January 2013

Executive summary*

Deutsche Bank Research Highlights: "Cliff Underweights Squeezed" and "2013 China Strategy – Recovery and Reforms"

In the wake of the fiscal cliff, the Asset Allocation team argues that managers continue to be very underweight despite the recent equities rally. However a sustained reallocation back to equities, which has happened in past cycles once rates begin to rise, would provide notable support for equities. In December, our team noted equity flows topped bonds – the first time since early 2011.

The Markets Research team forecasts GDP growth acceleration to 8.5% in China during 2013. They also highlight the 6 most important investment themes for China in 2013.

Investor Sentiment

At year end, the Capital Introduction team has seen investors trimming exposure to underperforming managers. In both the US and Europe, there is continued interest in high-quality equity l/s managers and, with a more stable macro environment on the horizon there is renewed interest in global event driven strategies. The team also explains the growing interest in the alternatives space in South Korea and the resulting challenges for managers and investors alike.

Performance

December was a strong month with the median up 1.13% and all strategies performing positively except market neutral, which was slightly down (-0.16%).

Year-to-date, credit funds led the pack in Europe (13.38%) and the US (12.36%). Among equity strategies, US event driven (8.49%), European l/s (7.02%) and China l/s (8.39%) were the top performing strategies.

Leverage

Volatility declined a significant 36.3% in December, ending the month at 7.4. Gross fundamental equity exposure also declined by 0.67% (2.38), but net fundamental equity exposure rose 3.67% ending the month at 0.57.

Securities Lending

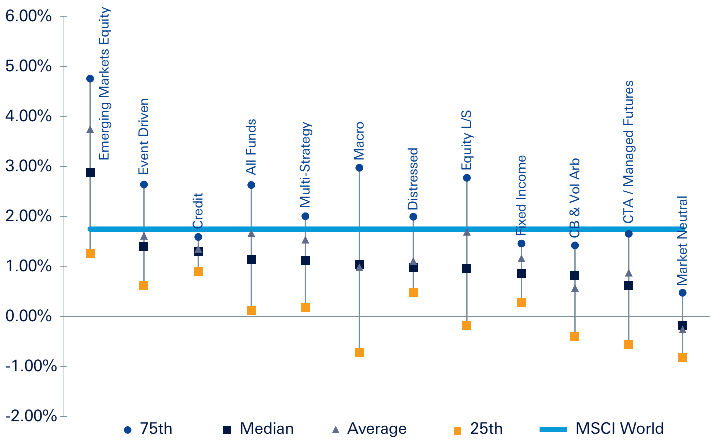
With the close of 2012, equity investors will look back and see another volatile year behind them thanks to political uncertainty across the globe. The securities lending team discusses the IPOs and sectors most targeted by short sellers in 2012, which includes metal & mining, oil & gas in the US, and tech and consumer discretionary in Asia.

Regulatory

There was a significant amount of activity in December. A number of guidelines or implementing rules were published for the AIFMD, EMIR and the existing UCITS directive. Progress was made on deliberations for UCITS V, CSD and an agreement was reached on proposals for an updated Market Abuse Directive and for a banking union in Europe. In the US, no action relief was provided by the CFTC on a number of rules that were due to take effect by the end of 2012.

Global performance

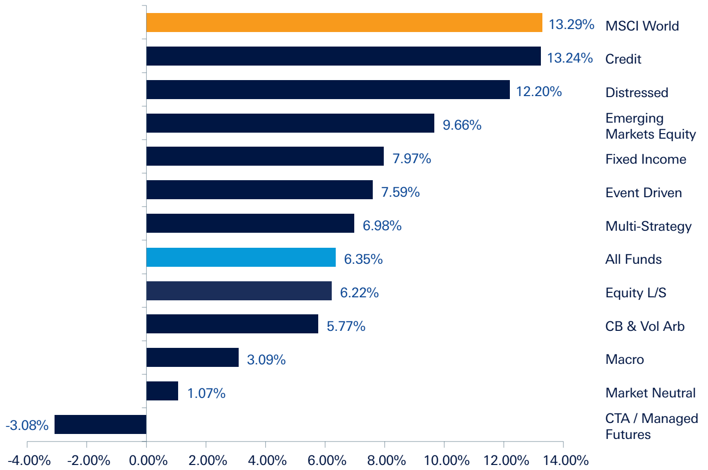
December 2012 Performance Dispersion



Median			
Emerging Markets Equity	2.89%	Distressed	1.00%
Event Driven	1.41%	Equity L/S	0.97%
Credit	1.32%	Fixed Income	0.85%
All Funds	1.13%	CB & Vol Arb	0.82%
Multi-Strategy	1.11%	CTA / Managed Futures	0.63%
Macro	1.06%	Market Neutral	-0.16%

Source: Hedge Fund Intelligence (HFI), January 2013

December 2012 Cumulative Median Performance by Strategy



Source: Hedge Fund Intelligence (HFI), January 2013

* This document contains extracts and opinions from various departments and business areas within Deutsche Bank, including extracts from Research Reports, as well as from external reports specifically referenced herein. It is not, however, a research piece and has been produced by a front office function. Also, please refer to the body of the document for a more detailed description of and proper references to the topics covered in the Executive Summary section.

Asset Allocation: Cliff Underweights Squeezed [1]

Asset reallocation flows back to equities for last six weeks despite the cliff

Mutual funds, long-short equity funds and hybrids cut exposure dramatically into the fiscal cliff pushing overall equity positioning (composite beta) back to three year lows ("Big Underweight As Fiscal Cliff Looms", Nov 12, 2012). Despite the big rally this week, fund managers are still very underweight; about 70% of our equity mutual fund sample underperformed the S&P this week suggesting managers have significant cash holdings to invest. Indeed, $118b went into money market funds in Nov and Dec, the biggest inflows since early 2009, supporting the notion of cash on the sidelines.

While fund managers have been risk averse, end investors have been "risk on" in the face of the fiscal cliff. Total equity inflows were $42b the last six weeks and equity flows exceeded bond inflows (by $28b) for the first time since early 2011. A sustained reallocation back to equities, which has happened in past cycles once rates began to rise, would provide notable support for equities.

Positioning remains very underweight across risk assets

Equity positioning is at three-year lows

- Mutual funds cut exposure by 4pp since mid Dec and are 6pp underweight;
- Hybrid funds slashed exposure and are now 10pp underweight;
- Long-short equity funds are now 7pp underweight after being neutral;
- Macro hedge funds again went net long after being neutral into the cliff;
- MFs are overweight Healthcare and underweight Financials and Energy;
- HFs raised exposure to Healthcare and Staples and cut Tech and Materials;
- Europe and Asia funds are overweight while other regions are underweight.

Futures and option positioning pared back in rates, FX and commodities

- Rates positioning has been pared back but remains net long;
- Extreme JPY shorts and AUD longs trimmed; GBP net long increased;
- Euro short positions covered and now neutral; USD long also back to neutral;
- Wheat positions now net short as corn long pared; copper net long cut back;
- Gold and silver positions were cut during fiscal cliff negotiations.

