



Opalesque Roundtable Series '18

SOUTH AFRICA

Opalesque Roundtable Series Sponsor:



Editor's Note

During the last two years the South African hedge fund industry went through a transition to implement the new collective investment scheme regulation with now **over 90% of the hedge fund assets successfully converted into regulated collective investment schemes**. While fund managers have been regulated for more than 15 years in South Africa, this is the first regulation that also governs hedge fund structures.

The new regulatory framework has unlocked opportunities for a different range of products, also on the distribution side with permitted access to retail investors, and there are still major growth opportunities ahead through the integration of hedge funds into the existing platforms for long-only unit trusts to enable seamless, large scale investments from retail investors and investment advisors.

There is also increased interest to establish "Section 65" type of funds – **funds established in other jurisdictions who are looking to distribute in South Africa**. This Roundtable discusses which criteria have to be met for this distribution, and also discusses opportunities and challenges around the Pan-African investment opportunity.

This Opalesque Roundtable, sponsored by SANNE Group, took place in Cape Town, South Africa, with the following participants:

1. Udesch Naicker, [Head of Hedge Funds, Financial Services Board \(FSB\)](#)
2. Richard Murray, [Head of ManCo, Hedge, SANNE Group](#)
3. Tony Christien, [Divisional Director, SANNE Group](#)
4. Nik Michalopoulos, [Chief Operating Officer, X-Chequer](#)
5. Jacobus Lacock, [Macro Strategist & Portfolio Manager, Fairtree Capital](#)
6. Steven Liptz, [Co-Founder, 36ONE Asset Management](#)
7. Kobus Esterhuysen, [Director, Peregrine Securities](#)

The group also discussed:

- What are some of the asset classes and strategies South African hedge fund managers are expanding into? (page 7,17,21)
- Which casual phrase or clause will the South African regulator FSB not tolerate in a hedge fund offering memorandum? (page 8-9)
- How does the industry cope with cost increases caused by the new regulations? (page 10-11,13)
- Why alternative fixed income strategies have experienced inflows (page 11,21)
- How do South African hedge funds access retail investors? (page 12-13,15) What are some of the remaining challenges? (page 13-14)
- Which were some of the FSB's guiding principles for the new legislation? (page 15)
- Pan-Africa investment opportunities & challenges (page 16-17)
- Is it possible to invest globally out of a country like South Africa? (page 17)
- The situation of emerging fund managers in South Africa (page 12,19-20)
- South African pensions could put up to 10% of their assets into hedge funds. What is the actual allocation, and why isn't it more? (page 22-23)
- Positive outlook for hedge funds: Reversal of unconventional monetary policies will bring more volatility and sector / asset class dispersion (page 24)

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles



(LEFT TO RIGHT):

Nik Michalopoulos, Jacobus Lacock, Richard Murray, Matthias Knab
Tony Christien, Kobus Esterhuysen, Udesch Naicker, Steven Liptz

Cover photo: Robben Island, South Africa, © Steven dosRemedios under Creative Commons license

Introduction

Steven Liptz
36ONE Asset Management

My name is Steven Liptz from 36ONE Asset Management. I started in the industry quite a number of years ago at a firm that was known as Simpson McKie initially after completing my accounting articles. Simpson McKie was then taken over by HSBC. At the top of the bull market I saw an opportune time to leave, and after considering a number of different options, the team that I was part of landed at Investec where I stayed for five-and-a-half years. At the end of 2004 I left Investec and started 36ONE Asset Management. My business partner was with me at Investec and joined soon after.

Today we manage a mix of long-only, predominantly unit trusts, segregated long-only mandates and long/short equity hedge funds, both locally-based and offshore. Our client mix is both South African and international clients. We are introducing a new fund soon, which will be positioned somewhere between market-neutral and opportunistic.

Richard Murray
SANNE

My name is Richard Murray and I am head of SANNE's South African Management Company, which is a regulated collective investment scheme manager and offers a co-naming hedge fund platform in South Africa. Prior to this I spent 14 years within financing products trading businesses at Morgan Stanley and Bank of America Merrill Lynch.

Udesh Naicker
Financial Services Board (FSB)

My name is Udesh Naicker. I am the head of hedge fund regulation in South Africa, so I work for the Financial Services Board (FSB). I am an accountant by profession and among other things, I have a few years' experience in corporate finance and investment banking before joining the regulatory side.

Kobus Esterhuysen
Peregrine Securities

I am Kobus Esterhuysen from Peregrine Securities. We are a prime broker for equity hedge funds. I started my career in the life insurance industry as an actuarial student and then moved across to asset management in the early '90s. I am a product development specialist in the derivatives and hedge funds industry. This involves financial modeling, legal, tax and regulatory compliance.

Tony Christien
SANNE Group

My name is Tony Christien. I am a Director at SANNE Group, locally here in South Africa and in Malta. I also spent some time in the corporate banking area with First National Bank and Barclays Bank, and then I have been in the administration sector for 15 years, originally with the IDS Group, which then was purchased just over a year ago by the SANNE Group. We administer a broad range of unregulated and regulated alternatives, including hedge funds, private equity funds, long-only funds and various credit and debt funds.

Nik Michalopoulos
X-Chequer Fund Management

I am Nik Michalopoulos from X-Chequer Fund Management. I joined the South African wealth management company Citadel in 1999, and that was my introduction to financial services. I was involved in establishing their product solutions business and was there for about 10 years before moving to X-Chequer. X-Chequer was started in 2007 by Werner Prinsloo. We are a primarily hedge fund-focused equity business.

Jacobus Lacock
Fairtree Capital

I am a Fixed Income portfolio manager at Fairtree Capital, a multi strategy alternative and long only asset manager, and co-manage our fundamental fixed income hedge fund strategy with Ian Millard. Prior to joining Fairtree in 2011 as macro strategist and co-portfolio manager on our multi-strategy portfolios, I worked for Goldman Sachs Asset Management in London where I focused on building global fixed income and emerging market debt investment solutions for clients.

This material reflects the analysis and opinions of the speakers as of 09, Jan 2018 and may differ from the opinions of Opalesque and/or the Roundtable sponsors. It is intended to be of general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy. It does not constitute legal or tax advice.

The views expressed are those of the speakers and the comments, opinions and analyses are rendered as 09, Jan 2018 and may change without notice. The information provided in this material is not intended as a complete analysis of every material fact regarding any country, region, market, industry, security or strategy. Statements of fact are from sources considered reliable, but no representation or warranty is made as to their completeness or accuracy.

SANNEGROUP.COM

SANNE

Experience the difference

Leaders in global alternative asset and
corporate administration services.

