THE LONG VIEW

BILL SALUS

The five key operational trends reshaping hedge funds

> "MANAGERS MUST APPLY THAT SAME INGENUITY USED IN THE FRONT OFFICE TO THEIR INFRASTRUCTURE"

Several watershed trends are impacting alternative investment managers, both hedge and private equity, in significant ways. Some may be on the longer-term horizon, such as the use of chain ledger systems which consolidate and eliminate the many intermediaries handling transaction information.

Others are just beginning to take shape, such as the use of augmented intelligence applications to distill the massive amount of investment-related information available today and deliver personalised, actionable data to investment managers, institutional and retail consumers through any medium and device at any time.

Some are more real today, such as the widespread use of low-cost securities in the form of ETFs and passive investment strategies taking a grip on global portfolio holdings and driving fees downward, or the constant barrage of regulatory and compliance reporting the sector is faced with.

These macro trends are pressing hedge and private equity managers into rethinking how they hire, how they create competitive performance distinction and how they manage their business and infrastructure. We see the following as active challenges and immediate trends:

Database management – An integrated database management platform is required, whether internal to the manager or with the assistance of outsourced/co-sourced/third party partners. The platform must first have the capacity to house all relevant portfolio, transaction and investor information.

It should also eliminate the redundant use of data for different purposes and have the ability to populate and combine market, performance and other analytical data.

Lastly, it should allow the manager to harvest information for GP and LP regulatory commitments. The goal is an efficient, cost effective platform that can be used to drive the manager's investment process and its unique positioning in the market.

Investor services – Simply put, investors will choose managers with efficient infrastructure that is automated to reduce offline manual workarounds and produce full transparency of the underlying assets and their performance. Operational due diligence exercised by investors now includes validating the institutional quality of manager infrastructure and their ability to produce accurate and adequate reporting.

Access – Alternative Investments are faced with delivering their products to smaller investors, perhaps even retail consumers, which requires a different platform for delivery and investor monitoring.

The trend is not towards smaller funds, but access to managed choices at lower monetary benchmarks than ever before. This has the effect of providing a virtual liquid market for illiquid securities. Taking it step further, an LP's ability to trade their interest alone, without impact to the fund, is a trend soon to be a reality in an exchange-like environment.

Fund administration – Fund administrators are taking on a new level of risk support for their fund managers, including cyber-security and compliance issues and requirements.

In meeting the demands of managers insisting on reduced expenses coupled with more comprehensive data management, service providers are developing fully automated, auditable launch services and fund accounting platforms, integrated with the manager's middle office.

In the private equity space, these include complex fee and waterfall calculations, along with management and reporting of underlying assets with no manual intervention, once the fund is live. In effect, a new service model is required for administrators' sustainability.

Fund manager CTO – Thrust into the centre of these trends is the CTO, who is now responsible for ensuring that manager costs are controlled, and that their operating platform is robust, secure and compliant. That's just the beginning.

The CTO must create an environment whereby the manager can pivot product development, respond to audits and support capital raises. Outsourcing, co-sourcing and other creative alignment with service providers is a critical aspect of the CTO's responsibilities.

Alternative managers are now faced with delivering value for a more demanding investor for lower fees. Managers are focusing on their investment process and tackling the difficult challenge of recruiting the talent.

Hedge and private equity managers must now apply that same ingenuity used in the front office to their infrastructure, in order to run an efficient, commercially viable business. ■

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THE SHORT VIEW

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Testing employees to evaluate your firm's vulnerabilities to phishing scams might not be the best method of measuring the human risk from 'internal' or 'inadvertent' cyber-security breaches.

According to Frank Ford, partner in Bain & Company's Emea information technology consultancy, a better and more realistic metric is the time it takes employees to report scams and suspected breaches.

This identifies what Ford terms 'security evangelists': mindful employees who are essential to maintaining a grassroots cyber defence.

"One of the mantras in our firm is that everybody's a compliance officer," says one CCO at a $4bn London-based asset management firm. "I'm just a resource. The front line is everyone sitting at their desks."

Almost 60% of security attacks in financial services originate internally, according to IBM's *Force Threat Intelligence Index 2017*, and more than half of 'attackers' are 'inadvertent actors' within the company, compared to less than 10% for communication, manufacturing and retail sectors.

At a panel event last month, a hacker-turned cyber-security consultant said that the most viable approach to minimising insider threats is to cultivate the right mind-set rather than impose specific rules.

An emerging theory is that the most effective way to grow your own cyber army is to use staff training to tackle personal security before company security.

Andrew Moir, head of global cyber-security practice at Herbert Smith Freehills, says increased media attention on cyber-attacks is already doing part of that work.

"We are seeing a trend where employees want to attend cyber-training, not only for the benefit of their employers but also for their own benefit, so any media coverage of cyber issues is helpful from that perspective," he says. ■