Content Includes:

Outlook on Regulation

How are hedge fund managers viewing regulation and its impact on the industry? How have their views changed?

Concerns Surrounding the AIFMD

We take a look at the key concerns hedge fund managers have about the AIFMD.

Are Hedge Fund Managers Ready for the AIFMD?

We look at the preparations hedge fund managers have taken in regards to the AIFMD, and how this varies by manager headquarters and size.

How Are Hedge Fund Managers Responding?

How are managers planning to market under the AIFMD? Are they choosing not to look for EU investors?

What Are the Opportunities in the EU?

We look at what capital managers complying with the AIFMD may be able to pick up from EU investors.

Global Hedge Fund Managers Respond to the AIFMD

July 2014

Plus Special Guest Contributor:
Richard H. Baker, **Managed Funds Association**

preqin
alternative assets. intelligent data.

Click here to download the data pack.

Global Hedge Fund Managers Respond to the AIFMD

After years of discussions and amendments the Alternative Investment Fund Managers Directive (AIFMD) was written into national law by EU member states on 22 July 2013. Following a year long grandfathering period, existing AIFMs have until 22 July 2014 to apply for authorization to the regulators.

The new Directive aims to provide harmonized regulatory standards across all alternative investment managers. In particular, hedge fund managers will need to obtain authorization, meet ongoing reporting conditions and comply with transparency requirements in order to manage and market hedge funds within the EU. Key requirements of the Directive include the appointment of a depository, reporting requirements, separation of risk and portfolio management, an appropriate and regularly updated due diligence process and remuneration controls. The AIFMD was introduced to increase investor confidence in alternative asset managers through the reduction of systemic risk and enhancement of investor protection. However some critics of the new regulations have said they increase cost and complexity.

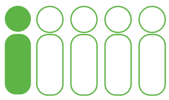
With that in mind Preqin turned its attention to hedge fund managers globally to find out more about how they are reacting to this regulation. In June 2014 Preqin conducted a survey of 150 global hedge fund managers representing $380bn in assets under management. We asked these managers to answer the following questions:

- What is their outlook on regulation and the AIFMD in particular?
- What are their concerns about the Directive?
- How prepared are they for the new regulation?
- How do they plan to market funds in the EU?

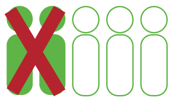
Preqin's Results...At a Glance

US Fund Managers

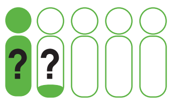
US fund managers have the most negative outlook on the AIFMD — **71%** believe the directive will affect the industry negatively.



18% of US-based fund managers are already AIFMD compliant.



40% will not actively market in the EU.



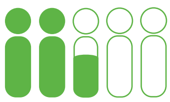
23% are looking for more guidance from the regulators.

12% of US-based hedge fund managers plan to rely on private placement regimes; these managers plan to do this in the following member states.

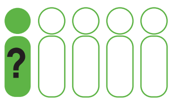
37% UK Only — **54%** in 2-4 Member States — **9%** in 5 or More Member States

Europe (Excl. UK Managers)

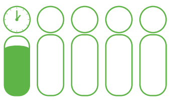
These managers are the most positive about the Directive — **40%** believe the AIFMD will have a positive impact.



48% of European fund managers are already AIFMD compliant.



19% are looking for more guidance from the regulators.

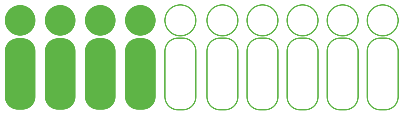


15% have submitted their application and are awaiting final approval.

53% of European (excl. UK managers) reported costs as their biggest concern about the AIFMD. **74%** reported costs have been higher than expected.

Click here to download the data pack.

UK Fund Managers

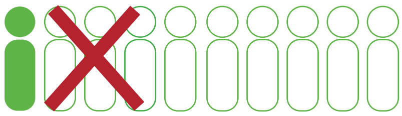


43% of UK hedge fund managers are already AIFMD compliant.

35% of UK fund managers have submitted their application but are still awaiting final approval from the FCA.

Costs are causing the least concern to UK based fund managers — just **29%** stated that as their key concern. This may be because they were more realistic at the start of the process: **73%** stated costs were as expected compared to **42%** globally.

Asia & Rest of World Fund Managers



Just **13%** of Asia and Rest of World-based fund managers are already AIFMD compliant. **27%** will not actively market in the EU.

50% of fund managers in these regions will rely on reverse solicitation to attract EU capital.

Three-quarters of Asia and Rest of World fund managers reported that AIFMD costs of compliance have been higher than initially expected.

