

Preqin Research Report Managed Accounts on the Upswing

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Looking back over the past 24 months an interesting trend in the hedge fund industry has emerged – the increased popularity of managed accounts. In order to better understand the reasons behind the change, Preqin carried out a survey of 50 institutional investors and 60 fund of hedge funds managers to discuss their investment preferences and attitudes to the future of the hedge fund industry. Investor concerns about transparency, liquidity and risk management were among the contributing factors for the shift towards a managed account structure. There has been a substantial demand for access to hedge fund strategies via separate accounts rather than pooled offerings. Thus, the popularity of managed accounts are on the upswing; however, they have certain drawbacks and not all investors or managers are convinced of their value, as will be discussed.

Investors' Perspectives on Managed Accounts

Preqin surveyed a broad spectrum of investors from Europe and North America, consisting of eight different types of institutional investors: public sector pension funds, private pension funds, endowments, family offices, foundations, insurance companies, banks and asset managers. Preqin found that 16% of all institutional investors have allocated capital to a managed account, with a further 23% considering such an allocation over the next 6-12 months (Fig. 1). European investors show a greater interest in managed accounts than their US counterparts, with 19% of European investors having at least one managed account versus 12% of US investors (Fig. 2).

Both large and small investors were surveyed, with a range of total assets under management from approximately \$40 million up to \$154 billion. A distinct trend emerged that the larger investors, those with hedge fund assets of over \$1 billion, were more likely to invest in hedge funds via a managed account structure, as can be seen in Fig. 3. This is due in part to the large initial capital requirements for managed accounts, in addition to higher associated management fees. For instance, one smaller US family office stated that it was not opposed to managed accounts, but was not big enough to invest in a such a platform. According to the survey results, costs are the most common barrier to investing in managed accounts, as shown in Fig. 4. Another deterrent reported by investors was insufficient resources, namely a lack of staff with adequate hedge fund expertise and specialization. This amounts to nearly half (49%) of investors stating resource-related issues as why they are currently not investing in a managed account.

Our survey revealed that investors are looking to managed accounts for transparency, for liquidity and to mitigate exposure to risks (Fig. 5). A Preqin survey of institutional investors conducted in November 2009 revealed that 33% of investors were looking for greater liquidity and 20% were looking for more transparency at the fund level. Other reasons why investors have been attracted to managed accounts include the provision of greater control or validation of assets, the ability to impose investment guidelines and more flexibility to manage negative performance. A significant proportion of the investors (34%) that

Fig. 1:

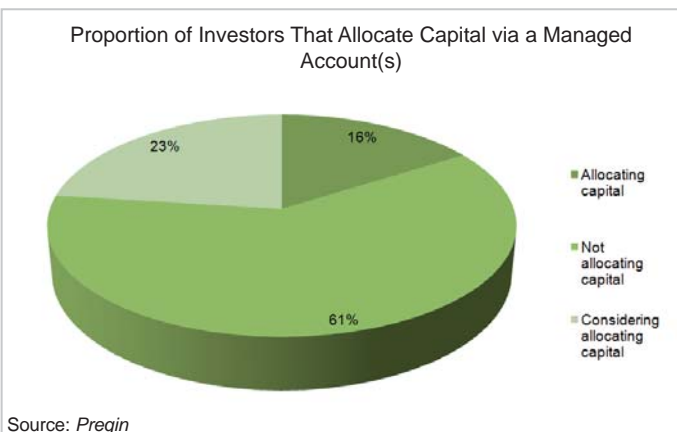
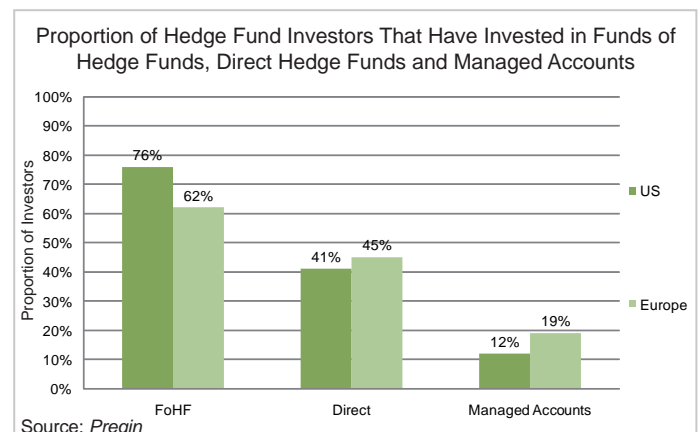


