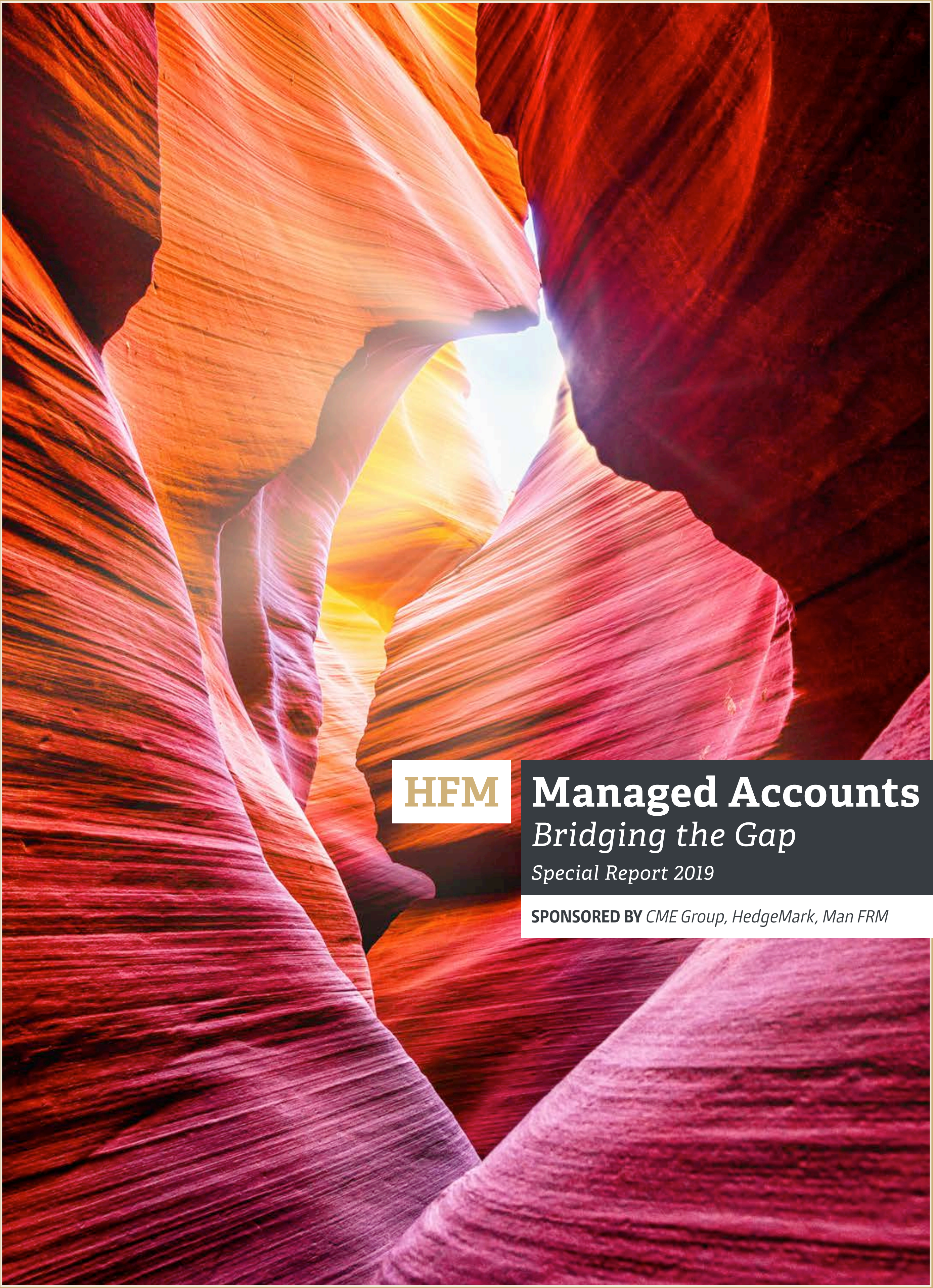


HFM

Managed Accounts

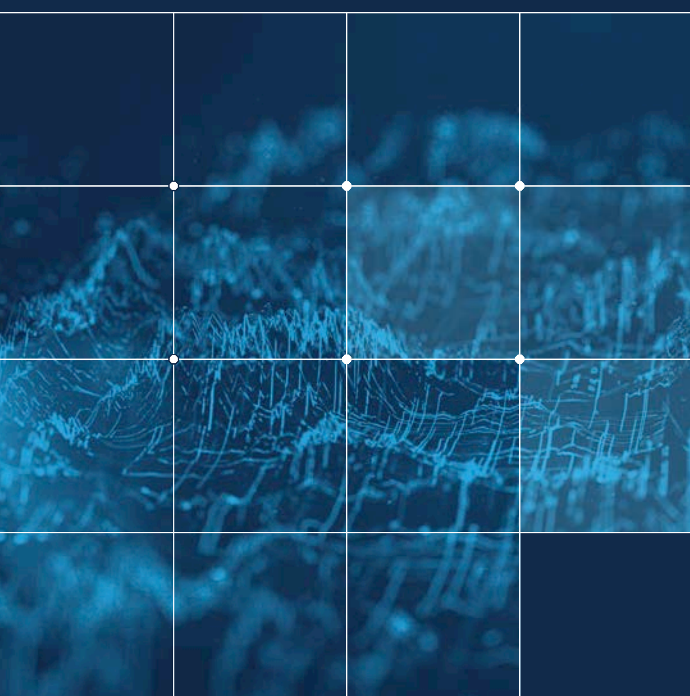
Bridging the Gap

Special Report 2019

SPONSORED BY *CME Group, HedgeMark, Man FRM*

CME Group

ENSO Core Managed Account Offering



Manage financing relationships and costs with ease.

ENSO ingests and normalizes data for the largest and most complex hedge funds, asset managers and managed accounts globally, who collectively manage ~$1 trillion assets under advisory. ENSO offers:

- Exposure Management Across All Funds and Prime Brokers
- Cost of Carry Monitoring
- Data Aggregation and Consolidated Reporting

Join the multitude of managers already utilizing ENSO and see how we build innovative products for the ever-evolving market.

New York 212 880 8106
London +44 20 7818 9959
Singapore +65 6831 0888

inquiry@ensofinancial.com
www.ensofinancial.com/request-a-demo

Managed Accounts 2019: Bridging the gap

A decade since the financial crisis empowered managed accounts as the institutional go-to structure for transparency, liquidity and control of hedge fund strategies, assets on dedicated platforms continue to grow, driven by convergence, customisation and soon socially conscious investing. Unlike fund administrators, custodians or prime brokers that offer a standardised set of services, the managed account industry is still maturing. The challenge for institutional investors is to pick between providers whose services can differ widely, but technology and the ability to parse big data is key if service-driven and allocator platforms want to enable investors to enhance 'alpha' operationally and structurally. As this special *HFM* report outlines, now that managed accounts have become the accepted face of alternative investing, platform providers have a new role to play: assisting institutional investors execute their hedge fund strategies in a socially responsible way.

Niki Natarajan,
Report editor

Contents

4	Demise or maturity?
4	Is winter coming?
5	Hedge fund renaissance
5	Managed accounts 3.0
6	Dedicated managed accounts
7	Smart data
8	Operational and structural alpha
10	Fees are still a big focus
10	Customisation
11	Emerging managers
12	Bridging the gap
12	Integrating ESG
13	Conclusion
14	Investor spotlight: MassPRIM
17	*HFM InvestHedge* Managed Accounts Survey 2019
19	Sponsor profiles

HFM

LONDON
One London Wall
London, EC2Y 5EA
T +44 (0) 20 7832 6500

NEW YORK
41 Madison Avenue
20th Floor
New York, NY 10010
T +1 646 891 2110

EDITORIAL

REPORT EDITOR
Niki Natarajan

HFMWEEK EDITOR
Matt Smith
T: +44 (0)207 832 6627
m.smith@hfmweek.com

HEAD OF PRODUCTION
Claudia Honerjager

COMMERCIAL

ASSOCIATE PUBLISHER
Lucy Churchill
T: +44 (0)20 7832 6615
l.churchill@hfmweek.com

HEAD OF NORTH AMERICA
Tara Nolan
+1 (646) 335 3438
t.nolan@pageantmedia.com

SENIOR PUBLISHING ACCOUNT MANAGER
David Butroid
T: +44 (0)207 832 6613
d.butroid@hfmweek.com

PUBLISHING ACCOUNT MANAGERS
Victoria Bennis
T: +44 (0)207 832 6615
v.bennis@hfmweek.com

Sigita Gravere
T: +44 (0)207 832 6631
s.gravere@hfmweek.com

THE MEMBERSHIP TEAM
+44 (0)20 7832 6511
membership@hfmweek.com

HEAD OF CIRCULATION
Rachelle O'Neill
T: +44 (0)20 7832 6527
r.oneill@pageantmedia.com

CEO
Charlie Kerr

HFMWeek is published weekly by
Pageant Media Ltd
ISSN 1748-5894

Printed by The Manson Group

Managed accounts: the next generation

It is fair to say that 2018 was not a vintage year for hedge funds. When industry legends such as Leon Cooperman and Guillaume Rambourg throw in the towel and turn their hedge fund operations into family offices, it is a clear sign that the markets are no longer fun. In fact, more than 400 hedge funds, including high-profile names such as Jabre Capital Partners shut down completely in 2018.

Demise or maturity?

With a backdrop of a potential global trade war and tech and oil stocks causing mayhem, the average hedge fund performance for the year was -0.8%, according to *HFM* data. Industry assets declined by almost $144bn – the most since 2008 – and it is easy to surmise that the hedge fund industry is in decline.