Foreword
- Richard H. Baker, President and CEO, Managed Funds Association

Hedge fund managers have embraced thoughtful regulatory oversight around the world. They see regulation as providing a level playing field on which to compete and providing additional assurance to their investors. That is a major change in the hedge fund culture. When the first hedge funds opened their doors, the financial marketplace and regulatory regimes were markedly different from what they are today.

The accelerated pace of information sharing, trading and interconnectedness driving changes in our global investment landscape also brought about an evolution in regulation internationally. Although no study or regulator linked the 2008 market crisis to hedge funds (and indeed the collapse of firms like Lehman harmed hedge funds), the crisis resulted in public demand for much greater regulation of financial markets. Today, the global hedge fund industry is strictly regulated by a range of laws and regulations worldwide, with recent legislative changes increasing the already extensive regulation of the industry.

While rules vary by jurisdiction, a primary method of oversight is the registration and regulation of advisers to the funds. In the US, for example, passage of the Dodd-Frank Act ushered in a new era of transparency and information sharing between managers and regulators. The MFA supported the change in the law that required hedge fund managers to register with the SEC. We also supported the creation of what is now the Financial Stability Oversight Council to look across markets and identify systemic concerns.

Similarly, the European Union (EU) adopted the Directive on Alternative Investment Fund Managers (AIFMD), the first EU directive focused specifically on alternative investment fund managers. The AIFMD requires hedge fund managers to register with national regulators and increases disclosure and reporting requirements for fund managers operating in the EU.

Since the adoption of the AIFMD, regulators in the EU have been finalizing the rules to implement the Directive. Ushering in a new regulatory regime can present opportunities and challenges – for regulators and fund managers alike. Throughout this process, we at MFA have been broadly supportive of the AIFMD's goals to bring about a more transparent and globally harmonized regulatory framework for the alternative investment fund industry.

As we approach the one-year milestone of the adoption of the AIFMD, which also represents the date that many managers will become subject to the Directive, this Preqin report provides timely insight into the mindset of alternative investment fund managers affected by the Directive. It also illustrates some of the challenges inherent in rolling out such a comprehensive shift in regulatory requirements. At the most basic level, the data presented here show that a good portion of fund managers are prepared to meet the requirements set forth in the AIFMD. They have established compliance programs either to meet the requirements of the Directive, or to ensure they do not engage in activities that are prohibited by the Directive while they wait for guidance from regulators. Progress on AIFMD compliance to date appears to be in line with other large-scale regulatory regimes.

While a good number of managers are proceeding apace with compliance, the results of this survey also show significant levels of uncertainty or concern about aspects of the new regulations. Chief among these concerns is the expectation that new regulation will increase the cost of compliance and general operations. This is to be expected with new regulations, particularly in the earliest phases when new rules have not been transcribed by authorities to paint a full picture of how funds must operate in the future. While these costs can be challenging to some, the data presented here show that a significant portion of managers remain willing to invest in the necessary staff and resources to operate in compliance across the EU. For a smaller group, this cost may prove to be a barrier to entry, but as time goes by and the full AIFMD regime landscape becomes clear, this group could shrink further.

Regulators need to maintain open lines of communication with the industry to gain feedback, including information about ambiguities that create unnecessary compliance risk and cost, and possible unintended consequences of the new regulations. At MFA, we look forward to continuing our constructive engagement with the European Commission, the European Securities and Markets Authority (ESMA) as well as member-state regulators to help inform their decisions and reach the goals that we all share. Regulators have made steady progress implementing this complex Directive, but it is clear from Preqin's data that questions – and frustrations – remain. As the EU moves forward with adoption, and clear guidance and increased harmonization are achieved, some of these questions and frustrations can be expected to subside.

Complex regulations are borne out of complex financial markets, but as our global marketplace becomes more interconnected by the minute, it is critically important that regulators seek to harmonize rules across borders whenever possible. Ultimately, we strongly believe that the transparency and regulatory oversight under a harmonized AIFMD will highlight alternative investment funds' ability to deliver safe, stable returns that provide investment diversification and sound risk management for pension funds, endowments, and foundations throughout Europe and around the world. We remain committed to working with policy makers and regulators as they continue to implement the AIFMD, including efforts to address remaining questions and uncertainties.

The **Managed Funds Association** (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets.

www.managedfunds.org

Outlook on Regulation

Governing bodies and regulators across the globe have been focusing their attention on alternative asset funds in recent years in the wake of the financial crisis and the growing size and institutionalization of the hedge fund and private equity sectors. In this section we examine the current sentiment of hedge fund managers towards regulation as a whole, and the Alternative Investment Fund Managers Directive (AIFMD) in particular, as we approach the 22 July 2014 authorization deadline.

