

Chapter Thirteen: The evolving role of the fund administrator in Asia

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Irrespective of investment profile or strategy, jurisdiction, domicile or legal structure, a hedge fund owes a duty to its shareholders to ensure that every aspect of its day-to-day operations is tended to in a professional and efficient manner. This chapter provides some guidance for managers and promoters in their selection of a suitable hedge fund administrator in Asia.

Taken at its most basic level, the administrator independently prepares the books and records of a hedge fund. Increasingly, however, managers in Asia appreciate that there is significantly more to the administrator's role than that. The administrator is the public face of the manager to the investor and the investment community as a whole. It acts as fiduciary, accountant, agent, consultant and chief operating officer.

The days when hedge funds chose their administrator on the basis of personal or previous relationships have come to a welcome end in the region. With the increasing institutionalisation and sophistication of investors, and the consequent depth and breadth of their knowledge, Asian managers are more conscious than ever of the need to research their choice of administrator. As a result, managers devote an increasing

amount of time during the establishment of the fund to the process of administrator selection and to due diligence.

People

The administrator needs to have qualified staff, preferably with experience gained in the alternative investment industry. It is crucial that they are familiar with industry practice, capital structures, GAAP and IAS accounting principles, performance fee and equalisation calculations, and the complexities of the many financial instruments. The administrator should be capable of handling long and short positions, bonds, futures, equities, forwards, swaps, multiple asset classes and hedging strategies.

Typically, the administrator will make a dedicated contact person available to the manager for day-to-day communication — somebody who is efficient, responsive and easily accessible. Due to the cultural diversity of the Asian region, it is optimal if the manager and investors can have access to multilingual staff — eg, Japanese and Korean speakers — as required.

A manager should take notice of retention levels and enquire into any evidence of high staff turnover. Generally, administrators that are committed to ongoing staff training and career path opportunities are the most successful in retaining good staff.

Legal staff are also of paramount importance, especially during the start-up phase. Check the availability of legal staff. What is their relationship with outside counsel? How does the administrator's international liaison system work? Does in-house counsel have access to, and relations with, an international network?

Structure and independence

The organisational landscape of the administrator and its own internal infrastructure need to be examined and understood. Which regulatory authorities supervise its activities, and how? Are its operations authorised in each of the jurisdictions in which it operates?

How are the various accounts structured internally, and where will the hedge fund fit into that model? Are there individual and distinct departments, which are more prone to miscommunication and delay, or does

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the administrator have a one-stop shop structure, a single point of contact that can resolve and assist with any issues in a prompt and effective manner? How many accounts does each account manager handle as a matter of course, and what back-up and support procedures are in place to facilitate unforeseen surges in workload?

Independence is of paramount importance. With the appetite for increased transparency, and in the role of fiduciary agent to the shareholders of the fund, the administrator must be able to demonstrate that its actions and decisions are conducted in the shareholders' best interests. Is it a separately held organisation without potential conflicts of interest, or part of a wider banking or investment group?

Independence means that an administrator will be capable of, and willing to, operate effectively with all prime brokers, lawyers and auditors. Consequently, one should be wary of the administrator that is quick to suggest one counterparty to the exclusion of others, or off-the-shelf solutions as a matter of convenience.

Global reach and location

An administrator that can demonstrate a successful track record in Europe and the US is likely to be able to replicate its operations within the Asian region. A truly global administrator must be able to accommodate both investors and managers in a similar time zone, or provide a variety of solutions for funds in which the parties are spread across multiple time zones.

Ease of access during the working day is too often neglected by the Asia-based manager, as is reflected in the number of local funds still serviced directly from Europe, or even the Caribbean. While there is nothing inherently wrong with such a set-up, the combination of time and distance can add to a manager's frustrations.

Invariably, such factors only become an issue when problems with the operation of the fund arise, at which point efforts to liaise with an administrator on the other side of the world tend to consume the manager and detract from what should be their main focus — trading the hedge fund. This factor stands out as the principal reason why European and US investors look for an established administrator with a proven track record and global reach.

