THE RISE OF THE PRIVATE PLATFORM

Andrew Lapkin and Joshua Kestler, of Hedgemark, speak to *HFMWeek* about new trends in how managed accounts are being used

Andrew Lapkin is chief executive officer and is responsible for the overall management of the firm. Prior to joining HedgeMark in 2011, Lapkin was the co-founder, president and chief operating officer of Measurisk, a JP Morgan company formerly affiliated with The Bear Stearns Companies.

Joshua Kestler is president and chief operating officer, and is responsible for oversight of legal/compliance, structuring, onboarding, accounting, operations and business development.

HFMWeek (HFM): HedgeMark experienced another year of strong growth in 2016. Were there any particular factors that played a role?
Andrew Lapkin (AL): You can think of 2016 as being a year of the private platform. HedgeMark is a specialist in helping institutional clients set up and operate their own private managed account platforms. In 2016, we began relationships with a number of large alternative asset managers seeking to create their own managed account platforms. We have seen an increased recognition in the benefit of having a platform that is tailored and customised for the investor. Investors have also become more focused on the issue of portability. That is, the ability to not have a disruption in any of their investments or investment structures if they needed to make a change to a provider. HedgeMark is a service provider to the client and the client's funds, but is not the platform owner. We create and operate managed account platforms for our clients, but the platforms are sponsored, named and owned by the clients themselves. Many investors have begun to recognise the importance of not having their platform structurally entwined with their platform provider. As a BNY Mellon company, HedgeMark is following a similar playbook to the bank's traditional investment services solutions. Clients want a strong, stable counterparty, but also one that provides the core non-investment services and allows clients the greatest flexibility and customisation.

Josh Kestler (JK): We also believe that another key factor to HedgeMark's success has been the robust nature of our platform offering. The full benefits of a managed account platform can only be achieved if the role of the investment managers is limited to trading the accounts. HedgeMark is one of the few platform providers that supports a structure where all non-investment functions are performed by the platform provider rather than the manager. For example, HedgeMark performs its own reconciliations, executes all cash and collateral movements and reviews and approves the NAV of each fund. HedgeMark has hired specialised staff and developed custom technology to support these operations and accounting functions across a broad range of investment strategies. We want to offer clients the ability to achieve all of the potential benefits of managed accounts unlike other platforms and fund-of-one structures where the manager maintains control of key operational functions and oversight of service providers.

HFM: What are the differences between a fund-of-one and a managed account?
JK: Investors should, but often don't, understand that there are key differences between a fund-of-one and a managed account. A fund-of-one generally refers to a fund created and controlled by a hedge fund manager for a single investor. In a fund-of-one structure, the manager rather than the investor typically controls the service provider relationships such as the administrator and auditor used for the fund. The manager would continue to have authority over key operational functions such as the ability to move cash and sign off on the final NAV of the fund. While a fund-of-one can remove co-investor risk, it does not achieve all of the potential benefits of a managed account, including limiting the manager's authority to trading authority only. Control of the vehicle remains with the manager which is one of the core tenets that we seek to change in a managed account structure. Unfortunately, many investors believe that they are receiving the same potential benefits in a fund-of-one structure that they would in a managed account. To complicate matters, many platforms market fund-of-ones as managed account offerings. The industry still requires significant education on the differences between these structures.

HFM: The term "structural alpha" has emerged as a benefit of why investors are increasing the use of managed accounts. Can you explain?
AL: Structural alpha is the ability to increase the net return of a manager as a result of the structure of the investment. Investing via a Dedicated Managed Account (DMA) provides a number of mechanisms by which investors may lower their overall fund expenses. The three most common aspects of structural alpha from a DMA include:

One, lower fund expenses. An investor's private platform utilises their own service providers and offers the opportunity to consolidate providers and obtain economies of scale. Additionally, a single investor DMA fund is inherently less

complex, and simpler to operate than a manager's commingled hedge fund. Most investors will realise savings on the fund administration fees and can eliminate manager pass-through expenses as well as other common expenses not required for the single investor fund.

Two, cash efficiency. Many hedge fund strategies are inherently cash efficient. That means that there is often a large cash balance sitting as an offset to the actual positions. In a managed account, the investor has control over this cash. A small incremental cash return can add meaningful cost savings as compared to a fully funded investment in a manager's fund.

Three is the category of 'other'. This will vary by strategy, but as an example, a pension fund investing in a long-biased equity fund would have control over the long equity book and could add a security lending programme to their investment strategy to generate additional return. This type of decision making regarding structural alpha benefits can be achieved when investors own and control their assets through a dedicated managed account platform.

HFM: Hedge funds have been getting substantial negative attention in the marketplace; will this slow the growth of managed accounts?

JK: To the contrary. Much of the negative attention highlights very real issues that need to be addressed by both investors and hedge fund managers – such as high fees, limited transparency and control. While a few high profile investors have chosen to exit the hedge fund space as a way to address these issues, we feel that a greater number of investors still find hedge funds attractive, and are focused on solutions to these issues. Managed accounts address many of the core issues with hedge funds – control, governance, fees and transparency. As a result, we think the negative attention will actually lead to a significant increase in the use of managed accounts.

> “MANAGED ACCOUNTS ALLOW INVESTORS TO FOCUS ON THE INVESTMENT THESIS AND ASSET CLASS EXPOSURE”

AL: Another interesting trend is the shift away from the use of the term 'hedge fund' as an asset class. Managed accounts allow investors to focus on the investment thesis and asset class exposure. Talented managers are hired for their investment expertise in equities, credit, commodity and interest rates. Because the investment is set up using a managed account, the investor is no longer investing in a hedge fund. The manager is being used in a manner similar to an investor's long only mandates where they just hire the investment manager to implement a particular strategy.

HFM: What other trends are you seeing in regards to the use of managed accounts?

AL: Transparency. While the benefit of transparency has been a key tenet of managed accounts, only recently have investors begun to effectively leverage the transparency. HedgeMark has made major technology investments over the past several years to provide clients with all of the tools needed to access and interpret the large amount of performance and risk information available for managed accounts. Custom reports, online dashboards and a web services application programming interface are just a few of the ways clients can access information. Importantly, our risk analytics have the ability to incorporate both platform and non-platform assets. In this way, clients can use our risk reports to capture how their managed accounts fit within a broader hedge fund or global, multi-asset class portfolio. We are also seeing an increased focus on active portfolio management. Managed accounts provide investors with the ability to leverage the transparency to support more active rebalancing or even portfolio overlays. As an example, a client might want to monitor their equity beta across all funds, and then add an equity hedge if the beta exceeded their desired level. The daily transparency and T+1 reporting afforded by managed accounts make this possible. ■