good year.

Overseas investors see that there is quality in Hong Kong particularly. We are also seeing that **more capital stays in Asia**, while in the past a lot just left the region to be managed from the West. Asian investors are now becoming increasingly aware of and diversify into less correlated / less beta type investments with strong downside protection. Many larger macro funds were able to attract assets, but unfortunately, it has not been a great year for macro strategies. It does remain a challenge for many investors to identify what types of strategies and which geographies are worth investing in.

The Asian hedge fund industry now is about \$180 billion of the \$3 trillion global hedge fund business, with dedicated China L/S equity funds at about \$40 billion. After 2008 Asian hedge funds suffered massive losses and redemptions, and shrank to about \$100 billion at its lowest point. Outflows continued all the way through 2011, and then probably 2012 was the turning point. Seeing the industry nearly doubling from that point is a positive sign for the future.

## The Mystery of the Chinese "Sunshine Funds"

In contrast to offshore hedge funds that are licensed and regulated by experienced and recognized agencies like Hong Kong, Cayman and based in a major financial center, the Chinese "sunshine funds", which are considered as local onshore hedge funds in China, are very lightly regulated. Only in 2014 did the Chinese government form an agency to start looking at the regulation of these funds. In December 2015, the Asset Management Association of China said 24,625 of such hedge funds are registered, up from nearly 17,000 in January of the same year.

Those funds invest exclusively onshore within China and are not doing any shorting of single stocks, because it's very difficult to source borrow of single stocks there. They may have been able to apply more futures hedging because until the government crackdown, China had a very liquid futures market.

Apart from the weak regulatory standards, investors are also cautious about the potential for illegal activity. But, as with everything in China, also **in financial regulations there's a real rush to get from Point A to Point B in a quarter of the time that it took that same process to happen in the West.** Because it is a controlled economy and environment, it can actually all happen in that short period of time: the whole process may not run through its entire course, and there are good and bad aspects of that. While you might think, objectively and reasonably, that it should take, say, five years for the regulatory regime to fully develop, chances are that things will be a lot faster in China. In a way, Asia seems determined to show the West that they can do it too and succeed on their own terms.

The Opalesque 2015 Hong Kong Roundtable, sponsored by Harneys and Eurex, took place end of 2015 in Hong Kong with:

1. Ally Chow, [Managing Director, Head of Asia-Pacific, Chenavari Investment Managers HK](#)
2. Angelyn Lim, [Partner, and Head of Asian Financial Services Practice, Dechert](#)
3. Chanel Fu, [Executive Director, Nomura Securities](#)
4. Eric Wong, [Director, Celera Group, Vauban Group, TCG Capital](#)
5. Harold Yoon, [CIO, SAIL Advisors](#)
6. Jonathan Culshaw, [Asia Managing Partner and Global Head of Investment Funds, Harneys](#)
7. Markus Georgi, [Senior Vice President, Head of Hong Kong Representative Office, Eurex](#)
8. Steve Bernstein, [CEO, Sinopac Solutions and Services](#)

The group also discussed:

- Why have most of the quantitative market neutral strategies in China actually done very well during the downturn?
- How is AMAC, the Chinese regulator in charge of sunshine funds (whose number jumped from 5000 one year ago to now 20,000) going about regulating them?
- Why is the sunshine funds' model to get finance broken?
- Why are a lot of China onshore managers who never bothered coming offshore looking at operating from offshore now?
- What's happening in the Shanghai and HongKou Hedge Fund Parks?
- (When) will Shanghai be the financial center of Asia?
- What is the investor's challenge when trying to make money in Japan?
- Which two unprecedented technical factors are still creating massive opportunities in Europe?
- Are Asian managers interested in launching UCITS or just Cayman funds?
- New platform solutions now available for smaller and start-up managers in Asia
- What is CEINEX, China's first JV with a Western exchange?
- Money, Money! What will the Chinese do with RMB 22trn savings in Chinese banks and 2trn offshore RMB deposits?
- What will the Chinese do against the looming threat of pension deficits?
- Will the demise of investment banks exacerbate future crises?
- How is the boom in Asian family offices troubling private banks?

Enjoy!

Matthias Knab  
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# Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Steve-Bernstein, Harold Yoon, Ally Chow, Chanel Fu, Angelyn Lim, Markus Georgi, Eric-Wong, Jonathan Culshaw.

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# Introduction

**Jonathan Culshaw**  
Harney Westwood & Riegels

My name is Jon Culshaw. I am the Asia Managing Partner of Harney Westwood & Riegels (*Harneys*), an offshore law firm advising on the laws of Cayman, BVI, Bermuda, Cyprus and Anguilla. We have four offices here in Asia; two full-service offices in Hong Kong and Singapore and two representative offices in Shanghai and Tokyo. I am also the Global Head of Harneys' Investment Funds and Regulatory Department where we have over 40 lawyers working in the team globally with 12 based in Hong Kong and Singapore.

**Ally Chow**  
Chenavari Investment Managers

My name is Ally Chow. I head up the Asia Pacific business of Chenavari Investment Managers. We conduct two main activities here in Hong Kong, which are investing in the Asia-Pacific credit space, both private debt and secondary, as well as capital raising, for all of our funds. Chenavari Investment Managers was founded by Loic Fery in 2008, who was joined by the Co-CIO, Frederic Couderc shortly afterwards. We started with around \$40mn of capital and we are now managing approximately \$5.5 bn with a focus on European credit and structured finance markets. The firm was founded to capture the unprecedented investment opportunities in the credit space stamped from European banks' deleveraging which started in 2008 and is continuing both in Europe and, to a lesser extent, Asia. Globally, we have more than 100 professionals and most of them are based in London, and we have offices in New York and Luxembourg as well.

**Angelyn Lim**  
Dechert

My name is Angelyn Lim. I am a partner at Dechert, which is an international law firm. Our firm has just been named as "Best Law Firm Overall" in Alt Credit Intelligence's inaugural European Services Awards 2015. The award recognizes outstanding services to the alternative credit sector through the provision of high-quality services and is testament to our firm's focus on, and investment in, this sector. We have 27 offices worldwide, and in 18 of those offices, across 9 countries, we have a total of about 160 funds, financial services and regulatory legal experts servicing the alternative space. I lead the team in Hong Kong.

**Markus Georgi**  
Eurex

My name is Markus Georgi. I represent Eurex, the Frankfurt-based International Futures and Options Exchange. I joined the exchange about three years ago and I am today Senior Vice President, Head of Hong Kong Representative Office of Eurex.

Before joining Eurex Exchange, I worked for international brokerage firms, as well as for a trading software provider firm in Singapore, Frankfurt and in the US. My responsibilities at Eurex are all kind of business development activities, mainly concentrating on buy-side and sell-side sales, market development and product introductions.

**Eric Wong**  
TCG Capital

Eric Wong, Principal at TCG Capital, a family office / asset manager based in Hong Kong and established in 2003. TCG Capital's Celera Group division was formed in 2012 to consolidate the financial markets holdings under TCG Capital, and its Vauban Group division engages in asset backed financing with a focus on trade finance.

We are quite active in China. One of the things we do in China and globally is identifying and working with emerging managers and traders, probably more focused on unorthodox strategies. You could in a way say that **the more esoteric the strategy, the more we'd like to take a look.**

**Steve Bernstein**  
SinoPac Solutions and Services

Steve Bernstein, CEO of SinoPac Solutions and Services. I am part of SinoPac Holding, which is a \$4 billion market cap financial services company from Taiwan

We handle all types of administration and support for hedge funds, private equity and family offices. Our main business is hedge fund administration and private equity administration.

