

# Introduction to Funds

## Link' n Learn

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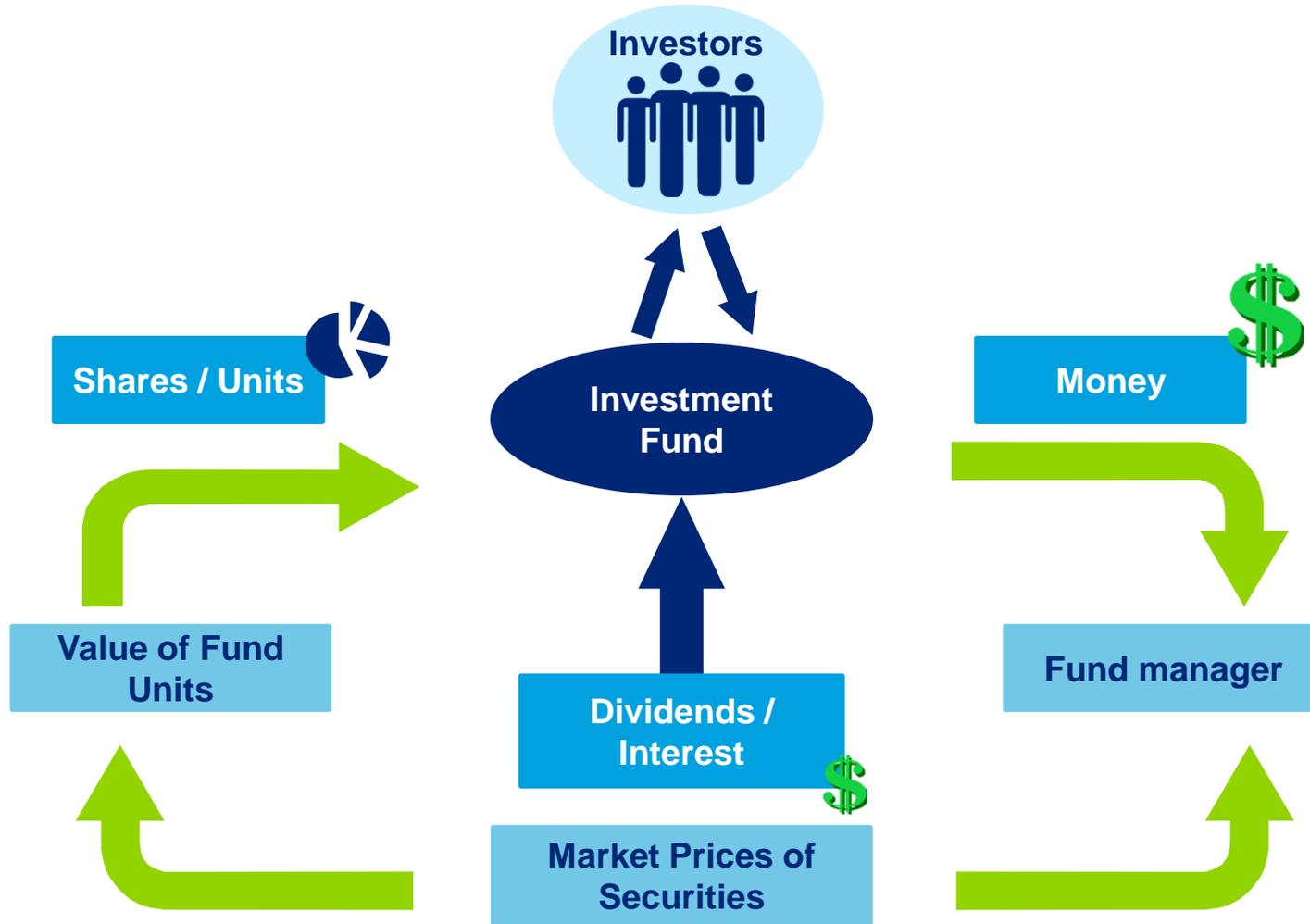


## Introduction to Funds:

- What is a Fund?
- Types of Fund Structures
- Legal & Regulatory Environment



# How an Investment Fund works?



# What is a Fund?

## Definition

"An investment fund is an entity that pools investors money in return for shares or units in the fund and invests this money on a collective basis based on the investment objectives of the fund. An investor can contribute a relatively small sum of money and still experience the benefits of diversification and liquidity as well as the benefits of a skilled investment team who manage the underlying performance of the investments".

## Why invest in a Fund?:

- Diversification – “spreading of risk”
- To generate a return to shareholders
  - Capital appreciation
  - Income maximisation

# Valuation

## What is a NAV and how is it calculated?

The value of an Investment Fund at the end of any given business day is its Net Asset Value or NAV. Essentially, the NAV per share is calculated as the total net assets of the fund divided by the total number of shares outstanding. Net Assets is essentially the “balance sheet” of the fund, where Net Assets equals assets of the fund minus its liabilities.