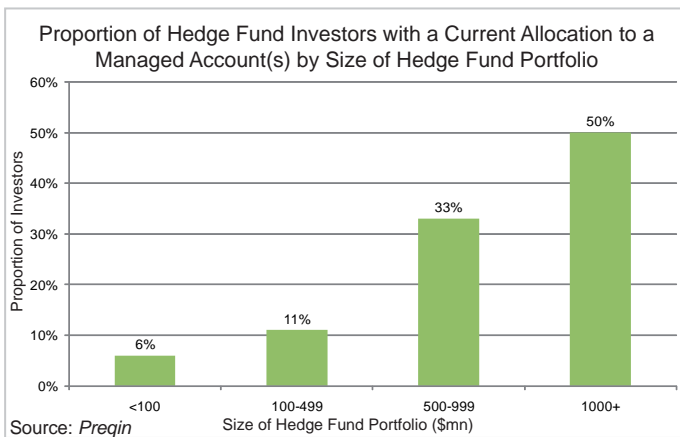
Fig. 2:



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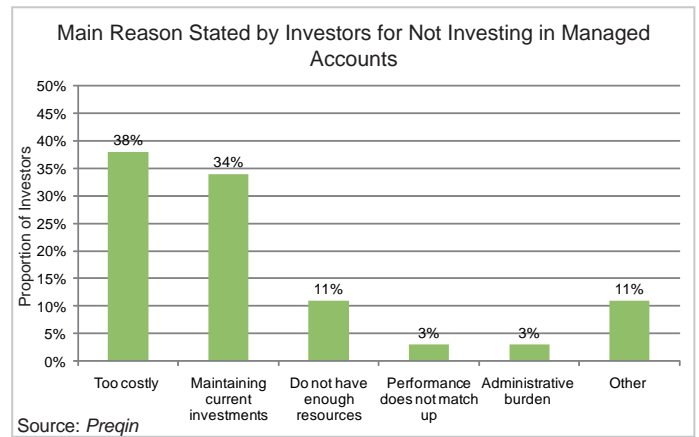
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Fig. 3:



said they were not looking to shift to a managed account stated the main reason was due to not seeking new investments at this time. In one case, this was because the investor had only just begun investing in hedge funds and was still in the process of building up its portfolio. In general, these institutions were not opposed to such vehicles, but did not expect to invest in hedge funds via managed accounts until they were more established investors in the asset class. Other investors remained unconvinced about managed accounts on account of a potential

Fig. 4:



performance mismatch, high maintenance, and administrative burden. For example, one large Swiss insurance company with approximately \$36 billion in AUM expressed scepticism that managed accounts were more liquid and transparent than a commingled fund. A Swiss public pension fund with a \$700 million allocation to hedge funds was of the opinion that managed account performance does not match up to that of pooled investments. Yet a number of investors were attracted to managed accounts, such as one large German private sector

Fig. 5:

