Service provision is key to regional success

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Only recently, a hedge fund focused on the Middle East and North Africa (MENA) took heavy exposure in Qatar, the UAE, Saudi Arabia and Egypt, in a move that suggests investment in the region is about to pick up. Khalid Abdul Majeed, managing partner of MENA Capital which runs the MENA Admiral Fund, said that the fund's country allocations were influenced by conversations they had with the big banks who are reporting a significant increase in interest by international investors. "These are well-researched markets and can absorb large amounts of money unlike some of the smaller markets such as Tunisia or Lebanon. Also, they are cheap, so we are positioning there in the expectation they will rise," he confirmed in a recent Reuters report.

This move is also in line with a recent global study, which indicated that by the end of 2013, Middle East investors will account for about USD194 billion in hedge fund assets, or about 7.5 percent of total global hedge fund assets. According to the study by Casey Quirk for BNY Mellon entitled "The Hedge Fund of Tomorrow: Building an Enduring Firm," the majority of flows for 2010-2013 from the Middle East will come from high-net-worth investors.

Clearly, there is a strong dynamic in the Middle East in terms of alternative asset management and investment. The factors that will drive the growth are the availability of instruments, reforms and foreign investor access – all of which requires the help of service providers. Indeed, the role of service providers in the region – the main catalysts of facilitating this perceived growth – cannot be underestimated.

David Aldrich, managing director at BNY Mellon, explains: "Investor sophistication, growing needs of compliance and regulation demand new levels of transparency. Hedge funds must depend on being flexible and, at the same time, follow the correct operating model to ensure investor access. Undoubtedly, hedge funds are turning to independent third parties for middle- and back-office functions such as portfolio accounting and reconciliation, custody of both collateral and non-collateral assets, pricing and valuation, cash management, and counter-party risk-mitigation in ISDA transactions, almost all possible administrative roles. Allowing third parties to play a bigger role in their business is in fact a sign that the hedge fund industry is maturing."

The provision of fund services in the Middle East has been progressing well, and is one of the main reasons encouraging fund managers to set up and manufacture home-grown funds. Today, world class independent and regulated investment service providers are available in the areas of custody, fund administration, legal advisory and auditing.

But the most crucial factor that service providers need to be mindful of in order to be successful in the region is consideration for local nuances and cultural characteristics. Larger organisations can often fail to recognise these and their lack of flexibility can cause difficulties. John Alshefski, senior vice president at SEI's Investment Manager Services division, clarifies, "One example is that the Middle East's work week differs from Europe and the US. Additionally, one must not lose sight of the fact that the Middle East or the GCC are not one country with one set of cultures/mores and one currency. The maturation and sophistication of the asset management industry, managers, service providers and investors is not the same throughout the region. Asset servicing firms in the Middle East are also careful with regards to the business partners with whom they work, as investment managers are looking for impartial and independent providers for their administration solutions, as well as cultural awareness and philosophical 'fit'."

In terms of products, the traditional long only strategy is commonly understood by regional investors. But Craig Roberts, CEO of Apex Fund Services (Dubai), adds, "Managers offering total return profiles may need to take extra efforts to explain the benefits to investors and there may also be some conflict with the investors' own ethical criteria, such as compliance with Sharia'a."

Domestic funds are increasingly turning to outsourcing to achieve greater transparency and efficiencies in the face of changing investor and regulatory demands.

Leading-edge technologies and processes make service providers an invaluable outsourcing partner, regardless of the client's investment product structure, asset classes in which they invest, or portfolio strategy. One major example in this area is the increasing investment presence of large investors like sovereign wealth funds (SWFs) and their varying requirements. These investors face the growing challenge of managing a complex portfolio of varied levels of transparency and risk and need the right operational infrastructure to track, consolidate, reconcile and analyse their investments in a manner that will enable them to make informed, insightful decisions on a portfolio-wide basis for the long-term, yet be aware of daily, weekly and monthly changes.

Here, flexibility is key because it allows for custom analyses to support investment managers' own compliance policies and risk models. In terms of SWFs, Alshefski says that these funds are looking not just to performance records in selecting investment managers, but are also looking for operational soundness and robust risk controls. "Maintaining confidentiality and reputation are extremely important to these investors, particularly as any blemishes will affect the sovereignty, not just the 'fund' itself."

Another important element of successful service provision in the region is the ability to manage the copious amount of data that is gathered on a day-to-day basis. Certainly, the importance of data management and how it can be managed cannot be underestimated, what with today's challenging environment and pressure for companies to be compliant with the increasing regulatory stance from all governments.

It is more critical than ever for investment managers to have ready access to reliable, relevant data to effectively manage their risk, grow their business and make the right decisions for their clients – and for this, one needs a reliable system and practices for quality data management. Due to the meticulous nature of this type of work, more and more investment managers are turning to their operational outsourcing partner to provide a sophisticated data management solution

David Morrissey, director of business development at SEI's Investment Manager Services division, adds, "There continues to be a strong focus on data management and technology, as clients are looking for ways to get enhanced risk reporting, transparency and business insights from their data. As a result of this, independent verification, independent valuation and daily reporting will be crucial to investment managers."

While the service providers are progressing well with regards to the evolving space in which they operate, there are a few hiccups that need to be cured. One of the main shortfalls in this area is that of third party distribution and other distribution channels. Marc Hambach, chief operating officer of Gulfmena Alternative Investments, explains, "For example, instead of selling third party funds, commercial banks have their own asset management divisions and push their own funds, thus competing with specialist asset management companies. In addition, regional private banking and wealth management are still embryonic."

But Eric Swats, head of asset management at Rasmala Investment Bank, argues that this is more a question of varying requirements between jurisdictions. He says, "The commercial banks typically manage their local market funds; and for foreign investment strategies, they either select investment advisors or have a selected open platform. In many of the local jurisdictions, there isn't the requirement to hire third party administrators and custodians, so the banks take on this role as well. In most cases, this hasn't presented a problem for investors as the commercial banks are quite able to handle the work."

The kinship between hedge funds and service providers is mutually beneficial to both. As the investment into the region increases, so does the size and the number of funds that operate within the market. With this, there are a growing number of service providers to cope with the increasing demand of investments. The evolution of prime brokers and service providers will also help the funds industry to blossom. Hambach explains, "For example, the surge in prime brokerage activity in the Middle East has provided facilities such as leverage, synthetic shorts and OTC derivatives and futures. This, in turn, has allowed the alternative space, in particular home-grown hedge funds that invest in MENA markets, to emerge."

Ever since the economic collapse, investors and distributors in the region have become more careful about what they buy, and investment managers need to demonstrate to clients and regulators that their product and operational foundations are solid – it appears that service providers are helping them do just that.

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