Introduction to Investment Funds
Speaker

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Agenda

1. Introduction

2. General principles
   - How an investment funds works?
   - Different structures
   - Parties involved

3. Regulatory evolutions

4. Market trends
Introduction
Asset Management Industry

“The asset management industry plays a distinctive role in capital markets by pooling the savings of investors and investing them strategically in financial instruments and other assets with the aim of generating returns.”

**Economic function of asset management industry:**

- Facilitate participation of small investors in financial markets (and sometimes offering a form of capital protection)
- Participate in both primary and secondary equity markets
- Providing short and long term credit to corporates, financials institutions and governments
- Participate in price discovery

Asset managers interact with banks and insurers in different ways, e.g.:

- Through commissions for managing their portfolios
- Presence in banking groups and corporate ownerships
- Sourcing of leverage through prime-brokerage agreements
- Distribution agreements
Introduction
Role of investment funds in the Asset Management industry

Investors

Retail
- HNWI
- Households

Institutional
- Pension Funds
- Insurance companies
- Banks
- Other

Discretionary Mandate
Private Banker
Investment management company
Depositary Bank

Invest

Investment fund
ManCo

Invest

Fund Administrator
General principles
How investment funds work?
Key principles

- Main principle: many small investors make one large investor
- Diversified portfolios
- Less risk (sometimes capital protected)
- Professional expertise (but costs are charged)
- Access to foreign markets (which might be blocked for private investors)
- Many types of mutual funds
Terminology

- **Net Asset Value (NAV):**
  - Intrinsic value of fund
  - Usually expressed per share outstanding

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<thead>
<tr>
<th>Assets</th>
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<tr>
<td>Investments</td>
<td>1,000</td>
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<tr>
<td>Cash at Bank</td>
<td>200</td>
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<tr>
<td>Debtors</td>
<td>50</td>
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<th>Liabilities</th>
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<td>Creditors</td>
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| Total Net Assets| 1,220   |
| Number of shares outstanding | 100    |
| NAV per share    | 12.2    |

**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.
Terminology

○ Prospectus:
  ○ Contract between investor and mutual fund
  ○ Publicly available

○ Determines:
  • Parties involved
  • Investment strategy of the compartment
  • Fee structure

○ Key Investor Information Document (KIID):
  A stand-alone, pre-contractual, 2-page document containing the essential features of the fund and is to be systematically provided to investors before they decide to invest
Different structures
Different structures

Many distinctions are possible between types of investment funds, based on:

- Legal criteria
  - Mainly dependent of country of origin

- Organisational criteria
  - Fund of funds, Master/Feeder, closed ended funds, ...

- Regulatory regimes
  - UCITS, AIFMD

- Investment policy
  - *We refer to the next slides for further details*
Risk and reward potential for types of funds

- Three basic types can be identified: stock (also called equity), bond and money market.
- Depending on the underlying investments of the fund, the risk and reward profile will also be different (at least in theory).
Parties involved
Parties involved

- **Investors**
  - Subscribe/Redeem
  - AML/Communications

- **Transfer Agent**
  - Manages Subs & Reds
  - Maintains Shareholder Register

- **Investment Managers**
  - Manages funds
  - Earns fees

- **Prime Broker/Custodian**
  -Executes trades
  - Holds Cash & Investments
  - Regular Reporting

- **Fund**
  - Calculates NAV
  - Reporting/Financial Statements
  - Governance and oversight

- **Board of Directors**
  - Regular Reporting

- **Regulator**
  - AML/Communications

- **Administrator**
  - Regular Reporting
Roles of key participants

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 execution, and cash management
- Global custody
Roles of key participants

**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 funds 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
Roles of key participants

- **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
Regulatory evolutions
Our understanding of current challenges

It’s relatively easy to identify the challenges facing funds, but it’s a lot harder to determine how an individual fund should respond. Understanding these challenges as external auditor hereby forms an integral part in carrying out a risk-oriented and client-tailored audit approach.

