New solutions on transparency

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Gottex Solutions Services was established to service the needs of the Gottex group's fund management arm, Gottex Fund Management, for risk transparency and managed accounts. We have deployed on the platform both managed accounts and transparent funds, that is, funds offering position-level transparency.

Following the early rush to managed accounts, investors now understand that rather than a simple binary decision, there is a continuum of possibilities that includes transparent funds, as well as solutions offering lower levels of transparency or less investor-friendly governance than a standard managed account.

The main benefits and drawbacks of managed accounts are known. Properly structured managed accounts provide for independent asset verification and pricing, as well as more investor-friendly governance. Conversely, managed accounts are expensive to set up and operate, many managers are reluctant to acquiesce to them, and the account may not trade pari passu with the flagship fund. In addition, contrary to common wisdom, managed accounts are only as liquid as the underlying assets they hold.

Transparent funds, where the fund administrator provides to a neutral third party the positions for risk processing, are becoming an increasingly popular alternative to managed accounts with institutional investors. While this does not at all mitigate fraud risk, the approach provides for more timely risk management, including in particular and most importantly monitoring of style drift.

Governance is another good illustration of a modular approach. In a traditional commingled hedge fund, while governance normally rests in the hands of the fund's board, the 2008-09 experience showed that, first, boards depended on information provided by the manager, secondly, boards were not always as independent as described in the offering documentation, and thirdly, the removal of the manager was typically an uphill battle.

In a managed account, the manager has little to no governance rights as the platform operator can prevent the manager from trading the account, with some level of notice. Between these two extremes, however, governance risk can be addressed differently, through measures such as a properly-formed board of directors, more narrowly defined circumstances in which the fund can suspend or gate, or defined cases where the manager can be removed, any number of mechanisms that may not involve managed accounts.

Asset pricing is another illustration of possible modular approaches. An independent pricing committee, not controlled by the investment manager, can meaningfully mitigate pricing risk in a commingled fund.

Clearly, such a modular approach does not gainsay the advantages offered by managed accounts. In particular, an important but rarely discussed benefit of managed accounts relates to access to financing when liquidity dries up. An investor with, say USD50m in a USD1bn commingled vehicle is a sitting duck if the fund suddenly finds its financing counterparties unwilling or unable to provide financing.

In 2008, a number of funds were liquidated by financing counterparties. Due to the size of the financing lines involved, institutional investors cannot step in and offer term financing. However, if the investor's USD50m is in a separately managed account, if the prime broker were to cut the line, the investor may be able and choose to replace it.

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[1] http://www.hedgeweek.com/special/hedge-fund-managed-accounts-ii-2010