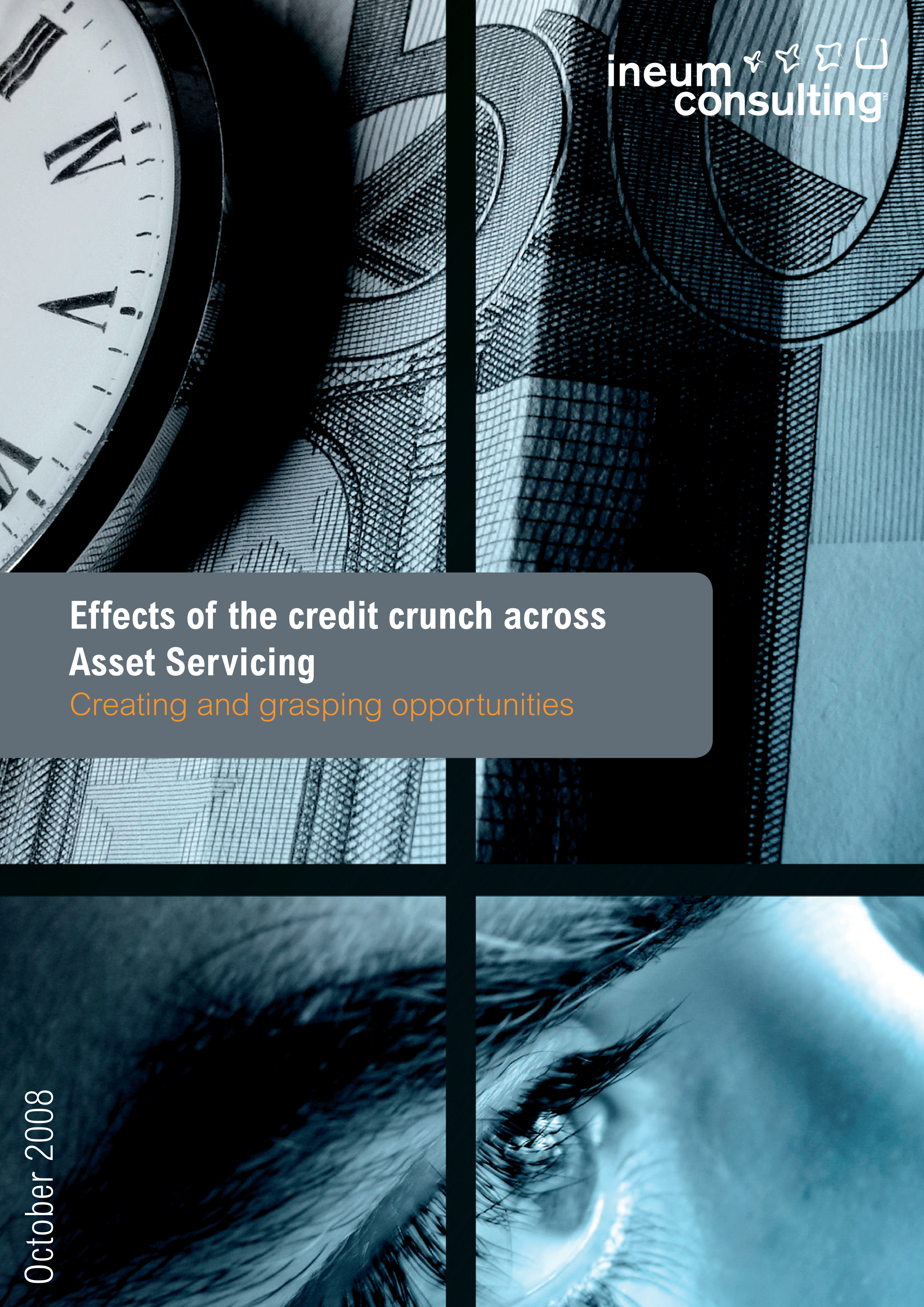

Effects of the credit crunch across Asset Servicing

Creating and grasping opportunities

October 2008

Ineum Consulting Comment

Following decades of massive growth and success, the challenges facing the asset servicing industry, are diverse and intriguing. Until recently, life wasn't so bad for custody and fund administration businesses. Some players within the industry echoed this sentiment saying that the global economic circumstances have created some challenges and opportunities. For example, fund of hedge funds' managers, will certainly increase their financing appetite; it means service providers will become extremely choosy. Moreover, the bankruptcy of Lehman Brothers has introduced another challenge with regards to settlement risk. This entails ongoing developments on technology to remain at the cutting edge; additionally this allows the industry to face down competition.

Some players are asking themselves if the time has come to focus more on specialization such as valuation with "quant profiles" fully provided internally; servicing alternative funds onshore or offshore; concentrating on profitable clients segment; attracting and retaining top talented staff and anticipating changes in regulation.
Following the recent EU measures to resolve the current liquidity crisis, a tremendous amount of questions and issues have been raised. This report was prepared prior the rapid deterioration of the market conditions.
It's about being conscious and creating opportunities.