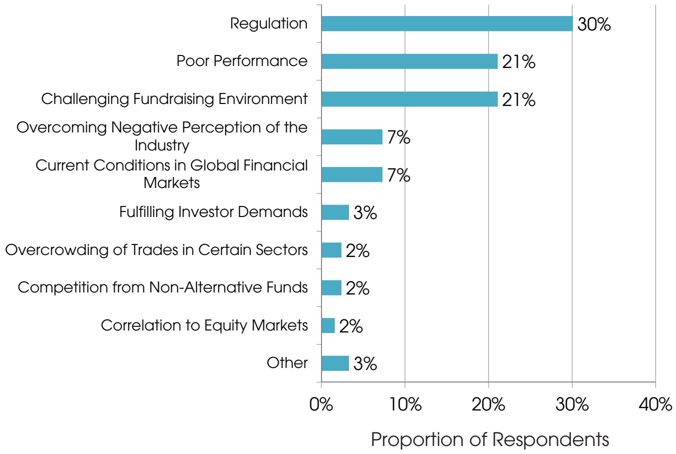
Regulation tops the list of key challenges hedge fund managers face today (Fig. 1). Despite a shaky start to 2014 in terms of performance, and a continued challenging fundraising environment, regulation is the issue at the forefront of the minds of the largest number of hedge fund managers. It is clear from Fig. 2 that regulation is becoming an increasing concern for fund managers. The proportion of managers that stated that increased scrutiny from regulators will affect the industry for the worse in June 2014 increased from a similar study in December 2013, which itself was an increase from December 2012. Today just 15% of hedge fund managers believe that increased global regulation will have positive benefits.

When looking at the AIFMD in particular, more fund managers in each region believe the Directive will have a negative impact than a positive one, with the US in particular showing a strongly negative outlook on the incoming regulation. However, fund managers based in Europe, excluding those headquartered in the UK, are more positive; approximately 40% can see the Directive having a positive impact, perhaps as a result of the ability to passport their funds across the EU, as well as improved investment sentiment towards a more regulated brand. There may even be opportunities for EU-based fund managers to grow, as funds from other jurisdictions choose not to market within the EU as a result of regulation.

In Brief

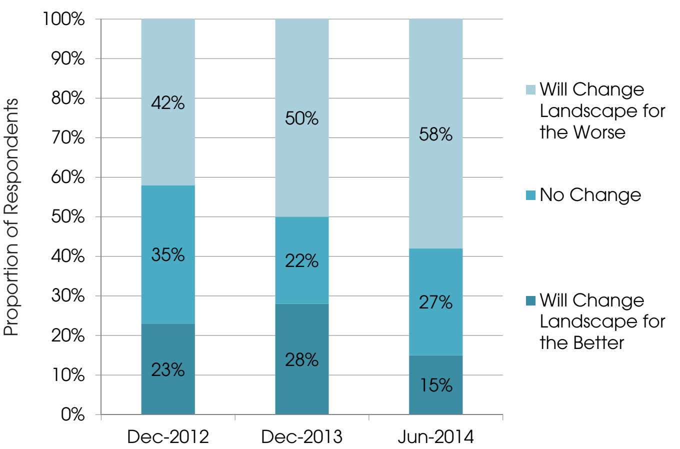
- **Hedge fund manager sentiment towards regulation is worsening.**
- **Regulation is the biggest challenge fund managers are facing in the industry today.**
- **US-based hedge fund managers have the most negative outlook towards the EU AIFMD regulation, and Europe-based managers, excluding the UK, have the most positive outlook on the Directive.**

Fig. 1: Fund Managers' Perceptions of the Key Challenge in the Hedge Fund Industry Today



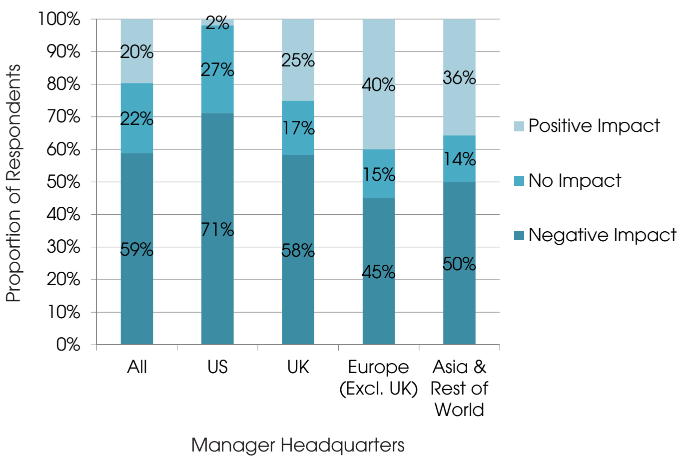
Source: Preqin Fund Manager Survey, June 2014