We also have a sister asset management company called SinoPac Asset Management, where we put small managers on to our platform so that they can also take advantage of our license instead of getting their own license. We do a bit of seeding as well.

**Harold Yoon**  
SAIL Advisors

My name is Harold Yoon. I am the Chief Investment Officer for SAIL Advisors. Our headquarter is based here in Hong Kong, and we have a large research office in New York. We are managing about \$2.2 billion of AUM, both in global fund of funds as well as Asia-focused fund of funds.

**Chanel Fu**  
Nomura

I am Chanel Fu. I am part of the Nomura Prime Brokerage Sales team based in Hong Kong. Nomura is a Global Investment Bank headquartered in Asia. We have been expanding our prime brokerage presence in the past 5 years. Particularly in the past two years, we have been very focused on expanding our footprints across AEJ by focusing our strength in our home continent. We believe in order to differentiate ourselves in this market, we have to be a specialist instead of a generalist.

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**Eurex Exchange – the home to the euro yield curve.**



Harold, could I maybe address my first question to you, because you invest locally in Asian funds, but also globally. Could you give us a brief review, how was 2015 for the industry, just a very broad macro perspective, what have been some of the important developments here? And what is your outlook regarding 2016?

**Harold Yoon:** 2015 was a volatile year in Asia, but one that actually has been pretty good for hedge fund investors, I think. The biggest source of alpha returns has been China.

We all know that an equity bubble was forming earlier in the year, and it popped in July. And the Chinese government has taken a lot of steps in order to try to manage a soft landing for the equity markets, as well as maybe for the whole economy. *Hedge fund managers generally had a very heavy long bias from end of 2014 into 2015. So we knew that they would have strong performance if the equity markets would do well, but the question was, how will they perform when the equity markets pull back?* The summer of 2015 was not a classical pull back, but rather a collapse within the Chinese equity market in particular.

What 2015 in particular has demonstrated once more is that being here in Asia is very important, it gives you an edge if you invest in the region. There are a number of funds that are based out of London or the US that are investing from a distant perspective, and they perhaps don't invest in the same style or the same types of stocks that more local managers are investing with. I would say that those foreign managers in general have had more difficulties in the sense that many were from July through September or October giving up all gains for the year. On the other hand, we saw that **the more locally based managers tended to actually manage the volatility quite well.** Of course, most of them probably had one difficult month, whether it was August or September, that depends upon the manager. But since then, especially in October, we have seen a very large rebound in some of these managers, and for 2015 it looks like they will have quite a good year.

The biggest hedge fund strategy within Asia I think is China long/short equity, but also other strategies have become more popular over the past several years. A number of macro funds have been able to get to multibillion dollar levels. Everyone probably knows Dymon Asia or Fortress Asia (now Graticule). Brevan Howard Asia is here, and a couple of other billion dollar funds operate now here in Asia. What is important to notice is that if we had looked three years ago, we didn't really see many funds over a few hundred million dollars.

I think a lot of the interest for investing in Asia has come from the West, so a lot of investors from the US or Europe are making investments into Asia for the first time. Those macro funds have been able to raise substantial assets, and as they are getting bigger, an interesting effect of that is that for many investors those funds have then become more investable. If you are a \$100 or \$200 million startup manager, it's going to be pretty difficult for a pension fund based in Europe or the US to feel comfortable investing with you. It will be a certain challenge for any analyst or portfolio manager in front of their investment committee to explain why this is a quality hedge fund, what's the background of the managers, and why you have a comfort level with their fund.

Many larger macro funds were able to attract assets, but unfortunately, it has not been a great year for macro strategies. In my view, *those macro managers were more or less trying to catch the equity uptrend in the beginning of the year, so they will have different positions and exposure compared to long/short equity managers who have very deep insights into each of the companies that they are investing with,* and also have some capabilities of doing shorting, maybe not so much in the local onshore market in China, but more in H-Shares which are traded here in Hong Kong or ADRs listed in the US.

Generally, macro funds would invest in indices or very large, well-known stocks where they are probably not going to have an edge from a bottom-up stock picking perspective. So when we saw the equity bubble pop, a number of macro funds who had large equity exposure were hurt.

When you look at ideas or trades of other managers, I think quite a few are focused on shorting emerging market FX. As people are anticipating the US Fed raising rates, for the last two-and-a-half, three years, or since the taper tantrum with Bernanke, investors have been shorting emerging markets.



Particularly countries with current account deficits or with a lot of foreign debt, together with a lack of a well-established investor-base to support them through difficult times – so countries like Indonesia or Malaysia – were suffering quite a lot on the foreign exchange side.

Funds focusing on shorting emerging markets FX found an opportunity to make quite good returns. Most managers have taken a lot of their profits and are now sitting on substantial amounts of cash waiting for the next opportunity to emerge.

I think that those were probably the two biggest opportunities. I don't really want to say a lot about credit, because we have no credit investments as we feel that credit markets aren't liquid enough. The definition of liquidity can really vary by what the investor is looking for. In our view, when markets are doing well, you see a lot of money going into credit, and then it seems like you can buy and sell whatever size that you want from dealers. It does look like plenty of liquidity. But when markets get difficult, and particularly if there is a crisis – we have seen this happen over and over again with Asian crisis, Russian crisis, and so on – what you will basically find in Asia is that you do not have that investor base who will step in and buy something at 5 points below yesterday's price. Instead, they are going to wait for a 20, 25, 30 points fall where then they feel comfortable buying what now has become a distressed asset at a cheap price.

We have therefore avoided credit, but we have seen a lot of investors invest long-only, as well as seen flows into credit hedge funds, but in general their returns are very much carry-driven. We also believe that for credit funds it is more difficult to demonstrate some type of active alpha from the management of the portfolios that we see on the equity side.

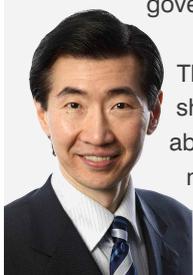
Let me also share a few thoughts on Japan, as a lot of people seem to be interested in the Japan story as well. The Japanese hedge fund industry had experienced significant growth and became quite large through 2006, but starting with the Murakami Livedoor scandal and insider trading allegations in 2006, it had shrunk to such a small size that it has become very hard to find good managers.

We do believe that Japan is an area that potentially could provide very good opportunities, but the investor's challenge is to find the talented local managers who can actually carry out good long and short stock picking and also apply good top-down portfolio management.

### Matthias Knab

Harold, you mentioned that in Asia a lot of the alpha was actually coming out of China. Looking at China from the outside, one of the headlines that I have in mind when the whole meltdown happened in summer 2015 was that some 1,300 Chinese hedge funds closed down. Myself and I think a lot of other people were surprised that this many hedge funds would actually be operating in China. And secondly, I would have guessed that those managers were local, and yet they seem to have failed. What would be your explanations for that?

**Harold Yoon:** First, maybe there are different definitions as to what constitutes a hedge fund. We basically invest only in hedge funds that are licensed and regulated, whether they are licensed with the Hong Kong regulator or through Cayman, and that are based in a major financial center. On the other hand, the **sunshine funds**, which I believe most people are considering as local onshore hedge funds in China, are very lightly regulated. I think only in 2014 did the Chinese government form an agency to start looking at the regulation of these funds.



Those funds invest exclusively onshore within China, and as far as we understand, they are not doing any shorting of single stocks, because it's very difficult to source borrow of single stocks there. They may have been able to apply more futures hedging because until the government crackdown, China had a very liquid futures market. Given the Chinese government-imposed restrictions, it is now difficult to find anyone doing significant shorting of futures indexes onshore. Probably the only vehicle for that now would be the Singapore A50 contract.

