Growing with a Globalised Industry

Q&A with Mike Serota, EY

CONDUCTED BY HAMLIN LOVELL

Hamlin Lovell: We are privileged to speak to EY’s Mike Serota, who is a recipient of one of The Hedge Fund Journal’s special awards for an outstanding contribution to the hedge fund industry. Well Mike, thanks very much for joining us today. So when did you join EY and how has your career progressed?

Mike Serota: I’ve been with EY for 10 years. I was originally with Arthur Andersen and then after Andersen collapsed I ultimately moved over to EY. I feel like I landed at a firm that really understands the industry and really puts everything behind it. It devotes a significant amount of resources and capital to growing the industry, growing the client base and supporting it.

HL: So since you joined EY a decade ago, hedge fund industry assets have roughly tripled, from about $1 trillion to about $3 trillion. Over that period, how has EY’s offering changed?

MS: I think it’s really a question of how the industry has changed. The industry has really become globalised and institutionalised, more so over the last 10 years; I think when the industry first started, and probably up until 10 or 15 years ago, a lot of it was a compliance-driven industry, from an assurance and a tax perspective. We’ve seen a real change or expansion in the scope of needs by our clients and the scope of services that we provide: cross-border; regulatory issues; transactional issues. You look at the future of the industry and it’s really more about asset managers and asset gatherers. Those types of asset managers and asset gatherers really have an institutionalised and globalised focus. So I think as we look forward and we project out a number of years, you’re going to see hedge funds that are more in line with asset managers and have multiple types of offerings underneath their role and structure.

HL: How big is your hedge fund team? And is it still growing?

MS: Yes, it’s still growing. I would say we’ve grown by a factor of eight times or so in the last 10 years, across all of our different offerings. The primary offerings are assurance, advisory and tax. I would venture to say we have more than 2,000 people that work in the industry exclusively – they don’t do anything other than work on hedge funds – and in excess of 200 partners and directors that work in the industry. And our focus is really still the same; we’re really focused on start-ups and supporting the industry and working with funds as they develop, and also supporting the industry more broadly. We also spend a lot of time working with charitable organisations that support the industry such as Robin Hood and Hedge Funds Care.

HL: How do you actually measure your market leadership? And what do you think your strongest and any weakest areas might be?

MS: We think we have about a 40% market share through all the major tranches, say larger funds, funds over $500 million in assets under management, and we look at the statistical information and that’s what our view is. It’s about 40%, give or take, depending upon how assets flow on a particular period. That’s been fairly steady for a number of years.

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HL: Which of your offices is growing fastest globally?

MS: It’s hard to say. I think I would look at it in terms of geographic regions and where the opportunity is. All the offices are growing, whether you look at the US as one unit, which is generally what we do, or you look at London or you look at Europe or you look at Asia; all the offices are growing and they’ve all been growing at a significant pace which has been consistent at least since I’ve been with the firm – 10 years, longer. But I think if you look at regions in terms of where opportunity is, clearly there is major opportunity in three places.

China I think is going to be explosive – mainland China’s going to be explosive; India is going to be explosive – it’s already starting to be; and I think South America really as an entre point through Brazil is going to be very interesting and is going to have explosive growth in this industry. In fact, I read that Brazil has approximately the sixth largest hedge fund industry globally, which most people probably don’t realise. So it just gives you a sense as to these emerging economies and these emerging markets where the opportunities are, which I think is really what the focus needs to be.

HL: Which areas of regulation are you most focused on now?

MS: Well clearly AIFMD is very important for all of our clients, but I think it’s really helping our clients through the regulatory process. There are regulatory issues that we need to work with them on. The SEC is obviously very focused on the industry right now, and it’s focused on the regulatory environment, and cybersecurity is becoming a very big issue, as everybody knows. It may be the biggest issue out there right now. If firms are not concerned about it they should be.