Equity flows top bonds flows in December – the first time since early 2011

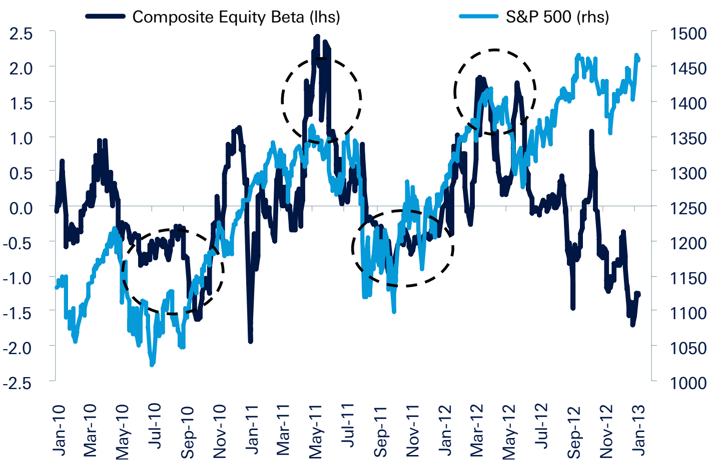
Large inflows into money markets as bond flows slow

- Money markets had $42b of inflows last week; $118b inflows Nov and Dec;
- Government bonds saw outflows the last 5 weeks totaling $2.5b;
- EM bond inflows continued their strong pace totaling a record $40b for 2012;
- Corporate HG inflows have slowed noticeably post elections;
- US HY outflows for the 3rd straight week; Europe HY inflows continued.

Equities get inflows for 6th straight week totaling $41.5b

- US flows flat last 5 weeks as inflows into ETFs offset by large MF outflows;
- EM inflows of $3.4b last week continued a strong run with Asia leading;
- Europe outflows last week snapped a 5wk run; Japan inflows continued;
- Inflows to Materials, Financials; outflows from Consumer, Utilities, HC, REIT;
- Large cap funds continue to garner the inflows, not small and mid caps;
- 5th straight week of outflows from growth and value funds.

Equity positioning very underweight



Source: Bloomberg Finance LP, Factset, Deutsche Bank

Markets Research: 2013 China Strategy - Recovery and Reforms [2]

Our baseline economic forecast is that GDP growth will accelerate to 8.5% in 2H13 from 8.0% in 1H13 and 7.6% in 2H12, and may accelerate further to 8.9% in 2014. The main drivers for growth recovery include corporate and infrastructure investments, as well as a rebound in export growth in 2H13.

The key downside risks include a stalemate on the US debt ceiling, geopolitical risks in the Middle East and an escalation in tensions between China and Japan. The main upside risk in China is higher-than-expected fiscal spending by the government.

Against the baseline economic forecast, we expect 15% upside to the MSCI China Index in 2013. This forecast is based on a modest re-rating of equity market valuations (i.e., forward P/E expanding to 10.8x from the current 10.3x) and normalized 10% EPS growth beyond 2013.

We highlight the following investment themes for 2013:

1. Growth recovery: cement, construction, and shipping companies will likely outperform, as 2013's cyclical recovery will be led mainly by investment and exports. However, the performance of FAI-related sectors will likely be short-lived, as inflation concerns could lead to policy tightening by the end of 2013.

2. Resource pricing reform: the power, gas, water and refined oil sectors will be the main beneficiaries.

3. VAT reform, social spending, and urbanization: healthcare and construction will enjoy the resulting upside potential.

4. NPL cycle: banks may continue to underperform the index, given the NPL ratio will likely rise until 3Q, but large banks are more resilient.

5. Capacity rationalization: coal and steel will likely underperform cement, due to the slower pace of capacity rationalization.

6. Anti-corruption: 2013 will likely witness the most vigorous anticorruption fight in decades. Macau VIP gaming, fine watches and gift card sales at department stores may suffer from revenue deceleration.

[1] Deutsche Bank – Asset Allocation: "Cliff Underweights Squeezed" 4 January 2013. http://pull.db-gmresearch.com/cgi-bin/pull/DocPull/3103-CA36/51127923/Investor_Positioning_and_Flows.pdf
[2] Deutsche Bank – Markets Research: "2013 China Strategy – Recovery and reforms." 6 January 2013. http://pull.db-gmresearch.com/p/1192-5ACE/53969747/0900b8c0863741eb.pdf

Southeast pensions, family offices & wealth advisors

Our team visited the Southeast region (Georgia, Florida) this month to speak with pensions, family offices and wealth advisors in the area. We noticed that while the hedge fund space is still of interest to investors, their priorities for immediate allocations have shifted away from specific asset classes to the broader investment portfolio. As such, we have seen significant investor interest in opportunistic trades, which are designed to take advantage of specific market dislocations. Regulatory capital trades (synthetic securitizations), trade finance and direct lending are some of the areas that have been cited by investors. Many investors are inquisitive about opportunities that may exist from disintermediation of the banking system forced by Basel III rules. We also found that several investors have made decisions to trim their hedge fund exposure due to lack of performance in their aggregated hedge fund portfolio.

With respect to overall hedge fund strategies in the region, we continue to see interest in the relative value space, notably nimble multi-strategy sleeves and equity l/s. Within these two strategies, investors have cited a specific interest in mid-sized managers ($500 million - $1billion AUM) with a 3-year track record.

Mid-Atlantic region investors seeking concentrated portfolios

The US team also traveled to the Mid-Atlantic region (Virginia, Washington DC) in mid-December. We met with a wide variety of investor types including pensions, endowments, family offices, fund of funds and wealth advisory firms. Many of the investors we met with are focused on maintaining a concentrated hedge fund portfolio with the intention to extract more alpha from what they consider to be their best ideas. Some of the investors have trimmed their underperforming manager exposure throughout 2012.

Regarding strategies of interest, the outperformance in credit hedge funds last year has persuaded investors who haven't yet made significant investments in credit to take a closer look at the space for 2013 allocations. While they are mindful of buying-high, the focus is on finding non-correlated fixed income hedge fund products vs. their broader long-only portfolio. Not surprisingly, we also continue to hear of investor interest in finding smaller equity l/s funds (i.e. sub $1.5 billion) that have exhibited solid performance and are less correlated to their broader long-only large cap portfolios.

Hedge fund fees continue to be a topic of great debate.

In December, the Hedge Fund Capital Group hosted a "Future of Equity Investing" panel event in London, which included panel discussions by leading hedge fund managers and investors. One of the key takeaways from this event was a conversation around pressure on hedge fund fees. Our lively investor panel discussed the relative factors that should be taken into account when calculating fees, particularly for fundamental equity l/s managers. These included ability to generate alpha based on the deliberate risks taken to leverage the manager's edge, as well as the diversification of alpha returns. Investors also suggested that correlation to risk assets, supply/demand and track record (stripping out leverage and volatility) are all important considerations for fee calculations. However, the investors did emphasize that fees are not the primary factor when it comes to manager evaluation. Indeed the team has noted that many of this year's asset flows have been received by managers with relatively high fee structures.

