Hedge fund managed accounts 2012

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Evolution centres on flexibility and customisation

By James Williams

Greater sophistication among hedge fund managed account investors is changing the way managed account platforms (MAPs) operate. Flexibility and customisation are at the forefront of the offering among independent platforms, free of the regulatory manacles being imposed on banks.

What appears to be driving this shift towards a more investor-centric model of customised solutions, is the changing nature of the investor. Increasingly, large institutions – state pension funds, insurance companies – are looking to allocate directly to managers they favour via bespoke single mandates, or, to a lesser extent, via portfolios of mandates. They have the assets to do it – most other investors do not.

Chicago-based independent platform, AlphaMetrix, has seen its assets grow from USD6.5billion at the end of 2011 to USD8.3billion according to its president and CEO, Aleks Kins, who estimates that half that growth has come from bespoke mandates. The number of managers on that platform has risen from 134 to 168.

Then there’s InfraHedge, the State Street-owned MAP that launched early last year and which has already raised USD7.6billion. Add Sciens Alternative Investments’ platform to the mix – where AUM has grown from USD450million to USD700million over the last 12 months – and the signs are that momentum on independent platforms is building.

“We keep investing in the firm and building our technology. This allows us to be more flexible and work with more strategy types. Early on we focused on liquid
exchange-traded derivatives. Now we’ve expanded our capabilities to cover the entire spectrum of instruments,” confirms Kins, who adds: “I also attribute the growth to very large investors who are embracing the need for transparency.”

Michael Newell is a London-based partner at law firm Norton Rose. He agrees that platform sophistication is improving, but in his view the managed account space remains a mixed bag. He sees numerous institutions moving away from managed accounts as well as new entrants.

“We’re seeing institutions becoming more confident with pooled funds again – for every institution that wants a managed account there’s probably another saying they don’t have the people or advisers in place to be able to do anything with the additional visibility.”

Newell’s point is that investors have to decide whether managed accounts are value for money. “One of the questions I always ask clients is: ‘Given the extra costs of being on a MAP, what’s in it for you? If you get all this extra transparency and reporting, what are you going to do with it?’”

Demand for customisation growing

John Godden, Head of Managed Account Platform, Sciens Alternative Investments, believes that large institutions are increasingly using outsourced MAPs to produce bespoke mandates, and sees it as “absolutely the major growth area in the managed account space”, but admits that investors are also coming in as “more generalist allocators”. Currently, the platform’s AUM is split 50/50 between public and private allocations:

“Half are coming to us and being very prescriptive, saying ‘We want that manager, we want this level of risk (which might be different to the benchmark fund), we want these controls, off you go’, and we create the account.

“Others are saying, ‘I’d like a commingled portfolio of managers on your platform, and I’m going to use the fact that you can give me T+1 information and I know exactly what risk I’ve got in my portfolio every day’. So it’s half and half between prescriptive users and commingled portfolio users.”

This raises a tricky point for managers. On public commingled platforms, the manager only has to concern himself with one mandate. However, as investors start to get more serious about customisation, a top-line hedge fund manager could find himself running several single-investor mandates, each with their own rules, alongside the flagship vehicle. This has the potential to create an administrative nightmare.

“That’s a perceptive point and you’re absolutely right – no manager likes different structures of managed accounts. Operationally they want things to be as painless as possible,” says Akshaya Bhargava, CEO of InfraHedge. “The type of structure we have set up means we can make it as painless as possible for managers. If a manager were to set up five or even 10 managed accounts for different investors on our platform they would all operate similarly in terms of reporting. All we want is a data feed from the manager, the prime broker and administrator. Once that’s in place, the manager doesn’t have to worry. It’s in everybody’s interests that we try to make it as easy as possible.”

Man Group’s managed account platform has over 80 managers. Having acquired fund-of-funds firm FRM this summer, the world’s largest listed hedge fund manager has integrated FRM’s operational risk management expertise into its managed account offering.

Stephen McGoochan, Head of Managed Accounts at Man Group’s FRM, says: “More and more investors are selecting FRM to

“We keep investing in the firm and building our technology. This allows us to be more flexible and work with more strategy types. Early on we focused on liquid exchange-traded derivatives. Now we’ve expanded our capabilities to cover the entire spectrum of instruments.”

Aleks Kins, AlphaMetrix
We don’t do conventional thinking. We don’t subscribe to conventional wisdom. You don’t become one of the world’s leading alternative investment managers by following the herd. You get there by deploying dynamic, innovative investment strategies. And you get these by employing quick, agile thinkers. In other words, people who think outside the box.

A different way of thinking, a different way of investing – we are innovating to perform.

Alternative investments can involve significant risks and the value of an investment may go down as well as up.
Lack of portfolio transparency continues to be a major worry for investors. And whilst managed accounts provide many with the control and transparency they need when investing in hedge funds, continued market uncertainty and counterparty risk prompted Man Group to develop an online portal solution in March this year.

