

Schulte Roth & Zabel

The Leading US Law Firm in London

BILL MCINTOSH

Perhaps no other service provider to hedge funds can boast of being present at the birth of the industry in the way that Schulte Roth & Zabel can. Paul Roth and Dan Shapiro, two of the founding partners who remain actively involved with clients, began advising hedge fund managers in the late 1960s, cutting their teeth with the formation of Steinhardt Fine Berkowitz & Co and later advising Julian Robertson and numerous 'Tiger Cubs.'

Over four decades later, SRZ is a full-service law firm with 450 attorneys in New York, Washington, D.C. and London. The firm offers a comprehensive trans-Atlantic service with a unique perspective on the US market, offering a specialism that extends from advising hedge funds to broad expertise across the financial services sector.

Christopher Hilditch joined SRZ in 2002 and worked alongside Shapiro to set up the London office. Shapiro is still actively involved in the London practice, although he spends the majority of his time as a partner of an alternative investment firm located in London and Boston, Lincoln Vale, a client of SRZ, which he joined in 2008.

Hilditch began working with hedge funds in the mid-1990s, just as the UK industry was gaining critical mass, and is well-known in London. He and Josh Dambacher, who came to London in 2008 to further expand the practice, spoke recently with *The Hedge Fund Journal* at the firm's offices in Savile Row, Mayfair.

What SRZ offers alternative investment firms in London is an unparalleled experience of the US hedge fund sector. Now it is marrying that expertise with a growing commitment of resources to London and nearly a decade of experience in the European market.

A unique proposition

"What we are bringing to hedge funds in London is unique," says Hilditch. "We are bringing the technology and the experience we have in the US and combining it with our European experience. We are very

busy bringing together the best of both worlds, and we are building funds from the start to take account of European and US considerations."

"We believe we are the only firm with a top tier practice on both sides of the Atlantic," says Dambacher. "It is a matter of getting the right US advice that also understands the UK environment and the right UK advice that understands the US environment," says Hilditch.

"There are many subtle differences. You need an understanding of both sets of rules to be able to advise the client how to be able to operate properly." Being a truly trans-Atlantic practice is the dominant focus for SRZ. "We are very gratified that today we represent, as general counsel or on various matters, over 60% of the 100 largest hedge fund groups in the world," Shapiro has said.

With the US still the undisputed leader in hedge funds, it is the place where more trends, particularly in terms of investment strategies, take shape. The leadership of the US is also felt in areas like the evolution of the terms and conditions that govern how funds operate.

"In terms of technology, if it's been done SRZ has done it and more often than not we have been the innovator," says Hilditch. "In many ways people still look to the US for new trends, whether it is in fund terms or investment styles. Europe has tended, historically, to be the leader in best practice and disclosure. What we have done is combined the best of both, and sought to address all the relevant issues from the start."

US regulation has shaped hedge funds for decades, though the EU's Alternative Investment Fund Managers Directive is having a big impact. But the significance of US regulation will remain a dominant theme because investors there provide most of the investment capital. Being on the ground in Europe and being able to draw on significant resources Stateside means SRZ can handle

any variety of issues that concern its hedge fund client base.

Advice to optimise business

"Our general approach is to represent hedge funds and give them the best advice to optimise their business," says Hilditch. "We have taken the lead in many of these matters and helped with how managers interact with investors."

For any hedge fund to be successful, it must strike a balance between operational efficiency and investor requirements. If this balance is lacking, a fund either won't attract enough allocations to be viable or won't allow a manager the flexibility to run a particular investment strategy successfully.

"One of the things we pride ourselves on is really getting to know and understand the manager, the way they run money and the thoughts they have about the terms they want to offer so as to be able to interact with them," says Hilditch. "We want to take the managers from ground zero up through the process so they come out at the end of the day with something that achieves their aims in terms of the investment strategy, but which can also raise money," he says. "It is a question of the balance and the compromise within that process."

A suite of services

The core of SRZ's practice in London is advising on fund formation and the firm has a keen understanding of the tax environment in the US, the UK and worldwide with Shapiro and Nick Fagge taking the lead in London. Here, it is important to be aware of the issues investors face from a tax perspective and the issues the fund will face from an investment perspective. SRZ also offers advice on numerous related areas such as regulation, registration, tax planning and management company business models. "The tax planning needs to be built-in from the start in terms of the fund model that is actually used," Hilditch says. "At the same time, you have tax planning for the managers and the management group. The funds will then have to negotiate the documents

setting up terms with their trading counterparties and prime brokers. We bring very significant experience to all this both in London and in New York.”

When a fund is up and running, it may require advice on investment transactions. This is particularly true of distressed strategies and with activist funds. There is also a lot of corporate work around financing. On the regulatory side, this ranges from, say, FSA registration to compliance with the ERISA rules governing UK pension plans. Over the life of a hedge fund business, most or all of the disciplines of law come into play.

During and after the financial crisis, SRZ invested in London by recruiting legal staff and boosting resources. The firm has a programme to send lawyers from the US to London for three year rotations and all of its UK associates are trained in US issues and work on US funds.

“The idea is to fully integrate the practices,” says Hilditch. “We want New York to really understand the European market, just as we in the UK understand the concerns of our US client base.”

An authority on US regulation

Obviously, the impact of regulations in the US is an abiding concern of most UK managers. SRZ is very well-positioned by having a US and UK regulatory advice capability at partner level resident in London.

