

How Transparency Creates Trust

It wasn't long ago that transparency was the rare exception in the alternative investment world. Fund managers were adamant about keeping their trading strategies opaque to their investors, and investors had little leverage. If an investor objected, there were plenty of investors in line behind them willing to accept those terms in return for the promise of consistently strong absolute returns.

With the last two years of dislocation in the financial markets setting the stage, everything has changed. For investors, it is important to feel confident that the fund manager has his finger on the pulse of the fund, its performance, and the state of the investor's account (value, returns, etc.). Preserving that confidence is as important as preserving the fund's performance.

Fund managers have identified a number of steps to help earn – and maintain – the confidence of their investors. They include:

- 1) A new willingness to respond to due diligence inquiries, from both new and existing investors;
- 2) Engaging the services of third-party administrators, providing independent valuation and portfolio and investor accounting;
- 3) Embracing increased fund transparency, affording investors the confidence that the fund is trading within the strategy and risk parameters set forth in the offering memorandum. Transparency may take various forms, including:
 - a. Delayed access to trades and holdings;
 - b. Reports detailing distribution of holdings by strategy;
 - c. Independent reporting (by risk management firms) detailing the risk attributes of a portfolio without sharing the discrete holdings in the portfolio; and
 - d. Full trade and holding transparency, generally granted through the use of managed accounts and single-investor funds.
- 4) Adoption of investor relations management technology, providing the fund manager with a consistent, stable, documented platform for tracking investor demographic and transaction information and efficiently retrieving that information to communicate with each investor both periodically and on a one-off basis.

The financial collapse of September 2008 was unprecedented, but it was still in the realm of possibility. Some of the fund managers who struggled through that period are now asking if they could have handled the situation differently. As global financial markets moved quickly downward, fund managers worked to minimize the effects of the crisis and effectively communicate those mitigation strategies with investors. The stress exposed weaknesses throughout many fund organizations. Those firms that had the processes and systems in place were in a good position to manage market fluctuations and communicate these steps efficiently with their investors, leading to fewer withdrawals and greater new inflows than funds that were less able to respond to investor concerns.

Not only did the dislocation weed out many alternative funds, but it also caused the survivors to develop a renewed focus on technology as part of a strategic plan to drive greater efficiency and improve transparency. In this environment, the primary focus for investment officers has been to reclaim their high watermarks and then exceed them. Meanwhile, the marketing and back-room operations teams are diligently focused on building processes and systems to give investors the service and information they need in any market climate.

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Finally, pending legislation and proposed regulation will not simplify the process. Technology, however, can help navigate these choppy waters and provide a constant during times of uncertainty and beyond. Here are a few of the pending regulations:

- Dodd-Frank Financial Reform Bill (US)
- Rule 2a-7 Money Market Fund Reform (US)
- UCITS IV (Europe)
- Directive on Alternative Investment Fund Managers (AIFM)

Investment in technology beyond commercial off the shelf desktop software is required. The advantages of investor relations management technology investments are spread throughout the firm:

- *Potential Investors:* Many surviving hedge funds are in growth mode. They have shown that they can weather the worst of markets; even if performance is not where everyone would like it to be, a survivor has an edge over an untested fund. To best position a fund to capture potential allocations, firms need to market their investment capabilities and client services with an organized, manageable, and sustainable approach to keeping all client introduction activities organized. A Client Relationship Management or “CRM” system tailored to the needs of alternative asset managers, such as Backstop, is the solution.
- *Existing Clients:* To stay on top of client requests, firms need tools to help them control their day to day operations. Effective processes and systems to manage cash, requests for information, and compliance can make the difference between a satisfied customer and one who ultimately redeems, allowing a manager to remain focused on strategy and performance. In addition, we expect to see industry consolidation among many asset management firms as they strive to achieve the scale necessary to remain profitable in a challenging investment climate. A scalable CRM system can make those consolidations proceed more smoothly for firm staffers and clients, making everyone’s life easier.
- *Investment Operations:* Although a CRM system isn’t designed to help firms make trading and investment decisions, it is not removed from the asset management side of the business. Information about customers and their cash flow requirements can help portfolio managers better assess their liquidity needs. Further, the better the back-office system, the more time and energy chief investment officers can dedicate to what they do best, investing.

As asset managers and the financial markets recover from the carnage of 2008, we’ve noticed an increasing emphasis on client communication, clear investor relations processes, and streamlined back-office operations. Standard desktop office software is great for many functions, but collections of spreadsheets and text files aren’t up to the task of giving clients accurate information in short order. Alternative investment managers handle funds that influence the financial health of retirees, institutions, and families all over the world. No longer can an industry that touches so many depend on piecemeal data repositories.

The final quarter of the calendar year is here and it is time for each firm to establish its path to meet the challenges to come. While this will be difficult, the right technology investment can make the road both smoother and more navigable. An investment in a robust and tightly integrated investor relations platform coupled with a web reporting portal is just the solution a firm needs to gain a competitive advantage in the new world of alternatives.

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Backstop Solutions Group, LLC (BSG) is an award-winning provider of innovative software solutions to hedge funds, funds of hedge funds, pensions, endowments, fund administrators, and family offices of all sizes throughout the United States, Europe, and Asia. BSG was founded in 2003 with the goal of creating the industry's first Software-as-a-Service platform designed to help firms in the alternative investment management industry operate efficiently, invest intelligently, and communicate effectively.

Backstop offers a constant back-office and front-office solution so chief investment officers can focus on what they do best, invest. It allows an asset manager to give clients better transparency on their positions, performance, and redemption rights, and that improves the trust that investors have in times of market stress.

If you have any questions regarding the content as well as Backstop's award winning CRM and or InvestorBridge web reporting portal platform, please don't hesitate to contact Geoff.

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