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This report was researched and written by Howard Moore, special reports writer for HedgeFund Intelligence



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## Introduction



Nick Evans

Managed accounts are as old as hedge funds themselves. In the early stages of the industry's evolution they were the main (and often the only) route by which investors could access hedge fund strategies, especially in the then dominant areas of managed futures and global macro investing.

Then the industry's headlong growth in the late 1990s and the early 2000s found managed accounts being relegated to the sidelines, as managers found them too burdensome to offer to their investing clients (at a time when money was pouring into their funds anyway) and as investors tended to be herded into the same commingled fund vehicles along with everyone else.

But the world changed in the maelstrom of 2008 and 2009, which forced investors to reassess the whole question of how and why they were investing in hedge funds and what improvements could be made to ensure that they had more influence over what was happening.

Now investors have the upper hand. And as money has started to flow back strongly into the hedge fund industry – particularly from the institutional investment community – investors are rightly demanding far more say over how they invest with hedge fund managers, how their assets are managed and how much visibility they have into what their managers are doing.

In the era of institutionalisation and customisation that has resulted from the tumultuous events of 2008 – with investors these days placing an over-riding value on transparency, liquidity and control in their investments, and on a true alignment of their interests with those of their managers – managed accounts have been the key driver of the renewed and accelerating global growth in institutional hedge fund investing in a much-changed, and more investor-friendly, industry.

In this special HedgeFund Intelligence report, written by Howard Moore, we look at:

- The reasons why managed accounts have become so popular again;
- The strengths and weaknesses of managed accounts as a route into hedge funds for different types of investors;
- The ways in which managers and investors can use managed accounts for their respective benefits and for their own particular needs;
- The advances in technology and product sophistication that have changed the nature of the managed account business in recent years;
- The different types of managed account platforms and vehicles that have emerged; and
- The outlook for continued growth in an increasingly broad and adaptable product that has become in many ways the key meeting point for hedge fund investors and hedge fund managers in an ever more institutionalised, customised and personalised investing world.

We hope you enjoy reading our special report – and that you find it useful.

Nick Evans  
Editor, HedgeFund Intelligence

# Managed accounts thrive on TLC: transparency, liquidity and control

**T**he investment community is not always known for its long memory or for lessons learned from the past. However, the hedge fund world is still in many ways recovering from, and re-adjusting to the impact of, the global financial crisis in 2008 – which marked the rise of managed accounts and, with it, an inflection point in hedge fund investing.

Where once hedge funds were seen as ‘black boxes’ offering outsized but somewhat opaque returns to a rather elite network of investors, they are now used strategically and in ever more sophisticated strategies by a far wider range of end investors and intermediaries to manage volatility, mitigate risk and boost risk-adjusted returns.

Major institutional investors are making ever increasing allocations to hedge funds, and they are frequently choosing to do so through managed accounts – for the benefits of transparency, liquidity, and control that they provide.

“Had you been investing through correctly structured managed accounts, you wouldn’t necessarily have had the liquidity or fraud issues that investors experienced in 2008,” says Martin Fothergill, managing director and head of hedge funds at Deutsche Asset & Wealth Management.

There was a significant change in 2009 with respect to investors’ views of managed accounts as a direct investment tool. At the time, some commentators thought that this might turn out to be just a knee-jerk reaction to concerns arising from the financial crisis, which would most probably recede again once things returned to a more normal footing.

Looking back now, though, it is clear that the events of 2008 were a catalyst for pushing the concept of managed accounts much more into the mainstream. “It’s interesting to look at how our client materials have changed over the years; from pre-crisis, to immediate post-crisis, to today,” says Fothergill.

“We used to provide a lot of material around the case for managed accounts and why investors would want to use them.” By 2009 and 2010, investors had embraced them and the hard sell was no longer necessary, with many major institutional investors already wanting to invest in managed accounts.

“Today we find our conversations being much more about the specific attributes of our offering, and about us as a partner,” he says.

“In 2008, managed account providers thought that 2009 was going to be the biggest year ever,” says François Rivard, president and CEO of Innocap. “That didn’t happen because many firms got out of the hedge fund space altogether.”

In the years that followed, hedge funds suffered from an unfavourable public reputation. However, investors realised that when properly allocated to, hedge funds could be excellent investments and useful tools – but they looked for better ways to own these assets.

“Prior to the Madoff scandal, it was more difficult to convince some pension funds to invest in a managed account, while others would never touch a hedge fund if it’s not through a managed account,” Rivard says.

After 2008, however, investors’ governance boards saw that investing in managed accounts could offer more control, enhanced governance and a clear separation between the hedge fund managers and the assets. “Investing in hedge funds through managed accounts is a good way for investors with high levels of governance to know for sure, following Madoff, that the assets are actually there,” says Donald Pepper, managing director of alternatives at Old Mutual Global Investors.

“In addition, the regulatory requirements for hedge fund managers, investors and fund vehicles in the US and Europe will underscore the importance of managed account platforms as well,” says Fothergill – referring to Basel, Solvency, UCITS and AIFMD in Europe, and ‘40 Act in the US, where compliance with all these regulations requires transparency and risk control. “This is where our services are truly solutions-based,” he says. “We can provide our clients with the detailed information and monitoring they need for compliance with their regulatory environment.”

Hedge funds can help investors to realise the rate of returns they want and they can also serve to lower the overall risk within their portfolios. But they also have some negative characteristics: lack of transparency, lack of control and governance, and high fees, for example.



**Donald Pepper**, managing director of alternatives, Old Mutual Global Investors

As a result, major institutional investors which have high levels of governance have often stayed away from them. It is for this reason above all that managed accounts have become attractive for institutional investors that want access to the hedge fund manager in a structure that allows them to understand their investments, address their fiduciary duties, maintain control over their assets, avoid the risk of fraud, and obtain independent evaluation of the overall portfolio.

“Managed accounts provide much more transparency, a higher level of governance, and a greater ability to have exactly what you want through a fully dedicated investment management agreement that’s negotiated specifically for the needs of the investor,” says Rivard. Managed accounts historically have been associated with hedge funds, but today they have become an investment vehicle that can support several different strategies and different underlying investments to achieve the same independent governance and enhanced transparency.

#### THE MARKET DRIVERS

In addition to having a vehicle that simplifies the process in the form of managed accounts, the current investment climate of low interest rates and equity markets at record highs is driving investor allocations to hedge funds in the hope and expectation of better risk-adjusted returns.

Many pension funds have struggled to generate the required returns on their portfolios, some are underfunded, and they are looking to hedge funds to provide diversification and non-correlation to the broader equity market.

“Pension funds are looking at hedge funds not for outsized returns, but as consistent additions to their portfolios to help control volatility, says Bill Maher, head of the global asset owner team initiative at Credit Suisse Prime Services. “It’s not for the highest yield possible – they want better risk-adjusted returns.”

Institutions are making larger allocations to hedge funds and have become better educated, more familiar and more comfortable with the various hedge fund strategies. As a result, they are also requiring actionable transparency into their investments, as well as control of their assets.

Another driver of market growth is liquid alternatives, such as UCITS in Europe, ’40 Act mutual fund structures in the US, and the interest in having daily liquid funds and transparency. This is opening up a retail market participation into hedge fund investing that thus far has been extremely limited. “To deliver that kind of a product in a mutual fund generally requires a managed account structure,” says Bill Santos, global head of business development at HedgeMark.

Managed accounts have become broader, more encompassing vehicles over the years. Investors have widely adopted them not simply to avoid what happened in 2008, but because they are now seen as a smart way to invest in hedge funds. As a result, there

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has been a surge of growth. Assets on managed account platforms have grown by 8% in the first half of 2014, with assets rising to \$85.72 billion as at the end of June this year from \$79.31 billion in January (see box on page 15).

“As allocators look for innovative solutions to help them achieve their risk-return objectives, managed accounts continue to be the most popular alternative format for investing into hedge funds,” says Robert Leonard, global head of Credit Suisse Capital Services.

Some 30% of respondents to the recently released 2014 *Credit Suisse Global Survey of Hedge Fund Investor Appetite and Activity* survey indicated plans either to begin allocating to managed accounts or increasing their current allocations, in addition to the 37% that are already using managed accounts. However, this dropped from last year’s figure of 35% of investors looking either to begin or increase allocations (see box on page 19).

In the past year, a number of major institutions, particularly in the US, have been issuing RFPs (requests for proposals) to modify their hedge fund allocations. Direct investments in the flagship funds themselves are often being shifted to a managed account platform, as are collections of managed accounts that may previously have been opened directly with individual hedge fund managers.

