

The AIMA logo consists of the word "AIMA" in a bold, black, sans-serif font, positioned above a solid magenta horizontal bar.

AIMA

# AIMA Journal

Edition 147 | Q3 2026

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# The Long-Short



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AIMA events



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## Message from AIMA's CEO



One of the things I enjoy about the AIMA Journal is the breadth of perspectives it brings together. This edition is no exception, covering everything from portfolio construction and emerging managers to regulation, digital assets, AI and the changing ways investors can access alternative strategies.

A recurring theme throughout this edition is how the industry is adapting as it grows and evolves. [AIMA's latest research with Marex](#), explored in more detail in these pages, points to renewed momentum among emerging managers and shows how firms are building more institutional businesses earlier in their development. Elsewhere, we look at the growing overlap between traditional and alternative investment strategies, including how hedge fund strategies are increasingly finding their way into ETFs.

AI is, unsurprisingly, part of the conversation too. But the debate has moved on considerably from a year or two ago. The question is no longer whether firms will use AI, but where it can add value and how they ensure the right governance and accountability around it. There is a similar discussion taking place in this edition around digital assets as institutional participation develops and attention turns to the infrastructure and controls needed to support it.

There is plenty more in this Journal, including thoughtful contributions on diversification, regulatory change, and operational resilience. Together, they provide a useful snapshot of some of the conversations taking place across our membership today.

Those conversations will move from the page to the stage over the coming months, as AIMA's flagship events calendar really ramps up globally. We will bring the industry together at the [Australia Forum in Sydney](#), the [ACC Global Summit in London](#), the [Global Investor Forum in Toronto](#) and our [APAC Annual Forum in Hong Kong](#). We are also launching a new Investor [Xchange event in London](#), before finishing the year at [Abu Dhabi Finance Week](#), where AIMA will host a dedicated day focused on hedge funds.

It is one of the busiest periods in AIMA's calendar, and a good reflection of what AIMA does best. Bringing our community together across markets to share ideas, discuss common challenges and help shape what comes next.

I look forward to seeing many of you at these events. In the meantime, I hope you enjoy this edition of the Journal.

Sincerely,

Jack Inglis  
CEO, AIMA



# AIMA CONFERENCE CALENDAR

## 2026 / 2027



### October 2026

|           |           |  |                                          |
|-----------|-----------|--|------------------------------------------|
| LONDON    | 7 Oct     |  | Alternative Credit Council Global Summit |
| TORONTO   | 14-15 Oct |  | AIMA Global Investor Forum               |
| HONG KONG | 28 Oct    |  | APAC Credit Refresh                      |
| HONG KONG | 29 Oct    |  | AIMA APAC Annual Forum                   |

### November 2026

|        |        |  |                       |
|--------|--------|--|-----------------------|
| LONDON | 17 Nov |  | AIMA Investor Xchange |
|--------|--------|--|-----------------------|

### December 2026

|           |       |  |                                                        |
|-----------|-------|--|--------------------------------------------------------|
| ABU DHABI | 8 Dec |  | AIMA Global Hedge Fund Leadership Platform - ADFW 2026 |
|-----------|-------|--|--------------------------------------------------------|

### February 2027

|       |        |  |                               |
|-------|--------|--|-------------------------------|
| DUBAI | 4 Feb  |  | AIMA Middle East Forum        |
| MIAMI | 22 Feb |  | Private Credit Investor Forum |

### March 2027

|        |        |  |                                       |
|--------|--------|--|---------------------------------------|
| CHINA  | 11 Mar |  | AIMA China Live                       |
| LONDON | 18 Mar |  | AIMA Global Policy & Regulatory Forum |

### April 2027

|           |       |  |                             |
|-----------|-------|--|-----------------------------|
| SINGAPORE | 8 Apr |  | AIMA Singapore Annual Forum |
|-----------|-------|--|-----------------------------|

### May 2027

|           |                 |  |                                            |
|-----------|-----------------|--|--------------------------------------------|
| TOKYO     | 13 May          |  | AIMA Japan Annual Forum                    |
| HONG KONG | To be announced |  | Acorns of APAC - Emerging Manager Outreach |
| LONDON    | To be announced |  | AIMA Next Generation Manager Forum         |

### June 2027

|          |         |  |                     |
|----------|---------|--|---------------------|
| MONTREAL | 16 June |  | AIMA Montreal Forum |
|----------|---------|--|---------------------|

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# True diversification

*A practitioner's case for genuine diversification in a multi-strategy portfolio*

Genuine diversification is a function of how many distinct economic forces drive a portfolio's returns, not how many strategies or asset classes it contains. This is why a regime-insensitive strategy such as trend following can occupy a distinct role within a multi-strategy portfolio.

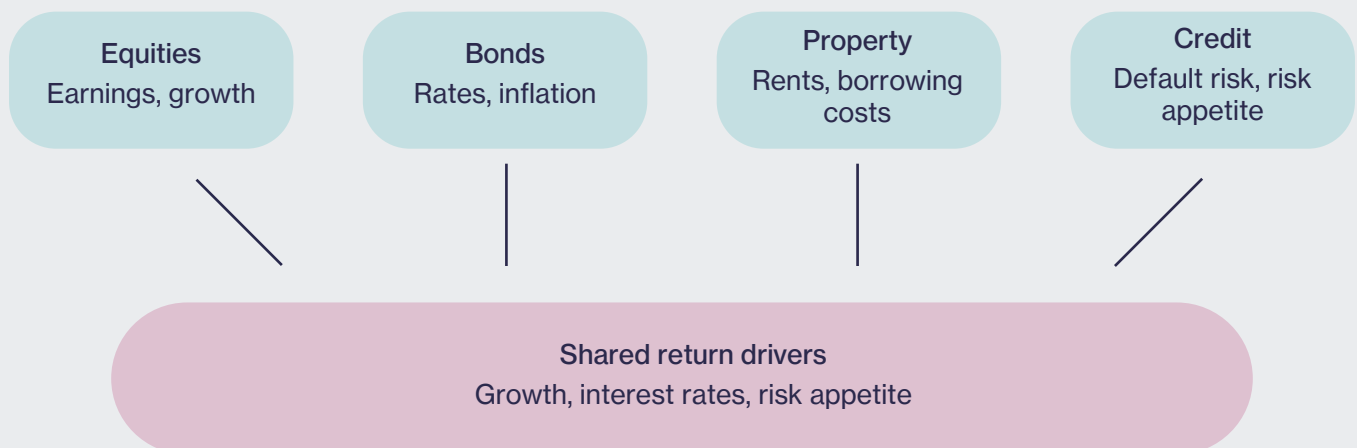
Portfolio construction in a multi-strategy context is often approached as a question of correlation between strategy returns. In principle, correlation should reveal where return drivers align. In practice, a shorter measurement window can mask this. Two strategies sharing an underlying driver can still show low correlation over that period, either because the driver has not moved, or because it shows up in each strategy with a different lag.

A return driver is the underlying economic force behind a strategy's profit and loss. Equity long/short is tied to earnings, growth and rates. Credit strategies are tied to spread movement, default risk and liquidity. Event-driven strategies depend on specific corporate situations, though the risk appetite behind their pricing is sensitive to growth and rates. These may look like distinct strategies, yet beneath the surface many share a common set of macro drivers.

That overlap tends to be masked during calm periods, when strategy returns can appear independent. It becomes visible the moment a shared driver is disturbed: a sharp rise in inflation expectations, for instance, pushes rates higher, weighing on equity valuations, raising property borrowing costs, widening credit spreads and eroding bond values, often all at once. A multi-strategy portfolio that looks diversified on a correlation matrix can still carry concentrated exposure to a single macro shock.



**Simone Haslinger**  
Chief Executive Officer  
East Coast Capital  
Management



*Equities, bonds, property and credit each connect down to a shared set of return drivers.*

Systematic trend following offers a genuinely distinct return driver. Rather than depending on economic growth, falling rates or rising prices, it seeks to identify and follow sustained directional price movements across futures markets. It requires no particular economic outcome to perform, which is the source of its regime insensitivity. It can participate in a rising equity market, a shift in bond yields, a commodity shock or a currency realignment: what matters is the presence of a trend, not its direction or the asset class involved.

That is why trend following tends to sit apart from the correlation cluster connecting most other strategies during periods of stress. It also carries a structural liquidity advantage: positions in single stocks, corporate credit or other less liquid instruments can become difficult to unwind exactly when a portfolio needs to reduce risk, while futures markets remain liquid and centrally cleared.

Trend following is often associated with providing “crisis alpha”, reflecting the style’s tendency to generate uncorrelated returns precisely when conventional portfolios are under the greatest strain. Sustained directional moves are common during market stress, since that is when investor behaviour turns most one-sided.

The pattern is not merely theoretical. During 2008, when equity and credit markets fell sharply, trend-following strategies as a group were widely documented to have delivered strong positive returns. That episode does not guarantee future performance, and trend following underperforms in range-bound or whipsaw conditions. It illustrates why the return driver, not the asset class, determines how a strategy behaves when a shared shock hits the portfolio.

The distinction extends to construction across strategies, not just asset classes. A 2018 paper by AIMA and the CAIA Association, [“Portfolio Transformers: Examining the Role of Hedge Funds as Substitutes and Diversifiers in an Investor Portfolio”](#), grouped hedge fund strategies into substitutes and diversifiers. Substitutes, such as long/short equity and event-driven, tend to retain meaningful equity beta. Diversifiers, such as global macro and managed futures (trend following), show materially lower correlation to that same driver. A multi-strategy book weighted toward substitutes may carry more shared risk than its headline diversification suggests.

