

Threats and opportunities face fund administrators as new regulations are imposed on the industry.

Cautious optimism for 2012

William Keunen, global director of Citco Fund Services, is relatively optimistic about 2012. He admits 2011 was a tough year for hedge funds with performance failing to live up to expectations. Nevertheless, he is not seeing the capital outflows that hit the industry in 2008 and 2009 in the wake of unsettled markets and severe liquidity constraints.

"Overall, capital has remained stable except possibly where funds have really underperformed. From our engagement with institutional investors, particularly the pension plans and endowments, the appetite for alternative assets is still there. So given that there appears to be money sitting on the sidelines waiting to invest and the fact that capital isn't flowing out is encouraging," says Keunen.

There are still challenges ahead. Fund launches are fewer than in the peak years and start ups are finding barriers to entry higher than a few years ago. This is a combination of increased regulation and a shift to institutional investors who want to see robust operational risk management in place from day one.

For Citco, one of the largest fund administrators with around 500 clients and fund groups under administration, this also means accommodating the smaller scale funds while they grow. "We continue to pitch for and work with new funds even if they start with low AUM, particularly where we feel that their pedigree will enable them to grow over time. We are encouraged by the fact that many institutions are seeding start ups, too," notes Keunen.

One of the biggest changes in the industry, however, is regulation. From a fairly regulation light environment pre-2008, the hedge fund industry has seen a raft of new rules hit it. This, believes Keunen, brings with it threats

and opportunities. "With the Securities and Exchange Commission (SEC) registration in the US, regulatory compliance will become much more onerous in 2012. Investment advisors will need to complete form Form PF and will likely seek help from administrators in compiling the extensive portfolio exposures and risk profiles required to comply with the rules," explains Keunen.

Some of the new rules, such as those bringing over the counter derivatives onto exchanges, will have a significant impact on how administrators work, says Keunen. In terms of the alternative investment fund managers (AIFM) directive in the European Union, there are still many question marks over implementation. Although administrators will need to adapt their operations to take into account some of the AIFM's prescriptions, Keunen sees it as an opportunity for administrators to provide additional services in the regulatory compliance and reporting areas as well as in independent pricing.

OTC central clearing will also impact administrators. Everyone in the industry has a different angle on OTC clearing, says Keunen. "We see central clearing as a good thing if it generates better data, more consistently produced data and a more efficient, automated process. Right now depending on the counterparty and the type of OTC, activities can be inconsistently reported and manually conveyed. OTC clearing through clearing houses will facilitate and lead to both more efficient processing and more pricing data," says Keunen.

Valuation is another topic Keunen says has not gone away since 2008. Citco has dedicated pricing and valuation teams. Level three assets (securities where the fair value cannot be determined by

using observable measures such as market prices or models) remains a subjective exercise.

Citco tries to verify prices but for some assets, particularly illiquid ones, there is no information or data. In that case Citco looks to verify whatever data it can obtain from counterparties, brokers and sometimes the fund manager.

Citco then applies a process so it can determine an independent price or value on the security in order to reassure investors that the price given is a fair one. "Inevitably there are challenges in pricing certain level three-type securities. The objective is to obtain multiple independent data points," he admits.

Looking forward to 2012 Keunen says there are several challenges facing the industry and administrators. One will be pricing. "Because margins are being squeezed in this environment, costs have become a big driver. For fund administrators improved efficiency and automation results in reduced costs, so this is an area where stakeholders could make a big difference by working more closely together on solutions," admits Keunen. ■

Top five rankings: fund administrator

