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Administrator Transparency Reporting in 2013

Coming out of the credit crisis, and especially following the fraudulent activity of Bernie Madoff, increased investor transparency became a major requirement, most notably for large, institutional investors. Over the last few years, this has extended from a concern of simply the largest investors to be shared by all members of the alternative investment community. To handle the matter, fund administrators began to introduce independent transparency reporting to investment managers and the investors they serve.

This trend towards administrator-provided transparency reporting looks to continue into 2013 and, potentially, take on greater importance. The alternative investment world is becoming increasingly complex as regulatory reporting and investor demands escalate further than ever before. Such reporting has the potential to materially simplify the due diligence process, attract more capital to the industry, and promote greater openness and confidence.

Broadly speaking, this initiative is geared towards independent reporting to hedge fund investors concerning a few of the major areas that are typically covered in due diligence requests. This would include a confirmation of assets and liabilities, pricing sources, counterparty exposures, and diversification information. The idea is that the administrator would regularly prepare such information in an industry-standard format to make interpretation simpler and the aggregation and comparison of the information more user-friendly and accessible.

Some of the major hedge fund due diligence firms, most notably Albourne, have been pushing for administrator transparency reporting for some time. Some see this reporting as one of the most important steps forward in openness for the industry as well as simplifying the due diligence process. No matter what one’s perspective is of administrator transparency reporting, it is gathering momentum and will continue to be a force of change in the industry.

There are some substantial benefits to administrator transparency reporting for a variety of stakeholders. For the investment manager, who is often already preparing such reporting regularly or on an as-needed basis, internal operational resources can be freed up and the data already housed at the administrator can be leveraged. Also, such transparency is becoming increasingly required for institutional investors, meaning that managers seeking to raise capital from these sources can more easily do so with independent reporting in place.

Many institutional investors have even cited this as a key requirement before an initial investment is made with a hedge fund manager, a condition to be met before capital is allocated. For smaller investment managers that are looking to attract capital, putting such a reporting process in place in advance of such conversations can serve as a major differentiator from competitors, leading to a more productive capital raising process and increased subscriptions into their funds. In such a competitive environment, items like administrator transparency reporting can make the difference between a new investor and a missed opportunity.

For investors, there is truly no substitute for receiving independent, timely information on their investments and administrator transparency reporting helps in this process. Certainly for substantial institutional investors, it is no longer sufficient to simply receive a monthly or quarterly investor statement displaying an ending net asset value. Additional details are already being demanded, so rather than relying on ad-hoc requests, investors are able to receive predictable, stable reporting from a source outside of the investment manager.

Perhaps most significantly, the investor can get information on the fund that they were either not receiving historically or were receiving very infrequently. As an example, following the collapse of Lehman Brothers and the downfall of MF Global, counterparty risk became an important consideration and a notable area of risk. However, it was previously given little attention and was rarely scrutinized. Administrator transparency reporting can change this in a positive way, making the monitoring of counterparty exposure a simpler process which can be performed on a more frequent basis.

In the case of both investment managers and investors, administrator transparency reporting seems to nicely bridge the gap between investor requirements for information and the desire of a portfolio manager to maintain their trade secrets. For instance, a “black box” trading strategy, as alluring as it may sound, has become a major hurdle for investors to overcome, meaning that there are usually significant demands for information from the investment manager. Understandably, the portfolio manager does not want to fully reveal the tactics they use to deliver alpha, fearing it may become broadly known and less profitable. Administrator transparency reporting is a cost-effective and meaningful way to reconcile these two requirements while still protecting the interests of both groups.

As the hedge fund industry evolves in 2013, administrator transparency reporting is likely to play a significant role in bringing further openness to the marketplace. Given all of the tangible benefits to investors and money managers, coupled with a relatively inexpensive price tag, it is likely that a continued push for the widespread use of such reporting will occur. In the best interests of the industry, this is a solid step forward in breeding confidence and will allow for a better understanding and management of risk across alternative investments.