While classified as a diversifier, trend following is not a hedge that only pays off when markets fall. Should equities, credit or any other market rise steadily, a trend-following strategy would typically participate too, generating positive returns correlated with the trend. It is positioned with whatever is moving, not against any particular strategy or asset class.

Conviction in a given strategy or asset class tends to be strongest after a sustained run of favourable performance. That is usually also the point at which crowding risk is highest. Long-run allocation frameworks exist to guard against this tendency, though they cannot say when conditions will actually shift.

Trend following does not need to call that top. Its systematic rules let it participate in a crowded, even bubble-like, market for as long as the trend continues, while built-in risk controls let it reduce or exit that position once the trend reverses. It requires no forecast of when a bubble will burst, only a disciplined process for responding once it does.

For an allocator, the practical discipline is mapping correlation at the level of return drivers, not strategy labels. Two managers with different names may still share the same underlying force, while two with similar labels may not. Genuine diversification sits in that distinction.

No manager, however sophisticated, can consistently time that turn in advance, and none needs to. The case for trend following in a multi-strategy portfolio does not rest on a view about where markets go next. It rests on holding a return driver, the presence of a trend, that is structurally distinct from most other strategies. That driver tends to assert itself when those strategies are under strain, and it requires no particular economic outcome to do so. That is a genuine complement to the prevailing consensus, capable of generating returns regardless of how it resolves.

*This article is prepared by ECCM Australia Pty Ltd (ACN 664 662 846), corporate authorised representative of East Coast Capital Management Pty Ltd (ACN 129 976 905, AFSL 339300). It is educational and general in nature and does not constitute financial product advice. Past performance is not indicative of future performance.*

# Hedge funds and ETFs: Delivering listed alpha to new investors

Exchange-traded funds (ETFs) were once synonymous with low-cost exposure to traditional benchmarks, delivering beta in a transparent and efficient format. Increasingly, however, ETFs have evolved beyond simple index tracking. Many now incorporate techniques associated with alternative investment strategies, including derivatives, dynamic risk management and absolute-return objectives, within a listed and regulated UCITS framework.

What is striking today is not only that hedge funds use ETFs within their portfolios, but that hedge fund managers are themselves becoming ETF issuers. Actively managed and alternative strategies that were historically available through private fund structures are increasingly being adapted for ETF wrappers, expanding investor access while retaining the liquidity, transparency and regulatory protections associated with UCITS.

## From beta trackers to strategy-driven ETFs

Early ETFs focused on broad market exposure. As the market matured, issuers expanded into fixed income, commodities and other asset classes before increasingly focusing on strategy-driven products. Today, ETFs can provide exposure to approaches traditionally associated with hedge funds, including:

- Long/short equity approaches;
- Managed futures style trend following;
- Volatility and options based strategies; and
- Multi asset absolute return frameworks.

Some products are rules-based, while others are actively managed and may incorporate performance-linked fee structures. Crucially, they remain subject to UCITS diversification, liquidity and risk-management requirements. While this limits the extent to which traditional hedge fund strategies can be replicated, it allows investors to access alternative exposures through a liquid, transparent and exchange-traded vehicle.

## Why hedge fund managers are launching ETFs

There are several reasons why hedge fund managers are increasingly choosing to launch ETFs alongside, or instead of, traditional private funds:

- **Distribution and access** - ETFs can reach a broader investor base, including wealth management platforms and investors unable or unwilling to invest through traditional private fund structures.
- **Liquidity and transparency** - the ETF format provides daily dealing, transparent pricing and more frequent disclosure of holdings than many private funds. This can be attractive for investors who want hedge-fund-style strategies but with clearer oversight and easier 'tradeability'.



**James McKnight**  
Partner  
Simmons & Simmons, Dublin



**James Cullinane**  
Managing Associate  
Simmons & Simmons, Dublin

- **Operational efficiency** - adding an ETF wrapper to an existing strategy may allow managers to leverage their existing research and risk infrastructure, while benefiting from the operational simplicity and scalability of a listed fund (subject to compliance with the UCITS framework and Eligible Assets Directive).
- **Commercial positioning** - ETFs enable managers to offer liquid alternatives while reserving more complex or less liquid strategies for traditional hedge fund vehicles.

In this sense, ETFs are no longer merely tools used by hedge funds; they are increasingly products created by hedge funds, reflecting a broader convergence between traditional and alternative investment management.

### Hedge funds still using ETFs inside their portfolios

Alongside this product innovation, hedge funds continue to use ETFs as practical portfolio management tools, particularly for cash equitisation and tactical exposure management.

Historically, managers used futures and swaps to maintain market exposure while cash awaited deployment. Today, the breadth of the ETF market allows them to achieve similar objectives through listed funds, which can provide:

- Exposure to major equity and fixed income indices;
- Access to harder to reach segments such as commodities, global sectors and listed private equity; and
- Increasingly, exposure that matches specific strategy styles, rather than just broad market beta.

With hedge-fund-style ETFs, managers can move beyond simple benchmark proxies. They can place temporary cash into vehicles that complement the fund's overarching philosophy - for example, a long/short equity ETF, a trend-following product or an options-based income strategy while retaining intraday liquidity and operational simplicity. This helps ensure that interim cash balances are invested in a way that is consistent with the fund's risk and return objectives. ETFs sit alongside money market funds and other enhanced cash solutions within hedge funds' broader liquidity frameworks, but the increasing availability of hedge fund style ETFs means that surplus cash can now be deployed in ways that more closely reflect the fund's strategy, rather than simply in pure cash instruments.

### Delivering hedge fund style strategies to new investors

Perhaps the most significant consequence of this trend is the expansion of investor access. As alternative strategies migrate into ETF wrappers, a broader range of investors can gain exposure to techniques that were historically available primarily through private fund structures.

This expansion brings both opportunities and responsibilities:

- **Access and diversification** - investors can access alternative and actively managed strategies through a familiar listed and regulated format.
- **Transparency and governance** - ETFs typically disclose holdings more frequently than many hedge funds and operate within established regulatory and exchange-listing frameworks. This can aid understanding of risk and facilitate oversight by advisers and fiduciaries.
- **Complexity and investor education** - active ETFs may employ derivatives, sophisticated investment techniques and, in some cases, performance-linked fees. Clear communication remains essential to ensure investors understand the strategy, risks and fee arrangements.
- **Commercial positioning** – launching an ETF can allow a manager to position part of their capability as a “liquid alternatives” offering, while reserving more complex, capacity-constrained or less liquid strategies for traditional hedge fund vehicles.

The expansion of ETF-based alternatives may also encourage hedge fund managers to focus their private fund offerings on areas where they can demonstrate greater differentiation, including event-driven strategies, specialist research, bespoke structuring and less liquid opportunities.

### Conclusion: listed alpha as a complementary toolkit

The rise of strategy-driven ETFs, including those launched directly by hedge fund managers, illustrates the continuing convergence of traditional and alternative investment worlds. ETFs are no longer simply vehicles for passive exposure; they are increasingly being used both to deliver and access alternative investment strategies.

Importantly, hedge fund managers are now engaging with ETFs in two complementary ways. They are increasingly issuing hedge fund style ETFs, bringing listed alpha to a wider investor base; and they continue to use ETFs inside their portfolios as efficient instruments for cash equitisation and tactical exposure.

For the alternative investment community, the key is not to view listed alpha as a replacement for traditional hedge funds, but as a complementary toolkit. Managers who engage thoughtfully with these products, both as issuers and as users, integrating them into liquidity ladders, asset allocation frameworks and risk processes may be better placed to navigate evolving markets and investor expectations.

As innovation in ETFs and money market solutions continues, hedge fund managers who combine flexibility and simplicity with rigorous governance are likely to make the most of this expanding universe of listed tools, delivering more efficient, targeted outcomes for a progressively broader investor base.

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# Stacking up: Momentum is building for emerging managers

Marex's latest research report, "*Stacking Up: Emerging Manager Survey 2026*," co-authored with the Alternative Investment Management Association (AIMA), offers a timely snapshot of the evolving emerging manager landscape. Drawing on insights from 180 hedge fund managers overseeing up to US\$1 billion in assets, alongside 50 institutional investors, the report explores the operational and strategic priorities shaping the sector - from fee structures and cost efficiency to the growing influence of AI and the rise of Separately Managed Accounts (SMAs).

The results suggest a sector that continues to mature, with emerging managers increasingly adopting institutional-grade infrastructure and governance earlier in their lifecycle. At the same time, investors appear more adaptable in their allocation approach, showing greater flexibility around factors such as fund size and track record, while maintaining high expectations for operational strength. Together, these trends point to a market gaining confidence and momentum, supported by a more pragmatic and opportunity-focused investor base.



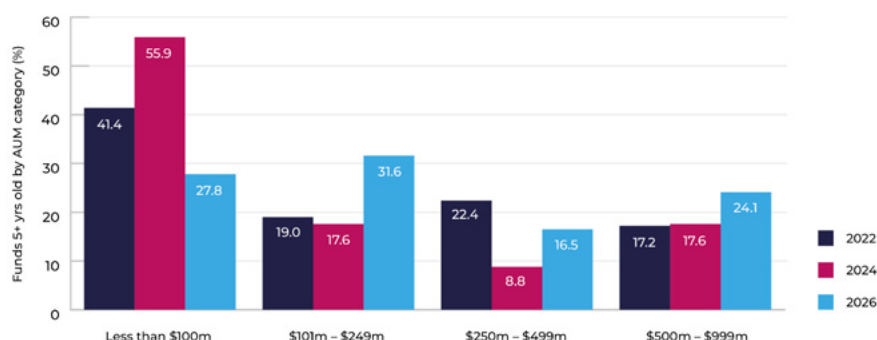
**Lawrence Obertelli**  
Head of EMEA Prime  
Service Sales  
Marex

## 1. The smallest managers are scaling faster – but there is growth at all levels

"Stacking Up" - a reference to the many indicators collectively pointing to renewed momentum across the industry - is the fifth edition of the Emerging Managers Survey published over the last nine years. The breadth and consistency of the data provide a unique lens into the evolution of the emerging manager ecosystem, highlighting how operational priorities, investor expectations, and growth dynamics have shifted over time.