<u>Assets</u>	
Investments	1,000
Cash at Bank	600
Debtors	<u>400</u>
	2,000
 <u>Liabilities</u>	
Creditors	<u>500</u>
 Total Net Assets	 1,500
 Number of shares outstanding	 1,000
 NAV per share	 1.50

# Valuation

## Importance of the NAV

All open-ended Investment funds must stand ready to redeem shares upon demand by the shareholder. The fund may also want to accept new capital. In order to complete either of these transactions without disadvantaging either the existing shareholders (be they continuing or cashing out) or the new shareholders, the NAV per share must be calculated.

# Types of Fund Structures

## Legal

Unit Trust

Limited Partnership

Investment Company

Common Contractual Fund

## Organisation

Umbrella Fund

Closed Ended Fund

Master/ Feeder Fund

Fund of Funds

## Regulatory

Mutual Fund

Hedge Fund

# Types of Fund Structures

- **Unit Trust**

- Structured under a Trust Deed
- Investors are referred to as unit holders

- **Investment Company**

- An entity structured as a company that invests pooled shareholder funds in securities appropriate to the organisation's objective.
- May be Open or Closed Ended..

- **Limited Partnerships**

- An arrangement where two or more people come together to share in a business venture.
- Each partner will contribute funds or other resources to establish the business

- **Common Contractual Funds**

- Established by a management company under which the participants by contractual arrangement participate and share in the property of the collective investment undertaking as co-owners.

# Types of Fund Structures

- **Umbrella Fund**

- A fund that is comprised of sub-funds with each sub-fund representing a separate group of investors and a separate portfolio of assets.

- **Closed Ended Fund**

- A type of investment fund which is not obliged to purchase units or shares back on request of investors. The monies of investors are locked in the fund for a definite period.

- **Master / Feeder Funds**

- Master/feeder funds refer to a structure whereby there is one underlying fund which holds all the investments (the master fund) and a number of feeder funds.
- The feeder funds only hold shares in the master fund.
- The advantage of this structure is that each feeder fund can be targeted to different investors.

- **Fund of Funds**

# Types of Fund Structures

- Hedge Funds

- Less Regulated than Mutual Funds
- Very Broad Definition of what a Hedge Fund is
- Alternative Investment Strategies – Short Selling, Derivative Usage, Use of Leverage

- Mutual Funds

- Undertaking for Collective Investment in Transferable Securities (UCITS)
- Generally invest in long only equities, bonds and money market instruments

# Example of a Fund Structure

## UCITS Fund

### Constitution of a UCITS

- Freely marketable within the EU
- Must comply with UCITS Regulations
  - Must be Open Ended
  - Transferrable Securities
  - Independent Custodian

### Eligible Assets

- Transferable Securities
- Money Market Instruments
- Index Tracking Funds
- Cash Deposits