Michel Kabanga Kayembe
Investment Funds Advisory Services, Practice Leader

Acknowledgments
First and foremost, we would like to thank the following custodian and fund administration institutions that contributed to our current research efforts by sharing their thoughts with us: Caceis Investors Services, Fortis Prime Fund Solutions and The Bank of New York Mellon and BNP Paribas.
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Contents

Executive Summary

This report describes the effects of the liquidity crisis or credit crunch on custody and fund administration, commonly referred to asset servicing. Our research conducted in August 2008, revealed that:

- Fourteen funds shut their doors in Europe. This included Spain, France and UK as investors continued to withdraw assets;
- Six funds temporarily suspended redemptions, and reopened;
- Mostly hedge funds were affected and some traditional and listed funds who invested in Asset Backed Securities (ABS), Mortgage Backed Securities (MBS) or Collateralised Debt Obligation (CDO).

Whilst the industry has an indirect exposure to the credit crunch, the crisis addressed different issues in Europe to custodian banks and fund administrators, notably in the following domains:

- Fund's valuation process for illiquid assets and complex financial instruments;
- Margin call and collateral management when dealing with Over-The-Counter (OTC) derivatives;
- Product control capabilities;
- Oversight to maintain compliance with regulatory requirements.

From consultations to recommendations, the temptation of over-regulation is hanging over the industry. CESR, IOSCO, the Council of European Union and others organizations are embarking in a challenging journey to tackle these issues.

Ineum Consulting recommends that the industry continuously pursues efforts to:

- Solve the valuation dilemma by assessing the portfolio composition, i.e. initiate a mapping process of the illiquid assets and less traded assets onto the corresponding valuation techniques, being mark-to-matrix or mark-to-model;
- Assign an appropriate risk profile to each individual fund by describing the complexity of strategy used whether in a perspective of hedging the underlying assets held in the portfolio or in order to gain an exposure to the investable opportunities;
- Potentially improve the operating model by introducing the principle of third party pricing services in the value chain.

Still, there are many challenges but all are within reasonable bounds. Ross Whitehill, Head of Offshore Management at BNY Mellon Fund Services (Ireland) contributed to our research, stressed that:

> - In the primary offshore markets, the need for experienced staff continues as before and while fund withdrawals may be painful there have been surges in money market funds and Exchange Traded Fund (ETF) that require different skill sets, different processing and obviously attract different fees. The need for staff does drive the search into new markets and evaluating competence, getting regulators and clients comfortable with increasing activity outside the main fund centers will always be a matter of priority.
> - Complexity of investment structures and investment products remain as continuing challenges as does the need for timely, accurate and complete information. We see an increasing demand for daily and intra day pricing and valuations, and with daily market volatility in common ranges of 2, 3 and 4%, institutional investors are likely to want a better feel for intra-day values, particularly where it applies to collateral and credit exposures.

The views and opinions expressed herein are those of the authors and interviewees and do not necessarily represent the views and opinions of Ineum Consulting firm.

The findings of our research conducted in August 2008 are based on a filtered sample of 41 investment funds that excluded either Structured Investment Vehicle (SIV) or any type of conduits. The total assets of our sample amounted to EUR 36 billion. Geographically, about 46 percent of the funds had their domicile in North America, 49 percent in Europe and 2 percent in Australia .

Fund closures and suspension of redemptions

The European Fund and Asset Management Association (EFAMA) in its 2007/2008 activity report concluded that the crisis has had two main impacts on asset management companies: first on revenues considering the volume of assets under management and second on operational procedures; unlike credit institutions whose balance sheets are directly exposed to the risks deriving from the credit events. Our research revealed the following elements:

Key figures from our research

- Fourteen funds shut their doors in Europe. This included Spain (4 funds), France (3 funds) and UK (3 funds) as investors continued to withdrew assets. Ireland, Netherlands, Austria and Portugal also reported one fund closure.
- Six funds temporarily suspended redemptions, and reopened in the following countries: Luxembourg (3 funds), France (2 funds); UK (1 fund);

Number of funds liquidated, suspended / reopened

Domicile	Liquidation (Number of Funds)	Suspension/ Reopened (Number of Funds)
France	3	2
Spain	4	-
UK	3	1
Luxembourg	-	3
Ireland	1	-
Netherlands	1	-
Austria	1	-
Portugal	1	-
Germany*	-	-
Total	14	6

*: Funds domiciled in other country

Source: Ineum Consulting

Hedge funds and some traditional funds caught by the crisis

A study conducted by Goldman Sachs for The ECB in 2006, revealed that there is a significant structural change within the Institutional Investors segment. Passive indexation and program trading for example, have increasingly been used in the growth of alternatives trading strategies. Additionally, in the segment of new investors, mainly hedge funds has introduced new investor classes such as high yield bonds, which in contrast to the more traditional funds who focused more on CDO/CLO.