One of the clear themes to emerge from this year's findings is the declining share of managers remaining below the US\$100 million AUM threshold for more than five years. This points to an environment in which smaller and earlier-stage funds are scaling more efficiently, supported by investors' increasing willingness to allocate capital earlier in a manager's lifecycle.

### Funds 5+ yrs old by AUM category



“One of the clear themes to emerge from this year's findings is the declining share of managers remaining below the US\$100 million AUM threshold for more than five years.”

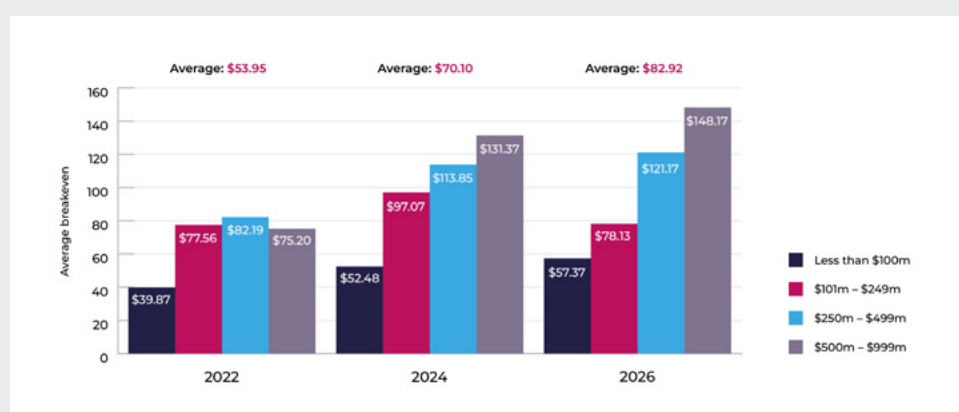
## 2. Institutional mindsets are driving success – but raising the cost base

This is a market in which allocators value robust infrastructure, governance, and operational discipline, with 86% of investors from this study citing Operational Due Diligence (ODD) as the biggest barrier to allocation.

Reflecting this, the findings reinforce a clear message that managers are prioritising institutional mindset from day-one. Firms are investing earlier in infrastructure and in-house capabilities, resulting in higher headcount. Emerging managers now have an average of 10 people in their businesses, up from 7 in the previous survey.

While this investment is helping firms meet allocator expectations and scale more effectively, it is also increasing the cost of building a sustainable business. Average breakeven has risen by almost a fifth to US\$82.9m. A more demanding regulatory environment is likely to be contributing to this increase, alongside rising competition for talent and higher service provider costs.

### More institutional operating models are increasing business breakeven levels



## 3. Operating costs are stabilising – but economies of scale remain critical

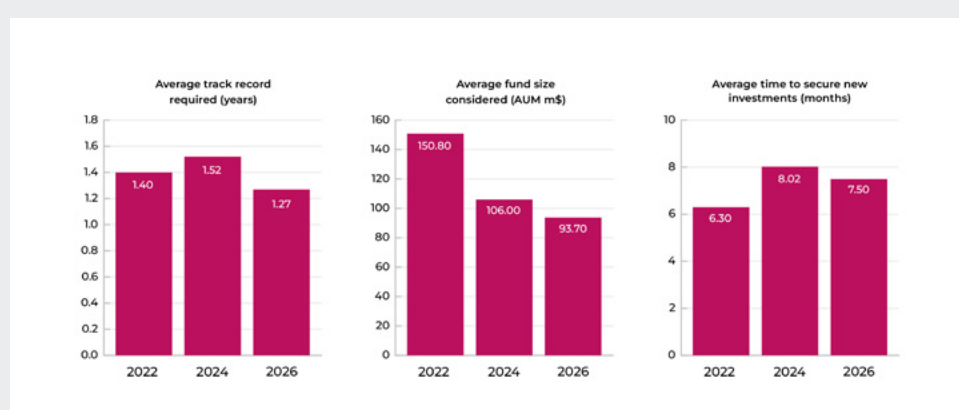
Average fund operating costs have stabilised at approximately 1% (total expense ratio), suggesting managers are succeeding in containing expense growth despite ongoing inflationary pressures. For many emerging managers, long-term profitability therefore remains heavily dependent on both asset growth and sustained investment performance.

## 4. Fundraising is a challenge – but investor attitudes are evolving

While fundraising remains a significant challenge across the industry, investors are increasingly open to backing managers with shorter track records. Managers are still expected to demonstrate institutional-quality platforms, operational robustness and clear strategic differentiation from an early stage.

Encouragingly, if funds are able to meet these expectations, they are being considered for investment earlier, and once investors engage, the average time required to close a new allocation has shortened, proving that managers are meeting higher expectations.

### Allocators are investing in emerging managers earlier



## 5. Fee competition is strong – but fees are holding up

Both management fees and performance fees have continued to hold up. Management fees average 1.43% across respondents, with 13% of emerging managers now charging management fees of 2% or higher, while funds launched within the past 12 months reported average management fees of 1.33%. Performance fees rose very slightly from 16.22% in the 2024 survey to 16.24% in this year's survey.

Although fee competition remains intense, particularly among early-stage managers, another notable trend is that firms are increasingly using mechanisms designed to better align interests with investors.

The use of hurdle rates has risen meaningfully, especially among newer firms. More complex alignment tools such as clawback provisions remain more common among larger managers. More than one-third of LPs (36%) now use a hurdle rate, up from 21% when the same question was asked in 2022.

## 6. AI adoption is accelerating – even if investors are not demanding it

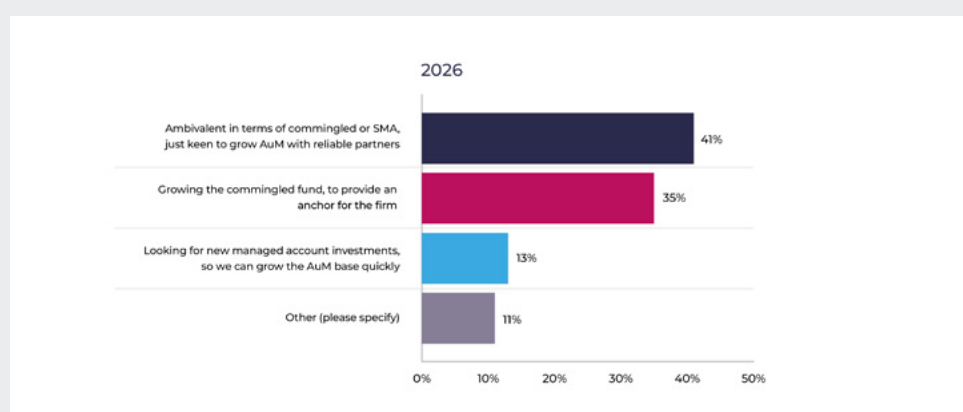
For the first time, this year's research examined attitudes towards AI. The findings suggest managers are embracing AI more rapidly than investors are explicitly requiring it. When asked whether it is important for hedge funds to use AI tools, around one-third (34%) of investors said they primarily assess managers based on their investment offering, pedigree, and opportunity set, with AI not viewed as a core consideration. Only 8% said they actively expect firms to use AI tools, whether for operational efficiencies or alpha generation. The majority of investors (58%) took a more pragmatic position, indicating that while AI is not a deciding factor, they would expect managers to utilise it where clear use cases exist.

## 7. A more flexible approach to scaling – but growing AUM with reliable partners is key

Managers are demonstrating greater flexibility in how they scale their businesses, including increased openness towards managed accounts and onshore fund structures. While two thirds of investors (66%) favour commingled vehicles as their preferred method of allocating to emerging hedge funds, managers are becoming increasingly pragmatic in accommodating a broader range of investor preferences.

Two-fifths of surveyed emerging managers indicated they are largely ambivalent between using between commingled funds and SMAs, they are just keen to grow AUM with reliable partners.

### Manager flexibility: Manager fundraising priority in 2026



Investors were asked: What is your preferred method of allocating to emerging hedge funds?



### Stacking up: emerging manager survey 2026

This year's survey presents a notably positive outlook despite a challenging market backdrop. Emerging managers are struggling less in respect of scaling up AUM, they are expanding headcount, and containing fund costs effectively. Investor attitudes are also evolving: track record requirements are becoming less onerous, funds are being considered for investment earlier, and investment decisions are being made more quickly. For emerging managers with the resilience, operational discipline, and differentiated insights required to succeed, the opportunity set remains substantial in what continues to be one of the industry's most competitive segments.

*Data for both the fund manager and allocator surveys were gathered between 1 March -10 April 2026. Responses reflect the global alternative investment industry, with North America (29%), the UK (27%), Europe (14%) Asia-Pacific (26%) and ROW (3%). The report also breaks down findings by region and investment strategy to provide a more granular view of how trends differ across the respondent base.*

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# The signals that matter: What FCA supervision means for governance and insurance

The UK's operational resilience framework is well established. What's changing is how the FCA supervises firms. Its observations are becoming a valuable source of risk intelligence and an opportunity for alternative investment managers to reassess whether their governance, resilience and insurance arrangements have kept pace with an operating model that's changing faster than ever.