### Investment Restrictions

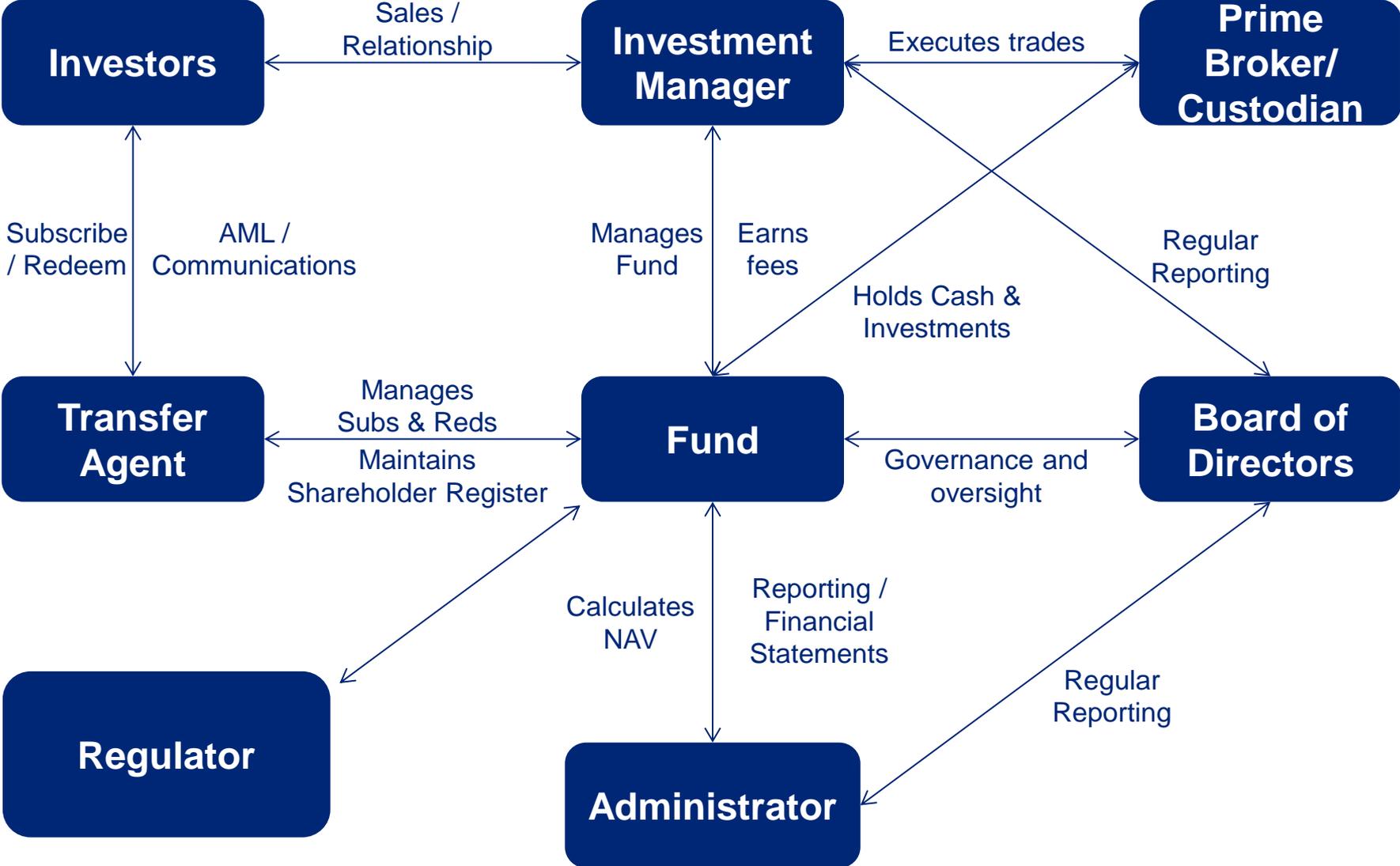
- General “5/10/40” Rule
- Exceptions – see UCITS notices

## Key Participants to a Fund

- Who are the Key Participants
- Roles of Key Participants



# Key Participants to a Fund



# The Investment Fund World

## Key Participants and Roles

### Regulator

- Authorisation
- Supervision

### Custodian

- To ensure the safe-keeping of investments.
- Ensures that the sale and the purchase of shares is made in accordance with the investment policy
- Execute the requests of the management company or the management of the fund in relation to the above.

### Prime Broker

- The services provided under prime brokering are securities lending, leveraged trade executions, and cash management
- Global custody.

# The Investment Fund World

## Key Participants and Roles

### Investment Manager

- Responsible for establishing the fund
- Often located in fund centres such as London and New York
- Vary in size from boutique firms to global players.
- Markets the fund to investors (often works with distributors to market fund across multiple jurisdictions).
- Manages portfolio of investments and makes investment decisions (portfolio management may be undertaken by a separate investment advisor).

### Administrator

- Calculation of Net Asset Value (NAV).
  - Maintaining and updating the portfolio of investments.
  - Pricing of assets.
  - Calculating fees and expenses.
- Preparing interim and annual accounts.

# The Investment Fund World

## Key Participants and Roles

### Transfer Agent

- Processes subscriptions and redemptions including the collection and payment of cash.
- Completes Know Your Client (KYC) and Anti-Money Laundering (AML) procedures.
- Maintains shareholder register.
- Manages shareholder communications.
- Processes dividends/distributions.

### Board of Directors

- Ultimate responsibility for the governance of the fund and for safeguarding the interests of investors.
- Also responsible for approving the fund documents, the financial statements and the appointment of the service providers.

Financial Instruments and Valuations:



# What is a Financial Instrument?

A **financial instrument** is a trading asset of any kind; either cash, evidence of an ownership interest in an entity, or a contractual right to receive or deliver cash or another financial instrument.

Financial Instruments are divided between:

## 1. **Non Derivative Financial Instrument**

Non derivative financial instruments comprise investment in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowing, and trade and other payables.

## 2. **Derivative Financial Instrument**

A derivative is a financial instrument whose value “depends on” or is “derived from” the value of an underlying asset. Derivatives cover a wide range of products. The purpose of entering into a derivative transaction may be either hedging or speculative

# Examples of Non Derivative and Derivative Financial Instruments

Non Derivative Financial Instruments	Derivative Financial Instruments
Equities	Forwards
Bonds	Futures
Cash	Options
Private Equity	CFDs
Real Estate	Swaps

# Listed V OTC Positions

## Listed Positions

- Securities which have been admitted for trading on an official stock exchange for example the London Stock Exchange.

