Generating Momentum:
Hedge Fund Trends for 2010 and Beyond

A Research Paper on the European Hedge Fund Industry
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In early 2010, as the European hedge fund industry emerged from a prolonged period of turbulence, two things were clear to most market participants: confidence was finally returning and major changes lay ahead, as evidenced by investor flows and an increase in new funds coming to market.

Three factors are driving the prospective transformation of the industry, namely:

- Regulatory uncertainty was rife, the draft Alternative Investment Fund Managers Directive (AIFMD) outlining significant changes in areas such as prime brokerage, custody, leverage, third-country marketing, remuneration, independent valuation and more.

- Traditional long and hedge-fund business models had started to converge with a significant crossover in terms of fund domicile, fund structure and potential investor base.

- With the growing institutionalisation of the industry, investors were demanding better transparency of information, enhanced liquidity and were engaging in a significantly expanded due diligence process prior to investing.

Against this backdrop, Citi’s hedge fund services team, part of the Securities and Fund Services business for Global Transaction Services, undertook a series of interviews with leading European hedge fund managers over the spring of 2010. The composition of hedge fund managers interviewed ranged between London based managers with average assets under management (AUM) of US$5 billion and continental European managers with average AUM of US$3 billion. The interviews gathered managers’ views of likely trends in the industry throughout 2010 and beyond, focusing on a number of key issues:

- Industry regulation
- Fund domiciles and structures
- Marketing and fund raising
- Management and incentive fees
- The demands of investors
- Fund valuation
- Governance models

One thing is certain above all: the findings do indeed point to changing times ahead.
Executive Overview

A number of salient messages emerged during the interviews conducted for this survey. Outlined below, they touch on the trends we are likely to see emerge from the European hedge fund industry this year and beyond.

"Prepare and Wait" on AIFMD Outcome
The managers interviewed are keeping fully abreast of the AIFMD and other regulatory developments. Most, however, are adopting a wait-and-see approach to the Directive prior to making any significant changes to their business models. There is a general consensus that the AIFMD will become a reality, with the scale of the challenges it poses for the industry depending on the final format adopted.

Cayman is Still the Leading Domicile
The Cayman Islands are still the predominant domicile for hedge funds. There is no widespread move to redomicile funds onshore ahead of final clarity on the AIFMD.

Onshore UCITS launches are prevalent among the larger managers, but still account for a small portion of overall hedge industry assets.

Institutional Pressures and Increasing Complexity
There is ongoing demand for managed accounts, particularly from large institutional investors.

Operational complexity is increasing as hedge fund managers offer a variety of products spanning traditional offshore domiciles, managed accounts and onshore domiciles.

Increasing institutionalisation of the investor base for hedge funds may lead to a two-tier manager community with big funds attracting the bigger players.

Investment in Marketing
Marketing and fund raising activities have been stepped up across the board with many managers adding staff and infrastructure. The successful marketing of UCITS brings additional costs and requires the maintenance of distributor relationships.

Intense Focus on Due Diligence . . .
Capital-raising continues to be difficult and time consuming. Investors are intensely focused on due diligence and require the active participation of hedge fund managers and their service providers. Investors in hedge funds run by European managers generally expect an external and independent administrator. Due diligence consultants are now frequently used, particularly by large institutional investors. Some institutions have added further experienced personnel to their in-house teams. Gathering startup capital is a challenge for most new managers.

“A much greater due diligence scrutiny now accompanies all net inflows.”

Interview Quote
... And Transparency
Investors value transparency, although their requests are generally seen as sensible – for example, FAS 157 (fair value measurement) disclosures, pricing policy disclosures and feeds to risk systems for consolidation purposes. Some due diligence consultants are actively seeking standard administrator disclosures around pricing, FAS 157 and counterparty concentration. There is also some evidence of a trend towards SAS 70-style reporting for the hedge fund manager.

