FUND INDUSTRY

Next phase for alternative funds

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Despite complaints about fees, **ALTERNATIVE INVESTMENT FUNDS** remain a popular choice. The cross-border fund specialist Luxembourg is benefiting and is beefing up its offering to fund managers.

Pressure to minimise the fees charged by investment fund managers has grown recently. The costs of "alternative" products such as hedge funds, private equity funds, real estate funds and the like have been under the spotlight, as these products are particularly costly to run. From time to time news emerges that large institutions are set to scale back their commitment to alternatives, but the overall evidence points to increased demand as investors seek original ways to generate financial returns. For example, total assets managed by the top 100 alternative investment managers globally reached $3.6 trillion in 2015, an increase of 3% on the previous year, said a recent survey by the consultancy Willis Towers Watson.

ADAPTING TO GROWTH

Further evidence is the buzz around the Luxembourg alternative fund sector. The specialist in cross-border distribution saw net inflows of €6.4bn into alternative investment funds (AIFs) in the first quarter of this year, out of a €43.4bn increase across Europe, said the European Fund and Asset Management Association (EFAMA). This resulted in total assets under management for AIFs in Luxembourg of €549bn, equating to 10.7% of the European market. This market share was two percentage points higher than that of Ireland, the Grand Duchy's friendly rival in the cross-border fund business. A total of 4,411 AIFs are domiciled in Luxembourg, the second-highest figure in Europe, with these funds run by more than 820 authorised or registered managers. If one includes funds sold to retail clients, regulated under the EU's UCITS directive, Luxembourg had total assets under management of €3.34trn in Q1 2016: 26.0% of the European market.

Such is the demand for AIFs in Luxembourg, that a lengthy backlog has developed at the local regulator, the CSSF. It is struggling to process requests swiftly, with some fund managers forced to wait months before being able to bring new products to market. The Reserved Alternative Investment Fund (RAIF) law that came into force on 1st August should ease the pressure.

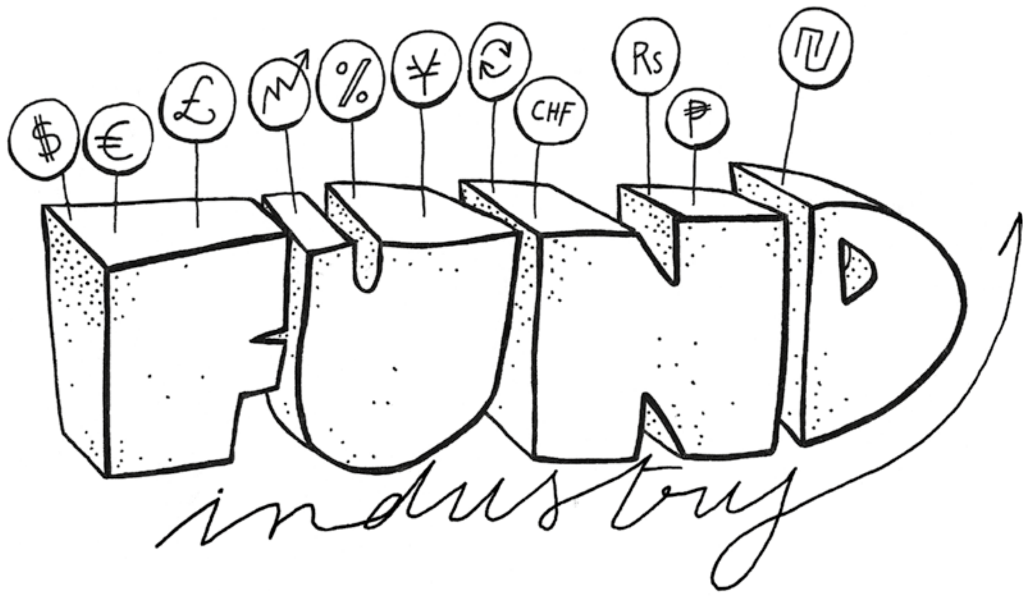
The problem originates with Luxembourg having added an extra layer of regulation to its interpretation of the EU's Alternative Investment Fund Managers Directive. EU law only requires that the management company be regulated, but Luxembourg also insists that the fund be supervised. The industry argued that this was often not necessary, as the vast majority of AIFs are sold to sophisticated investors (institutions or very wealthy individuals) who do not need regulatory protection.

LISTENING TO CONCERNS

The Luxembourg government responded to these concerns, worked with the industry and introduced the RAIF. Similar in structure to the country's venerable Specialised Investment Fund (SIF), the RAIF does not need prior approval and on-going supervision by the regulator if the end investor is demonstrably "sophisticated". Instead, AIFMD compliant fund managers (which can be based in any EU country) must submit regular reports to the CSSF about their RAIFs. With →

this in place, the RAIF is then granted an EU passport enabling it to be marketed without restriction across borders.

"*I understand from many industry colleagues that there is significant interest and demand for the RAIF,*" said Denise Voss, chairman of the Association of the Luxembourg Fund Industry (ALFI). "*Managers can set up their alternative investment funds as Part II UCIs, SIFs or SICARs if they prefer direct supervision of the fund by the CSSF,*" she said, but "*alternatively they can set up their alternative investment fund as a RAIF, thereby reducing time-to-market.*"



OPPORTUNITIES FROM BREXIT?
Brexit may also present some longer-term opportunities to the Luxembourg alternatives sector. For retail funds, the UCITS market is open to international players seeking to sell throughout Europe and beyond. Funds managed in the US, Switzerland and other non-EU jurisdictions are domiciled in Luxembourg or Dublin, the two main cross-border hubs and single market access is assured. The UK outside the EU would be able to follow a similar course, simply by conforming to European regulations.

The Alternative Investment Fund Managers Directive is less welcoming. Since coming into force in 2011, only fund managers based in the EU have relatively straightforward access to the marketing passport. This document enables them to sell around the single market without needing to gain regulatory approval in each country. However, non-EU countries have to find a way around this, with a favoured technique being to use in each member state of private placement regimes which mimic fund structures.

CHANGED ENVIRONMENT
There is the possibility of non-EU countries being granted a marketing passport. The European Securities and Markets Authority (ESMA) first gives a recommendation and then the EU decision-making bodies need to act. Last summer, ESMA said that Switzerland, Jersey and Guernsey were compliant with EU rules and could be given EU-market access, and Canada and Japan were added to this list in July this year. Applications from other countries (including the USA, Cayman Islands, Australia, Hong Kong and Singapore) received only qualified approval. At any rate, the Commission, European Council and European Parliament have not moved on last year's recommendations, so short-term access for non-EU jurisdictions is unlikely. Moreover, after Brexit there could be a hardening further of the EU stance, not least because the UK was the main large country pushing for a more liberal regime in EU decision-making forums.

The conclusion may be that non-EU fund managers come to think that they should establish a solid presence within the single market. Luxembourg would be one of the candidates for such a move. Over half of alternative fund managers in Europe are based in the UK, with 19% located in Switzerland. "*It is certainly too early to say what the impact on UK AIFMs would be, but if some decide to seek a EU hub, Luxembourg would be a clear choice*," Denise Voss remarked. ▬

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