“There is a change in the clients and in the ways they are using managed accounts,” says Michelle McCloskey, senior managing director at Man Investments FRM. As a result, a number of larger pension plans are looking for managed account providers. “These are very sophisticated investors, and they want to have their own platform and select their own managers, but they need help structuring, launching and monitoring the managed account itself,” she adds.

Indeed, recently there have been a number of significant managed account mandates from institutional investors globally – including some of the largest pension fund and insurance investors around the world. “These sophisticated investors want to move all of their existing hedge fund allocations to a managed account platform,” says Fothergill.



**Bill Maher**, head of the global asset owner team initiative, Credit Suisse Prime Services



**Martin Fothergill**, managing director and head of hedge funds, Deutsche Asset & Wealth Management



**Scott Warner**, managing director, PAAMCO

This marks a broadening of the hedge fund managed account platform business model. In the past, a managed account provider would typically find a good hedge fund manager, add it to their platform and then raise the assets, he explains. “That’s still an important part of our business, but increasingly we are working with institutional investors who select their own hedge fund managers that they then allocate to through our platform to benefit from the features and tools we provide,” he says.

New managed account clients are generally experienced hedge fund investors, and the benefits of managed accounts have allowed them to become more sophisticated. “Standard market practices have evolved,” says Scott Warner, managing director at PAAMCO. “We are seeing US state pension plans and sovereign wealth funds partnering with third parties to set up managed account structures,” he says.

This is not their first foray into the hedge fund space, but an evolution in terms of how they allocate hedge fund assets. The trend is toward managed account platforms for regulated products with wider distribution as well. “There’s a pick-up in usage and go-lives,” says Maher. For example, he explains: “We are seeing European platforms sponsoring US hedge fund managers to help them launch compliant vehicles to distribute across Europe, given the more complex regulatory environment post AIFMD and EMIR [European Market Infrastructure Regulation].”

Also in the European market, managed accounts also make it possible for platform providers to structure UCITS funds for distribution. “We had an offering of 15 single-manager ‘offshore funds’ but we will need to move these to UCITS funds going forward for our private wealth clients,” says Marc de Kloe, head of alternative investments and funds at ABN AMRO. “They were all Jersey or Cayman Island fund vehicles, and because of AIFMD, they could be sold only to professional investors otherwise.”

A fund manager who is used to managing a managed account has an easy transition to the UCITS world. “Simply put, all you need to do is put a different fund wrapper around an existing set-up,” he says. Over the past year, there has been fairly strong demand in the UCITS space, agrees Philippe de Beaupuy, UK head of the managed account platform at Lyxor Asset Management.

Several managed account providers began to make their platforms AIFMD-compliant in advance of the new European regulations taking effect from July last year, with Amundi being among the earliest to act.

“We started to re-domicile our Bermudian managed account platform in late 2010 – finishing in 2012, a year before the directive came into force,” says Nicolas Hirsch, business development manager at Amundi Alternative Investments.

“Today, all our managed accounts are registered alternative investment funds with the Central Bank

of Ireland, and two of them have obtained their EU marketing passports.” This facilitates investments between US and European-based managers and investors alike, both for offshore and onshore funds.

#### SIZE DOES MATTER

Allocations have to be large in order to make a managed account worth it to the hedge fund manager, but to the investor as well. The benefits of transparency, liquidity and control, when weighed against the costs, do not make sense unless they support a large investment.

“We’ve seen investments from \$25 million to several hundred million. We know that some pension funds are \$500 million-plus tickets,” says Rivard. “The majority is probably \$100-\$500 million, and the \$100 million mark is probably a good average estimate.” Indeed, major public and private pension plans, sovereign wealth funds, insurance companies and funds of funds often make allocations to hedge funds that are \$50 million and higher.

Amundi’s Hirsch notes that, in Europe, the cost of running a managed account plus the various related fees warrants a hedge fund manager to expect an allocation of €50 million from an investor to make it worthwhile for both parties.

“When you start talking about very large allocations, say \$100 million, \$200 million, even \$300 million per hedge fund, the investor can in many cases demand their own separate single-investor fund,” says Joshua Kestler, president and COO at HedgeMark.

Collectively, there is some \$10-20 billion in pension assets that are publicly acknowledged to be in managed account formats, and there are at least five or six pension funds talking about managed account investments upwards of \$2 billion each, and in some cases \$4 or \$5 billion each, notes Akshaya Bhargava, CEO at InfraHedge.

“This is a recent trend and the industry has never seen numbers like this,” he says. “If you go back several years, the largest firms had a few hundred million. Nobody had a billion in managed accounts. Now we have single investors showing up with multiple billions that they wish to allocate to managed accounts. They have the ability to demand a very different price and terms. And they will.”

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**Marc de Kloe**, head of alternative investments and funds, ABN AMRO



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(1) AIFMD: Alternative Investment Fund Managers Directive which came into force on July 22, 2013. Aims to create a comprehensive regulatory framework for hedge fund managers that reconciles investors' protection (mandatory segregation of administration/custodian and valuation duties from fund management, new prescriptive rules aiming to prevent excessive risk taking, such as on remuneration), while preserving the necessary flexibility in the “performance engines” with no prescriptive constraints imposed on investment guidelines, type of instruments used, level of leverage. Also, the AIF passport will allow to market alternative products within the EU for professional investors, outside of the private placement regime. There is no capital or performance guarantee. This publication cannot be reproduced or passed onto third parties, in whole or in part, without our permission. Published by Amundi Alternative Investments, SAS - Simplified Joint Stock Company with capital of €4,000,000 - Registered office: 90, boulevard Pasteur, 75730 Paris Cedex 15 - Portfolio Management Company registered with the ‘AMF’ (French Financial Markets Authority) under no. GP 01.044. Paris Register of Companies no. 439 614 553. This publication is intended for professional investors only. The information contained in this publication is not intended to be distributed or used by any person or entity in a country or court where such distribution or use would be contrary to legal or regulatory provisions or which would compel Amundi Alternative Investments, SAS or its affiliated companies, to comply with the registration obligations of the said countries. The data and information contained in this publication are supplied for information purposes only. Nothing in this publication constitutes an offer or request by any member of the Amundi Alternative Investments group, to provide advice or an investment service or to buy or sell financial instruments. The information contained in this publication is based on sources which we consider to be reliable, but we cannot guarantee that it is accurate, comprehensive, valid or relevant. Photo credit: Corbis. | W

To accommodate more traditional investors, those new to hedge fund investing, or those with smaller allocations, funds of managed accounts have appeared in the past 18 months, with notably positive growth in the last year. An evolution of funds of funds, they typically see allocations in the \$25 million range.

"They are offered to a more traditional client base that may still be interested in a commingled product but want the added transparency," says McCloskey at Man FRM. They offer all of the benefits of a managed account while drawing on the strategies of a variety of hedge fund managers. "We provide enhanced risk monitoring and risk analysis, and we deliver full portfolio-level factor exposures," she says.

#### REFOCUSING THE MARKET

In the pre-2008 era, the investor universe in hedge funds was mainly dominated by fund of funds and high-net-worth clients. Pension funds might take small positions in the flagship funds or go through a fund of funds.

Now, with a growing range of managed account options, the hedge fund business is more institutional than it was before, more driven by pension funds and other institutional clients, says Jean Baram, managing director of business development and investor relations at Innocap. This has led to direct investment through dedicated managed accounts instead of through the commingled or off-shore fund vehicles.

"After 2008, there was a big focus once again on managed accounts," says Caroline Bradley, director at Citi Prime Finance. They had seen moderate use in the early 1990s, and as the money flowed into hedge funds, many hedge fund managers were not willing to accept managed accounts.

However, as many hedge funds suffered big drawdowns and investor redemptions during the financial crisis, they were looking for ways to acquire new assets. After the collapse of Lehman Brothers, investors in hedge funds could not liquidate easily and they often did not even know what their portfolios contained. "They were left with a lot of illiquid positions and side pockets," Bradley says, "and there was certainly a move towards managed accounts and funds of one."

Investors do not want restrictions that limit withdrawals from a hedge fund, and they want transparency. In 2008, hedge fund investors typically received monthly data from their underlying managers with a two-week lag.

When the credit crisis hit, they did not have accurate visibility and actionable transparency into their investments. Furthermore, they did not have control of their assets and did not have a timely ability to redeem, with redemptions in many cases being suspended and gated. "This has been a major driver into managed accounts," says HedgeMark's Santos.

>> Today, the managed account space has evolved, which in turn has transformed hedge fund investing in general. The investor base has changed and now large institutions, mainly pension funds, utilise the framework of managed accounts to increase exposure to hedge funds >>

"With the high frequency of daily information, technology and analytical tools, we are starting to see fund of hedge fund managers moving towards managing the asset, not hedge fund managers. This is a major shift for portfolio and risk management with the ability to take action, in a more tactical and timely manner."