Acceptance of Appropriate Liquidity Terms
Liquidity continues to be a focal point, although investors generally accept liquidity terms that match the liquidity of the underlying portfolio and give a good balance between performance and the ability to access capital.

Talk of Fee Pressure Overblown
There was one overriding comment from all managers with respect to fees: investors will continue to pay for performance.

Custody Versus Multiprime
Custody of assets is an ongoing topic of conversation for investors, hedge fund managers generally opt for multiprime relationships and potentially utilise "triparty asset segregation models" or "bankruptcy-remote vehicles".

Independent Directors
The composition of the board is seen as increasingly important. There is a distinct market preference for a substantial board with more independent directors. Investors are asking more questions about the composition of the board and expect to see boards in place that are active, independent, well qualified and challenging.

“There is a greater role for independent non-executive directors going forward.”

Interview Quote
The cost of complying with the AIFMD is widely seen as a drag on performance. But as yet, there is little sign that hedge fund managers are making widespread changes to their business structures.

Without exception, the hedge funds interviewed show no issue with regulation per se and are comfortable complying with the various regulatory requirements across the jurisdictions in which they operate.

**The Draft AIFMD Provoked Heated Discussion**

Many interviewees express bemusement at the areas the Directive focuses on. They are not persuaded that its provisions will reduce the systemic risk that hedge funds supposedly pose or will substantially increase investor protection.

There is a distinct preference for regulation that focuses on processes and procedures, such as risk management policies, a portfolio valuation process, the role of the board of directors and the use of external administrators and auditors. Transparency is repeatedly noted as exceptionally important — for regulator and investor alike.

The most contentious areas of the AIFMD for most hedge funds are:

- The imposition of the custody model, ignoring the almost overwhelming use of prime brokerage in the industry.
- Liability provisions for depositaries, which may result in increased operating costs for funds and concentration among providers.
- Constraints on function delegation, including asset, risk and liquidity management responsibilities.
- Third-country marketing rules are seen as a particular concern since many hedge funds operate on a private placement basis throughout Europe.
- No acknowledgement of the role of the board of directors in managing a fund.
- The impact on non-EU jurisdictions such as the Cayman Islands that have traditionally served the hedge fund industry well.

**Compliance Costs are a Big Concern**

Overwhelmingly, there is concern over the cost of compliance — in terms of monetary and human resources. This cost is seen as having a direct impact on fund performance. The multiple, often diverging drafts emerging from the Presidency and EU Council through this process have left many finding it almost impossible to assess how the Directive might end up.

There was little evidence of a widespread move by hedge funds to make sweeping changes to their current business structures. Certainly, new fund domiciles and structures are being explored but, where these have been utilised, the AIFMD usually ranked low among the considerations influencing the decision.

There are some concerns about the lack of transatlantic synchronisation on hedge fund regulation and whether there will be a level playing field for US and European hedge funds in the future.
The majority of respondents see no pressing need to bring their offshore fund ranges onshore in the immediate future – though the AIFMD could change that.

It appears almost universally agreed that there has been little pressure from existing investors for managers to move towards EU domiciles such as Luxembourg or Ireland and away from the most commonly used domicile, the Cayman Islands.

It is accepted that offshore domiciles have suffered some credibility issues as a result of media coverage and attention from the US, but they are still seen as a key location by many hedge fund managers. While a small number of managers are redomiciling their entire range of funds, many are continuing to launch Cayman-domiciled products. The decision to do so is based on regulatory uncertainty and the one-time costs involved with a switch to onshore domiciles.

The AIFMD is seen as a major consideration in driving any future large-scale redomiciliation of existing offshore products. For now, however, offshore domiciles are still carrying the vast majority of hedge fund assets.

**UCITS vs QIFs and SIFs**

Any future redomiciliation activity may not be into UCITS products, which are seen as too restrictive for many hedge fund strategies. Rather the Irish QIF or Luxembourg SIF structures may be more attractive in the event that hedge funds see the need to effect a large-scale migration.

