InfraHedge

A novel approach to managed account platforms

BILL McINTOSH

Managed accounts became a watchword for better supervision of assets and giving investors more control over them following the onset of the financial crisis in 2008. Given some of the abuses that did occur, ranging from opportunistic gating by a number of single manager hedge funds to cases of outright fraud, managed accounts were an obvious response. Managed accounts have a long history of use, notably, by commodity trading advisors. Yet even before 2008, the use of the structure had extended well beyond CTA investors. Platform operators such as Lyxor and Deutsche Bank had attracted substantial assets to managed accounts. In recent years, these flows have grown and the number of managers available to investors through managed accounts has certainly increased.

Other firms have also embraced managed accounts. Man Group, for example, turned to managed accounts as a way to reassure institutional investors, some of whom lost money in the Madoff fraud. Other multi-manager platforms adopted a similar stance. Indeed, for a period of time managed accounts were a topic of intense discussion and interest in the alternative investment market place.

Focus on investor needs

Just as it might have seemed that the appetite for managed accounts was moderating in 2011, State Street launched a new unit offering a new take on using the structure. That subsidiary, called InfraHedge, has since the summer of 2011 put in place a new managed account proposition that is designed to focus entirely on the needs of investors.

"Our platform is different from others in that we are investor centric," says Akshaya Bhargava, CEO of InfraHedge. "We are at the opposite end of the spectrum. We give tremendous flexibility to the investors. Our model is to do what the investor wants and be manager and strategy agnostic, while providing transparency, governance and oversight. We are an asset serving-led platform. Others are asset management-led platforms."

The difference between what established managed account platforms offer and what InfraHedge is proposing is one of control and customisation (See Fig.1). Institutional investors, with the infrastructure and process, can control investment-related functions, for example, asset allocation, while opting for InfraHedge to set up managed account structures, do daily reporting and run oversight functions. As a result, InfraHedge can apply to any manager, running any strategy in any structure or jurisdiction. Reflecting the liquidity terms of the new era, the platform is also expressly designed for daily service.

InfraHedge is to go live imminently with a couple of large institutional investor clients who have chosen their own managers and jurisdictions. It is perhaps noteworthy that one investor has selected a Cayman jurisdiction while the other has opted for a Dublin-based UCITS. Investors are free to use consultants since their model doesn't compete with other service providers.

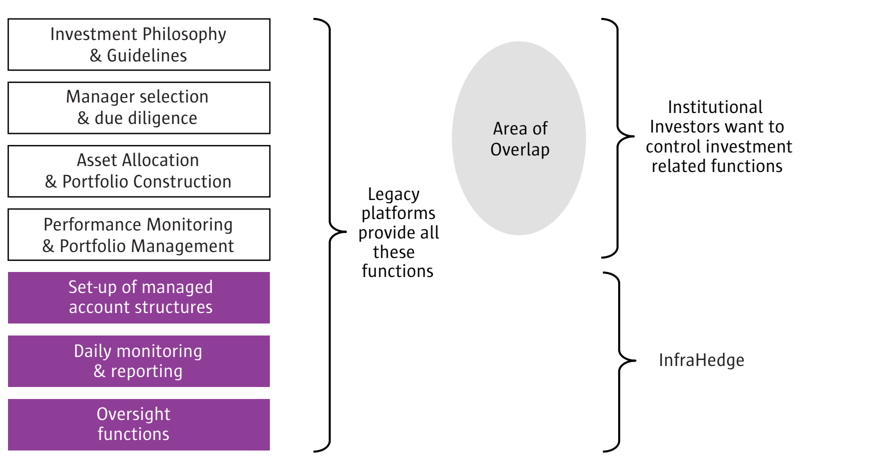
Operational readiness

InfraHedge is being run out of London with offices in New York. Back office, analytics and client service is being run from Bangalore. This provides a 24-hour operational readiness. As would be expected, the managed account service is integrated with State Street administration. Client marketing is being done through the parent's sales and market operation.

"It is a new product and that is always attractive for sales and marketing," says Bhargava. "Sales people will gravitate to what clients find interesting and this is very interesting to the right kind of investor." InfraHedge is set up as a product group within State Street. It has 16 people that focus exclusively on the managed account solutions. This extends from transactions management (onboarding and implementing client service, including the legal and operational set-up) to solutions engineering (customising the platform for investor clients), risk analytics reporting and client relationship management.

Fig.1 Distribution of functions in a typical managed account operation

Source: InfraHedge



Managed accounts currently hold around 5% of the estimated $2 trillion invested with hedge funds. Lyxor and Deutsche Bank are estimated to each have over $10 billion in assets, while Man Group trails closely in third spot with some $9 billion. AlphaMetrix is growing quickly after expanding from CTAs into the long/short equity sector, while Goldman Sachs is a substantial player with a number of managed accounts options.

Leveraging State Street

Infrahedge may be starting from scratch but it does enjoy a substantial opportunity to leverage its parent company's business platform. This is the benefit of its affiliation with State Street Alternative Investment Solutions which is among the biggest administrators to hedge funds.

"It is a market poised to grow," says Bhargava. "Why? Because of the demand that is coming from institutional investors. It is the change in demographics of hedge fund investors (towards institutions) that will drive growth. There is enough new business for all the platforms but you have to deliver a service that investors want and will pay for."

Though some managers have typically been unwilling to offer managed accounts, the likelihood over time is that this type of resistance will fade to the margins of the industry. Given the changed power relationship of managers and investors, it is also likely that, subject to certain conditions, most funds will be reasonably open to running managed accounts.

"The other issue for managers is not just ticket size but operational burden," says Bhargava. "The existing platforms aren't designed for asset servicing. As a result when we were building InfraHedge we paid a lot of attention to ease of operation. Not just from the point of view of the investor but also from the point of view of the manager."

It is expected that InfraHedge will be most attractive to new investors in hedge funds. But it will be pitching to all kinds of asset owners, ranging from pension funds to endowments, foundations and insurers. Funds of funds, private banks and wealth mangers will provide another focus as will banks and financial institutions looking to create structured products. THFJ