I can't really comment much on those sunshine fund managers, except that we don't invest with them. We have also been suspicious of the extremely high returns claimed by some managers, and it appears that this has now also caught the attention of the local regulators.

I think the regulation of those sunshine funds probably does not conform to international institutional standards, and therefore we would not make an investment in these funds. We are also cautious about the potential for illegal activity. When you look at the types of relationships and the broader history of the Chinese asset management and brokerage industries, some type of relationships could give a manager or a firm an edge. The question is, is it a legal or illegal edge? This is also in a way an ongoing challenge we are dealing with China long/short managers: is their research edge a straight forward research edge, or is it more than that?

**Matthias Knab**

So Harold, how large then do you think is the universe of let's call them eligible China hedge funds that you would actually look at?

**Harold Yoon:** From the last report I had read on EurekaHedge, the Asian hedge fund industry now is about \$180 billion of the \$3 trillion global hedge fund business. Our estimate is that the AUM of dedicated China L/S equity funds is about \$40 billion.

After 2008 Asian hedge funds suffered massive losses and redemptions, and I believe shrank to about \$100 billion at its lowest point. Outflows continued all the way through 2011, and then probably 2012 was the turning point. Seeing the industry nearly doubling from that point is I believe is a positive sign for the future.

But in general, it's a challenge for investors to identify what types of strategies and which geographies are worth investing in. We have the capability to invest globally, in any geography. And what we actually find is that many of our best investments are sourced here in Asia. **We probably get about two to three times the alpha generation with our Asia long/short equity managers versus US long/short equity managers.** The key is manager selection, as dispersion between managers is large. It is our job to identify managers that can deliver consistent alpha while practicing strong risk management and drawdown control.



**Steve Bernstein:** I just came back from visiting AMAC in Beijing, who is the regulator now of all the sunshine funds. At the end, it was very clear to me that there's a lot of work to be done. There are 20,000 funds now that are registered with AMAC whereas a year ago there were only about 5,000 funds.

Harold already talked about international standards, but they don't have them. Fund administration is done by the fund's custodian or in-house, so they don't have an external fund administrator. From an investment point of view, would you really want to put money into a fund onshore not knowing if they have an external fund administrator calculating your NAV?

On the other side, you do have the proper China hedge funds set up offshore in places like Cayman, and there is also more money coming from China setting up those funds in Cayman. *But onshore, they are registering these sunshine funds, but there's still no real plan in place yet about putting some structure around them. They don't want to spend the money to have external fund administrators, they also don't want to over-regulate too quickly, so they are in a way watching the onshore space develop.*



Yet, they initiated this hedge fund park in Shanghai, for example, where they want to grow the hedge fund business and try to encourage QDLP and external fund managers to move to Shanghai to set up shop and invest from there.

These whole developments are really fascinating to me, because the other thing is when the markets tank, they close markets or delist certain stocks for a period of time, but no one can manage a business when the rules are changing constantly, and where the government has this much ability to change some of the dynamics of how you are going to manage your portfolio.

So to me it's just fascinating to observe these broader developments. I moved to Hong Kong about six years ago, and already back then everybody was saying that in the next ten years Shanghai will be the financial center of Asia, but I just said, "No way...!" Actually, it used to be Japan: When I lived in Japan in the '90s, it was the capital of Asia finance, and now it's Hong Kong, and in my view Shanghai has got a really long way to go, between the corruption, the convertibility of currency, the regulation; I mean, I can list everything. So while they want to get there, I believe it will take them a long time.

Another point I would like to make is that naturally, people talk about "Asia" all the time, but to me, there is no Asia. There are **14 different countries and every country is different**, and there are different and very idiosyncratic developments going on between them. For example, talking about Japan, many Japanese fund managers now are going to Singapore. They are not coming to Hong Kong, and the reason is that there is already a large Japanese community in Singapore with for example Japanese schools. And this is despite the fact that it has become much harder now to set up a hedge fund in Singapore, because the capital requirement went up, you need three registered officers, and things like that have made it more difficult to set up a hedge fund there. Still when Japanese managers are getting out of Japan, and thus in a way also slowing down that industry in Japan, and come to Singapore, it's all about the family, about the Japanese schools and the language, the English language and the ability to live there.

I can continue looking at each country, let's take Korea; Korea studied hedge fund for eight years and they are finally now opening up and starting to commit capital.

I also agree with Harold's comment about location: you used to have a lot of guys trading nighttime in New York covering Asia, but I think that has become almost impossible. If you don't have your network on the ground, if you really don't understand what's going on, just trying to do it from across the world, I would believe it's really tough to generate alpha consistently that way.

When markets are up 20%, 30% every year, you could even say Helen Keller could do well. But the fact that there was this dislocation in summer 2015 really showed the good managers who stood out. I also believe that in Asia we are starting to see much better quality managers. Guard Capital, for example, is over a billion dollars now. They started a year ago with \$50 million. Overseas investors see that there is quality in Hong Kong particularly. We are also seeing that **more capital stays in Asia**, while in the past a lot just left the region to be managed from the West.

Of course, I still think we are the short leg of a three-legged stool between Europe and US as it relates to expertise and capital, but I see that starting to change. It used to be 80% of the money from overseas came from US and Europe; it's probably going to be down 60% or so, and we are seeing more money in Asia stay in Asia. It used to be that Chinese money would say, "I live in Asia, I don't need someone else to manage my money here," but I think also that is now starting to change.

**Angelyn Lim:** I agree that it is very interesting how the alternative fund space and alternative managers in China are developing. From our perspective, we can confirm that there is a lot of interest from our large Asian clients to have money invested in local regional products and to have the money stay in Asia. It is almost an attitude or thinking here that *Asia can show the West that we can do it too and succeed on our own terms*. We will talk more about that when we go into the topic of regulation.

On AMAC and its regulation of the sunshine fund managers and other managers, our impression is that the regulators in China are very open to learning from regulations in other jurisdictions. It will be interesting to see what regulation is eventually put in place in China to regulate the alternative funds industry and asset managers. We certainly see the regulators being encouraged by the government to put regulation in place as soon as possible.



**As with everything in China, there's a real rush to get from Point A to Point B in a quarter of the time that it took that same process in the West.** Because it is a controlled economy and environment, it can all happen in that short period of time: the whole process may not run through its entire course, and there are good and bad aspects of that. While you might think, objectively and reasonably, that it should take, say, five years for the regulatory regime to fully develop, it will likely be a lot faster in China. Just over the past 12-18 months, we have seen a large number of regulatory initiatives being rolled out very quickly, including Stock Connect; QDLPs, QFLPs.

All this really leaves the markets and players outside of China to keep up with China's development. Everybody, including the players from the West (some of who may not be located in Asia) all want a slice of the action. In order to participate in the returns from investment in China, one must play according to the rules which are coming out from China.

**Ally Chow:** I agree with Harold that there might be some very good local Asian or Chinese managers who performed well over the last couple of months. But on the other hand, the extreme volatility experienced in the Chinese equity markets raises an important reminder that there are **benefits in diversifying into less correlated / less beta type investments with strong downside protection.**

We believe that European credit is attractive from the technical standpoint which is also backed by constructive fundamentals. In terms of technical factors, there are **two unprecedented factors creating opportunities in Europe.**

Firstly, European banks' balance sheets at their peak had more than Euro 25 trillion of assets, which was equivalent to three times Eurozone GDP. The balance sheets of European banks are simply too big. The capital charge will be changed from Basel II to Basel III by 2019. To put this in simple terms, by 2019, banks need to fully comply with Basel III, which means that overall capital requirements for banks will be increased quite significantly. European banks are selling assets, selling non-core business or portfolios, raising capital and managing their risk-weighted assets.