That said, recent onshore hedge fund launches have largely been in the form of UCITS, or “NEWCITS” as they have been popularly dubbed. These launches were driven in the main by a desire to attract a new range of potential investors – such as traditional retail investors, institutional investors who prefer to allocate to UCITS or institutional investors who cannot allocate to offshore hedge fund products. Pension funds are particularly noted as being interested in UCITS products.

Many of the large managers interviewed are already well established in EU domiciles with several UCITS funds under management. As well as the ability to sell to new investors, these managers cite favourable tax-treaty networks and positive investor disposition to the transparency, liquidity profile and regulatory framework offered by UCITS as key reasons for offering these products as part of their range.

Ireland and Luxembourg are clearly the domiciles of choice for hedge fund managers. Ireland appeals to many UK-based hedge fund managers because of its longer involvement in hedge fund servicing. The choice of location is influenced by past experience such as relationship with regulators, the tax regime, the presence of suitably experienced service providers and the likely time to market for new product launches.

### Which Framework, What Jurisdiction?

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While many respondents are familiar with Malta as an emerging domicile, none were actively preparing to domicile product there. One firm has said it would seriously consider Malta as an alternative domicile within the EU. Factors for consideration include the level of hedge fund expertise, market perception of the regulatory framework and capacity to deal with an influx of new business.

The Challenge for Smaller Managers
There were some views expressing that smaller managers face a costs barrier to using UCITS. Set-up, ongoing compliance and additional operational requirements are more onerous for smaller firms than for the larger-scale managers with institutional-strength infrastructure already in place. Several of the larger managers who also run long-only UCITS products are already well established brand names in this space and can utilise existing distributor relationships to sell their range of UCITS hedge funds. This prior experience and market presence is seen as a distinct advantage over first-time entrants who may find it more difficult to gain momentum with UCITS offerings. It was also noted that many launches are starting with very low assets.

Lockups are still seen as appropriate, dependent on the fund strategy type. Several managers are using one-, three- and five-year lockups in order to match underlying portfolio liquidity to the redemption profile of the fund. They are not encountering investor resistance, except perhaps at the high end of the lockup period. Investors comfortable with investing in a less liquid strategy generally understand that the lockups make sense and exist for the benefit of all investors. Investors are generally not in favour of fund lockups where the underlying portfolio can accommodate ongoing liquidity for investors.

Early redemption penalties continue to be standard in most hedge fund private placement memoranda (PPMs). Gates on redemption activity remain a feature in many hedge fund PPMs. However, a number of managers say they have removed references to gates from their PPMs. One fund of hedge fund manager has said they have started to see some evidence of individual investor gates being proposed, which they see as an unwelcome development.

The Demand for Managed Accounts
Managed accounts are well in evidence with the majority of the managers. Most are happy to accommodate these for a substantial investment. There are occasional instances of large investors redeeming from a “main fund” investment and asking to be rehoused in an individual managed account. Most managed accounts, however, are set up from inception and there is ongoing interest from some of the large institutions, and particularly pension funds, to have their own mandate. Some managers also have productive relationships with certain high-profile managed account platforms. The downside is that these platforms eliminate any relationship with the end-investor.

Managers have generally commented that investment size is crucial if they are to provide a managed account. Delivering individual mandates across strategies is operationally more cumbersome and expensive for the manager. For investors, the attraction of a managed account is the transparency it provides over their investment and the liquidity control it gives them. However, managed accounts are not suitable for all investors. While they provide enhanced transparency, the investor needs to have the infrastructure to analyse and act on the information provided.

“Managers should utilise UCITS if their strategy can fit the regulation and liquidity requirements otherwise it is a square peg in a round hole.”

Interview Quote
In a difficult market, hedge funds are beefing up their marketing teams and diversifying their investor base. Larger firms look best placed to manage the challenges in both the institutional and the retail markets.

Marketing and Fund Raising

It was universally noted that the business of capital raising is a much more intensive and difficult process than in times past. Investors are conducting an extensive, front-to-back due diligence process over a much longer time period before they make a commitment. We discuss this in more detail in the next section.