Fig. 2: Fund Managers' Perceptions of the Effect of Regulation on the Hedge Fund Landscape, December 2012 - June 2014



Source: Preqin Fund Manager Survey, December 2012 - June 2014

Fig. 3: Fund Managers' Perceptions of the Effect of the AIFMD on the Hedge Fund Industry by Manager Headquarters



Source: Preqin Fund Manager Survey, June 2014

Concerns Surrounding the AIFMD

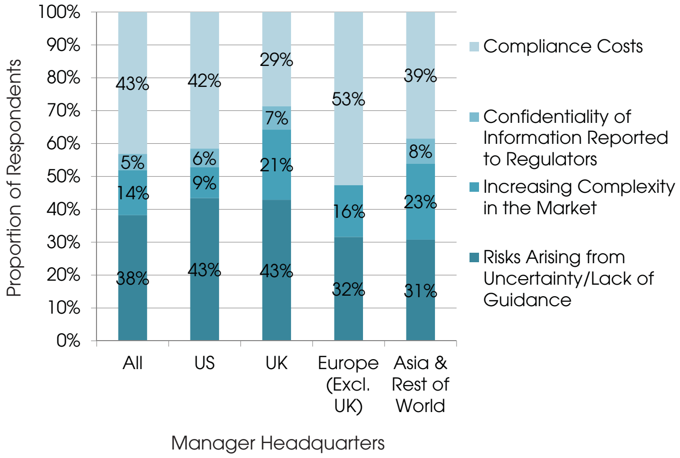
Nearly 60% of the hedge fund managers that participated in Preqin's study stated that they believe the AIFMD is negatively impacting the industry. Fund managers have been endeavouring to meet or navigate the regulatory burdens imposed by the AIFMD over the past 12 months; with this in mind, in this section we investigate the concerns fund managers have regarding the AIFMD, which are leading to such negative sentiment from the fund management community.

Fig. 4 shows that compliance costs were the leading concern across all hedge fund managers that participated in the study. When looking more deeply into this data it is clear that the smaller fund managers are the most concerned about the increased costs involved with complying with the directive (Fig. 6). European fund managers – excluding those based in the UK – also reported heightened concerns about the compliance costs of the AIFMD. As shown in Fig. 5, a large proportion of Europe-based managers (74%) reported that costs were higher than they had initially expected. This suggests that these managers were underprepared or over optimistic about the impact the AIFMD would have on their overheads.

In Brief

- **The cost of compliance is a concern for the largest proportion of hedge fund managers, with the smallest managers the most affected by costs.**
- **Risks arising as a result of the lack of clarity and guidance are another leading concern, particularly for managers based in the US and UK.**
- **No fund managers reported that costs were lower than expected – and costs exceeded expectations for three-quarters of fund managers in Europe (excl. UK) and Asia and Rest of World.**

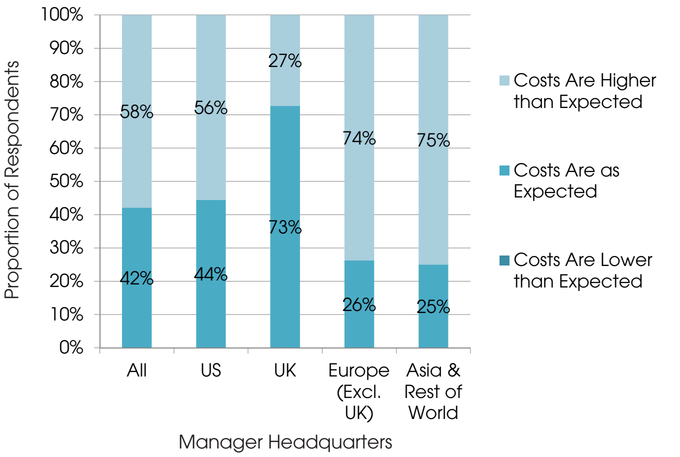
Fig. 4: Primary Concern Fund Managers Have Regarding the AIFMD by Manager Headquarters



