Fund administration takes centre stage

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The administrator's time has come. Once a relatively obscure part of the asset management industry, administration is now in the front line of services to hedge funds. "Given that self-administration – or external administration, which is limited in scope – appears to be a theme underlying many of the recent high-profile hedge fund collapses, independent oversight has become central to the hedge fund industry," says Canover Watson, managing director of Admiral Administration. The role of administrators has grown as the role of individual banks has reduced. "In the last two to three years, most managers have started using multiple prime brokers so their ability to act as a one-stop shop has largely ended," says Watson. The demise of Lehman Brothers and Bear Stearns only increased this trend, as hedge funds sought to avoid too much exposure to a single prime broker. The result was a vacuum that has been filled by administrators. Watson notes: "There was a need to have someone to consolidate all the information that came from the prime brokers, to do all the reconciliations and pricing checks. Having an administrator which already has the IT connectivity to multiple prime brokers for straight- through processing of trade activity can create significant efficiencies and thus cost savings for a fund." The changing nature of the hedge fund industry itself has also enhanced the role of the administrator. The complexity of many of the assets, particularly the more illiquid ones, has created a need for strong, independent valuations. "Checks and balances are expected by investors, and daily reconciliations are now routine to ensure there are no breaks," says Watson . Another trend in the industry is the role of the administrator as "transparency" agent. Institutional investors increasingly ask the administrator to provide special reports directly to investors. These reports include such items as assets broken out by broker and security type, the percentage of securities valued by the investment manager versus those valued by an administrator or other third party and the percentage of securities valued using an exchange price versus broker quotes. To position themselves as closely as possible to the manager's skillset, administration companies are increasingly hiring staff with similar skills. "A greater depth of expertise is required as the assets become more esoteric," says Watson. "We have beefed up our staff and we also work with third-party pricing agents in the valuation space." But no matter the level of experience of administration personnel, they will never have the answers to all questions of valuation. "There is an expectation gap between the roles of the administrator and the investment manager," says Watson. "You cannot exclude the investment manager from the process completely because they are the real experts and know the assets – particularly the complex ones – better than anyone else. Our part is to do everything to ensure consistency and that policies are applied, and where the issues cannot be resolved with the investment manager to escalate them to the independent directors where appropriate." That means, effectively, that there is a partnership, and administrators have to tread a fine line between understanding the client's business and making sure there is a full separation of responsibility. Click here to read the Cayman Hedge Fund Services 2009 Special Report [1]

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