On US regulation, the message is encouraging for hedge funds. Registration is to occur in earnest after a seven year period of partial application. Also some additional reporting via the PF form will be required by funds. But the passage of the Dodd-Frank Reform Act will have a bigger impact on investment banks and the financial services sector generally than on alternative funds. “For our client base in the UK, which is already regulated by the FSA, we don’t see getting SEC-registered as being as big of a burden as it may be for US-based managers who have not been registered with any regulator,” says Dambacher.

“In addition, the Investment Advisers Act has been around for 70 years and has been tested on the industry. It is not like the AIFMD where there are a lot of provisions that are going to affect how funds operate, how they compensate staff and potentially how they use leverage.”

Dambacher sees the AIFMD posing much trickier questions for alternative funds, even though the final content of the directive remains unresolved. He expects the imposition of depositories for onshore funds will lower returns for investors through increased costs, while the provisions on remuneration are likely to be very contentious once an attempt is made to define them.

Tough EU regulatory regime

“The regulatory landscape in Europe is becoming more difficult for our clients and more important for our business,” Dambacher says.

A possible benefit for hedge fund managers could be a one stop EU distribution passport for fund managers. However, because the cost of the depository provisions and the benefits of a passport aren’t known, it is impossible to do a cost benefit analysis.

“Right now no one is feeling the political pressure to avoid Caribbean-based funds because European investors just haven’t been investing in hedge funds the way they did before the crisis,” Dambacher says. “If European investors start investing again, we will have a better sense of how much they are really going to demand onshore products. Then managers will have to make that call. Are the depository provisions that apply to an EU fund, the extra costs of operating a European fund and the extra regulatory hassle worth the extra investor AUM they might raise?”

Advice on US regulation

Even if what US regulation requires is more concrete, it remains important for hedge funds to get the best legal advice. It is obvious that registration is to be much more widely applied and it is important for

overseas managers looking to crack the US market to be well versed in the regulatory practices that govern investors.

“UK managers need US advice,” says Dambacher. “The regulation may not materially affect a manager’s cost structure, but if a manager doesn’t have decent and direct US regulatory advice it could easily trip up. It is relatively easy to become SEC-registered but more difficult to comply with the rules that follow. A compliance issue in this regulatory environment could be devastating.”

Such issues include SEC rules on advertising, affiliate transactions and change of control transactions, which can be much more prescriptive than their FSA equivalents. Legal advice is also often necessary for regulatory reporting, whether it is Blue Sky filings, Section 13 filings for significant positions or, if registered with the SEC, Form ADV and Form PF.

Another area where SRZ is increasingly asked for more advice is for US hedge fund clients looking to set up offices in London. There is also growing demand for advice from a lot of European clients looking to get established in the US. A further area of expertise SRZ offers is US personal tax. Many US nationals are running hedge funds in London and SRZ has for some years focused closely on providing high level advice to them.

A trans-Atlantic practice

Hedge fund managers, of course, are big consumers of legal advice. As a firm, SRZ is particularly close to the industry in both London and New York. Both Hilditch and Dambacher have interesting perspectives on how London is faring as a leading hedge fund centre.

“There have been articles about the impact of the AIFMD and of tax changes in the UK being all good news for other jurisdictions, including New York,” says Hilditch. “But I think you need to take a step back. People will want to be where they invest. I think then it is a question of how onerous regulation or the tax burden has to be to make people really move. If you look at

Switzerland there is a lot of talk about relocating there, but the actual degree of activity is a lot less. We advise managers to look into it and assess their options.”

Dambacher has a more nuanced view that is both optimistic and pessimistic. He believes that the London hedge fund market has better growth prospects than its US rival, but also faces threats.

“The City has a lot going for it; there is a critical mass of talent, extensive service providers and it is well positioned between the US and Asian markets,” says Dambacher. “So I take a positive view in the long run. The wild card is regulation and tax. For example, the continuation of the 50% UK tax rates, restrictive tax rules for non-domiciled residents or further attacks on compensation in the financial industry could be a disaster

for London. The FSA’s implementation of AIFMD could also have a devastating effect on the positive trend I would otherwise expect London to gain from.” **THFJ**

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Partner Investment Management Regulatory & Compliance

Josh Dambacher focuses his practice on corporate, securities and regulatory matters. He primarily represents institutional and entrepreneurial investment managers, financial services firms and private investment funds. He advises on structuring investment management firms, hedge funds, private equity funds, hybrid funds, UCITS funds and funds of funds. He also advises investment management firms and their principals on US and UK regulatory compliance, acquisitions and reorganisations of investment management firms.



Partner Investment Management Regulatory & Compliance

Christopher Hilditch advises a wide range of institutional and entrepreneurial managers on structuring and establishing investment funds, especially hedge funds and funds of hedge funds, and other innovative products. He advises promoters and managers on operational issues, including prime brokerage arrangements, investment transactions and relations with investors. He also advises on regulatory issues affecting funds and their managers, as well as on corporate, securities and partnership law issues.



Partner Investment Management Tax

Daniel Shapiro is a founding partner of SRZ. He concentrates his practice in the areas of tax, fund structures, seed capital and other business issues related to investment funds. He lectures and writes extensively on the legal, tax and business aspects of investment funds.



Special Counsel Tax

Nicholas Fagge principally advises investment management clients on the structuring of UK management companies, covering all relevant partnership and tax issues. He also advises more widely on UK and international tax issues relating to the taxation of private investment funds, their UK investors and managers.



Special Counsel Investment Management

Kerrie Walsh focuses her practice on UK and US financial services law and regulations affecting investment managers and investment funds, including the formation of hedge funds, funds of funds, hybrid funds, activist funds and management companies.