A Global Perspectives White Paper

Global Perspectives

The move to Managed Account Platforms

By Shane Brett,
Managing Director
Global Perspectives

www.globalperspective.co.uk

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Contents

Introduction

A growing trend in the Hedge Fund & Asset Management industry over the last few years has been the rise of Managed Account Platforms as a new investment structure.

This industry segment has existed for some time and has to date been dominated by one established giant – Lyxor. This is starting to change as increased competition enters the sector from fast growing competitors like UBS's Liquid Alpha Platform.

These Managed Account Platforms sign up traditional and Hedge Fund Managers who then market their funds to institutional investors worldwide.

The catch for Managers is that the Platforms impose much tighter investment controls around trading, investment allocation and risk management.

We will look at why this part of the Hedge Fund industry is growing rapidly and also examines the challenges that exist for Managers and Platforms working within this type of structure.

Opportunities

Managed Accounts are capitalizing on a major trend in the Hedge Fund industry - the push towards increased checks and controls. The on-going regulatory avalanche across the whole industry has obviously contributed towards this, but in fact the main driver has been Investors themselves.

Investors want to see their investment managed carefully and in a fully controlled environment. They want to ensure Fund Managers are not taking unnecessary risks or engaging in dangerous trading activity. This can be especially important for investors into alternative funds or those exhibiting a similar investment objective (for example “Newcits” in Europe).

It is even more important for Institutional Investors. As they already represent a very large and growing segment of the whole industry, it is likely that the trend toward Managed Account Platforms will continue. In many cases Investors can actually access the underlying funds themselves without having to pay the Platform fee. Instead they pay this fee to gain an extra level of comfort. After the Madoff debacle who can blame them.

Institutional Investors are insisting on a high degree of flexibility, transparency and liquidity. The extra reporting and controls provided by these Platforms addresses these concerns. Investors can easily redeem their assets (on an often daily basis) and are better protected from fraud or manager error (due to the Platform’s internal additional layer of operational checks).

Challenges

There are a number of important factors to consider for Hedge Fund Managers considering joining a Managed Account Platform. In many ways some of these issues may limit the growth of this structure in the years ahead.

The first obvious challenge for many managers is that they do not like being kept on such a short leash. We have seen examples of managers’ keen to sign up to a Managed Account structure but who have balked when they realize the scale on controls that will be placed upon them.

Managers recognize that these Platforms are a potential new revenue stream, in a market that has been tight on new investor allocation. Of course the investment limits will vary from Platform to Platform but they will likely place firm limitations on the managers' ability to use leverage, gain exposure to specific derivatives or illiquid securities and engage in OTC Counterparty Trading.

In many ways joining a Managed Accounts Platform is akin to running a regulated Mutual or UCITS fund. It certainly won't be for every manager.

Many managers (particularly US Hedge Fund Managers) will not have Pre-Trade Compliance checks in place to ensure trading activity does not breach their investment levels **prior** to placing the trades in a the market. This would be a big change for some Managers. Before joining a Platform they will have to make a sizable IT investment and also change many of their internal operations to anticipate the effects of their investment activity

Managers who breach their agreed investment guidelines will have to compensate the fund. This means they will have to directly write a cheque from their own company resources to make good the shareholders of the mutual or hedge fund. This represents a potential challenge for Platform Managers. It will be up to them to chase the Fund Managers for compensation and this will likely involve tense negotiations to determine the exact monetary size of the breach.

Fund Managers will be expected to sign off and assume liability for their valuations. Hedge Fund Managers will validate their Fund NAV's from their Administrator as normal but the big difference here is that the liability for having the NAV right will lie not just with the Administrator as before – it will also lie with the Fund Manager as well.

This is because on a Managed Accounts Platform the Manager will review the NAV sent to them by the Administrator (as will the Platforms operational team) and sign it off. The NAV may be calculated perfectly correctly by the Administrator but if the Fund Manager signs off a Fund NAV which breaches their agreed Platform risk and compliance limits, then they are writing a cheque. It's that simple.

Global Perspectives
www.globalperspective.co.uk
Email: Shane@globalperspective.co.uk
Phone: +44 (0) 20 3239 2843

Finally existing managers will have their own internal Pricing Policy which they will have used for their investments. This will likely have been agreed with their Administrators over a period of time and cover the acceptable price sources for a full range of standard and exotic financial instruments. It will also have been reviewed and approved by the Fund's Board.

In a Platform structure the Fund Manager will be expected to throw their Pricing Policy in the bin, Instead they must adopt the Platform's Pricing Policy in full. Understandably this can be a significant change for many Managers and the nature of the Platform structure means there is little room for negotiation – if you want to join the Platform you have to sign up to its Pricing Policy.

Conclusion

Given the recent economic environment and a new emphasis on due diligence prior to allocation, it is natural that investors are looking for increased controls on their allocations over the life of the investment. This trend is where Managed Account Platforms can prosper.

These Platforms provide an extra level of controls on the Fund. They can also provide increased reporting and flexible liquidity. They can effectively supervise the Fund Managers actions and investments closely, in a way not possible in a traditional Fund Manager - Administrator relationship.

While this structure won't be for every Manager, the access to new capital allocation as well as the on-going demand from investors should mean a bright future for Managed Account Platforms.

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www.globalperspective.co.uk
Email: Shane@globalperspective.co.uk
Phone: +44 (0) 20 3239 2843

• New regulatory requirements - including FATCA, AIFMD & the JOBS Act,

• Future operational trends - including Operational Due Diligence & Managed Account Platforms,

• Emerging Service Provider opportunities – including Hedge Fund Administrators,

• Hedge Fund investment strategy - including new emerging investment opportunities,

• Best practice change management – how to manage Hedge Fund industry change.

The "Future of Hedge Funds" also examines the current and future global economic environment and what this will mean for Hedge Funds in the years ahead.

Available from Amazon in paperback here-

www.amazon.com/Future-Hedge-Funds-Trends-industry/dp/1481130226/

And for Kindle here-

www.amazon.com/The-Future-Hedge-Funds-ebook/dp/B00AHACY8Y

Shane Brett is an expert in Hedge Funds, Asset Management and the wider global economy.

He is the founder of Global Perspectives, the Asset Management & Hedge Fund Consultancy.

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www.globalperspective.co.uk
Email: Shane@globalperspective.co.uk
Phone: +44 (0) 20 3239 2843