European investors increasingly bullish on equity strategies

Conversations with investors have naturally turned toward their plans for the year ahead, and have revealed a healthy mix of strategy searches. There have been a notable number of investor requests for high quality equity l/s managers. We believe that the reasons for this are two-fold. Firstly, equity l/s has outperformed the composite hedge fund index in 2012 (returning 5.07% up to November versus 4.82% composite), with some particularly outstanding performers.[4] As a result, at least part of this interest is a natural rotation towards better performing managers.

Secondly, with equity flows approximately $1.2 trillion below trend levels since 2008, many have expressed that they are now tentatively bullish on equity strategies ahead of what is being termed "the Great Rotation".[5,6] Specifically, European investors are seeking high quality equity l/s managers who can extract value from what are expected to be rising, but volatile, equity markets, as assets shift away from fixed income and back into equities.

Increased interest in event driven managers

We have also seen a pick-up in interest in event-driven strategies, with a number of European and US investors requesting information on global event managers. Investors expect event driven managers to have a more interesting opportunity set in 2013 following the resolution of fiscal cliff issues and an expected more stable macro environment. Areas of interest across the broad event driven categories are managers that have a focus on credit/special situations expertise and can invest opportunistically across the capital structure, distressed opportunities in middle-market bank debt, as well as distressed corporate and sovereign opportunities in emerging markets.

South Korea investor update

The hedge fund investor universe in South Korea is still relatively small and in its infancy. It has taken a few knocks in the recent past with regard to some investors having money with Madoff or structured products. Demand on the whole remains muted. Nonetheless, there are some big investors based there and over the last couple of years some pension plans have started to move into the alternatives space. A couple of managed account platforms have made some headway, however it has been necessary to commit to educating investors and have a Korean speaking sales force. There are also an increasing number of distributors looking for international hedge fund managers and fund of funds to distribute domestically.

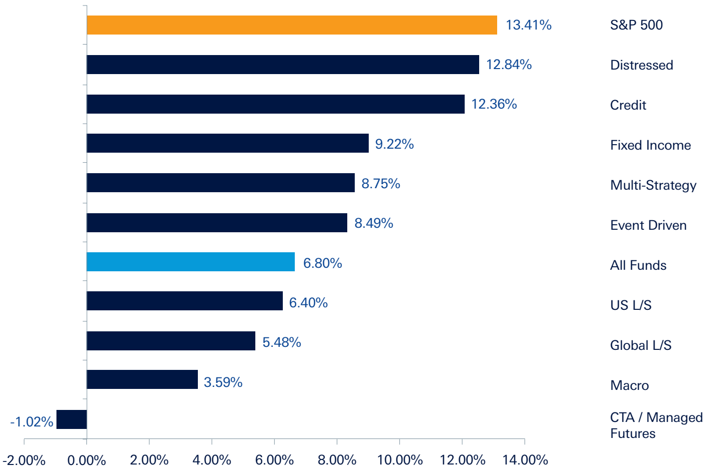
South Korea has a population of 50 million people, compared with 7 million in Hong Kong. This is one of the reasons that the National Pension Scheme is the fourth largest in the world. NPS currently manages $380 billion however, in 15-20 years time it is predicted to be over $2.4 trillion. The pension plan does not currently look at hedge funds; however the sheer size of the scheme represents an incredible future opportunity for hedge fund managers to monitor while the passage of time fosters continued education and relaxation of policy restrictions.

[3] From Deutsche Bank's Hedge Fund Capital Group
[4] Hedge Fund Intelligence Global Indices – Equity Index and Composite Index, 3rd January 2013
[5] "Time is right for the markets' 'great rotation'" – Financial Times, December 28, 2012 – Ralph Atkins and Stephen Foley
[6] Deutsche Bank Research – Global Asset Allocation – Themes and Trading Strategies for 2013 – Binky Chadha, December 2012

Marketing material - For institutional investors only

Americas

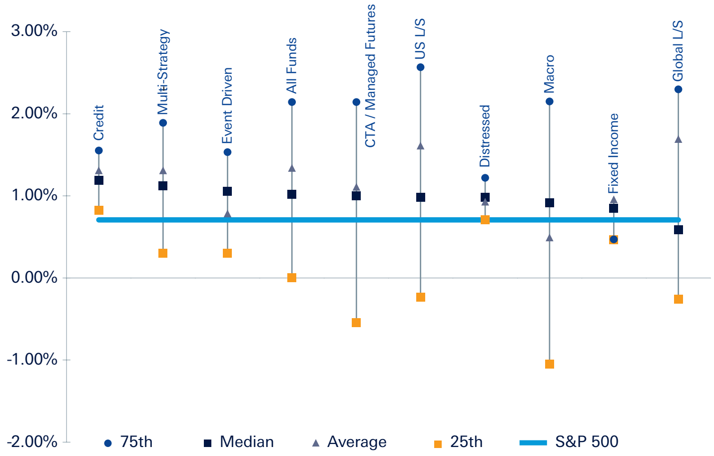
2012 Year to date median performance



Source: Hedge Fund Intelligence (HFI), January 2013

Americas

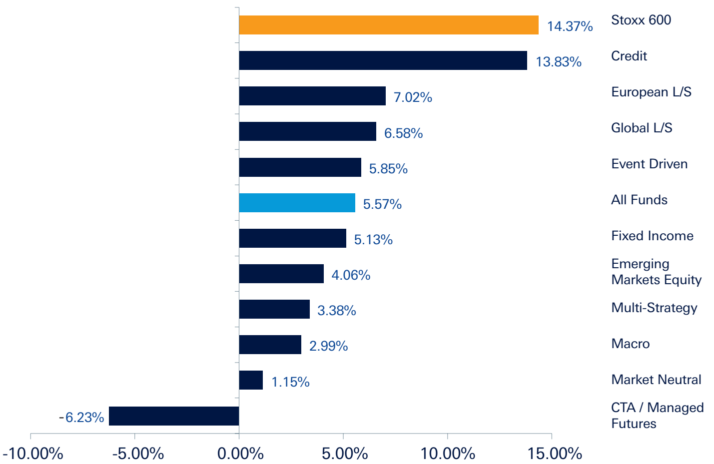
December 2012 Performance dispersion of returns