We can see some of the deleveraging happening in Asia through the Asian offices of European banks although a lot more of banks deleveraging is taking place in Europe.

The second technical factor is the European Central Bank's Quantitative Easing which started in early 2015 and it has now been extended to March 2017 or even beyond. The monetary policy is decoupling between the US and Europe. European Central Bank's Main Refinancing Rate is expected to remain low, whereas the US Federal Reserve is expected to hike rate further in 2016, although timing is uncertain.



Since QE was announced, partly due to contagions of China and oil price drop, credit spreads are much wider, versus a backdrop of improving fundamentals in Europe such as improving GDP, PMI figures and lower delinquencies. For businesses which are consumers of commodities and exporters, low euro/low oil should also improve bottom line which is a sharp contrast to many Asian countries.

And so we are witnessing these technical and fundamental factors attracting some institutional money moving from the US to Europe. We also see Hong Kong and Chinese fund-of-funds and wealth advisors searching for European credit managers as a way to diversify their exposure away from China and Asia.

**Chanel Fu:** In the first two quarters of 2015, we continue to see active fund launches. With the market volatility over the summer, the fund launch space has slowed down a bit, but we still see increasing interest from both the investors as well as fund managers to launch more liquid vehicles and leaning towards more liquid asset classes.

**Launching a UCITS vehicle to attract European investors is a continued theme we hear in Asia.** On the strategy side, we see more APAC equity long/short funds launched with lower vol and liquid market cap. The pendulum does swing the other way during volatile time, over the past four months, there are more activities in the credit funds space for steady yield return.



**Matthias Knab**

That was an interesting point from Chanel about new funds coming up. As we know, smaller and start up funds are now facing more issues and challenges than ever attracting capital, even if they got initial seed capital to get going. So regarding those Asian startups, could you tell us more please, how they are being funded, and what would be your outlook for them to really make it and attract further capital?

**Chanel Fu:** When we spoke to some of the onshore China private fund managers, most of them would tell us they are funded by family and friends. Family and friends are not traditionally categorized as institutional investors, hence their requirement on the fund due diligence process tend to be a lot different from what you'd expect in the institutional, a more regulated environment.



For managers who are looking to attract institutional investor capital, we see these managers would select prime brokerage and fund admin based on its robust infrastructure, complete reporting suite, and prompt delivery of reporting/NAV, to attract institutional investors by offering data transparency.

**For those European and US investors who knew China well, we have not seen them pulled capital due to the recent market volatility.** For the European and US investors who were on the fence about investing into China, we see them shift the investment capital to either an APAC regional fund or Japan focused fund.

**Matthias Knab**

Steve, do you want to talk a bit more about the platform you operate for smaller and start up managers?

**Steve Bernstein:** Looking at the hedge fund industry, Asia is certainly different from the rest of the world. You can count on your hands how many funds with over \$1 billion assets are based in Hong Kong. The average fund is probably \$50 million in size versus \$300 or \$400 million in the US.

Conservatively, if you don't have at least \$75 million or so that you are managing and getting fees on management, it's very tough to cover your rent, cover your infrastructure and run a proper fund with the proper people and compliance with the systems and technology that institutional investors require for their investments.

SinoPac Asset Management offers a platform solution, where basically someone could come in and utilize our fully licensed entity that includes internal legal and compliance systems, and through a separate entity, which I lead, we'll also do fund administration and middle office.



It's therefore a full-service support platform, and the key is that the manager can then really focus on investing.

I believe a lot of small managers, let's take the proverbial "two guys and a dog" set up, make the mistake trying to do all of that themselves: they are trading, they are settling their trades, they are dealing with all their service providers and **end up spending 60% of their time on things that don't help them generate any returns or help raise capital.**

That is why a lot more small funds are very interested in coming on to a platform where they leverage the licensed entity for all of those activities, and on top we also have capital introduction in-house. We are also able to seed select managers. I think for the next few years we are going to see a lot more of smaller managers realize that they just can't compete or survive on the long term, especially when they are \$30, \$40, \$50 million in size. And I think we will see the platform solution, not just from us, but from other platforms as well, really take off and run.

**Eric Wong:** I was told by some prime brokers that *if you are aiming to be a \$1 billion dollar fund, at \$100 million AUM the asset manager should be losing money as a business, because you are expected to be paying for a lot more infrastructure than a \$100 million fund would need.*

So that kind of sets the bar. You should be out of the gates with \$100 million, at which point you are still losing money as a business, or else you have a limited timeframe in which to get to \$100 million before people start asking questions like "Why are you still below \$100 million?"

**You probably have a year or maybe two to get to \$100 million. If you are not there by then, then you will probably be placed in the uninvestable zombie fund category by institutional investors.** You will be floating around along for possibly a good period of time if you are making decent returns, trying to raise funds with small tickets to get to \$100 million, but not many get there.

From a non-institutional investors' perspective like ours, *it actually appears to us to be the responsible way to manage your own and other people's money, i.e. starting with a smaller amount and proving the strategy thoroughly before growing it steadily.* However, in this day and age, where money is so desperate to find a home, **the large investors want you to be big right away**, so that they can invest large amounts. So you either fit a box, regardless of what the returns look like, or you don't.

Our firm does not invest in brand name startups starting with size and going for even more size based on some supposed prior reputation rather than a real track record. We prefer to focus on smaller managers that are harder to understand, or running not scalable strategies for a significant period of time.

What's interesting for Chinese managers is that **the dynamics of what is actually possible onshore in China is changing.** A lot of the sunshine funds get their capital from wealth management products. These products often involve some kind of senior fixed return tranche. *This is necessary because there is no prime broker in China, so a manager has to solve problems such as leverage themselves via creating debt in the fund structure through such wealth management products.* That fixed return used to be in the range of 6-9% and the manager took first loss but could also keep whatever returns after paying the fixed return. That structure was disastrous for the long managers over this summer, but worked very well for managers who run market neutral strategies.



Most of the quantitative market neutral strategies we know in China actually did very well during the downturn, possibly accidentally. Those funds are mostly short index futures and long a basket of stocks. With the ease of selling futures (before restrictions were imposed), those collapsed more than the stocks, and the divergence between the basket versus the futures just kept on getting bigger, thus somewhat magnifying their returns.

The problem now is that the CSRC seems to be trying to reduce leverage in the system. The wealth management products usually have a one year life and then need to be renewed which used to be quite easy, but in the present environment they may not be renewed. In such a situation the manager doesn't have a viable investment strategy because without the leverage – futures margin is at 42% and only 50% of applications to get that lowered to 23% for hedging purposes get approved – the strategy becomes very unattractive from a return perspective.

**What is starting to happen is that a lot of the onshore managers who never bothered coming offshore will start coming offshore by necessity**, at which point they would hope prime brokers can provide Hong Kong-Shanghai Direct, QFII quotas, RQFII quotas. *But the problem is that most prime brokers, through QFII or RQFII, will not allow the offshore fund to use the onshore futures to hedge nor to short stocks.* How does the manager then recreate a market neutral book from offshore? Yes, there are ETFs, but they are all tilted towards the large cap A50 and the CSI300 indices. No one really has a liquid CSI500 hedge, which is better for hedging mid cap names. We therefore believe that those managers will need a platform, not just for all the services Steve mentioned, but also to create that hedge.

We think actually volatility strategies might be a way to synthetically recreate a hedge that is semi-decent offshore, just because all the other choices are so terrible. A manager is not going to make their name saying, "I am going to do long Bank of China versus A50." They have to go into mid caps, which are much more interesting in terms of value, or when they are quantitative or tied to volatility in some way, but also that is much harder to hedge. This is really a new paradigm to operate in, and managers will look for more complex solutions because those strategies were so successful onshore that they will try to replicate them, but they don't have the hedge.