"Seven years ago, investor gate provisions weren't even talked about," says Martin Visairas, managing director in Citi's capital introduction team. Now, if the underlying liquidity justifies it, then in the spirit of treating customers fairly and evenly, hedge funds are imposing an investor level gate of 25%, which means that, in any given quarter, if an investor has quarterly liquidity, it will not be able to redeem more than 25% of the investment. To get all the money out will take a year.

Liquidity misalignment was also a big problem during the crisis, but hedge funds have generally become smarter about how they are aligning the underlying strategy with the liquidity requirements of their investors.

The use of managed accounts has certainly grown in the six years since the global financial crisis.

"The noise that managed accounts created five or six or five years ago in the market seems to be slowing down," says Visairas. "They've become a little bit more mainstream." In general, hedge funds know the pros and cons of having investors through managed accounts on their books.

Industry specialists say that the managed account space has changed tremendously since the financial crisis. "Before, it was somewhat homogeneous, with each of the providers and platforms doing essentially the same thing," says de Beaupuy. "The services were embedded in banking and asset management." At that time, the main advantage of a managed account was access to hedge funds and liquidity, and mostly to a specific investor base, such as private banks and funds of funds very often with a structured product component.

Today, the managed account space has evolved, which in turn has transformed hedge fund investing



**Jean Baram**, managing director of business development and investor relations, Innocap



in general. The investor base has changed and now large institutions, mainly pension funds, utilise the framework of managed accounts to increase exposure to hedge funds.

Their needs have revolutionised the old hedge fund structure as well. The old hedge fund model of one size fits all – Cayman-domiciled, the 2 and 20 fees structure, quarterly liquidity – has disappeared. “This is finished, and this signifies a very important source of growth in the market,” says de Beaupuy. “The market is fragmented in terms of new entrants, and the market is evolving into creating tailor-made solutions for investors.”

He adds: “The managed account approach has been key in the development of these trends.” On one hand, institutions, particularly pension funds, have been the main source of growth in the market since 2009. “Their specific investment needs have revolutionised the old hedge fund structure, pushing towards more risk management and more transparency,” he says.

On the other hand, the introduction of regulated offers such as UCITS or ‘40 Act funds has pushed towards a form of retailisation in the industry. “The market is fragmented in terms of new entrants,” de Beaupuy says. “Investors’ needs are broad. They can be infrastructure or technology-based. They range from manager selection and risk management to portfolio construction and advisory. In order to be an investment solutions partner to your clients, experience and expertise matter.”

#### THE RISE OF CUSTOMISATION

The market for accessing hedge funds through managed account platforms began to take off shortly after 2008, largely because of issues encountered during the financial crisis. “Investors were exposed to unexpected liquidity limitations such as side pockets of illiquid assets, suspensions of redemptions and hedge fund failures,” says Ben Browning, director of business strategy at K2 Advisors.

Many of the platforms were built essentially to mitigate such liquidity risks as they offered clients enhanced liquidity, such as monthly or even weekly redemptions, through investment funds controlled and overseen by the platform sponsor.

“In some cases, particularly in credit and event strategies, modified versions of a hedge fund’s flagship strategy were implemented through these more liquid managed account structures. In a dedicated managed account, however, an investor has more power to customise strategies to suit their own needs,” says Browning.

Traditionally, managed accounts have been utilised in the long-only world in areas like sharia funds and socially responsible investing – and they can similarly be used for hedge funds to modify their investment strategies to suit the particular requirements or constraints of specific investors.

“If the investment guidelines exclude weapons or tobacco, for example, a hedge fund manager may be able to implement that in the managed account, while continuing to invest the main fund in those sectors,” says Pepper at Old Mutual. A managed account may also be able to reproduce a specific strategy or concentrate in a specific region. “A managed account can replicate a manager’s strategy to apply to a specific set of circumstances or for a specific objective,” he says.

A managed account allows for investment in a hedge fund while accommodating differences in style from the main fund. Socially responsible investing is a good example. “For example, in the Netherlands, an investor cannot hold more than 5% of his portfolio in a manufacturer of cluster munitions,” says de Kloe. With a managed account you can create a dedicated portfolio. “Now, you can see the positions and make those exclusions,” he says.

Managed accounts allow informed and experienced investors the ability to assess strategy, liquidity, risk for an extra measure of control and, more recently, customisation. “Within a managed account structure, you can work with managers in more creative ways,” says McCloskey. “Based on the amount of interest we’re seeing in terms of customised investment solutions, we expect the momentum to continue.”

Historically, managed accounts might have been customised only at the margins, perhaps with specifically tailored risk control, or with specific portfolio manager allocations. “Now we’re seeing much more active involvement,” she says. Investors are becoming more interested in investment content that is concentrated or aimed at a specific theme. These concepts can then be executed by the investment manager in the managed account. “They ask, ‘How do we structure a managed account to give us a specific exposure?’ It’s all about investment customisation now.”

Take, for example, an investor on a managed account platform that controls the level of leverage that the underlying hedge fund can use to achieve a specific alpha strategy. “At the managed account level, any exposure from that investment is controlled by the end investor,” says Visairas.

With the transparency and insight they have, the investor can apply overlays to take out any beta in the portfolio. In a cash management strategy, an investor could put \$10 million in a managed account, an amount that might not look profitable, instead of \$50 million, but could lever the exposure three or four times. “Depending on the level of sophistication that some of these investors have, they can get quite resourceful in the way they’re getting their market exposure,” he says.

Another application of managed accounts is notional funding. “With a \$100 million allocation, you can fund a managed account fully or award separate



**Martin Visairas**, managing director of capital introduction team, Citi



**Caroline Bradley**, director, Citi Prime Finance

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mandates to several managers based on total gross long-short notional allocations, by posting the margin requirement plus a buffer,” Maher explains. “They can stretch their allocation dollars so there’s no cash drag on investment performance.”

Managed accounts can help with portfolio construction as well. “Say you have two managers, and you rebalance quarterly,” he says. Say a macro strategy is doing well versus others. “Managed accounts enable that asset owner to turn the various dials in their investment portfolio to move more into macro while decreasing the notional in those strategies that are lagging,” he says. Investors are starting to use this kind of flexibility and agility in increasingly subtle and sophisticated ways.

When investors considered managed accounts in the past, they usually thought in terms of just replicating an existing strategy of a hedge fund manager. But these days the product can be used far more cleverly and specifically.

“Increasingly investors want to take advantage of particular market situations,” says Kestler. They may hire a manager to employ a specific, nuanced and customised strategy – sometimes only for a finite period of time to execute a specific trade or idea.

“A manager may go to a client with a great trade idea,” he says. “For example, there could be a trade that they want to execute and hold for the next 12 months or that they want to implement to hedge an exposure in their broader portfolio.” One of the ways to do that is to set up a managed account and buy such positions or execute the relevant strategy.

In all of these respects, it is clear that managed accounts serve the over-riding purpose of allowing institutional investors to gain more control. “Managed accounts are a wonderful tool to achieve flexibility,” says de Beaupuy. “Terms – whether fees, liquidity or the specifics of the investment mandate – can be negotiated.”

Managed account providers see what hedge fund managers do, how they invest at the individual trade level, and the alpha generated by each strategy. This provides a lot of information and insight on their expertise, and on their strengths and weaknesses. “As investors become more sophisticated, we can help them define tailor-made mandates to better fit their investment needs,” he says.

#### CHANGING THE LANDSCAPE OF INVESTING

Managed accounts are playing a major role in the transformation of the hedge fund industry. “There are several forces moving the business towards managed accounts,” says Santos. Institutions are increasingly requiring a structure to invest in hedge funds that is similar to their traditional investments in a separately managed account – shifting functional responsibilities to their various service providers in terms of treasury management, middle office, administration and custody.

>> The trend towards housing assets on platforms is showing signs of accelerating in the coming years as end investors look at different ways to allocate to hedge funds and other alternatives on a centralised platform >>

“Institutions have become much more concerned about the lack of transparency and having less control,” says Santos. They are no longer accepting opaque investment structures, and they are much more comfortable with a separately managed account that gives them control of the assets, actionable transparency and shift of functional responsibilities to their service providers.

“If I’m an asset owner or asset manager, I’m hiring a hedge fund manager for their investment capabilities – not to perform back-office, treasury and other activities,” he says. “That’s what I have my managed account platform provider and other service providers for.”

The trend toward housing assets on platforms is showing signs of accelerating in the coming years as end investors look at different ways to allocate to hedge funds and other alternatives on a centralised platform. “This way, one adviser can keep an eye on known risks across the portfolios of various assets in one place,” says McCloskey.

The number of allocators and types of allocators have increased as well. “There is a much broader adoption of investing in hedge funds through managed accounts – it’s growing,” says Warner. “Allocators are increasingly appreciative of the transparency and safety provided through managed account structures.”

