REUTERS

French launch flags hedge funds' transparency drive

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*Manager sticks with regulated structure after Lehman lesson

*UCITS-registered funds ever more popular with institutions

*Laffitte says UCITS leverage limits give investors comfort

By Martin de Sa'Pinto

ZURICH, Nov 27 (Reuters) - French alternative asset manager Laffitte Capital Management, which had a narrow escape from the Lehman collapse, has sought EU regulatory approval for its newest hedge fund to win broad investor appeal after the crisis.

The launch this week of Laffitte Equity Arbitrage as a UCITS fund underlines a broader trend for managers of alternative products such as hedge funds to eschew unregulated offshore structures in favour of more transparent onshore funds.

"Institutions such as insurance companies like investments in UCITS-regulated funds after the problems many of them had with their alternative investments last year due to illiquidity and leverage," Laffitte co-founder David Lenfant told Reuters.

The European Union directives known as UCITS are designed to protect retail investors by setting out strict rules for investment funds opened to the general public.

They had excluded some hedge funds and certain complicated high-risk products but have gained more traction among institutions following the financial crisis, the collapse of Lehman Brothers and the Bernard Madoff fraud.

UCITS funds follow a set of EU rules that allow asset managers to market funds throughout Europe on the basis of a single authorisation in one member state. They also allow the use of derivatives and shorting.

They are generally more accessible to retail investors because minimum investment levels are much lower than the $500,000 often required by offshore hedge funds. Laffitte Equity Arbitrage requires a minimum investment of 1,000 euros.

Large hedge fund managers that have recently launched UCITS funds include Man Group (EMG.L: Quote, Profile, Research, Stock Buzz) and Cheyne Capital.[ID:nLA62414]

But smaller funds, such as Laffitte, are coming on board.

"There is a huge new trend to promote UCITS III structures with alternative strategies across Europe, and especially in France," said Lenfant, whose company manages 43 million euro ($64.90 million).

Investors who want to diversify from equities or bonds typically choose alternative asset classes such as hedge funds or commodities, but some can be highly leveraged, and they can turn illiquid in difficult market conditions.

The UCITS structure limits investor risk by restricting fund leverage and requiring periodic liquidity -- usually daily or weekly -- meaning funds are priced transparently and investors can exit quickly when they need to.

LAFFITTE'S LEHMAN LESSON

Lenfant said his company would continue to favour regulated structures after its Laffitte Risk Arbitrage Fund was caught up in the Lehman collapse.

Lehman was the fund's prime broker, and about 70 percent of the fund was blocked when the bank failed.

However, that fund, was saved by its ARIA EL tag, a French-regulated structure similar to UCITS in that it also requires regular liquidity and has leverage restrictions.

"Under ARIA EL regulations, the custodian of the assets is responsible for the assets if the prime broker fails. A French court confirmed this in April, and our assets were returned," said Lenfant. The custodian was RBC Dexia.

"The law also says there is no clawback, and that makes this is something of a test case." This means the Lehman liquidators cannot require the fund to return the money at a later date.

In the case of Laffitte Equity Arbitrage Lenfant said his company chose the UCITS structure over ARIA EL, because UCITS has tighter limits on leverage which is more appealing to some investors.

UCITS funds limit leverage to 200 percent of investor assets, while the limit for ARIA EL is 400 percent. Managers say the structures are complementary.

"You can't export all strategies to UCITS, because some -- for example those looking to arbitrage, or exploit the differentials in, fixed income securities prices -- need leverage if they are going to make money," said Lenfant.

He said Laffitte Risk Arbitrage would therefore maintain its ARIA EL designation since "the fund targets fund of funds, family offices and so on with a higher risk appetite."

($1=.6625 Euro)

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