Named Clarus, the managed account portal provides clients with an additional layer of transparency by enabling them to visualise their hedge fund allocations and gain a better understanding of the investments they’re making.

Explains Stephen McGoohan, Man Group’s head of Managed Accounts: “Clarus was built with one of our key institutional clients so it’s basically been built by investors, for investors and tailor made for the investment community that we’re looking to market into.

“Being an online customisable tool Clarus allows investors to visualise the drivers of return and performance at the portfolio and managed account level but also allows them to visualise and understand the risks and risk factors they’re exposed to in their portfolio and underlying managed accounts.”

Crucially, this means Clarus is both backward-looking – what has already driven performance – and forward-looking – what is the risk exposure to commodities, for example? A client can then drill down deeper and analyse their exposure to energy, and then to oil, gas, etc. This enables investors to get a deeper handle on the performance of the portfolio, and adjust exposures accordingly.

This is important at a time when investors have concerns about increased market correlation, not to mention potentially high exposure to market beta.

“They can either adjust their asset class exposure themselves or they can get us to do it for them through a managed portfolio,” says McGoohan, who confirms that the majority of the USD8billion in platform AUM (representing 80 active managers) is invested in discretionary or advisory managed portfolios.

In McGoohan’s view, this added transparency has helped move the fund-of-funds model to Mark 2.0; where investors have the capacity to make sure-fire decisions based on meaningful insights: “Post-2008, we find ourselves working with more sophisticated institutional investors so it’s important that we make it easy for them to invest in hedge funds.”

Continues McGoohan: “Clarus makes it easier for a client to understand their hedge fund exposure and to think about it in a broader portfolio context. It’s all about insight and getting a better understanding of what’s driving risk in the investment portfolio.”

Insight is the key point. Investors want to feel more in control. Recent market volatility has unnerved them: the better customised the data is at their disposal, the greater confidence they will take from investing in hedge funds through managed accounts.

This means that rather than looking at hedge funds as separate distinct buckets, investors can visualise the role they play as part of their overall portfolio asset allocation. For example, a particular pension fund might have high exposure to US equities and decide they want specific exposure to emerging market equities in their managed account portfolio.

Managed futures can also be helpful for investors in terms of monitoring over-exposure to market beta. “If you’re worried about beta in your portfolio you can look at the data and then, potentially, reduce exposure to managed futures at that particular stage of the cycle (e.g. bull market). It’s allowing investors to think about hedge funds in a broader context,” says McGoohan.

After 2008, taking the surprise element out of hedge fund investing is a welcome development.
design bespoke solutions using managed accounts. Given FRM’s investment capabilities, we continue to innovate and design bespoke mandates for clients based on a deep understanding of the investor’s needs.”

Nevertheless, most investors still heavily rely on the expertise of a MAP provider like Man Group or Deutsche Bank and are perfectly happy with commingled solutions. “Ultimately, they don’t have the size, resources or technology to go it alone. The majority of the USD8 billion in platform AUM is allocated through discretionary or advisory managed portfolios,” confirms McGoohan, who adds: “We have a research team of 20 people and a portfolio management team of 15 people, meaning we have the breadth and scale needed to make fiduciary decisions on behalf of clients. This year we’ve launched several products of managed accounts to meet specific client needs, including providing diversification and non-correlation to long equity exposures.”

Hybrid solutions
Until recently, the way investors allocated to managed accounts was two-fold: either directly into commingled public platforms like Deutsche Bank’s dbalternatives, or by building their own platform infrastructure and choosing their own managers and service providers.

But as MAPs have started to evolve, so have the choices available to investors.

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Michael Newell, Norton Rose

One trend that Martin Fothergill, managing director, dbalternatives managed accounts platform, is starting to see is the “hybrid” investment, and this, he says, is creating a “blurring of the lines” between solutions. “Quite a few clients are saying, ‘We like 10 of the managers on your platform but there are four other managers that we’d like to have, can you onboard them for us?’ There are advantages to having this mix-and-match solution where investors are holding some commingled accounts, and some bespoke accounts. Structurally it all looks the same, the risk engine we use is the same, reporting is the same.”

Adds Fothergill: “It’s basically a hybrid solution that lies between investors just using managers on our platform, and making that significant jump to having their own platform of managers.”

Newell says that this year it’s been a case of platform providers becoming more sophisticated to offer customised services to institutions as opposed to any tangible demand from investors: “I think it’s more an evolution of the industry where platform provision is improving.”

So what are independent MAPs doing to ensure that when pension fund “X” has done its due diligence and is ready to commit USD1 billion, it chooses their platform?

Manager-centric becomes investor-centric
The most obvious structural shift in focus in independent platforms is away from the manager-centric model – where distribution
and raising AUM is the name of the game – toward an investor-centric model. Bhargava says the reason for InfraHedge taking this approach was on the back of research, which led them to conclude that tomorrow’s hedge fund investor base would be dominated by institutional clients.