Managed accounts have been around in the hedge fund space for well over a decade, not least via the development of a few investment banks that were heavily involved in the structured product business leading up to the 2008 crash.

They created managed account platforms mainly to have control and transparency of the underlying investments which served as the hedges for structured products issued to clients. “Now, the managed account landscape has definitely changed, and there are a couple of factors that have driven that,” says Kestler. He points to the 2008 financial crisis, the Madoff scam and other frauds that occurred with hedge fund investments, in addition to the structural issues like gating provisions and liquidity suspensions that caused investors to reconsider the way they access the hedge fund asset class.



**Philippe de Beaupuy**,  
UK head of the managed  
account platform, Lyxor  
Asset Management



Demand for managed accounts has shifted from products like certificated notes designed for a more retail investor base to institutional investors like pension plans, endowments and sovereign wealth funds that are seeking control, transparency and customisation when allocating to hedge funds.

In addition, pension plans – which, to begin with, typically invested in hedge funds through funds of funds – have begun to shift the way they access the hedge fund asset class. “This may have been the first experience of a pension plan to allocate to the asset class, and it wanted a third-party adviser to build its portfolio,” says Kestler.

Over time, as those pension plans have become much more sophisticated, they have begun to move towards a direct-investing model. “When they’re no longer investing through fund of funds products, they’ve built in-house investment staffs or they’ve hired third-party advisers to help them invest directly in hedge funds, rather than through an intermediate product,” he says.

This shift has become the perfect opportunity for plans to transition to investing through managed accounts. “Plans are trying to align their hedge fund investments more closely with what they’ve done on the long-only side for years: to have transparency, manage risk and control their assets,” he says. This has created a much greater focus on managed accounts and a shift in the way that the investment community regards them and utilises them.

“For large institutional investors, there is a lot of pressure to generate consistent returns, minimise volatility, especially on the down side, and, in the current low interest rate environment, it’s become a challenge for investors to meet their hurdle rates,” says Andrew Lapkin, CEO of HedgeMark.

As a result, the focus is on how best to build a well-diversified portfolio in a globalised economy. With markets more interconnected, the hunt for diversification has become much more difficult. Simply investing in different countries or even a wider array of asset classes has led to increasingly correlated investment portfolios that tend to drop when the markets drop.

“While investing in hedge fund strategies involves substantial risks, many hedge funds have shown an ability to generate returns that have both lower volatility and lower correlations to traditional markets, and, as a result, they may fit well into a large equity-heavy institutional portfolio as a proper component of the asset allocation,” says Lapkin.

In the past, many large asset owners considered hedge funds to be satellite strategies and were generally treated as a separate investment bucket away from their main portfolios and off to one side. Now, they play an ever increasing and integral role in a portfolio. However, in many ways, hedge funds are no longer seen as a separate and distinct

>> For large institutional investors, there is a lot of pressure to generate consistent returns, minimise volatility, especially on the down side, and, in the current low interest rate environment, it’s become a challenge for investors to meet their hurdle rates >>

asset class, but rather as part of wider allocations to traditional and established asset classes. “They’re starting to be viewed as another source of active management but, to be clear, active management that can be beneficial within a diversified portfolio,” he says.

New client requests reflect this emerging idea of viewing portfolios holistically and on a risk-budgeted basis. Not only do they want the full infrastructure platform, but they want integrated advisory services as well, including strategy selection, manager selection and portfolio construction.

“We’re seeing RFPs of a hybrid nature asking us to offer a fully fledged solution in hedge fund managed accounts and long-only investments,” says de Beaupuy. “This is an important step to stop considering alternative investments as an outlier to their overall asset-allocation process.”

Transparency allows them to know at any given point in time exactly where their risks lie across their portfolio, including their exposure to hedge funds. “The transparency of managed accounts can allow investors to free themselves from the traditional frontier between hedge funds and their long-only strategies,” he says.

Accelerated by the arrival of AIFMD, this idea is blurring the lines between mainstream and alternative asset classes. “Allocators may want to stop considering hedge funds as a separate asset class,” says de Beaupuy. “When you have transparency you can begin to fully integrate them into your overall asset-allocation process.”

#### DIFFERENT MARKET SEGMENTS

In essence, there are four groups of managed account providers in the business, explains Rivard. The first is full service. In addition to providing a stable of hedge funds, they offer broader asset management and other advisory and administrative services.

The next group is asset managers that are essentially funds of funds. They have existing relationships with hedge fund managers, and are open to



**Akshaya Bhargava,**  
CEO, InfraHedge

working with new strategies. They have championed investments into managed accounts for some time, having originally built the platforms to support their own investment programmes.

The third group, which includes Innocap, provides the architecture itself and rigorous frameworks ensuring optimal asset oversight. They provide sophisticated institutional asset managers with tailored investment infrastructures into hedge fund strategies while benefiting from best practices in terms of governance. Last but not least, some pension funds go it alone and build their own internal managed account platforms.

There are some very important changes taking place within the managed accounts universe. Some years ago, the managed account landscape was dominated by platforms that were part of major asset management houses and today, they remain part of the asset management business of these organisations.

They found and vetted good hedge fund managers, negotiated a managed account structure with each of them and invited them to join their platform. The platform was available to prospective investors who wanted to invest in a managed account format, and this would be governed by the platform provider.

“However, there are some drawbacks to this structure,” says Bhargava. “If I’m an institutional investor, my choice of managers is limited to those the platform has selected.” Many investors did not want to be limited in such a platform structure and wanted to be able to select from a larger universe of hedge funds, able to pick managers and strategies of their choice.

Generally there is growing interest in managed accounts because there is growing interest in hedge funds. Investments into hedge funds continue to grow, and the source is more often increased allocations from existing investors rather than commitments of capital from new investors.

“Once they understand what a hedge fund is and what a managed account is, and they’ve done their due diligence, they can get the green light from their board or from their end investors,” says Hirsch. “Then they typically put more money in.” Looking ahead, new allocations to hedge funds via managed accounts are likely to be higher than those to hedge funds’ main commingled flagship funds.

As with most things, the choice of a provider is investor and client-dependent. “Investors with relatively limited investment staffs or resources rely on us to provide a consolidated view of performance, risks and other metrics across their entire portfolio,” says Browning. Other clients with greater resources may require more frequent reporting, greater risk transparency and play a greater role in the portfolio management process. “Such clients may be interested in increased risk reporting to

manage risks across the client’s entire portfolio on a daily basis or better insight into counterparty risk and exposures,” he says.

#### **FEES, FEES, FEES**

Investors in managed accounts can usually negotiate different fee structures, and can often negotiate lower management fees with the hedge funds as well depending on the size of the allocation.

“The allocations are often sizeable, and a large investment provides greater leverage for an investor to obtain a fee discount,” says HedgeMark’s Lapkin. “Managed accounts facilitate that discount because they are segregated funds, and as a result, the manager may not be subject to preferential terms or be required to issue a side letter.”

Additionally, with a managed account, the hedge fund manager only trades the portfolio, and the non-investment functions are greatly reduced. A portion of the management fee would cover the hedge fund’s accounting, operations and legal services as well. “With some of those non-investment functions no longer being handled by the hedge fund, naturally some of the fees could come out,” he says.

Managed accounts also allow investors to adjust and control how fees are paid, with the aim of creating better alignment between the investor and the hedge fund. “Many investors are hesitant to allocate to hedge funds because of some of the high fees. The concern is paying high fees and possibly obtaining poor performance,” says Lapkin. “It is also very difficult to assess the quality of a typical fund’s returns. With managed accounts, you have the metrics to measure performance and the sources of that performance. Additionally, investors may restructure the fees to ensure proper alignment.”

In a typical fund investment, if the hedge fund has strong performance in one year, the investors pay a high fee. If there are losses in the next year, an investor usually does not have the ability to claw back any of the fees. In a managed account, an investor could structure the fees in a way that the calculation of fees is done over a multi-year period. “That way, an investor is paying fairly, based on long-term performance,” he says.

For managed account services, there is an inherent minimum that the business is worth, notes Innocap’s Rivard. “There are firms that charge minimum fees when they take on an investor, but two or three years later, both parties are totally unsatisfied,” he says. Some mandates are won for just 12 or 15 basis points, and sometimes even as low as 10.

“Our understanding is that they’ve been terrible for both parties,” he says. “It’s not possible to do business at those levels.” Depending on the size of the books and their complexity, this business should cost between 25 and 50 basis points. “Right now it may be between 40 and 60, but in the next five years it will probably normalise to between 25 and 50 basis points,” he says.



**Ben Browning**, director  
of business strategy,  
K2 Advisors

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# MAPs: the future of hedge fund investing?