## OTC Positions

- A market for financial instruments which are not listed on a stock exchange, comprising a collection of bilateral dealing contracts between brokers.

# Long V Short Positions

## Long Positions

- The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value.
- Price increases are beneficial to the fund, decreases reduce the value of the asset

## Short Positions

- A short position is not a derivative as such. The idea of shorting an asset entails selling an asset which you don't own.
- The rationale for doing this is that if the price falls, you will be able to buy the asset back at a lower price than you sold it for, thus profiting from a fall in prices.

# Different Types of Financial Instruments

## Equities

- Equities represent the common stock in companies, and are often quoted on a stock market. Equities usually pay dividends.
- The value of an equity varies with the markets opinion of the state of the company.

## Bonds

- Bonds, also called fixed income securities, are debt securities issued by governments, companies, municipalities (local governments) and ,in the US, by certain government backed agencies.
- Bonds are characterised by a number of factors:
  - Nominal amount
  - Coupon
  - Coupon date
  - Maturity

# Different Types of Financial Instruments

## Forwards

- A contract to buy or sell a specific quantity of a specified asset on a specified date in the future at an agreed price.
- The specified date in the future is often referred to as the settlement date while the date the contract is entered into is referred to as the trade date.
- No payment/delivery is made by either party until the settlement date.

## Futures

- Futures are a type of forward contract which are distinguished by being highly standardised and are traded on a futures exchange e.g. the London International Financial Futures Exchange (LIFFE), the Chicago Board of Trade (CBOT) and the Chicago Mercantile Exchange (CME).
- A futures contract is an agreement to buy or sell a standard quantity of a specific asset at a pre-determined future date at an agreed price.

# Different Types of Financial Instruments

## Options

- An option gives the holder (purchaser) the right, but not the obligation, to buy or sell a fixed quantity of a specified asset from/to the counter party at a specified price at a time (or within a period) in the future.
- Options include:
  - Call Option
  - Put Option

## CFDs

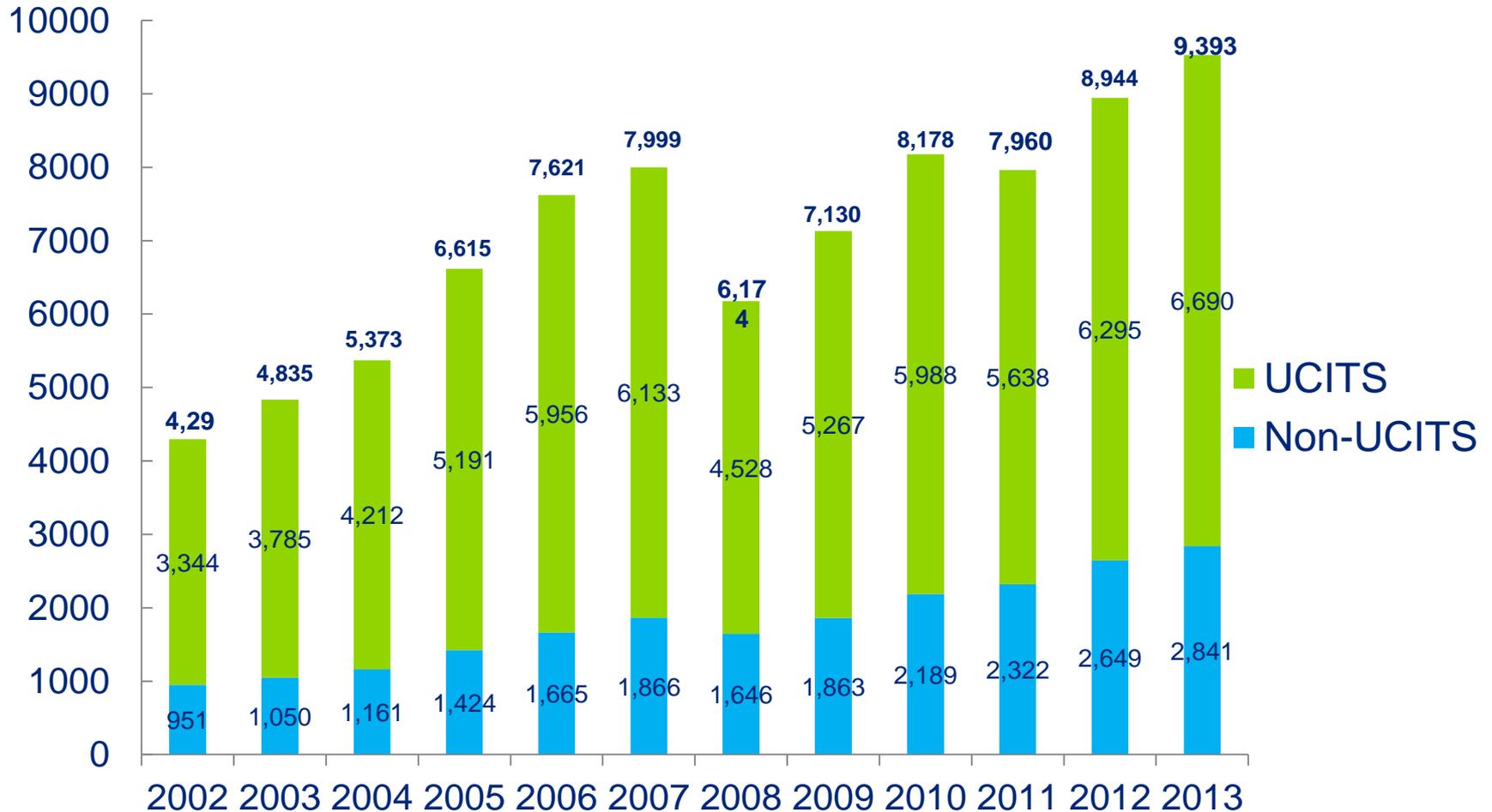
- A CFD (contract for differences) is an agreement which exposes buyers to the change in value of an asset without having to purchase the asset itself.
- If the value of the underlying asset changes, one of the parties to the CFD will gain and the other will lose.