The growth in partnerships between managers and their investors, enabled by dedicated managed account platforms, is one trend driving assets to the larger managers, even in spite of a small fall in overall assets.

According to the latest spring 2019 *HFM Global Review*, the assets of 463 hedge funds with $1bn or more in assets under management – 90% of the total hedge fund assets under management – fell from $2.8trn to $2.6trn in the second half of 2018. Not only that, the assets of the 57 firms with more than $10bn in assets fell from $1.5trn to $1.3trn in 2018.

Credit Suisse's latest Hedge Fund Investor Survey titled *Trimming the Sails* refers to a consolidation in the number of hedge funds in allocator portfolios: now 31, down 35% from 2009. This trend is echoed by JP Morgan's Capital Advisory Group's 16th annual institutional investor survey, where with the exception of the banks and platforms and consultants, investors consolidated portfolio holdings.

Going into 2018, 21% of JP Morgan's respondents had thought they would reduce the number of hedge fund holdings, but 40% ended up doing so. Not all the money is leaving hedge funds, instead some of it is being recycled. According to Credit Suisse, 89% of investors who redeemed in 2018 expect to recycle that capital into other hedge funds, with an increasing amount going to existing managers in the portfolio.

"Investors are staying the course on their hedge fund exposure. It is important to highlight they are focused on re-underwriting their existing portfolios; reducing the overall number of positions and sizing up where they have conviction," says Melissa Toma, co-head of Credit Suisse Capital Services Americas.

> ***Investors are staying the course on their hedge fund exposure. It is important to highlight they are focused on re-underwriting their existing portfolios; reducing the overall number of positions and sizing up where they have conviction.***
>
> MELISSA TOMA

A sign of a maturing 'winner takes all' industry, perhaps?

At the same time, a number of leading industry hedge fund investor surveys are suggesting allocations to hedge funds are going to increase. Of the 227 respondents of JP Morgan's survey, 32% are expecting to increase their hedge fund allocation in 2019, more than double the 15% that were planning to do so in 2018.

Different investors are more or less likely to increase allocations. For example, banks and platforms (54%) and insurance companies (50%) are likely to increase their allocations, while fewer of the pension funds (20%) and consultants (22%) are planning to.

Is winter coming?

When hedge fund performance continues to lack lustre, why are investors such as Harvard Management Company, San Francisco Employees' Retirement System and Massachusetts Pension Reserves Investment Management Board (MassPRIM) adding more managers to their portfolios?

According to NEPC, MassPRIM's asset allocation adviser, in its 2019 Asset Allocation Letter titled *Winter is coming, but when?* late cycle dynamics, tightening global liquidity, China transitions and a globalisation backlash are key market themes.

"Diversification and disciplined

rebalancing are critical to survive the transition into and through the late stage of an expansionary economic cycle," the letter said. Late-cycle economies are typically characterised by moderating growth and profit margins, rising interest rates, and equity markets peaking, typically followed by a recession.

Perhaps N.P. "Narv" Narvekar, chief executive officer of Harvard University's $39bn endowment, is simply positioning the portfolio for the next market cycle. So, what properties do investors see hedge funds giving them?

Interestingly, alpha generation is still the primary reason to look at hedge funds, according to 52% of JP Morgan's respondents, while for 88% it was among their top three reasons. Portfolio diversification comes in second as the primary, secondary, or tertiary reason for 73% of JP Morgan's respondents, although diversification as a primary reason has risen by 8% to 24% since last year.

For example, the JP Morgan survey found that 48% of the pension fund allocators cited diversification as their primary reason to allocate, but alpha generation was only considered important by 32%.

Hedge funds are also known for their volatility dampening properties.

Yet, even though 68% of JP Morgan's respondents indicated that their hedge fund portfolio underperformed relative to its target by at least 1%, reducing volatility does not seem to have surfaced as a driver to allocate to hedge funds.

Hedge fund renaissance

The majority of institutional hedge fund allocators including California Public Employees' Retirement System (CalPERS) and MassPRIM started their hedge fund journeys through funds of hedge funds, eventually transitioning to direct allocations with advisers alongside as they got comfortable with alternative investment strategies.

The after-shock of the financial crisis saw some large public fund investors including CalPERS, the New York City Employees' Retirement System and Dutch PFZW, eschew hedge funds completely, typically citing complexity and costs as reasons.

The anticipated end of the equity market bull run, the potential for associated volatility and perhaps a recession on the horizon seems to have given hedge funds a second chance to prove themselves.

There is clearly still a need for investors to decorrelate and diversify portfolios as well as generate alpha, and these are the core skills upon which hedge funds sell themselves. That said, this does not mean investors are concern-free when it comes to allocating to them.

Hedge funds still have an image problem. Even though 2008 returns are no longer part of the 10-year timeframe, too many trustees, and much of the mainstream press, still associate hedge funds with Bernie Madoff, the financial crisis and private jet-financing fees. Reputational risk is one that is often managed by avoiding the asset class altogether.

"Those that either never went into hedge funds or left disillusioned still argue that fees are too high, there is poor governance, a lack of transparency and not much flexibility," says Andrew Lapkin, chief executive officer at HedgeMark, BNY Mellon's managed account business with $21bn in client platform assets as of April 30th, 2019.

Style drift, lack of communication and transparency are the other most referenced concerns in JP Morgan's survey. For 80%, however, crowding continues to be the primary concern for investors when allocating to hedge funds.

But a dichotomy exists. Despite 88% of the universe citing alpha generation among the top three reasons to invest in hedge funds, more than 82% of the respondents believe there are too many funds chasing limited alpha-generation opportunities.

All of these concerns notwithstanding, the hedge fund landscape has changed irrevocably since 2008. "An increasingly regulated environment pushing disclosure, transparency and governance standards has changed how most hedge funds operate," says Joshua Kestler, president and chief operating officer at HedgeMark.

Andrew Lapkin
HedgeMark

Managed accounts 3.0

What is supporting this new age of hedge fund investor empowerment? In a 'geek turned cool kid' transformation, managed account platforms morphed from a largely investment bank-driven guaranteed product-based asset-raising business to a tech-enabled operational turnkey service offering investors transparency, liquidity and control over an investor's entire asset inventory.

"Managed account platforms continue to be a sector of growth in the alternatives world as increasingly sophisticated investors demand more from their managers. In an environment where transparency, risk controls, efficiencies of scale and liquidity matter more to the investor, managed account platforms are the ideal way for an investor to gain access to those strategies most desired while maintaining a level of control," says Ted O'Connor, head of Americas business development at ENSO.

Today, investment bank platforms no longer make up the top 10 in the *HFM InvestHedge* managed account survey (*see page 17*). Deutsche Bank, for example, created its Global Investment Solutions group by taking the hedge fund managed account platform, the retail structured products unit db-X Markets and alternative Ucits out of the asset management unit and into the investment bank, to sit alongside the risk premia operations.

Today, the managed account space is broadly divided into two: fiduciary platforms typically managed by asset managers, usually funds of hedge funds groups such as Man FRM; and non-fiduciary operational service provider platforms.

Seven of the 10 largest managed account platforms on the *HFM InvestHedge* survey are run by hedge fund allocators, while the remaining three, InfraHedge, Innocap and HedgeMark, fall under the umbrella of dedicated platform providers.

"Many of the large funds of hedge funds today are capitalising on their experience as fiduciaries to offer clients oversight on a daily basis that helps to create bespoke solutions," says Sam Thompson, head of managed accounts and a member of Man FRM's management committee in New York.

Man FRM was originally founded to invest in hedge funds in 1991, but has been using managed accounts to gain transparency for risk management with its underlying managers since 1998. The current managed account platform, with assets of $18.6bn, has grown out of that.

Man FRM is not the only one. Managed accounts underpinned the early businesses of Lighthouse Partners, K2 Advisors and Pacific Alternative Asset Management Company (now Paamco Prisma). Offering fiduciary (and non-fiduciary if preferred) investment-driven managed account platform services has allowed the funds of hedge funds industry to evolve from product driven to solutions driven businesses.

The original managed account platforms were created for managed futures strategies. For this reason, managers of complex strategies have often refused to offer a managed account because they feel the service provider will not be able to support their needs.

Man FRM's Thompson is quick to dispel that myth. "We have been using managed accounts for more than 20 years for our own hedge fund investing programme and, in that time, launched more than 380 managed accounts. This gives us the knowledge, understanding and ability to handle complex investment strategies from a simple commodity trading adviser fund to a more complex credit strategy," he says.

The ability to handle complex securities is at the heart of HedgeMark's offering too. "We operate many credit strategies, complex global macro and derivative-based strategies for clients. Many of our staff members have prior experience working on the operations and accounting teams at hedge funds and therefore, have the skills necessary to support complex hedge fund strategies," says HedgeMark's Kestler.

Given the choice, many hedge funds would still prefer to commingle assets, arguing that the increased operational burden of creating funds of one or separately managed accounts (SMAs) is a significant issue, particularly when investors want to customise the strategy.

Even so, according to the JP Morgan survey, while funds of one might be less popular than managed accounts, one quarter of the investors interviewed used one and 48% of pension fund allocators use them, by far the highest percentage across investor types. Typical allocation sizes for funds of one vary with 40% of respondents allocating $50m, while another 40% allocate at least $100m on average.

Hedge fund managers in the EY *2018 Global Alternative Fund Survey* also indicated that on average 25% of their firms' assets are in funds of one or SMAs. This is set to increase as roughly 20% of investors say they expect larger future allocations to them.

