

WHITE
PAPER

Alternative Managed Accounts: Opportunities in Fund Administration

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Overview: Opportunity Calling

Institutional investors are steering more and more of their alternative investments from hedge funds to managed accounts, posing a new and potentially lucrative opportunity for fund administrators. Administering a multiple managed account platform is beyond the core competency of the vast majority of institutions, and they are looking for help. Administrators that can successfully leverage their infrastructure and adapt their skills to the needs of institutional investors will have the opportunity to expand their business into a whole new market beyond hedge funds.

According to a Moody's Investors Service report, the top ten managed account platforms had \$41 billion (or around 2% of all hedge fund assets) as of mid-2010. And the market is growing quickly. TABB Group research estimates that the amount of money invested in alternative managed accounts will reach \$790 billion in 2011, a jump of nearly 70% over 2009. As a result, a variety of players—from money center banks to wirehouses to fund-of-funds providers—have leapt into the fray to offer managed account platforms.

With investors driving the market rapidly in the direction of managed accounts, fund administrators will not want to be caught behind the curve. Many already have the operational building blocks in place, combined with the accounting talent and experience in working with multiple managers, to administer managed account platforms for investors.

Still, launching a managed account platform is a formidable undertaking. Firms must decide for themselves whether they are in a position to take it on, and whether the opportunity makes sense economically to justify a commitment of substantial resources. This document is intended to help administrators understand what it takes to serve this new market. It spells out the six essential ingredients of a successful managed account platform and the technology required to support it.

Why Managed Accounts— and Why Now?

In the years leading up to 2008, many institutional investors, attracted by the benchmark-beating returns they historically delivered, steered significant percentages of their portfolios to hedge funds. Then came the market meltdown, and hedge funds were hit particularly hard. Not only were investors stung by large losses, but many found their funds “gated”—they could not redeem their shares at any price. With a lack of transparency around leverage, exposure and liquidity, many investors did not fully understand the extent or the nature of the risks the funds entailed.

Hedge fund investors came to realize how interdependent they had become with each other as part of commingled vehicles. For example, if a critical mass of investors suddenly decided to reduce their holdings within a fund, some managers needed to prematurely exit positions to provide



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liquidity for redemptions, jeopardizing less-liquid strategies and adversely impacting overall fund performance for remaining investors.

Having to answer to their own constituencies and governing boards, institutional investors sought a way to access hedge fund strategies without incurring the operational and liquidity risks that made the funds so vulnerable to market volatility. The solution: managed accounts, run by experienced hedge fund managers pursuing alternative investment strategies.

Hedge fund managers have long been accustomed to operating with a relatively free hand, with few questions asked as long as they delivered the returns investors desired. In the new environment, however, many managers have proven amenable to managing separate accounts, notwithstanding the extra operational and administrative costs involved, in order to attract or retain institutional capital that might otherwise go elsewhere.

Transparency, Liquidity, Flexibility, Control

Long a mainstay of traditional, “long-only” money management, managed accounts have taken on a new role in the alternative sphere. Often referred to as “hedge fund managed accounts” or “alternative managed accounts,” these new accounts appeal to institutional investors for a variety of reasons.

Direct ownership of assets. In a hedge fund, the fund entity owns the underlying assets. The investor simply owns shares or units of the fund and sees only the net asset value of the fund. In a managed account, the assets are custodied in the name of the investor. The investor, therefore, has total visibility into the portfolio’s holdings, weightings and exposures.

Separate management. In a managed account, the investor’s assets are not commingled with those of others. There’s no risk of a “redemption run” when several investors try to exit a fund at once, resulting in illiquidity and gating of the fund.

Control. The investor has more direct control and can establish more precise mandates for each portfolio, as opposed to “buying in” to a manager’s stated strategy.

Transparency. Investors can obtain position-level information across multiple managers, giving them a better idea of what’s going on in the account and the risks involved, and enabling them to take necessary action.