The operational resilience conversation has changed. Not because the rules have changed. Because the regulator has.

For several years, alternative investment managers have invested heavily in identifying critical business services, mapping dependencies and testing disruption scenarios. Those capabilities are now embedded across much of the industry.

The FCA has noticed, and in its recent supervisory activity suggested the conversation is moving beyond implementation. Increasingly, the question isn't whether firms have a framework. It's whether that framework reflects how the business really operates and whether boards understand where operational risk now sits.<sup>1</sup>

As the FCA puts it, firms should treat resilience as "a core business capability, integrated into strategic planning... rather than as a standalone exercise."<sup>1</sup>

That's a subtle shift, but one with much wider implications than compliance alone.

## Supervision is becoming a source of risk intelligence

Regulation traditionally tells firms what they need to do. Supervision tells firms where others are still getting it wrong, and that's an important distinction.

Portfolio letters, thematic reviews and supervisory observations are more than regulatory updates. Read collectively, they offer an independent view of the operational risks that continue to challenge firms across the market.



**Chris Rigg**  
Executive Director, Asset  
Management  
Howden



**Richard Langdon**  
Head of Business  
Development, Financial  
Institutions  
Howden

<sup>1</sup> Financial Conduct Authority (2026). Operational resilience: Insights and observations one year on.

Rather than waiting for an incident or a regulatory finding to expose weaknesses, firms can use those observations to test their own assumptions.

The question is no longer simply “Are we compliant?” It’s increasingly “If the regulator continues to identify these weaknesses elsewhere, could they exist within our business too?”

That makes supervisory insight more than a compliance exercise. It becomes a governance tool.

### Why this matters for insurance

Insurance may not be the focus of supervisory communications, but it’s often where the financial consequences of operational failures ultimately land.

Yet many of the issues attracting regulatory attention, supplier failure, cyber events, technology outages and governance weaknesses, share one characteristic: they can all create significant financial loss.

This is where supervisory insight becomes particularly valuable.

Alternative investment managers have transformed the way they operate. Outsourcing has increased. Technology has become more interconnected. Critical services increasingly depend on external providers rather than internal infrastructure.

Those changes affect far more than operational resilience. They also change the nature of financial risk.

The rapid adoption of generative AI is a good example. Many firms are embedding AI into research, operations and client-facing processes, often through third-party platforms. While these technologies offer clear opportunities, they also introduce new questions around governance, accountability, intellectual property, data security and third-party dependency.

The issue isn’t whether firms should adopt AI. It’s whether the controls, resilience planning and insurance arrangements supporting that adoption are evolving at the same pace. As with cloud technology before it, innovation changes the operational risk profile and supervisory expectations are evolving alongside it.

Verizon’s 2025 Data Breach Investigations Report found that around 30% of breaches involved a third party, highlighting the growing financial impact of supplier-related incidents.<sup>2</sup>

The question therefore isn’t whether firms have insurance. It’s whether their insurance has evolved at the same pace as their operating model. Insurance shouldn’t be the last conversation after resilience planning. It should be one of the first.

### Governance means challenging assumptions

The FCA’s supervisory observations reinforce a broader message for boards. Resilience isn’t demonstrated through policies alone. It is demonstrated through decision-making.

2 Verizon. (2025). 2025 Data Breach Investigations Report.

“The issue isn’t whether firms should adopt AI. It’s whether the controls, resilience planning and insurance arrangements supporting that adoption are evolving at the same pace.”

That applies equally to insurance governance.

Reviewing insurance once a year as part of the renewal process may have been appropriate when operating models changed slowly. Today's environment is different. Technology, outsourcing arrangements and supplier ecosystems evolve continuously, meaning firms' exposures evolve too.

Insurance should therefore be reviewed alongside governance discussions, resilience assessments and scenario testing, not because regulation requires it, but because good governance does.

### Reading the signals

Every supervisory observation is an opportunity to ask a better question.

Rather than waiting for a regulatory finding, firms should use those observations to challenge whether their governance, operational resilience and insurance arrangements still reflect the way the business operates today.

That doesn't mean buying more insurance. It means reviewing whether the cover, limits and scope of protection remain aligned with an evolving operating model, changing supplier dependencies and emerging operational risks. In a world where supervision increasingly focuses on outcomes rather than frameworks, regular insurance reviews should become part of good governance, not just good procurement.

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# The FCA's 41.1% market cleanliness challenge

The FCA's latest market cleanliness indicators should prompt UK hedge fund managers to test whether their market abuse risk assessments are fit for purpose and their surveillance arrangements work in practice.

## The data is an indication, not a verdict

At 41.1%, the headline number is hard to ignore. In the FCA's 2025/26 market cleanliness results, the figure is the proportion of UK takeover offer announcements preceded by positive abnormal price movements in the two trading days before the news. The FCA's Abnormal Trading Volume Measure also rose by 2.5% compared to 2024, while the FCA received 3,806 Suspicious Transactions and Order Reports (STORs), of which over 82% were suspected cases of insider dealing.

These indicators do not establish that market abuse has occurred. Genuine market volatility, legitimate trading, analyst activity, and media speculation can affect the results. But for a compliance officer, indicators moving in the wrong direction provide a timely reminder to test whether the firm's controls can identify the right issues.

## Showing evidence of controls

The FCA is no longer satisfied with a policy that merely states that the firm monitors for insider dealing and market manipulation. Firms must now go further and explain how those risks arise from their specific strategies and demonstrate that the controls addressing them are complete, operating effectively, and regularly tested.

Article 16(2) of the UK Market Abuse Regulation (UK MAR) has always required alternative investment managers to maintain systems and controls designed to detect and report market abuse. The FCA has made it clear that firms must ensure that those arrangements are effective and proportionate to the risks which arise from their business model and control environment.

A detailed Market Abuse Risk Assessment (MARA) provides a practical foundation for a framework that meets the FCA's expectations, although UK MAR does not require a firm to have a MARA.

A firm's MARA should map realistic scenarios in which market abuse risk may arise by strategy, instrument, venue, information source, and trading behaviour. Firms pursuing event-driven investment strategies should consider how inside information relating to targets of M&A transactions or secondary offerings of the target's equity capital.

Firms executing credit investment strategies may need to assess the risks associated with lenders, restructurings, and private-side information, together with the controls designed to mitigate



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them. Firms operating systematic strategies should consider whether order placements, amendments, or cancellations could create misleading signals. The analysis must also cross-desk boundaries, recognising that information that has been received by one team could affect the trading activities of another. The framework should link each material scenario to preventive controls and surveillance techniques, as well as escalation and remediation procedures.

### Surveillance must be tested end-to-end

Trade and communications surveillance systems are critical controls for detecting market abuse. Supervisory findings show that the production of trade alerts alone is a poor measure of surveillance effectiveness. Surveillance can appear healthy, while missing news feeds, defective alert logic, or incomplete order and trade data can leave areas of activity unmonitored.

A surveillance system's model may generate credible alerts and support STORs while failing to capture less liquid instruments. A compliance officer at an alternative investment manager must therefore establish not only whether alerts are being received, but also whether the scope of the firm's surveillance is complete.

Accordingly, a firm should be able to demonstrate:

- which inputs are used to trigger an alert (e.g., orders, trades, instruments, client accounts, trading venues, events).
- that relevant communications are incorporated into reviews, where applicable.
- how completeness and accuracy are governed and checked.
- that alert thresholds are appropriately calibrated. Well-calibrated thresholds cannot compensate for defective logic or incomplete data.

The same disciplines apply to manual surveillance. A lower-volume investment manager may use event-based reviews rather than complex models or systems, but the trade population, alert triggers, reviewers, timeframes, and supporting documentation should still be defined. Alert ageing, false-negative testing results, data exceptions, and overdue remediation should be visible to the compliance officer and senior management.

### Proportionality does not justify informality

Smaller managers may use simpler controls, but simplicity is not the same as informality. Risks can emerge in several ways. Close working relationships can erode independent compliance challenge, unwritten procedures can lead to inconsistent decision-making, and shared offices or unrestricted access can undermine information barriers.

Proportionate controls may be simpler, but they should still be written, repeatable, and evidence-based. Senior management oversight and staff attestations can also help to demonstrate that responsibilities are well understood.

Internal discipline is particularly important during market soundings. A central gatekeeper is usually appointed to control a firm's consent to receive a market sounding and identify which staff may receive the sounding. Only individuals who have been wall-crossed should receive the information, and expanding email chains should be prohibited.

A firm's records must capture the details of the market sounding, including consent, time, source, issuer, instruments, recipients, information received, restrictions imposed, and the basis for cleansing. The firm must also make its own assessment of whether it holds inside information rather than relying solely on the disclosing party's determination.

Personal account dealing is another area where firms should test control effectiveness. Senior acquiescence is not a control. Watch lists, restricted lists, and employee dealing records should enable compliance to identify conflicts between personal activity, information held by the firm, and fund trading.

### Escalation must produce defensible decisions

Surveillance is only effective if concerns lead to a timely and independent review. Firms should preserve data relating to relevant orders, trade executions, investment research, and internal communications. Investigations should consider related instruments, accounts, and any identified conflicts. STOR decisions should be recorded with a clear rationale. The threshold for reporting is reasonable suspicion, not proof, and internal investigations should not create avoidable delay.