Joshua Kestler
HedgeMark

> ***We operate many credit strategies, complex global macro and derivative-based strategies for clients. Many of our staff members have prior experience working on the operations and accounting teams at hedge funds and therefore, have the skills necessary to support complex hedge fund strategies.***
>
> **JOSHUA KESTLER**

Funds of one and SMAs were created by the hedge fund for the investor to avoid co-investor risk or a work around the Most Favoured Nation clause, designed to make sure all investors are treated equally. In the end, the hedge fund still controls the assets.

Yet the managed account industry is growing. Not only did the assets of the 10 largest managed account platforms included in the *HFM InvestHedge* survey grow in 2018 from $102.5bn to $113.3bn, but the majority of the 10.5% increase came from the growth of providers of dedicated managed account services.

Dedicated managed accounts

Dedicated managed accounts (DMAs) provide additional benefits to investors and are designed to also reduce operational burdens for the hedge fund manager. The rise of the dedicated managed account means that only hedge funds at capacity that do not want to raise assets can now argue against them.

"All the hedge fund managers have to do is to implement their strategies consistent with the investment guidelines and objectives and we handle the core non-investment functions including all cash and securities movements," says HedgeMark's Lapkin.

Unlike funds of one and SMAs, DMAs are turnkey platforms set up for, and controlled by, a single institutional investor. "In the traditional commingled hedge fund vehicles, the manager is the one that controls the assets and the cash," says Matt Liposky, chief investment operating officer at MassPRIM (*see Investor Interview, page 14*).

"If anything were ever to go south with the manager, it takes sometimes six to 12 months to get your capital back. In the SMA, if something were to go south, we have the ability to shut off the manager's access of cash and capital that day," continues Liposky.

Knowing what is in your portfolio is the key point to managed accounts. Liquidity and control, the 'l' and the 'c' of industry's acronym TLC, allow investors to be in charge so they can exit when they want and not have to wait six months to redeem.

This helps institutional investors meet their fiduciary responsibilities. "Public pension plans are facing pressure because 'hedge funds' have increasingly become a political target. By using dedicated managed accounts, institutions can avoid certain flaws of the commingled investment structure and access a particular investment strategy in a more controlled manner," says HedgeMark's Kestler.

In addition to giving the investor control of their assets, more specifically removing the co-investor risk associated with investing in commingled funds, DMAs address most of the issues investors raise against the commingled hedge fund structure: sub-optimal governance; high fees; poor expense transparency; lack of strategy flexibility; and lack of investment transparency.

"This type of platform is ideal for allocators who have their own conviction about the managers and strategies they want to allocate to. We do not offer any investment advice. We provide the operational infrastructure to support those have a clear idea of how they want to fund their programme," says HedgeMark's Lapkin.

HedgeMark Advisors recently surpassed 110 active client DMA funds since it launched its service in September 2012.

Among the non-investment functions services HedgeMark offers are: onboarding and fund set up (including counter party accounts and ISDAs); daily operational oversight (including oversight of the administrators that calculate the NAVs); overseeing pricing policies; OTC trades; daily T+1 risk and performance monitoring, analytics and reporting; and cash and collateral management.

Abraham Maslow once said: "It is tempting, if the only tool you have is a hammer, to treat everything as if it were a nail." More than two decades ago, hedge funds were the 'nail'. A single product – complete with gates, locks, illiquidity, high fees and additional expenses – that investors bought to do everything: dampen volatility, achieve returns and decorrelate portfolios.

Today's tools – transparency combined with smart data and technology – make hedge fund investing more akin to micro surgery. "Dedicated managed accounts are now used strategically to meet risk and return objectives. They are an investment tool, not just to mitigate risks but to also offer better transparency so investors now have better control," says Man FRM's Thompson.

"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," explains HedgeMark's Lapkin.

Unstructured transparency data is of no value so producing meaningful and useable reports is integral to a platform's success. "We have developed an online reporting portal that allows investors in dedicated managed accounts to log in and set up their own profile within this portal," says Man FRM's Thompson. "This enables them to drill down into their portfolios and analyse their investments based on a very wide range of performance and risk metrics."

All the hedge fund managers have to do is to implement their strategies consistent with the investment guidelines and objectives and we handle the core non-investment functions including all cash and securities movements.

ANDREW LAPKIN

Technology-enabled managed accounts are allowing active portfolio management where investors can monitor style drift; identifying position concentration across managers; run beta analysis; have more active rebalancing; and create portfolio overlays. "Continuously enhancing that operational oversight over dozens or hundreds of accounts calls for a significant investment in technology," points out HedgeMark's Kestler.

Because of the sophistication of the tools on these platforms, instead of being seen as a single product, hedge funds can now be deconstructed into alpha and beta generating assets and strategies, so investors can then leverage the granularity of data and ultimately pick and mix the risks, returns and leverage to create customised portfolio exposure.

Smart data

The gamechanger for managed accounts has been the ability to aggregate and digest volumes of unstructured data. In 2006, Clive Humby, a UK mathematician and architect of Tesco's Clubcard, was quoted as saying: "Data is the new oil. It's valuable, but if unrefined it cannot really be used. It has to be changed into gas, plastic, chemicals, etc to create a valuable entity that drives profitable activity; so, must data be broken down, analysed for it to have value."

Sam Thompson
Man FRM

For asset management this is true too. Allocators and services providers able to collect, parse, visualise and deliver meaningful outputs for their clients will be winners in the managed account space when the inevitable consolidation starts.

"In the case of transparency, for example, what has improved is our ability to analyse the data and report it both to our internal teams and to our clients in a way that helps them to make informed investment decisions. This has been supported by our own investment in technology, which has helped us to consume and interpret data more quickly and more interactively," says Man FRM's Thompson.

Part of CME Group, ENSO is a technology innovator in the portfolio finance and treasury industry. ENSO bridges the gap for those managed account platforms, as well as for the underlying hedge funds, that want to increase the efficiency of their transparency and maximise data management.

"Our role is to create efficiencies that bring operational and financial alpha to alternative managers by aggregating and normalising data that is not easily accessible. We collect data from our clients' counterparts, such as prime brokers, swap providers, repo and custodians," explains Paul Busby, chief executive officer at ENSO Financial.

"We have an extensive client base that covers varying fund strategies – multi-strategy, long/short equity, quant and credit, with a heavier bias towards equity-oriented strategies. Our sweet spot is helping client optimise their securities finance, such as securities lending, cash and collateral management," continues Busby.

ENSO is an eight-year-old firm, which with $1trn in assets under administration is the largest aggregated treasury and portfolio finance technology counterparty in the space. "We ingest an incredible amount of data that is aggregated and normalised each morning that is efficiently accessed by our clients via our online suite of dashboards and analytics and custom reporting," says Busby.

"We see trends and flows across regions, sectors large and mid-cap, so our analytics and visualisation tools provide useful intelligence where a timely data edge is valuable," says ENSO's O'Connor, adding "ENSO is the ideal solution for managed account platforms that need the level of transparency, financial and operational alpha that their investors expect."

"For managed account platforms that have a look into dozens or hundreds or managers, this information is a great source of intelligence that allows them benchmark the strategies. Custom reports, online dashboards and a web services application programming interface are a few of the ways clients can access information," says O'Connor.

ENSO's platform was originally created to help hedge fund managers aggregate their market exposure as well as their financing across their multiple prime brokers, but now managers can engage directly on counterparty credit risk, collateral management, portfolio financing and treasury with their respective counterparties.

"Most of the large platforms on the *HFM* survey use us to maximise their treasury operations, we like to call it operational alpha," says ENSO's Busby.

"Until now, only the largest most sophisticated hedge funds and asset managers could afford in-house specialist treasury operations that they could leverage to give them a competitive edge in and cost savings, but the increased cost of liquidity and the rising cost of funding means all managers need access to alpha enhancing treasury and portfolio finance tools. In most cases even now, the largest managers would rather use a third party to manage this process than build inhouse solutions," continues Busby.

Despite having its own treasury operation, Man FRM understands the power of useable data and as such is a client of ENSO. "We use ENSO as a vendor to provide us a counterparty data feed as they have great connectivity to all counterparties on the street. What we get is one consistent data feed into our systems," says Thompson.

ENSO Data Insights provides hedge funds, asset managers and banks with access to a diverse pool of global multi-asset class securities to help them compare best execution financing rates, trend analysis for long and short position sector changes, sector breakdown, top position movers, crowdedness scoring, and the most active stock borrow rate changes as it relates to the ENSO Rate.

"The market has had limited access to aggregated and anonymised long and short alternative data," said ENSO's Busby, adding, "ENSO Data Insights taps into our derived data to provide the market with a unique insight into how trending securities are being positioned by alternative fund managers. This allows for an enhanced analytical process, driving better informed investment and best execution financing decisions."

ENSO is not alone. "We have developed data enrichment process technology that leverages the transparency made available in a managed account to produce customised reports tailored to the clients' requirements for risk exposure and performance reporting," says HedgeMark's Lapkin.

Operational and structural alpha

In his February 2018 blog, MassPRIM's CIO, Michael Trotsky wrote: "We value a basis point of cost reduction more than a basis point of return. Why? We can count on cost savings every year, but nobody ever really knows what the markets will deliver."

One way to reduce costs and 'save' money is through operational and treasury management efficiencies, sometimes referred to as efficiency financing or operational alpha, made possible with advances in technologies and the rise of software as a service, such as ENSO's suite of products.

"The enhanced transparency driven by huge volumes of digested and aggregated data is allowing investors to customise their strategies,

Paul Busby
ENSO

manage liquidity, capital usage and fees across portfolios, creating additional costs savings particularly in treasury management that is now commonly referred to as operation alpha," says ENSO's Busby.