Source: Hedge Fund Intelligence (HFI), January 2013

Europe

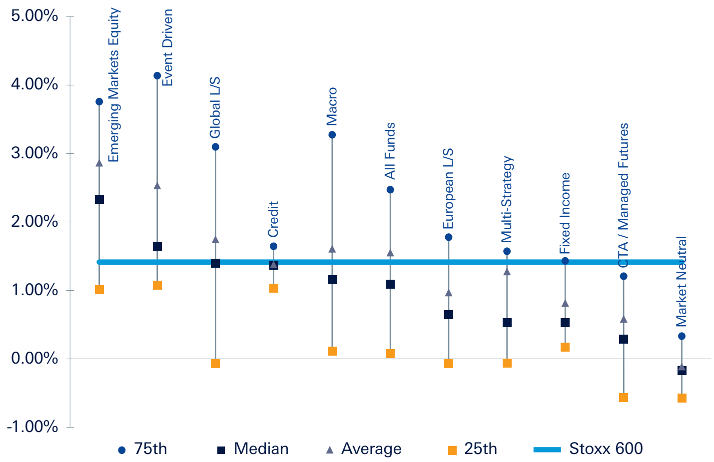
2012 year to date median performance



Source: Hedge Fund Intelligence (HFI), January 2013

Europe

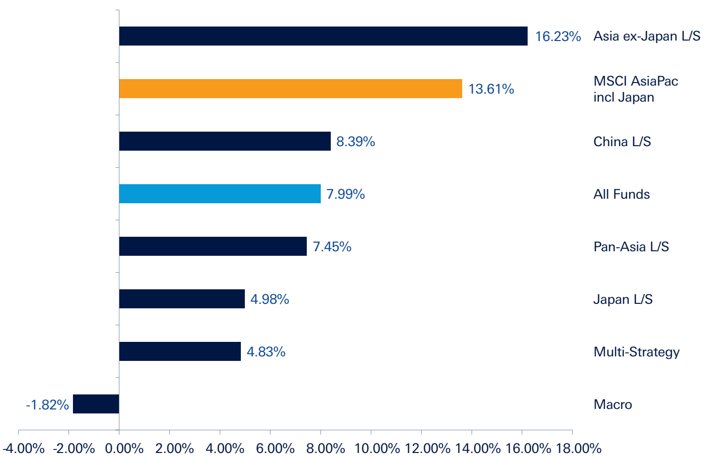
December 2012 performance dispersion of returns



Source: Hedge Fund Intelligence (HFI), January 2013

Asia

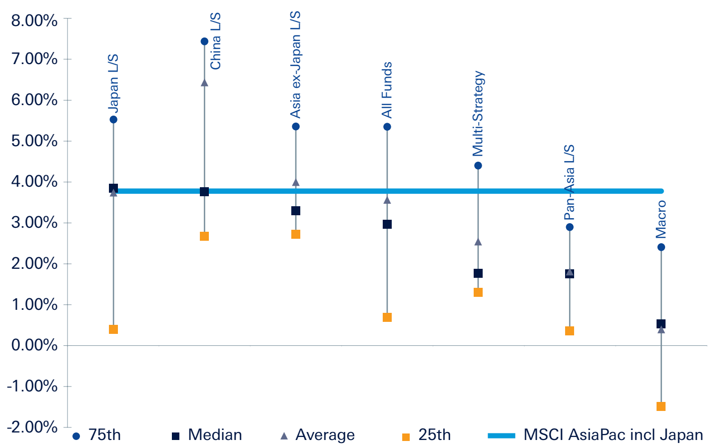
2012 year to date median performance



Source: Hedge Fund Intelligence (HFI), January 2013

Asia

December 2012 performance dispersion of returns



Source: Hedge Fund Intelligence (HFI), January 2013

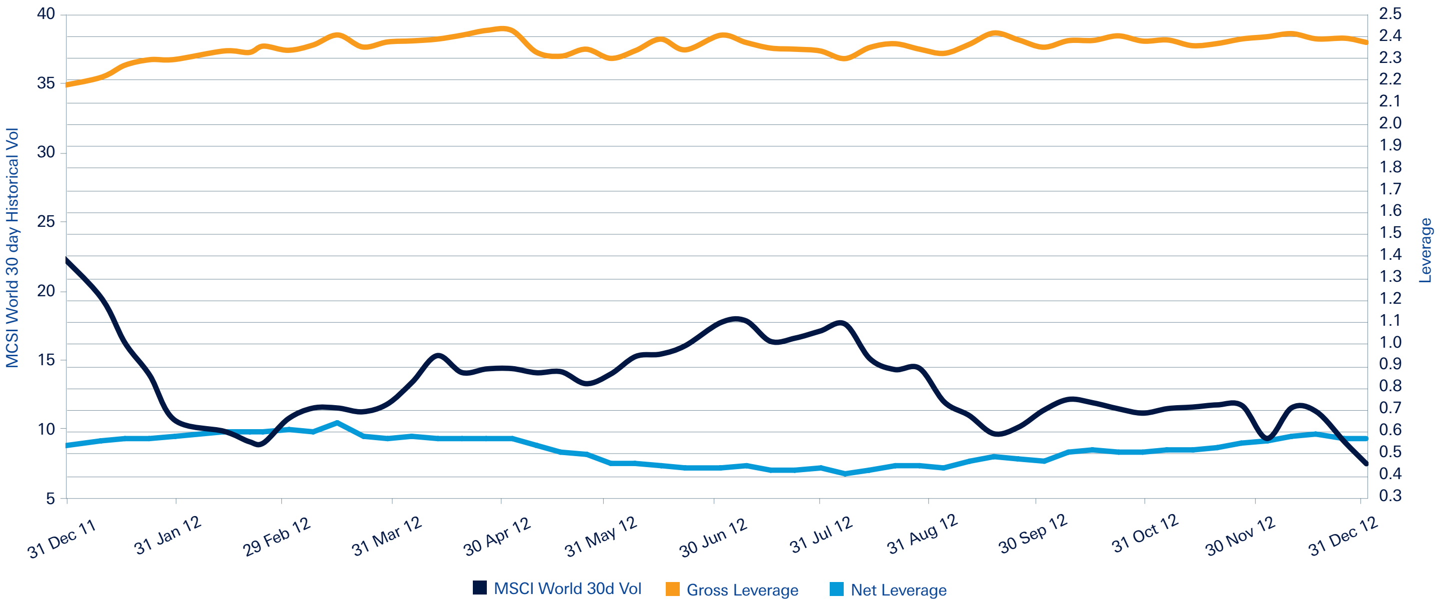
Marketing material - For institutional investors only

Global

– MSCI World 30 day volatility declined over 36% in December, ending the month at 7.4. Gross fundamental equity exposure also declined by 0.67% (2.38), but net fundamental equity exposure rose 3.67% ending the month at 0.57.