Contact us for further information:
enquiries@sannegroup.com



Over
1,200 people
worldwide



FTSE 250
listed
business



In excess
of £200bn
assets AUA

AMERICAS | EMEA | ASIA-PACIFIC

THE DIFFERENCE

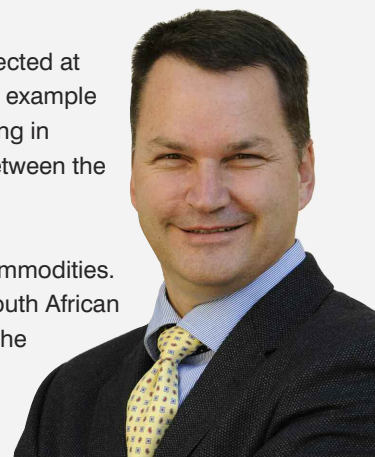
Kobus Esterhuysen: Correct, South Africa has a fairly new regulatory framework for hedge fund products (also called collective investment schemes ("CIS") / mutual fund or unit trusts). While fund managers have been regulated for more than 15 years we never had regulation that governed hedge fund structures.

In 2015 regulation was published to govern all hedge fund investment products available to the general public. During the last two years the hedge fund industry went through a transition to implement this new regulation. We estimate that 90+ percent of the hedge fund assets have successfully converted into regulated collective investment schemes. During this transition there was a consolidation of the hedge fund industry with a slight decline in assets under management.

At the same time we see the formation of new types of hedge funds. Traditionally the South African hedge fund industry was dominated by long/short, market neutral and interest rate hedge funds strategies. We now see an interest from managers and product providers to expand the range of hedge fund products and strategies. The new regulatory framework has unlocked opportunities for a different range of products.

Peregrine Securities is the prime broker for equity hedge funds, so my comments are more directed at this part of the industry. Products are developed that use non-typical hedge fund strategies, for example long funds with geared elements to it. Previous product regulation precluded any form of gearing in collective investments schemes. In the investment spectrum these new funds fit somewhere between the long only funds and the more traditional hedge funds.

There is also a trend towards other asset classes, including currency, commodities and soft commodities. Previously these asset classes were not allowed in long only retail investment products. The South African hedge fund industry is still relatively small and young, but there are many initiatives to expand the industry.



Richard Murray: I echo what Kobus has said about the transition of hedge funds into the regulated Collective Investment Scheme (CIS) environment, which was an intense exercise. It took a fair amount of focus and resources from the industry to execute, involving all stakeholders from the management companies and service providers to the investment managers.

We are now more able to focus on developing the opportunities of this regulated hedge fund product, which is further assisted by the industry's stronger performance in 2017 versus 2016.

Steven Liptz: Over the past months we have indeed seen better industry returns and hopefully if that's sustainable and lasts for some time, we will see more asset flows back into the industry. Some of the outflows were certainly a consequence of the weaker performance in 2016, but also a consequence of investors, particularly pensions, switching to investments with a lower total expense ratio (TER), so to cheaper ways of investing into the market while trying to get the same or similar exposure.

I also believe that in a way this transition to the new regulations has also inhibited new business and asset growth. In general, people tend to more oppose or at least adapt a wait and see attitude when it comes to change, rather than embracing or jumping into it. And then secondly, I believe that we also still have some structural limitations in the market. For example, *we still need to integrate hedge funds into the existing platforms for long-only unit trusts to enable seamless investment from retail investors.*

And then of course, as a consequence of the current political situation, money is flowing out of South Africa. That's for one money that used to be invested into South Africa from offshore which probably hasn't increased most recently, and also money South Africans are sending abroad to diversify and to reduce risk.

But I also agree with Richard and Kobus that there is still a lot of opportunity for the industry to grow as we are now in a fully regulated environment, and because of the organic growth and expansions into new strategies.



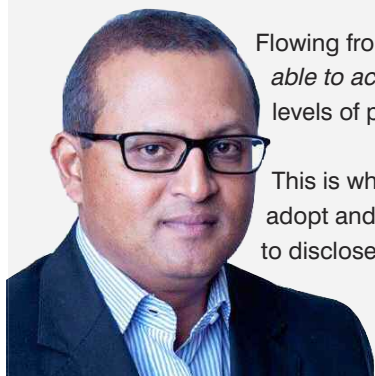
Matthias Knab

Can you tell us more about the current interaction of international investors with the South African hedge fund or alternative investment industry?

Steven Liptz:

I think that there is still interest, but these are investors that have got access to the whole world. And so naturally, the South African investor base is very important for us.

Udesh Naicker: We have certainly seen **an uptick in the activity or in the interest shown by what we term Section 65 type of funds. These are funds established in other jurisdictions who are looking to distribute in South Africa.** Of course, some limitations apply to this. The largest or the most prominent of those is obviously reciprocal or equivalence of regulation in the country of origin. Our focus as the regulator is always investor protection, so everything around that aspect will always take precedence.



Flowing from that, *we also would like to see that managers offer the types of products that investors are able to actually understand.* Investors should also take comfort from the fact that they are offered the right levels of protection and they understand what they are getting into.

This is why our regulations are focused on the disclosure of the types of strategies that managers will adopt and on the type of risk that particular investment strategies will present. Managers are now required to disclose upfront the disallowed investment categories, for example.

And one of the trends that we actually noticed and have been **disallowing** is a casual phrase or

an additional clause in some of the deeds or some of the supplemental deeds which would allow a fund of funds to “invest into any other type of investment”, if they wish so. However, we don’t take the view that they are anything other than a fund of funds, so we wouldn’t allow them to take an active equity management type position, for example.

Those kinds of things have, I think, stymied some of the managers. It has forced them to register or define certain portfolios or schemes that enable them to undertake those kinds of strategies. But also, and Steven mentioned that as well, a lot of the discomfort has really got to do with the fact the managers now essentially operate in a new, regulated environment. So while the regulations were promulgated two years ago, we have spent the last year now going through the actual operations of the managers, to ensure that the terms and conditions under which the licenses were granted are actually being adhered to.

And where necessary, we actually have to point out where the deficiencies or where the shortcomings lie. That has taken some time, but I also don’t think that that is an indefinite state of affairs. *To date, everybody who has had any shortcomings have actually put it right.* We have set timelines for compliance and we have been quite firm in terms of what it is we require.

Matthias Knab

If I am a manager in the US or in the UK or Continental Europe, what are some of the steps I need to take in order to be able to distribute my funds in South Africa?

Udesh Naicker: It’s actually very simple. If say you run a UCITS fund registered in Ireland, we would generally accept Ireland as an equivalent regulator. So the things that we look at are, for example, is the product offered for sale in the country of origin? *So in other words, it can’t merely be registered in there but it actually has to be offered for sale.*

We also consider if there is a *regime of ongoing and rigorous regulation*. There can’t be a sort of post box arrangement whereby anybody can register a fund and they pretty much allow other regulators in the world to oversee it.

Then we consider the kind of investor to which the fund is offered in that country of origin has to be similar to the target market in this country.

So those are really some of the broader criteria, and once those criteria are met, we are pretty much okay with the fund being distributed in this country. There’s always going to be a level of judgment, I presume, but we look for things that are substantially similar.

