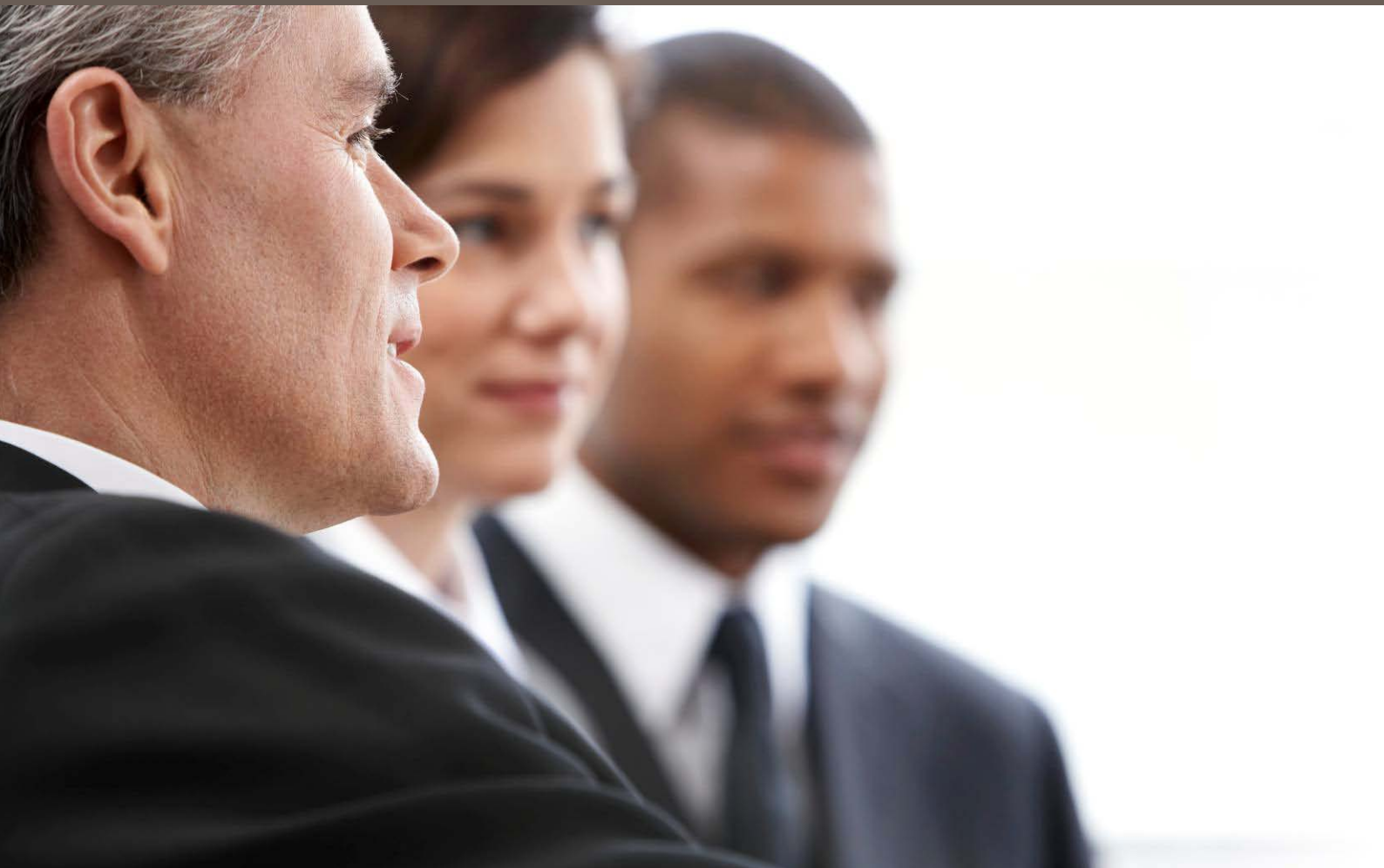


UCITS

A Brief Guide for Hedge Funds: Operational Challenges, Technology Solutions



Foreword



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I am pleased to bring you this paper on the operational challenges and technology solutions for hedge funds considering running UCITS funds. Amongst the hedge fund community there is a huge interest in the UCITS market and Linedata has a unique depth of expertise in this area. We have a number of our largest customers running UCITS funds on Linedata solutions and are familiar with this territory where hedge fund innovation and institutional regulation converge. We have written this guide to share some of that expertise.