Management information should expose weaknesses rather than merely report activity. Useful metrics include: surveillance coverage gaps, the number of data exceptions, alert ageing, investigation outcomes, STOR decisions, wall crossings, restricted list changes, personal account dealing breaches, testing deficiencies, and remediation status.

### Good practice is demonstrated, not described

A defensible market abuse framework enables a hedge fund manager to show how its risks were identified, how controls have addressed them, how surveillance has been tested, and how concerns are escalated and resolved. The 41.1% statistic is not a guilty verdict on the UK market. But it represents a control challenge, “Can the firm show that its control framework would identify suspicious conduct before the FCA asks why it did not?”

Regular testing and independent assessment help firms evidence the effectiveness of their market abuse framework before regulators ask them to do so.

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# Show me the money: SEC risk alert highlights advisers' economic conflicts

Recently, the Securities and Exchange Commission (SEC) Division of Examinations published its second risk alert ([Risk Alert](#)) since Paul Atkins became chair. The SEC staff uses risk alerts to provide information to investment advisers on SEC staff observations from exams to assist them in developing their own compliance programmes.

This Risk Alert focuses on investment adviser fiduciary obligations with respect to economic conflicts of interest that might influence advisers and their financial professionals to recommend certain products, services, or account types to their clients. Citing the SEC's fiduciary interpretation from 2019 and longstanding examination priorities, the Risk Alert identifies several specific observations arising from SEC examinations, many of which are summarised below.

The staff made the following observations:

## Cash management programmes

The staff noted that some investment advisers recommended cash sweep programmes to their clients, including those offered by affiliated banks, without disclosing revenue received in connection with those recommendations, such as revenue sharing tied to client cash balances in bank deposit sweep programmes or incentives to recommend higher cost (or lower interest) sweep vehicles. The staff also noted that some advisers also failed to disclose that swept cash was subject to their asset-based advisory fees, including where clients earned negative returns on cash after fees and expenses.

The staff also took issue with certain adviser disclosures, noting that some advisers disclosed that they "may" receive revenue from third-party bank sweep programmes when they in fact did receive it. Under the 2019 fiduciary interpretation, stating that an adviser "may" have a conflict is inadequate when the conflict actually exists; the use of "may" is appropriate only for potential conflicts that do not yet exist but might reasonably arise.

## Share class selection

The staff also found that some advisers failed to disclose that lower cost share classes of the same funds were available to clients, while recommending higher cost classes that generated revenue for the advisers or affiliated brokers. This issue appeared in both the cash context, where some advisers' only cash management recommendations were higher-cost money market funds that shared revenue with the adviser, and where advisers selected mutual fund share classes that paid ongoing Rule 12b-1 fees to dually registered advisers, affiliated broker-dealers, or individual representatives, even though a lower-cost class of the same fund was available.

## Disclosure of other economic benefits

The staff further noted that some advisers don't adequately disclose (in Form ADV or otherwise) economic benefits available to them from custodial credits, margin loans and credits, and marking up fees charged by clearing brokers. The staff specifically cited insufficient disclosures relating to broker-dealer affiliates who received revenue from interest rate markups on margin loans made by advisory clients, or where advisers received credits for maintaining custodial and clearing relationships (and faced termination fees if they exited those relationships). The staff also addressed disclosures in Items 10 and 12 of Form ADV Part 2A, the narrative brochure delivered

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*This Risk Alert focuses on investment adviser fiduciary obligations with respect to economic conflicts of interest that might influence advisers and their financial professionals to recommend certain products, services, or account types to their clients.*

to clients, observing that some advisers lacked sufficient disclosures regarding material compensation arrangements with affiliates and factors considered in selecting broker-dealers (e.g., revenue share).

### Fee billing errors

The staff observed that some advisers charged higher fees than agreed to for services that were provided. For example, some advisers charged asset-based fees on excluded assets (assets that were not subject to fees), assessed incorrect fee rates or did not apply reduced asset-based fee rates for cash and fixed income assets, or did not rebate certain transaction fees. Some advisers had prorated fees for large mid-month deposits, which conflicted with their disclosures that fees were based on beginning-of-month balances. The staff also found that some advisers billed accounts that received no services, including charging fees on accounts where representatives departed and the accounts were not reassigned to remaining advisory personnel; billed inactive accounts that predominantly held cash and remained open even after clients had asked in writing to close; and failed to refund prepaid fees when clients terminated mid-period.

### Compliance programme deficiencies

SEC-registered investment advisers are required to have policies and procedures reasonably designed to prevent violations of the Investment Advisers Act of 1940 and the rules adopted thereunder, tailored to the firms' operations. In examining some advisers, the staff found policies that did not address billing arrangements the firms actually used, such as prepaid fees, householding, and margin; compliance documents, disclosures, and client agreements containing conflicting fee information; and no controls to test fee calculations for errors or to confirm that terminated accounts stopped being billed and refunds went out.

### Looking ahead

The Risk Alert follows several enforcement actions against investment advisers involving economic conflicts of interest and fee billing practices, and it is consistent with our observation and experience that conflicts of interest will continue to remain an exam priority in 2026. The staff encouraged advisers to review their billing policies, procedures, and practices routinely, to identify and address new conflicts of interest as they arise, and to confirm that disclosures give clients full and fair notice of the advisers' economic conflicts and noted that examination findings often led to advisers returning money owed to clients and improving their disclosures and billing practices. We believe this Risk Alert can serve as an inflection point for investment adviser to review their own economic conflicts of interest and fee billing practices to confirm that the items addressed by the staff in the Risk Alert are not present at their firm.



*SEC-registered investment advisers are required to have policies and procedures reasonably designed to prevent violations of the Investment Advisers Act of 1940 and the rules adopted thereunder, tailored to the firms' operations.*

The background of the entire page features a series of diagonal lines that create a sense of movement and depth. The lines are colored in a gradient, transitioning from a deep blue at the top left to a bright yellow and orange at the bottom right. The K&L Gates logo is positioned in the upper left corner, set against a solid dark blue rectangular background.

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# ESMA's integrated collection of funds' data: Simplification will require transformation

ESMA's integrated collection of funds' data could become the most significant change to European regulatory reporting since AIFMD was introduced. While implementation remains several years away, the proposals signal a fundamental shift from managing individual regulatory returns to managing regulatory data itself.

It is an early signal of how European supervisory reporting is likely to evolve: fewer standalone templates, greater standardisation and increased data reuse. For fund managers, the question is not only what ESMA may require in a future template, but whether existing data, controls and operating models can support a more integrated regime.

ESMA's Final Report sets out a clear objective: replace a fragmented landscape of overlapping supervisory, statistical and national returns with a system based on "report once, use many times". For managers, however, simplification is likely to involve regulatory, data and operational change.

The report, produced under the revised AIFMD and UCITS frameworks, sets out ESMA's preferred architecture for future funds reporting. At its centre is a single, dynamic and modular reporting template, supported by a common regulatory data dictionary and harmonised definitions. Data would still be collected by a designated authority at national level, but validation, storage, sharing and analytics would increasingly be organised through a central EU data hub.

## A broader reporting perimeter

The first phase would consolidate reporting under AIFMD and UCITS. A second phase would seek to incorporate MMFR, statistical reporting and potentially other fund obligations.

A modular structure is intended to provide proportionality. Core information would apply across AIFs and UCITS, while additional modules could be activated according to fund type, strategy, leverage, liquidity profile or other risk characteristics. A leveraged hedge fund, an alternative credit fund, a liquid UCITS and a fund of funds should not complete an identical return.

The practical question will be whether activation criteria are clear and stable. A framework that frequently moves funds between modules or frequencies could replace today's duplication with a new form of complexity.

## The data challenge comes first

For reporting teams, the most consequential proposal may be the common data dictionary. Current difficulties often arise not because a data point is unavailable, but because similar concepts are defined differently across regimes. Assets under management, asset classifications, investor categories, maturity buckets and look-through requirements are familiar examples.



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*The practical question will be whether activation criteria are clear and stable.*

*A framework that frequently moves funds between modules or frequencies could replace today's duplication with a new form of complexity.*

A common semantic layer could materially improve consistency. It may also expose weaknesses that have been hidden by today's fragmented reporting regimes. Many firms currently produce accurate returns despite inconsistent internal definitions because each regime is prepared in isolation. Firms will need to know where each element originates, how it is calculated, who owns it and whether the same definition is applied across administrators, portfolio systems, risk platforms and internal records.

The framework also points towards more granular information. ESMA envisages portfolio holdings as a key module and recognises the potential reuse of security-by-security data already collected for statistical purposes. This should reduce duplication, but will increase the importance of instrument identifiers, counterparty data, reference data and reliable look-through processes. Private asset managers may face challenges where standard identifiers are unavailable, and exposures sit across less standardised systems.



### From reporting to data management

A key implication of ESMA's proposals is that regulatory reporting may become less of a periodic filing exercise and more of an ongoing data management discipline. Today, many obligations are still managed return by return, even where they rely on similar underlying information.

The integrated collection model challenges that approach. If data is to be reused across supervisory, statistical and financial stability purposes, managers will need greater confidence in data consistency, lineage and ownership.

This has clear operating model implications. Managers will continue to rely on administrators, vendors and reporting providers, but roles and responsibilities will need to be more clearly defined. For managers and their service providers, the challenge will move beyond generating files to maintaining a regulatory data model, interpreting definitions, identifying data gaps and evidencing controls.