Source: Preqin Fund Manager Survey, June 2014

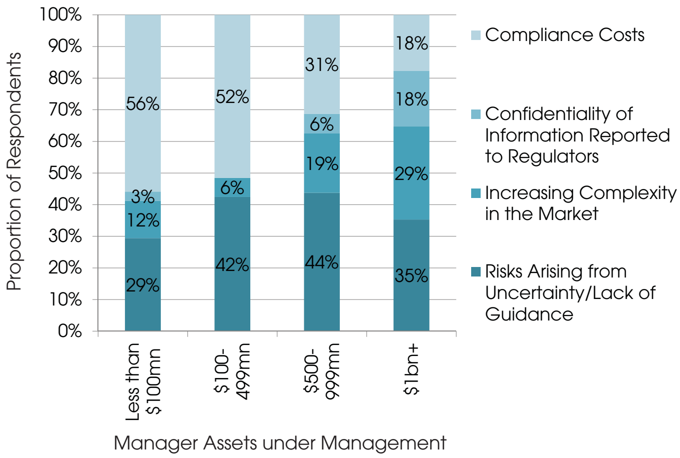
Hedge fund managers headquartered in the UK and US reported risks arising as a result of a lack of clarity and guidance as their leading concern in higher numbers than managers based in other regions. US-based fund managers may be relying on private placement regimes or reverse solicitation in the short term to raise capital from investors in the EU. With each EU member state imposing their own private placement regime with differing levels of severity, as well as some uncertainty about what constitutes reverse solicitation, this may lead to some US-based fund managers having concerns about taking any capital from the region in case they contravene the regulation.

Fig. 5: Fund Managers' Experiences to Date of Costs of Regulation by Manager Headquarters



Source: Preqin Fund Manager Survey, June 2014

Fig. 6: Primary Concern Fund Managers Have Regarding the AIFMD by Manager Assets under Management



Source: Preqin Fund Manager Survey, June 2014

Click here to download the data pack.

Are Hedge Fund Managers Ready for the AIFMD?

As shown earlier in the report, fund managers are concerned about the impact of the Directive, and particularly by the costs of compliance, as well as the risks arising due to a lack of clarity of its implementation. Despite these concerns, with the transitional period for the AIFMD expiring on 22 July 2014, fund managers will need to have made their decisions on how they intend to react to the Directive. In this section we examine how prepared hedge fund managers are for the AIFMD.

As shown in Fig. 7, 26% of all the fund managers we surveyed stated they are already compliant with the Directive. In Europe these numbers are higher, with 58% of Europe-based managers, excluding those in the UK, and 64% of UK-based fund managers already compliant or expecting to be compliant by the deadline. Fourteen percent of UK-based managers have submitted their application to the FCA but do not expect their fund to be approved by the deadline, perhaps reflecting some of the backlog the UK finance regulatory body is facing as a result of the sheer size of the UK hedge fund management industry. However, positively for the FCA, no UK-based fund manager reported they need further guidance from their local regulatory body.

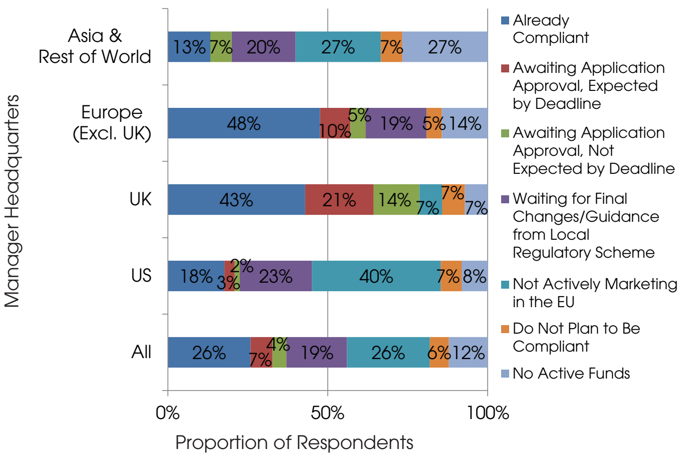
A greater proportion of the biggest fund managers, or those with more than $1bn in assets under management, are already compliant or were due to be so by the 22 July deadline than is seen among managers of other sizes. These fund managers are likely to have a global client base, including those in the EU, and therefore obviously have the need to comply, as well as the resources to do so.

In Brief

- **Nearly half of hedge fund managers with more than $1bn in assets under management are already compliant.**
- **A large proportion of US-based managers do not plan to actively market in the EU.**
- **Approximately 60% of fund managers based in Europe are already either compliant or expect to be by the deadline.**