“Taking that philosophy to its logical conclusion, what it means is you have to give the investor maximum flexibility; that’s what large institutions want. They don’t want to be presented with a pre-selected group of managers, however good they might be, because different institutions have different objectives. They want the freedom to choose their own managers.

“I believe the model we have at InfraHedge is the kind of model that appeals to institutional investors and represents the next generation of managed account platform,” opines Bhargava.

By default this means that platforms, by utilising an open architecture that allows them to handle different service provider relationships, fund structures etc, are becoming necessarily complex entities.

“Investors want the freedom to choose their own domicile, to negotiate their own commercial terms with the hedge fund manager. We don’t select managers, have pre-determined structures or domiciles, and we don’t charge any fees to the manager,” adds Bhargava. “It’s completely driven by the investor. They decide everything and we then set it all up and run it for them.”

This manager-agnostic philosophy is echoed by Godden: “It’s not our job to care about the quality of manager that an investor wants to run a mandate with. We don’t make value judgements about whether one manager is better than another. As long as there’s enough money going into a given mandate to make it function effectively, we’re immune as to what investors do.”

Kins is well aware of the cost implications of single-investor mandates. To that end, AlphaMetrix has been aggressive in building “an institutional offering that has allowed us to reduce fees down to 10 basis points. If you take an institution allocating 30 per cent to alternatives, that actually equates to 3 basis points across their whole portfolio.”

Not being affiliated to a bank is also helping independent platforms, with Godden confirming that it’s in the process of onboarding 11 managers. One of the most recent was Citi Capital Advisors’ event-driven fund. Funds like this are going to Sciens to resolve regulatory or governance issues. The platform, says Godden, is being used as a utility “by people like Citi who want to have a new style of fund vehicle, but for various reasons are unable to build it in-house because of Dodd-Frank issues etc.

“One of the advantages we have is that we’re not a bank. For example, from a regulatory perspective, we are bringing on a manager who has money from a wealth manager but who needs an independent MAP. They originally went to a bank platform but found they were unable to hold the swap. So we’re in a good place right now not being a bank platform. It resolves a lot of regulatory and practical issues for clients.”

AlphaMetrix appears to be taking the investor-focus approach one step further: by looking at investors’ portfolios and identifying where they can benefit from extra transparency in managers they like and are perhaps already invested in.

“As we work with larger groups, we’re not trying to convince them of new managers, but to provide them with transparency on their existing portfolio. That’s where we’re seeing the biggest growth. We’re working with them to turn the managers they like transparent,” says Kins.

The firm has invested heavily in technology to adapt to the growing transparency demands of investors, who are now beginning to ask for managed account mandates in a wider range of strategies.

“There are advantages to having this mix-and-match solution where investors are holding some commingled accounts, and some bespoke accounts. Structurally it all looks the same, the risk engine we use is the same, reporting is the same.”

Martin Fothergill, dbalternatives
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Increased demand for bespoke portfolio solutions

Interview with Nathanael Benzaken

Lyxor’s Managed Account Platform, with over 100 funds and approximately USD11 billion in AUM, has long been a leading light for investors wanting to allocate into commingled managed accounts.

And whilst this remains the easiest “gateway” into hedge fund investing for small and medium-sized institutions, there are signs that the demand for more sophisticated customised solutions is underway according to Nathanael Benzaken, deputy head of the alternative investment business line at Lyxor.

“Customisation is gaining favour with the investment community as portfolios can be designed within a specific context,” says Benzaken. Whether investors choose to build bespoke portfolios is a function of their allocated size: pension funds with USD100 million or more to allocate per manager are more likely to approach a platform like Lyxor for a tailor made solution than one with USD20 million or less, where the commingled platform is a perfect fit.

“Small to mid-sized investors, rather than have fixed costs (the service provider costs are often floored) which might have a drag on performance in a bespoke portfolio, are more inclined to choose our commingled platform, which very much complies with their institutional needs, i.e. segregation of assets, independent risk management, enhanced transparency.

“However, the demand for bespoke solutions - which is a separate part of the business we started in 2009 - is accelerating,” confirms Benzaken, who adds: “We see pension funds pushing up their allocation into hedge funds from two to three per cent of their total portfolio to seven or eight per cent of their portfolio, and even higher in some instances. Rather than us being responsible for manager selection, large institutional investors want to have the control over selection and portfolio construction. We provide everything else.

“An investor with, say, USD2 billion, might choose to rent our infrastructure to implement a dedicated solution and benefit from the associated ‘structural alpha’: i.e. full transparency, negotiated business terms with the managers, market counterparties and service providers, optimised cash utilisation etc. They might choose a portfolio of 20 managers and say to us ‘Lyxor, please build these managed accounts for me’.”

Also emerging, as a kind of intermediate solution straddling commingled accounts at one end of the spectrum and dedicated accounts at the other, are hybrid structures, confirms Benzaken: “This might involve a client having a core hedge fund allocation in a dedicated portfolio, and one or two tactical allocations by utilising our commingled platform.