# Market Trends



# Net assets of European Investment funds 2013

Eur Billion

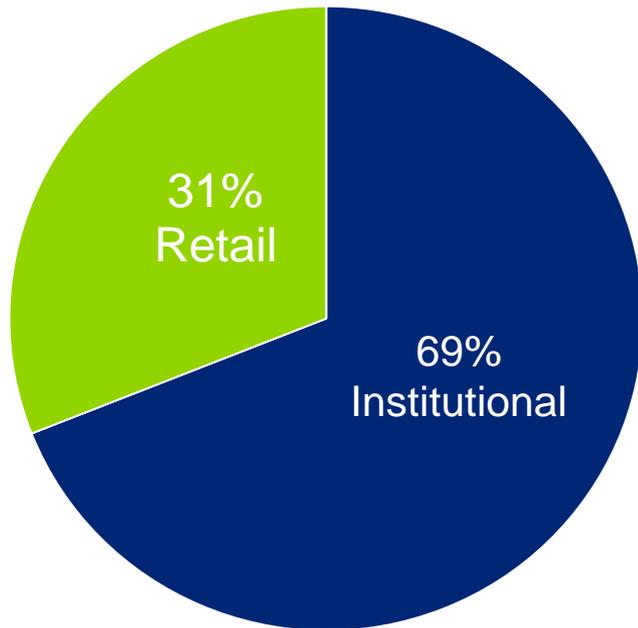


Source: EFAMA, Trends in the European Investment Funds Industry, 2013 Q3

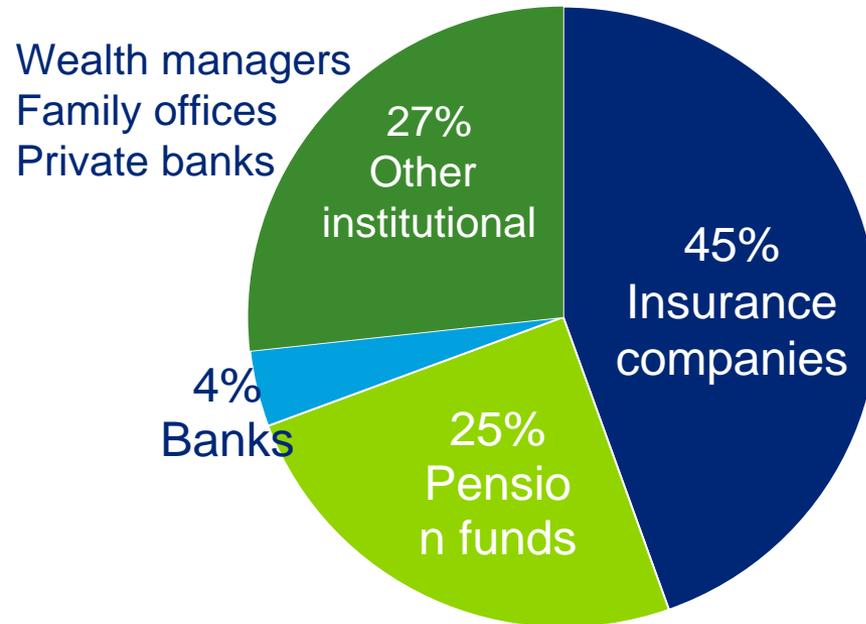