Beyond due diligence, investors also look for a proven track record and a clear investment process and philosophy before they commit capital. Capital-raising for startups continues to be challenging and there is a sense that investors are less comfortable with startup investments than in the past.

Many hedge fund managers report that they have beefed up their marketing teams, recognising that they need to market themselves much more proactively than in the past. Communication with future and current investors is seen as crucial. Generally speaking, marketing activities need to be more sophisticated and targeted than in the past, particularly as hedge funds attempt to diversify their investor base as noted below.

Reducing Reliance on High-Net-Worth Individuals

There is a consensus among interviewees that reliance on high-net-worth individuals and family offices must be reduced and the investor base widened to include institutional investors such as universities, endowments, foundations, insurance companies and pension funds, and other corporates. It is also clear that institutional investors will place increased demands on the manager, pushing for transparency of information, a strong compliance culture, robust operational infrastructure, brand name service providers and regular liquidity.

An emerging view was that the demands of these institutional investors may only be satisfied by the larger managers - those with substantial assets under management and the necessary financial position to deliver the institutional framework required. This could lead to a two-tier industry in the future as larger institutional investors trend towards the larger managers and away from smaller, boutique-style managers and startups.

UCITS: Distribution is Key

For managers who have dipped a toe in UCITS waters, marketing becomes a still more diverse process, particularly where the manager wants to attract a new retail investor base. Several managers have entered into distribution relationships with banks in order to sell their UCITS products. Others are reviewing platforms that can provide them with the necessary distributor relationships. Going it alone without distributor relationships is seen to be very difficult unless significant internal infrastructure is put in place.

Marketing and selling through distributors and intermediaries also comes with a cost in terms of trailer fees and commissions on all new investments. Additionally, in order to maximise the use of distribution channels, there is a need for in-country registration in certain countries, which brings costs such as document translation, the need to have a local paying agent and, in some cases, local tax reporting. To make the most of UCITS opportunities, it was seen as important to have a clear strategy as to which distributors and which countries to target.
Investors are carrying out exhaustive checks to understand every facet of firms’ daily operating procedures, and demanding new levels of transparency and asset security.

It goes without saying that fund performance, track record and investment philosophy and process remain key areas of investor focus. But, since the events of 2008, operational issues have assumed greater importance than ever before.

**Due Diligence Focus Shifts to Operational Processes**

Overwhelmingly, interviewees noted that institutional investors have stepped up their due diligence efforts in the last year. Many have added additional experienced personnel to their in-house teams to manage this function. The process is now seen as very intensive and protracted. Several managers describe it as “exhaustive”. While many investors have traditionally focused on the investment decision-making process and portfolio construction, they are now looking in great detail at the operational structure and processes not only of the manager but also of the administrator and prime brokers/counterparties.

Due diligence visits to hedge fund managers now typically involve a deep dive into operational and risk management processes. Investors require a “day-in-the-life” walk-through. They often follow specific trades or the manager’s internal valuation right through to the records held by the administrator and prime broker. Many investors are now attempting to “add up” the valuation by collating all balance-sheet-level information from the prime brokers and counterparties.

Often, the entire operations team within the manager’s back office is now involved in the due diligence process as investors focus on day-to-day procedures around trade flow, reconciliation, risk management, portfolio pricing and counterparty exposure management. Visits are now more regular than before with ongoing follow-up. In many cases, standard due diligence informational request forms have to be completed.

The external administrator is now contacted in most cases for completion of standard due diligence documentation, for telephone follow-ups and in many cases detailed, face-to-face due-diligence sessions. This parallels the increased scrutiny experienced by managers. These visits focus in detail on reconciliation and pricing processes.

Investors are keen to see written pricing policies that incorporate the procedures to be followed in the case of price challenges to the administrator.

**Investor Focus**

- Operational Due Diligence
- Custody of Access
- Transparency
- Controls Infrastructure
- Liquidity
and take comfort from the existence of valuation committees as sub-sets of the board of directors.