“Ultimately, we want to be as flexible as possible for the client. In dedicated portfolios you have more flexibility to negotiate business terms, including fees and fee formula. That’s why the hybrid solution is there on the table for clients; it depends how much they value tactical allocations.”

Benzaken confirms that Lyxor has created such a hybrid solution for large clients already, the idea being that if they are satisfied, performance-wise, then at a later point in time they might allocate more capital and invest in a fully dedicated portfolio.

Looking ahead, Benzaken thinks there are two catalysts that will drive growth in customised portfolios: average performance returning to historical trend levels, and regulation: “Managers haven’t lost their ability to generate alpha, rather it’s because the markets have been driven by fear for an unusually long period of time. I also think that as hedge funds move onshore under the AIFM Directive in 2013 we’ll start to see increased allocations.”
Clients are getting so excited about having daily or even intra-day valuations in their managed accounts that they’re asking AlphaMetrix if they can extend such transparency to their long-only portfolios for what Kins calls a “total portfolio solution”.

“For us the two buzz phrases are “continuous monitoring solution” and “total portfolio solution”. Our technology allows us to provide scale, it brings down cost, and it’s easier for clients to start aggregating data. Even if five different brokers are being used in a managed account, you can aggregate data from all five into one place allowing you to see a total picture.

“We’re now working on technology to allow for this [wider extension of managed account transparency across the whole portfolio]. We aim to roll out a fully integrated solution at the start of 2013.”

The ability to adapt a model that was built for one kind of client to a range of different clients represents both a strategic and structural challenge says Bhargava. This is especially so for open architecture platforms where the end investor can literally decide on structure, domicile, trading rules in the mandate. From a transparency perspective, this is a substantial undertaking.

“We’ve built our own reporting systems. We’ve invested a lot in data discovery software, which really deals with the issue of how to present information in a readable and understandable form from vast quantities of data.

“There’s a lot of complexity in the numbers. The point of offering daily reporting and analytics is to help investors make better portfolio decisions. You can’t just provide the information; it needs to be actionable,” comments Bhargava.

Sciens’ MAP is about to launch a T+1 portfolio management solution as it concentrates on building out new front-end tools to benefit managers and provide investors with more granular information.

“It’s basically a build out of our risk engine into portfolio and risk management tools for end investors to take advantage of,” states Godden.

Regulation – catalyst for growth?
Aside from the transparency and control benefits, regulation could also act as a catalyst for further growth in this space.

“Large institutions don’t want to be presented with a pre-selected group of managers, however good they might be, because different institutions have different objectives. They want the freedom to choose their own managers.”

Akshaya Bhargava, InfraHedge
dbSelect sees ongoing growth

Interview with Effie Datson

For CTA managers on Deutsche Bank’s dbSelect platform, 2012 has very much been a year of contrasting fortunes. According to Effie Datson, director, product head for dbSelect, 1H12 was a challenge for these trading strategies, but managers generally posted good returns in July, August and September. And, though October has been a difficult month, the long-term case for adding such strategies to a portfolio remains robust.

Which is no doubt a relief for dbSelect, having chosen to ramp up its CTA manager offering to investors over the past two years. “We recently added Man AHL, Crabel, and RG Niederhoffer to an already outstanding collection of more than 70+ trading strategies in this area,” confirms Datson. “Most of this has been in response to a number of large investor mandates. We have also been adding pure commodities managers over the past 12 months, including such flagship programs as the Hermes Commodities Absolute Return program, Coeli, Abraham, Global Advisors and JE Moody.”

The dbSelect platform focuses on liquid hedge fund trading strategies. Typically, these include FX, CTAs, global macro, commodity and, to a lesser extent, fixed income and volatility arbitrage strategies. Together with Deutsche Bank’s other MAP, dbalternatives, the bank has more than USD11.6 billion in AUM, making it the leading industry provider of managed account platform solutions.

Investors are looking for liquid strategies in today’s uneasy market environment, and this has very much played to dbSelect’s advantage. Inflows have largely followed the pattern of manager performance – slow at the start of the year, picking up in Q3.

One interesting trend in 2012 has been a shift in the source of investor inflows. Says Datson: “From the close of business 2011 until now I would say the largest shift in allocation from our underlying clients has been a proportional decrease in assets from pension funds – including those in Japan – and a quite considerable increase from US asset management companies. We’ve also seen a relative increase in FoHF money as well as inflows from US endowments and foundations.”

The nature of managed account investors has always been largely institutional. Indeed, the amount of technology and infrastructure spending undertaken by Deutsche Bank has, over time, enabled it to create a truly institutional-class platform. But within that institutional investor mix, things do change.

Japanese institutions have not suddenly turned their back on hedge fund managed accounts. Rather, the reduction in exposure may be linked to increased regulatory scrutiny of the alternative investment industry and trading practices in Japan. Since the start of the year, dbSelect has seen net outflows from the Japanese market, though Deutsche Bank is optimistic that interest will resume in the not too distant future.