"When returns are low, finding ways to save basis points is as important as ways to add basis points and this can be done through managing financing costs. Transparency ensures that balance sheet capital is used efficiently. Optimising every trade creates operational alpha," explains ENSO's O'Connor.

"Active treasury management can add 10 to 15 basis points, and sometimes two or three times more depending on the strategy and asset class. For example, regional, small cap and leveraged strategies will have more savings and efficiencies," he adds.

ENSO Data Insights taps into our derived data to provide the market with a unique insight into how trending securities are being positioned by alternative fund managers. This allows for an enhanced analytical process, driving better informed investment and best execution financing decisions.

PAUL BUSBY

The most obvious cost savings come from the economies of scale that managed accounts are able to leverage. "Managed account investors are often able to negotiate reduced, platform-wide rates with service providers, which can result in lower fund operating expenses and an improvement in the total return," says HedgeMark's Kestler.

"We are continually looking to use our greater buying power to try and achieve improved fee reductions and discounts," says Man FRM's Thompson. "Consolidating prime broker relationships across managed accounts can enable our clients to achieve better economies of scale and also helps to ensure a

Man | FRM

Partnership-based approach

Man FRM offers a full spectrum of services, ranging from platform operations to full investment support, to help investors meet their specific objectives. Our focus is on providing increased flexibility, transparency and cost efficiency.

Built by investors, for investors

Our managed account platform was built in-house for our own use, drawing on more than two decades of hedge-fund investment experience.

Benefits of size and scale

We leverage the full resources of Man Group, one of the world's largest independent alternative investment managers. Allocators benefit from the same technology, intellectual capital and efficiencies of scale that power all of Man Group's businesses.

www.man.com/frm

This material is for information purposes only and does not constitute an offer or invitation to invest in any product for which any Man Group plc affiliate provides investment advisory or any other services. This material was prepared by Financial Risk Management Limited, which is authorised and regulated in the UK by the Financial Conduct Authority. Unless stated otherwise this information is communicated in the European Economic Area (ex Austria, Germany and Lichtenstein) by Man Solutions Limited which is authorised and regulated in the UK by the Financial Conduct Authority. In Switzerland, this information is communicated by Man Investments AG which is regulated by the Swiss Financial Market Authority FINMA. In Australia, this is communicated by Man Investments Australia Limited ABN 47 002 747 480 AFSL 240581, which is regulated by the Australian Securities & Investments Commission (ASIC). In Austria, Germany and Lichtenstein, this is communicated by Man (Europe) AG, which is regulated by the Financial Market Authority Liechtenstein (FMA). In Hong Kong this is communicated by Man Investments (Hong Kong) Limited and has not been reviewed by the Securities and Futures Commission in Hong Kong. In the United States this material is presented by FRM Investment Management (USA) LLC and is communicated by Man Investments Inc. FRM Investment Management (USA) LLC is registered as an investment advisor with the US Securities and Exchange Commission ('SEC'). Man Investments Inc. is registered as a broker dealer with the SEC and is a member of the Financial Industry Regulatory Authority ('FINRA') and the Securities Investor Protection Corporation ('SIPC'). These registrations and memberships in no way imply a certain level of skill or expertise or that the SEC, FINRA or SIPC have endorsed FRM Investment Management (USA) LLC or Man Investments Inc. Man Investments Inc. 452 Fifth Avenue, 27th floor, NY, NY 10018. Tel: (212) 649-6600 more comprehensive service across the full portfolio," he adds.

In the managed account space, additional 'alpha' can be created by how investments are structured. "Another component of the potential cost savings that is more specific to the managed accounts space is that we are able to construct simpler structures compared to co-mingled alternatives and that can save money," says Man FRM's Thompson.

The rise in the use of dedicated managed accounts has also allowed investors to save money in another way: cash efficiency. This is related to the management of the cash balances held aside to offset strategies such as long/short equity and macro that do not need to be fully funded.

In a SMA, the investor has control over unencumbered cash, so finding ways to get returns on this liquidity can add to the overall returns. "We have a tool kit that will allow a managed account to have the operational treasury efficiency that a large multi-strategy fund can have," says ENSO's Busby.

"The low to negative rate environment of the last decade left cash as a forgotten asset on the balance sheet of hedge funds. Rising rates in the US provide an opportunity for active treasury management of cash and collateral to be a source of alpha for the fund," he adds.

"Identifying optimisation opportunities and maintaining discipline in best execution finance are the most important roles in treasury. The reports and analysis we provide to MAP's and managers help them do that in a timely manner," says ENSO's O'Connor.

At Man FRM, the managed account platform is part of Man Group's larger asset management business with a treasury service that sits across all of the business units and, as such, the Man FRM unit can leverage Man's counterparty relationships for the potential benefit of MAP clients.

"While there is nothing new about the potential cash efficiency generated by managed accounts, we are now seeing investors more rigorously scrutinising the amount of capital they need to commit in order to create a certain investment exposure," says Man FRM's Thompson.

Fees are still a big focus

Saving basis points from operational and structural efficiencies are a great addition to returns, but headline fees are still an issue, particularly for public pension fund investors. Dedicated managed accounts, however, have moved the goal posts for fees (and expenses).

As Otto von Bismarck, the first Chancellor of the German Empire between 1871 and 1890, said: "He who has his thumb on the purse has the power." Transparency has allowed the investor to take control of the fees.

It is not only about reducing fees, most investors also want to re-align them, as well as know what expenses are being passed through to the fund. DMA fee structures today include utilising hurdle rates, longer crystallisation periods and performance or management fee-only models. "We see investors negotiating a wide range of custom fee structures that meet their particular preferences," says HedgeMark's Kestler.

Ted O'Connor
ENSO

> ***Identifying optimisation opportunities and maintaining discipline in best execution finance are the most important roles in treasury. The reports and analysis we provide to MAP's and managers help them do that in a timely manner.***
>
> TED O'CONNOR

For the first time in the history of JP Morgan's institutional investor survey, more than half (54%) of all investors are negotiating or looking to negotiate fees paid to hedge fund managers, up from 38% in 2014.

Fee negotiation and/or the application of hurdle rates is one trend that is set to continue in 2019 as 'alignment of interests' is the new face of the hedge fund manager/allocator relationship. Various permutations on the 'outdated 2 and 20' exist.

Allocators are looking to motivate managers through alignment of interests, such as the 1 or 30 fee structure, which has nearly tripled in use year-over-year. Nearly half of all respondents paid less than 1.5% on average in management fees to their hedge fund managers in 2018, an increase of 11%.

Performance fees for 46% of JP Morgan's respondents range between 17.5% and 19.9%, but 40% are paying less than 17.5%. In a similar fashion to the long only world, fees can go down further on an asset weighted basis for larger mandates with 67% of the respondents getting a size discount in 2018.

Allocators that have the lowest fee arrangements, according to JP Morgan, are the banks and platforms (33%) and pension funds (28%) paying less than 1.25% in management fees.

Of the respondents, consultants, one third of which negotiated fees in 2018, seem to pay the lowest performance fee with 67% paying less than 17.5% and the higher average performance fees being paid by banks and platforms (26%) and insurance companies (24%) paying at least 20%. Additionally, 48% received loyalty discounts for the length of time invested with the manager.

The ability to separate alpha and beta means investors can pay appropriately for skill and not expensive beta strategies in disguise. As MassPRIM's Trotsky wrote in the February 2018 blog: "We make sure that every active manager we hire has skill, and we have developed tools to identify managers with skill. We only pay active fees for managers with skill – an attractive manager will produce strong returns that cannot be explained by persistent factor tilts."

Customisation

As investors prepare for potentially turbulent times, Credit Suisse was optimistic about the destination of institutional investors' hedge fund allocations: customised offerings.

"Allocators continue to recalibrate how they employ hedge funds. Preference is shifting to customised solutions through managed accounts and co-investments that tailor fit specific investment objectives, exposures and risk parameters," said Joseph Gasparro, head of content for Credit Suisse

Capital Services Americas.

With almost 60% of allocations over the past 12 to 18 months directed to alternative structures, bespoke managed accounts and co-investments were the principle beneficiaries, according to the 2019 Credit Suisse survey, which polled more than 310 institutional investors globally representing $1.1trn in hedge fund investments.

The trend towards customisation and co-investing has helped funds of hedge funds evolve from being a product-driven business to a solutions driven one. "We are seeing a number of investors looking for support beyond the traditional managed account platform services such as portfolio rebalancing, market insight and manager selection," says Man FRM's Thompson.

Man FRM's managed account platform offers customised bespoke solutions, as opposed to products, as its core service, complete with support in creating the accounts with the managers, operational oversight, treasury oversight, collateral management, analytical services, engagement reporting, rebalancing, due diligence as well as other additional services.

According to the JP Morgan survey, operational due diligence remains a critical piece of allocation decisions with 24% of respondents either outsourcing their operational due diligence functions to third parties (56% in the case of pension funds) or do not have a dedicated operational due diligence team.

"Our role is to support the investors making their investment decisions and to provide risk due diligence on managers. While many institutional investors have investment teams, most do not have specialist operational risk teams. The additional oversight and analysis provided by our operational risk team has been a large draw for mandates. The daily monitoring of manager limits is also a key benefit," notes Man FRM's Thompson.

"Investors are focused on growing relationships with managers who have differentiated expertise, strong risk management skills, and a clear track record of being accretive to an investor's portfolio," adds Credit Suisse's Toma.

Man FRM's Thompson agrees. "Once clients become used to transparency, they experience an often-unexpected mindset shift. What starts as a valuable tool for aggregating performance and risk data, becomes a basis for more targeted conversations, and more meaningful questions."