Another aspect of Chinese investors coming offshore is that they now have much more realistic expectations on returns, having witnessed the collapse in their stock portfolios which also probably were leveraged as well. I believe we live in interesting times, and we can see the rules are being rewritten by the Chinese money and potentially by the Chinese managers as they step offshore, but they certainly need a lot of support and help.

**Jonathan Culshaw:** I have only been based in Asia here in Hong Kong for four years, but even in that period going up to Shanghai, Beijing and other Chinese cities I have seen an exponential increase in the level of experience and knowledge of local service providers, particularly the major Chinese law firms who work in the investment fund space, but also from managers and service providers.

You can see the industry getting a bit more organized; by way of example, over the last couple of years several Shanghai based hedge fund associations have been formed in different districts in Shanghai, supported by local governments, including a hedge fund association in the Pudong New District and a HongKou Industrial Park for Hedge Funds. We've also seen the rise of fund of funds emerging in the Chinese market. It was reported that CITIC Securities, the largest securities company in China, has already invested RMB1.5 billion in about 60 private funds since 2010, alongside other key players in the market such as China Merchant Securities.

I also agree with Angelyn that PRC law and regulation should move quickly to support and regulate this nascent industry as the government seems to be focused on the space and can move in a rapid and unimpeded way to establish laws and an appropriate regulatory framework.

As an offshore law firm, we are also seeing more interest from law firms and managers in Shanghai looking to set up offshore vehicles with typically some kind of Cayman structure becoming increasingly popular. I think **Cayman will continue to be more popular than UCITS**. Trying to source money from Europe is often seen as not worth doing, depending on your size, given the additional complexity of setting up a UCITS structure. And compared to the more flexible lower cost Cayman model, the only certainty of a UCITS investment is a lower return which is a natural consequence of the increased need for liquidation, convoluted replication of traditional hedge funds strategies and a more complex service provider/fund relationship matrix.



Recent market events with the Chinese government stepping in to support markets have attracted some criticism from laissez-faire economists but I believe that some level of government intervention is justified for newer markets with more inexperienced participants, and to prevent the credibility of newer less robust markets being permanently damaged by uncontrolled volatility, in particular on the downside, as the leveraged positions of inexperienced participants are stopped out in a waterfall of losses.

Of course, recent market disruptions have triggered a wave of fund redemptions but our expectation is that this is just a bump in the road and long term the fund management industries in both PRC and Hong Kong will continue to prosper. In particular the more rapidly developing economies and huge consumer base available here means that **expert investors can generate higher returns in Asia than in more mature economies**, and of course that potential for higher growth must be reflected by some level of increased volatility natural to any kind of high return market, and so there will be major corrections from time to time.

**Matthias Knab**

China is of course also a very important market for Eurex and Deutsche Börse. What you see from your perspective in China, Asia, or Hong Kong?

**Eric Wong**

Please launch a China midcap index future and option for all of us hedgers' sakes.

**Markus Georgi:** China is seen as a high-potential market, given the size of its economy and growth rates. China has already been reaching its potential to some extent and will do so more in the future.

China's market opening and RMB internationalization process have provided major opportunities to the international investment community, exchanges included.

Since 2004, China has slowly begun to open up its current accounts and strongly encouraged the use of RMB in cross-border transactions. Driven by the increasing use of the RMB as a cross border settlement currency, offshore RMB deposits have grown significantly to more than RMB 2trn. Approximately half of them are sitting in bank deposits in Hong Kong. Europe, and especially Germany as an offshore RMB clearing center, is playing an increasingly important role in China's market opening and RMB internationalization process.

Especially the RMB internationalization process provides major opportunities. The most recent big step towards internationalization was the setup of the Shanghai-Hong Kong Stock Connect. Prior to this initiative, investors in Hong Kong and from overseas could only participate in China's financial markets through certain investment channels such as the QFII or RQFII schemes. Mainland investors, on the other hand, could only invest and trade overseas through the QDII program, subject to strict quota and approval processes.

Investors all over the world have been closely observing China's internationalization process, which led to the outperformance of the A-share market over the past one to two years. Interest rate easing by the PBoC has supported market demands as well. The recent market turbulences have certainly had an impact on the Chinese market, but will most likely only have a temporary effect. The Chinese economy is still underrepresented in global stock market portfolios when compared to China's share of global GDP. The inclusion of China A-shares in MSCI Emerging Markets and FTSE Emerging Markets indices is highly anticipated and will contribute to increased demand of Chinese equity products.



Another very important point is the pending inclusion of the RMB into the Special Drawing Rights Basket and the promotion of RMB as an additional reserve currency.

In our market consultations at Eurex Exchange and Deutsche Boerse Group, we were informed by multiple different market participants, especially out of Asia, that China and thus Chinese financial products are imperative to Deutsche Boerse and Eurex' success in Asia for above-mentioned reasons.

In order to respond to these developments, Eurex and Deutsche Boerse have worked on multiple projects over the course of the past years. These include the setup of a regional exchange and a clearing house in Singapore – Eurex Asia – which will go live in 2017; and the setup of our new Frankfurt-based joint venture company with the Shanghai Stock Exchange and CFFEX – the China Europe International Exchange or CEINEX – which has gone live with specifically-chosen Chinese cash market products on 18 November 2015. Product focus will be on A-share ETFs, money market ETFs, denominated in RMB and Euro; Depository Receipts; and RMB bonds. As a next step, derivatives on Chinese A-shares indices are considered, pending Chinese approval of course. This JV will bring China and Europe closer together in terms of Chinese product access for the Chinese and European investors.

**Eric Wong** So that's Deutsche Börse that's launching these products first?

**Markus Georgi:** It is CEINEX launching multiple Chinese products on Deutsche Boerse infrastructure. Deutsche Boerse holds 40% on CEINEX, the remaining 60% are with our Chinese partners – 40% with SSE and 20% with CFFEX.

CEINEX as an exchange however uses the same infrastructure as the German cash market Xetra and Eurex. The membership structure is what you are used to from Deutsche Boerse, hence access to CEINEX products is fairly easy.

Another important point to highlight is that the products are listed in Germany and thus fall under German regulation and Deutsche Boerse rules.

We announced another key development end of October as we are entering into a strategic cooperation to connect the respective markets of CFETS in China and Deutsche Boerse to foster product innovation. This can be seen as the next step of RMB internationalization and is designed to offer access to Chinese fixed income and RMB FX markets to international investors.

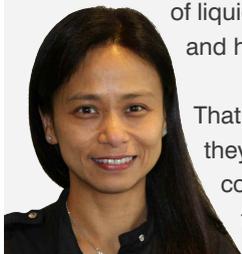
If we look at the outbound potential from Mainland China, it is also of paramount importance to position ourselves accordingly and to offer the right products to the Chinese community. We expect much more capital and investments coming out of China over the next years. This has multiple reasons, for example, the difficult access to investments outside of China. Mainland investors, out of which 82 per cent are retail customers, are heavily skewed towards the Chinese A-shares market and real estate assets. Portfolio diversification is the next logical step and has already started. Additionally there is the looming threat of pension deficits in China through a rapidly aging population which will lead to the search for yields in international markets. Furthermore, there are around RMB 22trn savings in Chinese banks today, which represent a huge capital stock for investments inside and outside of China.

Germany is a partner of choice for China, given the international trade volume between the countries, the investment volumes and the very intact political relations. Deutsche Boerse and Eurex as market infrastructure providers play an important role in connecting both markets.