Due diligence consultants are now frequently brought in by institutional investors to carry out due diligence visits and follow-ups. Many managers noted that these providers are thorough in their approach and highly knowledgeable given that they work across many managers and service providers.

**Greater Demands for Information Disclosure**

Again and again, transparency came up as a key issue in our interviews. Investor demands in this area take many different forms.

Some investors are reportedly requesting access to a full portfolio breakdown within the fund. Clearly, this is the norm for managed accounts. In terms of a standard hedge fund, managers are generally open to requests on a case-by-case basis, but they will often ask the investor to sign a non-disclosure agreement or side letter. They also prefer to provide the information on a delayed rather than a real-time basis. In the case of event-driven or activist strategies, managers have a strong preference not to provide a full portfolio breakdown. To date, managers have generally given some form of portfolio disclosure within their investor newsletter, for example, but this is normally in a summarised format.

Interviewees noted that feeds to consolidated risk reporting tools, as offered by specialist market vendors, were also being requested on a more regular basis. Most managers are happy to provide consolidated-level information and recognise the benefits for large investors invested across multiple hedge fund managers and fund strategy types.

Requests for FAS 157-type classifications are becoming more prevalent, with hedge fund managers required to define the portfolio as level 1, 2 or 3 on an ongoing basis. Again, most managers do not have an issue with this type of disclosure.

Self-administration of hedge funds is seen as unacceptable by investors. External and independent administration is a basic expectation. Many hedge fund managers are seeing requests for more information to be confirmed directly by the administrator to the investor. Examples include the confirmation of assets under management and assets held by counterparty. More frequent administrator-calculated valuations are being requested on occasion. This may involve mid-month or weekly valuations where a monthly frequency has been the norm. Investors are clearly looking for a more frequent view of fund valuation and performance, whether that is provided by the administrator or not.

Some due diligence providers are pressing for a standard information disclosure from the administrator laying out the details such as where assets are held, FAS 157 classification and confirmation that assets have been priced in accordance with the fund’s PPM. One hedge fund manager noted that the firm had set up an internal transparency committee — such had been the rise in information requests from investors.

**Controls Infrastructure Audits**

One key trend is that some managers are contemplating generating a SAS 70 (Statement on Auditing Standards 70) style report over internal procedures and related controls as a means of giving additional comfort to investors. SAS 70-type reporting originated in the US and utilises the services of an external audit firm to perform an

“Investors must carry out their own due diligence. They cannot rely on regulatory frameworks.”

*Interview Quote*
audit on the existence of the stated controls at a particular point in time (a Type I report) or an audit on the operation of the stated controls over a set time period (a Type II report).

**New Asset-Holding Models**

Most hedge fund managers say the issue of custody is regularly raised during investor due diligence. Investors are closely focused on exactly where the fund assets are held and in what legal structure. Hedge fund managers have been addressing the topic of asset custody and collateral arrangements on an active basis since late 2008. They have put considerable resources into reviewing the available options.

Pure custody models are not that commonly utilised. Hedge fund managers have focused on spreading their counterparty risk through the use of multiple prime broker relationships by fund. Two-to-three relationships per fund are now common, although the number is influenced by the scale of assets under management. Multiple relationships may not be cost-effective where the asset base is small.

Managers have also carefully reviewed the terms and conditions of their prime brokerage agreements, paying particular attention to the prime broker’s ability to rehypothecate the assets. Some managers note that, in the wake of the Lehman collapse, they moved immediately to cut out rehypothecation regardless of the cost implications.

Outside of multiprime models and a review of rehypothecation, the step most actively taken by hedge fund managers is to adopt one of the two following models:

- A “triparty asset segregation model” (also known as a “prime custody model”), where unencumbered assets are moved to a custody arrangement. This is not seen as overly cumbersome in operational terms – particularly where it is operated within a one-stop shop.