Key figures from our research

- Mostly hedge funds (33 Non UCITS) were affected and some traditional (5 UCITS) and listed funds (3 funds) who invested in ABS, MBS or CDO.

Assets potentially impacted by the Credit Crunch

Type of Funds	Assets (EUR billion)
Hedge Funds	28,97
UCITS	4,39
Listed Funds	2,63
Total	36

Source: Ineum Consulting

Challenges ahead

While asset servicing has not been as badly affected as investment banks, the liquidity crisis raised some challenges in the areas of:

- Fund's valuation process for illiquid assets and complex financial instruments;
- Product control capabilities;
- Operating model enhancement for asset servicing.

Valuation dilemma and risk management

Valuation became a problem because certain types of securities such as mortgage-backed securities and other derivative products became relatively illiquid. The absence of market quotes forced market participants to rely more heavily on mark-to-model as opposed to mark-to-matrix techniques .
Statement 157 of the Financial Accounting Standards (FAS) Board, which was adopted by most large firms in 2007, provides investors with a better understanding of securities that can be priced based on readily available quotes and those that may be harder to value.
The first step in attempting to solve the valuation dilemma goes through an identification of the asset class universe held in each fund, followed by a mapping process of illiquid assets and less traded assets onto the corresponding valuation techniques, being mark-to-matrix or mark-to-model. Once completed, an appropriate pricing procedure can be defined per type of assets and risk management can be re-evaluated.

Risk management

In a second step, assign an appropriate risk profile to each individual fund by describing the complexity of strategy used whether in a perspective of hedging the underlying assets held in the portfolio or in order to gain an exposure to the investable opportunities. For example, purchasing a Put option on IBM through a regulated and exchange market to hedge an underlying position in your portfolio will require a mark-to-market valuation technique for a low risk portfolio.

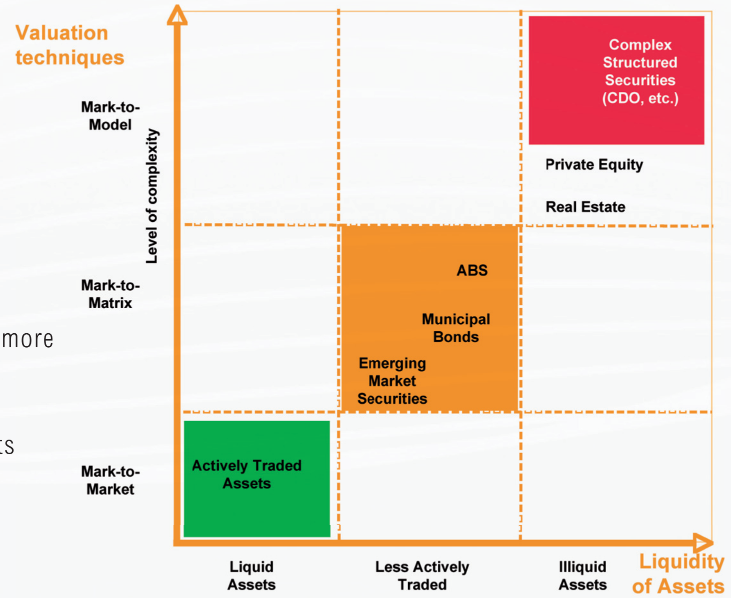
Valuation dilemma

Three types of valuations techniques

Mark-to-Model
- Assign prices based on statistical inference

Mark-to-Matrix
- Estimate a credit spread of the asset relative to a more actively traded instrument that can be priced easily

Mark-to-Market
- Use of quoted prices for actively traded instruments



Source: Ineum Consulting

Clustering portfolios per risk profile

Complexity of strategy	Portfolio composition & transaction type	Trading venue	Underlying assets	Risk Profile
Hedging purpose	Put/Call	Regulated & Exchange Market	Equities, bonds	Low
Hedging purpose	Futures	Regulated & Exchange Market	Index, currency, equities	Low
Exposure	Exposure Put/Call	Non regulated market	Equities, bonds	Medium
Exposure	Exotic options Asian options, option on option	Non regulated market	Spot, Forward, Swap, Spread	Medium
Arbitrage	CDO	OTC	ABS, CDO, CDS	High
Arbitrage	MBS	Regulated	Subprime Bonds	High

Source: AMF / Ineum Consulting

Product controls capabilities

Product innovation entails capabilities to adequately challenge the front office with skilled staff, systems and processes in middle and back office. As asset class universe is evolving, some custodian and fund administrators have enhanced their business models by implementing valuation tools initially used by investment banks such as Summit, Murex or Kondor.
Traditional asset servicing value chain has evolved and will continue to do so to embrace the use and administration of complex products.