> ***Our role is to support the investors making their investment decisions and to provide risk due diligence on managers. While many institutional investors have investment teams, most do not have specialist operational risk teams.***
>
> **SAM THOMPSON**

"What we have found is that once investors have the technical information that enhanced reporting offers, in their hands, they can use their time to have more meaningful conversations about what is next for the portfolio," says Man FRM's Thompson.

"This helps to facilitate and foster the strategic partnerships. When you have a strategic partnership between a manager and their investors, creating a bespoke solution comes naturally and often if there is an opportunity for a fee netting component then costs start to come down," continues Thompson.

Customisation via managed accounts solves a number of problems. One of which is the allocation of risk. Custom solutions allow investors to dial up overall risk across the portfolio to achieve the required returns. Investors were finding that with a portfolio of 10 or more hedge fund managers they were overdiversifying and therefore not hitting return targets, as the overall level of risk was not enough to get returns.

"The issue is, if a manager increases risk, it can be a big risk to its business, but in some cases that level of risk is not enough for the investor, so part of the popularity of managed accounts with large allocators is that they can customise their required risk and return targets across the whole portfolio," explains Man FRM's Thompson.

The new regulatory environment makes enhanced reporting essential for investors such as insurance companies to be able to tailor portfolios to target specific needs. Position level transparency allows banks to comply with Basel regulations and insurance companies to meet solvency II reporting requirements.

In the quest for alpha, co-investing and allocations to emerging managers is growing and collaboration between managers and investors via dedicated managed account platforms is supporting this growth. Co-investment opportunities are often the 'best ideas' of a hedge fund, perhaps investments with less liquidity but greater return potential.

The fees are typically lower too as co-investments often give managers the additional capital they might not otherwise have for the deal. "A co-investment opportunity often arises from the manager approaching the allocator with a specific, opportunistic investment idea," says HedgeMark's Kestler.

Emerging managers

As the largest managers continue to get larger through strategic partnership and consolidated assets, the need for niche and size dependent idiosyncratic returns remains as reflected by the programmes being funded by large US public funds.

In addition to MassPRIM's appointment of Innocap and NewAlpha to run the emerging manager programme jointly *(see Investor Interview, page 14)*, the Employees Retirement System of Texas (ERS) has teamed up with Paamco to create a co-investment platform called Paamco Launchpad to seed and support emerging hedge fund managers.

This partnership, launched in June 2018, allows ERS to expand on its $1bn emerging manager programme with the goal of bringing such investments to nearly 10% of its externally managed investment portfolio. Paamco Launchpad is planning $3bn in assets dedicated to supporting emerging managers.

Earlier this year, the Teacher Retirement System of Texas hired Kirk Sims to lead the System's $5.7bn Emerging Manager Program that was started in 2005 and is currently advised by GCM Grosvenor and the Rock Creek Group. Sim is also heading the roll-out of the system's new $3bn commitment to the Emerging Manager 3.0 Program.

According to a study by AMG, looking at returns from 31 March 1998 to 31 March 2018, boutique active investment managers have outperformed both non-boutique peers and the indices over the last two decades. Investing only with boutiques would have created 16% greater wealth over the 10-year period.

That said, today launching a hedge fund requires $50m to $100m in assets to gain traction and the compliance costs alone are eye watering. DMAs are one way around this by allowing managers to focus on portfolio management and trading.

"Managed accounts allow investors to eliminate many of the operational due diligence concerns, such as daily cash control, net asset value oversight, and gating decisions among other things," HedgeMark's Lapkin.

"We have seen several clients use their managed account platforms as a means to access emerging managers. Given that HedgeMark is performing the key non-investment functions including cash movements and NAV approval, it is easier for investors to approve allocating to managers who may have strong investment acumen but lack an institutional operational infrastructure," says HedgeMark's Kestler

In the new NewAlpha/Innocap arrangement, new managers that do not quite adhere to the MassPRIM emerging manager guidelines are supported and guided by the platform joint venture until they are ready to receive funding.

"Transferring boutique operational risk to an institutional managed account platform immediately opens up a whole new universe of managers that otherwise would have been excluded from investors' selection process," says Man FRM's Thompson.

Bridging the gap

Managed accounts are not only helping to bridge the gap between managers and their investors, but between traditional and alternative asset managers. "Investors are increasingly looking at allocations through the lens of their overall portfolio, converging hedge funds with traditional asset classes." said Credit Suisse's Gasparro.

One of the consequences of the post crisis regulation of the hedge fund, banking and insurance industries was the growth in the 'regulated' onshore structure that through managed accounts addressed the liquidity and oversight issues it highlighted.

In Europe, this resulted in the European Commission creating the Alternative Investment Fund Managers Directive (AIFMD), which came into force in 2014. In the US, a movement to bring hedge funds onshore resulted in a growth of alternative mutual funds registered with the SEC under the 1940 Act.

"Ucits seem to have become the preferred managed account investment structure for hedge fund investors looking for improved control, governance and transparency in Europe," says HedgeMark's Lapkin. One of the reasons is that the onshore brand is also valid in Asia and Latin America.

The hedge fund move to onshore Ucits and the long-only world's step into alternatives has also seen a convergence, and consolidation, among asset managers. Traditional asset managers that have added hedge fund businesses have typically favoured managed accounts to aggregate data on hedge fund and long-only holdings into a simplified report.

Integrating ESG

The convergence of the traditional and alternative asset management worlds is also driving the need to consider environmental, social and governance (ESG) issues as part of running a hedge fund business. "There is an emerging trend is to help investors with monitoring restricted lists so they can comply with ESG or other investment restriction guidelines," notes HedgeMark's Lapkin.

Globally, sustainable investing assets in the five major markets stood at $30.7trn at the start of 2018, a 34% increase in two years, according to the 2018 *Global Sustainable Investment Review*. In all the regions, except Europe, which remains the biggest socially conscious investing market, sustainable investing's market share has also grown.

Responsible investment now commands a sizable share of professionally managed assets in each region, ranging from 18% in Japan to 63% in Australia and New Zealand. For some, however, ESG and hedge funds is almost an oxymoron.

In the hedge fund universe, managers and their investors largely disagree as to the importance of ESG factors moving forwards.

Steven Desmyter, global co-head of sales and marketing, co-head of responsible investment and co-chair of the responsible investment committee at Man Group, says responsible investing is being driven by the fiduciary expectations of clients. JP Morgan's investor survey shows that 41% of investors are accessing their ESG/SRI exposure through their hedge fund investments, up from 37% last year.

"ESG integration is not a recent trend at Man Group. The firm has been taking ESG factors into account for years, but there is growing demand to understand ESG performance, and this is driving better reporting and disclosure as investors generally move from exclusionary to integrated ESG strategies," Desmyter says.

Man Group approaches responsible investing in three ways: rules-based screening (restrictive lists that exclude coal or weapons, for example, or positive inclusion); ESG integration (measuring ESG factors, looking at non-traditional risk); and impact investing, where investors intentionally want to do good and typically aim to use the 17 United Nations Sustainable Development Goals, as well as target returns.

Steven Desmyter
Man Group

"From a hedge fund perspective, we are using all three frameworks to inform discussions, and we are aware that not all are compatible with all strategies. For example, quantitative strategies do not generally lend themselves to impact investing or corporate engagement, but they can be useful tools for rules-based screening," says Man

Group's Desmyter.

"If there are certain types of exposures that investors do not want, the investor will contractually restrict the manager in terms of what they can use in the mandated portfolio. This can include implementing ESG factors, such as a restricted list, and managed accounts can help with the oversight and reporting," explains Man FRM's Thompson.

"As a manager, we can help with proxy voting, connecting pension funds and their proxy voting advisers to the corporate actions teams at the prime brokers or custodians, making sure voter ballots are directed to the right place," says Man Group's Desmyter.

To help hedge funds move towards a better understanding of what responsible investing is the Principles for Responsible Investment (PRI) launched the first industry-standard due diligence questionnaire for hedge funds two years ago.

More recently, the Alternative Investment Management Association published its *Responsible Investment Primer* answering the more frequently asked questions particularly around perceived conflicts that arise when running a hedge fund and signing up to the UN's principles.

"Take systematic strategies. They technically go against the spirit of responsible investing as defined by the PRI's principles, which focus on active ownership and positive engagement with companies, but they are proving particularly compatible with responsible investing when it comes to exclusionary overlays given they have a large investment universe," says Desmyter.

The $226bn quant fund AQR Capital Management, which signed up to the UN PRI in 2014, is proof of this. Some 75% of the Greenwich, Connecticut-based firm's assets are in ESG-related strategies with $10bn in dedicated ESG solutions, according to its website.

"We believe Man Group's quantitative expertise allows for better analytics and reporting around ESG factors and frameworks," says Desmyter. "One of Man's investment arms, Man Numeric, is building a tool that we can use to look for positive ESG alpha. Governance and exclusion lists are also part of this. There are more than 1,200 non-traditional datasets that can be applied to ESG on the quantitative side, all of which can be used to create information," he explains.

> ***The main challenge for ESG and hedge funds is not that the factors are not credible, but that ESG datasets are hindered by a short history and weak comparability, requiring better understanding than traditional factors. At Man Group our quantitative capabilities provide a distinct position with which we can innovate and apply ESG datasets.***
>
> **STEVEN DESMYTER**

Technology-driven data transparency is helping to bridge the gap and bring ESG into hedge funds. Most recently AQR released a paper called *Hedging Climate Change News*, where it explains its strategy to dynamically hedge climate change risk by analysing newspaper coverage of climate change as a basis.

"The main challenge for ESG and hedge funds is not that the factors are not credible, but that ESG datasets are hindered by a short history and weak comparability, requiring better understanding than traditional factors. At Man Group our quantitative capabilities provide a distinct position with which we can innovate and apply ESG datasets," says Desmyter.