Deutsche Boerse, with its listed German blue-chip companies for example, is looking at a great opportunity in China, also due to the high market penetration and reputation of German manufacturers and products. Derivative products on Eurex in the equity, equity index and fixed income space increasingly represent opportunities to Chinese investors as well. I would like to highlight that we recently introduced our Mini-DAX® Futures in order to respond to the demand from Chinese and other investors to offer a smaller version of our German blue-chip index Futures.



**Ally Chow:** In terms of new fund launches, in order to capture the opportunities from the European Bank deleveraging which I have discussed earlier, we have launched the European Deleveraging Opportunities Fund II which is targeting two types of transactions. One is acquiring portfolios which banks consider non-core. These portfolios could be performing assets but still come at interesting discounts. The other type of transaction is bilateral risk sharing transactions with these banks to help them manage efficiently their regulatory capital over their core, on balance sheet, assets. So these strategies could potentially generate very interesting, less correlated returns which may be double digits, but of course you do give up a little bit of liquidity as the fund structure will be similar to, although typically shorter than, a PE structure with investment and harvesting periods.



That's something that Chenavari has actually done since 2011, and talking to some of the investors here in Asia, they found that is quite an interesting way of accessing performing whole loan portfolios that banks no longer consider core and at the same time receiving income returns, which Chanel also mentioned is important, as there is also a good income component in these investments.

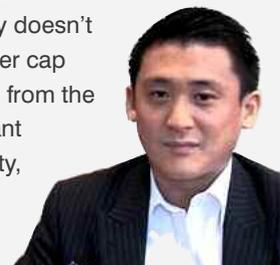
**Eric Wong:** There is a cycle banks go through where they first aggregate power, then lose power, and then the cycle is back to them aggregating power again, however now we are definitely in a phase where virtually everyday a bank is being penalized for something, rightly or wrongly. At some point you may even think of banks as a cash machine for the government. What that means for the markets themselves is that nobody is left to step in to provide liquidity to a lot of markets. In OTC for sure, and even on exchange, we observe the absence of what once was a function fulfilled by banks.

This actually describes what we believe will be **the greatest opportunity for a considerable period of time**. But in order to fully seize this opportunity set, you have to be structured in a similar manner as a bank with multiple regulated entities, credit lines / balance sheet and access to multiple markets. What this may mean in the end is that this opportunity set may not be for funds. Funds are not generally natural liquidity providers. They buy a position they want but they are not in the business of trading and providing liquidity. If you talk to the interdealer brokers, who are a very interesting source of information, they don't generally like to deal with the funds because the funds are focused on getting a good position, but they trade a few times a month, and it's only to gobble up a good position. They might be a big fund, but in terms of the sheer volume of turnover, they're not that big. There are other smaller proprietary operations or still the banks turning over much more volume who are the real liquidity providers. So for some of that activity you may have to be regulated as a broker-dealer. I can't think of too many funds that have gotten themselves regulated as broker-dealers to participate in this opportunity. So perhaps this is more a private equity into public markets type of opportunity.

Alongside the general liquidity issue there is another phenomenon that is relevant for both Hong Kong and Singapore in terms of equities. I mentioned previously there are zombie funds, but there are also **a lot of zombie listed companies** where typically they are majority owned by a family and nobody really trades it, and the family doesn't exactly know how the firm should be packaged to make it a more viable listed company for investors.

Perhaps what is missing is something we had seen on the London Stock Exchange where there is a corporate broker or a designated adviser for every listed company whose role is to inform the management about their investor base and how they can present themselves to the investor base, and possibly also provide a central point of liquidity for potential large investors who are interested in the stock. The absence of such services in Asia possibly also contributes to us having so many zombie listed companies. One may ask, aren't the banks fulfilling such a role?

The problem with M&A specialists and the investment banks is that they typically are in for the specific deal like a listing or merger, so they do the deal and then move on. They are not there on a day-to-day basis merging investor communications with providing liquidity. You need to be aware that these are things that a large company doesn't even have to think about because everyone is trading and looking at their stock. But for medium to smaller cap names, it's necessary to formulate the message and also to provide the liquidity. That liquidity may come from the founder offering up some % of their holdings to provide liquidity to the market, and this would be important because some institutional investors cannot go into a stock that does not have a certain degree of liquidity, no matter how attractive that stock may be. So if those things don't happen, the stock will always be a zombie. How can these zombie names be revived is a major question.



**Steve Bernstein:** A point Eric touched that keeps me up at night is that investment banks have been so constrained, the negative relationship they have now with governments and regulators is actually scary to me, because as a consequence this means that markets have lost a certain level of protection and support.

I was at Solomon Brothers for many years in fixed income. We were the primary dealer, so we were there to provide liquidity. Everyone could rely on us to make markets and to protect the customer business. We had a customer business that drove a lot of liquidity for our clients. Well now, clients just want the best price. They'll go off exchange and further disintermediate the investment banks while the investment banks are being penalized by governments and regulators. Now, **if there will be a severe event like we had in the global financial crisis, the investments banks, (a) aren't set up to provide that support and provide that liquidity, and (b) they'll just say, "Look, it's not our business anymore."** They have been regulated out of being that leverage. It used to be possible to make money because you would put your capital at risk, and you would be able to buy stuff in very volatile markets. Sure, investment banks could buy stuff cheap then, but they were that last bid. They were there with a bid.

Whereas now, because of capital constraints and regulatory hurdles that banks have to comply with, a firm like Citi and others aren't going to put up that capital. They are not going to take that risk, and they are not going to be paid to take that risk, and the proprietary desk that sometimes used to take that risk aren't even there anymore. To me, this is a huge concern that if there is another global financial crisis or meltdown, no one will be there to offer support. Of course, at some point the government will come in like Japan does or China, and support the market and buy equities. But that also just gives people a chance to short them against those big funds.



So those good roles and functions investment banks had played in providing liquidity are not there anymore and that I think could seriously enhance and increase the volatility of any major downside move or any major problems going forward.

**Angelyn Lim:** Liquidity is an interesting area which is high on the radar screen for all the players in market. We know that the SFC is certainly looking at it very closely, as are all the other regulators in IOSCO's working group on liquidity risk management. With initiatives like Basel III which restricts the banks, we have also seen in Asia the beginning of a trend that had already started in the West where individuals are coming out of the big banks and big shops and setting up their own small investment banks; these are going to be more agile and able to service the smaller to mid-sized players and potentially fill that gap in this particular market that both Eric and Steve have talked about.

Coincidentally, we were talking last week with a local Asian player about setting up a debt fund. As far as we are aware, there are two large Asian debt funds that we work with, and this new client is looking to also have the same structure, the same process to go into trade financing. This is certainly a very niche area which is well developed in Europe and, potentially, we see the sector developing in Asia as well.



**Ally Chow:** Trade finance is definitely one area which banks are getting less involved in due to Basel III constraints, and we have been active in this area in Europe and to a lesser extent in Asia for quite some time now. We run a dedicated mandate for several large institutional investors. It is a very stable asset class which investors such as pension funds like a lot. Addressing the point about liquidity and decreasing number of market-makers, we experience it in Europe, especially in the asset backed securities market where we manage a relatively large book. We are in a sweet spot when investors who want to sell but cannot find buyers due to absence of market-makers or lack of liquidity, so they typically also come to us. We are of course not committed to buy as we are not a market-maker, however when we do buy, it is often at an attractive level. This is precisely what Steve and Eric have been talking about, the vacuum of not having market-makers any more also offers us an interesting spot where we sometimes are able to benefit from this opportunity.