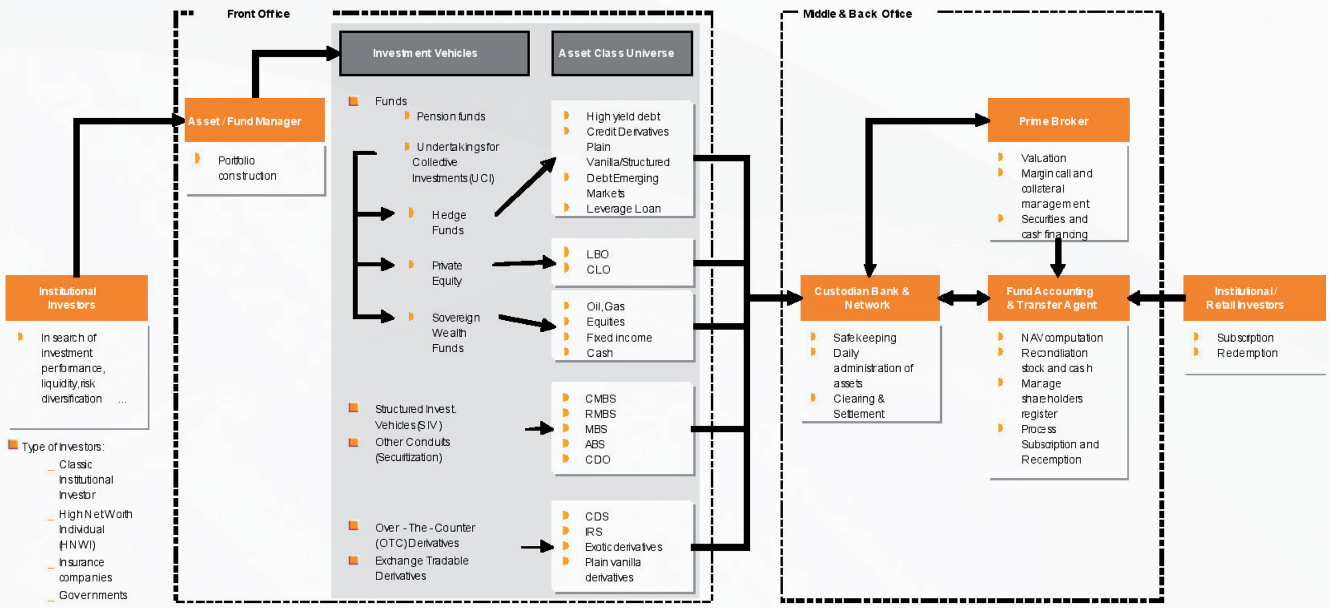
Improving the operating model for Asset Servicing

Core and value-added capabilities can introduce alternatives in the operating model service delivery. We have observed that, this could be achieved in different ways:

- By automating derivatives trades and sourcing valuations, custodian banks and fund administrators are in a position to compete with investment banks and particularly their Prime Broker business. We have seen a trend towards Middle Office OTC outsourcing services, securities lending and extensive usage of borrowing / cash financing services;
- By introducing a Trustee/Custodial function who will ensure that:
    - Depositary duties of the bank are fulfilled though regular reviews including due diligence on Prime Broker and Broker dealing with OTC derivatives;
    - Fund governing bodies are regularly informed of all breach and board decisions are taken accordingly;
    - Changes in regulation are effectively translated into operational controls.
- By outsourcing portion of business where the organization does not have sufficient expertise. This could include the administration of alternatives funds such as hedge funds or traditional funds investing in new asset class such as secured bank loan or high yield debts.

Challenges ahead

Asset servicing new landscape



Source: Ineum Consulting

Fund's valuation principles

The key principles for valuation of hedge funds including fair value and disclosure are summarized below.

Valuation hedge funds / CESR Fair Value and Disclosure

	IOSCO	CESR
Work undertaken	Principles for the valuation of hedge fund portfolios	Fair value and disclosure in financial statements
Released date	March 2007	July 2008
Responsibility	Governing body of the fund	
Main objectives	Mitigate conflict of interest between the fund manager and the fund Ensure appropriate valuation policies and procedures have been adhered to	IAS 39 Measurement of financial instruments and disclosure
Instruments coverage	Complex financial instruments Instruments traded in relatively illiquid markets	
Published for	Public consultation	
Scope	Nine principles: 1.Documented policies and procedures 2. Methodology for valuing each instrument 3. Financial instruments held or employed by hedge funds should be consistently valued 4. Policies and procedures to be updated periodically 5. Policies and procedures shall be applied independently 6. An independent review to evidence that polices and procedures have been adherence to 7. Process for handling and documenting price overrides 8. Initial and periodic due diligence on third parties that are appointed to perform valuation services 9. The arrangements in place for the valuation shall be communicated to investors	1.Distinction between active and non active markets for fair value measurement 2.Inputs to valuation techniques for financial instruments in illiquid markets 3.Disclosures of financial instruments in illiquid markets: Forced transactions or distressed sales, Prioritization among several price sources, Information regarding assumptions and data used, etc.