Managed account platforms (MAPs) look set to become the backbone of hedge fund investing as the industry moves towards two separate models.

"The managed account platform industry is polarising into two separate models; the first can be described as 'manager-centric' (where the starting point is the manager who is chosen by the platform), while the second model is 'investor-centric' (where the investor gets to make all the key decisions around manager selection and account structure)," says Akshaya Bhargava, chief executive officer of InfraHedge.

The 'manager-centric' managed account platforms include those asset management-based models whereby the client can select from the managers listed on the platform, while the 'investor-centric' model gives the investor the autonomy to make all of the decisions, in terms of which managers they allocate to, and provide the structure for them to action their investment decisions.

InfraHedge tops the managed account table in terms of assets, managing \$15.17 billion at the end of June 2014, up from \$11.45 billion at the end of June 2013, an annual growth rate of 32.52%. InfraHedge is an infrastructure-only model where the assets are not managed by InfraHedge themselves, meaning that clients use InfraHedge's managed account infrastructure. "An in-house platform (commonplace some years ago) is operationally intensive, the upfront costs are high and the technology this requires needs continuous maintenance and investment," explains Bhargava.

"The InfraHedge model takes away the need for the investor to allocate in-house resource for operational, technological and financial impediment of hedge fund investments. Such a model provides

institutional investors with all the benefits of a private managed account programme without any of the upfront costs and ongoing maintenance expenses. The InfraHedge platform is to hedge fund investing what the NetJets model was to the private aviation segment – NetJets provided all the flexibility and advantages of private jet ownership, without any of the upfront cost or need for day-to-day maintenance of aircraft," Bhargava adds. Another example of an infrastructure-only platform is Innocap, which saw its assets grow by 10.48% in the first half of 2014 to end-June with \$2.74 billion on the platform.

Overall assets on managed account platforms have grown by 8.07% in the first half of the year. Through to the end of June, there was \$85.72 billion of hedge fund assets on managed account platforms compared to \$79.31 billion in January. The surge in growth over the six-month period supports the trend that managed account platforms are growing in popularity for investors who are looking to allocate to hedge funds directly. An industry survey conducted at the end of last year predicts that managed account platform assets will swell to \$100 billion in the next 18 months (*InvestHedge*, July/August 2014).

As funds of funds move toward expanding the way they offer hedge fund selection to investors, more are likely to opt for putting their managers on 'display' on a managed account structure. Whether or not they buy, build or rent it is the choice that many are having to make. Of the 14 firms listed in the table, 11 also manage funds of hedge funds. The UBS Liquid Alpha Platform and Goldman Sachs managed account platforms have been removed due to data that could not be updated since 2012, although it is believed

that these banks continue to offer managed account platform services.

Lyxor Asset Management was the leading firm at the end of last year in terms of assets, but in the first half of 2014 the platform assets declined by 8.33% to \$11 billion. Lyxor offers a third-party platform, accessible to other FoHF groups, as do Amundi Alternative Investments and Sciens Capital Management. Assets on Amundi's managed accounts platform grew by 2.98% to \$5.32 billion, while Sciens' platform grew by 3%.

Those funds of hedge funds that invest only their own clients assets via their managed account platforms have included their platform assets in the main *InvestHedge Billion Dollar Club*™ rankings, and these been marked accordingly. Lighthouse Partners, for example, had \$6.7 billion of its clients' assets invested via its managed accounts platform, which accounts for 82.5% of its total \$8.12 billion in assets. Of those FoHF managers that do not offer a third-party platform, Lighthouse Partners is the firm with the largest percentage of its total assets invested via managed accounts.

Swiss Capital Alternative Investments' assets on its managed accounts platform grew by 42.16% in the first half, the largest percentage growth of those listed in the table. Its platform was also the fastest-growing of last year as it swelled assets by 83% in 2013; the firm now has 30% of its total assets invested via its managed accounts platform. The firm started the year with \$1.02 billion and this increased to \$1.45 billion at the end of June. Private Advisors' platform also had a strong half as assets on its platform grew by 17.30% to manage \$2.03 billion, up from \$1.73 billion. The platform's assets have doubled in the year to June: at the same point in 2013 there was \$1 billion on the platform.

The benefits of using a managed accounts platform for an investor include lower fees, ability for enhanced customisation, a greater level of transparency and greater liquidity. In essence, a managed accounts platform provides investors with greater control over their portfolio. An example of this is Massachusetts Pension Reserves Investment Management Board (MassPRIM), which recently selected HedgeMark to provide hedge fund managed account services, with Arden Asset Management hired as its hedge fund adviser.

The trend towards housing assets on platforms is likely to accelerate in the coming years as end investors look at different ways to allocate to hedge funds and other alternatives on a centralised platform where one adviser can keep an eye on all the risks across the portfolios of various assets in one place.

## Managed account platforms ranked by assets

	AUM 30/06/2014 Total \$bn	AUM 01/01/2014 Total \$bn	Growth \$bn	% growth
InfraHedge <sup>1</sup>	15.17	11.45*	3.72	32.52%
Lyxor Asset Management <sup>3</sup>	11.00	12.00	-1.00	-8.33%
Deutsche Bank <sup>3</sup>	10.00	10.00	0.00	0.00%
Pacific Alternative Asset Man Co. <sup>2</sup>	9.65	8.95	0.71	7.91%
Permal <sup>2</sup>	8.50	8.00	0.50	6.25%
FRM <sup>2</sup>	8.20	8.00	0.20	2.50%
Lighthouse Partners <sup>2</sup>	6.70	5.80	0.90	15.52%
Amundi Alternative Investments <sup>3</sup>	5.32	5.16	0.15	2.98%
LGT Capital Partners <sup>2</sup>	3.71	3.40	0.31	9.18%
Innocap Investment Management <sup>1</sup>	2.74	2.48	0.26	10.48%
Private Advisors <sup>2</sup>	2.03	1.73	0.30	17.30%
Swiss Capital Alternative Investments <sup>2</sup>	1.45	1.02	0.43	42.16%
Sciens Capital Management <sup>3</sup>	0.79	0.77	0.02	3.00%
Gottex Fund Management <sup>2</sup>	0.45	0.56	-0.11	-19.14%
<b>Total</b>	<b>85.72</b>	<b>79.31</b>	<b>6.40</b>	<b>8.07%</b>

<sup>1</sup> Infrastructure-only assets (i.e. client use the managed account infrastructure). <sup>2</sup> Assets included in *InvestHedge Billion Dollar Club*™ entry.

<sup>3</sup> Assets not included in *InvestHedge Billion Dollar Club*™ entry. \* Data provided on a 12-month basis. Source: *InvestHedge*

*This box originally appeared in the InvestHedge Billion Dollar Club feature in InvestHedge, September 2014 edition.*

# Enhanced transparency: getting what you paid for

**T**ransparency is the key driver in the managed account space. It has had a direct impact on changes in the way in which hedge fund managers are managing portfolios and the way in which investors are allocating.

With enhanced transparency, better and more frequent performance reporting, or even more detailed performance attribution, investors can feel a little more certain about whether they are actually getting the kind of alpha that they are paying for.

“Investors often complain about high fees in hedge fund investing, but in many cases they can be comfortable with high fees as long as they’re getting a high return or a high risk-adjusted return,” says HedgeMark’s Lapkin.

For example, a hedge fund’s returns may be lower than those of a broadly diversified portfolio, but on a risk-adjusted basis they may be many times greater. In the past, it has been difficult for investors even to verify whether they were getting an enhanced risk-adjusted return or not.

“With transparency and enhanced reporting, it’s easier to understand which managers are providing alpha efficiently without risking too much of the investor’s capital,” he says. Even more important, in many cases, is to understand the actual role of that fund or strategy within an investor’s total portfolio. That becomes helpful for making the right allocations, or making smarter decisions, in terms of weightings and additions or subtractions of managers within the overall investment plan.

Liquidity and transparency terms enjoyed by investors in a managed account should be disclosed to ensure that the respective investors are treated fairly in handling any conflicts with hedge fund managers.

“Investors will need to know the answer to questions like: ‘Can the managed account be terminated and liquidate ahead of the main fund?’” says Old Mutual’s Pepper. With less liquid assets or if the manager is secretive about positions, investors in the main fund can be worried about the extra transparency received by the managed account.

Equally the managed account investor implicitly knows that there will be similar, potentially larger, positions in the main fund. “They [managed

account investors] may have the right to get out ahead,” he says. “Investors in the main fund need to be aware of this and take account of the potential implications for them of this.”

Managed accounts generally offer relatively high levels of liquidity. “That doesn’t mean that investors are actively trading among managers,” says Deutsche Asset & Wealth Management’s Fothergill. It simply means that investors are able to act in a more timely way when they decide to make an allocation change.

