THE LONG VIEW

JOSHUA KESTLER

Can dedicated managed accounts keep investors interested in hedge funds?

> “DMAs PROVIDE INVESTORS WITH THE ABILITY TO SEE, MONITOR AND ANALYSE DAILY PERFORMANCE”

Calpers' recent decision to eliminate its hedge fund program has received significant industry attention and has further focused the institutional investment community on many of the key challenges faced by investors when accessing the asset class. While Calpers cited the "complexity, cost, and the lack of the ability to scale at Calpers size" as the rationale for eliminating its hedge fund programme, there are other key issues with traditional hedge fund investment structures for investors to consider such as transparency (or lack thereof). I do not believe that Calpers' decision is indicative of a larger industry trend, but I do think that many of the issues they raised will continue to garner the attention and focus of investors. The question investors should be asking going forward is: "Are there better options available to institutional investors than significantly reducing hedge fund exposure or exiting the asset class altogether?" The answer is a definitive yes – Hedge Fund Dedicated Managed Accounts (DMAs).

A DMA is a customised single investor hedge fund with portfolio assets ultimately owned (and controlled) by the investor. DMAs provide numerous benefits including greater control, transparency and governance of hedge fund investments, the ability to customise investment mandates and structures, and the potential for fee compression. Several of these benefits directly address the issues noted above.

FEES

In the current marketplace, large allocators have significant leverage to negotiate material reductions from the standard 2% management fee and 20% incentive fee structure used by hedge funds. The DMA structure provides such investors with the opportunity and flexibility to negotiate a discounted and/or tailored fee arrangement with each manager. A DMA is a separate vehicle and can often have key differences from the manager's commingled benchmark fund, such as reduced operational burden on the manager, differences in investment strategy and guidelines. DMAs also allow the investor to design custom fee structures such as fixed or flat management fees, incentive fee hurdles, multi-year (deferred) incentive fees and performance claw-backs. These fee structures can work to better align the interests of the manager with those of the investor.

COMPLEXITY

The historical lack of transparency in traditional hedge fund structures has made it much more complex for investors and their advisors to effectively analyse, select and monitor managers (both on an individual basis and as part of a broader portfolio). Transparency is a core benefit of investing in DMA structures. DMAs provide investors with the ability to see, monitor and analyse daily performance, performance attribution and risk exposures. The frequency and granularity of this data should allow the investor and/or its advisor to more effectively manage their hedge fund portfolios.

SCALABILITY

DMAs offer investors a variety of solutions to scaling their investment with a particular manager. A DMA allows an investor to segregate its assets from assets managed for other clients. The DMA structure can eliminate co-investor risk and when considered in combination with asset control and transparency, mitigates many of the risks associated with being a particularly large investor in a fund. DMAs also allow a client to customise strategies such that they can absorb significant scale.

Finally, the daily transparency and control available in a DMA structure should allow investors to achieve greater comfort with making larger and more concentrated investments with managers.

CONCLUSION

An allocation to hedge funds, and the promise of less correlated, lower volatility investment returns, typically comes with the steep price of higher fees, coupled with a lack of control, transparency and governance. As a consequence, investors will continue to review their approach to hedge fund investing. Institutional investors should understand that there is an alternative to reducing their exposure to hedge funds or exiting the asset class altogether – Dedicated Managed Accounts can provide a mechanism to address key issues and ultimately improve and enhance the hedge fund investing experience. ■

JOSHUA KESTLER is president and COO of HedgeMark, a BNY Mellon Company

THE SHORT VIEW

CHRIS MATTHEWS
c.matthews@hfmweek.com

Non-EU managers registered under the AIFMD received a welcome reprieve from the FCA after it confirmed master fund data is not required as part of Annex IV filings.

But what managers may not know is that the UK regulator's supervisory co-operation arrangement with the SEC will allow the FCA to gather the information from managers' existing Form PF filings.

With the first report deadline looming, the news is timely for the majority of managers working towards a 31 January submission date.

Annex IV reporting has caused headaches for many firms trying to implement the documentation and this paring back of reported information is a welcome development.

Anna Maleva-Otto, partner at Schulte Roth & Zabel, describes the move as "sensible" and notes that it will also benefit the FCA internally when it begins to wade through the mound of data filings in 2015, as covered in our front-page story this week.

Signed by the SEC and Esma in July last year, the co-operation agreement permits information sharing between financial regulators in the 25 EU and three EEA member states and the US regulator, while the FCA signed its first co-operation agreement with the SEC back in March 2006.

Calls for stronger ties between the SEC and European regulators have been growing for some months. Sister title *HFMCompliance* revealed in June that the FCA was leading a behind-closed-doors initiative to better harmonise reporting globally.

Although nothing has been finalised, the FCA's decision to omit master fund data from non-EU AIFMs' checklists offers firms some relief amid escalating regulatory demands. ■