Source: Ineum consulting

Enhance the existing Risk management regulation

The key findings of the report on the "subprime" crisis conducted by IOSCO and CESR consultation on risk management are summarized below.

ISOCO report on subprime crisis / CESR risk management

	IOSCO	CESR
Work undertaken	Report on the subprime crisis	Risk Management
Released date	May 2008	August 2008
Type of Collective Investment Scheme (CIS)	CIS distributed to Retail Investors	All UCITS funds
Instruments coverage	CDO RMBS ABS CDS	OTC Derivatives
Submitted to	Public	Asset Management Company / Self managed UCITS
Scope	1. Issuer transparency and investor due diligence: disclosure regarding structured finance products 2. Firm risk management and prudential supervision: inadequate risk modeling and internal controls, over reliance on credit ratings, balance sheet liquidity, 3. Valuation: accounting and valuation, calibration of valuation 4. Credit rating agencies	1. Monitor and measure the risk of each positions at any time 2. Contribution of each risk to the overall risk profile of the portfolio 3. Employ independent valuation 4. Reporting to the regulator 5. Adequate systems adapted to the risk profile

Source: Ineum Consulting

Temporary ban on short selling of publicly traded financial and insurance companies

In an effort to protect investors and markets, the US Securities and Exchange Commission (SEC), and others European financial authorities temporarily prohibit short selling on financial and insurance stocks.

The measure which is not applicable to market maker or counter party in block trade transactions; requires to report all cumulated net economic short position exceeding 0.25% of the capital of one of the financial companies involved.

Thus, the Asset Servicing industry is challenged on its monitoring capabilities when dealing with securities lending to promptly recall transactions and adequately handle orders execution and settlement.

The table below provides the key elements applicable in some EU countries.

SHORT SELLING RULES – APPLICABLE IN SOME EU COUNTRIES AS OF SEPTEMBER 19TH, 2008

Country & Regulator	Belgium CBFA	France AMF
Applicable period	3 Months (starting as of Sept. 22nd)	Minimum 3 Months (As of September 19Th, 2008)
General Rules	Undefined	Settlement T+3
Securities issued by	Financial instruments with voting rights issued by financial institutions traded on Euronext Brussels	- ALLIANZ - APRIL GROUP - AXA - BNP PARIBAS - CIC - CNP ASSURANCES - CRÉDIT AGRICOLE - DEXIA - EULER HERMES - HSBC HOLDINGS - NATIXIS - NYSE EURONEXT
Trading Venue	Euronext Brussels	Euronext Paris MATIF MONEP
Instruction initiated for	Own account or for the account of third parties	Own purpose Or on behalf of a third party
Detail	Any sales order that may lead to delayed settlement and delivery of one of the securities in question must be 100% covered by the securities that are the subject of the sales transaction. Anyone who holds a net short position which represents an economic interest in excess of 0.25% of the capital of one of the relevant companies must disclose this to the CBFA and the market by any appropriate means, at the latest on D+1.	Article 516-5, paragraph 2 of the AMF General Regulation, Any investor giving A sell order for one of the securities concerned with instructions for deferred settlement and delivery must hold 100% of the securities to be sold on its account with its financial intermediary. In reference to Article 570-1 of the General Regulation, any investment service provider receiving a sell order for one of the securities concerned must require its client to deposit the securities to be sold on its account with the investment service provider before the order is executed. If the investment service provider is not the custodian of its client's assets, it must obtain assurance from its client that the client holds the relevant securities. Any person holding a net short position that represents an economic interest of one quarter of one percent or more of the capital of one of the companies concerned must disclose it to the AMF Financial institutions are requested to refrain from lending any of the securities concerned in order to reduce the causes of market disruption. This does not apply to securities lending to cover existing positions, to meet commitments made before these measures were implemented or, more generally, to transactions that are not related to creating short positions.
Out of scope	Exception of transactions entered into by intermediaries acting in the capacity of a market maker, a liquidity provider or a counterparty of block transactions	They do not apply to transactions made by investment service providers acting as market makers, liquidity providers or as counterparties for block trades in equities.