- Bankruptcy-remote vehicles offered by prime brokers. These arrangements have been adopted by several of the managers interviewed. While seen as “not perfect”, they were considered to “give enhanced security of assets”. On the downside, this option was seen as costly and time-consuming to put in place.

Regardless of the option selected by hedge fund managers, it is clear that the custody of fund assets is close to investors’ hearts.

**Liquidity an Issue for Incoming Investors**

This topic came up again and again as a key focus for investors, although it was seen as a topic for discussion more for new investors than existing ones. It is generally felt that sophisticated investors are comfortable with the liquidity arrangements already in place – provided that the hedge fund manager can demonstrate that the liquidity terms are appropriately matched to the liquidity profile of the underlying portfolio. As noted previously, liquid underlying portfolios that have lockups or a non-standard investor-dealing pattern compared with those of competitors are under pressure from investors.

“Liquidity continues to be key . . . but investors do understand less frequent liquidity where this matches the underlying strategy and makes sense.”

*Interview Quote*
Fees

Downward pressure on fees exists, but it is mainly targeted at management fees. Our leading question to all interviewees on this topic was “2 and 20 – is this fee model outdated?”

There was one overriding comment from all managers: investors will continue to pay for performance. By implication, there will be less in the way of fee pressure where investors are happy with the way their investment is performing. It is generally the case that any downward pressure on fee levels is primarily targeted at management fees. Among interviewees, these ranged from 2% downwards, with a 1% rate potentially felt as too low to be viable by many hedge fund managers.

Several managers noted that they would be prepared to negotiate on fees if an investment was of sufficient size to warrant it. Others managers said they never negotiate on fee arrangements. In some cases, it was noted that there may be a trade-off between liquidity and fees. Less frequent liquidity could entail a lower ongoing management fee rate as a trade-off. Conversely, the costs of providing very frequent liquidity could bring about the opposite.

With convergence between the traditional mutual fund industry and the hedge fund industry continuing, management fees are being carefully considered in the case of UCITS products. Some see a potential issue where an existing Cayman hedge fund is cloned in a UCITS wrapper offering a lower management fee.

Investors Relaxed on Performance Fees

Performance, as always, is king and it is the case generally that less pressure is being brought to bear on performance fees. Managers feel that investors will continue to be amenable to the traditional level of performance fees at 20% of fund uplift over prior high watermarks (and variants thereof) in return for all-important fund performance.

Many feel that taking incentive fees more than once a year – in line with year-end audits – would be even less common in the future than it is now. Particularly for less liquid fund portfolios, incentive fee arrangements should seek to crystallise in a similar manner to the liquidity of the underlying portfolio or in line with lockup arrangements if those are in place. Additionally, incentive fees earned should potentially have some form of claw-back arrangement in place for less liquid strategy types.

Incentive fees based only on realised gains and losses earned, rather than on both realised and unrealised gains, are seen as uncommon and unwieldy to operate. Generally speaking, there is always an element of mismatch between incentive-fee crystallisation and the physical realisation of portfolio-level gains. The approaches in place today are a best attempt to manage fairness for investors and managers alike, with a calculation method that is relatively simple to operate.

“Investors are more likely to seek rebates for significant investments.”

Interview Quote
All hedge fund managers interviewed were clear that the administrator is responsible for the overall calculation of the fund valuation. The board, however, has ultimate responsibility for the valuation and, while it delegates the function to the administrator, it must satisfy itself as to the valuation processes and procedures adopted.

The area of valuation seen to provide most challenges for administrators is where a fund held unlisted or illiquid securities, for which a readily observable market or independent price source is not available or where there is an element of subjectivity over where they are to be marked. Generally in such cases the administrator would ask the board – and any valuation committee set up by the board for this specific purpose – to review and approve the pricing method to be applied.

“Administrators are not valuation experts and in some cases prices need to be sourced from the experts.”