**Jonathan Culshaw:** I think that the disintermediation Steve was talking about and the retreat in the firepower and influence of the global banks is perhaps a beneficial development over the long term. **At crisis points, both in the GFC and other major financial crisis, the banks weren't really able to provide the liquidity the market needed and as over-leveraged titans with in some cases horrible concentrations of high yield junk assets of all kinds they added to rather than provided a panacea to the economy's general problems.** Their business models were similar and balanced in favour of risk and leverage as only this provided the ability to compete in terms of outsize profits with their peers when times were good. And so they all found themselves struggling to survive in tough times through essentially the same over-leveraged business model and the same root failures of that business model.

With disintermediation other players can come in – generally smaller, more agile players – with a more diverse set of risk parameters and business models and less accountability in terms of having to justify on a quarterly basis a level of ever increasing profits to a demanding public investor base. And these alternative sources of liquidity may provide a more diversified and available liquidity base in future crises. This, combined with Basel capital controls reducing the amount of leverage banks can deploy in the market, should help to reduce and not increase the level of systemic risk in the global market.

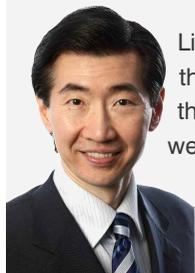


**Harold Yoon:** I agree with Jonathan on the banks's role, particularly during the different crises that hit us in Asia over the years, the banks really did not really step in to provide significant liquidity. So I don't really see that role for banks here in Asia. However, if we look at the US and increasingly also in Europe, distressed funds, mostly hedge funds with significant amounts of capital, often step in. When the market gets really beaten down and investors feel they can get really good assets cheap, then they are going to act.

The situation in Asia though is a bit of a chicken and egg question because the major distressed funds really don't have a big presence here in Asia, and the ones that did got hurt very badly during the Financial Crisis, so their investor base would most likely also prefer them not to have a large allocation in this region.

The solution to that may be something that is kind of quasi-private equity, but the thing with private equity funds is that they don't get started until the world is in crisis, and they see a huge investment opportunity. So maybe the bridging of that will probably be more sovereign wealth funds, basically governments deciding to support assets that are incredibly cheap. Then, when distressed hedge funds see that there is this opportunity where governments are actually providing a put to some extent, they will also start to get more involved.

At SAIL, we carry out extensive research on the hedge fund universe. We already mentioned that on the quant and market neutral side, Asian funds are doing very well. Our research and our insights into the markets tell us that **some of the highest returns of both start-up funds and larger US and European quant funds are generated in their Asian strategies and Asian allocations.** Therefore, I hope that we see a similar positive development also on the debt side and other asset classes which need liquidity, but right now it's a chicken and egg perspective, because myself as an investor, I value liquidity very much, and the only time I would invest in distressed assets is when that dislocation really happens, and I feel that I can get high quality assets for 30% or 40% discounts. I believe there are a lot of investors like me who are waiting for that opportunity if and when it emerges.



Linked to that is the question which investment vehicles would you use, once you want to position yourself for those opportunities? What we have done is to maintain relationships with hedge funds who are usually based in the US and Europe, but who have Asian capabilities, with the prospect that if a dislocation happens in the future, we could then quickly make an investment through them. But again, I believe that the liquidity issue that arises in Asia is something that will be hard for many investors to overcome.

Matthias Knab

We have started to look at challenges or potential threats going forward. Is there anything you would like to add here?

**Angelyn Lim:** I think that regulation is one of the biggest challenges for all managers, irrespective where they are located. You can't run away from regulation. Of course, sitting here in Asia, Asian managers expect and are willing to comply with the local regulations here. But, unfortunately, Asian managers are also increasingly being subject to imported or extraterritorial regulation from the West. Initiatives like FATCA or AIFMD have all been imposed, and pretty soon, in 2016, the Common Reporting Standard as well.

While you might say, "Well, it's some time down the road", that's what everybody said about FATCA and AIFMD as well, and before you know it, it's upon you. The amount of regulation to be dealt with these days calls out the smaller players. Today, it is no longer possible to launch a hedge fund with two men and a computer. You must have the scale from the beginning in order to deal with these issues in order to attract investors, and that means large fixed costs.



**Jonathan Culshaw:** The most significant new regulation affecting all Cayman funds will be the implementation of the new common reporting standard on automatic exchange of information developed by the OECD (**CRS**). The Cayman Islands government recently enacted regulations to implement CRS into Cayman Islands law which will come into force on 1 January 2016 with the first reporting date applicable to more than 50 countries being September 2017. From 1 January 2016 all funds will need to carry out due diligence on new investors, existing individual investors and entity investors investing US\$250,000 or more to determine their tax residence and the tax residence of controllers of investment holding vehicles. The number of countries participating will increase to around at least 90 over the next few years.

It is fairly onerous, particularly as it relates to contacting existing investors who may have supplied information from which it isn't possible to determine the relevant tax residencies, and who may not be particularly focused on providing additional information and certifications once their investment has been made. There is also the point that **CRS and FATCA, once you boil down the verbiage, actually constitute an investor self-certification regime.** What this means is that while it is fairly onerous for the average investor in terms of having to provide documentation and certifications, and also for funds and their lawyers in working through the legislation and exceptions, collating information and making filings, it may be unlikely to deter tax evaders who can always choose to provide inaccurate information. *Self-certification regimes are often ineffective in deterring fraud and other financial crime; a recent example of this was the failure of self-certification mortgages to prove creditworthiness in the GFC; forms were just completed with entirely inaccurate information.*

On the plus side, at least Cayman and also BVI and Bermuda are responding quickly and sensibly to this new world, bringing in clear legislation on a timely basis and producing standardized self-certification forms to ease administrative burden, and so all three jurisdictions will be fully compliant and not subject to any blacklisting or penalties.

But I agree with Angelyn, this type of ongoing regulatory drift will increase costs across the board for managers and as fixed costs will hit those newer managers with smaller AUM hardest as they look to grow.



**Chanel Fu:** Regarding the challenges we see in a market, there are a couple of things I want to mention. One relates to China, where around 80% of the market is driven by the retail investors. This creates or contributes a lot to the unpredictability, the volatility and inefficiency in that market. With 2016 and beyond, hopefully with the capital market continuing to open up and with the RMB internationalization we end up seeing more institutional players go into the Chinese market so that the ratio becomes more like 40-60, with 40 being retail, and 60 the more institutional side of the market, just as it is anywhere else in the developed markets.

Another imminent challenge around the liquidity capital reserve will come into play in 2018, specifically for EU and US investment banks. With these requirements for banks to hold more and higher quality capital, thus increasing the regulatory capital ratio, will also raise the cost for investment banks. We already see a number of responses. I read in the news media that one of the major investment bank has started talks about moving their business headquarter from UK into Hong Kong simply because this will reduce the levy on their capital reserve requirement.



**Steve Bernstein:** I would like to share two things, and they are totally unrelated.

My first thought is that I believe there is a huge opportunity over the next few years in the family office space considering the amount of wealth has been created in China, and that we will see similar developments in other countries in the region, like Malaysia and Indonesia. And a lot of that wealth used to go into the private banks who then would allocate money to the hedge funds and everything else, however now, a lot of those wealthy families are going direct.

We are seeing a lot of wealthy families setting up their own funds and hiring managers to manage those assets. I think that trend will continue where we will see some **disintermediation out of the private banks** as families start to manage their own vehicles. We have seen a few of those already. We are offering consolidated reporting for family offices, and we see some of them putting in infrastructure for the first time and ultimately they may become multifamily offices. I think this is a positive trend in Asia where the number of millionaires and billionaires are the fastest growing in the world, so this will continue.