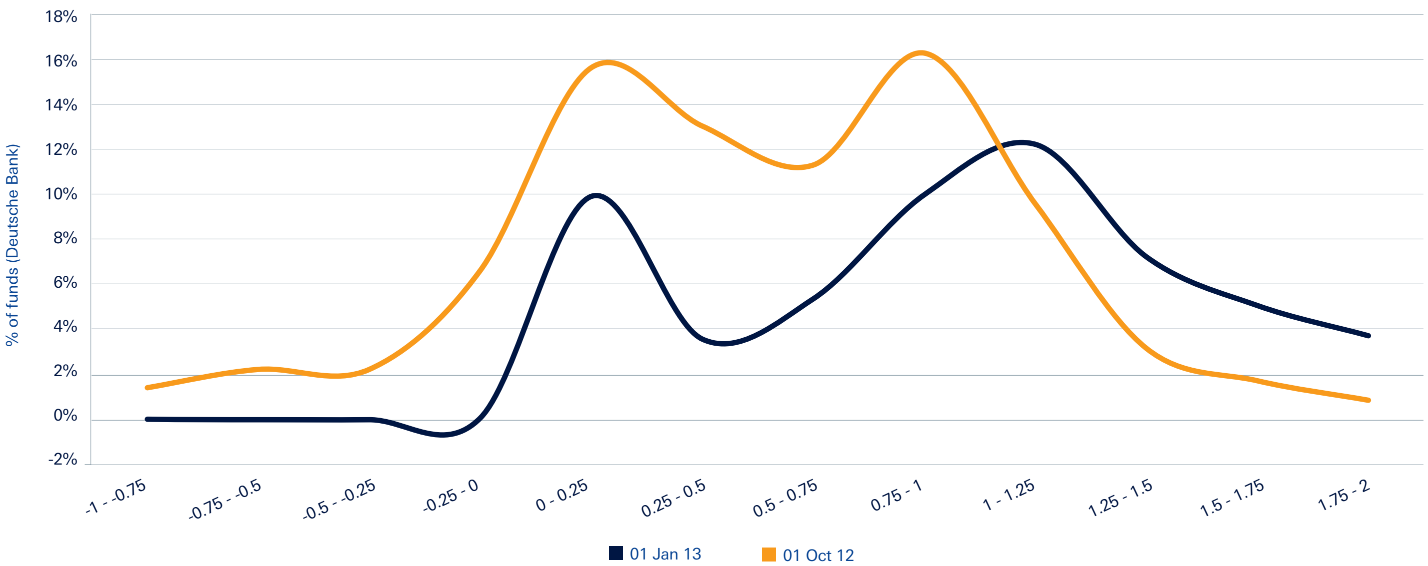
– The percentage of funds in most net equity leverage bands (-1 - 1) have decreased since the beginning of October. Managers have increased exposure over the past three months though, leading to an increase in the percentage of funds across the higher (1 - 2) net equity leverage bands.

Global net & gross equity leverage vs. volatility



Source: Deutsche Bank Global Prime Finance Risk, January 2013

Global – December 2012 Quarterly change in net equity leverage distribution across funds

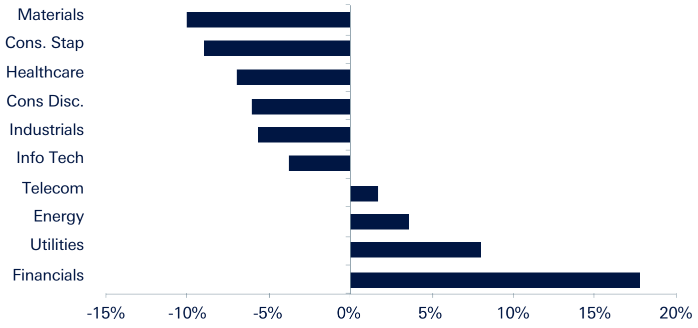


Source: Deutsche Bank Global Prime Finance Risk, January 2013

[7] Deutsche Bank Global Prime Finance Risk, January 2013

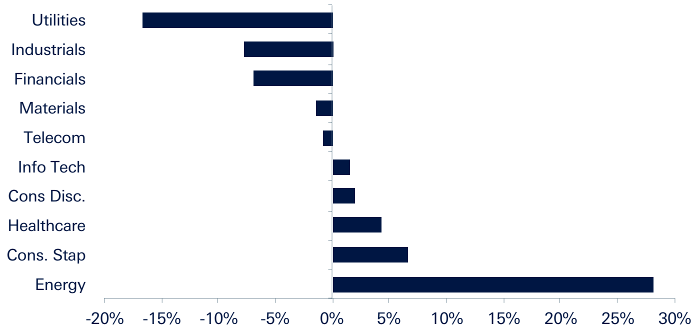
Global [8]

US % short interest sector change - December 2012



Source: Data Explorers & Deutsche Bank, January 2013

European % short interest sector change - December 2012



Source: Data Explorers & Deutsche Bank, January 2013

US - A disappointing year for IPOs, metals & mining, oil & gas and specialty retailers

The US markets proved to be the bright spot among the global uncertainty despite the election and political stalemate leading into the "fiscal cliff." Those swings however did not prevent the US Dow Jones Industrial Average from finishing up almost 6% on the year.

IPO's made headlines in 2012, with Facebook leading the charge into its May 2012 debut, but quickly fizzling once it began trading. Overall, IPOs had a tough time this year as many anticipated new listings quickly disappointed investors after they failed to live up to expectations. Those IPOs which were most targeted by short sellers include (by percentage of short interest over each company's free float): YELP Inc, Annie's Inc, Greenway Medical Technologies, Synacor, Roundy's Inc, Servicenow Inc, and finally Facebook. All of these have more than 9% of their free float on loan, which represents more than three times the S&P 500 average, according to Markit Data. At year end, the most shorted IPO is the online social listing firm Yelp, which has more than 25% of its free float on loan.

From a sector perspective, short sellers were actively trading based on the economic issues that affected the markets throughout the year. Metal and mining, specialty retailers, and oil and gas firms represented a large portion of the overall interest from short sellers. Those companies which saw specifically high short interest that fell into these sectors include Patriot Coal Corporation, RadioShack Corp, Niko Resources Ltd, and Supervalu Inc. Patriot Coal represented the top short of last year and the now bankrupt coal manufacturer saw its share price fall by 92% since January 2012 as the company came under pressure from natural gas. Retailer Radio Shack also saw its stock price fall considerably as it hit its 2012 high on January 18 and then closed down more than 80% since then at $2.12 on December 31. We saw short interest rise to its annual high of 8.2% in January 2012 as well.

Olam rebounds from Muddy Waters attacks

Olam rebounded over 10% in the second half of December following public attacks on the company's accounting practices and excessive debt profile. Olam announced plans to issue $750 million of 6.75% bonds and 387.4 million detachable warrants via a rights issue in January.[9] Lender recalls and short covering into the strength led to a 15% drop in short interest during December.

Macau gaming plays

Macau gaming borrow came back into focus in the first half of December given in-line November revenue numbers and news that China had detained Macau junket operators. Increased flow on Wynn and Sands were particular easy to borrow focus shorts. There was a degree of short covering as stock recovered towards the end of the month.

Exporters and financials lead performance in Japan

The Topix was up 0.8% in December and the Nikkei ended the year up 22.1%. Nikkei share average ended at a 21-month high on December 27, led by exporters and financials, as the new Japanese prime minister's vow to battle deflation and a strong currency buoyed investor risk appetite.[10]

An emerging trend was the increased short interest for the technology hardware sector.[11] Stocks such as Ricoh, Sharp, TDK, Hitachi and NEC were all in demand as the strengthening Yen created additional pressure on the export sector.

