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**2016 INVESTMENT MANAGEMENT CONFERENCE**

# Alternative Products/ Registered Funds with Alternative Strategies

George Zornada, Partner, Boston

# REGISTERED FUNDS AND ALTERNATIVE INVESTMENTS

- During the post-crisis period of low interest rates, which continues, traditional fixed income investments have produced low interest income while many equity markets have exhibited volatility.
- Investor demand increased for "alternatives“ to traditional equity and fixed income investments and strategies. Many advisers recommend such alternative allocations as part of an investor’s diversified investment portfolio.
- Advisers and "average" investors are comfortable with a traditional mutual fund form, and advisers seek alternative exposure for their clients. Registered funds thus have expanded the borders of traditional investments and strategies to meet demand.

# REGISTERED ALTERNATIVE PRODUCTS

- Open-end and Closed-end Funds
  - Depends on liquid or illiquid nature of assets

- Registered alternative funds can involve alternative assets as well as alternative investment strategies

# REGISTERED FUNDS WITH NON-TRADITIONAL ASSET CLASSES OR STRATEGIES

- Mutual funds using "hedge fund" like strategies
  - Long/short equity funds
  - “Macro” funds using multi-manager, multi-strategy model
  - “Macro” multi-strategy fund of funds
  - Event-driven funds (special situations)
  - Event-linked funds (catastrophe bond)
  - Global macro/managed futures
  - Risk weighted multi-asset funds
  - Emerging market or frontier market investments
- Commodities Exposure (also ETPs that are not investment companies)
- Energy master limited partnership funds (MLPs in open and closed-end funds)
- Closed-end funds and illiquid and less liquid strategies
- **Although these strategies and asset classes involve creativity at work, registered funds do have distinct limits - there always will be hedge funds**

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# MUTUAL FUNDS WITH “HEDGE FUND" STRATEGIES

- Long/short funds
  - Invest in long and short positions in securities
  - With a long position, the fund purchases a security outright; with a short position, the fund sells a security that it does not own and must borrow to meet its settlement obligations
  - Asset  coverage requirements limit the amount of shorting by a registered fund
- Multi-manager, multi-strategy funds
  - Main adviser allocates fund assets to distinct sleeves managed by separate (often unaffiliated) sub-advisers
  - Sleeves may pursue same overall strategy using different sub-advisers, or different strategies
- Multi-strategy fund of funds
  - Access alternative investment strategies (e.g., convertible arbitrage, event driven (merger arbitrage), fixed income relative value, equity market neutral, long/short equity, global macro, managed futures and emerging markets) by allocating among in other investment companies
  - Similar objective to multi-manager, multi-strategy but using underlying funds

# MUTUAL FUNDS WITH “HEDGE FUND" STRATEGIES

- **Event-driven funds (special situations/activism)**
  - Invests in the securities of publicly traded companies involved in mergers, takeovers, tender offers, leveraged buyouts, spin-offs, liquidations, or similar events (“corporate reorganizations”).
  - A variety of strategies can be employed to capitalize on the mispricing of corporate securities during corporate reorganizations, including transactions involving common and preferred stock, debt instruments and derivative securities.
  - Strategies often involve the use of arbitrage, which involves taking advantage of small price differences between two otherwise equivalent assets.
  - Such strategies considered to be less dependent on the overall direction of stock prices.
  - Can be “activist” as well, where fund adviser lobbies management of portfolio companies for change.
- **Event-linked funds (catastrophe bonds)**
  - Return of principal and payment of interest contingent on the non-occurrence of a specified trigger event(s) that leads to economic and/or human loss, such as an earthquake of a particular magnitude or a hurricane of a specific category.
  - The most common type of event-linked bonds is known as “catastrophe” or “CAT” bonds.
  - In most cases, the trigger event(s) will not be deemed to have occurred unless the event(s) happened in a particular geographic area and was of a certain magnitude or caused a certain amount of actual or modeled loss.  If the trigger event(s) occurs prior to a bond's maturity, the fund may lose all or a portion of its principal and forgo additional interest.
  - Liquidity of the CAT bond market is biggest challenge, although increasingly liquid.
  - Uncorrelated to equity or bond markets.

# MUTUAL FUNDS WITH “HEDGE FUND" STRATEGIES

- Global Macro/Managed Futures
  - Focus on investing in instruments whose prices fluctuate based on the changes in economic policies, along with the flow of capital around the globe - instruments move based on systemic risk rather than security specific
  - In general, focus on trading futures in currency strategies, interest rates strategies, and stock index strategies
  - To run as a RIC, must use offshore subsidiary for any commodities futures that produce “bad income”
  - Utilize inherent or “economic” leverage in futures typically with programmatic trading
  - Asset coverage requirements
  - CFTC has “harmonized” requirements for such funds, which also are commodity pools

# COMMODITIES EXPOSURE

- Commodity RICs
  - Often similar/same as “managed futures” funds but focused on commodities futures rather than financial futures
  - Must use offshore subsidiary structure to be a RIC
  - Asset coverage requirements
  - CFTC harmony
- Commodity ETPs (exchange traded products)
  - Pool that holds only physical commodity (i.e., gold, silver, copper)
  - **Neither an investment company nor a commodity pool**
  - Exchange-traded issuer like a public company

# MUTUAL FUNDS WITH "HEDGE FUND" STRATEGIES

- Risk weighted multi-asset funds
  - Focuses on allocation of risk among asset classes
  - Goal is to earn the steady level of return with less volatility and overall risk, or to realize better returns with an equal amount of risk and volatility (versus traditional asset allocation strategies)
  - May use pre-determined asset class allocation or dynamic balancing
  - If using futures/derivatives, asset coverage issues
- Emerging market and frontier market investment
  - Focus on securities of non-government issuers in developing countries
  - Liquidity may be an issue

# MLPS

- MLPs are "master limited partnerships" mainly in the energy/resources areas.
- MLPs are generally treated as partnerships for U.S. federal income tax purposes.
- A RIC is limited to 25% direct holding of MLPs. Registered funds that are RICs must diversify assets into MLPs, related companies or exposure to such companies through other instruments.
- Some MLPs are not RICs but are registered investment companies that operate as "C corporations" rather than as a RIC.
- To be treated as a partnership for U.S. federal income tax purposes, an MLP must derive at least 90% of its gross income for each taxable year from qualifying sources, including activities such as the exploration, development, mining, production, processing, refining, transportation, storage and certain marketing of mineral or natural resources.
- MLPs are generally publicly traded, are regulated by the SEC and must make public filings like any publicly traded corporation.
- Many MLPs operate oil, gas or petroleum facilities, or other facilities within the energy sector.
- Midstream MLPs may also operate ancillary businesses including marketing of energy products and logistical services. The MLPs in which the Fund invests may also engage in owning, managing and transporting alternative energy assets, including alternative fuels such as ethanol, hydrogen and biodiesel.

# CLOSED END FUNDS: INTERVAL FUNDS, REGISTERED FUNDS OF HEDGE FUNDS AND PRIVATE EQUITY FUNDS

- Closed-end and continuously offered, rather than exchange traded
- Liquidity is limited
  - Provide investors with liquidity using either periodic repurchases within a fixed range (interval funds) or tender offer repurchases
- Partnership or RIC structure
- Partnership structure provides exposure to potentially anything investable, anywhere, RIC structure still has limits but not on liquidity of portfolio holdings
  - Particular increase in interest in private equity fund of funds
- Not generally available to all investors (accredited investor standard), even if publicly offered based on SEC staff policy