

IRELAND



As Dublin's reputation as a centre for onshore funds and independent administration takes on renewed importance in a shifting hedge fund world, *HFMWeek* tracks the region's progress



partner the international industry.

As the success of any partnership depends on mutual benefit, the success of Ireland as an international fund jurisdiction would be dependent on our ability to provide solutions and deliver efficiencies to the international industry. At the end of January 2009, with total assets under administration of €1.4trn of which significantly more than half represents the administration of hedge funds, the industry in Ireland has proven itself as a worthy partner. The original concept on which the industry was established is still relevant and now, more than ever, the international industry requires a partner that will provide solutions and deliver efficiencies.

Recent events in financial markets have

Over 20 years ago, when the investment funds industry was being established in Ireland, the concept was to develop an industry that would

shaken confidence and questioned the operating model of many sectors of financial services and the hedge fund industry has clearly not been immune from such challenges. The events of 2008 have required the industry all over the world to re-assess its operations and priorities.

With an attractive solution, the Qualifying Investor Fund (QIF), to the increasing demand for a regulated but flexible product, Ireland has laid a significant claim to be the domicile of choice in this changing world. However; in the administration of alternative investments, the industry's credentials are well established and Ireland is often referenced as the world's leading administration centre for alternative investments. This reputation, which is evidenced by the scale of activity, has been maintained by the development of industry leading best practice and thought leadership; nothing less than you would expect from a partner to the global funds industry.

Gary Palmer,
IFIA



BARRY MCGRATH

partner, is head of investment funds group at **Maples and Calder (Dublin)**. Barry specialises in financial services law and advises on the

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is group operations manager and managing director of **Apex Fund Services (Ireland)**. Along with managing the Irish operation, John bears overall responsibility

for the group operations and internal audit function for the group.

due diligence and the integrity of hedge funds should also benefit jurisdictions such as Ireland which have a long-established reputation for servicing these vehicles through independent, professional third-party administrators.

John Bohan (JB): It really depends on what side of the table you are sitting on and what kind of overheads you had coming into this downturn. Clearly there have been a number of fund impletions that have been subject to market, liquidity, Madoff and Stanford exposures. Many more funds will not survive the year ahead and the loss of revenues for a lot of firms has been very damaging. Many have taken swift action through lay-offs and severe cost cutting to stop

HFMWeek: How would you describe the current state of the hedge fund industry in Ireland?

Barry McGrath (BM): As with all other jurisdictions, we are seeing the effects of the recent meltdown in the global markets. All of the participants in the market, perhaps with the exception of lawyers to date, are downsizing. Where the opportunities lie very much depends on what the G20 decide in terms of the level of regulation for hedge funds and its participants going forward. However, Ireland as an onshore jurisdiction will benefit from any increase in such regulation.

Dermot Butler (DB): With a few exceptions – including CTAs, which have done extremely well in the last couple of years – the current state of the whole hedge fund industry could be described as shell-shocked. From the administrator's point of view, where Ireland is 'over-weighted', there has been a global decline in assets under administration of somewhere

between 30% and 40% – indeed, some have suffered 50%. This has meant cost cutting all round, which has been painful, and will continue to be, depending upon how 2009 turns out.

Ian Headon (IH): The global financial services industry is reeling from recent high-profile financial failures and frauds, with knock-on impacts experienced in the funds industry.

Last year was a struggle for many asset managers, with pressure on performance and asset flows presenting commercial and survival challenges for many. When combined with high profile investment failures, 2008 has been an annus horribilis for many.

However, a sense of perspective is, as always, required. We are beginning to see evidence that some degree of confidence will return towards the end of this year and, while there is undoubtedly a requirement for improvements in the regulatory environment, it remains a concern that we may see an over-reaction.

On the flip-side, the greater emphasis on

the bleed as quickly as possible.

