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Implementing a hedge fund dedicated managed account program with limited staff

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By Joshua D Kestler(pictured), President & Chief Operating Officer, HedgeMark – ***Dedicated Managed Accounts (DMA) are typically single investor funds established for the exclusive use of, and owned and controlled by, an institutional investor, such as a public or private pension plan. The benefits of using DMA structures for hedge fund investments are clear – transparency, asset control, cash efficiency, customisation of investment strategies and structures, and the ability to negotiate discounted or custom fee arrangements with hedge fund managers.***

While these benefits are clear and should lead most large institutional investors to establish DMA platforms, many investors express concerns over their ability to implement such programs with limited in-house staff. This article highlights how the use of a managed account platform provider, like HedgeMark, can empower investors to launch their own DMA platforms efficiently, while reducing the time commitment required by existing internal staff.

Platform and fund implementation

Both the initial structuring of the platform as well as subsequent fund launches involve significant work and complexity. As an initial matter, the investor has to make various structuring decisions relating to its DMA platform including, amongst other things, the specific fund structure (both domicile and vehicle type), governance model (internal vs. external board) and platform service providers (fund administrator, auditor, legal counsel). The role of the platform provider is to support the investor in developing a platform structure and selecting service providers that meet its needs and objectives. A variety of fund documents and agreements will be required both to establish the platform and to launch each fund. These documents include fund governing documents (eg memorandum and articles of association, LLC or LP Agreements, etc), an investment management agreement with each hedge fund manager and various trading and counterparty agreements and account opening forms (eg prime brokerage, FCM, ISDA/CSA, MRA/GMRA, cleared derivatives). The negotiation of these documents and completion of the many account opening forms require expert resources who understand prime brokerage, derivatives and the intricacies of the necessary documentation (including market standards and key considerations). A good platform provider will manage the documentation and account opening process for the investor. Sophisticated platform providers have relationships with bulge-bracket prime brokers and counterparties with whom they have developed launch protocols, allowing the platform provider to more quickly and efficiently navigate the complex approval and account processes than if the client were to do so themselves; and have developed template documents (including IMAs and brokerage documents) which their clients and client counsel can leverage, resulting in reduced external legal expenses and faster time to launch. The use of a platform provider to manage the platform and fund launch process should significantly simplify this process and minimise any resource burden on the investor.

Ongoing fund operations and data management and reporting

Two of the key benefits of DMAs are control and transparency. The ability of an investor to properly take advantage of these benefits requires significant resources and sophisticated technology. An investor needs to decide whether it has (or is willing to hire or build) the necessary staff and technology to support its platform or whether it would prefer to outsource these functions to a platform provider. Working with a platform provider allows the investor to outsource certain critical aspects of the operational infrastructure, middle office services, managed account expertise and hedge fund risk monitoring and analytics.

The DMA structure shifts control of fund governance, service providers and day-to-day operations from the hedge fund manager to the investor while the manager merely retains the authority to trade the account in accordance with the agreed investment guidelines. The investor is now responsible for many of the non-investment functions that were previously performed by the hedge fund manager for its commingled fund. The primary purpose of the platform provider is to take on these non-investment functions allowing the investor to avoid building a large internal team to support its platform. The platform provider will take responsibility for the day-to-day oversight of fund service providers (including the fund administrator) and provide various independent checks, middle office services and monitoring and reporting functions (eg NAV review and reconciliations, monitoring of investment guidelines, cash and margin movements, trade-related payments, risk and performance reporting, audit coordination, etc).

A good platform provider also provides significant value to the investor by helping to manage and make sense of the large volume of data that is available due to the position-level transparency afforded by a DMA structure.

Sophisticated platform providers have the technology and staff to enable them to receive and process the managed account data and provide the investor with high quality, daily (T+1) risk and performance data including investment guideline monitoring, performance attribution, stress testing, scenario modelling, and Value at Risk (VaR) statistics. This technology can provide the investor with user-friendly, daily, weekly or monthly reporting on exposures and performance both at the individual fund level as well as aggregated data across the investor's entire platform portfolio.

Conclusion

Large institutional investors often face staff and resource constraints which may deter them from establishing a DMA program despite the many benefits. Outsourcing to a managed account platform provider can empower these investors to take advantage of these benefits without the need for additional staff or technology development.

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