This is particularly important at times of market stress and changing fundamentals. “Managed accounts allow investors to rebalance from one manager or strategy to another exactly when they want to, rather than having to plan many months in advance,” he says. Managed accounts also provide a high degree of comfort that allocation changes can actually be implemented when the time comes, and not be subject to unexpected lock-ups or gating.

Since the crisis, the industry has seen a meaningful increase in operational due diligence, with a strong focus on an investor’s ability to retrieve their capital when required. “There is no doubt that the liquidity features of our platform provide investors with significant comfort from an operational due diligence perspective,” explains Fothergill.

The ability to have position-level transparency also provides numerous benefits across the spectrum of investment, risk and even regulatory components. Investors in traditional hedge fund structures will know broadly what the strategy is and there also may be some parameters that the manager has laid out in its offering materials. But for the most part the managers have broad flexibility to trade as they like – and the investor generally has very little insight into what is happening on a daily, monthly or even quarterly basis.

“Maybe you get a monthly report on a lag with certain key risk attributes, but that’s it,” says HedgeMark’s Kestler. “You don’t know what’s in the book, and you don’t know whether the manager’s really sticking to its strategy – whether there’s been style drift.”

A more recent example of how managed accounts can help investors to get a better picture of what is happening is the technology sell-off in April 2014, when a lot of long/short equity funds lost money.



**Andrew Lapkin,**  
CEO, HedgeMark

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“The hedging they were doing wasn’t working,” says ABN AMRO’s de Kloe. Many managers were long tech stocks and shorting the S&P, using an overlay of various option strategies. “They probably should have been shorting the NASDAQ or a dedicated technology basket instead,” he says. “In the old days, they wouldn’t have had the evidence, but now in a managed account, they can verify the hedge fund manager’s strategy, track any style drift, keep an eye on the exposures and challenge the manager on his decisions.”

Investors have a window of visibility into their hedge fund programmes, and now there is the ability to compare managers. “Say there are three managers in a certain space, and two are really doing well, while one is doing poorly,” says HedgeMark’s Santos. Now, position-level information can be compared, performance can be explained, and an investor can make better-informed decisions – which otherwise they were making somewhat blindly in the past. “Before, decisions were based on what the hedge fund manager was providing, and now you’re receiving daily holding and returns-based information and analytics,” he says.

Usually, the motto of managed accounts is “liquidity, transparency and control”, essentially risk control, but the information is used very carefully. “Transparency is very important to us, and it’s a pledge to the manager more than to the investors,” says Amundi’s Hirsch.

While full transparency is needed to perform official net asset value calculations, risk management and client reporting, many investors often do not have the technology or the in-house expertise to utilise this kind of information effectively.

“Transparency means we can give you aggregates, we can give you some indicators of the positioning of the portfolio, but we’re not going to dump the whole portfolio and every position’s size and price to any investor,” he says. It is important to understand that this kind of transparency often involves complex but more importantly sensitive information. “The usage made of the transparency is, in fact, the trust that you put in place with a manager,” he says.

With a managed account, investors own the assets and can see what is going on every day. This information creates a number of new opportunities. An investor can see how correlated a particular manager is to the broader indices, and know whether its performance is just beta or if the manager is producing real alpha.

If there are losses, investors can see where they are coming from. “They can see performance attribution, they can understand if they’re over-weighted in Apple across 10 different funds, they now know that where they were blind before, they can now see what is happening in their portfolio and can take action, if necessary,” says Kestler. “If they want to

hedge a specific risk, they can, and if they want to ask a manager to reduce certain exposures, they can.”

These are dramatic differences and improvements that investors in hedge funds have never before been able to experience. Now the question is, do you have the expertise to handle that information, and what do you do with it?

Managed account platform providers generally have proprietary risk systems that are able to help clients dissect that information and get the type of reporting they need to properly analyse it. “We provide them with the tools to help them to understand what the value at risk of a portfolio is, what the various exposures are whether it’s country exposure, issuer exposure, or exposure to a particular industry or sector,” he says. “Now sophisticated investors have the ability to understand their hedge fund risk exposures.”

Many investors have long been able to understand what the risks are in their long-only portfolios because they can see those positions. “But you usually didn’t know what the position-level risks were in your hedge fund portfolio until there were losses,” he says. Now, not only can investors know, but they can actually do something about it. “We call that actionable transparency,” he says. “Not only do you have a visibility into the positions in the portfolio, but you can actually do something with it.”

Investment approaches are changing as well as institutional end investors become more sophisticated. “Asset managers are moving much more into risk budgeting as opposed to managing managers, and the daily inputs enable them to do that,” says Santos.

Following the crisis, and in response to investor demands, many managers improved the transparency provided to investors. While more transparency is a positive development, it is not without its own challenges. “The difficulty faced by investors being offered ever more transparency is how to normalise, manage and analyse so much data coming from different sources in different formats,” says Fothergill.

“Consider a portfolio of 20 or more managers each sending a daily spreadsheet with a full list of position-level information across multiple strategies and asset classes. What do you actually do with that unless you have the appropriate in-house skills and systems to handle it?” he asks. “We listen to our clients’ needs and aim to deliver useable reporting and aggregated data in the format they require.”

“In the last seven years, there have been two different trends,” says Citi’s Visairas. One is a marked upward trend in terms of demand and a perceived need to use managed accounts since the financial crisis. This is mainly because investors want to have full control of their assets, and have the ability to manage liquidity and their exposures in a more comprehensive way than is possible with commingled vehicles.

However, some institutions have recognised the operational burden that managed accounts can bring and how resource-intensive they can become. “You



**Nicolas Hirsch**, business development manager, Amundi Alternative Investments

need to have the in-house workforce and expertise to best use the information that a managed account is giving you,” he says. “There is a greater level of responsibility on the institutional side.” As a result, some institutions have developed in-house teams to handle the increased responsibility. Others have outsourced it to managed account platforms and providers.

There has been significant development work done on risk reporting and risk aggregation systems. “Our clients can see their hedge fund portfolios online as if they were directly holding each of the underlying instruments,” says Fothergill, referring to Deutsche’s online reporting system, MARS.

“There has been a dramatic increase in the detail of information we can deliver to our clients and how it is presented to show changes in a manager’s positioning over time, even from day to day,” he says. “Our reporting shows, in a very usable format, how

the aggregated risk profile of a client’s portfolio is developing, which makes a significant impact to investors’ ability to make informed decisions.”

Many pension funds have very small in-house investment teams, and this in-house capability is an important consideration in how best to utilise managed accounts. “Some public plans have only five people who can just keep the investment programme running,” says InfraHedge’s Bhargava. “This core team makes the big decisions about the size of asset allocations, and who to allocate to, but after that, they often let the managers take over.”

In such instances, they may find it attractive to go to a manager who takes care of all the asset management and risk management decisions. While this may be expedient, however, it is not necessarily the best scenario to ensure the highest standards of independence, control and transparency.

## Investor appetite for managed accounts

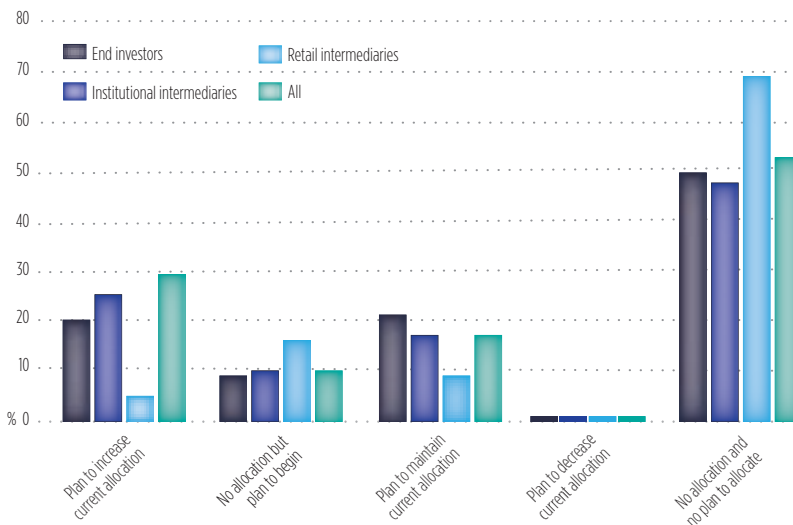
The alternatives landscape continues to evolve with new product offerings and innovative structures, as managers look to access new pools of capital and allocators look for new solutions to help them achieve their risk/return objectives.

Managed accounts continue to be the most popular alternative format for investing into hedge funds — 30% of respondents indicated plans to either begin allocating to the product or increase their current allocation, in addition to the 37% already using managed accounts. However, this dropped from last year’s figure of 35% of investors looking to either begin allocation or increase allocations.