There is, however, a clear silver lining in that there is still a lot of activity both in the Irish funds and offshore sectors. New business is coming in from several directions: Firstly, funds that have shrunk in size are having to find new homes as they no longer fit the model of the larger institutions, secondly, new emerging managers are launching funds availing of the many opportunities in the markets – the funds are admittedly much smaller but may form the foundations of the new wave to come, and thirdly, in a post-Madoff era there has been an outcry for independent administration. There are a lot of large institutional plays from large Indian/Middle East and Asian investment managers seeking a branded product such as Ucits and these are steadily coming to our shores.

HFMWeek: What is being done to attract international talent to the jurisdiction?

BM: Currently, Ireland is predominantly a back-office jurisdiction. The Irish government, together with the IDA, have always tried to attract front-office jobs; the most attractive feature has been the 12.5% corporation tax rate but this has seen limited success to date. Again, greater opportunities may arise depending on to what extent other jurisdictions decide to over-regulate the industry as Ireland, with the help of the IDA, has all the necessary infrastructure in place to attract key international talent.

DB: Frankly, I believe any attempt to attract international talent to Ireland today will be wasted in the current market. Dublin is a high-cost environment and, at this time, there are many more commercially attractive places. Of course, the lifestyle in Ireland still remains excellent (if you can afford it), but so it is in many other places.

IH: Northern Trust believes that the best way to achieving investor comfort is to provide clarity and transparency of the valuation process. It is key that the investor, the manager and the external parties see a clear, transparent process by which the price is arrived at, what the primary source is, what happens if the primary source is not available or is materially different from the secondary source.

This transparency of process is an area where the industry has provided much greater clarity to the investor and manager community over the last number of years.

HFMWeek: How are distressed assets being dealt with? What is being done to tackle liquidity issues?

BM: With distressed assets you are seeing, in Ireland and other jurisdictions, funds being suspended. For example, for the year January 2008 to January 2009, there were 29 Irish-domiciled funds suspended and 60 non-Irish-domiciled funds suspended which were listed on the Irish Stock Exchange. In terms of liquidity problems, side pockets have been put in place in order to free up liquidity where documentation allows it. Other than that, we are seeing the Irish regulator trying to be more flexible by changing some of its rules to allow for gates and side pockets where they would not normally be allowed.

HFMWeek: How has the financial regulator's history of firm yet flexible regulation served the jurisdiction in light of recent events?

BM: The regulator, as always, has tried to work with the industry to tackle these problems. It has put in place reasonably strict rules in relation to gates and side pockets, with different

rules applying depending on the type of fund. On 4 December 2008, the regulator relaxed its rules to essentially remove limits on the amount of assets that PIFs or QIFs can allocate to side pockets. It also made it easier for funds to impose gates. It is clear that the regulator recognised that more flexibility than normal was needed under such market forces.

JB: The hard work in building Ireland as a jurisdiction of choice has already been done over the last 20 years. There is no doubt we have lost ground in light of the banking failures, and it does bring into question some of the applications of the requirements. The important thing is we work quickly to change the model and get in place some new minds and strong leadership to allow the government and the financial regulator to steady the ship and re-build what remains a very strong reputation. No regulator has come out of this unscathed and, therefore, all remain still in play. The industry in Ireland, in conjunction with the regulator, will provide the comfort and leadership needed and will emerge ahead as a more rigorous framework as application of that framework comes into play.

DB: In the context of hedge funds, the financial regulator has continued to show an awareness of what the industry needs. It moves quickly (except for the Third AML Directive) and, although they have got some 'egg on their face' in the context of banking, with hedge funds, they have, in my opinion, performed well. Given the likelihood of aggressive regulation being introduced by the EU, it is open to question as to how sympathetically the financial regulator will handle the implementation of those regulations.

IH: We need to remember that the European hedge fund space is already highly regulated.

“If a flight towards onshore jurisdictions becomes the buzz, Ireland will obviously benefit”

Barry McGrath, Maples and Calder

Most hedge fund managers are located in the UK (regulated by the FSA), most prime brokers in the UK (regulated by FSA), administered in Ireland or Luxembourg (IFSRA/CSSF), listed on the Irish Stock Exchange and audited by a major international auditing firm (various international bodies). In addition, many funds are domiciled in regulated centres such as Ireland or Luxembourg where an additional layer of regulatory coverage is mandated via the appointment of a trustee/custodian or equivalent.