*For managers and their service providers, the challenge will move beyond generating files to maintaining a regulatory data model, interpreting definitions, identifying data gaps and evidencing controls.*

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### Simplification may not mean less reporting

The report suggests a monthly base frequency for core AIFMD and UCITS information, with frequencies calibrated at module level. It also leaves open daily reporting for a limited number of time-sensitive fields and event-driven reporting for matters such as activation of liquidity management tools.

This illustrates the central trade-off. Integration may reduce the number of separate returns, but supervisors may receive more granular data, more frequently and with stronger validation. The burden should fall if authorities genuinely reuse information and remove overlapping national collections. Until then, firms should not equate a single framework with a smaller compliance obligation.

### What should managers do now?

The earliest proposed go-live is the first half of 2029. That may appear distant, but ESMA plans a consultation later in 2026 and aims to provide the RTS and ITS by April 2027. The key design choices will emerge well before implementation.

Managers should begin with a reporting data inventory covering AIFMD, national UCITS returns, MMFR, central bank reporting and related transaction-reporting datasets. They should identify duplicated fields, conflicting definitions, manual adjustments, missing identifiers and areas where responsibility is split between the manager, administrator and other delegates.

Outsourcing will remain important, but it will not remove the need for governance. Managers will need clear ownership of interpretations, data quality, sign-off and regulatory engagement, supported by operating models that can adapt to modular requirements and evidence controls.

ESMA's proposals offer a credible route to a more coherent system. Yet the benefits will not arise simply from replacing several forms with one template. They will depend on harmonised definitions, genuine data sharing and removal of duplicative national requirements.

## Conclusion

For many firms, the greatest challenge will not be completing a new reporting template, it will be building the data architecture capable of supporting future frameworks. ESMA's proposals therefore represent more than a reporting initiative they mark the gradual transition from regulatory reporting as a filing exercise to regulatory reporting as a data discipline. Firms that begin that transformation early are likely to be best positioned as the new framework takes shape.

# AIFMD II: Key implementation developments in Luxembourg

## Overview

Two years on from the entry into force of Directive (EU) 2024/927, commonly referred to as AIFMD II, the 16 April 2026 transposition deadline has passed, and the state of play across the EU is best described as uneven, with compliance posture increasingly dependent on where an AIFM is authorised. However, Luxembourg, which hosts the largest shares of EU AIFs within the Union, transposed the Directive without material gold-plating.

The transposition deadline has also brought the EU's liquidity management tool (LMT) framework into focus. ESMA's Guidelines on LMTs for UCITS and open-ended AIFs were formally published on 12 March 2026, following amendments made in December 2025 to align them with the final Regulatory Technical Standards (RTS) adopted by the European Commission on 17 November 2025 (Commission Delegated Regulation (EU) 2026/465).

AIFMD II has moved from legislative text to operational reality. This article focuses on the two areas where that shift is most visible: loan origination, which will shape how private credit funds are structured, and liquidity management, where the Guidelines now give the Directive's requirements practical substance.

## Liquidity management tools

In brief, the LMT regime requires AIFMs to select and embed at least two LMTs (from gates; notice extensions; redemption fees; swing/dual pricing; anti-dilution levies; and, for professional-investor-only AIFs, redemptions in kind - with swing and dual pricing barred as a sole pairing) into the fund documentation of open-ended AIFs, alongside suspensions and side pockets as last-resort tools; to make corresponding disclosures under Articles 23 and 24 AIFMD; and, at AIFM level, to maintain a liquidity management policy with supporting governance and training, notify the NCA of that policy and LMT selection, and report activations or deactivations outside business-as-usual use without delay.

## What has worked well

When it comes to implementation, certain practices have distinguished themselves as effective. Firms that engaged fund boards and delegates early on LMT selection, rather than treating it as a late-stage compliance task, have generally navigated the transition with fewer governance friction points. AIFMs running multiple fund ranges have also benefited from adopting a single, consistent LMT framework across those ranges, materially reducing the cost of amending constitutional and offering documents fund-by-fund. At NCA level, the CSSF's approach has drawn particular praise: its handling of offering document



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and LMT disclosure updates, its speedily-issued circular on the ESMA Guidelines, and its LMT eDesk online reporting platform have given Luxembourg AIFMs a clear, workable compliance pathway.

### Where firms have encountered difficulties

Other aspects of implementation have proven harder to navigate. The treatment of non-EU AIFs managed by EU AIFMs has generated uncertainty, as has investor sensitivity to particular LMT choices, given the direct economic consequences of gates, fees and pricing adjustments for redeeming and remaining investors alike. Firms have also grappled with sequencing: having achieved Level 1 compliance, managers are asking when and how to revisit their frameworks once the Level 2 RTS and ESMA's Guidelines take full effect, particularly given the twelve-month transitional period for existing AIFs. Divergent views on the appropriate level of investor disclosure have led to inconsistent approaches, and uncertainty around the pace and content of national implementing legislation compounded the difficulty of planning fund document amendments against a fixed Level 1 deadline in certain jurisdictions.

### Loan origination

In brief, AIFMD II permits and regulates loan origination (direct or structured lending by an AIF) and, more stringently, “loan-originating AIFs” (LO-AIFs) whose strategy is mainly to originate loans or whose originated loans represent at least 50% of NAV. All AIFs that originate loans must implement loan-origination policies, procedures and processes, must keep exposure to any single financial undertaking, AIF or UCITS borrower under 20% of capital, must observe connected-party restrictions, and cannot run “originate-to-distribute” strategies; transferred loans require 5% risk retention for at least eight years, with proceeds attributed in full to the AIF. LO-AIFs face further constraints: closed-ended by default (open-ended only with NCA sign-off and LMT selection), and leverage limits of 175% (open-ended) and 300% (closed-ended).

### Navigating the transitional thicket

The applicable transitional and grandfathering provisions run from AIFMD II's entry into force on 15 April 2024, not from the national transposition deadline – a distinction market participants should keep in mind when assessing their compliance timetable. AIFs constituted before 15 April 2024 that have not raised additional capital since that date are permanently exempt from the diversification, leverage and closed-ended requirements. AIFs constituted before that date but which have continued to raise capital thereafter benefit from a transitional exemption from the concentration limit, leverage caps and closed-ended requirement until 16 April 2029. AIFs constituted on or after 15 April 2024 must comply in full from 16 April 2026, with no benefit of grandfathering. Certain other rules – implementation of loan-granting policies, allocation of loan proceeds, connected-party restrictions and the risk retention requirement – apply to all newly originated loans regardless of the AIF's vintage, subject to any national transitional measures.

### Looking ahead

What AIFMs should now be doing depends on when their AIFs were, or will be, constituted. For AIFs constituted before 16 April 2026, the immediate task is a gap analysis against the forthcoming Level 2 RTS, identifying where systems, processes and documentation require updating, alongside preparation for the broadened regulatory reporting obligations that apply from 16 April 2027. Existing LMT policies and calibrations should be reviewed against the RTS and Guidelines to ensure activation and deactivation procedures are robust, delegation oversight frameworks should be updated for the more granular delegation reporting to come, and, for existing LO-AIFs, the applicable transitional provisions should be revisited on the basis that AIFs continuing to raise capital must reach full compliance before 16 April 2029.

For AIFs constituted on or after 16 April 2026, the position is more straightforward in principle: new fund documentation must be drafted in full compliance with both Level 1 and Level 2 RTS requirements from inception; enhanced regulatory reporting infrastructure must be built for the obligations taking effect from 16 April 2027; LMT frameworks must satisfy both the Level 1 selection requirements and the Level 2 RTS on calibration; and new LO-AIFs must comply in full, from launch, with the leverage limits, diversification requirements, retention obligations and connected-party restrictions described above. Whether an AIF pre-dates or post-dates the 16 April 2026 watershed, AIFMD II implementation is no longer an abstract exercise but a matter of operational execution, and the firms best placed to meet it will be those who have already turned their attention to the practical detail.

# The missing layer of institutional crypto: Separating operational control from investment discretion

As alternative managers take on digital asset exposure, the decisive operational risk is not where assets are held but who can move them. This article argues that the next stage of institutional maturity in digital assets depends on separating operational authority from investment discretion, and proposes a governance standard, the Independent Counterparty Control Framework, for doing so.

The institutionalisation of digital assets has been told as a story about custody, regulation, and market structure. Each has advanced. Qualified custodians now hold substantial client crypto, regulatory frameworks have begun to replace improvisation, and execution and settlement have matured. Yet a fourth element, less discussed and arguably more important, has not kept pace. It is operational governance: the question of who, inside a fund, can actually move assets, approve counterparties, and control the accounts through which capital flows.

Custody answers where assets are held. Regulation answers what a fund may do. Market structure answers how trades settle. None of them answers the question that has historically destroyed the most investor capital: who holds the keys, and what stops one person from misusing them. This is increasingly relevant beyond crypto-native managers. Hedge funds, alternative credit managers, and funds of funds are taking on digital asset exposure, and funds of funds in particular are being asked to diligence operating models they have not previously encountered.

## The layer the industry skipped

An allocator evaluating a digital asset strategy will probe the custodian in detail, and rightly so. But a custodian can be impeccable while the fund's own arrangements remain dangerously concentrated. Assets held by a qualified custodian still require someone to initiate withdrawals, approve destination addresses, administer the exchange accounts used for trading, and control the email and authentication credentials behind all of it. If those functions collapse into one person, the quality of the custodian becomes secondary. The weakest point is not the vault. It is the set of human permissions that can instruct the vault to act.

Traditional asset management learned this the hard way. Over decades, a series of frauds taught the industry that no individual should simultaneously control investment decisions and the machinery that executes, holds, and accounts for them. The response was structural. The investment manager decides but does not hold assets or strike net asset value. The administrator values independently. The custodian holds. The auditor verifies. The board oversees.