Conclusion

Managed account platforms have come a long way from the asset raising structured product platforms of the investment banking days. Today, they help to bridge the gap between investors and underlying managers by giving the investor control of the assets, flexible liquidity, enhancing tools for customisation, and lower costs and fees.

Managed accounts also bridge the gap between the long-only world and alternatives by providing a platform to consolidate and actively manage overlapping holdings. For an investor wanting to add alpha beyond the strategy allocation and niche returns of emerging managers, operational and structural alpha is now a very real area where savings can increase the basis point returns. And dedicated managed accounts are the conduit for this.

"We continue to believe that using a dedicated managed account structure will become the accepted way for large institutional investors to allocate to hedge fund managers in the future. Since the launch of our platform, we have seen an increasing number of institutional investors adopt managed account structures each year. We expect that trend to continue for years to come," says HedgeMark's Lapkin.

As more and more hedge funds start to engage in ESG integration, dedicated managed accounts are also likely to become an access point for those managers that are not in a position to invest in the technology and data. "We have the ability to run client portfolios against proprietary ESG metrics built in-house for the firm's own use, but when it comes to ESG, there is no 'one-size-fits-all' approach. Clients have varying appetites for ESG integration and Man FRM is focused on providing bespoke client solutions," says Man FRM's Thompson.

"Continued growth in the managed account space is inevitable. Those that are able to invest in the technology to optimise both treasuring financing and active portfolio management will be best suited to thrive," says ENSO's Busby.

One challenge for investors new to managed accounts, however, is that the space is not mature. Fund administration, custody and prime brokers are judged on who has the better technology, people and pricing but the services are largely similar. This is not yet so in the managed account space.

Until the industry matures, MassPRIM's Eric Nierenberg and Matt Liposky offer some advice: invest time on doing due diligence. "There are a lot of platforms out there, and it is important to find the right partner offering the complete service package." ◘

From FoHFs to direct emerging manager allocations: *the iterative 15-year evolution of a hedge fund investor*

Highlighted by the financial crisis, institutional investor requirements such as fee sensitivity, returns, diversification, control, transparency and liquidity, have helped to usher in a new era of collaboration, co-investment and customisation between investors and their managers that has redefined hedge fund investing.

Massachusetts Pension Reserves Investment Management Board (MassPRIM) is the perfect example of the iterative journey from funds of hedge funds to direct allocations, and most recently directly to emerging managers in the global macro space. Today, MassPRIM no longer sees hedge funds as an asset to allocate, but a tool to complete the risk/return requirements of the overall portfolio.

MassPRIM is the supervisor of the Pension Reserves Investment Fund (PRIT), a pooled fund that invests the assets of the Massachusetts Teachers' and State Employees' Retirement Systems and assets of county, authority, district and municipal retirement systems that choose to invest in it.

Its mission is to provide a professional investment service that maximises the return on investment within acceptable levels of risk by broadly diversifying its investment portfolio, capitalising on economies of scale to achieve cost-effective operations and providing access to high quality, innovative investment management.

More than 15 years ago, MassPRIM started down the hedge fund route and decided to invest 5% via funds of hedge funds. With advice from NEPC, the board hired a number of funds of hedge funds including Arden Asset Management, Ivy Asset Management, K2 Advisors, Grosvenor Capital Management and Pacific Alternative Asset Management Company (Paamco) to run the $1.6bn Absolute Return Program.

Right from the start, the board had authority to 'invest directly in hedge fund managers to eliminate the layer of fees incurred with funds of hedge funds'. The plan was to transition to this once the investment team and board became more comfortable with the different strategies.

The state plan realised early on that additional returns could be gained from looking at alphas and betas separately and in 2006 decided to invest 5% in a US Equity Portable Alpha Program that included both a beta overlay as well as a fund of funds programme.

The lack of liquidity and the gates and locks on hedge funds during the financial crisis saw many portable alpha strategies struggle. The programme was dismantled three years later, but at the same time MassPRIM committed to increase the hedge fund allocation to 8%.

By 2012, not only had funds of hedge funds fallen out of favour in terms of value for money, but MassPRIM was ready to move to direct allocations and issued a request for proposal for Hedge Fund of Fund Transition Management Services.

The plan was to liquidate four funds of hedge funds and transition approximately $2.8bn in assets allocated with 175 underlying hedge fund investments to directly managed separate accounts. A move that according to board documents was designed to save approximately $36m per year in investment management fees.

Working together with Cliffwater, incumbent fund of hedge fund manager Arden Asset Management was retained as transition manager to transfer the underlying hedge fund assets it managed as well as those of Grosvenor Capital Management, K2 Advisors, Paamco and the Rock Creek Group to 20 new board-approved hedge fund managers in the Direct Hedge Fund Program.

The transition process took almost two years. Once completed, direct hedge funds represented 85% of the new portfolio, the remaining 15% was left with Paamco due to its focus on emerging managers.

The purpose of the portfolio also shifted from being an 'absolute return' allocation to become a Portfolio Completion Strategy portfolio. "We really view [hedge funds] now as a completion tool for the total programme; a diversifying tool to generate risk-adjusted returns across the entire portfolio," says Eric Nierenberg, chief strategy officer.

We are a state plan with fiduciary responsibility, so for us control is key. Control in the sense that in the traditional commingled vehicles, the manager is the one that controls the assets and the cash.

MATT LIPOSKY

"The best way that we are able to do that is through separately managed accounts because of the ability to get transparency on underlying positions. Combine those with your other [long-only] assets and you get a really good sense of what your total positions and exposures are," adds Nierenberg.

The managed account platform mandate went out to public tender and MassPRIM received 14 proposals, from which it shortlisted seven, including the managed account services of incumbent funds of funds Arden, Paamco and Rock Creek.

Matt Liposky
MassPRIM

"The four main drivers [for setting up the SMAs] are control, transparency, customisation and fee terms," says Matt Liposky, MassPRIM's chief investment operating officer. "We are a state plan with fiduciary responsibility, so for us control is key. Control in the sense that in the traditional commingled vehicles, the manager is the one that controls the assets and the cash," he adds.

"In the past, lockups and redemption schedules were so complex that if something went wrong, an investor could be gated or locked in for six to 12 months before getting capital back," explains Liposky. "In a separately managed account if something were to go south, we have the ability to shut off the manager's access of cash and capital that day," he adds.

MassPRIM appointed HedgeMark, a subsidiary of its existing custodian BNY Mellon, to provide these services. "HedgeMark provides the full service including cash, collateral, margin management as well as onboarding managers, creating counterparty agreements across many strategies even the more complex ones, all in a six to eight-week period," says Liposky.

When MassPRIM first embarked on its hedge fund journey in June 2003, the objective was to reduce the volatility of the total fund, while continuing to maximise returns in a variety of market environments.

In 2019, following advice from its asset allocation consultant NEPC, which has been advising clients to reduce public equity exposure as the US economy transitions from a mid-to-late cycle environment, the rationale to up the allocation by 1% ahead of potential recession, is no different.

What has changed is how the $69.3bn Boston-based fund uses hedge funds: the increased allocation will go to the Portfolio Completion Strategies portfolio, which now also includes alternative risk premia.

Three of the hedge fund managers in the Portfolio Completion Strategies portfolio – PanAgora Asset Management, AQR Capital Management and Goldman Sachs Asset Management – now provide the plan with alternative risk premia.

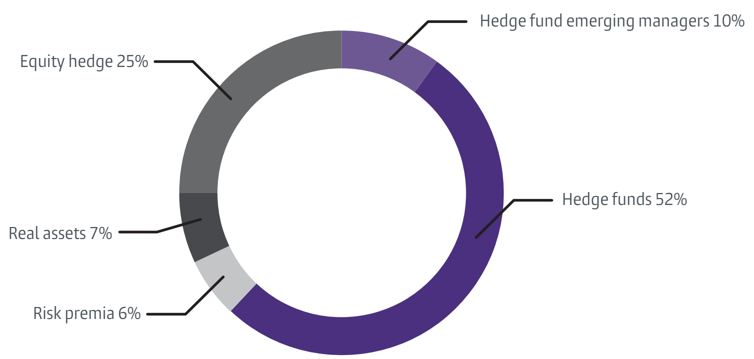
Customisation of risk and return profiles across different strategies has only been made possible since certain managed account platforms have evolved to become far more sophisticated and integrated technology and data-driven partners.

Nierenberg's Harvard University background in behavioural finance was one of the reasons the public fund decided to dig deeper on what precise skills managers bring to the table. It was on his recommendation that the board developed a framework to assess manager returns and the $600m Portfolio Completion Strategies portfolio was created in 2013.

By 2017, the results spoke for themselves. In the August 2017 blog, MassPRIM's CIO Michael Trotsky said: "Over the past few years, we have re-engineered our hedge fund portfolio, re-engineered the fixed income portfolio, and added significant risk-reducing strategies such as long-duration Treasury securities, agriculture, the put-spread-collar options strategy and alternative risk premia harvesting.

"We have reached an important milestone in the hedge fund portfolio. Now, more than 50% of our direct hedge fund portfolio is invested in separately managed accounts, providing improved transparency, more control and lower fees than the commingled format.

Portfolio completion strategies portfolio*



** as of 30 June 2018 Source: MassPRIM*

"As a great illustration of our attention to risk, the hedge fund portfolio returned 9.4% net of fees, 3.1% above the benchmark, while exhibiting extremely low realised volatility of approximately 1.5%. This combined with a return of 9.4% was the highest risk-adjusted return in the entire PRIM portfolio."