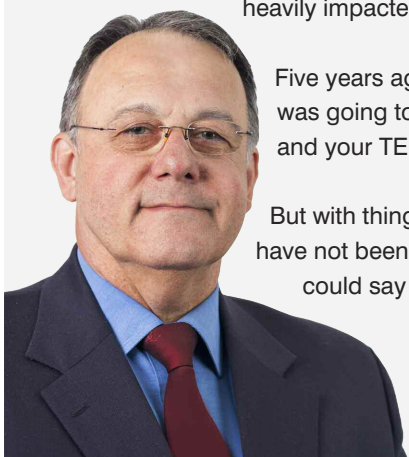
Obviously you would have to have representative offices in South Africa or an appointed representative, whichever you choose. And finally, there may be some issues around naming conventions. Here we have been quite rigorous on naming convention – it’s not in the interest of any investors if you have a hedge fund that makes no reference. That would be misleading and we will not allow non-disclosure. In the case of foreign funds, it is sometimes impractical to change the name to reflect “hedge funds”. In these cases, we insist that all local marketing information be amended to clearly disclose to consumers that the fund is actually a hedge fund.



Tony Christien: Flows into the industry over the past 18 months or so have become a bit of an issue. As an administrator, while the SANNE Management Company is a significant part of our administration, we also administer other Management Company's as well. We therefore get to see quite a bit of a spread as an administrator. I think that one of the issues that is a bit problematic, and I think where investment managers are still struggling to come to terms with, is the fund of fund model.

Traditionally in the alternative space, before regulations came in, your typical funds would attract high-net-worth-individuals directly into the fund or through a platform. And then your pension funds would invest through the larger fund of funds, and that's the way it would generally work, although there were funds of funds whose model relied specifically on high-net-worth-individuals.

The problem you have now is that you have always had **two layers of fees** involved with your single fund manager and your fund of fund manager. Maybe both charging one-and-twenty, depending on fund fee structures. This has now become a bit more complicated because you have now got the additional CIS costs that come through. You have the trustee costs and the additional Management Company and FSB costs. So when it comes to things like the TERs for instance, these are quite heavily impacted – and also makes it difficult when comparing these to the traditional long-only products.



Five years ago, when the markets were performing well and hedge fund managers knew exactly what was going to happen because their models were working well, if you were producing 20-25% per annum and your TER is sitting at 3%-4%, your investors would not be concerned.

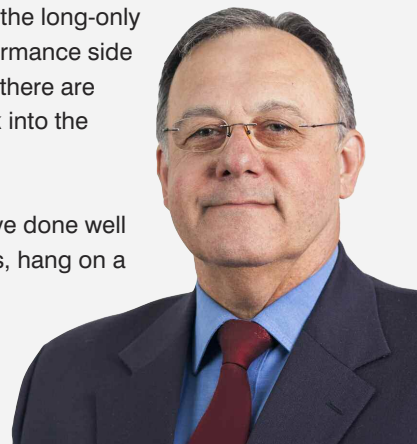
But with things that have been happening, as Steve inferred earlier, performance over the past 18 months have not been terrific and you are producing maybe 7% or 8% per annum while TER is 3%-4%. Investors could say "Well, why don't I just put my investment into a bank if I am going to get 7% before tax?".

Matthias Knab

And your TER really shouldn't be bad when your performance is bad.

Tony Christien: Yes, exactly! And that was always the issue that you could debate – it was the long-only space. But in the hedge space, it was "don't just look at the cost side of it, look at the performance side as well". And I think if the hedge fund managers can get back to that type of scenario, and there are some funds that have been doing it, then I think you will then be able to attract capital back into the industry.

There are investors who are quite happy to sit and stay with the manager because they have done well in the past, but that only goes up to a particular point, and then the investor eventually says, hang on a minute, let's stop being a part of it.



Udesh Naicker: Just on the fee issue, one thing I would like to clarify is that firstly, we don't regulate those fees, so that is completely at the discretion of the manager. Our only oversight on any kind of fee structure is the fact that it clearly discloses what exactly the fee comprises.

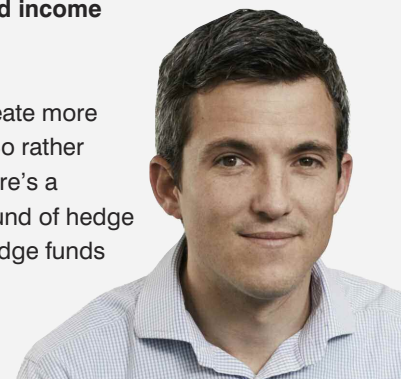


Now, to your point, Tony, you are quite right in that people are ambivalent to the fee quantum when the performance is through the roof. However, when that performance is compromised, the fee quantum suddenly becomes quite important.

And then it has also happened on one or two occasions over the last 18 months that we found that managers seem to have the belief that they were entitled to certain level of fees. This is certainly one of the things we need to weed out, because in my opinion, *one of the adverse or negative perceptions of hedge funds is around exorbitant fees and how managers go about charging it.* But again, we don't regulate fees. We only require that investors be made fully aware of how the fees are levied.

Jacobus Lacoek: The industry has seen outflows from certain hedge fund strategies, particularly on the equity side, long/short and market-neutral. However, **alternative fixed income strategies have experienced inflows over the last 12 months as performance has been good relative to equity strategies and traditional fixed income benchmarks.**

Regarding the fee discussion, we at Fairtree believe that we have to find creative ways to create more value around our product offering and being more flexible in providing solutions to clients. So rather than just offering a typical on the shelf fund, we aim to engage with our clients and see if there's a different construct or solution that's more appropriate for our investors, whether they are a fund of hedge fund, multi manager or pension fund. For example, more pension funds are approaching hedge funds directly and we are prepared to build unique solutions and a unique service.

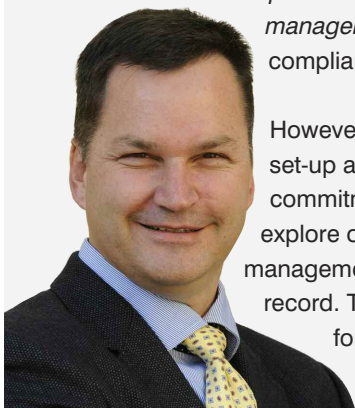


Steven Liptz: Just want to clarify, the pension fund interest that you have seen, is that on the fixed income side?

Jacobus Lacoek: Correct, some pension funds have gone directly to alternative fixed income providers. One reason has been to cut fees, but also because their investment teams are better educated today. However, as more clients choose to come directly to hedge fund managers, the industry has to focus more on providing investment education.

Kobus Esterhuysen: Coming back to fees. Since inception of the hedge fund industry asset management fees were the main cost to investors in hedge funds. *The recent regulation of the CIS hedge fund product has added other cost elements.*

Independent entities (CIS managers) now oversee the product side, while external administration and risk management increase the cost of these regulated products. We admit that there is a substantial compliance and independent oversight benefit to the general public in the regulated product.