Since Linedata acquired Beauchamp Financial Technology and its suite of hedge fund solutions in 2005, we have been committed to the hedge fund market and that commitment continues today. We invest in products and in people to ensure that we both meet and anticipate the technology demands of this market, working in partnership with our customers, industry bodies and other stakeholders to create innovative and costeffective hedge fund market solutions.

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UCITS - A brief guide for Hedge Funds: Operational Challenges, Technology Solutions

Why are hedge fund managers launching UCITS funds?

UCITS funds are very much in vogue in the asset management industry at present and can offer managers significantly greater distribution opportunities. Latest figures now show that AUM in these funds amounts to over \$7 trillion (EFAMA, January 2010) with some of the largest hedge fund managers in the industry launching UCITS compliant versions of their strategies. According to research firm Hedge Fund Research, there are already more than 200 hedge funds offering UCITS compliant alternative strategies, with 50% of managers considering the launch of similar products. The provision of access to alternative investment strategies in a registered fund format coupled with the regulatory oversight, independent administration and risk monitoring requirement have UCITS quickly gaining popularity both within and outside of Europe, particularly in Asia and Latin America.

The launching of a UCITS fund not only attracts retail investors, but also sends a clear message to institutional clients that hedge funds are not only committed to maintaining the highest operational standards but are also prepared to improve transparency. UCITS legislation effectively removes the barriers which prevented the retail investor from gaining access to hedge fund style strategies and expertise and also allows European pension funds to allocate far higher weighting to these hybrid hedge funds.

Hedge fund managers in the US are also showing significant interest in UCITS. As they make efforts to recover from the redemptions they have faced due to the financial crisis, many are looking to UCITS products as a way to raise assets offshore. Furthermore, as the Alternative Investment Fund Managers (AIFM) directive will potentially form barriers to selling offshore funds into Europe, US funds must prepare for the future regulatory landscape; UCITS products that can be sold in most countries outside the US may just be the answer.

The financial crisis and numerous scandals have investors looking for transparency, capital requirements, and tighter limits on risk as key requirements. UCITS funds can provide these safeguards while also offering a number of additional benefits to the investor, including gearing and concentration limitations, improved liquidity and effective tax treatment.

The Operational Challenges:

So what should hedge fund managers be asking themselves when looking at the compliance and operational challenges of launching and operating a UCITS fund? The UCITS directive outlines mandatory processes that must be followed, some of which vary from domicile to domicile and some of which are open to interpretation. A manager needs to answer the following questions:

Can I meet the liquidity requirements of my investors?

Retail investors are used to higher levels of liquidity; hedge funds operating on a monthly or even quarterly basis need to examine how they can meet the differing requirements of traditional investors who may demand daily or weekly subscriptions and redemptions, not just in terms of the liquidity of the assets invested, but also in managing the flow of funds with no minimum holding periods. Maintaining consistent asset allocation across strategies with regular cash flows is also a new challenge to many hedge funds and rebalancing will become a key operational consideration.

Can I calculate daily point-in-time NAV and reconcile with my administrator?

Managers of UCITS funds must be able to calculate for each fund a daily point-in-time NAV and reconcile this with their administrator. Furthermore, if you are operating globally, you will need

to take into consideration different pricing points for different markets. These represent not insignificant operational challenges. Independent pricing is also required and though not an issue for listed securities, as per the UCITS guidelines, OTC derivatives are subject to reliable and verifiable valuation on a daily basis.

Can I interact with traditional custodians, not just prime brokers?

Prime brokers manage the settlement and custody process for a hedge fund with a minimum of data. Interacting with a prime broker, experienced in dealing with long-short hedge funds and leverage is not the same as dealing with a traditional long-only custodian. For UCITS funds, custodians require a manager to supply full settlement instructions, and you will need to be able to capture and maintain that data. This will inevitably mean more administration for the manager and there will also be custodial costs to take into consideration.