Reduced fraud risk. The Madoff scandal served as a vivid reminder of the potential for fraud anytime investors entrust their money completely to a manager. Managed accounts reduce that risk by taking ultimate control away from the manager and placing it with the investor.

Liquidity. Managed accounts do not bear the liquidity risks of hedge funds, for the reason of non-commingling cited above, as well as reduced counterparty risk where assets can be frozen with prime brokers or custodians.

This paper primarily focuses on single investor managed accounts—bespoke vehicles in which an investor’s assets are segregated from other investors. Note that there are variations on the managed accounts theme, including multi-investor platforms, that are associated with similar benefits and challenges.

The Challenges: Many Moving Parts

Attractive as managed accounts may be, however, the barriers to entry for institutions are significant. In the hedge fund model, one manager serves multiple investors. The managed account model is exactly the reverse—one investor must oversee multiple managers. Few institutions have the operational infrastructure to deal with the complexity of aggregating data in different formats from multiple managers, or the accounting expertise to properly value multiple investment vehicles.

In a typical managed account program, the investor will take a sum of capital (e.g., \$1 billion) and divide it evenly into “sleeves” (e.g., 10 sleeves of \$100 million) each run by a different manager. The first challenge arises in dealing with so many different components. Each investment vehicle is a separate legal entity with its own rules, terms and mandate. The managers will likely have different formats for trade files. They will be trading different types of securities and in different currencies. The investor has to track its capital commitments to each manager. The complexity is beyond the scope and outside the core competencies of most institutions, which is why all but the very largest are likely to seek an outside administrator.

From an administrator’s point of view, the biggest challenge is the level of custom integration required—and the resulting cost—to exchange data with multiple managers. Putting the right kind of infrastructure and flexible processes in place at a price point that makes sense is difficult to figure out. When a firm is the administrator for, say, a \$2 billion hedge fund, the revenues justify the investment of time and resources to build the interface necessary to service the fund. Building 10 such integration points to process accounts of \$100 million each on behalf of an investor is another matter. You need to determine not only whether your existing infrastructure is up to the technological challenge, but also whether the investment required is likely to pay off economically.





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The Six Pillars of a Sound Platform

What is required to bid for, win and successfully execute on a managed account administration mandate? Here are the six essential underpinnings that sponsors are looking for and administrators must be prepared to deliver.

1. Meaningful consolidated reporting. One of the main reasons investors are turning to managed accounts is the ability to see and understand what is happening with their investments beyond just the NAV. The administrator’s primary role is to aggregate the data coming

 When your client becomes one investor with multiple funds, the type of information that needs to be tracked changes considerably and your systems must be adapted.

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from different managers in different formats and turn it into clear and consistent reports. For example, investors want reports that enable them to compare relative performance of various managers, monitor exposures (by strategy, asset class, manager, etc.), and identify various risks across a portfolio.

2. **Position-level transparency and data analytics.** Another attraction of managed accounts is having access to data on the underlying holdings. Because the investor owns the assets, the investor should have access to position-level reporting not previously available. The investor and the administrator need to figure out how to make the best use of that data, whether for risk reporting, performance analysis or any other purpose that strengthens the investor's control.
3. **Integration with fund managers, brokers and custodians.** Two-way communication with the multiple parties involved in the execution of a managed account can be a daunting endeavor. Not only do you need to gather trade activity data in various formats via different channels, but you also need to reconcile with them and provide error and log files needed to verify and confirm position and transaction data. Your technology platform needs to have the flexibility and scale to support multiple custom interaction points.
4. **Accounting expertise.** Alternative managed accounts are likely to include derivatives and hard-to-value holdings much like hedge funds. You need people who understand the nuances of the instruments managers are trading—for example, how to properly process an account for paydowns on bank debt or variable credit facilities—and how they need to be treated and configured in your systems.
5. **Timeliness of data.** Your portfolio accounting system should have the flexibility to allow you to report on specific time horizons and knowledge dates, and to differentiate between best available data and actual close period data.
6. **Effective investor record keeping and reporting systems.** Administrators who want to serve managed account investors will need to adapt their record keeping and reporting systems to be able to track capital flows and commitments for the investor. Most administrators' systems are built around the hedge fund model—one fund, multiple investors. When your client becomes one investor with multiple funds, the type of information that needs to be tracked changes considerably and your systems must be adapted.