“The fallout of several specific incidents in Japan has been that hedge funds have basically fallen off the front burner for these institutional investors. We still see interest – they still want exposure to the asset class – and my view is that the managed account solution is the ideal solution to the issues in that market,” says Datson. “However, it will take time for those investors to come back to the market with confidence.”

Conversely, when asked why US real-money asset inflows into managed accounts have risen this year, Datson credits it to the fact that access to hedge fund strategies has evolved markedly this year. The market seems to more fully understand exactly what it is dbSelect can offer and the rise of US 40-Act funds linked to alternative strategies has fuelled much of that growth.

“Having built a presence in the US for
though, so performance has been better in recent months,” observes Datson.

In terms of how investors are allocating to dbSelect, the fact that it has such a wide representation of leading managers means that more institutions are choosing to invest with the managers that are currently available. There have been some large institutions with significant tickets to allocate, and who come to Deutsche Bank with their own manager preference to invest with privately, but as Datson explains:

“Increasingly we are building a very good representation of high quality managers on the platform. We are now seeing investors coming to us and selecting specifically from the universe of managers we have, even for those with sizeable allocations. So it’s working both ways.

“We’re always happy to put new managers on the platform where an investor has interest provided they’re willing to allocate above a minimum size. In that sense, dedicated single mandates are an important part of our business. However, what we’re seeing is that very often investors want to invest in a manager’s flagship strategy and it’s more the exception rather than the rule that someone asks for a bespoke mandate.”

Unlike other MAPs, investors who allocate to dbSelect receive a bespoke product. Each investor can choose how to receive the return stream from a chosen manager or portfolio of managers: for example, as a swap, certificate, or a note, to name a few options.

“The note can be principal protected or not. It can be denominated in any currency. There are a wide variety of options available to suit the end investors’ needs; it’s not a one-size-fits-all approach,” says Hans Feder, Global Head of dbSelect.

This avoidance of using underlying funds has its advantages: it means managers can be more quickly onboarded; the risks can be better controlled on a real-time basis; and it also eliminates unnecessary costs.

Everything on dbSelect is geared towards delivering exactly what the investor needs.

Concludes Datson: “We understand who the investors are, who the managers are, and I’m very optimistic on the prospects of the platform growing even more next year: watch this space.”
Despite the operational challenges that face managers who decide to take on managed accounts, it seems almost inevitable that as more institutional money comes into the alternatives space, managed account AUM will continue to climb. This is because capital raising, for all but the biggest and best managers, remains an almost Sisyphus-like endeavour.

According to a recent industry report, assets on the leading managed account platforms rose 15.9 per cent between June 2011 and June 2012 to USD72.8billion. Managed accounts are here to stay. However, to what extent they will supersede commingled funds remains to be seen.

Ed Gouldstone, Head of Hedge Fund Product Strategy at Linedata, estimates that the firm has spoken to around 30 per cent of its clients on matters pertaining to managed accounts.

“In most cases this has been a result of
funds attracting new investment but maybe 10 per cent has been a result of existing investors asking whether they can move across to a managed account structure,” notes Gouldstone.

Part of the catalyst behind growth in managed accounts is a function of herd mentality. Investors look at what everyone else is doing and decide they should do the same.

“There’s a clear trend by large institutional investors with meaningful hedge fund portfolios, or who are planning to build meaningful hedge fund portfolios, to use managed accounts. It’s something we’ve seen building over the last two years,” observes Martin Fothergill managing director, dbalternatives managed accounts platform, Deutsche Bank.

Eric Weinstein is a managing director at Neuberger Berman and Chief Investment Officer for the NB Alternatives Fund of Hedge Funds team in New York. He believes that institutions with significant assets and who have added knowledgeable staff will increasingly turn to custom portfolios – as opposed to investing in commingled managed accounts.

“Our first custom portfolio was launched in 2004. Our flat decision making structure and the oversight of each relationship by a senior member of our investment team have allowed us to effectively serve this client base,” says Weinstein. He notes that institutions wanting managed accounts with underlying hedge fund managers do so because they place a high priority on liquidity, control, and operational issues.

However, there’s no sign, yet, of a wholesale shift in investor mentality towards customisation, and indeed, Weinstein is pragmatic on the overall growth prospects of managed accounts: “We believe that managed accounts with underlying hedge funds have a permanent place in the hedge fund landscape, but we’d be surprised if they become a majority of the industry’s AUM.”

Eric Weinstein, Neuberger Berman

“*We believe that managed accounts with underlying hedge funds have a permanent place in the hedge fund landscape, but we’d be surprised if they become a majority of the industry’s AUM.*”

One strategy that has a long association with managed accounts is managed futures. The fact that CTAs trade liquid global futures markets means that operationally they are often regarded as a “pure” managed account. Each investor has a completely segregated account held with a Futures Commission Merchant (FCM) of their choice. They have full control of the assets.

The investor simply gives the manager Power of Attorney over the sub account to put trades on as per the strategy. If the investor isn’t happy with performance, they instruct the FCM to revoke the POA.