Interest for long-only funds offered by hedge funds managers was also significant, with 28% of investors planning to increase their allocations or begin allocations. Appetite for managed accounts is primarily driven by institutional and end investors, with a higher-than-average proportion of retail investors looking to begin allocations.

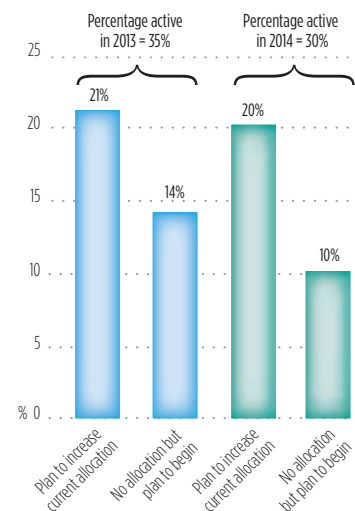
*Source: The 2014 Credit Suisse Global Survey of Hedge Fund Investor Appetite and Activity — survey of more than 500 respondents representing \$1.16 trillion in collective single-manager hedge fund allocations*

Appetite for managed accounts – by investor type



Source: Credit Suisse

Year-on-year comparison of appetite for managed accounts



Source: Credit Suisse

# New regulatory requirements: easing the compliance burden

"Regulation has become more significant everywhere," says Innocap's Rivard. Nowhere more so than Europe. European policy-makers have enacted major new legislation relating to hedge funds with the Alternative Investment Fund Managers Directive (AIFMD), which came into effect in July this year, and hedge funds are working through the detail and figuring out how to fulfil all the new obligations.

Although the precise implications of it all are unclear, it is very clear that there is a lot more reporting that is necessary. "Hedge funds and pension funds cannot bear the liability of being fiduciaries as they face these regulations," he says. Instead they can rely on managed account providers to bear the fiduciary responsibilities resulting from these new regulations. "Regulation is a big deal, and it's going to continue to be a big deal," he says.

Drafted as a response to the financial crisis, AIFMD is a European Union directive that covers the management, administration and marketing of alternative investment funds. "It requires significant reporting changes, as well as onshore registration," says Deutsche Asset & Wealth Management's Fothergill. "As of July, when the regulation came into force, a non-EU manager faces potential challenges if it wants to access European investors."

For example, US hedge fund managers seeking to operate in Europe must, unless they rely purely on reverse enquiry or private placement rules – which are due in any case to be phased out in 2018 – have a European onshore presence and registration, he adds.

Deutsche's managed account platform, being AIFMD-regulated, can help hedge fund managers to meet the necessary requirements by acting as sub-adviser to one of the platform's funds, Fothergill says.

Nevertheless there remains some uncertainty in the industry over the implementation of AIFMD, he admits. "While we view regulation as a good thing, and an opportunity for our managed account business, the broader situation is proving difficult, particularly for non-EU-based managers," Fothergill says.

"Our research shows that many managers, particularly those in the US, are remaining on the sidelines – which will reduce the breadth of choice for European investors, at least in the short term," he says.

From a global perspective, regulation is affecting the way investors approach hedge funds in all sorts of fundamental ways. "In Europe, the UCITS requirement makes managed account structures appealing for sponsors because they need to be able to identify the constraints that affect leverage, margin and so on," says HedgeMark's

Santos. In the US, the same thing is true with the liquid alternative '40 Act mutual funds.

Managed account providers are uniquely positioned to handle the requirements, Santos believes. "Traditional mutual service providers are not used to dealing with some of the instruments that we deal with in the hedge fund world," he says.

"Their specialty is long-only fixed income and equities. Their systems are generally not designed to handle all of the attributes and characteristics of complex OTC derivatives and other alternative investment products which need to be included in the data aggregation process required to determine compliance with '40 Act rules and to effectively manage the portfolio and related investment risks," he says.

By contrast, managed account providers have position-level information, the ability to aggregate all the exposure analysis, to do all of the attribution analysis and be able to support the governance and oversight on those regulatory constraints.

Japanese financial institutions, for instance, are particularly sensitive to the requirements of Basel II and Basel III reporting relating to their hedge fund investments. "The transparency of a managed account provides the data they need to comply and, therefore, to reduce their capital charges," says Santos.

Additional regulatory requirements undoubtedly make it more expensive to run a hedge fund. In addition to AIFMD, there is Form PF (private fund), an SEC rule



**Bill Santos**, global head of business development, HedgeMark

established under Dodd-Frank that requires private fund advisers to provide risk-exposure statistics regarding the type and size of assets held by private fund firms. These are in addition to the existing rules that apply directly to hedge funds themselves, either hedge fund vehicles or hedge fund managers – which some industry participants say creates a barrier for entry for smaller managers and makes life more expensive for everyone.

The main regulatory change that has an impact on hedge fund investors is Solvency II, which focuses on how insurance companies invest their assets. "Solvency II is pretty punitive

to investors in regular commingled hedge funds," says Citi Prime Finance's Bradley. The capital requirements are particularly high. "However, if you invest in a managed account with full transparency to the underlying assets – 60% fixed income, maybe US Treasuries or investment-grade bonds, and 40% equity – you actually get a capital charge dependent on those specific assets that is significantly lower," she explains.

There have not been many insurance companies investing in the hedge fund industry in the past. One reason is they have to have assets that meet and match their liabilities, and they tend to invest largely in fixed income as a result, but certain insurance companies have been able to take advantage of managed accounts. "Insurance companies are big organisations, and they can support the necessary allocations," she says. "They can get the same strategy in a managed account but without going into the offshore fund vehicles."

There are regulatory components driving greater transparency round the world, and in many situations the managed account becomes one of the only mechanisms through which investors can comply with the changing requirements. In Europe and Asia, Solvency II regulations for insurance companies and Basel II and Basel III reporting requirements for banks are driving an increase in the demand for managed accounts.

"As an example, many Asian banks are major investors in hedge funds," says HedgeMark's Lapkin. "To comply with the appropriate reporting requirements hedge fund investments have to be done in structures that allow transparency."

**>> There are regulatory components driving greater transparency round the world, and in many situations the managed account becomes one of the only mechanisms through which investors can comply with the changing requirements >>**



# Information and technology: managing the deluge of data

Investors need and expect much more information than in the past. “You need a technology infrastructure that is strong and flexible enough to provide clients with a way to see the risk compared to how other clients see it,” says Innocap’s Baram.

Investors need transparency, they need to facilitate their individual investment and their portfolio positions, but at the same time they need aggregate views to simplify their analysis and investment decision-making.

“This means that they don’t want to handle the 40 files of the managers they have invested in,” he says. “They want to see how they’re positioned and how adding a new manager or reallocating to another manager can enhance their returns.” Managed account platform providers can facilitate their investment decision making, and the technology provides them with tools to make strategic decisions.

“There is an enormous amount of data received every day,” says Man Investments FRM’s McCloskey. “There are reams of it, with thousands and thousands of line items.” If an investor does not have a way to process and manage it, the volume can be overwhelming. “It’s important to have the appropriate technology to be able to map and model the securities and visualise the data,” she says.

Sophisticated data analysis and technology infrastructure is needed to map complex structures and the volume of daily positions. Managed account providers should have a team that receives the administrator files every day and reviews the line items to ensure that they are mapped appropriately. “You need the right system to drill down to the position analysis and to perform the risk analysis,” she says.

A good managed account platform provider will have spent a lot of time and committed significant investment in technology for data enrichment. They need to have the ability to take data from different sources, supplement that information with the data from market data vendors and have staff oversee the process to make sure the data is complete.

Only then can it be fed through modelling software. For example, a lot of issuers are incorporated in tax-friendly jurisdictions, such as Bermuda and the Cayman Islands. “But simply knowing the

country of incorporation does not help you understand your global exposures,” says HedgeMark’s Lapkin. “You want to know the risk of the country where the operations really are.”

The data characteristics of derivative products can be tricky as well. “For derivatives you need to have all of the attributes of the derivatives that are held,” he says. “Without that data, even the most risk sophisticated models aren’t going to be effective.”

Daily position-level data on 200 managed accounts is an enormous amount of information. Generally it is collected from the fund administrators and not from the hedge fund managers themselves, because there needs to be a clear separation to comply with governance standards.

Managed account platform technology has to integrate with the systems of a number of counterparties to gather and aggregate data. The best ones also give insight into portfolio-wide position and risk monitoring, not only that of an investor’s hedge fund allocations.

“With the managed accounts that HedgeMark handles, we can aggregate all that security-level detail of the hedge funds with all the security-level detail held within the accounting systems of BNY Mellon [HedgeMark’s parent],” says Lapkin. A lot of the focus for HedgeMark’s proprietary managed account platform technology has been in the area of data enrichment. “It is particularly important when modelling risk in hedge fund portfolios to have clean data and to ensure that the attributes of each security are correct,” he says.