Source: AMF, CSF, AFM and FSA

Regulation: a response to the challenges

Country & Regulator		France AMF	Luxembourg CSSF
Applicable period		31 December 2008	Undefined
General Rules		Undefined	Undefined
Securities issued by	- PARIS RE - SCOR - SOCIÉTÉ GÉNÉRALE	AAREAL BANK AG ALLIANZ SE AMB GENERALI HOLDING AG COMMERZBANK AG DEUTSCHE BANK AG DEUTSCHE BÖRSE AG DEUTSCHE POSTBANK AG HANNOVER RÜCKVERSICHERUNG AG HYPO REAL ESTATE HOLDING AG MLP AG MÜNCHENER RÜCKVERSICHERUNGS-GESELLSCHAFT AG	Financial institutions and insurance companies
Trading Venue		Undefined	Undefined
Instruction initiated for		Undefined	Transactions entered into on own account or for the account of third parties
Detail	Any person holding a net short position that represents an economic interest of one quarter of one percent or more of the capital of one of the companies concerned must disclose it to the AMF Financial institutions are requested to refrain from lending any of the securities concerned in order to reduce the causes of market disruption. This does not apply to securities lending to cover existing positions, to meet commitments made before these measures were implemented or, more generally, to transactions that are not related to Creating short positions.	Short positions arise when at the time of the transaction the seller of the shares does not own such shares, or at the time of the conclusion of the transaction does not have any absolutely enforceable legal claim under the law of obligations or under property law to be transferred title in shares of the same class, or does not have any absolutely enforceable legal claim under the law of obligations or under property law that results in the title in shares of the same class being transferred.	Ensure that the clients hold at maturity the shares offered for sale
Out of scope		Transactions agreed by trading participants with a customer for settlement of a transaction in shares concluded at a fixed or definable price (fixed price transaction) are exempted from the ban on short selling as defined in the General Decree of BaFin issued on 19 September 2008.	Undefined

Source: AMF, CSF, AFM and FSA

Country & Regulator	The Netherlands AFM	UK FSA
Applicable period	3 Months as of September 22nd, 2008	January 16Th, 2009 Will be reviewed after 30 days
General Rules	Undefined	Undefined
Securities issued by	Shares issued by financial companies	UK bank (a) UK insurer (b) UK incorporated parent undertaking of a company referred to in (a) or (b).
Trading Venue	Euronext Amsterdam stock exchange	UK stock market
Instruction initiated for	On own account or on behalf of third parties	A person who enters into a transaction :whether by itself or in conjunction with other transactions
Detail	A transaction or order or a combination of transactions or orders that in itself does not come under the above measures, but may bring about the same effect, can also be deemed to fall under the prohibition contained in article 5:58 FSA. Each Party having a cumulated net economic short position exceeding 0.25% of the capital of one of the financial companies involved, is requested to report these positions to the AFM immediately, but not later than on the next working day (t+1) after their realization.	creating a net short position in a UK financial sector company; or increasing any net short position in a UK financial sector company that the person had immediately before 19 September 2008; is, in the opinion of the FSA, engaging in behavior that is market abuse (misleading behavior)
Out of scope	Exception of transactions performed by intermediaries acting as cash market maker1 or counter party in block trade transactions	Does not apply to a person acting in the capacity of a market maker. Does not apply to a transaction entered into or an order placed before 19 September 2008.

Source: AMF, CSF, AFM and FSA

Ross Whitehill,

Head of Offshore Management at The Bank of New York Mellon

Question 1 Business models

The subprime raises the question of which custody and fund administration business model is best suited to weather the problem and prosper: specialist provider with niche focus or universal banks?

It is fair to note that both groups have suffered as a function of the credit crunch. The universal banks, who have custody and fund administration services as an embedded capability, and generally greater exposure to the mortgage and credit markets than specialist providers, have suffered doubly. They have lost significant amounts through write downs and write offs and have suffered the consequent ignominy of falling asset values impacting ad valorem revenue generation. Some scope for making back part of those losses through widening credit spreads has existed but clients aversion to those groups who have had to make significant write offs has affected those universal banks ability to repair the damage.

The specialist providers have not suffered to the same extent but equally have less opportunity to make good through other profitable broad based banking activities that their universal cousins might. Recent FX volatility will help as will healthy spreads but it is clear that there are uncertain days ahead for asset managers and asset servicers, particularly those with exposure to weak credits.

Question 2 Valuation issues

Fund boards of directors are obligated to evaluate the accuracy of the valuations including when valuation is provided by third pricing services. As some funds failed to adequately evaluate their pricing, what would you recommend as service provider?

The Board of Directors will normally delegate the Fund's valuation process, which will be detailed in the legal agreements, to the Fund Administrator.

The Fund Administrator should then provide the Board with their pricing policy and seek its approval. The following are a number of points that would normally be included in such a policy document;

- Policies applied to Price Feeds received from vendors,
- Pricing policies for equities and for fixed income,
- Derivatives and OTC Derivatives policies.
- Fair valuation, suspended, stale and static pricing.

In addition, the Service Provider should seek to have the Board establish a pricing committee to monitor and review pricing procedures, so that there is an ongoing mechanism for ensuring that there is no disconnect between the work that is being done by the administrator and what the fund board expects or believes to be happening.

Question 3 Margin on collateral

Liquidity decreased for subprime products led some broker-dealers relying more on price models than on third party pricing services, i.e. failed to establish or adhere to procedures regarding issuance and resolution of margin calls.
Is it a true statement what would you recommend?