Can I comply with the derivatives exposure limitations and reporting requirements?

A challenge for managers in launching UCITS compliant versions of existing hedge fund strategies will be compliance with derivatives restrictions. The continuous monitoring of compliance with mandated investment objectives and regulations is also required.

Handling of derivatives: exposure reporting is the approach used for non-sophisticated UCITS. Positions on derivative instruments must be considered as equivalent exposures to underlying assets, which may require inclusion of additional analytics in exposure calculations. Coverage and closeout of offsetting positions also applies. Many systems would find such reporting of synthetics a challenge and potentially would require onerous manual workarounds to generate the reports required.

Issuer concentrations: voting shares, outstanding debt, money market limits, time deposits, the monitoring of leverage and look-through to underlying securities for netting purposes: all present operational challenges when it comes to systems, and data must be accurately maintained and must have sufficient supplementary information regarding issuers, guarantors and counterparties to be able to aggregate exposures appropriately for each of the rules. This issue could be significant, particularly for smaller hedge funds with limited operational resources.

There are specific rules and defined limits for counterparty and concentration risk. Funds need to have the tools in place to be able to measure and document these risks. You must ensure that you can meet the risk reporting requirements that go with running a UCITS fund, deploying a risk management process which enables you to monitor and measure at any time, the risk of the positions and their contribution to the overall risk profile of the portfolio.

Can I handle the frequent clarifications/ amendments in the form of circulars published by the local regulators?

The local regulations derived from UCITS are updated and clarified from time to time. Funds need to be prepared to adapt and ensure they are compliant with the rules at the present time and are equipped to deal with future developments as the landscape shifts.

Looking forward – UCITS revisions and the implications of the AIFM Directive

There have been several revisions to the UCITS directive since its inception and it continues to evolve under consultation with the regulatory bodies of member states and specialist groups including many senior figures from within the alternative industry. The latest revisions being implemented broaden the use of the master feeder structure common to many offshore funds, add further disclosure rules and will include creation of an easy-to-digest Key Investor Information document to form part of the funds prospectus. These steps should go some way to demystifying the alternative style strategies now on offer to the retail investor. The deadline for adoption of

the revised UCITS IV directive is July 2011.

The UCITS IV revision consists of four principal items. The first is the inclusion of the Management Company Passport which will allow funds authorised in one Member State to be managed remotely by a management company established in another Member State and be authorised by that Member State's regulatory body. The second is the removal of administrative barriers to cross-border distribution of UCITS funds by improved Co-operation mechanisms between national regulators. Next, the creation of a framework for mergers between UCITS funds and allowing the use of "masterfeeder" structures. The fourth item is the replacement of the "Simplified Prospectus" with a short two-page "Key Investor Information" document.

In addition to UCITS revisions, the spotlight is firmly on the potential implications of the Alternative Investment Managers (AIFM) directive. The AIFM directive's objective is to achieve a comprehensive and effective regulatory and supervisory framework for hedge funds operating in the EU.

The key risks which the directive seeks to mitigate are:

- Macro risk (systemic) relating to the use of leverage.
Potential weakness in internal risk management systems
- with respect to liquidity, market and counterparty risk.
Investor protection and gaps in disclosure of risk and
- investment policy which may create barriers to effective
- due diligence.
Market efficiency: the impact of short selling techniques on market function and the potential for market abuse.
- Corporate control: market impact and transparency
- concerning ownership of listed stocks and through CFDs
- and lending. Concerted 'activist' strategies.
Acquisition and control of companies by hedge funds.

The operational implications of the draft directive are still to be clarified, but given its objective, we can safely assume a set of provisions will be standard for all Alternative Fund Managers covering effective arrangements for risk management, valuation, asset safe-keeping and audit. Disclosure to both investors and regulators will require a level of regular reporting which, if managed well through the appropriate technology should be neither costly or onerous. Major risk concentrations, major contributors, leverage, significant ownership interests will all need to be available metrics at the touch of a button.