This point is critical, especially in today’s climate of counterparty risk concerns. London based Katmai Capital Advisors launched their inaugural trading programme, Commodities+, in October 2012. The programme is offered exclusively via managed accounts and as the founder of Katmai, Michael Cook, explains: “It’s not that managed accounts are less risky, it’s the fact that they put more of the risk under the control of the investor. Is there credit risk? Yes. But rather than it being the manager’s choice, it’s the investor’s choice. That’s the key factor.”

Cook was formerly an institutional fixed investor wants to take: would they prefer someone like Deutsche Bank to operate it for them or to have a toolbox provided by the platform to help them build it in-house?

“We tend to see clients asking us to run everything for them and not have too much customisation because it is more complex and takes longer to set up. The reality is there may be too many choices and too much responsibility for them to assume,” says Fothergill.
In an uncertain and turbulent world, maintaining an optimal asset allocation requires flexibility, discipline, and a broad palette of available strategies. With over 20 years of experience, EIM develops innovative solutions, precisely aligned to the needs of each client, within an exceptionally transparent and rigorous risk framework.

In designing solutions, EIM makes use of the strategies most adapted to circumstances, whether active or passive, traditional or alternative, as well as robust analysis and systematic tactical asset allocation tools.

“Do I have the right strategic allocation? How should I position myself tactically?”
The four advantages of EIM’s LumX platform

By Eric Bissonnier & Francesco Samson

**Robust independence**

Institutional investors remain, to some degree, nervous allocating to bank-owned MAPs because of counterparty risk concerns. Admittedly, some are now using independent administrators, but LumX uses a completely open architecture. Explains Bissonnier: “We built our platform from an asset manager’s viewpoint. It’s not a profit centre for us, it’s a tool that has to be as efficient and flexible as possible. All the service providers we use are independent from each other.”

Samson says that complete platform independence achieves two goals: “Firstly, you avoid some of the conflicts of interest that might arise if you had economic interests in the platform. Secondly, by getting the best deal possible for each client it allows us to offer an economic structure for our clients.”

Platform independence is a clear benefit to large investors who want to build their own infrastructure solutions, and while Samson confirms that a few clients have taken this approach, Bissonnier states: “From what we’ve seen it requires USD1.5-2billion to allocate for it to make sense.”

**Building specific investment mandates**

LumX allows EIM to approach managers with specific investment goals in mind. The objective here is not to constrain the manager’s trading style, but rather to build a solution that focuses purely on a sub-set of the strategy. This is easier for systematic strategies like CTAs.

Bissonnier illustrates the point by referring to an inflation solution they’ve built that will capture a downturn in US treasuries and bunds, noting that there are no funds in the market that offer such a solution. “We chose a trend-following CTA. The solution is part of their overall implementation; we’re just using a specific part of it to capture the fall in US treasuries. We’ve done something similar for a long/short credit fund, building a solution that only captures returns from the short side of the book.”

**Investing in emerging talent**

LumX invests in a number of large managers, but given the alpha generation capabilities of smaller, emerging managers, that ratio is falling. In some cases, says Bissonnier, EIM will happily invest USD50million, even with managers only running USD50-100million in AUM because the managed account structure allows them to do so.

“Around 25 per cent of LumX is invested in these managers. Going forward, emerging managers will continue to represent a clear opportunity for the platform.”

Concludes Samson: “The platform is really a facilitator that enables us to capture the diversity of the hedge fund space in a controllable fashion, and then build solutions that leverage that diversity.”
What is indisputable is the transparency benefits managed accounts offer. Lyxor’s commingled MAP is one of the largest in the industry with approximately USD11.5 billion in AUM. With over 100 managers on the platform, it is in a unique position to analyse how managers adapt their portfolio trading as markets fluctuate.

Stefan Keller is head of MAP research at Lyxor. He notes that within the long/short equity space, average net exposure has shifted dramatically in the last 12 months: “Hedge fund managers had a cautious view on Europe in the first half of the year, leading to low directionality and leverage in their portfolios. However, we noticed that this started to be adjusted upwards during September. Average net long beta exposure is now 20 per cent; compared to last year that’s a 20 per cent swing.”

Lyxor’s website portal, dedicated to managed account investors, has proved highly successful this year says Keller, with literally hundreds of clients using it as a daily tool for making better-informed allocation decisions.

When asked what further technology developments were in the pipeline, Keller says the next step will be to aggregate data at the FoHF/client’s allocation level for those running portfolios of commingled managed accounts. “We plan to launch this next year. It will give investors an aggregate view across all hedge fund positions and allow them to analyse previous performance through back-testing capabilities.”

Enhanced transparency and more frequent reporting give investors a wealth

**The co-alignment issue**

This could help overcome some of the disadvantages that currently exist when managers are asked to shoehorn their existing fund into a managed account. Jeff Holland, co-founder of Liongate Capital Management, a London-based FoHF firm, thinks there is a place for both commingled funds and managed accounts, but is quick to stress the difficulties investors might potentially face by choosing the latter.