Japan's ailing tech and consumer discretionary sectors

Breaking down short interest to the constituent sectors, we see high short interest in Japan's ailing tech sector. Ricoh, Dena, Seiko Epson, TDK and Gree remain the top most-crowded names over the past few weeks.

The consumer discretionary sector recorded above average short interest at 2.2% of total shares out on loan. Panasonic's rating was raised to overweight by Barclays and cut to just above junk by S&P last month.[12] Sharp's stock, which was downgraded to BBB by Fitch, has little liquidity on the street and was trading in the 18% range.[13] Sony, which is relatively stable compared to Panasonic, saw short interest pick up since its announcement in early November to sell convertible bonds worth as much as $1.6 billion.[14] As exporters surge on the Yen's weakening, the stock is trading at general collateral level. The most in-demand securities for this quarter have been: Ricoh (third mention) (directional interest), Kintetsu (convertible bond demand) and Osaka Securities (merger demand).

Global M&A

Finally, as we look towards 2013 in M&A, ongoing access to cheap capital and strengthened balance sheets may fuel deal activity. Once again the oil and gas industry was in the spotlight as fear of the fiscal cliff helped drive a record $254 billion in energy industry M&A deals in 2012. More than 670 deals were agreed to in 2012 as energy companies looked to take the lead among competitors in an industry facing higher oil prices, cheapening natural gas prices, and the growth of emerging economies.

An unexpected setback in the scheduled merger between Taiwanese chipmakers Mediatek and MStar proved both opportunity and challenge for event funds in December. Mediatek, who acquired a 48% stake in MStar in August 2012, extended the date of completion to May 2013 due to delays in overseas approvals.[15] This led to spreads widening from 5% to 17% in December and a new wave of borrow demand.

[8] This material has been produced by the Deutsche Bank Securities Lending Group and must not be regarded as research or investment advice.
[9] http://www.reuters.com/article/2012/12/03/olam-muddywaters-rights-idUSL4N09D2RP20121203
[10] http://www.guardian.co.uk/business/2012/dec/27/japan-nikkei-share-index-high
[11] http://www.reuters.com/article/2012/12/27/markets-japan-stocks-idUSL4N0A116W20121227
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[15] http://www.reuters.com/article/2012/06/22/us-mediatek-mstar-idUSBRE85L0G320120622

European Commission publishes the delegated acts for the Alternative Investment Management Directive (AIFMD) on 19 December

The long awaited publication of the detailed rules by the Commission follows the publication of the ESMA technical advice in November 2011. The rules provide a degree of clarity on some controversial aspects of the proposals, notably in relation to 'letter box entities' and depository liability. The Commission has taken a more stringent approach compared to ESMA's advice and states that in order for an AIFM to avoid becoming a 'letter box' it must avoid delegating the performance of investment management functions "to an extent that exceeds to a significant extent the investment management functions it retains". The approach also goes further than the initial advice in that it now provides for a review two years after implementation and allows ESMA to issue guidelines to ensure a consistent assessment of delegation structures across the EU. Separately, depositories will have strict liability for the actions of all direct and indirect sub-custodians, except in circumstances where the depositary has been able under the Directive to discharge itself contractually from liability. These detailed rules are subject to a three-month scrutiny period by the European Parliament and the Council, after which they will enter into force provided that neither objects. It will apply from 22 July 2013 and there is a one year transitional period for existing funds.

ESMA also issued two consultations which are designed to clarify the scope of the AIFMD by determining those entities that fall into the definition of an 'alternative investment fund'. In order to achieve this, the guidelines set out the criteria for what is considered to be a collective investment undertaking, and the meaning of a number of terms such as capital raising, defined investment policy and the number of necessary investors. ESMA is consulting on the proposals until 1 February 2013 and will issue final rules in the first half of 2013.

Guidelines for Regulation on Short Selling and Certain Aspects of CDS (SSR) expected in January

Subject to regulatory approval, market making and primary dealing exemptions are available for firms acting in those capacities. Final guidelines from ESMA on the operation of these exemptions were not published in December and are now expected during January 2013.

EMIR - European Commission adopts 9 technical standards for the implementation of European Market Infrastructure Regulation (EMIR), but ESMA advice still expected on certain issues

The standards cover indirect clearing arrangements, the clearing obligation procedure, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP. With regard to central counterparties, the standards specify the necessary capital, retained earnings and reserves of a CCP and the necessary format of records that must be kept. With regard to trade repositories, the technical standards specify, amongst other things, the minimum details of the data to be reported to trade repositories and the format and frequency of trade reports to trade repositories.

As the Commission did not amend the standards by ESMA, they will now be subject to a 1 month objection period by Member States and the European Parliament. Following this period and assuming no objection (objections are unlikely in cases such as these), the technical standards will enter the EU official journal and apply from mid-February 2013. At this point, EU CCPs may begin to apply for authorisation and firms may apply for intra-group exemption from clearing.

ESMA also published a consultation paper on 20 December on the technical standards for interoperability between CCPs. The guidelines clarify the obligations for national regulators on how to assess existing or new interoperability arrangements between CCPs focusing on; legal risk, fair and open access, identification, monitoring and management of risks to ensure prudent management, ring fencing of collateral deposits and cooperation between regulators.

Going forward, ESMA is also required to produce guidelines or recommendations on a number of other aspects of EMIR including advice to the European Commission on the equivalence of third country regimes and standards for margin requirements for OTC derivatives that are not cleared by a CCP. On the latter issue, an ESMA consultation on margin requirements for non-cleared swaps is expected in the first half of 2013, following the publication of the Basel principles which is expected in the coming weeks.

US Commodity Futures Trading Commission (CFTC) grants relief from various mandatory derivatives requirements under Dodd-Frank

December 2013 was a very busy month at the (CFTC) as several no-action letters were released including relief for the commodity pool operator of a fund of funds from registration requirements until the later of June 30, 2013, or six months after the effective date (or compliance date, if later) of any revised guidance on the application of the de minimis thresholds to funds of funds, subject to certain conditions described in the letter. Operators of investment pools that invest in legacy securitization vehicles were also granted certain relief. Relief was also provided, subject to various conditions, for bespoke or complex swaps from certain reporting obligations and for commodity trading advisors that are subsidiaries of a registered commodity pool operator from registration requirements. Guidance was issued for operators of securitization vehicles regarding whether they may be excluded from the definition of commodity pool and provides relief from registration requirements.

CFTC delays deadline of external business conduct duties for swap dealers and major swap participants

The CFTC also released an interim final rule on business conduct and documentation requirements for swap dealers and major swap participants, delaying the compliance deadline for certain requirements. The compliance deadline for most external business conduct duties is extended until May 1, 2013, and the deadline for portfolio reconciliation and swap documentation rules is extended to July 1, 2013.