**Securities Financing Transaction Regulation (SFTR)**
- Q1 2016: entry into force
- Q3 2016: start of the phased-in implementation
- To be confirmed by ESMA and European Commission

**European Market and Infrastructure Regulation (EMIR)**
- 21 June 2016: Clearing obligations start for certain types of interest rate derivatives
- Q3 2016: Start exchange of initial and variation margins for non-centrally-cleared OTC derivatives
- To be confirmed by ESMA and European Commission

**UCITS V**
- March 2016 at the latest: Implementation of the Directive

**CRS**
- UCITS V: Implementation
- CRS: Go-live of new on-boarding packages related to CRS classification / Go-live of data capture
- CRIS: First exchange of data with Luxembourg tax authorities

**SECURITIES FINANCING TRANSACTION REGULATION (SFTR)**
- January 2016 - Receipt of feedback on the draft RTS
- March 2016 - The ESA will deliver the draft RTS to the EC
- December 2016
  - Entry into force of the Regulation
  - New KIDs are required
- December 2019 – End of the grandfathering period for UCITS

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<th>Year</th>
<th>Event</th>
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<td>MiFIR/MiFID: Final delegated regulation and delegated directive</td>
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Our understanding of current challenges

**Common Reporting Standard (CRS)**
- New on-boarding packages (subscription forms) regarding CRS classification of both entities and individuals must go live on 1 January 2016
- Contractual documentation such as general terms of business and prospectuses should be updated before 1 January 2016
- Data capture for CRS purposes (tracking financial data) should go live on 1 January 2016
- Classification and remediation of pre-existing clients (client relations established before 1 January 2016) must be carried out before the end of 2016 or 2017, depending on the typology of the client

**Capital Markets Union (CMU)**
- In 2016: the current call for evidence on the impact of recent regulation and the impediments to funding will result in initiatives to alleviate any identified blocks to cross-border distribution
- It will also see proposals brought forward to increase transparency in the sector of SME funding with consideration given to the Prospectus Directive and standardized credit information. It will review and propose new legislation on safe securitization
- Finally, it will continue to focus on ELTIFs as a key initiative to stimulate and finance infrastructure development. Other initiatives are expected to follow

**Capital Markets Union (CMU)**
- Building blocks of CMU in place by the end of the EU Commission's mandate in 2019

**Common Reporting Standard (CRS)**
- Entry into force on 1 January 2016

**MiFID**
- MiFID: Entry intro force

**AIFMD**
- AIFMD: End of private placement regime in EU

**PRIIPS**
- PRIIPS: Entry intro force and new KIDS

**CMU**
- CMU: Building blocks of CMU in place by the end of the EU Commission's mandate in 2019
Market trends
Net assets of European Investment Funds 2016

Source: EFAMA; Trends in the European Investment Fund Industry in the First Quarter of 2016
Net assets of European Investment Funds 2016

European investor base
By % of assets

- Retail: 26%
- Institutional: 74%

European Institutional Investor base
(by % of assets)

- Banks: 2%
- Insurance Companies: 21%
- Pension Funds: 64%
- Other Institutional: 13%

Source: EFAMA; Asset Management in Europe; 8th Annual Review. April 2015
Asset allocation in UCITS (by % type)

Source: EFAMA; Trends in the European Investment Fund Industry in the First Quarter of 2016
### Global Private Equity Fundraising

**No of closed funds** | **Aggregate capital raised ($bn)**
---|---
2003 | 558 | 105
2004 | 862 | 220
2005 | 1,109 | 366
2006 | 1,331 | 547
2007 | 1,527 | 682
2008 | 1,510 | 706
2009 | 982 | 322
2010 | 1,050 | 306
2011 | 1,187 | 356
2012 | 1,297 | 415
2013 | 1,395 | 569
2014 | 1,394 | 589
2015 | 1,062 | 551

Source: 2016 Preqin Global Private Equity & Venture Capital Report
Q&A
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