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Chief Executive Officer  
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*Assets held by a qualified custodian still require someone to initiate withdrawals, approve destination addresses, administer the exchange accounts used for trading, and control the email and authentication credentials behind all of it. If those functions collapse into one person, the quality of the custodian becomes secondary. The weakest point is not the vault. It is the set of human permissions that can instruct the vault to act.*

The lifecycle is deliberately fragmented so that no single party controls it end to end. The principle is segregation of duties, the same idea banking formalised long ago through maker-checker workflows and the four-eyes rule.

### What digital assets changed

Digital assets have quietly recreated the concentration that traditional finance spent decades dismantling. Not through carelessness, but because the technology makes concentration easy. Creating a wallet, whitelisting an address, and authorising a withdrawal can be done by one person in an afternoon. The friction that once forced responsibilities apart does not exist by default; separation must be engineered, and where it is not, it does not happen. The consequences are also sharper, because a confirmed transfer is final. There is no wire to recall and no settlement window in which to catch an error.

The operational permissions that deserve scrutiny are numerous: ownership of exchange master accounts; control of registered email and multi-factor authentication; wallet creation, whitelisting, and address approval; transfer and withdrawal authority; the scope of programmatic interface keys; security settings and recovery procedures; and the monitoring alerts that would warn an independent party. In a fund without a deliberate design, a meaningful number of these can sit with the same person, frequently the person who also makes the investment decisions.

### A proposed standard

The Independent Counterparty Control Framework can be defined in one sentence: the structural separation of investment discretion from operational authority over counterparties, wallets, exchange administration, and digital asset movement. Investment managers keep complete discretion over investment decisions; that is their craft and their value. What they should not hold, as a matter of structure rather than trust, is sole authority over the accounts, credentials, counterparties, and wallets through which assets move.

It is a governance framework, not a technology. Multi-signature wallets and policy engines are useful instruments, but tooling alone does not prevent concentration. The framework is about who holds which powers and what independent check sits between intention and irreversible action. Its contribution is framing rather than novelty: most of the individual controls already exist in banking and in well-run funds. Gathering them under one heading lets allocators compare managers, lets managers demonstrate maturity, and gives the market a standard to converge on.

The case is practical, not theoretical. Concentrated operational authority is the common denominator of digital asset loss, whether through fraud, key-person dependency, irreversible error, cyber compromise, insider abuse, or social engineering. Global standard-setters have extended anti-money-laundering and counterparty information requirements, including travel-rule obligations, to virtual asset transfers, and institutional allocators are developing operational due diligence built specifically for the asset class.

That diligence is where the framework becomes usable. The questions are simple and revealing. Who owns the exchange accounts? Who controls the registered email and authentication factors? Can any single person move assets, or whitelist a wallet, without a second approver? Who onboards counterparties? Who receives security alerts, and are they independent of the people being monitored? A manager who answers each with a version of “I do” is describing a single point of failure, however capable and honest.

The next evolution of institutional digital asset investing will be driven not solely by better custody or clearer regulation, but by better governance: the deliberate separation of operational authority from investment discretion, as traditional finance separated them long ago. The principle is not new. It is simply overdue in this asset class.

*This article is general thought leadership and does not constitute legal, regulatory, tax, or investment advice.*

# The governance gap: Why AI-assisted investment decisions must be built to withstand future scrutiny



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As AI becomes embedded in alternative investment workflows, from credit underwriting to manager due diligence, organisations are measuring success at the production moment while underinvesting in the governance architecture needed to defend those outputs under future adversarial scrutiny. This piece outlines why evidentiary discipline must be built into AI workflows from the outset, and what that requires in practice.

AI has earned its place in alternative investment management. Across credit underwriting, counterparty due diligence, manager selection, and portfolio risk, the efficiency gains – scale, speed, cost – are real and no longer debatable.

But the industry's evaluation framework remains incomplete.

Most organisations measure AI performance at the production moment: throughput, cycle time, cost per output, and stop there. The harder question is rarely asked: if an AI-assisted decision becomes material to a regulatory inquiry, LP dispute, or investment committee challenge eighteen months from now, can your team reconstruct and defend the evidentiary foundation behind it?

## The prosecution standard

I spent the early part of my career as a prosecutor. In that world, a compelling presentation alone wins nothing; your case must be built on evidence so solid that it can withstand any number of pretrial challenges such as a motion to suppress. Chain of custody, source integrity, and reproducibility under adversarial conditions are not procedural formalities, they are the architecture that determines whether a conclusion survives scrutiny.

That discipline is directly applicable to alternative investment workflows.

Two managers can run AI-assisted due diligence or credit review processes that look identical from the outside. One treats the AI output as a terminal conclusion, without a structured ability to reconstruct how a specific finding was formed. The other has built in source attribution, traceable reasoning pathways, and human validation at critical decision points.

In normal operating conditions, these organisations appear indistinguishable. The difference becomes visible when an adverse event occurs like a regulator requests documentation of a credit decision, an LP challenges the basis for a manager allocation, or litigation requires reconstruction of an investment thesis.

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At that point, the conversation changes entirely. The output is no longer the subject, the process that generated it is. That's not a technical problem; it's an institutional governance problem.

### The financial reporting parallel

No sophisticated LP trusts an audited financial statement because it looks clean, they trust it because the process behind it is traceable, documented, and designed to survive scrutiny. The output is defensible because the process was designed from the outset to survive adversarial reconstruction.

Most AI operates under the opposite assumption. Outputs get evaluated while they're unchallenged. The right framework flips that question: can this process be reconstructed and defended when it needs to be?

### Four disciplines for defensible AI

For alternative investment managers building AI workflows that can withstand institutional scrutiny, four disciplines are essential:

- **Lock the decision record.** Every AI-assisted decision has a context: model version, data source, reasoning applied. When models update or data shifts, that context disappears and only the conclusion remains. Systems must automatically capture full context at the moment each material decision is made. If it can't be reconstructed, it can't be defended.
- **Evidence over assertion.** Probabilistic AI systems produce outputs that sound authoritative but aren't verified. In credit underwriting, manager selection, or counterparty diligence, every finding must tie back to a traceable data point. "The algorithm generated it" is not an institutional defence, and a confident output with no traceable origin is an assertion, not a finding.
- **The expert signature.** An algorithm cannot be questioned by a regulator or explain its reasoning to an LP. AI should function as an analytical accelerant, not an autonomous decision-maker. Requiring a qualified professional to validate AI-generated outputs at key decision points establishes a clear, accountable individual who can articulate how a conclusion was reached and stand behind it.
- **Rehearse the challenge.** Most AI governance failures surface under pressure, not by design. Alternative managers already stress-test risk; the same logic applies here. Periodically attempt to fully reconstruct the evidentiary basis of sampled AI-assisted decisions, before any adverse event forces it. Gaps are far easier to fix when nothing is at stake.

### The standard LPs already expect

Alternative investment managers already operate under a high bar for defensible decision-making. LPs conducting operational due diligence, regulators requesting documentation, and counterparties in dispute are not introducing a new standard, they are applying an existing one to a new category of output.

The question is whether AI-assisted workflows have been built to meet it.

Organisations accumulating AI outputs without the governance to reconstruct them are carrying risk that doesn't appear on any report today. It surfaces only when a specific decision is revisited and the process behind it can't be explained. At which point, the efficiency gained at production becomes considerably more expensive to defend.

For alternative investment managers, the practical question is not whether to adopt AI-assisted workflows, it's what to require of them, and of the providers who deliver them. The evidentiary disciplines outlined here are not internal engineering challenges; they are the right questions to ask of any AI system or service operating on your behalf. Because governance does not begin when a challenge arrives, it begins the moment a decision is made.

*The views expressed in this article are those of the author alone and do not constitute investment, legal, or regulatory advice.*

# Five smart questions every fund COO should ask service providers about AI



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There's a strong likelihood that everyone you run into these days is 'AI-enabled.' But it often feels like 'AI-enabled' is code for 'human-disabled.' At a recent tradeshow, another fund administrator told me they'd automated their entire NAV calculation process via AI. When I started asking pointed questions like, "How does your team handle edge cases?" I realised they had no idea how the underlying logic worked. My guess is AI was brought in just to populate their marketing messages with the latest tech buzzword.

Unvalidated 'AI-enabled' claims introduce invisible risks — cognitive debt, oversight effects, compounding errors — which you may unknowingly absorb as a client. Here are five questions you can ask a vendor to determine if they have thoughtfully adopted AI or if they're just jumping on the AI bandwagon.

## 1. Can you explain your validation process?

It's easy for a vendor to claim their models are highly accurate, but compared to what?

A strong validation protocol runs AI systems parallel to existing human workflows before deployment. Add the AI, keep the humans, compare the outputs, and investigate the mismatch. Over multiple iterations, human teams essentially teach the model where to look for specific data, creating a continuous improvement loop versus a one-time correction.

Providers also need a validation process specifically designed to catch hallucinations. A [UCSD study](#) found that LLMs hallucinate 60% of the time when summarising product reviews, but users still overwhelmingly chose the AI-generated summary. We are psychologically predisposed to trust AI due to its confidence and fluency.

Your vendors should be able to walk you through their validation process, what specific mechanisms exist to catch hallucinations, and how their confidence intervals are designed to counteract human bias towards AI output.

## 2. When AI fails, who's accountable, and at what cost?

Humans can explain their reasoning, own their mistakes, and course correct. AI cannot.

In a fiduciary context, human accountability is critical.