Specialisation and business model

It is important to consider whether or not hedge fund administration is a core business and primary focus for the administrator, or merely a product of a far larger organisation.

The Asian manager should establish how long the service provider has been in the alternative investment business. Has the administrator established its track record supporting long-only mutual funds and is it only just entering the hedge fund sector? Or, is it an organisation that has evolved with the industry and is therefore more appreciative of its characteristics and investor needs? A hedge fund-specific administrator will be more familiar with the complexities and requirements of the strategies present in Asia. The fund will not risk paying for the learning curve of a less experienced service provider.

Further, the manager would do well to enquire about the business model of the administrator. To ensure profitability, the administrator must achieve high volumes at low cost. Equally, it must have sufficient business to create organisational standards. In establishing this critical mass, however, the temptation for many service providers is to take on business for its own sake, invariably resulting in a disjointed client base that it may struggle to support.

Again, the manager must determine the focus of the administrator. Does it regularly turn away new business and, if so, on what grounds? Is the administrator asking as many questions about the manager and its strategy as the manager is asking about the fund administrator? Due diligence is a two-way street: the administrator should be busy establishing whether the client is of the quality and class of fund it targets and can effectively support.

Technology

The Asian manager should look for a commitment to technology, adaptable systems, as well as web-delivered products and capabilities. A manager should ascertain how systems are sourced and developed, and should look for proprietary systems tailored to the needs of the fund.

As a result of their pivotal role in delivering a timely and accurate net asset value (NAV), hedge fund

administrators increasingly face the challenge of offering automated processes. At the very least, the administrator should have an integrated portfolio, general ledger and partnership accounting system, which can handle multiple currencies and has direct electronic interfaces with the major prime brokers.

Electronic data feeds enable the administrator to receive all necessary information in a timely and efficient manner, enabling it to calculate the NAV within pre-agreed deadlines. The extent to which manual processes are necessary should be highlighted, because they are more prone to error.

Independent pricing feeds and corporate actions from a range of sources should also be in place. The fund should assess the administrator's ability to obtain supplementary pricing sources, and to obtain prices for unquoted instruments from independent market makers and brokers.

Once the accounting process has been finalised, the relevant information can be disseminated to investors promptly.

A copy of a tested and audited business continuity and disaster recovery plan should be made available for a manager to review before he engages the administrator.

Fees

A manager will have to justify to the fund's shareholders why a particular administrator has been chosen. A saving of a few thousand dollars in fees will not be an acceptable reason. Only when the administrator has been fully evaluated should the manager examine the fee structure.

Although the majority of administrators in Asia are similarly and competitively priced, the product offering between them can vary significantly. Having evaluated the strengths and weaknesses of the various providers, and narrowed the selection down to those considered to be a suitable business partner for the fund's structure, domicile, size and investor base, each fee proposal should be reviewed in detail.

The current industry norm is for an administrator to calculate fees as a percentage of the assets held by the

fund, subject to an annual minimum fee. But it is important for the manager to dig deeper than this. Some fees may be hidden, or not immediately disclosed.

In Asia, the manager should be conscious that some administrators may offer unnecessary custody functions to the hedge fund structure. Since this is already adequately performed by the prime broker, it adds an unnecessary layer of fees. The manager should also enquire as to whether or not there exists a set-up or inception charge. Is there a separate subscription or redemption charge? Are there additional costs (or, indeed, a capability) for US tax preparation services? Is in-house legal counsel, for example, included as a value-added service, and, if not, how do they charge? Is it a flat fee, or on a time-spent basis?

Cumulatively, such miscellaneous services can significantly impact upon a basic fee quote. Hence, there is a duty on the fund sponsor to be clear as to what charges the fund can expect, particularly during the initial post-launch months as the fund strives to establish an attractive track record.

The launch

The administrator's experience with a variety of hedge fund structures and strategies can make it an invaluable resource in the run-up to a fund's launch. In-house lawyers and accountants will assist in reviewing the offering and other constitutional documents, examining them for consistency and operational accuracy in matters such as performance fee calculation and equalisation methodology.

