

THE FLIGHT TO QUALITY

There has been a seismic shift in the way institutional investors approach their hedge fund allocations, prompting global hedge fund managers to evolve their approach to meet this new opportunity, according to **Ian Headon of Northern Trust**

With *HFMWeek's* latest industry survey (May 2010) results showing the global hedge fund industry now has US\$2,700bn of assets under management, it is clear the market events of 2008 and the subsequent liquidity storm did not herald the 'beginning of the end' for institutional investors' appetite for hedge funds. However, these events and today's continued fragile global operating environment have created four compelling investor themes: asset control, liquidity management, transparency and counterparty exposure.

As a result, institutional investors are changing the way they access the hedge fund community as they look for a variety of investment options and more regulated fund products to meet their new requirements. It is critical that hedge fund managers understand these needs as they compete for new investor flows. These demands on the structure of hedge funds can be broadly divided in four different areas across the industry:

1) GREATER INVESTOR CONTROL

In our experience, the hedge fund community has recognised that there are greater investor concerns around governance, control and transparency, and have responded through:

- Deeper performance and risk analysis reporting
- More frequent valuations
- Provision of portfolio transparency to investors
- Greater investor involvement in corporate governance
- Reviews and updates to fund documentation

To meet the demand for greater investor transparency, administrators need to have the technology and expertise to provide their clients with access to more sophisticated tools and greater breadth and depth of data delivered more quickly than before. This ultimately requires significant investment from administrators, as demonstrated by Northern Trust. Our Hedge Fund Monitor™ solution has been specifically designed to allow for the fund of hedge funds manager, and institutional hedge fund investor, to track the performance, liquidity, counterparty exposure, foreign exchange exposure and scenario analysis for a portfolio of hedge funds.

2) UCITS

Undertakings for Collective Investments in Transferable Securities (UCITS) are investment funds permitted to



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operate throughout EU member states after approval by domestic regulators in one member state. Under UCITS III, investment managers are permitted to use alternative investment strategies such as leverage and synthetic shorting for investment purposes. While it is too early to say how great the trend in UCITS hedge vehicles will become, many institutional investors are showing considerable interest as they favour the protection, restrictions and greater opportunity for distribution.

3) REGULATED FUND JURISDICTIONS

While the global hedge fund industry is already widely regulated, many vehicles are located in lighter-touch jurisdictions. There is now a shift to more widely recognised 'regulated' fund vehicles, in jurisdictions such as Ireland and Luxembourg, together with the Channel Islands and Malta as investors value the greater layer of investor protection and investor regulation offered in these jurisdictions.

4) SEPARATELY MANAGED ACCOUNTS

Other hedge fund managers are setting up separately managed accounts specifically tailored to meet a large institutional investor's needs. These vehicles are more suited to institutional investors who have a highly established hedge fund investment infrastructure, which enables them to benefit from the high levels of control available.

SUPPORTING KEY TRENDS

Northern Trust has more than 15 years' experience supporting complex multi-strategy and multi-domiciled hedge funds for leading hedge fund managers and has been focused on supporting emerging trends by creating solutions for clients including:

- Assistance with the creation and structuring of UCITS III absolute return vehicles supported by the development of a global operating model
- Project management to support the redomiciliation of hedge funds
- The creation of reporting, processing and asset servicing solutions for separately managed accounts.

LOOKING FORWARD

It is clear that hedge fund managers will need to match up to greater investor scrutiny and demand for a variety of investment structures to ensure their futures. This underscores the importance of selecting a fund administrator 'servicing partner' who can demonstrate a commitment to meeting these evolving requirements through the ongoing development of data reporting and delivery tools within a flexible, global operating model. ■