Each AI function should have a clear owner and escalation process. But it's also important to ask how the humans are coping. [Harvard Business Review](#)

“Humans can explain their reasoning, own their mistakes, and course correct. AI cannot.”

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studied the impact of AI usage on mental fatigue and burnout. It found that the more AI output demands review and supervision, the more stress it causes — leading to higher decision fatigue, poorer decision making, and increased employee turnover.

Journalist Cory Doctorow introduced the idea of the “reverse centaur” in a recent Medium column. For people who use AI to boost their own productivity, AI can become a valuable tool — strong and tireless, directed by human judgment. Doctorow calls these users ‘centaurs.’ Reverse centaurs are the opposite: humans trying to monitor heads of endless AI output with fallible human attention.

Service providers should build centaurs. You don’t want to work with a vendor who points to the model itself for accountability or describes an extensive oversight structure that creates burnout. AI should be used to take over repetitive tasks to support staff, not create a new category of exhausting work.

### 3. What’s the real ROI?

How much ROI is AI really delivering? MIT NANDA recently published [a study](#) that rattled Wall Street, showing that of the 80% of organisations that have implemented AI programmes, 95% have achieved zero return. Despite the billions invested into GenAI, a meaningful return remains elusive.

Your vendors should be focused on AI initiatives that make a real difference for clients, like adding new features and functionality and significantly cutting service delivery timeframes. A lot of the hype around AI was that it would save money by reducing headcount. But we’ve seen the hidden costs there — poor user experience when people have to talk to bots versus a human account manager, and poor quality “AI slop” that feels low-thought and low-effort. As use cases are more defined and token costs rise, it’s becoming clear that AI’s real value is to complement human talent for better client service.

“Data privacy deserves equal scrutiny.”

Can AI access your investor data, especially in third-party systems?

### 4. Where specifically are you not using AI, and how is data protected?

Where AI is not being used is just as important as where it is. AI should be focused on repetitive and routine tasks, not creative work or anything that requires judgement. MIT’s Media Lab ran brain scans on students using ChatGPT to write essays and found that participants had significantly poorer recall of what they produced. Critical thinking remains a key competitive edge and shouldn’t be outsourced.

Most fund administration calculations are deterministic. The formulas for fee computations, allocations, and P&L calculations are historically reliable and easy to write, understand, and debug. If your vendor is automating these with AI, ask why. They are probably unnecessarily introducing risks into a process that previously had none.

Data privacy deserves equal scrutiny. Can AI access your investor data, especially in third-party systems? A vendor should conduct rigorous data privacy and security audits and obtain enterprise-grade licenses when available. Make sure client data isn’t used as part of model training that can be accessed by other third parties. If your service provider is operating AI systems but cannot explain how the underlying architecture actually handles your data, you might be handing sensitive information to a black box.

## 5. How do you measure success, and what's your baseline?

Take AI productivity claims with a pinch of salt. A recent [METR study](#) found that developers using AI actually built new features and resolved bug fixes at a slower pace with AI, but they thought they were working faster.

Individual productivity doesn't always translate to organisational productivity either. I may be able to write an email in two minutes instead of four with AI, but because it's verbose, it takes twice as long to read.

If your vendor doesn't share measurable data, instead gauging success by how users "feel" about the tools, you may be hearing an inaccurate story. Ask the vendor how AI saves time in end-to-end processes versus at the individual level. Outcome metrics should be tied to client-facing results and measured against pre-AI benchmarks.

### Final thoughts

None of this is to say that AI isn't useful. It's an impressive technology that works well in specific applications: reading documents, extracting data, managing operations, and reducing repetitive tasks. The companies that get it right match the tool to the problem with clear acceptance criteria and measurable outcomes.

Those that don't quite get it are the ones chasing mandates and measuring success by perception, hoping no one asks the hard questions.

AI delivers output, but it's people who give you accountability. Before you sign off on any vendor's AI pitch, make sure they can tell you who stands behind their work and not just which AI model runs it.



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# Insurance as a strategy: The case for specialty insurance in institutional portfolios

Over the past decade, the relationship between private credit and insurance has largely been understood through the lens of asset gathering. Insurance companies hold large pools of long-duration capital, and alternative asset managers have increasingly sought to manage those assets, acquire those liabilities or partner with insurers to access stable, permanent capital. That model has been highly successful, helping reshape parts of the alternatives industry and providing access to large, durable pools of long-duration capital. For many managers, insurance has become synonymous with permanent capital and AUM growth. The European MGA market now exceeds €20 billion of annual premium, highlighting the growing scale of specialist underwriting across the region (Howden Re, 2025).

However, this framing risks obscuring a different and, in my view, increasingly important opportunity. Insurance should not only be understood as a source of capital for private credit strategies. In certain specialist markets, insurance can be the investment strategy itself. That distinction matters. The first model is primarily about managing assets backing insurance liabilities. The second is about underwriting risk, structuring complexity and earning returns from specialist insurance markets where expertise, judgment and access can matter more than scale alone.

The most interesting parts of this market are not life insurance, annuities, catastrophe risk or commoditised consumer insurance. Those are large and important sectors, but they are not where I see the clearest opportunity for institutional capital seeking underwriting-led returns. The more compelling area lies in specialist, non-catastrophe lines such as after-the-event insurance, contingent risk, tax insurance, warranty and indemnity insurance, surety and selected credit-related products. These are markets where risks are bespoke, outcomes are idiosyncratic and successful underwriting requires a level of expertise that cannot easily be automated or commoditised. While individual specialist lines may appear niche in isolation, collectively they form part of a substantial global specialty insurance market, benefiting from structural growth drivers including rising transaction activity, increasingly complex regulatory environments, greater use of litigation finance and growing demand for bespoke risk-transfer solutions in corporate and private capital markets.

A crucial point is that buyers in these markets are often purchasing insurance for reasons that go beyond a simple expected-value calculation. Buyers frequently use insurance to facilitate transactions, manage legal uncertainty, satisfy lenders or release trapped capital. In each case, the value of the insurance is not limited to the probability of a claim. It lies in the commercial outcome the policy enables: certainty, liquidity, execution or risk transfer.

That distinction is central to the economics of specialty insurance. In more commoditised markets, pricing tends to converge towards expected loss plus expenses and capital cost. In specialist markets, the buyer may be solving a broader commercial problem, which can allow disciplined underwriters to earn attractive economics where the underlying risk is well understood. The opportunity is not that these risks are risk-free; it is that they can be mispriced or underserved when the market lacks the expertise, capital or appetite to assess them properly.



**Dan Adams**  
Managing Director  
Arrow Global Insurance

*A crucial point is that buyers in these markets are often purchasing insurance for reasons that go beyond a simple expected-value calculation.*

## The opportunity in fragmented markets

Europe is an especially interesting environment because the market remains fragmented. European MGA premium has been growing at approximately 15% annually, reflecting increasing demand for specialist underwriting capabilities (Howden Re, 2025).

Specialist underwriting expertise is often found in small MGAs, local platforms and niche teams that possess strong technical capabilities but lack the capital or infrastructure required to scale. As investors have seen elsewhere in European private credit and other fragmented markets, this combination of local expertise, operational complexity and information asymmetry can create attractive opportunities for those able to aggregate and support specialist businesses. In specialty insurance, the most valuable asset is often not the balance sheet itself but the underwriting expertise that originates, assesses and prices risk, making underwriting capability a far more important determinant of value than scale alone.

## Insurance as a strategy, not a source of capital

This is also where the comparison with traditional insurance-led private credit strategies becomes important. Many alternative asset managers use insurance to create or access large pools of assets to manage. The insurance company effectively becomes a source of permanent capital, while the manager earns fees by investing those assets into credit portfolios and other alternative strategies.

The opportunity I am describing is fundamentally different. The objective is not simply to accumulate liabilities in order to invest the float. The objective is to own and control the underwriting economics of specialist risk, supported by appropriate capital, governance and investment management. Returns are generated through underwriting profitability, specialist origination and disciplined risk selection, with investment income acting as an additional contributor rather than the primary driver of value creation.

This distinction may appear subtle, but it has important implications for investors. In the traditional insurance asset-management model, scale is often the key determinant of economic success. In specialist insurance, expertise is the scarce resource. The value lies in understanding risks that others cannot analyse effectively, structuring solutions to complex problems and maintaining the discipline to participate only where the risk-adjusted economics are attractive.

## What this means for institutional investors

For institutional investors, the potential appeal lies in the combination of several return sources: underwriting profit, fee income from origination and servicing, and investment income on premiums held before claims are paid. More importantly, those returns are generated by a set of drivers that are often distinct from traditional fixed income and private credit exposures. The underlying disciplines will feel familiar to experienced credit investors: assessing downside risk, understanding legal documentation, evaluating recoveries and pricing complexity. However, the return profile is distinct from that of traditional private credit.

Specialty insurance should not be viewed as a replacement for private credit, but as a complementary strategy. Both disciplines rely on underwriting expertise and rigorous risk analysis, however specialty insurance introduces exposure to different underlying risks, creating potential diversification benefits within alternative portfolios.

In an environment where capital is abundant and many alternative strategies are increasingly crowded, genuine differentiation is increasingly difficult to find. Specialty insurance is not without risk, but it remains one of the few areas where expertise, judgment and underwriting discipline can still create a meaningful competitive advantage. For institutional investors seeking differentiated sources of return, it is an opportunity worthy of serious consideration.

## Reference

*Howden Re (2025) Filtered for Quality. London: Howden Re.*

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## PUBLICATION PLAN 2026

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Deadline for submission 5pm UK time Monday 12 October | Publication Monday 23 November

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