However the experience for new startup managers is that the cost of compliance create a **high hurdle** to set-up a regulated hedge fund. The regulated space require fixed cost elements that demands a large commitment of capital for any start-up. Current regulation leaves very little room for start-up managers to explore opportunities and build experience. There is no easy way for an individual with good asset management skills to set up a fund business, to attract money, to reach a break even and build a track record. The breeding ground for new funds has become quite a tough environment. We need to find ways for entrepreneurship to happen at this level.

Matthias Knab

So, have you seen new alternative investment managers launched in South Africa recently or was there more of a still stand?

Kobus Esterhuysen:

Well, probably more of a still stand. Both on the product offering and from the flows into the industry, for all the reasons we discussed earlier. Working on a regular basis with experienced investment professionals that come from bank proprietary desks or from other established asset managers wanting to start an own fund, there is this high fix-cost hurdle. Product development is now mainly concentrated in the few larger hedge fund houses.

Matthias Knab

I think one of the aims of the new regulatory framework was also to open up hedge funds for retail investment, right? Can you tell us where we are in that respect?

Nik Michalopoulos: I think hedge fund businesses in South Africa have typically been fairly boutique businesses. One of the consequences is that they don't have equivalent capacity for marketing or distribution business relative to the traditional asset managers. This of course inevitably affects visibility, it affects engagement with investors around what the solutions are and the understanding of hedge funds.

It was already mentioned that there is still a challenge to add hedge funds to the different investment product platforms. That's a process that will take some time still and will require some structural change to the way funds are currently administered. And then also on the investor side we need to bring the message about our value-add and investor benefits to retail investors and to independent financial advisors so that they can research our offerings and see how they fit within their investment solution for their clients.



Steven Liptz: On retail investors, I think we must just be careful in comparing us to traditional unit trusts, because traditional unit trusts started in the late 1960's in South Africa, so they have had about 50-year track record and history. Comparing the alternatives industry to the traditional unit trusts is probably not a fair comparison given the newness of our industry compared to that. Hopefully in 50 years we are ahead of where they are now.



I agree that **we need to get private investors and IFAs educated** on the underlying investments and the fact that they are not as complex as they are perceived to be. This understanding of the strategies is important, and secondly also having a clear understanding how they can invest. Even if investors are comfortable with hedge funds but don't know how to actually make the investments, there will be a friction.

Performance is obviously important as well, but I think that at this stage if we can get the platforms right, i.e. offer alternative investment funds also via the large retail fund distribution channels, I think there is a huge growth potential.

Jacobus Lacoek: Under Regulation 28 of the Pension Fund Act, it makes provision for up to 10% investment in hedge funds. However, this provision has been largely underutilized due to regulatory constraints around the investment vehicles used to gain hedge fund exposure.

Now that hedge funds have transitioned into the regulated collective investment scheme (CIS) framework, the next step should be to allow pension funds and Unit Trusts to invest in these CIS hedge fund structures. I think that will do a lot to create comfort with retail investors and will be a key step towards the evolution of the retail market place for alternative funds.



Udesh Naicker: We have been approached on several occasions not just to **create access for unit trust into hedge funds, but also alternative asset classes**. This is a conversation that we have started already with our National Treasury, and it is a project for which we also have to garner support for from the industry itself that needs to bring this message across to the right officials.



So yes, I can understand why it would be beneficial for a two trillion rand industry to be allowed to invest into hedge funds. We all heard the argument about the 25% allocation being fully utilized. The kicker that this will give the unit trust and hence the flows to the hedge fund all make good sense, but you have to make a compelling case and communicate that.

Then we are also considering creating a **new class of investment to relatively illiquid investments**.

When I say relatively illiquid I am referring here to investments that don't meet the 90-day liquidity criteria. When, for example, people are going to want to wrap an infrastructure funding project under a hedge fund, then obviously you can't meet the liquidity terms and conditions within 90 days, and so there will be a longer lock-in period.

There will also be issues around things like valuation, transferability of interest, the time period and the type of investor that will be exposed to such investments. Largely it will be institutions,

we understand that, but we have got to be careful not to change the essence of our current regulations.

The good news is that the policymakers, which is National Treasury, have come back, and they have not rejected the option. They haven't said no. But I think it is something that's going to have to start sooner rather than later if you are going to want to see the benefits in the medium term, but at the same time I can't see it happening in 2018 but possibly at some point in 2019.

The challenge we have with hedge funds as opposed to the unit trust is the daily pricing and the daily liquidity. Now, I am sure we can work around those things and potentially stretch that – and let me add this this is just my opinion – but how far do you stretch it, I am not sure. But what you can't have is a unit trust investor who wants to redeem but he is unable to, because the hedge fund manager on the other side needs 30 days. That sort of issue would have to be addressed.

Nik Michalopoulos: Udes, I just want to ask you a couple of questions if I may. Firstly you spoke about equivalency, but we have a situation where hedge funds, even though they are now CIS funds, don't have equivalency relative to the traditional long-only CIS funds in several senses, one being that traditional CIS funds cannot currently invest into Hedge Fund CIS funds. How do you feel about that? I would presume that ultimately you would want a situation where all CIS funds are seen as and treated as the same thing and one then has equivalency across product or investment solutions for all CIS product types.

The other thing I want to ask you, because you mentioned the infrastructure fund, is that I think that one of the big problems that we have as a hedge fund industry is that everything that doesn't fit into the traditional asset class categories of fixed income, property, bonds, equities, is labelled a hedge fund. *The hedge fund industry therefore has this catchall situation where everything that's not a traditional asset class is a hedge fund. There is little thought in the public conscious as to whether that's a valid classification.*

If you look at what's happened in the traditional CIS space, they have gone to great lengths to segment all the different funds into very specific categories; high equity, low equity, et cetera. This is something I think would greatly benefit the hedge fund industry. I believe the current lack of clarification on hedge funds and their strategies negatively impacts our ability to explain to potential investors what we do. As an industry we also have to compete with stereotypical views that have been created a result of media coverage of funds that have failed and been labelled hedge funds when they probably shouldn't have been called hedge funds to begin with.



Udes Naicker: I will try and answer that. The equivalency that I mentioned had to do with the foreign funds and the local funds. On the CIS fund, we need to look at what a CIS is. It's a pooling of investment and that is where the equivalency will end. Remember, we regulated the terms and the kind of risk that hedge funds present as opposed to unit trust.

A unit trust is relatively vanilla, it's long-only. We like to think not much can go wrong – ok we have had one case, but we like to think generally not much can go wrong with it. And if something happens it can be contained.

On the hedge fund side, remember the industry is new. I also don't think that we have a market depth like the US or UK for that matter, where you have these huge liquidity reserves in the that



market so that active managers can take positions and adopt strategies, some of them may not work in this country, okay? We just don't have that type of market, I think we can agree to that.

