UCITS – THE KEY CONSIDERATIONS

RICHARD DAY OF **ML CAPITAL** DISCUSSES THE KEY QUESTIONS MANAGERS SHOULD BE ASKING THEMSELVES PRIOR TO LAUNCHING AN ALTERNATIVE UCITS FUND

Richard Day
is chief operating officer of ML Capital, investment manager to the MontLake Ucits platform. Prior to joining ML Capital in 2010, Day spent the first ten years of his career at Morgan Stanley working within asset management, international equities, operations and technology.

It is important before embarking on a Ucits fund launch that hedge fund managers ask themselves the following key questions:

Do you have committed seed capital?
The 'build it and they will come approach' is likely to lead to a lot of expense and wasted time – before embarking on any significant amount of work, it is important to have a firm idea on where the seed capital is coming from. Generally, we find that existing hedge fund managers consider launching a Ucits structure as a response to investor demand, however, in order to be a viable option managers need to have $25-$50m in committed seed capital.

Do you have a clear strategy on how you are going to increase assets under management once launched?
Approximately 90% of alternative Ucits funds are sub-$100m, however 90% of the allocators to alternative Ucits funds are looking at funds in excess of $100m. Therefore, having a strategy to reach that sum is very important and having a cornerstone investor is invariably not enough. The ongoing total expense ratio (TER) of a fund can have a huge impact on asset raising so it is important to have a clear strategy on how you will grow AuM to reduce the TER. A further consideration is that the 2/20 fee model doesn't fly; a lot of allocators are simply not willing to pay this.

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Does your strategy work within Ucits rules?
Specifically, what changes if any will you need to make to the strategy to make it work and how will this affect performance – both on a backward-looking basis in terms of your track record and on a forward-looking basis in terms of your ability to generate returns?

You need to work out how to gain the sufficient knowledge to understand the rules in detail, as this will have a direct impact on your ability to run the strategy within the Ucits framework.

Are you equipped operationally to manage a Ucits fund – either on a standalone basis or as part of a platform solution?
Ucits funds are typically managed on a daily NAV basis and there is a raft of new regulatory considerations that need to be taken into account. It is often a custody-led model as opposed to a PB-led model, so managers need to understand the difference between the two offerings.

If the answer to any of the above questions is 'no', you are likely to fail before you have even started. If the answers are 'yes', then the question is how do you proceed to ensure the greatest degree of success?

Should you go it alone or seek help from a partner?
There are a plethora of organisations that will offer to help you figure out the best Ucits solution for your organisation (while often positioning their own services in that very solution): independent consultants, onshore and offshore fund lawyers, PB consulting teams, administrators, custodians, the list goes on. Ultimately, the decision to either go it alone and launch an independent fund, or partner with a Ucits platform and launch a sub-fund on an existing umbrella should be driven by the need to build a successful distribution strategy and to cater for the operational demands of running a Ucits fund. If a manager considers those two core areas, they will be better placed to come up with solutions that work for them and give them the best opportunity to be successful.

What does it take to get a fund up and running and become successful?
Simply put, it's time, money and expertise, with the latter driving how long it will take, what it will cost you and how successful you will be.

How do you build a successful distribution strategy?
It is important to understand from the onset what you are ultimately targeting. Something that is core to us at ML

Capital is the opportunity set: are you looking to penetrate the $200bn and rising alternative allocators to Ucits or is the $7trn mainstream Ucits allocators what you are really after? The latter is where the bigger opportunity is, but it is also typically harder for the average hedge fund manager to penetrate.

Before you even begin to sell your Ucits fund, there are many operational areas to consider. A common misconception of many hedge fund managers is that by launching a European onshore regulated fund you are immediately open for public sale in the key markets in Europe. The reality is far from this and a lot of work needs to be done to get yourself operationally ready. Consideration needs to be given to country registrations, tax reporting in key markets and access to the key platform providers that control so much of the investor flow, for example.

Once ready operationally, you need to have the resources at your disposal to sell the fund – resources that understand the intricacies of each of the core European markets (such as the UK, Germany, Switzerland, Italy, France), have the ability to converse in the native language and have access to the key decision makers.

Selling Ucits funds is very much a long game; it takes a lot of time and effort.

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How do you cater for the operational needs of running a Ucits fund?

Are you sufficiently regulated to manage a Ucits fund with discretion? Do you have permission from your home regulator? And are you able to get yourself authorised either in Luxembourg, Ireland or Malta?

Service provider selection is key – Ucits funds require operational expertise that is alien to many of the traditional hedge fund services providers. It is very much a case of long-only meets hedge, and avoiding the car crashes in the middle is crucial. In many instances, hedge fund managers will be moving from a monthly or quarterly NAV cycle to a daily NAV cycle, so they need to get themselves operationally prepared for this in order to be successful.

As mentioned on page 21, it is important to understand the difference between a PB-led model and a custody-led model – both in terms of fees and the level of support you receive. The PB model is often very hands-on, offering a lot of support, and while the custody-led solution is significantly cheaper, the level of hand-holding provided is greatly reduced. Many managers have struggled to get to grips with the operational intricacies of running a Ucits fund without the high level of PB support.

It is essential to get to grips with the Ucits rules; not just understanding them but also appreciating the consequences of getting it wrong, for example understanding the differences between advertent breaches and inadvertent breaches. Advertent breaches can end up costing managers a lot of money if they make a trading mistake that leads to a breach of the Ucits rules and causes the fund to make a loss; it can also lead to regulatory sanctions. The operational burden of running a Ucits fund on a small/mid-sized hedge fund manager is significant and should not be underestimated.

CONCLUSION

Hedge fund managers looking to enter the Ucits space should do so only after doing their homework. The opportunity is clear for all to see with $7trn of assets to be tapped into, however opening up that pool of capital is not without its challenges. If you can successfully navigate your entry point and build a long-lasting strategy, you can be very successful. ■