“The manager isn’t able to make use of cash flow, you might get tracking issues, and of course, the manager’s own capital is invested in the commingled fund,” says Holland. This ensures a co-alignment of interests that don’t exist in a managed account. “It could create potential conflicts of interest when allocating trades. Does the manager give preference to trades in the commingled fund? It’s an important consideration because it could create a lack of focus,” adds Holland.

Perhaps the biggest disadvantage to managed accounts is the restricted choice of managers available to investors compared to commingled funds. Admittedly, platforms are expanding their range of strategies, but within the grand scheme of things quite a few of the larger managers aren’t interested, precisely because they don’t need the capital.

Moreover, many would prefer to maintain a lack of transparency in the portfolio for strategic reasons; a long/short equity manager might not be keen on having his short positions fully disclosed for example.

"It’s not that managed accounts are less risky, it’s the fact that they put more of the risk under the control of the investor. Is there credit risk? Yes. But rather than it being the manager’s choice, it’s the investor’s choice. That’s the key factor."

**Michael Cook, Katmai**
Meeting the operational challenges

Interview with Ed Gouldstone, Linedata

Whilst managers might welcome investor requests for managed account mandates given today’s tough capital raising environment, the reality is that, operationally, they still present certain challenges. Ten years ago, most managers would have balked at the idea of taking on managed accounts, but that mindset is starting to shift.

“A fund manager doesn’t necessarily want to flat refuse such a mandate, they want to consider it. However, there can be a significant cost to getting the infrastructure ready and building additional relationships,” observes Ed Gouldstone, head of hedge fund product strategy at Linedata.

There are numerous operational challenges that managers need to consider before taking on managed account mandates.

First is to understand how the mandate will impact the front office team. An investor might like a manager running a long/short equity strategy but request that they run the long-only portion of the book in the managed account.

“That gives the manager a potential problem in terms of how idea generation turns into actual trades. That’s where OMS technology, which we offer as part of Linedata Global Hedge, can be helpful. If your OMS allows you to translate those rules so that your ideas can be implemented through the main strategy and appropriately converted using new rules into the managed account, then a manager will be flexible enough to say ‘Yes, sure, let me know what your restrictions are’,” says Gouldstone.

Linedata Global Hedge is the firm’s latest solution and is a comprehensive and modular platform integrating all of Linedata’s products for the hedge fund market.

Commenting on how the Linedata Global Hedge trading and order management module is able to overcome this front office challenge, Gouldstone adds: “The ability for a portfolio manager to place his order in the OMS and have it automatically reflected across managed accounts which are running pari passu to the commingled strategy or else apply specific rules pertaining to the specific mandate(s) is a key part of our front office technology strategy.”

A second, potential challenge is having to develop new relationships with service providers. Large institutions who want customised solutions will often insist on using their preferred administrator, custodian, and prime broker(s).

“From an operational perspective this involves adding new relationships, a new reporting solution, running a separate reconciliation process, all of which needs to be presented in an aggregated format to the front office team.”

Along with the software toolkit provided by Linedata Global Hedge, the platform is able to help managers overcome this relationship challenge. Confirms Gouldstone: “We have standard connectivity to 30-plus prime brokers, 50-plus administrators, giving the client access to a library of connections they may need.”

Third is the bespoke reporting challenge. Managers are required to provide more granular information on a more frequent basis for investors.

“We have a number of clients who have to produce reports in a variety of different formats, which does present quite a challenge,” says Gouldstone, pointing out that the goal for a manager, every time they take on a new mandate, is not to have to bring on new operations staff and systems.

“We work in partnership with risk providers to provide standard reports on various risk parameters, scenario analysis and stress testing. Additionally, we have the Linedata Global Hedge reporting aggregation layer. That allows us to put together reports across all the different modules, be they front office trading statistics, accounting information, risk exposures etc.”

For further information on Linedata Global Hedge click here: www.linedata.com/solutions/alternative-institutional-investment/alternative-investment/hedge-fund-platform/
Managed accounts
Hedgeweek Special Report Nov 2012

of information, but they need to know what
to do with it. This is especially true of those
using bespoke mandates. Consequently, data
aggregation has become an important focus
for service providers.

Jim Cass is vice president and managing
director, SEI Investment Manager Services,
one of the industry’s leading operational
outsourcing providers. He comments: “Our
investor dashboard aggregates data across
multiple mandates and allows investors to
make best use of the transparency they
receive. What we’re seeing is that they’re
beginning to categorise investments their
underlying managers are making in the
managed account. For example, when they
want to filter down to a specific industry e.g.
energy, using the investor dashboard they
can quickly find out what their exposure
is, and drill down further to oil, gas, clean
energy etc.”

End-users are now able to aggregate data
the way they want and generate their own
customised reports. This is enhancing their
investment process. By keeping on top of
their investments investors are able to gain
insights on performance, risk, and ultimately
make more decisive portfolio management
decisions.

“For those instances when a client needs
more customisation, our view is we want
to put the tools in their hands. We’re in a
position to get clients information on
a trade day basis so they can go in and
see the impact of the underlying managers’
activity.