For fiscal year 2018, the PRIT Fund returned 9.5% net of fees, with the Portfolio Completion Strategies allocation returning 6.8% net of fees, 78 basis points above the benchmark while exhibiting low realised volatility of approximately 2.8%.

The 30 direct hedge fund managers (*see table page 16*) currently listed under the Portfolio Completion Strategies category now make up 13.4% of the total assets. The majority are housed on the dedicated managed account platform run by HedgeMark, a mandate that was renewed in May.

In fact, at the start of the year, MassPRIM issued a request for proposals for both portfolio completion strategies advisory and managed account platform services. It received 11 proposals and as well as retaining HedgeMark, the board also renewed its contract with Arden, now part of Aberdeen Standard Investments, as the primary adviser for the Portfolio Completion Strategies portfolio.

At the same time, the board decided to appoint NewAlpha Asset Management as a specialist adviser to source and do due diligence on global macro, relative value trading and systematic strategies.

Now on the next leg of its hedge fund journey, MassPRIM is going to be allocating directly to emerging managers initially in the discretionary macro, systematic macro, commodity trading adviser and relative value space.

For the emerging manager direct hedge fund advisory services mandate, NewAlpha submitted a joint proposal with Canadian structuring and operational alpha managed account platform Innocap, which is now part of La Caisse de dépôt et placement du Québec. The Innocap platform started in 1996 as the internal managed accounts-based fund of hedge funds within National Bank of Canada's Treasury operations.

Emerging managers are not a new area for Innocap's managed account platform. The Montreal-based firm had previous experience in structuring and operating a similar programme that was launched in 2016. The Quebec Emerging Manager Program was supported by the Quebec financial community to promote entrepreneurship and invest with local emerging managers.

MassPRIM's assets under management sweet spot for hedge fund managers in general is $2bn. "We looked at the programme and wanted to make sure we were not missing out on interesting trading ideas so decided to create an explicit emerging manager programme to seek out firms with less than $500m in assets under management," explains Nierenberg.

The increasing sophistication of the transparency and data provided by managed account platforms has created a life line to smaller, niche managers that both need to raise assets but also require infrastructural and operational support. "We decided to appoint a separate managed account platform provider because onboarding and monitoring early stage managers requires different skills," says Liposky.

"Ten to 12 providers pitched for the mandate, but we were impressed by the creativity of the NewAlpha and Innocap partnership. They are willing to work with the newer managers we would like to allocate to, to get them to the institutional level we require. Almost like a mentoring programme," says Liposky, noting that with two to three members of staff at MassPRIM they would not have had the required resources to do this inhouse.

PRIM staff believe that emerging managers tend to outperform their larger peers and that the defensive nature of global macro strategies could help improve the return/risk profile of the PRIT fund. "Our goal is to find managers who are employing eclectic strategies that are not easy to find and don't necessarily scale," says Nierenberg.

Eric Nierenberg
MassPRIM

For the emerging hedge fund manager mandate, MassPRIM defines 'emerging as those managing less than $500m. "For now, we will not be a day one investor, so we need them to have some form of track record and we need their strategies to be uncorrelated to the rest of the managers and assets we have," says Nierenberg. The plan has so far invested with four managers and in the medium term hopes to be able to allocate $500m.

One of the key pieces of advice that Nierenberg and Liposky offer anyone looking at managed account platforms to invest time on doing due diligence. "There are a lot of platforms out there, and it is important to find the right partner offering the complete service package."

Portfolio Completion Strategy Managers

Manager	Location	Inception date	Mandate	Strategy
400 Capital Management	New York, NY	Jul-15	Direct Hedge Funds	Relative Value
Aeolus Capital Management	Hamilton, Bermuda			Real Assets
AgIS Capital	Boston, MA	Apr-16	Agricultural	Real Assets
Anchorage Capital	New York, NY	Nov-11	Direct Hedge Funds	Event Driven
AQR Capital Management	Greenwich, CT	Oct-15	Risk Premia	
Arden Asset Management	New York, NY	Jul-04	FoHFs Transition Management	
Brigade Capital Management	New York, NY	Jan-12	Direct Hedge Funds	Relative Value
Cantab Capital Partners	Cambridge, UK	Nov-13	Direct Hedge Funds	Global Macro
Canvas Capital	Rio de Janeiro, Brazil	Nov-17	Direct Hedge Funds	Event Driven
Capula Investment Management	Greenwich, CT	Jan-12	Direct Hedge Funds	Relative Value
Claren Road Asset Management	New York, NY		Direct Hedge Funds	Relative Value
Contrarian Capital Management	Greenwich, CT	Aug-16	Direct Hedge Funds	Event Driven
Davidson Kempner Capital Management	New York, NY	Jan-12	Direct Hedge Funds	Event Driven
East Lodge Capital	London, UK	May-16	Direct Hedge Funds	Relative Value
Elliott Management Corporation	New York, NY	Jan-12	Direct Hedge Funds	Event Driven
Goldman Sachs Asset Management	New York, NY	Jul-15	Risk Premia	Equity Hedge
Highfields Capital	Boston, MA	Jan-12	Direct Hedge Funds	Event Driven
Informed Portfolio Management	Stockholm, Sweden	Sep-16	Direct Hedge Funds	Global Macro
JEN Partners	New York, NY	Jun-16	Residential Land Development	Real Assets
King Street Capital Management	New York, NY		Direct Hedge Funds	Event Driven
Land and Buildings Investment Management	Stamford, CT	Aug-16	Direct Hedge Funds	Event Driven
Markel CATco Investment Management	Hamilton, Bermuda			Real Assets
Mudrick Capital Management	New York, NY	Sep-15	Direct Hedge Funds	Event Driven
Och-Ziff Capital Management Group	New York, NY	Nov-11	Direct Hedge Funds	Event Driven
Paamco	Newport Beach, CA	Aug-04	Fund of Hedge Funds	Emerging managers
PanAgora Asset Management	Boston, MA	Jan-15	Direct Hedge Funds/Risk Premia	Relative Value
Pershing Square Capital Management	New York, NY	Jan-12	Direct Hedge Funds	Event Driven
SECOR Capital Advisors	New York, NY	Mar-16	Direct Hedge Funds	Global Macro
Steadfast Capital Management	New York, NY	Sep-12	Direct Hedge Funds	Equity/Long Short
Winton Capital Management	London, England	Jan-12	Direct Hedge Funds	Global Macro

Source: MassPRIM

Leading MAPs continue to grow in 2018

BY **SIOBHÁN HALLISSEY,** DATA AND RESEARCH MANAGER, *HFM*

The assets on the 10 largest managed account platforms continued to grow in 2018, despite poor performance across much of the hedge fund industry in the second half of the year.

The assets of the MAPs included in the rankings increased by 10.5%, from $102.5bn to $113.3bn, during 2018, with the majority coming from the growth of providers of dedicated managed account services.

The assets of BNY Mellon's subsidiary, HedgeMark, increased by 16.5% to manage $16.2bn by December, up from $13.9bn at the start of the year. Assets on the platform grew by 19% in the first half of 2018 to reach $16.6bn, before falling by 2% during the second six months.

The fall was in line with the 2% decline of the HFM Global Composite Index.

According to president and COO Joshua Kestler, HedgeMark saw significant demand for managed accounts from large pension plans and asset managers in 2018, with the asset management space a significant driver of growth for HedgeMark.

Kestler has seen growing interest for custom solutions focused on emerging managers, co-investments and socially responsible investing, he explains.

HedgeMark onboarded a new client in 2018 that had previously built managed account capabilities internally but had opted to outsource due to the operational burden involved.

"Today, there are far greater options at a reasonable price to outsource," Kestler says. "A decade ago, there weren't many viable options to outsource the set-up and operations of a dedicated manged account platform.

"The industry has really begun to focus on dedicated managed account service offerings in the last five or so years, so a lot has changed to give investors more avenues to invest via their own dedicated managed accounts."

Kestler expects 2019 to be another big growth year and the team has focused on developing technology to automate the operational requirements of managed accounts, to allow the firm to continue to scale up to manage a greater asset base, he says.

InfraHedge tops the table, although its $35.4bn asset figure and the 12-month growth percentages are to June 2018, as the platform only reports its assets once a year.

Andrew Allright, CEO, explains that platform assets were relatively flat during the second half of 2018, which coincided with a notable increase in decisions being made around hedge fund allocations.

"Investors were re-analysing their investments, some chose to close out, while others added further assets to their hedge fund managed accounts," he says.

He explains that, while performance has been a problem, it wasn't the primary driver. Most of the clients that redeemed their investments had been looking at doing so for a long time, monitoring many of the hedge fund closures that have occurred in recent years, he adds.

In Allright's view, the investors that chose to close their hedge fund managed accounts exited at "exactly the wrong time, as with increased volatility in markets, hedge funds should provide protection or outperformance if and when there is a downturn".

According to Allright, asset management consolidation has helped to drive growth. Traditional asset managers that have bolted on alternative/hedge fund business favour managed accounts, as they provide the same insights, transparency and oversight as long-only products.

"Managed accounts allow investors to aggregate their hedge fund investments with their long-only investments into a simple reporting engine, allowing them to make more informed decisions," he says.

At 21.9%, Lyxor Asset Management's MAP achieved the strongest asset percentage growth in 2018.

Assets rose from $14.6bn to $17.8bn over the year and Nathanael Benzaken, chief client officer at Lyxor, expects they could rise by a further $1bn in the first half of 2019.

The growth has been driven by its dedicated MAP, which is domiciled in Jersey.

The Lyxor team is leveraging its hedge fund investor DNA to grow the platform, rather than being a pure infrastructure provider, says Benzaken.