But I also agree with Steve that there is a lack of education in the market. People may look at hedge funds and they presume that everything is high-risk. You are right, there's bad press and movies that show hedge fund managers investing into some oil well in Africa or some open pit diamond mine that nobody knows about, and we all know that this is not really what happens. *However, that's a perception which we were hoping the regulation will help address and rectify, simply because we have required managers to disclose exactly what are doing.* So how you create your return and what strategies are you going to follow must be made clear. And importantly, you have to answer to an authority if you stray from what it is you have undertaken to do.

So with that transparency let's hope that in the medium term we will start getting through to a target class of investor. Whether or not we have depth in our retail market for a significant uptick in assets, I don't know. I am getting differing views from the managers. Some are very bullish on it. Others have set entry limits at a million rand, and we have actually asked them to reduce those limits. I believe that even a 200,000 rand limit into a retail fund is a barrier to entry; a reasonable level has to be reached by consensus.

Apart from that I don't know what more one can do other than wait it out and see whether or not the retail product is actually going to be worthwhile. I don't have that crystal ball so we will have to wait and see what happens.

On your question of lumping anything else into a hedge fund, that's also an issue we have. Everything that's an alternative people presume is a hedge fund. We have had guys with private equity funds trying to wrap them in hedge funds.

We as regulators are not closed to intelligent suggestions, and I think, it's important that we explore every possible opportunity that may result in some sort of growth in the market up to the point where we decide whether or not it can be done. That is a function we actually owe to the market. It would be both premature and unfair of us to refuse off the bat without understanding what is being suggested.

The reason I mentioned infrastructure is that I have had a few approaches this year around infrastructure projects from fund promoters who thought they could float as hedge funds. For various reasons we couldn't do it and we have declined them, but we had to go through that process. And during that process we thought that it may be plausible to explore a third category of investor within the legislation. The biggest challenge is the current liquidity requirements which may prove restrictive in certain instances.

But again, our focus is on investor protection and so all of our regulations have been drafted with the interest of the investor in mind, not the manager.

Richard Murray: To go back to the point of unit trust access to retail hedge funds and to provide support to allowing such investment; currently retail hedge funds are available to a large pool of retail investors that also access unit trusts and as such, can make a decision of investing into one or the other of these fund types. It can be reasonably expected that a unit trust investment manager is generally better qualified than most of these retail investors to determine the merits of available retail hedge funds and where appropriate include an exposure thereto in the unit trust they manage.

I recognise the point regarding a unit trust that may invest in a retail hedge fund that does not offer daily investor liquidity, however, this would merely be a factor in the unit trust manager's investment liquidity management process that they ordinarily consider to ensure they can meet investor redemption requirements. Further, one would see a move by retail hedge funds to daily



investor liquidity should that demand exist from unit trusts wanting to invest and setting such liquidity as a requirement. So, if we could push those policymakers a lot harder on the merits of the case, we could possibly get there a lot quicker.

The move by retail hedge funds to a standard of daily investor liquidity is also being forced by the LISP (Linked Investment Services Providers) fund distribution platforms, which are a key point of investor access to regulated investment funds. We have been engaging with the LISPs and most will not take a fund on their platform unless it provides daily investor liquidity.



Kobus Esterhuysen: The regulated hedge fund space covers quite a diverse universe of investment strategies. Any collective investment product with gearing, short positions or even just a concentrated portfolio is classified as a hedge fund. The industry is still in the process to find consensus on a classification framework. A consensus is required on simple universal acceptable parameters to classify funds. This is an ongoing process.

Matthias Knab

Are there any comments regarding the Pan-Africa investment opportunity?

Kobus Esterhuysen: From a prime broking execution perspective investment into Africa has unique challenges. South Africa has a relative efficient and liquid financial market, however in most other African countries we see large bid/offer spreads, high cost of trading, low liquidity and settlement risk. This makes investment into Africa an expensive and risky exercise. *Many hedge fund managers have underestimated the pure difficulty of investing into Africa.*

The other problem is that it is not always possible to short sell in African markets. So you have a fantastic opportunity, but the ability to short is constrained, which makes the trade unfeasible.

At present there are **approximately 20 to 30 South African based hedge funds focusing on African strategies.** Following years of relative underperformance these funds have returned 30% to 40% during the last 12 month period.

Clearly, the opportunities are there. Everyone who has been to Africa and has interacted there sees those opportunities, but there are material challenges.





Steven Liptz: And in addition to what you mentioned is people see Africa as a country. But Africa is not a country, it's a continent, so if someone decides to invest into Africa and include that as part of a mandate, he has a whole host of countries to look at. So if you have got a team that focuses on one country and now and you add Africa to that, how do you split one team and absorb the whole of Africa as a market that is that large? I don't know, it's very difficult.

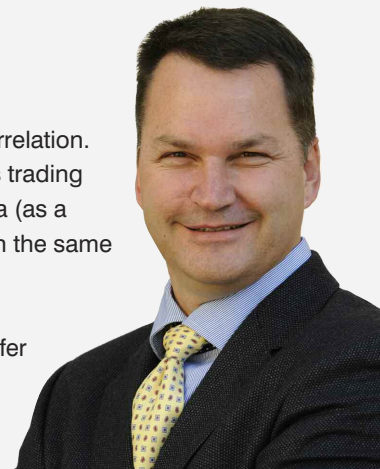
But what have you seen from local managers investing in other developed markets, to what extent do you see that or not see that?

Kobus Esterhuysen: In the last 18 months we have seen hedge fund managers directing focus away from South Africa to developed markets. The managers went through a **very conscious expansion of horizons**. It's about using current investment processes but increasing investment opportunities in developed markets and diversifying the investment universe. As prime broker we have seen a substantial increase in the deal flow to developed markets.

Our take on it is two-fold.

Firstly, the South African investment universe is quite limiting in potential diversification and correlation. The high correlation across asset classes is a result of a liquid currency. International investors trading macro portfolios can heavily influence asset prices by moving capital into or out of South Africa (as a liquid proxy for other developing markets). These macro trends affects all local asset classes in the same direction.

The other element comes down to competition which necessitate managers to diversify and offer a global product range to local investors.



Nik Michalopoulos: We have been investing in global strategies with internal funds for a while, having recognized the opportunity that the globe represents as an investment universe and that we have the skills and opportunity to trade it.

There is inevitably the question of whether it is possible to invest globally out of a country like South Africa. The commonly held view that we have come across is that in order to trade a global strategy you need to be positioned somewhere like London. We don't agree with that because we don't believe that sitting in a different location necessarily gives you a strategic advantage to investing. We have seen that the advances in technology have created access to market and company information that was previously unheard of. So we like the opportunity.