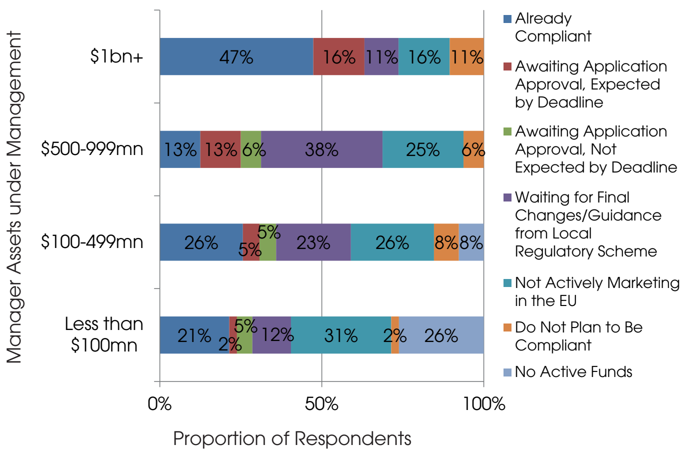
A large proportion of US-based fund managers (40%) do not plan to openly market their funds in the EU (Fig. 7). These fund managers may instead rely on private placement regimes or reverse solicitation, or simply not look for capital from EU-based investors.

Fig. 7: Hedge Fund Manager AIFMD Compliance Status by Manager Headquarters



Source: Preqin Fund Manager Survey, June 2014

Fig. 8: Hedge Fund Manager AIFMD Compliance Status by Manager Assets under Management



Source: Preqin Fund Manager Survey, June 2014

How Are Hedge Fund Managers Responding?

Europe has seen a relatively large proportion of hedge fund managers report that they are either already compliant with the AIFMD, or will be in the near future. However, outside the EU large numbers of hedge fund managers are currently not compliant and are unlikely to be so in the near future. With this in mind we asked this group of fund managers how they intend to raise capital from EU investors – if at all.

Those fund managers outside of Europe which are not currently AIFMD compliant – in the US and Asia and Rest of World – are largely looking to rely on reverse solicitation to gain inflows from EU-based investors in the near future (Fig. 9). These managers will be relying on investors to proactively find their funds through conferences, recommendations from peers, or tools such as Preqin Investor Network. Preqin Investor Network is used by 6,000 accredited investors to source and find out more information on all of the alternative investment funds open to investment today.

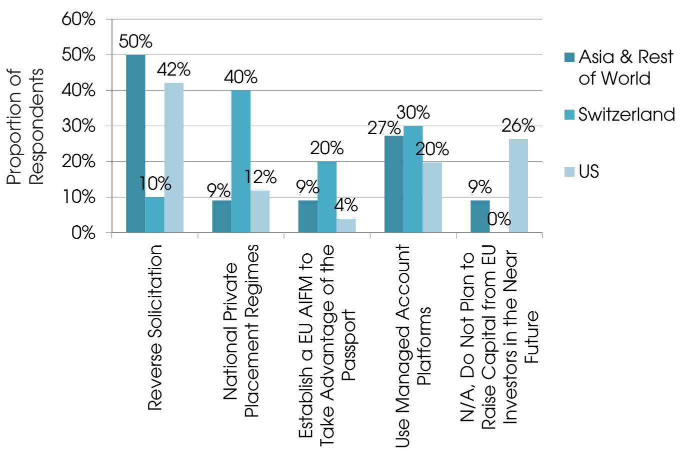
Switzerland is one of the largest centres for hedge fund management in Europe, yet it is not an EU member state. Fund managers based in this region are reacting differently to other non-EU areas, likely as a result of their position in Europe. These groups are much less likely to rely on reverse solicitation, but instead will be drawing on private placement regimes, establishing an EU AIFM or using managed account platforms to gather capital from EU investors.

For those fund managers that are choosing not to market in Europe, the primary reason was the additional cost of complying and reporting because of the AIFMD (Fig. 10). Within Asia and Rest of World, the case is different, however; in this region fund managers are choosing not to market in the EU for business reasons unrelated to the AIFMD. Many managers in these regions are small, and in the early stage of operations; these managers often choose to market to local investors within their markets before they grow to a size where marketing beyond their borders becomes a possibility.

In Brief

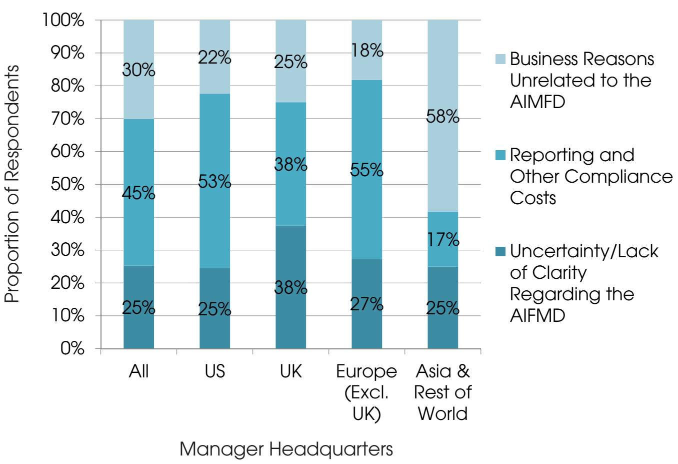
- **A large proportion of managers will be relying on reverse solicitation.**
- **For those fund managers relying on reverse solicitation or private placements, most will be concentrating on less than four member states.**
- **The extra costs associated with complying with the AIFMD are deterring many managers from marketing in the EU.**