Do you have the necessary technology and infrastructure?

Portfolio / Order Management

The liquidity implications of daily or weekly traded funds require the use of tools to effectively manage and allocate cash accordingly. The distribution or raising of cash across a portfolio whilst maintaining fair allocation of executions across funds / books / positions / strategies can give any portfolio manager an operational headache. An Order Management System (OMS) can solve this problem whilst also providing a host of additional benefits.

Compliance system

The UCITS regulatory requirements arguably present the largest operational challenges to hedge funds. A comprehensive compliance tool, which seamlessly functions both pre-trade with your portfolio and trading tools and continuously monitors the post-trade effect of price changes and cash flows, will deliver significant operational risk reduction and cost savings. Critical to the system selection must be the ability to capture compliance on counterparties and exposure aggregations. The ability to do all this whilst minimising the workflow impact on investment decision makers is vital; a good compliance tool should be working with you, not against you.

A valuation system capable of calculating NAV

The ability to trade CFDs and derivatives within sophisticated UCITS funds means operational efficiencies can only be achieved by using a valuation system which can support the various synthetic products on offer. Accounting for the related financing on swaps and CFDs is essential in order to accurately estimate your NAV at the frequent valuation points.

Flexible Reporting

With increasingly vigorous UCITS rules, internal controls are escalating the demands for audit tracking and reporting on internal compliance and operations teams. Coupled with the demands for investor transparency, a reporting solution that can seamlessly integrate with all internal systems is necessary to provide a scalable, secure option supplying accurate real-time information. A web-based reporting solution adds the flexibility of internal and external access allowing users to log in and view historic data or run ad-hoc reports.

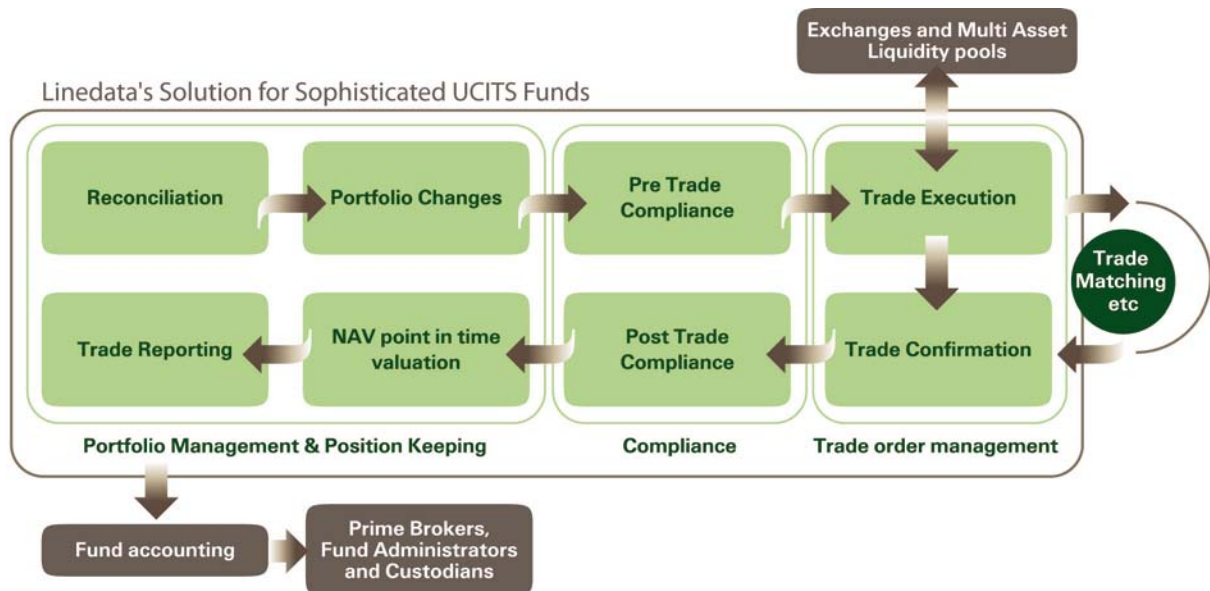
Streamlining communication with minimal operational impact can set a firm ahead by removing the administrative burdens of manually preparing reports while mitigating the risk associated with manually calculated data. With intuitive sophisticated report building tools, advanced data capture and a myriad of delivery methods, Operations staff can automate any type of audit tracking and customized reporting to meet the needs of the organization and the demands of their investors.

