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The *long* and the *short* of it
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BAML appoints new cap intro chief in PB shake-up

Elizabeth Hammond named head of cap intro for the Americas as PB industry focuses on increasing value

BY ELANA MARGULIES

BANK OF AMERICA Merrill Lynch (BAML) prime brokerage has promoted Elizabeth Hammond to head of capital introductions for the Americas, following an earlier *HFMWeek* report that the role's former incumbent was to leave the firm, and as primes in general use personnel shake-ups to maximise returns.

According to an internal BAML memo seen by *HFMWeek*, Hammond, who worked for three years in a senior-level role in capital introductions, will deepen relationships with existing hedge fund clients and expand BAML's US prime brokerage business overall. She will also be in charge of the US Capital Strategy team.

Hammond, who will report to Michael Terry, global head of the capital strategy group, replaces Justin Fredericks, whose departure to pursue a new venture in the next couple of weeks was revealed by *HFMWeek* earlier this month.

The re-organisation at the top of the BAML's cap intro division comes as many prime brokers re-focus the structure of their service and evaluate the best way to add value in an increasingly competitive market.

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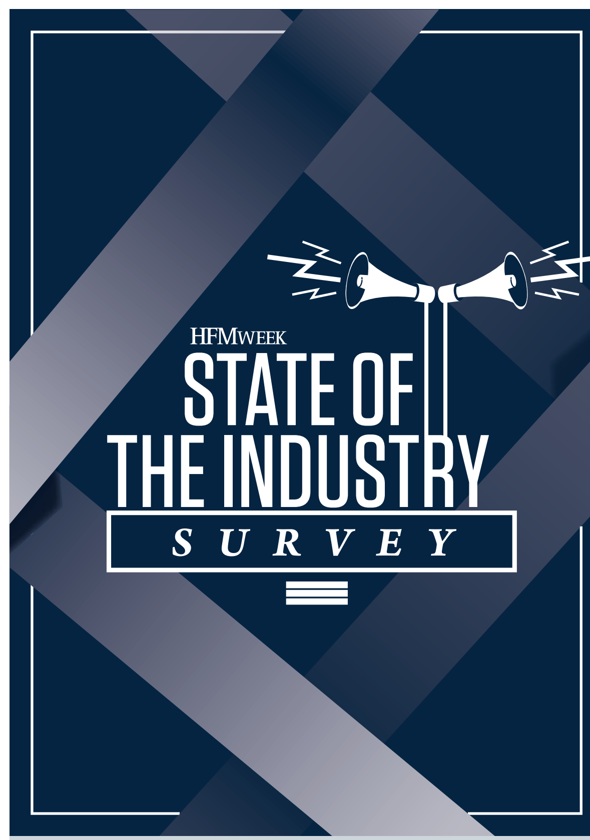

Halfway through 2012, *HFMWeek* canvasses opinion on what the next six months holds for hedge funds

FEATURE 18

FOCUS ON

ADVANTAGES OF ONSHORE DOMICILES

As waves of regulation hit onshore jurisdictions and investor expectations continue to mount, decisions concerning where to domicile a hedge fund become more and more pressing. *HFMWeek* talks to three industry experts about the advantages of onshore domiciles and how these times of transition are redefining the way hedge fund managers do business

Lachlan Roos is a partner at PwC and is the UK tax hedge fund leader. Lachlan focuses on advising the alternative investment management industry and is responsible for a portfolio of high-profile and well-established global hedge fund and alternative investment clients.

Q HFMWEEK (HFM): HOW WILL THE REGULATORY CHANGES FACING THE INDUSTRY AFFECT THE DECISION TO DOMICILE AND TO WHAT EXTENT IS REGULATION MATERIALLY AFFECTING THE NUMBER OF FUNDS ONSHORE?