Structure and Governance

Institutional investors entering into a managed account program suddenly find that they are responsible for many details previously left to the hedge fund manager. They need proper legal counsel on fund formation, structuring, domiciling and governance. They may well look to administrators for guidance on matters where they lack experience, such as offshore

funds. Investors will also want to consider some sort of oversight that is independent of both the investor and the platform to keep tabs on managers and further manage risks. Administrators must be able to account for a wide variety of different legal entities with different structures, rules, restrictions and governance.

Technology Requirements

For many administrators, strength in technology is likely to be the key determinant of success in servicing institutional investors. The three essential components of an effective technology platform for managed accounts are:

- 1. A robust portfolio accounting engine.** Your core “books and records” system needs to be able to support complex investment strategies and multiple fund structures. It has to accommodate the full breadth of security types being traded. It should have the flexibility to extract the data you need in the format best-suited for presenting to the client.
- 2. Flexible integration capabilities.** Your systems need to easily integrate with those of multiple fund managers so that you receive, confirm and reconcile trade data seamlessly and automatically. Interfaces should be easily customizable to accommodate different trade file formats.
- 3. Comprehensive reporting.** You need the ability to aggregate data from multiple managers into detailed reports and analytics that investors require. Your system must enable you to provide accurate, consolidated position-level reporting every day so investors can manage risks, monitor adherence to mandates and make adjustments as necessary.

Firms that invest in the right technology and leverage it as a differentiator will have a decided competitive advantage in pursuing managed account administration mandates.

Conclusion: Positioning for Growth

The amount of capital invested in managed accounts with alternative strategies is expected to grow rapidly in the near term, as institutional investors increasingly turn to these vehicles for the advantages of transparency, liquidity and control. Hedge fund managers that are amenable to running separate accounts alongside their funds stand to benefit from the trend.

The vast majority of institutions investing in managed accounts do not have the internal resources nor do they want to administer a multiple managed account platform. For that, they look to independent third-party administrators.

This adds up to a big opportunity for fund administrators, not only to capture more assets under administration, but also to engage directly with investors and grow their client base beyond their traditional hedge fund clientele. To capitalize on the opportunity, however, administrators will



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need to adapt to a model that is the opposite of the hedge fund model—one investor, multiple managers. They will need to meet exacting requirements for consolidated reporting, position-level transparency and analytics capabilities. And they will need the robust technology infrastructure and integration capabilities to handle the complexity that a managed account platform entails.

With the right level of commitment, the right accounting skill set and the right technology, fund administrators can position themselves to take advantage of this growing opportunity in managed account platforms.

About Advent Software

Advent Software, Inc., a global firm, has provided trusted solutions to the world's financial professionals since 1983. Firms in more than 50 countries rely on Advent technology to run their mission-critical operations. Advent's quality software, data, services and tools enable financial professionals to improve service and communication to their clients, allowing them to grow their business while controlling costs. Advent is the only financial services software company to be awarded the Service Capability and Performance certification for being a world-class support and services organization. For more information on Advent products visit <http://www.advent.com/about/resources/demos>.

About Maples Fund Services

Maples Fund Services is an independent global fund services provider. It has offices in a number of leading financial centres including the Cayman Islands, Dubai, Dublin, Hong Kong, Luxembourg, and New York. The firm provides a full range of fund administration services to onshore and off-shore funds. The firm's clients come from a wide range of investment management firms and global financial institutions. Maples Fund Services is led by a team of experienced professionals and is committed to providing a high level of service, tailored to specific client requirements. For more information, visit www.maplesfundservices.com.



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