Are you ready?

The question many of our clients have been asking themselves in recent months is, are we ready? Whether your intention is to open the doors to the retail investor or to maintain an offshore business model, regulation and compliance is upon us.

Linedata has been a market leader in the design and delivery of asset management systems to both the traditional and alternative investment industries for many years. It is our role to anticipate change and we have been working hard to ensure our solutions are ready. Our clients have always been innovative in taking the investment industry forward and here at Linedata, we are confident our efforts can help you take your business forward into this exciting new era.

Linedata's Solution for Sophisticated UCITS Funds



Advanced OMS

Linedata's award winning OMS Linedata Longview provides real-time transparency and insight, helping managers quickly see, understand and respond to opportunities. Over 150 clients including ten of the top 25 global asset managers rely on Linedata Longview to help optimise portfolios, make trading decisions and execute transactions. By providing seamless integration to hundreds of trading destinations globally, and supporting the process from portfolio management through to post-trade, Linedata Longview simplifies and automates the entire trade process.

Comprehensive Compliance

Linedata Compliance is a market leading compliance system which delivers all of this. Complete with a full set of the latest UCITS rules, maintaining rules and managing mandates across multiple funds becomes easy. Linedata Compliance is a fully integrated, multi-user compliance solution for buy-side institutions and hedge funds that supports the business requirements and workflows of compliance officers, portfolio managers and traders. Linedata Compliance can be delivered either stand alone upon your existing infrastructure or integrated with any of Linedata's other products.

A valuation system capable of calculating NAV

Linedata Beauchamp Fundmanager is Linedata's flagship portfolio management platform which gives you total control of your portfolios and transactions, from post trade, straight through to custodial and prime broker reporting. Linedata Beauchamp Fundmanager presents a single consistent view of your entire organisation on the same page, maximising performance, reducing errors, cutting costs and speeding up every deal. Linedata Beauchamp Fundmanager enables sophisticated tracking of product and counterparty financing, enabling accurate NAV estimation to both reconcile with and monitor third party administrators.

Flexible Reporting

Linedata Reporting is a fully integrated solution providing a robust reporting package which makes it easy to create sophisticated reports for both internal and external reporting. With its drag-and-drop report building tools, graphically rich management dashboards and its auditable historical data retention, Linedata Reporting is the most simple, intuitive and robust reporting solution in the market, making it easy to create great looking reports by providing a comprehensive report building toolbox. Linedata Reporting utilises comprehensive, permission based access that keeps the underlying data of a report safe from changes being made to the look and feel of the report. Operations staff have access to the report designer and the data without the risk of corrupting that data. Updates to reports can be delivered online in real-time

About Linedata

Linedata is a global solutions provider with 700 clients operating in 50 countries. With more than 840 employees across the globe, Linedata is dedicated to the investment management and credit community. Linedata has been at the service of the financial industry from day one, and applies its market and client insight to provide innovative and tailored mission-critical software and services that help its clients grow. As a pioneer for over 10 years with the set up of ASP infrastructure for the financial industry, Linedata has preached and spread this model throughout the global financial community, for its full range of products. Headquartered in France, Linedata achieved revenues of EUR 144.5 million in 2009. This company is listed on Euronext Paris FR0004156297-LIN - Reuters LDSV.LN - Bloomberg LIN:FP.

Linedata provides comprehensive front-to-back solutions and services to manage all types of investment processes, from pre-trade to post-settlement, across a wide range of firms, including institutional portfolio and collective management companies, hedge funds, prime brokers, fund managers, transfer agents, corporate savings fund managers, and subsidiaries of banks or independents.