A LACHLAN ROOS (LR): While regulatory change is undoubtedly influencing decisions on where to domicile a fund vehicle, the more important factor is pressure from investors. Key institutional investors are increasingly finding comfort in the greater regulatory oversight and perceived improved transparency of so-called 'onshore' jurisdictions (for example, EU jurisdictions). The impending Alternative Investment Fund Managers Directive (AIFMD) may influence decisions on domiciliation, but the proposed third country (from July 2013) and EU passport (from 2015) provisions suggest that offshore jurisdictions such as Cayman Island will remain as popular as ever. This is because they tend to enable funds to be established quickly and cost effectively in a fiscally neutral manner, which investors know and understand.

A FRANÇOIS PFISTER (FP): The regulatory changes are very substantial and will bring structural changes that will affect all jurisdictions, whether onshore or offshore. While there is more regulation in the onshore world, offshore jurisdictions will be indirectly affected by it. Certain investor groups are generally geared towards more regulated structures, meaning that the onshore world is gaining momentum with such categories of investors; particularly institutional investors dealing within imposed asset allocation strategies.

A GUENTHER DOBRAUZ-SALDAPENNA (GDS): Regulation has the power to establish dominant designs. We have, for example, seen this in the retail funds space following the introduction of the Ucits standard. EU initiatives such as the AIFMD clearly aim, initially, to bring money managers' management entities under onshore oversight and in a second step to have them onshore their products. This regulatory push, combined with a slightly delayed market pull based on altered investor requirements, will most likely lead to more funds being set up or migrated onshore. US initiatives such as the Dodd-Frank Act also lead to increased complexity and administrative burden for offshore products and might reinforce an onshore trend.

Q HFM: HOW ARE ONSHORE DOMICILES DEVELOPING IN LIGHT OF GENERAL CHANGES IN THE HEDGE FUND INDUSTRY, SUCH AS INSTITUTIONALISATION AND REGULATION, AND HOW WILL THEY DEVELOP IN THE FUTURE?

A LR: Onshore fund domiciles are getting more attention with 'traditional' jurisdictions such as Ireland and Luxembourg continuing to be the onshore domiciles of choice. However, there is increasing competition among onshore domiciles to attract new funds. The UK has been making incremental changes to its regulatory and tax regimes in an attempt to become competitive in the onshore market. For example, the proposed introduction of a Tax Transparent Fund could be beneficial for the UK as a fund domicile. However, it is unlikely to be appropriate for hedge funds. To truly capture the hedge fund market, the UK would need a fund that could (at least):

- be part of a master/feeder fund structure to accommodate different types of investors;
- have fiscal neutrality including increased certainty over the treatment of trading income;
- be free from stamp duty or other transaction taxes.

All of the above would need to be combined with increased certainty and stability.

That said, recent changes to the controlled foreign company (CFC) rules, together with other changes such as dividend exemption and nil withholding tax on dividends paid by a UK company, mean that the UK has become increasingly competitive as a suitable domicile for special purpose investment vehicles (SPVs).

A FP: Jurisdictions have different approaches to institutionalisation and regulation, leading to more diversification across jurisdictions. Global asset managers today do not choose one jurisdiction over another. Rather, they have a presence in several jurisdictions with specific vehicles tailored to specific needs.

A GDS: By and large they are profiting and growing. Over the past 24 months we have seen a significant number of funds that were originally set up offshore migrating onshore. This is largely accomplished by way of continuation, in order to preserve the funds' historic track records. In some instances, we also see parallel structures benefiting from both onshore and offshore structures

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Liechtenstein's Government House, in Vaduz. Swiss managers are currently extremely interested in Liechtenstein.