Northern Trust believes there is an argument for a 'Basel II' global approach for hedge funds, leveraging from existing data collection and regulatory touch points, such that the regulatory community can be better informed, have greater transparency, more information, clearer data and risk metrics but without the need for excessive additional prescriptive regulation.

HFMWeek: How important is independent fund administration and what benefits does it provide?

IH: As a large global asset servicing firm, clearly independent administration is the best model – the role of the administrator is not to detect or prevent fraud but is a key part of a governance structure.

It remains a source of interest to us that the governance culture in Europe differs from that in the US. It is absolutely standard in Europe for a European-managed hedge fund to appoint an administrator whereas in the US, many funds self-administer.

There is nothing inherently wrong about self administration, and the appointment of an administrator does not guarantee fraud prevention, but international best practice dictates that the appointment of quality independent service providers is a key part of a quality governance framework.

JB: It is essential, and it will be difficult for any investment manager to gain credibility without that independence. The key thing will be to carry out the correct due diligence on your administrator and ensure they have the proper depth of control, breadth of experience, global coverage to meet your strategic goals and the comfort of an SAS 70 Type II audit that allows some assurance the controls and experience have been sufficiently tested.

DB: The word 'independent' says it all. Post-Madoff, several Swiss banks have insisted that



all self-administered funds in the US should appoint an independent administrator. It is inevitable that this investor pressure will grow, and it is possible, if not probable, that the US regulators may also require this, through new regulations, perhaps before year-end. It has, after all, been a requirement of almost all other non-US jurisdictions for many years. The benefits are that an independent organisation is reviewing independently sourced prices for the assets and, if required, providing independent verification that the assets exist. Put simply, independent fund administration provides comfort to the investor.

BM: It does not matter whether you are an asset manager or an administrator; investors will more than ever want transparency and independence. That, going forward, will be an industry requirement. As a lawyer, there is an inherent conflict in an asset manager producing his own valuations, so removing that conflict can only be a good thing.

HFMWeek: What opportunities can Irish-based funds expect in the coming year?

DB: The main opportunity from which Irish funds will benefit – over all other fund centres, except Luxembourg and Malta – is the possible fallout from the vigorous and aggressive attack that Messrs. Brown, Merkel, Sarkozy and Obama have launched against offshore centres (which could include Switzerland, Liechtenstein and Luxembourg). It is likely that sophisticated and professional investors will decide to invest in funds established in the EU centres, because of their lower profile. The recent extraordinary Stanford scandal and UBS's US tax problems have added to the offshore centre's woes and this time they may not be able to shrug off the attacks as effectively as they have in the past.

However, to take advantage of this opportunity the Irish industry will also have to shrug off the inevitable concerns of investors about the Irish banking debacle and, of course, be able to compete on cost.

JB: The latter half of 2009 will see a surge of activity in the Ucits and non-Ucits space. Global investment managers are seeing this as a key opportunity to move into the European market and gain greater market coverage. It is important to note we will see strategic acquisitions of FSA-regulated investment managers by Mena, Asia and Indian Investment Managers as a bridge through to the Irish market. The capital is there but the organisational structures and depth of experience in these markets sometimes is not. By acquiring these it can allow managers to move a lot quicker to fulfil their goals.

IH: Northern Trust believes the Irish industry has an opportunity around the self-administered hedge fund space, particularly in the US. Market events have focused investor attention in this area and we expect that many of these funds will now look to appoint independent firms to act as administrator. We see investor demand driving this requirement and Ireland has an opportunity to win some of that business.

BM: If a flight towards onshore jurisdictions becomes the buzz, Ireland will obviously benefit, provided the industry continues to be flexible and competitive and we should see a significant increase in hedge funds being domiciled in Ireland. In addition, Irish-based administrators will benefit from the fact that it is likely that asset managers will no longer be able to self-administer their own funds. That would provide fantastic opportunities for Irish-based administrators who are already recognised globally as the leaders in hedge fund administration. ■