# European investor base

Heavily institutional

**European investor base**  
(by % of assets)



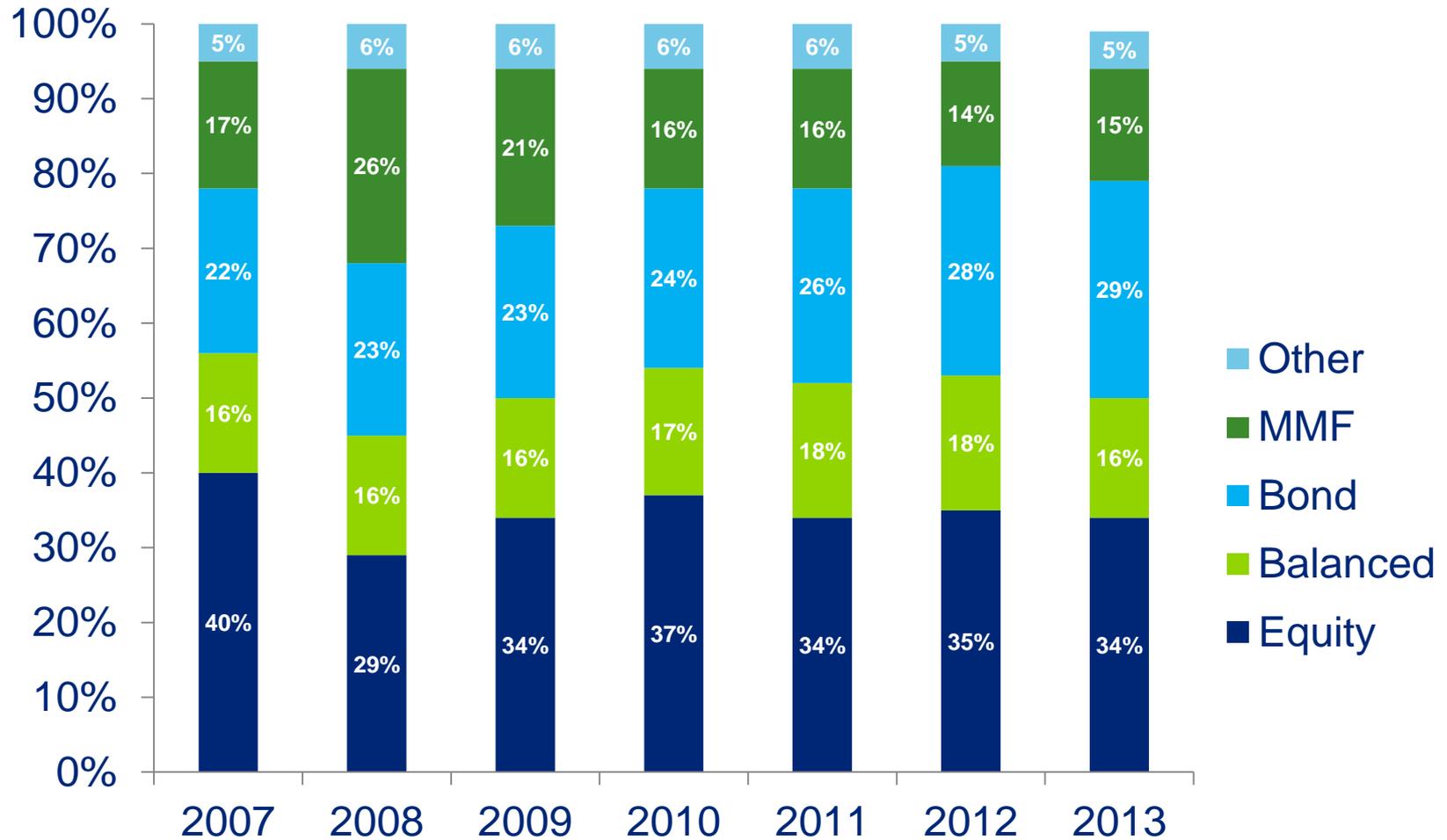
**European institutional investor base**  
(by % of assets)