"The performance of the platform in 2018 was not down to luck, but due to our robust investment process," he says, adding that growth on the Paris-headquartered firm's dedicated MAP has been driven predominantly by where we are in the market cycle.

Investors are expecting growth will begin to slow down across the board and are nervous about the beta exposure in their equity and fixed income portfolios. As alternatives such as private equity, real estate and infrastructure have long seven to ten-year investment horizons, Benzaken argues that it only really leaves hedge funds as an attractive liquid solution to address diversification.

"Investors want to make the diversification impactful. A one to two percent allocation to alternatives doesn't move the needle, so they need to allocate bigger tickets, and this is where dedicated managed accounts kick in," he says.

Innocap's platform grew by more than 20% in 2018, with assets rising from $5.9bn to $7.1bn.

Jonathan Planté, who leads the business development efforts for the Montreal, Canada-based firm, explains that the 2018 growth came from new pension clients in the US and Canada.

The platform's assets have risen

by more than 20% every year since François Rivard joined Innocap as president and chief executive officer in 2013. It has grown by 45% in the last two years alone, jumping from $4.9bn in December 2016 to $7.1bn by the end of December 2018.

Assets on Man FRM's MAP increased by a more modest 5.5% in 2018, rising from $16.4bn in January to $17.3bn by the end of the year.

Dedicated managed accounts drove growth, with a notable percentage of new clients to the platform interested in accessing additional services and support, Sam Thompson, head of managed accounts, explains.

"Our position as a hedge fund allocator with an experienced investment team means we can supplement the services offered to our dedicated managed account clients. We can provide support with the operational and investment due-diligence process, as well as advisory services to assist clients with selecting and monitoring mangers," he says.

Another emerging trend the team has noticed in the last 12 months is that portions of its new asset owner clients have begun to look for ways to optimise its trading relationships across the aggregate portfolio to improve cash efficiency.

Thompson explains that treasury management is a consistent service for a MAP provider, but in a rising rate environment, assistance with efficiency improvements, such as consolidating prime broker relationships across the aggregate portfolio, has become more of a focus.

"Consolidating prime broker relationships across managed accounts can enable our clients to achieve better economies of scale and also helps to guarantee a more comprehensive service across the full portfolio," Thompson says.

"We are independent of large trading houses, so we are free to source and select what we believe to be the best provider with the best terms for our clients," he adds.

Man FRM's client base is spread geographically. North America accounts for the largest share of the assets and the team has also seen interest from Europe and Asia during 2018.

Most of its clients are asset owners, but Thompson explains that the team has also had conversations with hedge fund intermediaries, such as investment consultants. "These would be symbiotic relationships, as we would both be working for the best result for the client," he says.

Lighthouse's MAP grew in 2018 by about 3% in terms of assets and nearly 6% in terms of number of managed accounts. It finished the year with 114 active accounts.

While Lighthouse's funds continue to be the largest consumer of its MAP, the managed account infrastructure services business saw a 25% increase in terms of total assets.

Lighthouse launched 19 managed accounts last year, the majority of which were in equity and quantitative-related strategies.

Lighthouse also launched eleven managed accounts for portfolio managers that are exclusive to the firm. This group represents over one-third of total managed accounts on Lighthouse' platform.

It estimates that since it began using managed accounts in the early 2000s, the firm has launched over 400 managed accounts.

For 2019, Lighthouse is focused on continuing to grow its MAP/infrastructure services business with strategic partners. In addition, it is seeking to convert certain underlying investments acquired from Mesirow Advanced Strategies to managed accounts.

The largest asset-loser last year was Paamco Prisma, whose MAP AuM fell by a third to stand at $3bn by the end of December 2018.

The outflows came during a transitional year for the firm. The two groups merged in July 2017, with co-CEOs Jane Buchan and Girish Reddy announcing their departures from the combined firm last June.

A consequence of mergers and leadership changes is often that consultants opt to put a manager on watch as a precaution, which can lead to investor redemptions. Since the beginning of the year, the firm says it has received substantial new allocations in the US and Europe.

LGT Capital Partners and EnTrust were the other multi-manager-owned platforms that saw assets fall in 2018.

LGT's 11.1% decline was in line with the groups' overall asset losses for 2018, as reported in the HFM InvestHedge Billion Dollar Club, while EnTrust's MAP lost 6.5%, based on figures submitted in June, when it managed $2.7bn. ◘

Top 10 managed account platforms ranked by assets

	AUM 31/12/2018 ($bn)	AUM 01/01/2018 ($bn)	12-mth growth ($bn)	12-mth growth (%)	AUM 30/06/2018 ($bn)	6-mth growth ($bn)	6-mth growth (%)
InfraHedge*	35.4	30.2	5.2	17.2%	35.4	0.0	0.0%
Lyxor Asset Management	17.8	14.6	3.2	21.9%	16.3	1.5	9.2%
Man FRM	17.3	16.4	0.9	5.5%	17.9	-0.6	-3.4%
HedgeMark	16.2	13.9	2.3	16.5%	16.6	-0.3	-2.0%
Lighthouse Partners	9.5	9.3	0.2	2.2%	9.5	0.0	0.0%
Innocap	7.1	5.9	1.2	20.3%	6.3	0.8	12.7%
K2 Advisors	6.2	6.2	0.0	0.0%	6.9	-0.7	-10.1%
LGT Capital Partners	4.3	4.8	-0.5	-11.1%	4.2	0.0	0.5%
Paamco Prisma	3.0	4.5	-1.5	-33.3%	4.0	-1.0	-24.8%
EntrustPermal*	2.7	2.9	-0.2	-6.5%	2.7	0.0	0.0%
Total†	**113.3**	**102.5**	**10.8**	**10.5%**	**112.9**	**0.4**	**0.4%**

*† Total adjusted to avoid double counting of platform assets * Data as of June 2018 Source: HFM InvestHedge database*

CME GROUP

As the world's leading and most diverse derivatives marketplace, CME Group (www.cmegroup.com) enables clients to trade futures, options, cash and OTC markets, optimize portfolios, and analyze data – empowering market participants worldwide to efficiently manage risk and capture opportunities. CME Group exchanges offer the widest range of global benchmark products across all major asset classes based on interest rates, equity indexes, foreign exchange, energy, agricultural products and metals. The company offers futures and options on futures trading through the CME Globex® platform, fixed income trading via BrokerTec and foreign exchange trading on the EBS platform. In addition, it operates one of the world's leading central counterparty clearing providers, CME Clearing. With a range of pre- and post-trade products and services underpinning the entire lifecycle of a trade, CME Group also offers optimization and reconciliation services through TriOptima, and trade processing services through Traiana.

CME Group, the Globe logo, CME, Chicago Mercantile Exchange, Globex, and, E-mini are trademarks of Chicago Mercantile Exchange Inc. CBOT and Chicago Board of Trade are trademarks of Board of Trade of the City of Chicago, Inc. NYMEX, New York Mercantile Exchange and ClearPort are trademarks of New York Mercantile Exchange, Inc. COMEX is a trademark of Commodity Exchange, Inc. BrokerTec, EBS, TriOptima, and Traiana are trademarks of BrokerTec Europe LTD, EBS Group LTD, TriOptima AB, and Traiana, Inc., respectively. Dow Jones, Dow Jones Industrial Average, S&P 500 and S&P are service and/or trademarks of Dow Jones Trademark Holdings LLC, Standard & Poor's Financial Services LLC and S&P/Dow Jones Indices LLC, as the case may be, and have been licensed for use by Chicago Mercantile Exchange Inc. All other trademarks are the property of their respective owners.

For further information/

e/ inquiry@ensofinancial.com **w/**www.ensofinancial.com/request-a-demo

HEDGEMARK

HedgeMark, a BNY Mellon Company, specialises in supporting institutional clients in the development and operation of their own private hedge fund dedicated managed account platforms. As one of the industry's largest platform providers, HedgeMark provides platform services on over $18 billion in assets as of April 2019. HedgeMark's dedicated managed account services and position-level risk and performance analytics are aimed at institutional investors seeking increased customisation, transparency, control and governance around their hedge fund investments. HedgeMark's team is led by wellestablished industry professionals with extensive experience in the structuring, operations, monitoring and oversight of hedge fund managed account structures.

For further information/

Benjamin Yaffee, Global Head of Sales

HedgeMark Advisors, LLC, 240 Greenwich Street, 6th Floor East, New York, NY 10286

e/ byaffee@bnymellon.com **t/** Main: +212 888 1300 **w/** www.hm.bnymellon.com

MAN FRM

Man FRM is an alternative investment specialist, deploying investment, advisory and managed account services for client portfolios. Man FRM provides an open-architecture, full service offering to clients, ranging from advisory work to customised portfolio solutions, as well as a technologically advanced managed account platform. Man FRM continues to develop its managed account platform services, responding to increased client interest. The business works closely in partnership with clients, in areas such as portfolio allocation, risk analysis and risk architecture. These services are complemented by Man FRM's Clarus tool, an internally developed, sophisticated online portal providing clients with enhanced transparency and insight into their alternative investment portfolios. Founded in 1991 and becoming part of Man Group in 2012, Man FRM's managed account platform assets under management were 18.6bn* as of 31 March 2019.

**Figure includes the assets of managed accounts managed by internal investment engines in connection to an affiliated manager's ("Man Solutions Limited's") Alternative Risk Premia product offering.*

For further information/

Sam Thompson

e/ Sam.Thompson@man.com **t/** +1 212 649 6610 **w/** www.man.com/frm

Steven Desmyter

e/ Steven.Desmyter@man.com **t/** +44 207 144 1296 **w/** www.man.com