Temporary relief for non-US persons, non-US swap dealers and non-US major swap participants from certain cross-border applications of Dodd-Frank

Regarding the extraterritorial reach of Dodd-Frank, the CFTC approved an exemptive order providing time-limited relief which expires on July 12, 2013 from certain cross-border applications of certain provisions. Under the order, a non-US person that registers as a swap dealer (SD) or major swap participant (MSP) may delay compliance with certain entity-level requirements, and non-US SDs and MSPs and foreign branches of US SDs and MSPs may delay compliance with certain transaction-level requirements, subject to specified conditions. Transaction-level requirements will still apply for swaps with US counterparties. The order also includes a definition of the term "US person" which will apply for purposes of the order, which is largely similar to criteria set out in the CFTC's October 12, 2012 no-action letter. In addition, the order clarifies what activities must be included by non-US persons in their determination of whether to register as a SD or MSP. Temporary relief is provided from the requirement that non-US persons aggregate the US swap dealing activity of their non-US affiliates.

12 EU Member States granted permission to proceed with a financial transaction tax (FTT) using enhanced cooperation procedure

Austria, Belgium, Estonia, France, Germany, Greece, Italy, Netherlands, Portugal, Slovenia, Slovakia, Spain have requested permission to implement an FTT using this procedure, which allows a sub-set of Member States to adopt measures if they cannot be agreed at EU-27 level. Now that the Parliament has consented, the EU Council must decide whether to allow the FTT to proceed, using the usual weighted voting procedure. The EU Commission is expected to then publish a revised FTT proposal and updated impact assessment, which will be negotiated by the 12 participating Member States who agree unanimously. There is no implementation date, but the earliest would be January 2014.

Separately, a number of Member States including Italy and Portugal have announced plans to unilaterally introduce FTTs as part of their 2013 budgets. While Portugal's is still to be determined, the Italian law including an FTT was approved before Christmas. The Italian FTT will apply from 1 March 2013 to purchases of shares and similar securities, including ADRs and conversions to existing shares, from Italian issuers. This will be set at 0.1% for transactions on regulated markets or multi-lateral facilities and at 0.2% for OTC transactions. There are exemptions for share issuance, securities lending and repos, market-

[16] Deutsche Bank Government & Regulatory Affairs Group
This is a summary of some of the themes underlying recent regulatory developments affecting hedge funds and their managers. It does not purport to be legal or regulatory advice and must not be relied on for that purpose. Deutsche Bank is not acting and does not purport to act in any way as your advisor. We therefore strongly suggest that you seek your own independent advice in relation to any legal, tax, accounting and regulatory issues relating to the merits or otherwise of the products and services discussed.

making, supporting underwriting, intra-group transactions, listed firms under a EUR 500 million market cap and "subjects merely interposed in the execution of a transaction." The law also includes a tax on derivatives related to the securities covered by the FTT, to apply from 1 July 2013. The rate at which they would be taxed is to be determined but will be a fixed amount which varies by the nature and notional value of the contract. The law also includes a 0.2% duty on significant modification and cancellation of electronic orders in a short time frame for instruments covered by the FTT.

ESMA completes guidelines for Undertakings for Collective Investment in Transferable Securities (UCITS)

The European Council and Parliament are continuing to debate the update to the UCITS Directive (UCITS V) which aims to clarify the scope of the depositary's liability in order to align with similar proposals in the Alternative Investment Fund Managers Directive (AIFMD), strengthen the sanctioning regime and put in place requirements for the remuneration of fund managers. Both institutions have published compromises and discussions will continue into 2013.

Separately, the guidelines cover the repurchase and reverse repurchase agreements that UCITS-compliant funds may enter into. This final element completes ESMA's overhaul of guidelines on UCITS and ETFs, which will enter into force in mid February. The combined guidelines require significantly enhanced transparency around the activities of UCITS, new requirements for the use of strategy indices and a requirement that all revenues arising from efficient portfolio management techniques should be returned to the UCITS. Specifically on repos, agreements must allow the assets to be recalled by the UCITS at any time (i.e. within seven days), with additional requirements for reverse repos.

By mid February, competent authorities must inform ESMA as to whether they intend to implement these rules. Existing funds have a one year transitional period from mid-February in which to become compliant.

Basel Committee on Banking Supervision (BCBS) issues full text of revised Liquidity Coverage Ratio (LCR)

The LCR, originally formulated as part of the Basel III accord in 2010, aims to ensure that a bank has an adequate stock of unencumbered high quality liquid assets (HQLA) to meet its liquidity needs for a 30 day liquidity stress scenario. The revisions announced expand the range of assets eligible as HQLA. It allows for the use of equities and high quality mortgage backed securities, providing they meet certain conditions. The update also introduces some refinements to the assumed inflow and outflow rates to more appropriately reflect actual experience in times of stress.

The BCBS has also agreed that the LCR should be subject to phase-in arrangements, to align with Basel III capital requirements. Consequently, the LCR will be introduced as planned on 1 January 2015, but the minimum requirement will begin at 60% of liquidity needs, rising by 10% per year to reach 100% in 2019. It was also agreed that during periods of stress it would be "entirely appropriate" for banks to use their stock of HQLA, thereby allowing them to fall below the minimum LCR requirement. The revised rules will need to be implemented across various jurisdictions. In Europe, the Capital Requirements Directive / Regulation (CRDIV) will need to reflect the revised rules, following an observation period conducted by the European Banking Authority.

ECB gains responsibility for a single supervisory mechanism (SSM) for euro-zone banks

In a departure from the Commission's original proposal, the EU Council agreement from 12 December will see direct prudential supervision by the ECB only for banks which are: "significant" in terms of size, cross-border or importance to domestic economy or in receipt of financial assistance from euro-zone rescue funds. Significant banks are those with more than €30 billion in assets or which make up more than 20% of a Member State's GDP. The ECB would also directly supervise the three largest banks in each participating Member State. All other banks will remain the responsibility of national supervisors, although the ECB can conduct investigations, direct national supervisors to act or take over direct supervision. Even for banks supervised by the ECB, national supervisors will retain primary responsibility for some key tasks – authorisations, resolution and third country relations - and all non-prudential tasks, e.g. market conduct, consumer protection, anti-money laundering.

Under the agreement, the ECB can start to implement its powers as soon as the legislation enters into force but need not be "fully operational" until 1 March 2014. Even then, the ECB can push this back if it is not ready to assume its responsibilities. Although the decision to confer these powers on the ECB is for the EU Council alone, the European Parliament has to agree to changes to voting rules in the EBA. As such, it is possible that the proposals may be amended during negotiations with the Parliament, which are expected to agree a final text by February 2013.

FSB makes several proposals to progress toward final recommendation deadline of September 2013

The FSB has been tasked by the G20 with developing final recommendations by September 2013 in five areas of "shadow banking": i) bank interaction with shadow banking entities; ii) money market funds; iii) other shadow banking entities; iv) securitisation; and v) securities lending and repos.

In the remaining two areas, the FSB currently have two consultations open for comment until mid-January. On securities lending and repos, the FSB set out 13 initial recommendations, covering improvements in transparency, regulation of securities financing, and structural changes to these markets. Central among these is a call for feasibility studies on trade repositories for securities lending and repo transactions - initially national or regional as appropriate but eventually global. In addition, the FSB proposed minimum standards and a review by the BCBS of existing regulatory requirements for firms' calculations of collateral haircuts to minimise pro-cyclicality, including an examination of minimum numerical floors. The FSB also proposed limits on cash collateral reinvestment and re-hypothecation of client assets.