“Our objective is keeping that information
as close to real-time as you can get it,”
adds Cass.

**Customisation: commingled versus
bespoke portfolios**

One of the key drivers post-08 for investors
wanting segregated solutions, according
to Holland, was to avoid co-investor risk.
Motivationally, that appears to be changing.
 “Today, the objectives of sophisticated
investors have become more nuanced.
Managed accounts are being used more to
tailor a mandate as opposed to any fears
over co-investor risk,” says Holland, who
continues: “Our flagship fund is a multi-
strategy fund. An investor might say they
want a more concentrated portfolio targeting

“**Our investor dashboard aggregates data across
multiple mandates and allows investors to make
best use of the transparency they receive. What we’re
seeing is that they’re beginning to categorise
investments their underlying managers are making in the
managed account.”

**Jim Cass, SEI Investment Manager Services**

a higher return, maybe they have a different
liquidity preference, or maybe they want
to focus on a specific strategy like global
macro, which has been a big theme for
some time.”

Most investors who choose managed
accounts are happy with a commingled
structure as they still get to enjoy the
benefits of additional transparency. However,
customisation – be it in a single mandate or
a full blown portfolio – is building traction as
pension funds look to diversify their holdings.

These investors lie at the most
sophisticated end of the spectrum. They
might have already been investing in
commingled funds with a FoHF, perhaps
even in a fund-of-one (where the FoHF
approaches a manager to set up a mandate
for their investors alone but where the
manager retains control of the assets).

Tentatively, some are switching their attention
away from FoHFs and investing directly via
the managed account route.

Holland confirms that the firm is in active
discussions with three large institutions.
All three want bespoke portfolios of global
macro managers. But whereas two of them
are happy to hold these investments in the
underlying commingled funds, “one of them
wants a portfolio of managed accounts, and
they understand that this limits their manager
universe,” says Holland.

Cass believes the appeal of managed
accounts depends on the underlying strategy
type as far as the manager is concerned:
“When you do managed accounts in less liquid strategies then you’re stuck splitting your trades with multiple custodians, and unless you have a big enough mandate, it might not be worthwhile pursuing. It’s much easier running a managed account for a LSE strategy than it is for a bank debt strategy.”

Rahul Kanwar, senior vice president and managing director of alternative assets, SS&C GlobeOp, says that they’re actually starting to see more product coverage specifically in areas such as bank loans, and derivatives-based strategies. This shows that the space is steadily evolving. As a result, it’s putting more of a technology/operational burden on administrators.

“What this requires, from an administration standpoint, is a global organisation. You can’t tell a MAP that you can’t support a manager they’ve onboarded from Asia. You have to handle all markets and all types of asset classes,” says Kanwar, who notes that the capabilities of MAPs and administrators have “improved tremendously” in recent years.

“The challenges come because you might have different valuation processes for different asset classes, different timings for reports. Ultimately, whatever the mandate, you have to bring all the data together in an accurate and timely way, and make it look the same. It has to be credible. Whether it’s a monthly or daily NAV, a P&L report, reconciliation, risk reporting: they all have to be consistent despite the sources of data, and make sense when viewed together.”

GoMAP is SS&C GlobeOp’s main operational infrastructure for handling these increasingly sophisticated managed accounts across the middle and back office.

Technology and administration are the two pillars of expertise within SS&C GlobeOp. On the one hand, GlobeOp has a long history of servicing some of the industry’s largest managed accounts. On the other, SS&C’s cloud-based capabilities - web portal reporting, mobile applications - are being leveraged to benefit every client on the GoMAP platform.

Kanwar says that the strategy for evolution on the GoMAP platform is three-fold. The first ties in to Cass’s point regarding quality of reporting and accessibility of data. “That means enriching our web presence and mobile presence. We brought out an Android app a few months ago for example, to ensure that all of our clients – on managed accounts or otherwise – have access to data wherever they are.”

Continues Kanwar: “Secondly, we continue to expand GlobeOp’s existing command and control structure. We use a system called GoCheck to manage every aspect of the process. If a client is a third party MAP with 40 different managers it means you’ve potentially got 40 different trade files coming to you at different times, with different NAV requirements – you need to be able to control that process carefully.”

The third big area of focus is regulation, in particular Form PF and FATCA in the US. “One of our big focuses has been to become a custodian or warehouse of all this data coming in. We want managers to comply with regulatory reporting requirements directly using our systems; a one click web-enabled solution that allows them to generate the report and send it straight to the regulator.”

Linedata’s Gouldstone says that regulation is changing the way service providers interact with their clients. Previously it was a case of providing the software tools for managers to monitor activity both in the flagship fund and the managed account(s). Now, with so much operational complexity and regulatory compliance, things are moving towards a service-oriented model:

“Rather than just having a piece of technology they want the expertise that goes along with that. We are trying to tailor our solutions to include service components to help our clients better deal with these [regulatory] challenges,” says Gouldstone.