> "THE INVESTMENT INDUSTRY HAS BECOME SO MUCH MORE SOPHISTICATED THAT WE NEED THIS DIVERSITY OF TOOLS, JURISDICTIONS AND REGULATIONS"
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being established. We have also noted increased interest in master-feeder structures to bridge the two worlds, but actual implementations are still low. New Ucits structures employing swap-based on/offshore funds also continue to be of interest, but the distribution advantages are often offset by significant tracking errors. Luxembourg and Ireland continue to dominate the market, but Malta is also becoming popular. Swiss managers are currently extremely interested in Liechtenstein which, due to its proximity, offers the possibility to realise an effective place of management and hence has the clear potential to become a significant location for Swiss-based AIFMs and their products once the principality's AIFM Law enters into force in 2013.

Q HFM: WHAT ARE THE KEY BENEFITS TO DOMICILING A FUND ONSHORE AS OPPOSED TO OFFSHORE?

A LR: The improved perception of transparency and oversight that comes with increased regulation, access to double tax treaty networks, and arguably, a more positive brand image for the fund are key benefits. However, it should be said that most of these benefits can still be gained in an offshore context with appropriate structuring.

A FP: If you are looking for a brand as an asset manager or even a hedge fund manager, you may want to benefit from the Ucits brand, which is being exported to Asian markets in particular. If you are a Ucits-compliant fund, you benefit from a passport in the EU, and that may prove to be very beneficial in terms of distribution. These are clear advantages of being onshore in the EU. In future, the same may happen with the AIFMD brand – the downside is the cost. Many non-EU investors say they don't want the burden of the cost of their EU co-investors on their shoulders. They would prefer to keep their structure separate from EU structures, so there could be a trend towards a multiplication of parallel offshore and onshore fund structures under a single manager. However, it must be said that we need both worlds, as they respond to different needs. The investment industry has become so much more sophisticated that we need this diversity of tools, jurisdictions and regulations.

François Pfister is a partner at Ogier Luxembourg. Graduating with degrees in law, economy and finance, François opened Ogier's Luxembourg office in April 2012. Besides being a Lawyer, he is also the director of several regulated investment funds and has a number of memberships, including ALFI (Luxembourg Fund Association), the Luxembourg Private Equity Association (LPEA) and the Monterey Funds Club.

A GDS: With EU onshoring, the role of the custodian in alternative investment funds will be strengthened under AIFMD and will thus add more control (and incidentally more liability). At latest, following the abolishment of the national private placement regimes in the member states of the EU harmonised market, the combination of a licensed AIFM and an onshore AIF is expected to generate significant distribution benefits. We believe that for certain institutional investors, onshore vehicles will become, if not a requirement, at least a preference and this might lead to better positioning in the competition for assets. We are certain there will always be a market for offshore funds. The key is in knowing which vehicles are best suited for which strategies, investors, distribution channels and desired positioning.

Q HFM: WHAT FACTORS SHOULD INFLUENCE THE DECISION TO CHOOSE ONSHORE OVER OFFSHORE AND HOW HAS THIS CHANGED IN THE PAST 12 MONTHS?

A LR: We consider that there are two key points that influence the decision on domiciliation: key investor preferences and regulatory impact. We have seen a number of funds re-domiciling to onshore locations. However, this has typically been due to key investor demands. An alternative to re-domiciling is the establishment of sister onshore funds that mirror the strategy and investments of the existing offshore fund, but give investors the opportunity to invest in an onshore vehicle. We have seen a greater shift in the past 18 to 24 months; prior to this time, hedge fund managers would not have seriously considered using an onshore vehicle. Despite this shift, in the start-up market it is rare to see an onshore fund being used, typically due to lower costs and ease of setting up offshore.

A FP: Generally speaking, the offshore world is accommodating alternative strategies, is more self-

The London City skyline. The UK has been making incremental changes to its regulatory and tax regimes in an attempt to become competitive in the onshore market.

regulated and focuses on disclosure, while the onshore world is more investor-focused and market intrusive. This trend dates back to the financial crisis. If you want to have a passport you go for a Luxembourg-based fund, for example. If you don't need a passport, and you don't have EU investors, you would choose to go offshore. Sophistication is definitely an element, as there are more criteria now for deciding where to establish your presence. Also, the idea of a fund manager with one presence in one jurisdiction is a thing of the past. There will be more diversification and more multi-jurisdictional set-ups in the future.