Negotiations continue under new presidency for Markets in Financial Instruments Directive (MiFID 2)

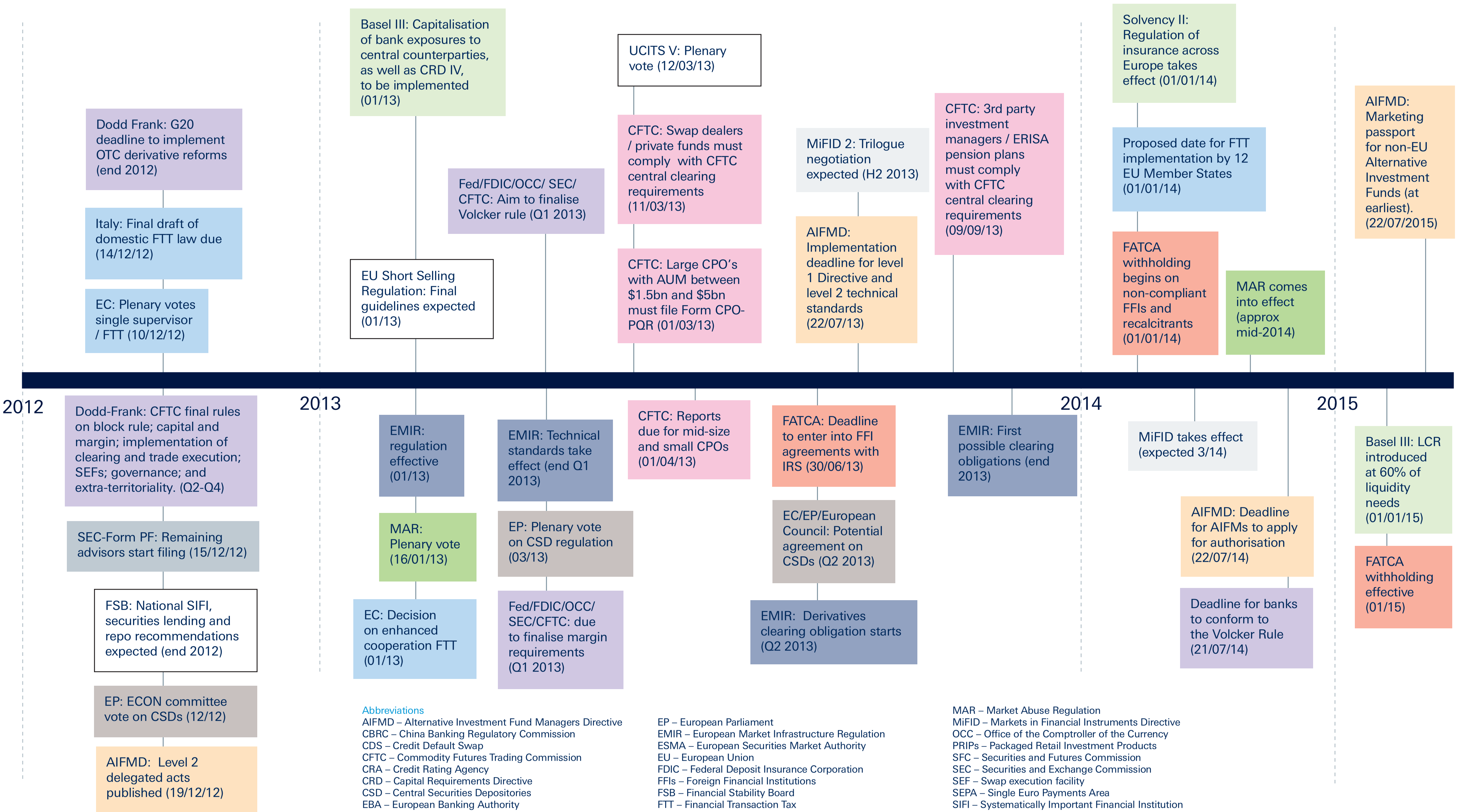
Negotiations will continue under the Irish Presidency in 2013. The key outstanding issues for Member States include, market structure and associated transparency requirements, the scope of the OTF regime and use of own capital, and the trading that may be conducted over the counter (OTC) without pre trade transparency. Once the Council have reached a position, a three-way "trilogue" negotiation to agree a final text will take place with the Parliament and the Commission later in 2013. The European Parliament adopted their position on 26 October 2012.

The European Council adopts position on the proposals for the Market Abuse Directive and Regulation (MAD/MAR)

The adopted text reinserts a number of useful recitals from the original MAD, clarifying that research produced on the basis of public information and plans and strategies for trading should not be considered as inside information. The text also contains a favourable definition of inside information, including its application to commodity derivatives. The text also allows for a number of legitimate behaviours where a person possessing inside information shall not be deemed to have used that information, and consequently to have engaged in insider dealing under certain circumstances (such as market making).

The Economic and Monetary Affairs Committee (ECON) of the European Parliament have also already voted to agree a position on the European Commission's proposal. Among other things, the Parliament text widens the scope to include the manipulation of benchmarks and obliges all Member States to ensure that maximum jail sentences apply throughout the EU. MEPs also voted for sanctions to be made public and for fraudsters to be named unless this would jeopardise ongoing official investigations.

Now that both the Council and the Parliament have adopted their respective positions, a trilogue negotiation will take place in 2013 to agree a final text.



Abbreviations
AIFMD – Alternative Investment Fund Managers Directive
CBRC – China Banking Regulatory Commission
CDS – Credit Default Swap
CFTC – Commodity Futures Trading Commission
CRA – Credit Rating Agency
CRD – Capital Requirements Directive
CSD – Central Securities Depositories
EBA – European Banking Authority
EC – European Commission
ECON – Economic & Monetary Affairs Committee
EIOPA – European Insurance and Occupational Pensions Authority
EP – European Parliament
EMIR – European Market Infrastructure Regulation
ESMA – European Securities Market Authority
EU – European Union
FDIC – Federal Deposit Insurance Corporation
FFIs – Foreign Financial Institutions
FSB – Financial Stability Board
FTT – Financial Transaction Tax
HFT – High frequency trading
IRS – Interest Rate Swap
JFSA – Japanese Financial Services Agency
LCR – Liquidity Coverage Ratio
MAR – Market Abuse Regulation
MiFID – Markets in Financial Instruments Directive
OCC – Office of the Comptroller of the Currency
PRIPs – Packaged Retail Investment Products
SFC – Securities and Futures Commission
SEC – Securities and Exchange Commission
SEF – Swap execution facility
SEPA – Single Euro Payments Area
SIFI – Systematically Important Financial Institution
UCITS – Undertakings for Collective Investment in Transferable Securities

Source: Deutsche Bank Government & Regulatory Affairs and Hedge Fund Consulting

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