My other point is really just an observation. Over my years here, and so not only looking around at this Roundtable, I have found that **the number of women professionals in the hedge fund space in Asia is much higher than anywhere else**. If we had this meeting in New York or in Europe, it would be all or to the most part all men, no?



I read an article recently that said women fund managers outperform men based on a survey. We are all in this business for many years, we all know each other, so we know that there is a huge number of very highly qualified women on the service and also on the fund management side. Also the AIMA and CAIA organizations have had a number of female heads and executives.

Gladys, who runs a quant fund, was quant fund of the year at SinoPac Asset Management. So to me, I think this is a really fundamentally good development that also in a way differentiates us positively against the otherwise rather masculine hedge fund world elsewhere, and hopefully this trend will continue.

Matthias Knab

You are right, Steve. When I organize these Roundtables in the other major financial centers, I try each time to include women, and most of the time I struggle to include even one.

Meredith Jones has written a whole book researching the outperformance of women managers called “The Street: Why Female Money Managers Generate Higher Returns (And How You Can Too)”, and I have done an interview with her on the book and her findings on Opalesque.TV.

Eric, do you want to add anything to Steve’s comments about the growth of the Asian family office space?

**Eric Wong:** Yes, certainly, **Asian/Chinese family offices continue to be a growing phenomena**. We saw in the past two to three years a lot of Chinese wealth created for example from an IPO in Hong Kong, and the money never went back to China but rather stayed in Hong Kong and was used to form a family office. In just two or three months, such family offices can have been set up with say five professionals running let’s say \$500 million. So it is quite amazing how fast they can move. What you often see these days is that the patriarch, matriarch, or founder would hire their favorite private banker and have him/her take care of all the family’s banking requirements, whether it’s the investment banking needs of the family business, the private banking needs of the family, etc. The Chinese wealth seems to like such a consolidation at one point. Another thing we saw was the coming together of Chinese money and Taiwanese money or money from other regions to form multi-cultural multi-family offices. The fact is Asian family offices are a rather young phenomenon, so we are still in the formative years where functions and roles are not that clearly defined.

Basic questions regarding what is a family office, e.g. when is it single vs. multi, are still to be defined clearly by Asian family offices whereas Europe and US families have gone through multiple iterations and generations and have answered more of these questions.



**Chanel Fu:** To continue touching upon the regulatory topic that Eric mentioned. In the upcoming year, we will continue to see Anti-Money Laundry being the leading topic in the regulator’s mind. Transparency and trade reporting will become a big topic from MIFIR, which will require impose reporting requirement on the buy side firm.

Coming back to opportunities, we see continued growth in Asia that is still driven to a large extent by China. As China is moving from an export-driven economy model into more of a service consumer-driven model, we definitely will continue to see a lot of opportunities in China. We have already seen double digit growth in the retail consumer as well as tourism for the last couple of years.

Let’s take a look at Asia region as a whole. Asia is very fragmented; with a good mixture of developed and emerging countries. A number of countries are competing to become the next favorable market for the global investor. And that competitive spirit will often lead to product innovation and then further opportunities.



Matthias Knab

Would you like to point to specific countries here?

**Chanel Fu:** For example, Hedge Fund Park and free trade zone setup in Shanghai in the effort to make Shanghai the stronger financial center in Asia.

As another example, since the success of Hong Kong Shanghai stock connect that gave unprecedented access to foreign investors to Shanghai A-share stocks, there will be further expansion of global access by a **Hong Kong Shenzhen stock connect**. To follow the capital internationalization trend, Taiwan and Singapore stock exchanges are talking about the connect program to draw more international capital to a traditionally ID investor trading market.



**Ally Chow:** I agree with the previous comments on the impact of regulations, whether it is Basel III or Total Loss-Absorbing Capacity (TLAC) or others, they will continue to impact banks' behavior in the years to come, and that also creates opportunities as well in the space we are involved in.



We also anticipate volatility to continue. I wouldn't say we are bearish on China, however I believe we definitely need to follow closely what is happening in China, that is, the pace of China slowdown, the currency, the debt levels, the PBoC rate cuts, which could have spillover effects into the rest of Asia and beyond. I believe any strategies or products which are focused on idiosyncratic opportunities or with a market neutral profile should be less affected by, or even able to benefit from, the volatility, whether caused by China, oil or other factors.

**Angelyn Lim**

A concern or threat for asset managers globally is cyber crime and cyber security. Distributions are increasingly going online and that is a good thing, which increases opportunities for the asset managers. But at the same time, obviously, the regulators are concerned as to how they can effectively regulate online distributions. **Investing in cyber security will be an increasing part of the overall infrastructure costs.** Systems need to be properly set up, maintained and constantly upgraded.

**Matthias Knab**

In April 2015, the US SEC has issued a guidance regarding cyber security, and local regulators may come up soon with their recommendations as well.

**Steve Bernstein:** We talked a lot about China, but so many things are still left to say... China is increasingly looking outwards. You have the **One Belt, One Road initiative**, which is an adaptation of the historical Silk Road that could sow the seeds for a new geopolitical era, and then think of the first time meeting of the leaders of Taiwan and China.

I think those things are pretty significant and will lead for opportunities for China and other countries. China is putting in the most amount of money, \$60 billion or whatever the number is for infrastructure projects, and certainly, Chinese companies in those countries will do well. I think it's good that China is looking outwards as this will help the Chinese economy as well to grow outside of China instead of relying just on their internal economy.

I work for a Taiwanese bank, so it will be interesting to see what happens there. ICBC took a 20% stake in SinoPac, but they never got approved by the government and so the deal expired, and now all of a sudden they are meeting again. So it will be interesting to see if there's movement in that space that can unfold further positive dynamics for the financial markets.

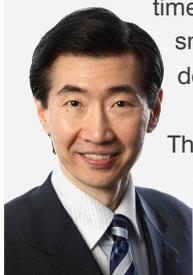


**Harold Yoon:** From an investment perspective, I am very bullish on the Asian economy in the long run, but at the moment I think that there are still a lot of concerns about China. And if China is having problems, then it will impact all of Asia and maybe even the global economy and markets. So our style of investing is long/short, we are not a long-only type of investor for the reasons we discussed earlier.

We discussed today the issue and challenges around liquidity, and in this context it is important to understand that **it is often the foreign investors who are still driving markets here in Asia**. We have seen what happens when there are outflows in Malaysia, or even with inflows or outflows from Japan or India, markets react quite dramatically to what foreign investors do.

I think for whatever reasons Asian investors are still rather hesitant to invest within Asia. Let me give an example. If we look at the big sovereign wealth funds here in Asia, Korea, China, et cetera, who do they invest in when they invest in hedge funds? Citadel, D. E. Shaw, Paulson, we can go through all the big names.

So the question is **who is going to invest in a \$50 million manager here in Asia and give them a chance?** Sure, over time, with good returns and good alpha generations, investors will eventually find them, but it's a lot harder here for smaller hedge funds. When you look at Asia, I think we are still in the early stages of the hedge fund industry development, and in general of the capital markets as a whole.



Therefore, from my perspective as a CIO, I am still cautious on Asia, because there is such a big dependence on China, and if China should have the unthinkable hard landing, it is probably going to set the entire region back for a considerable amount of time.

**Angelyn Lim:** I agree that the sovereign wealth funds are obviously going to be very concerned about who and what they invest in. This will be true for any sovereign wealth fund.

Some of the Asian managers have also grown bigger and now run multi billion dollar funds. Depending on their preferences, we have seen some of these Asian sovereign wealth funds invest into those larger Asian players. But they are not going to be investing in the \$50 million startup fund; those who have hit a billion and over are seen as the safer bet.



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