Source: EFAMA Factbook, 2012

# Asset allocation in UCITS

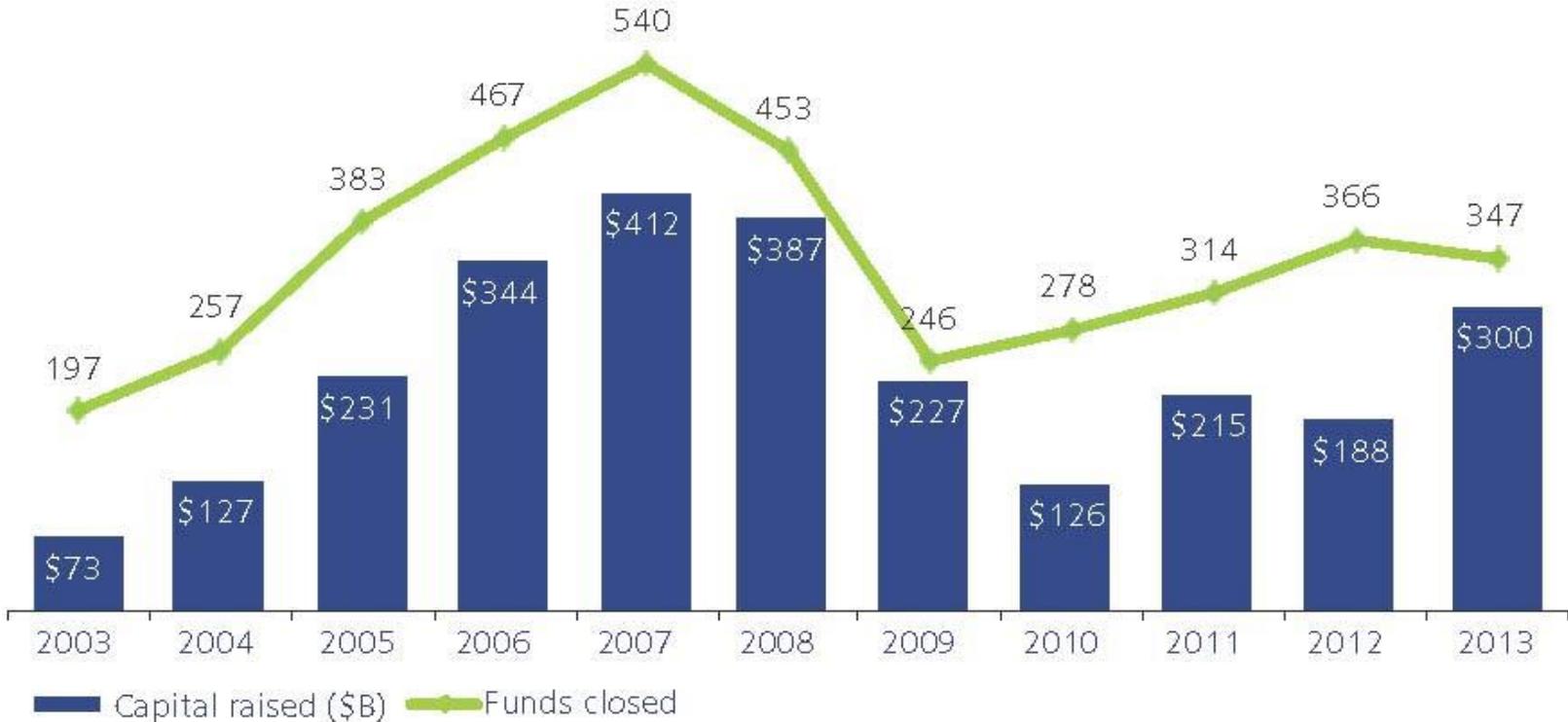
By type in percent



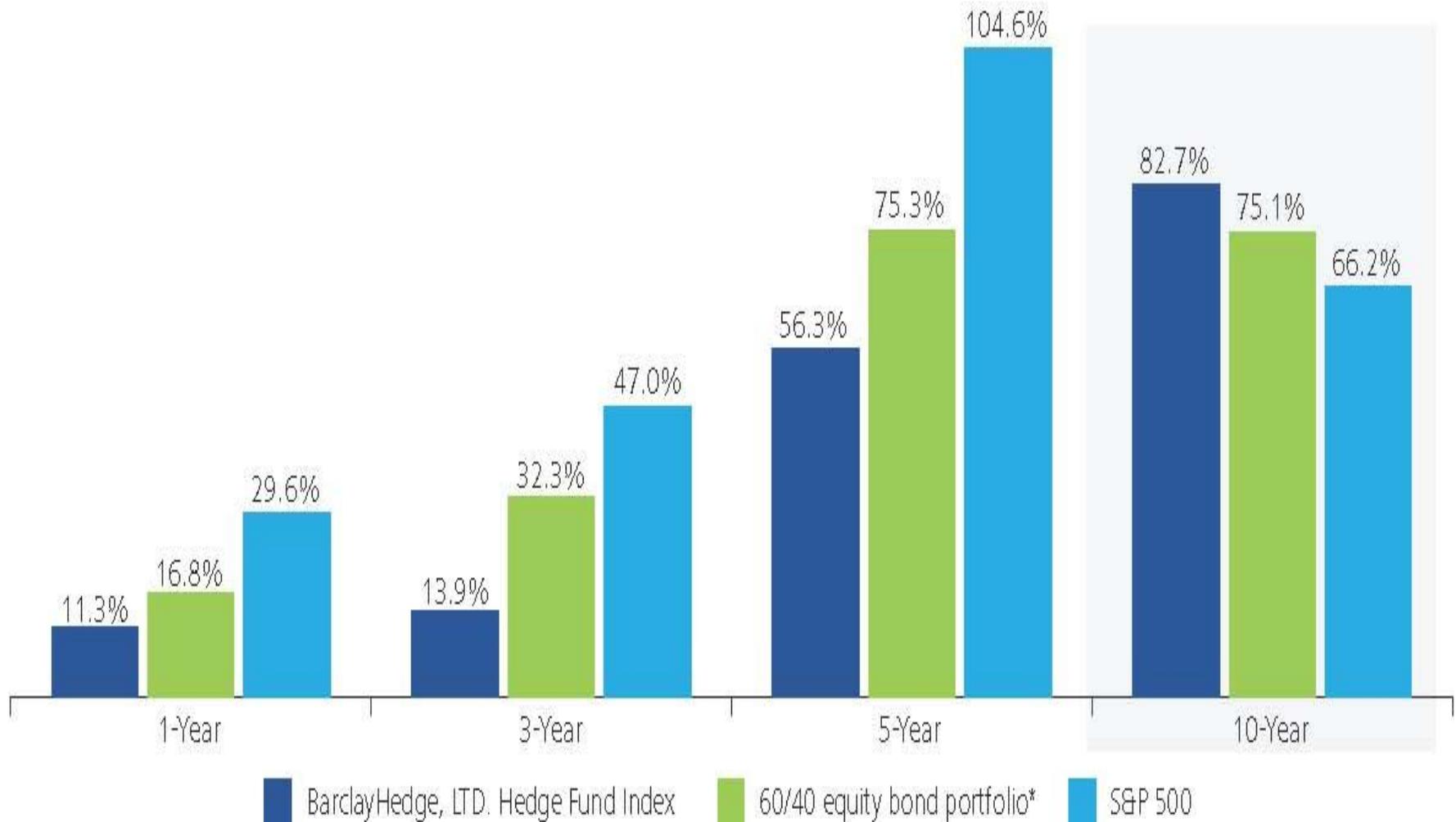
Source: EFAMA, Trends in the European Investment Funds Industry,

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# Global Private Equity Fundraising



# Hedge Funds Superior Performance

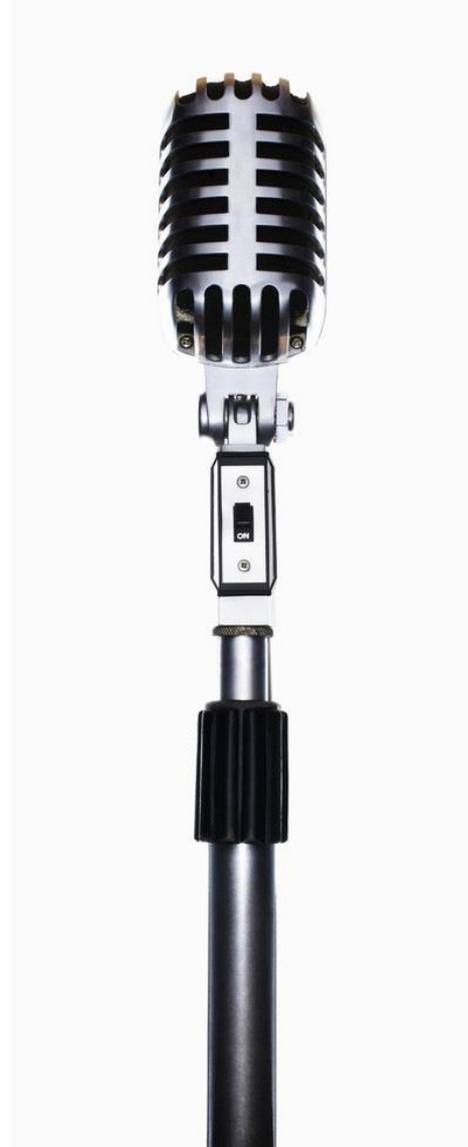


Source: Investment Company Institute, Worldwide Market 3Q10, 3Q13

<sup>1</sup> Investment Company Institute, "Worldwide Mutual Fund Market Data, Third Quarter 2013," January 7, 2014.

<sup>2</sup> Sue Thompson, CIMA, "It Was Twenty Years Ago Today," The Blog, November 1, 2013, BlackRock, <https://www.blackrockblog.com/2013/11/01/twenty-years-today/>.

**Q&A**



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