HL: The other day we spoke to AIMA, the Alternative Investment Management Association, and they told us that judging by the number of consultation papers they’re asked to comment on, they think the pace of regulatory change is slowing down. Does that match up with your experience?
MS: I think it’s really a question of how products develop, how the industry develops, how cash flows continue to come in. The industry is still continuing to grow, both from an asset perspective and from a product diversification perspective. The pace of change is only quickening, so I don’t know that I would say definitively that regulatory change is going to slow down, but obviously I respect their view, and they’re probably right, but I think we just need to wait and see what happens. But the industry is just continuing to grow; new products, new opportunities, and that will bring new regulatory oversight.

HL: Do you think there is a genuine danger of hedge funds getting caught in the FATCA net? And what steps can they take to safeguard against that?

MS: At this point I would hope not; I would hope there wouldn’t be a danger. I mean, this has been out there for so many years at this point and it’s been delayed so many times that the major hedge funds should all be compliant, understand what they’re doing. The fund administrators understand the business and the needs. They’re critical to the process; they’ve been engaged; they know what they’re doing. So I would think that the major hedge funds, the larger hedge funds, the ones with significant assets and you can even say, those that are of decent size – north of $200 million, $300 hundred million, all have done what they are supposed to do. If there is a fund administrator, the fund administrator’s been telling them what to do, and they’ve been coached through the processes that they need to go through, so I don’t think at this point that I’m all that concerned about a hedge fund falling foul of it. Hopefully I’m right.

HL: Right. Moving over to Europe: do you have any views on the Luxembourg leaks controversy?

MS: I really can’t comment on the Luxembourg leaks, but what I can comment on is the fact that all hedge funds really need to review their cross-border set-ups, just as a matter of course. They need to understand how they’re structured: have they done the right things to make sure their structure passes scrutiny and do so in a robust way? And I think that what this suggests is that there really needs to be a re-examination of how these structures work: do they make sense? Are they viable? Have they gotten good advice, and is their platform sustainable in the event that they are reviewed?

HL: Once again the EY survey was released for 2014, and it has become a very respected reference point for the industry. I think we all know that regulatory compliance costs are continuing to rise so moving on to perhaps some more positive aspects of the survey, how are hedge funds growing their assets and diversifying their investment bases through new types of products, structures and vehicles?

MS: So the highlight of last year was that liquid alternatives and hedge funds were being formed for a couple of reasons: one was to diversify their client base and to offer new products to their clients. And as I mentioned earlier, the industry is changing and hedge funds are offering new products to their client base and diversifying; they’re becoming asset managers, so liquid alternatives are a way to do that. BDCs, UCITS, managed accounts, long-only funds are all along the same path of developing new product and giving clients additional ways to invest with them. So I think that pace will obviously continue.

I think you’ll see more funds launching products along those lines – it doesn’t matter where they are, whether they’re in the US or Europe or Asia. I think there was more of that in the US and the UK at first, and kind of in Europe. I think Asia will pick up the pace as well.

HL: Right. And on the less liquid side, do you see signs of hedge funds converging towards private equity models in areas such as direct lending?

MS: It’s a good question. I think what’s happening is that you have a hedge fund that has investors, and those investors want different types of products and opportunities. One of those is private equity-like, and it might be direct lending, it could be a credit operation, or it could just be a pure play private equity fund, along the lines of offering new products. And I think you see the same thing on the private equity side, where the major private equity shops may be launching hedge fund-like products or other types of products to their client base. So that goes back to the earlier point that you have all of these larger organisations, whether they’re hedge funds or private equity funds, moving down a path of becoming asset managers, offering different types of products to their clients, and really moving along that path. So I think that that’s all consistent, I think that started maybe three years ago, four years ago, but the pace has definitely picked up in the last few years.

HL: Well Mike Serota, of EY, thanks very much for your time and insights today and we look forward to watching the continued growth of EY and the hedge fund industry.

MS: It was my pleasure, thank you. THFJ

Watch the full interview at www.thehedgefundjournal.com