One of the challenges for us is how we actually take the opportunity forward as a business particularly with the limitations imposed by Section 65. Specifically Section 65 requires a fund to operate in a jurisdiction that has regulatory equivalency to that of South Africa, however these jurisdictions are often prohibitively expensive to establish funds there.

Udesh, please forgive all these questions being directed to you, but one of the questions that occurs to me is, given the fact that you have South African fund managers which fall under the FSB as investment managers, is there a case for a type of voluntary regulation by the FSB being chosen by a fund manager of a fund or structure that would give you the ability to have oversight and regulation?



Reach Your Target Investors and Generate More Leads

Leverage Harvest's AI platform to get discovered, increase brand awareness, cultivate leads, and unlock customer insights.



Exclusive Offer!

Sign up for a Harvest marketing package, receive a custom-produced OpalesqueTV video to share your firm's message.

Who is on Harvest?

142,000+
MONTHLY VISITORS

24,000+
PUBLISHED INSIGHTS

71%
ACCREDITED INVESTORS

TRUSTED BY THOUSANDS OF TOP INVESTMENT FIRMS



BLACKROCK



LEGG MASON
GLOBAL ASSET MANAGEMENT

PIMCO



Produce content through Opalesque.TV

Opalesque.TV produces hundreds of manager videos for the industry's biggest names. Enhance your brand and SEO through highly engaging, professionally produced video content.



Schedule a call to learn how Harvest and Opalesque can help your firm get more leads: sales@hvst.com

Udesch Naicker: The thing is that the issue around voluntary regulation ended with the introduction of the hedge fund regulations in South Africa. Once we let people operate outside of the ambit of that framework, we effectively lose track of what is going on. It's impossible to establish standards and possibly even less so to achieve accountability, and that's the whole purpose of regulation.

And if you don't have the accountability or you can't enforce that accountability, then you actually have nothing. So it is a challenge.

In many ways this also refers back to what Kobus mentioned earlier around incubation and the difficulty for entrepreneurial managers to take off. We would be naive to presume that any business is able to start without a fair bit of cost, and then secondly, we have also got to bear in mind that the size of our market is limited, and that new entrants are obviously going to be hampered by the fact that there are existing established players. So are you looking at new investments or are you looking at displacement from those existing managers? If we had sufficient growth in the economy, I can't see why it will be problematic for new managers to start up. This would be a function of your economic wellbeing, so to speak, of the country as a whole. So therein, for me, lie some of the challenges.

But equally I think there should be some willingness for the existing managers to incubate those new skills. And that is why we adopted that model of a platform of enabling asset managers to host themselves in existing manager platforms. The idea being that economy of scale is important and eventually those costs will come down if you have enough of them on the platform.

Now, whether that actually plays out in reality again, who knows? That was the noble intention, but I guess it's got some way to go before it proves itself.



Tony Christien: You are certainly right, Udesch. From our perspective as an administrator we have seen new managers wanting to come to market. The first pitfall is that guys have to have a license, and in order to do that they need to be in a bigger house and under supervision.

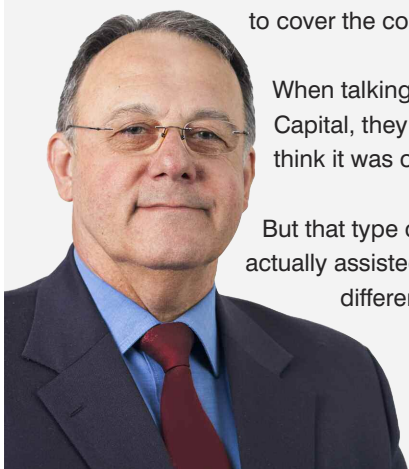
But then you get managers that have generally been able to either access to a little bit of money or make a little bit of money themselves while they were undergoing their supervision. They actually come to us and say, "I have five million rand, and for the next 18 months I want you to administer that five million while I generate a track record".

And once that has happened, they can then decide to move the fund into the regulated space. I am prepared to cover the cost to get to where I wish to be, but there are not many guys like that.

When talking about access to capital, if you go back 10 years and you look at someone like Edge Capital, they acquired huge amounts of cash from various pension funds in a very short space of time; I think it was over 12 months. And they were seeding managers with over 100-150 million rand.

But that type of opportunity doesn't come around very often, and that was very beneficial because we actually assisted a lot of managers startup in the unregulated space, and those managers are still here in different capacities.

I believe the point was made by Kobus earlier. Unless we are able to do these kinds of



things, as an administrator we are also prepared to charge a lower fee for a period of time, we will not see many new managers being able to come to market. Unless we have growth in the industry with new managers and perhaps have new strategies as well, we end up just like a cooking pot where you just boil and boil, but without new ingredients coming in, over time you just end up offering the same meal over and over again.

Udesh Naicker: I take your point, Tony. Again, as regulators, we are not closed to suggestions around how one might want to grow the industry. For example, currently I maintain a running list of issues that in my mind require or may require revisiting at the first redraft of these regulations.

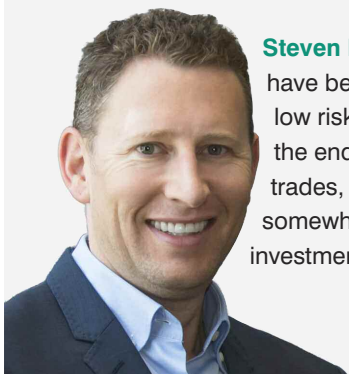
Because obviously with the first versions, some things can also go wrong, there are unforeseen consequences of the regulation, but this will not prevent us from considering new ways of accommodating growth, and I would actually welcome it.

However, this also has to be done within the ambit of understanding that we are not the policy setters; we merely oversee the regulation, and we would have to go through the necessary processes to get any changes to legislation approved. *It's by no means a promise, but if one of the options were to be a lower fee base or an exemption from certain fees for an incubated portfolio for a certain amount of time, I am sure that can be looked at*, provided that there's no risk or there's certainly heavily mitigated risk of public loss from such an endeavor. But certainly, those are the kinds of things we welcome and we would definitely look at.



Matthias Knab

Steve, you mentioned you have a new fund in the making, can you tell us more about it?



Steven Liptz: The idea for that fund was born a while back when markets were more difficult than they have been the last month or two. We saw an opportunity to actually hold cash and look for selected low risk, potentially high return opportunity for a short period of time and then reverting back to cash at the end of that opportunity, while at the same time augmenting that with certain market-neutral type of trades, but not in the typical market-neutral format. It would be more concentrated, but just in order to somewhat reduce that concentration. There would be a balance, not fully invested, but a balance of investments which would be along the lines of a more market-neutral, traditional market-neutral approach.

Kobus Esterhuysen: Interestingly, the CIS regulation initiated a new category of long only equity funds. Previously regulation required that the traditional long only collective investment schemes have a diversified portfolio. We have recently seen a number of startups using the CIS hedge fund regulation, not necessarily for gearing or shorting or managing a long/short fund, but purely using the opportunity to set up a *more concentrated focused fund in the listed equity space*. These funds have the ability to add moderate gearing. Here you have funds that are long-only but is using the more relaxed investment limits of new regulation to create unique products.