From experience none of our clients has actually changed their methodology or source for pricing Illiquid Fixed Income instruments used for valuation purposes, Data Vendor to Broker especially off the back of subprime problems. There is of course tighter scrutiny around validation i.e. stale checks etc across the board.
Evaluations of price from any vendor, say IDC, are a form of 'model'. To maintain accuracy, any groups like IDC would use actual trades to assist their calculation. Where we hit illiquidity in the market this can cause issues in building a price but this would be across the board not just unique to a Data Vendor. It is obviously important that the pricing provider be an industry recognised/approved source with whom the service provider and client base can be confident.
The question is probably more applicable to the broker-dealers or traders actively involved in trading the products and possibly the Prime Brokers providing Collateral Management services to their clients.
In general the view of most Central Pricing Units is that it appears clients have stayed with a recognised data vendor with increased scrutiny around Stale Price checks.

Question 4 Offshore funds

Several cases of cross-border insolvency involving offshore investment funds come into the spotlight (Cayman Islands amongst other). Would this damage the Off-shoring business?

Any form of scandal or market event quite naturally scars a reputation and the offshore funds market is no exception. The major funds markets in Europe such as Luxembourg and Dublin for example though are not generally impacted by insolvencies in other jurisdictions like the Cayman Islands, and potentially vice versa.
Specifically, the institutional investment market looks to the type of failure, who was involved, the trading strategies employed, and what the root causes were before passing judgment. In mature markets that are known to be well regulated and professional, to an extent it will be business as usual. If the event that causes a failure is generic such as a subprime problem or anything that is broad based in the industry, market participants will take a pragmatic view.
If any of the participants had the sense that the failure was because of lack of proper governance or regulatory oversight in the market, the impact could be broad based and the market generally would be punished.

Etienne Carmon,

Head of international product development at CACEIS Bank Luxembourg

Question 1 Business models

The sub-prime raises the question of which custody and fund administration business model is best suited to weather the problem and prosper: specialist provider with niche focus or universal banks?

It is very difficult to say if the sub-prime crisis has impacted more or less niche players or universal banks. At CACEIS, the 2 main trends that we have observed over the last few months are the following:

- Some of our Clients have showed a certain appetite to launch funds investing in those depreciated assets.
- From a transaction volume point of view, we have noticed some small decrease in subscriptions and slight increase in the number of redemptions of shares from investors.

It is for sure that our ongoing efforts to monitor the profitability of our clients and products have been reinforced since the sub-prime crisis.

Question 2 Transparency for investors

What transfer agencies could bring as recommendations to increase transparency for investors (key information to disclose in prospectus, suspension of subscription redemption, etc.)

First of all, the TA appointed by the Fund, which means the Fund promoter, is not allowed to do any recommendation to the end-investors, unless specifically required by the Fund promoter. Transfer agency has been considered for years as a back office business driven by the regulatory pressure and investment managers' requirements. The nature and contents of the information to be disclosed to investors are usually originating from there.
Furthermore, information provided to the investor does not necessarily transit via the TA, at least for the Fund's institutional Clients.
Therefore, even if the Transfer Agent was able to make recommendation, the only counterpart to whom he can do it is the Fund promoter.

Question 3 Offshore funds

Several cases of cross-border insolvency involving offshore investment funds come into the spotlight (Cayman Islands amongst other). Would this damage the Offshoring business?

Managing a fund and distributing it onshore while the administration is conducted in a tax wise jurisdiction should not seriously be impacted mainly due to the advantages in the regulatory regimes.

Question 4 Outflow from European's fund

European funds suffered from massive outflows in the final three months of 2007 (EUR 178 Billion, FTfm/Lipper Feri). Recently it seems that there are some recovery signs. What would you considered as your top 3 challenges: in terms of service offerings, market coverage: geographical reach and regulation)?

Our challenges are intimately linked. We are looking into new markets such as Asia where CACEIS is going to open an office before end of this year. The Middle East and South American countries may become of interest for CACEIS but in a later stage. Those markets are surrounded by specific regulations that require additional investment in terms of knowledge and IT costs at least to tackle the language and reporting challenges ahead.
In countries where we are already active, we are exploring how we could enlarge our service offering. As an example, CACEIS Prime TA® solution is specifically designed to support the Asset Manager in their effort to expand their business abroad and to offer to the distributor a central point of contact for all their trades.
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Chris Adams,

Global Head of Product, Alternative Funds BNP Paribas Securities Services

Question 1 Prime Broker marketplace: evolving landscape

The Prime Broker marketplace was mainly dominated by Investment Banks. As some of the top ten firms were directly impacted, what type of opportunities would you see as hedge funds service provider?

There has been discussion within the industry for some time now about the changing roles of prime brokers and hedge fund administrators, and the extent to which the services historically provided by these organizations are interchangeable. In particular as the industry has moved to a multi-prime broker environment fund administrators have been required to provide many of the risk management and reporting services across assets serviced by a number of prime brokers so that the manager has a global view of their assets. We see this is a development which is complementary to rather than undermining the historic prime brokerage model.

