

CANADA

With favourable costs and strong public sector support, Canada is becoming an increasingly popular alternative to traditional fund domiciles. *HFMWeek* spoke to those in the industry about why the area is attracting administrators, and what they expect from the country's undoubtedly bright future

PROGRESS REPORT

How far has Canada progressed as a domicile for hedge funds since 2005?

Christopher Mulhern (CM): The past three years have seen a continuance of Canada-based managers offering some type of Canadian domiciled entity, in many instances a unit-trust structured vehicle. It should be noted however, these same Canada-based managers seem to be also incorporating more and more offshore entities; primarily through jurisdictions such as Cayman. This strategy allows for more flexibility and a broader potential investor base, supporting the drive toward increasing capital capacity.

James Loewen (JL): There has been significant growth in the Canadian domestic hedge fund market since 2005, not so much a result of being a hedge fund domicile of choice, but rather from increased domestic and foreign

investor interest in Canadian hedge fund managers. Also during this period, there has been several changes in the regulatory environment with more expected to follow, including significant changes with respect to the registration of managers.

Last year, it was considered that Canada's hedge fund community had ample scope for growth in the hedge fund community because of strong regulations, a resource boom, and adequate returns. What about 2008?

JL: The resource markets have remained strong in 2008, albeit with plenty of volatility, and many market participants expect the resource sector to finish the year strong. There has also been a considerable uptick in international investor interest in Canadian assets and managers. We also continue to see more managers entering the market and a broadening of product offerings. ■

STRATEGY

In 2007, it was reported that nearly 80% of Canadian managers planned to raise more capital in the next 12 months using futures/commodities strategies. What strategies/developments of this kind have been introduced in the last 12 months? Have they been successful?

CM: As the globe's hedge fund managers move in a particular direction, typically Canadian managers follow. As a global hedge fund administrator, based on our clientele, the strategy direction has been quite diverse in the past 12 months. Fund launches have ranged widely from long/short equity, to those with many forms of complex derivatives, to private equity. Success in terms of

rate of return has been modest and in many cases funds have been recovering previous losses dating back to 2007, regaining high water marks.

As market pundits debate the future direction of commodities, what are Canadian hedge fund managers doing to position themselves to achieve non-correlated status? What, beyond oil and gas, are managers offering to investors?

JL: We have witnessed continued launches of equity long/short and fund-of-funds strategies, as well as more exotic offerings such as Shariah-compliant funds and renewable energy strategies. We have also seen a number of distressed credit offerings. ■

HEDGE FUND SERVICES

As Canada continues to attract administrators of all types, what is being done to fend off competition from traditional hubs such as Bermuda, BVI and even Ireland?

CM: Canada's recent successes in the administration industry are driven both passively and aggressively. On the aggressive front, Canada-based administrators have not been shy in promoting the strength of its qualified accountant designations, whether it be the CA, CMA or CGA programmes; Canada also produces a high number of CFAs. As the hedge fund industry continues to gain complexity, this highly educated workforce becomes more attractive. Further to this, more instances of provincial support are being recognised through items such as payroll rebates; by combining the Canadian Revenue Agency's

willingness to develop fair cost-plus agreements with global administrators' willingness to operate in Canada, you enable administrators as a whole the opportunity to succeed here. Of course, enabling and executing are two different things; access to good people at reasonable costs does not ensure a positive outcome, especially for those administrators who have inefficient and ineffective operating models.

On the other side of the coin, Canada, to an extent, has become a more attractive locale due to many egregious factors in historically popular jurisdictions. Dublin specifically has had problems retaining talent and attrition has been at extremely high levels, and some Caribbean jurisdictions have lost attractiveness due to high costs. Also worth mentioning is the eastern US, specifically Boston and New York, where administrators have lost the pace of growth

experienced from 1995-2003, with high costs and high attrition being the obvious reasons; but there is also the issue that many hedge fund managers hire talent for internal operations roles and generally they lure the best staff away from administrators.

The best outcome for Canada will be derived from focusing on quality. Canada has the people, a good cost environment and public sector support. Quality, for a lot of administrators, remains in question among hedge fund managers. Many horror stories of experiences with administrators are told in the tight-knit circles of this industry. Being nimble and flexible to change, either in the services provided or the model they are provided from, along with a higher concentration on quality assurance and controls, will be the differentiating factor that could allow Canada to prosper over the longer term. ■

THE FUTURE

What does the future hold in store for Canada's hedge fund community?

CM: For the managers, the future is likely to be, to an extent, a continuation of the past. The number of Canadian hedge fund managers will grow at a good pace, however, this does not come without some potential peril. The biggest concern is probably size. New fund launches with low starting capital are experiencing less success in today's environment and the larger funds with decent historical returns seem to be getting a better percentage of allocations from investors than in the past.

For the administrators, as well as the other service providers such as audit firms and counsel, the future holds continued opportunity in Canada. Differentiating oneself will be critical. That said, the successful administrator has to offer a global model with around-the-clock coverage in the daily service environment that the industry demands today.

JL: We expect continued growth in the Canadian domestic hedge fund market as well as in the global hedge fund administration business in Canada.

The domestic hedge fund market in Canada is small, relative to other asset classes, especially when compared to hedge fund markets in the US and

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Europe. It is likely there will be increased domestic high-net-worth and institutional interest in hedge funds as investors seek increased diversification, especially as commodities cool. We can also expect a continued appetite in Canadian markets by international investors, and the continued build-out of hedge fund capabilities by both financial institutions and traditional managers.

In terms of hedge fund administration, we fully expect that more global administrators will establish a presence in Canada, be it Toronto, Halifax or elsewhere. Local, provincial and federal governments have taken an interest in attracting financial services and are offering incentives, while the factors that have attracted those already here, such as our highly educated workforce and quality infrastructure, remain compelling. While there may be some short-term pain as new entrants increase the competition for experienced hedge fund accountants; organic growth and the continued repatriation of offshore expertise will provide balance in the mid to longer term. ■

REGULATION

With talk over whether US and other jurisdictions will raise the bar on regulation, how is Canada's regulatory framework an example for the rest of the world to follow? And what can be learned and applied from other global jurisdictions to Canada?

JL: There has been no real change to the underlying factors that have attracted administrators and other assets service providers to Canada, namely: a highly educated workforce, high quality infrastructure and relatively low cost – although the appreciation in the Canadian dollar has reduced the cost advantage somewhat. We are also seeing more government interest at all levels in attracting and retaining administrators and other highly skilled businesses, as well as in offering a variety of incentives. Overall, as more global administrators establish a Canadian presence, we are witnessing an increased awareness of the hedge fund community in the local marketplace. ■



Christopher Mulhern is the chief operating officer of **Butterfield Fulcrum Group (BFG)**. As part of the company's global executive management team, Christopher has overall responsibility for the management, production and delivery of fund administration services.



James Loewen is an audit partner in the Toronto financial services practice and has over fourteen years' experience in the investment management industry. He is the national director of **KPMG's Investment Management and Funds Practice** and sits on the firm's global leadership team for asset management.