Administrators also draw upon their experience to ensure the fund is conscious of the 'dos and don'ts' inherent in launching a new hedge fund in Asia. The administrator will liaise with external auditors, prime brokers and independent legal counsel during the preparation of documentation, and may also be in a position to provide introductions if necessary. The administrator is increasingly requested to make itself available to seed investors to explain how its business processes and structures facilitate a competent and timely service from within the region.

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Investor relations

Once the initial offering period begins, the administrator will liaise with hedge fund investors. It will send offering documents to all potential investors and ensure that they comply with onshore regulations. The administrator will receive completed applications and subscription moneys, ensuring that the documentation is complete and correct and that all necessary 'know your customer' information and verifications are supplied.

The administrator will then issue shares or units based on the initial offering price, or on the NAV of the fund if subscriptions are received after the initial offering period.

The method used by the administrator in its ongoing communication with investors is therefore crucial, particularly where a geographically diverse investor base has become the rule, as it has in Asia. An investor needs timely access to the latest fund information, current holdings reports, transaction history reports, and the status of pending subscriptions and redemption orders. Therefore, an administrator's ability to provide an investor with web-based, on-line access is a distinct advantage to an Asian-based manager with global investors. Continuous access negates the need for costly and inconvenient communications with an administrator on the other side of the globe.

Accounting functions

NAV calculation begins with downloading the trade activity of the manager. Hedge funds will have either a custodian or a prime broker with whom the administrator should have an automated electronic feed established. This feed will in turn download each day's trades from the broker to the administrator, and it is interfaced with the systems of the administrator to produce daily portfolio listings. These listings are then matched to corporate action data supplied by various vendors to a central securities database to price portfolios and accrue dividends and other corporate actions. Automatic reconciliation matches the portfolio to the trades fed from the manager, or to portfolios produced by the back office of the bank or broker.

Such technological requirements have coincided with an appetite for greater transparency, resulting in

increasing pressure to provide more timely reporting. Asia-based administrators are today being asked to produce daily and weekly NAVs, and to turn monthly NAVs around far more quickly. Hence, the responsiveness of experienced personnel and sophisticated systems are central to successful reporting.

With this reporting goes a full set of financial statements, including a statement of assets and liabilities, a statement of operations, a statement of changes in net assets and a portfolio. This will often be backed up by portfolio analysis and other statistics of interest to the manager, such as price variances. The manager should enquire about the degree of customisation available from standard reporting, such as comparisons to benchmarks. The administrator adds value as a clearing house for increasingly complex funds, integrating investor and accounting records for fee calculations, and separate classes of shares for illiquid/liquid investments, hot issues and tax reporting.

Compliance

The fund employs the manager and administrator. The fund delegates its anti-money laundering checks to the administrator, in the same way that it delegates money management to the manager. The administrator is therefore the entity responsible for scrutinising the credentials of the investors. Asian managers are expected to prove their own high standards by ensuring that their hedge fund administrator has good anti-money laundering procedures in place, and that these procedures are exercised in accordance with the laws of the jurisdiction in which they operate.

The administrator must attend to the best interests of the investor by ensuring that the fund's activities remain firmly within the confines detailed in its prospectus and constitutive documents, that all investors are treated equally where required, and that all necessary filings and fees are submitted in a timely manner to the various regulatory authorities and stock exchanges.

Conclusion

In an industry where perception dominates, the ability to afford the investor peace of mind is crucial. Hedge funds today are doing full due diligence on their service providers, with detailed requests for proposals. This

change in attitude is investor driven. There is more investor participation, and word of mouth is no longer an adequate way of doing business.

The trend is increasingly towards an administrator being selected by an informed board of directors, as it is the administrator who has a fiduciary duty towards the board and investors. The Asian manager must therefore be in a position to justify the 'why'. Why have you chosen this administrator, and is it one that can work with us as our products develop? Can it efficiently deliver a completely integrated product, covering corporate issues, accounting, investor relations, and legal and compliance issues? In short, does it genuinely provide total administration?