Several managers express a view that they prefer the administrator to stand over all pricing – no matter what the instrument type – and not involve the board or valuation committee. Others do not believe that the administrator community is sufficiently expert to be able to set prices for unlisted, illiquid or esoteric instruments. Administrators generally are not seen as comfortable with accepting pricing responsibilities in such cases.

**A Role for Expert Valuers?**

One solution that has been suggested is the appointment by the administrator of independent and expert valuers for specific instrument types, although it is noted that this is an expensive option and administrators would expect to recharge the cost to the fund. There is also a debate on whether these valuers will actually set a price or only generate a price range.

Perhaps the most workable solution is the one generally in place today. The administrator manages the valuation process, ensures a pricing policy is in place for the fund and ensures that it is consistently applied. Any exceptions to the pricing policy or instances where an independent market price is not available are then taken before the board or valuation committee.
All of the hedge fund managers interviewed stress the importance of the role of the fund’s board of directors.

The composition of the board is seen as increasingly important. There is a distinct preference for more rather than less representation from suitable independent directors. Investors are asking more questions about the composition of the board and expect to see boards in place that are active, independent, well qualified and challenging. Prior investment management experience from independent members of the board is also seen as a positive factor, as these individuals are in a position to challenge the investment manager on detailed matters relating to the investment decision-making process. Backgrounds such as legal and accounting are also seen as valuable. Investors must believe that the board will at all times act in the best interests of the investors alone.

It is clear that boards of directors are themselves actively considering their responsibilities and qualifications. For example, some of the boards of the hedge fund managers consider engaging investment valuation expertise and some consider establishing an external independent compliance function to report monthly to the board.

Notably the supply of high-quality independent directors, particularly those with specific hedge fund expertise is limited. Many independent directors already sit on a significant number of fund boards and have limited capacity to take on additional relationships.

“We would like to see the majority of representation on the Board being independent.”

Interview Quote
Conclusion

In summary, the events of the past year have shifted a lot of investors’ priorities and lifted the bar on standards of regulation, transparency and risk management. While all the evidence suggests that institutional acceptance of the investment case for hedge funds remains as strong as ever, investors want the comfort of external administration, the protection that comes from ring-fencing assets and improved liquidity.

Hedge fund managers need to respond to the changed circumstances with more than knee-jerk cost-cutting. They need to reassess the entire business model and ask themselves a series of questions.

• Is the product portfolio attuned to the times?

• Can we rationalise the range of funds to focus on key competencies and deliver better performance and client service?

• Do we have the scale to succeed in today’s world? If so, are we optimally structured to exploit that scale – or positioned properly to make the most of our market niche?

• Have we responded adequately to investor demands for asset protection and transparency?

Above all, hedge fund managers need to review their operational approach. Is in-house administration still viable or even desirable? What is truly core and what is not? Is there merit in moving from a fixed to a variable cost base – at least in some functional areas? Are there opportunities for new efficiencies through asset pooling? Firms prepared to take a long, hard look at not just the economics of their business but their entire operational approach will be best placed to exploit the opportunities when the good times return.

Clearly, the hedge funds succeeding in the years to come will be those that stand up to intensified due diligence by exhibiting institutional quality, providing more transparency and delivering consistent, non-correlated returns over time.
By partnering with Citi, you can draw on the complete range of front- to back-office solutions, which are integrated across the entire investment value chain. For every strategy, across all major asset classes, we leverage our local and global strengths in execution, leadership in prime finance, custody and comprehensive fund administration, so you can deliver what the market and your clients demand.

Our enduring commitment and continuous investment means you can be sure we have the resources to support your decisions, now and in the future.

As one of the top five largest administrators globally, with over 20 years' experience and a client list that includes many industry leaders, we are your hands-on partner of choice. Our market-leading solutions, dependable service and experienced personnel can be relied on to help you turn your strategic goals into realities.

Contacts

Marion Mulvey
t: +353 (1) 622 8548
e: marion1.mulvey@citi.com

Andrew Collins
t: +44 (0) 20 7508 2704
e: andrew.j.collins@citi.com