A GDS: Funds are vehicles for investment strategies. The variety of structuring and domiciliation options has to be viewed purely as horses for courses. The only truly relevant factors are: the ability to efficiently and effectively deliver the fund strategy; compliance with investors' requirements; and regulatory sustainability. Institutional quality in Europe increasingly means onshore domiciliation.

Q HFM: WHAT SERVICES DO YOU OFFER FIRMS LOOKING SPECIFICALLY TO ESTABLISH FUNDS ONSHORE AND WHAT ADVICE DO YOU GIVE THESE FIRMS?

A LR: At PwC, with our global 'One Firm' approach we are able to provide the full range of professional services including tax, regulation, assurance and advisory in each of the onshore and offshore fund domicile jurisdictions, with specialist networks around the world to ensure that the clients' needs are met. We focus on meeting the commercial expectations of our clients with tax and regulatory efficient vehicles.

Dr. Guenther Dobrauz-Saldapenna
heads PwC Zurich's Asset Management Regulatory & Compliance Services practice. Earlier, he practised with Deloitte and as an attorney. He also was Legal Counsel to a VC/PE firm and to a hedge fund group. He holds a PhD in investment law, an MBA degree, and is co-founder of the Swiss Strategies Group.

A FP: We are able to offer the full range of business law services. The client comes to us with a strategy and we advise on the best structure. We are agnostic in terms of jurisdictional choice. What we want to achieve is the best device for our client. We provide expert jurisdiction-neutral advice on the most suitable fund structure to choose. If it is in Luxembourg, my team would give advice on the vehicle, seek regulatory approval and assist during the whole life of the fund until its liquidation. Ogier Group also offers fund administration services.

A GDS: PwC Switzerland, in close collaboration with the international PwC network, is able to offer comprehensive services in areas such as conceptual fund design; multi-jurisdictional tax and legal structuring; support in the authorisation of products and managers; tax reporting; as well as audit services. Our aim is to ensure the sustainability of set-ups in a changing environment. The continued convergence of the tax and regulatory realms increasingly limits structuring options, but at the same time it opens up opportunities for those who are prepared. Whatever the case, we advise clients to put the investors at the core of all considerations. Here, the difficulty lies in anticipating their potential future requirements and distilling that knowledge into specifications for sustainable structures.

Q HFM: WHAT ARE SOME OF THE MAIN DIFFICULTIES ONSHORE FUNDS WILL FACE IN THE NEXT 12 MONTHS AND HOW DO THESE COMPARE TO OFFSHORE FUNDS?

A LR: The changing regulatory environment, including continued uncertainty around the implementation of AIFMD, future organisational tax obligations (for example the proposed EU Financial Transactions Tax and FATCA), and GAAR applications will continue to challenge hedge fund managers in the next 12 months. European onshore domiciles will face increasing competition from global offshore jurisdictions.

A FP: The main challenge for onshore funds is adapting to changing regulation and to investors' changing requirements in relation to disclosure, transparency and protection. Managers should focus on managing portfolios, but it has become more and more difficult to concentrate on this primary role of providing return. The regulatory environment and a difficult fund raising and leveraging environment have increased the cost of entry, particularly for smaller players or first funds.

A GDS: There is still some uncertainty about the ultimate shape of the new onshore regulatory environment, since a lot of the implementation is still a work in progress. Keeping up with the anticipated changes and responding to them will be a demanding task. During the 2008 crisis, offshore authorities who, by and large, have greater experience with alternative products than their onshore counterparts, often had a better grip on tackling the issues that arose from general liquidity problems – such as side pockets and gating. Should a similar situation unfold as a consequence of the current crisis, it unfortunately has to be anticipated that this scenario will recur. ■