Everything is now fed through the risk analytics to provide total reporting. As a consequence, investors can begin to see specifically how the hedge fund investments work alongside all the other assets and look at total exposures, concentrations to single names, to certain areas or regions of the world, and different types of security exposure.

It becomes helpful to many investors that the reporting is no longer about traditional assets or hedge funds. “It’s about the total plan,” he says. “That’s really what the investment officers and the boards are looking for, to understand the total plan and the role of their hedge fund investments within that total portfolio.”



**Michelle McCloskey,**  
senior managing director,  
Man Investments FRM

The best managed account platform providers also pay close attention to how the right information goes back to investors. Any risk system can produce thousands of different numbers, but it becomes important to know where to pay attention so as to enhance the quality of the information being provided to the investor.

“Some investors say that managed accounts give you a lot of information on a daily basis and that it creates information overload,” says Lapkin. “They don’t know what to do with all that information.” HedgeMark’s managed account system, he says, has a compliance and surveillance guideline monitoring module to help filter out the relevant data.

Even though the information is available daily, investors do not always need to be looking at every number every day. “Instead you can have the system screen and only report on the information that will be of interest or importance to you,” he says. If little is changing, if things are running smoothly, and everything is within certain prescribed bands, an investor may not need to look at anything. “If you’re getting a report that says that everything is within your pre-defined bands, then you may choose not to review the underlying data,” he says. “But as soon as something is outside of those bands, the system can flag it, and you can apply the appropriate resources where they are needed.”

Managed account platform providers have to invest heavily in technology, and some make it a priority in order to stay ahead of the curve. “Things are moving fast, and it’s very competitive,” says Innocap’s Rivard. “We offer technological change but, more important, we can customise our system to our clients’ needs.”

Investors need the ability to see what they own on a daily basis and see what their risks are on a daily basis. “Different kinds of books have to be amalgamated on a daily basis,” he says. “That’s what we’re offering them.” The quality of the data and the management of the information is key, he says. “It’s the result of that investment in technology that differentiates many players in the field, and it has to be taken into consideration.”

Technology development is something that never stops. It is a case of ‘evolve or die’. “The first two years of our operations were dedicated almost exclusively to the development of the technology,” says HedgeMark’s Kestler. “We’re constantly improving and enhancing the system by taking feedback from our clients, and we issue regular releases to enhance the system and respond to clients who want a specific statistic or to have a report or screen on the portal look a specific way,” he explains. “Often if one client would like to see a particular statistic, then it’s likely that other clients would as well,” he adds.

>> The best managed account platform providers also pay close attention to how the right information goes back to investors. Any risk system can produce thousands of different numbers, but it becomes important to know where to pay attention so as to enhance the quality of the information being provided to the investor >>

Reducing the amount of work that investor clients have to do internally means that platforms have to be more flexible. Their offerings have to accommodate diversified jurisdictions and be able to answer the needs of clients who do not necessarily need to be in Europe or the US but want to invest in hedge funds. Today investors ask themselves if they need to be based in Europe, the US, or in the Cayman Islands to face the appropriate regulatory environment, depending on whether they are pension sponsors or distributors. “It’s changing how clients look at their investments and how they achieve their goals to invest in hedge funds,” says Rivard.

“I cannot name more than 50 hedge funds companies or platform operators that could do what we do,” says Amundi’s Hirsch. “A lot of players now pretend that they can do hedge funds or managed accounts, and I don’t believe that’s right.” The costs of technology and infrastructure are tremendous in order to do the job correctly, competitively and competently, he argues.

Investors appreciate the ability of managed account platform providers to communicate with them in a way that addresses their needs, rather than simply providing a portal that is populated with data. “That’s the way we decided to do it,” says Hirsch. Some providers make available very powerful risk analytic tools, for example, but it may not be the ideal solution for a particular investor or type of investor.

“We sit down with our investor clients and we ask what type of information they want to see and what specific insights they need,” he says. No one likes to log on to a system to do searches and queries, for example. “We sit down with them and define first at the beginning, and then redefine it all the way through the relationship, what data they require and what output they want at the end of the day,” he says.



**François Rivard**, president and CEO, Innocap

# Managed accounts and hedge fund managers: friends or foes?

Most hedge fund managers would probably prefer just to run a single vehicle and pool all of their investors' capital, as was traditionally done in the past. But these days many managers recognise that in order to retain their existing investors and attract new capital, they have to be willing to provide more tailored reporting and to offer customised solutions like managed accounts to potential and existing clients.

"It's a natural reaction for many funds to say no, and they'll continue to say no as long as they're able to retain existing investors and attract new investors," says HedgeMark's Lapkin. Most managers understand that the industry is evolving, and with allocation amounts rising, hedge fund managers need to be willing to run a managed account to serve certain types of clients. "If they won't support managed accounts, they may not be competitive for large institutional investor mandates," he says.

"We haven't found working with hedge fund managers through managed accounts to be a hindrance at all," says Man Investments FRM's McCloskey. "We work closely with a range of them, from small, specialist start-up managers to well-known managers that have been around for 10 or more years."

Managed accounts actually allow for investors to work with a broader range of managers than they would otherwise be able to do without the use of managed accounts. "Particularly the newer and potentially more innovative ones," she says. This is because the managed account structure allows the investor to implement institutional controls around smaller organisations.

Some infrastructure-only managed account platform providers are more open to working with a broader range of hedge fund managers than some of the full-service platform providers. "The full-service players are often in the

business of signing up managers and positioning them into the portfolios of institutional investors," says Innocap's Rivard. The infrastructure-only players, he explains, are in the business of looking at the portfolios of institutional investors, working with them to see what they want, and helping them in the search.

"Our job is not only to make sure that we do an operational due diligence, an investment due diligence, and make sure that managers' backgrounds check out, but also to provide large investors with an independent oversight over their assets," he says.

A managed account platform provider performs many of the non-investment functions required to operate a separate managed account fund. This includes setting up legal structures, overseeing prime broker and other counterparty agreements, monitoring the administrator and other service providers, and managing all of the day-to-day risk analysis, reporting and compliance monitoring.

As a result, the hedge fund managers themselves can focus predominantly on just trading. "The engagement of a good managed account platform provider can make it much easier for a hedge fund to say yes to a managed account," says Lapkin. "The willingness to offer a managed account may increase, as long as the hedge fund manager is willing to split trades and accept that the investor has greater transparency, the burden of taking on a managed account becomes very manageable."

Listed securities are easily trade-split, and it becomes a question of, for example, putting in an order for 120 shares instead of 60, and making sure



**Joshua Kestler**, president and COO, HedgeMark

that 60 go to one account and 60 go to another. "That's pretty simple for most managers, but once you get into more exotic strategies, where you're trading complex over-the-counter derivatives, they have to do separate trades," says HedgeMark's Kestler.

When a hedge fund manager sets itself up on an asset manager platform, its relationship with the platform is an investor-manager relationship. "But that is in reality, an intermediary relationship, because the actual end investor is somebody else," says InfraHedge's

Bhargava. Some of the managers on the larger asset manager platforms have \$200 million from their asset management businesses, but they do not know who the actual end investors are.

"Many managers have told us that this scenario is frustrating for them, because in times of stress, they can't communicate to the actual client," he says. "Such managers can only communicate with an intermediary, the platform, and the platform guards the end investor relationship jealously, because that's what the platform brings."

"There is a major hedge fund manager, who's among the top 10, with whom we don't have a managed account, because we need full transparency," says Amundi's Hirsch. A managed account platform provider needs to see each position, transaction, cash balance, accrual and so on. "This fund manager said we would be allowed to see only 75% of the portfolio, because the other 25% was his secret recipe," he says. "We said, 'That's impossible. It's all or nothing.'"

The sweet spot of fund managers with which many managed account platform providers prefer to do business is those with around \$1 billion under management. "We have strict minimum requirements in terms of assets under management and track record," says Hirsch. Often by working with a managed account platform provider, a hedge fund will grow its assets to reach that billion-dollar mark and be part of the billion dollar club, a significant threshold. "If we can get \$100 million or \$200 million of capacity at the beginning, we can help them reach that target," he says.

**>> We haven't found working with hedge fund managers through managed accounts to be a hindrance at all. We work closely with a range of them, from small, specialist start-up managers to well-known managers that have been around for 10 or more years >>**



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<sup>1</sup> Amundi Group figures as of 30 June 2014 – Total AUM. <sup>2</sup> For professional investors. <sup>3</sup> On an AUM basis – According to the HFMWeek 2014 Survey.

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