

Investor transparency

The winning formula for hedge funds

WHITEPAPER

Investors of all types have become more sophisticated. Increasingly, we exist in a real-time, data-driven world. That is fueling expectations of instant and seamless access to information across all aspects of our lives, investments included.

Investor transparency

Transparency has become a critical consideration in investors' decision-making processes.

A joint SEI/Preqin survey¹ of institutional investors across the alternative asset industry found more than half (54%) said transparency is an extremely important consideration when evaluating funds and managers. The remaining 46% agreed it is an important factor.

Similar concerns were evident in a 2017 Northern Trust/Economist Intelligence Unit survey². "Degree of transparency" was cited as "very important" by 63% of respondents, making it their top investment consideration—ahead of regulations, the firm's investment policy and fees.

Investors want greater transparency for a variety of reasons, according to a follow up study³. Key among them are a need to:

- See and understand a manager's processes to be comfortable with an investment.
- Understand exposures and allocations for risk and stress testing.
- Understand liquidity details to manage cash flows and meet obligations.
- Forecast market liquidity to plan for volatility or unforeseen events.
- Have understanding of and confidence in valuation practices to satisfy audit requirements, support ASC 820/IFRS 13 reporting and assess risk.
- Confirm that assessed fees match legal documents.
- Have detail on fees to assess value creation.
- Demonstrate due diligence has been properly conducted on controls.

However, transparency expectations continue to lag reality. The SEI/Preqin survey notes only 19% of investors had seen significant changes to transparency levels over the preceding three years, while 28% had seen little or no change.

Investor frustration at the level of transparency available to them extends across a number of areas. Operating expenses are a particular bugbear, with three out of four investors saying they are not transparent enough. European and North American investors are most dissatisfied (85% and 76% respectively), while it is less of an issue for Asian investors (29%).

Perceptions vary too between managers and investors. The SEI/Preqin survey found general partners are much more likely to believe the levels of transparency provided to their limited partners (LP) are sufficient. This disconnect between managers' and investors' viewpoints extends across every category covered by the survey, but is especially marked when it comes to operating expenses, fee amounts and how they are structured, and performance attribution.

Clear requirements

Enhancing transparency through better and more frequent reporting will be key to addressing investors' concerns and dissatisfaction. As the SEI/Preqin survey noted, "it's reasonable to think that LPs who receive clear and comparable reports from their managers are more likely to trust their managers and feel that nothing is being concealed."

The old days of hedge funds providing a monthly or quarterly investor statement with a basic headline NAV figure and how it has changed, or some pie charts that show high-level exposures and positions by asset class, industry and geography are

gone. Transparency and granularity—enabling investors to monitor and analyze their portfolio composition, performance and risk exposures—are now essential.

Much of this shift reflects the institutionalization that has transformed the hedge fund sector over the last decade. Institutional investors have exacting fiduciary responsibilities to their stakeholders. Fulfilling those duties requires more frequent and detailed information on the activity, composition and performance of their portfolios, to understand what has changed over the period and why.

But it is not just institutions. Investors of all types have become more sophisticated. Increasingly, we exist in a real-time, data-driven world. That is fueling expectations of instant and seamless access to information across all aspects of our lives, investments included.

Inevitably, this demand for detailed oversight becomes even more stringent during down or volatile periods. With the performance gloss coming off the hedge fund sector in recent years, pressure has grown on fees, as investors have become increasingly intent on seeing what they are paying for.

¹ *How to Meet Operational Challenges While Pursuing Opportunities Investing in Alternatives*, SEI and Preqin, January 7, 2018, <https://sei.com/en-gb/knowledge-center/how-meet-operational-challenges-while-pursuing-opportunities-investing>

² *The Path to Transparency in Alternatives Investing*, Northern Trust and Economist Intelligence Unit, June 20, 2017, https://www.northerntrust.com/documents/campaign-landing/cis/2017/path-to-transparency.pdf?CMPID=Alts_Paper_#2_Results_Paper_Embed

³ *Alts Transparency: Finding the Right Balance*, Northern Trust, October 19, 2017, <https://www.northerntrust.com/documents/campaign-landing/cis/2017/alt-transparency.pdf>

Providing real transparency depends on an ability to look-through into the underlying investments and fund structures, to see precisely where money has been invested and the resulting returns, risks and exposures.

Moreover, investors have an expanding range of options. They no longer need to allocate money to a hedge fund to access hedge strategies and alternative assets. If hedge fund managers don't provide the detailed look-throughs their clients want, investors may opt to go elsewhere.

Two birds with one stone

While hedge funds face investor pressure to deliver clear and effective transparency, it can also serve as a selling point, helping to differentiate firms from their rivals. Transparency offers an opportunity to both inform and educate investors and their stakeholders on the benefits a fund can provide. That can help boost client retention and attract fresh inflows.

In addition, there are close parallels between the information investors want and the data needed to meet hedge funds' evolving regulatory requirements. The right infrastructure allows hedge funds to drill down into the most granular version of their business, and analyze and collate that information in different ways. They can then report to investors and regulators in a more efficient, automated manner. This flexibility also helps future-proof hedge funds' compliance capabilities, equipping them to meet any subsequent regulations without needing to throw bodies at the problem.

Tools for the job

Providing real transparency depends on an ability to look-through into the underlying investments and fund

structures, to determine where money has been invested and the resulting returns, risks and exposures.

Ultimately, that depends on data—being able to capture sufficiently granular data, having the controls around it to ensure its integrity, and assigning attributes to that data so it can be sliced and diced for information collation. By tagging the data at a granular level in this way, it becomes possible to track the lifecycle of the capital that comes into a fund, look through into complex investment structures, and report that data back to investors.

A robust and interconnected portfolio management, performance measurement and reporting infrastructure will be key. It needs the flexibility to manage any type of fund structure and instrument in any region, and combine it with the tools to deliver real-time performance, P&L, position and exposure information. This information must then be available for investors to access at the time and via the channel they want.

Delivery service

Delivering the level of transparency investors (and regulators) want is fast becoming an imperative. The only question is how best to meet that demand.

Hedge funds have a number of options:

- Employ (or redeploy) more people.
- Maintain a proprietary or third-party IT infrastructure with the requisite functionality in-house.

- Outsource to a dedicated service provider.

The determination then comes down to a balance of which option offers the best return on investment, most effective capabilities, appropriate controls and greatest flexibility for the future.

Ensuring transparency with SS&C Advent

SS&C Advent is ideally equipped to help hedge funds meet their investors' evolving transparency requirements. Our comprehensive and flexible portfolio management and reporting solutions ensure firms have the tools to provide investors with on-demand and interactive information that shows how their portfolios are allocated, and how they are performing in easy-to-follow formats with just the right level of detail. Users can implement our solutions on-site or leverage our industry-leading hosted offering, giving hedge fund managers the operational flexibility to meet all their current and future needs.

With a world-class suite of tools at your fingertips, your firm can satisfy clients' and prospects' transparency expectations, and be well-placed to thrive in this fast-changing environment.

To learn more about the right SS&C Advent services for you, contact advent@sscinc.com.



advent.com | advent@sscinc.com

© 2018 SS&C Technologies Holdings, Inc. WP-001-AD

This communication is provided by SS&C Advent for informational purposes only and should not be construed as or relied on in lieu of, and does not constitute, legal advice on any matter whatsoever discussed herein. SS&C Advent shall have no liability in connection with this communication or any reliance thereon.