Fig. 9: How Non-EU-Based Fund Managers Intend to Raise Capital from EU-Based Investors in the Next 12 - 18 Months by Manager Headquarters



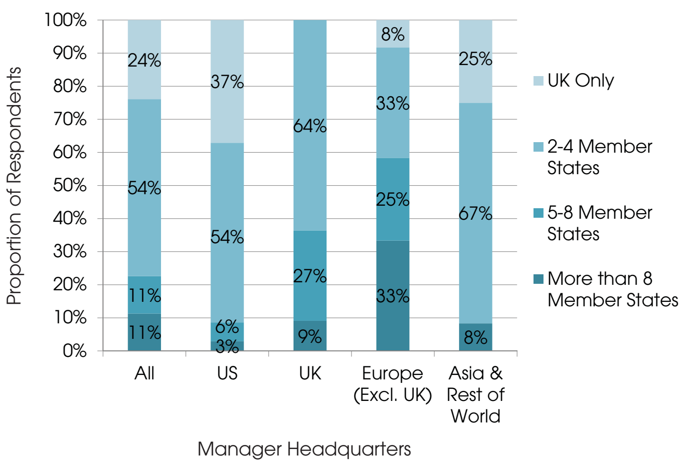
Source: Preqin Fund Manager Survey, June 2014

Fig. 10: Reasons Why Fund Managers Are Choosing to Not Market in the EU by Manager Headquarters



Source: Preqin Fund Manager Survey, June 2014

Fig. 11: Number of Member States Managers Will Be Involved in When Relying on Reverse Solicitation or Private Placement by Manager Headquarters



Source: Preqin Fund Manager Survey, June 2014

What Are the Opportunities in the EU?

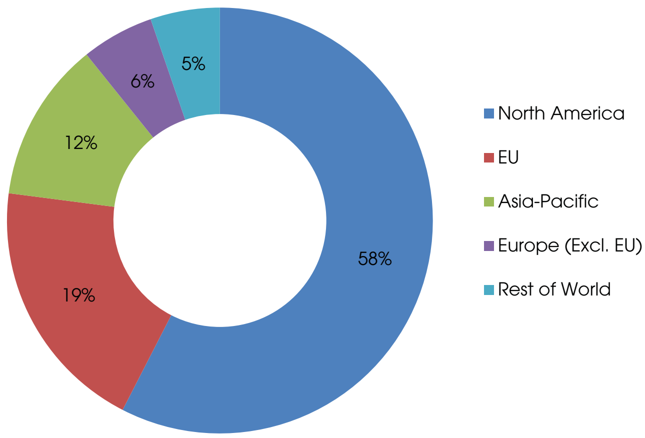
The new regulations within the EU are adding new burdens to alternative asset managers when marketing and operating out of the economic region. The increasing costs and complexity which will be imposed on fund managers are a concern to much of the industry, yet many fund managers are still choosing to take on these extra stresses and are continuing to look for investment in the region. With this in mind, in this section we examine the opportunity set in the EU in relation to the investors based in the region.

As shown in Fig. 12, the 732 institutions based in the EU invest capital which amounts to approximately 19% of all the capital invested in hedge funds by institutional investors today. Although there is a diverse range of investors based in the EU, private and public sector pension schemes, asset and wealth managers and insurance companies are the most significant allocators to hedge funds in the region.

Just two countries in the EU – the UK and the Netherlands – account for over 72% of capital invested from the EU. This might explain why such a large proportion of the fund managers that are relying on private placements or reverse solicitation will be focusing on just the UK, or 2-4 member states (Fig. 11).

Preqin's Hedge Fund Investor Profiles online service shows that 83% of investors based in the EU search for fund managers on a global basis. With hundreds of billions of dollars invested from the region, fund managers from outside the EU will find it hard to ignore the opportunity within the borders of the European Union. These investors look set to continue investing in hedge funds for the long term, therefore those fund managers which go the extra distance and which register as AIFMs in the future, or market through private placement regimes, will be able to pick up capital from those managers which may not have the resources to navigate the complexities of the current regulatory climate in the EU.