However what we have seen in recent weeks and months is a sequence of events that few could have anticipated. Therefore what has been seen recently is a flight to quality in terms of funds seeking to place assets with very highly rated banks. BNP Paribas' Prime Brokerage and Securities Services businesses have been major beneficiaries of this, thanks to the group's AA+ credit rating, one of the three highest in the world. It is our firm belief that these assets will remain with highly rated banks, and therefore the ability to accept assets and the financial standing of the institution will become of primary importance to funds when selecting their service providers.

Question 2 New asset class, investors' confidence and products disclosure

The asset class universe has evolved tremendously over the past decade. Although Hedge Funds were mainly impacted by the liquidity crisis and some traditional funds who invested in ABS, MBS or CDO; what would you recommend in terms of disclosure for both Institutional and Retail Investors?

Literally dozens of papers have been published by governments and industry bodies regarding hedge funds' disclosure of their investments and pricing models, and I don't see any merit in going over the arguments again here. My thinking is simply this: institutions are professional investors and funds seeking investments from these bodies may or may not decide to disclose information regarding their activities, providing that any disclosure is not misleading. Therefore the old maxim of buyer beware must apply – I do not understand how an organization can position itself as a professional investor on one hand and then on the other say when investment returns are poor that insufficient information was provided.

For retail investors clearly the position is very different, and the maximum amount of information should be disclosed. Therefore the issue in this case is whether certain asset classes are appropriate for retail investors if the fundamentals of that asset class is that there is not a high degree of disclosure.

Question 3 Offshore funds

Several cases of cross-border insolvency involving offshore investment funds come into the spotlight (Cayman Islands amongst other). Would this damage the Offshoring business?

The recent turbulence in financial markets has brought into sharp relief that when funds are imperiled, it is absolutely critical that their activities are rigorously controlled both internally and commercially by robust legally enforceable agreements, and externally by transparent and rigorous regulation and legislation. This is absolutely imperative if the rights of investors, managers and administrators are to be protected.

Investors know which fund domiciles afford the greatest levels of legal and regulatory protection, even if on occasion this is through bitter experience. Therefore I do not believe that these cases will necessarily damage the offshore industry, but I do think that institutional investors in particular will focus to a much greater extent on the protection that they are afforded by virtue of where a fund is domiciled, and will make their investment decisions accordingly.

Question 4 Challenges ahead

What would you consider as being your top 3 challenges in the current market conditions (regulation, clients and staff retention, market positioning, etc.)?

The greatest challenge is always, irrespective of market conditions, attracting high quality employees. The market for talent in the financial services industry broadly and funds industry specifically is fiercely competitive. Whilst Luxembourg benefits from access to a well-educated and highly motivated workforce spread across four countries supported by a largely modern and efficient transport infrastructure, it is impossible to underestimate the challenge of attracting the very best candidates.

The new challenge that we face at the moment is that whilst historically the market's expectation was that in times of turmoil it was the hedge funds that would fail, what we see now is that it is the investment banks servicing the funds that have come under the greatest pressure. Therefore hedge funds need to reinvent their business model so that the fund and the trading counterparty are each protected from the default of the other, rather than as has occurred historically whereby the trading counterparty, typically an investment bank, solely protecting itself from the fund.

It is in this environment that the major custodian banks have a role to play, and the precise definition of that role is the major challenge. One thing is clear however – default risk is going to be the number one consideration for hedge funds for the foreseeable future, and therefore custodians that are well capitalized with sound risk management practices will continue to benefit from this seismic shift in the industry.

About Ineum Consulting

Ineum Consulting is a strategy, organisation and information systems consulting company. Ineum Consulting, objectively helps its clients make strategic, operational and technological decisions.

The company's range of services, based on its in-depth knowledge of its clients' businesses and ability to implement specific solutions, is a unique asset. Ineum Consulting has 1,050 employees in France, Belgium, Luxembourg, the Netherlands, Switzerland, United Kingdom and the United States. It is part of Management Consulting Group Plc, which has over 30 offices on the five continents.

About Ineum Consulting Luxemburg

Ineum Consulting Luxembourg was established in March 2006. Since then the team has grown significantly. Our staff comprises experienced, highly knowledgeable, multicultural and dynamic consultants with solid references in consulting and/or industry.

Our service offerings are dedicated in the first place to the financial services industry. These industry skills are supported further by more specific offerings such as financial management and strategic IT management, which we propose also to our clients in the public sector, as well as in the industry & services.

The overall focus is threefold: **strategy, improving operational performance and project/program management**. Furthermore, Ineum Consulting has demonstrated its ability to adapt to the size and business scope of our customers by focusing on a collaborative approach and creative style, and our ultimate goal is of course geared towards results.

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