Tony Christien: Another trend we see as an administrator is a good number of credit funds coming to market, not in the regulated space, but **credit type funds** which are attracting investment from institutional investors.



These are different types of credit funds that try to lock in a certain IRR, and, the ones that I have seen are compliant in this regard. They invest only in Triple A debt, and the returns are measured, but good. Institutional investors can use those type of funds almost as an additional hedge, based on that static return they know they are going to receive and so they can build a portfolio around that building block.

Kobus Esterhuysen: Yes, we have seen similar activity in the credit market. The South African corporate credit market is not well-developed. Over many decades managers were looking at that market. From an availability and liquidity point of view there is little opportunity.

We have seen hedge funds exploring the higher end of the credit market. For example bank credit are traded versus government credit. In our market there are good spreads embedded in this credit trade. The spread is then geared several times.



Udesh Naicker: Earlier in 2017 we also looked at some credit type funds, mainly asset-backed credit. I hear what those funds are doing around the higher end bank credit and government debt. That is doable I suppose as long as it's properly managed. But the thing we steer clear off is anything that even resembles a CDO. We would obviously have to put the brakes on that immediately as we wouldn't allow it. So just as a word of caution, if you see it, do let us know.



Steven Liptz:

One of the things we mentioned earlier as potentially an area for more potential for the industry is around the Regulation 28 limits for hedge funds. Is there any potential for more flexibility?

Udesh Naicker: We need to bear in mind that Regulation 28 applies to pension funds, it has nothing to do with hedge funds. It stipulates what a pension fund can go into and the kinds of limits that apply.

So the short answer is 'no' because it has nothing to do with hedge funds in the first place. However, one of the things that I would have liked to have seen is a bigger allocations to Regulation 28 compliant funds on the pension side.

Now, *one thing to look at is why there may be reluctance for pension funds to put any money into hedge funds.* They are allowed a 10% allocation, so we are talking about an industry worth a few trillion rand making a sizeable allocation to hedge funds.

The cynical view that has been expressed to me by some managers is that the consultants to the pension funds actually have no vested interest in making that allocation and/or that they don't actually understand how hedge funds work. So again, we as the regulator can't drive that allocation; that is something the industry has to drive.



Steven Liptz:

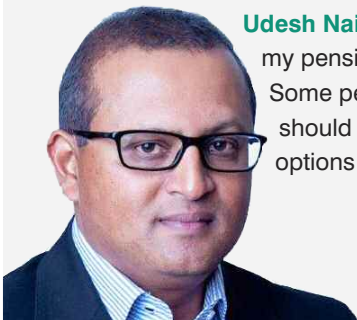
Which leads directly into opportunities. Udesh mentioned a few trillion rand of opportunities while the South African hedge fund industry is at tens of billions, so that's pretty massive.

Udesh Naicker:

So the current 10% threshold in Reg 28 is really all you need. You don't need more. In fact, with a 5% allocation you would see a massive uptick in AUM for the hedge fund industry.

Steven Liptz:

Right, and if that would happen, then of course one thing leads to another, and then private investors would then also do more. It could be a positive cycle that builds on itself.



Udesh Naicker: Well, more importantly – and I use myself as a typical consumer and I look at the returns my pension fund gives me – some of the pension fund returns are rather on the lower side or even flat. Some pensioners may think they could have done better on the market themselves, so they obviously should be looking for some sort of kicker on their return. Surely hedge funds should be one of the options that offers that upside.

Kobus Esterhuysen: We have mentioned the pension funds investment into hedge funds. Just to clarify, regulation permits retirement funds a 10% allocation to hedge funds with a sub limit of 2.5% per specific hedge fund. **The reality is that not even 1% of South African pension fund assets has been invested into hedge funds.**

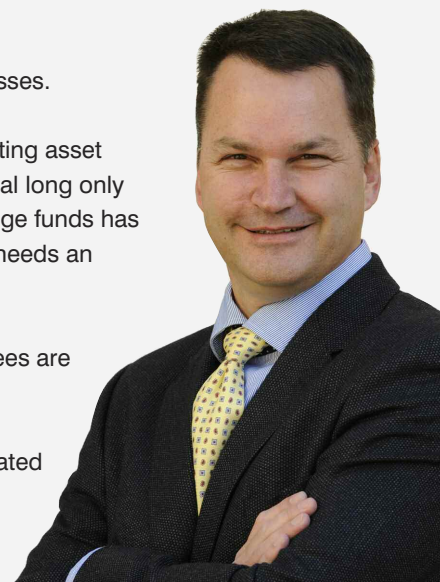
We interact with pension fund consultants on a regular basis. Their feedback is that there are two reasons *why there haven't been large pension fund investments into hedge funds.*

Firstly, hedge fund returns have not been noticeably better than the traditional assets classes.

Secondly, many of the best performing hedge funds have a high correlation with the existing asset classes. If you are a pension fund you probably need to choose between a pure traditional long only equity or a hedge fund. Assume the competing products have the same return. Now hedge funds has several new features that the trustee may not be comfortable with. Then the hedge fund needs an uncorrelated return to the current asset classes to justify investment in hedge funds.

Many pension fund trustees also ask conceptual questions whether the value add after fees are sustainable.

As a hedge fund industry we need to challenge ourselves to deliver competitive uncorrelated returns.



Nik Michalopoulos: We have spoken a lot about the need for inflows and where can the industry get inflows and new managers. But there are also some concerns on the flip side of this. For example, it is commonly understood that capacity to trade certain strategies in the South African investment universe is limited. It is crucial for the industry to survive and thrive that we are able to continue to deliver the returns that have made this industry a success story over the last decade. This may come with a requirement for fund managers to continue to innovate and expand their trading capacity to continue to deliver strong returns, whether this is through including global trading capabilities within their solutions or innovating locally. We are confident that South Africa has great hedge fund management talent and that the industry will continue to be good stewards of investor's funds as the industry continues to become more mainstream and attract more attention in the market.



Matthias Knab

Any final comments about the outlook for South Africa and its investment industry?

Steven Liptz: I think there are a few things that will affect us. One is stability in South Africa, both economic stability and political stability. There are currently challenges around both of those, and so at the same time they also have upside potential.

We also mentioned that there is a lot of scope when it comes to the pension fund regulation and Reg 28. We touched on the ability of unit trust to invest into hedge funds.