Fig. 12: Proportion of Institutional Capital Invested in Hedge Funds by Investor Location

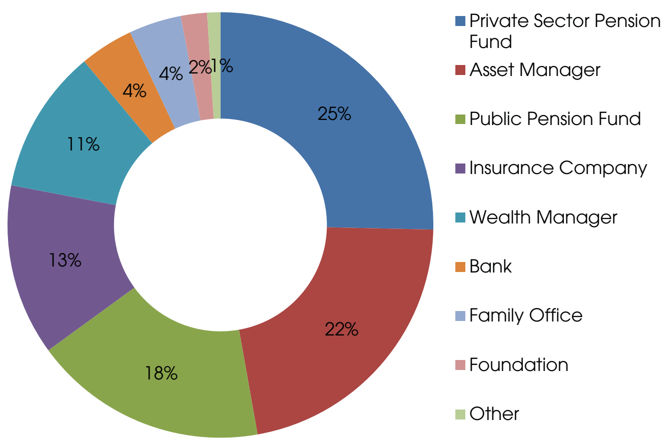


Source: Preqin Hedge Fund Investor Profiles

In Brief

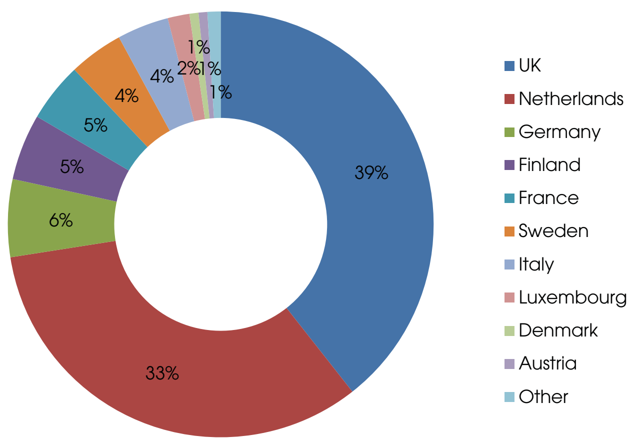
- **Institutions in the EU represent a fifth of all institutional capital at work in hedge funds today.**
- **The UK and the Netherlands represent 72% of all capital invested by EU investors.**
- **Investors in the EU look to allocate capital to managers spread across the globe.**

Fig. 13: Proportion of Institutional Capital Invested in Hedge Funds by EU-Based Investors by Investor Type



Source: Preqin Hedge Fund Investor Profiles

Fig. 14: Proportion of Institutional Capital Invested in Hedge Funds by EU-Based Investors by Investor Headquarters



Source: Preqin Hedge Fund Investor Profiles

Global Hedge Fund Managers Respond to the AIFMD

July 2014

Preqin: Global Data and Intelligence

With global coverage and detailed information on all aspects of the hedge fund asset class, Preqin's industry-leading Hedge Fund Online services keep you up to date on all the latest developments across the hedge fund universe.

Source new investors for funds

Find the most relevant investors, with access to detailed profiles for institutional investors actively investing in hedge funds, including insurance companies, pension funds, family offices, foundations, wealth managers, endowment plans, banks and more.

Identify potential investment opportunities

View in-depth profiles for hedge funds seeking capital, including information on investment strategy, geographic focus, structure, service providers used, sample investors, direct contact information and more.

Find active fund managers in hedge funds

Search for firms operating hedge funds. View information on key contacts, assets under management, performance history, key investment preferences, known investors, and more.

Benchmark performance

Identify which fund managers have the best track records with fully customizable performance benchmarks, and view performance details on individual named funds and share classes.

Examine fund terms and conditions

Access fund-by-fund and industry level fund terms and conditions data for individual hedge funds, enabling you to see the current trends for specific strategies, structures, sizes, and more.

View detailed profiles of service providers

Search for active administrators, custodians, prime brokers, auditors and law firms by type and location of funds and managers serviced. Customize league tables of service providers by type, location of headquarters, and total known number of funds serviced.

For more information on how Preqin's hedge fund data can help you, please visit:

www.preqin.com/hedge

If you want any further information, or would like to request a demo of our products, please contact us:

New York:

One Grand Central Place
60 E 42nd Street
Suite 630
New York
NY 10165

Tel: +1 212 350 0100
Fax: +1 440 445 9595

London:

Equitable House
47 King William Street
London
EC4R 9AF

Tel: +44 (0)20 7645 8888
Fax: +44 (0)87 0330 5892

Singapore:

One Finlayson Green
#11-02
Singapore 049246

Tel: +65 6305 2200
Fax: +65 6491 5365

San Francisco:

1700 Montgomery Street
Suite 134
San Francisco
CA 94111

Tel: +1 415 835 9455
Fax: +1 440 445 9595

Email: info@preqin.com
Web: www.preqin.com