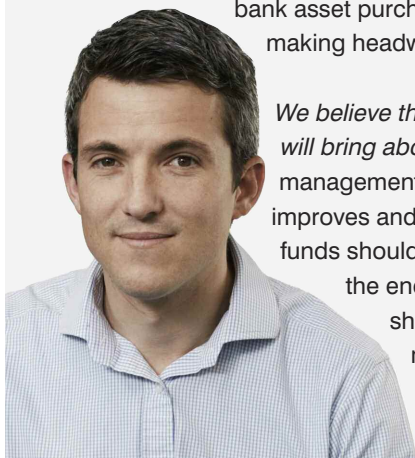
Returns also depend on markets, which are cyclical. The markets have been tough for a while and the returns have been tough. So maybe after the tough times, better times lie ahead.

And lastly, time is an important consideration in all of that. I believe our industry will see healthy growth with the passing of time.



Jacobus Lacock: We are currently in one of the longest economic cycles in history; second longest or third longest ever. Towards the middle to end of 2018 the overall size of the G4 central bank balance sheet may start to decline as central bank asset purchase programs stop or fades. At the same time more and more developed central banks are making headway into raising interest rates after years of zero interest rate policy.

We believe the reversal of unconventional monetary policies and flows that went into assets since 2009 will bring about more volatility and sector / asset class dispersion. In such an environment active management and alternative strategies may perform well as the scope for security and sector selection improves and hedging and diversification strategies start to play a bigger role. We believe alternative funds should continue to perform well in this environment while traditional equity markets gets closer to the end of this economic cycle. In South Africa, the scope for economic and political reforms should provide opportunities for fixed income managers as risk premiums normalise and monetary policy turns pro-cyclical.





DON'T MISS OUT

ACTION REQUIRED

Business decision makers LOVE online video because it gives them the most amount of information in the shortest amount of time.

– Bob Wies / President MV Digital

When done correctly, all you need is one video to build up highly targeted traffic for a really long time.

– Carey Lowe / Marketing Consultant

Video marketing is the most effective way for you to get someone's attention and engage them for a substantial period of time. Keeping someone engaged is the best and quickest way to gain their trust. Gaining trust is the only way to convert your audience into happy, long-term clients and customers.

– David Grimes / Marketing Manager

Video solidifies your online presence while building deep and meaningful relationships with your customers. It adds a personal touch to your brand while increasing your conversions! Videos are now an expected component of any website.

– Lilach Bullock / Marketing Consultant – Forbes top 20 women power influencers

It's more effective:

Video attracts two to three times as many monthly visitors, doubles their time spent on the site and has a 157% increase in organic traffic from search engines like Google.

– Marketing Sherpa

And more cost effective:

Video promotion is 600% more effective than print and direct mail combined.

– Diode Digital

One minute of video is worth 1.8 million words.

– *Forrester Research*

Video content can increase the chances of front page Google ranking by 53 times

– *Cisco*

And did you know that:

Online video is shared 1200% more times than links and text combined.

– *Simply Measured*

75% of executives watch videos while working.

– *Forbes*

"The Opalesque videos are a clever solution to the persistent problem of getting to know managers' style and philosophy within a dizzyingly large universe of possibilities and with increasingly limited time. More managers would be wise to step out of their 20th century shells to embrace the new economy of communication technology to find more efficient ways to convey their story and message to existing and prospective investors."

Adam Choppin, Manager Research & Investment Strategy of FIS Group

Opalesque videos are regularly featured among the best in any top 10 or top 20 hedge fund / investor video ranking, such as this one which lists 4 Opalesque videos out of a total recommended of 19 videos.

Opalesque started shooting manager videos in 2009 – you will probably know that **Julian Robertson, Izzy Englander, Jim Chanos, Jeffrey Ubben, Danny Yong, Elena Ambrosiadou**, and **many other hedge fund legends** have produced videos with Opalesque. We have also produced videos for some of the **biggest institutions** as well, such as **Morgan Stanley, State Street Global Advisors, M&G Investments.**

Save up to 50% in travel costs by making your first meeting the second one

Have you ever spent time and money to take a trip to present your fund, only to hear, *"Thank you for coming to our office, and please keep sending me your reports ..."*?

What if you had known before that the investor is looking for something else?

By sending their video to prospects **before the meeting**, the manager wins twice. Should the investor be looking for something else, the manager can focus his efforts on those investors who watched the video **and liked** what they saw.

In these cases, managers tell us that the first real meeting becomes more like a 2nd meeting (the 1st one being the video) as the groundwork has been laid and the meeting will be much more successful and achieve much more compared to a regular first meeting. By better **qualifying your leads**, you can basically halve your travel budget and raise more assets quicker.

Compliant

- Opalesque.TV videos are produced to comply with your regulatory requirements
- Allow for true reverse solicitation

You're in control

When you're doing a custom Opalesque.TV video, you have full control about any aspect of your message. This is not a given in any other regular media coverage.

A manager portrait on Opalesque.TV is generally designed to simulate a first time meeting with a prospective investor, meaning that questions like the following will be discussed:

- Please introduce yourself and your firm
- What is special about your strategy?
- How are you different from your competitors?
- What else is important regarding the asset class?
- Opportunities you focus on

Working with a trusted partner

Over 1.3 million people have watched one or more Opalesque.TV videos, which means that the people you may be targeting will already be familiar with Opalesque.TV videos.

Managers like **Julian Robertson, Izzy Englander, Jim Chanos, Jeffrey Ubben, Elena Ambrosiadou, Anthony Scaramucci**, and many others have done Opalesque videos, as well as institutions like **Morgan Stanley, State Street Global Advisors, M&G Investments**.

Broad distribution

You can either produce a private video with us, which will only be hosted on the non-public part of your website, or we can offer you the broadest possible multi-channel distribution on Opalesque.TV and our partners like Reuters and other leading platforms. Contact us to discuss your custom distribution package.

Managers have **quadrupled assets** thanks to our video (\$700m to \$2.4bn in 1 year) and also received a book contract or **invitation to speak at the World Economic Forum or at TED** through our video:

- View count: Over 1.3 million views (hundreds of thousands of people)
- Thousands of investors will view your presentations
- Longterm effect: Views do not drop significantly over time
- Without investing a single additional minute of your time – time required to record a video is approximately 90 minutes.

Costs

For a 10 minute video the all-inclusive package price is US\$10,000 which includes: travel (Europe and NY tristate), full production at your office, multiple edits (cuts), provision of the final video file, and a global, multi channel distribution package. A 15 minute video is \$15,000, so \$1,000 will be billed for each additional minute above 10 minutes. The client determines the final length of the video.

Links

Opalesque.TV video which got 104 views over 2016 Christmas:

<http://www.opalesque.tv/hedge-fund-videos/patrick-stutz/>

Opalesque.TV videos sorted by number of views:

<http://www.opalesque.tv/most-viewed-hedge-fund-videos/>

Opalesque.TV videos sorted by number of social media shares:

<http://www.opalesque.tv/most-shared-hedge-fund-videos/>

Contact

Matthias Knab
Founder
Opalesque Ltd.
www.opalesque.com
Email: knab@opalesque.com
Tel: +49-89-2351-3055
Mobile: +49-170-189-0077