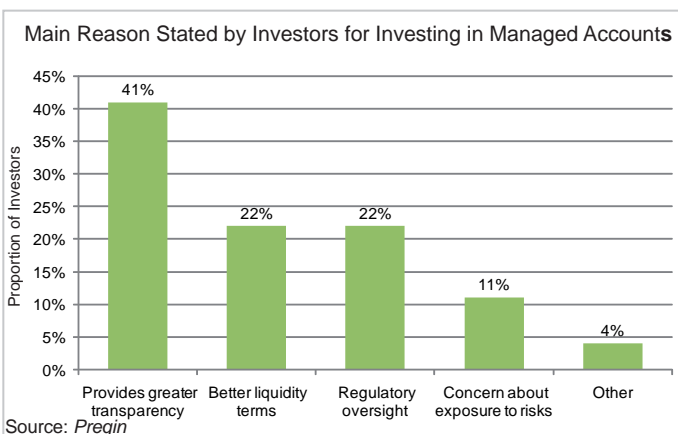
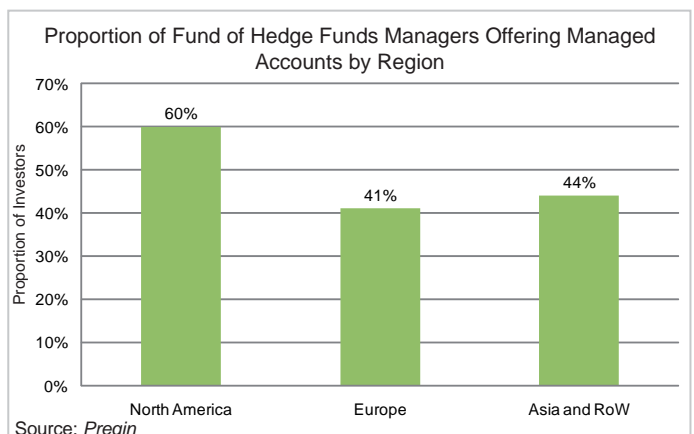


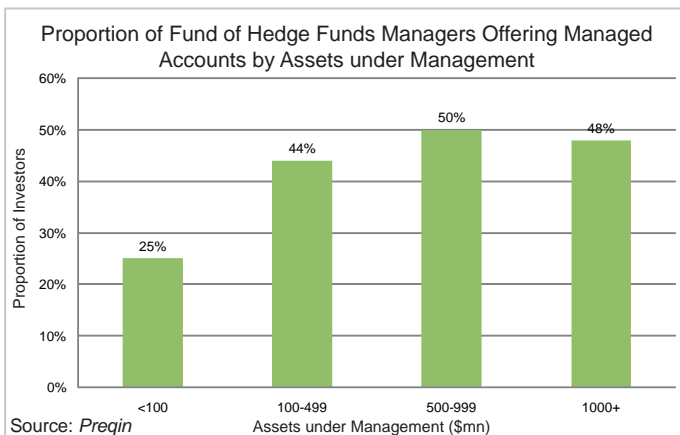
Fig. 6:



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Fig. 7:



pension fund which preferred managed accounts as it meant its investments were not affected by other investors' redemptions.

Fund of Funds Managers' Perspective on the Growth in Demand for Managed Accounts

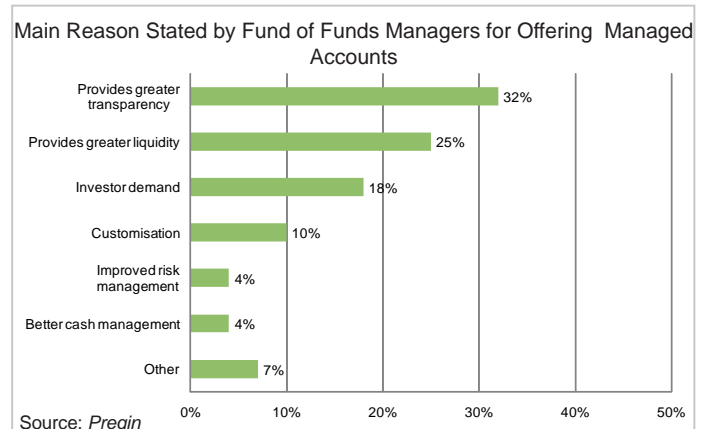
Preqin surveyed 60 fund of hedge funds managers from across the globe to report their perspective on managed accounts. Managers from 13 countries were asked about their current hedge fund offerings. Fig. 6 shows the proportion of fund of funds managers in each region offering a managed account structure – 60% of North American managers, 40% of European managers and 44% of managers from Asia and Rest of World (including Hong Kong, Singapore, Japan and Israel) run a managed account structure. The total assets under management of the surveyed managers varied widely, producing interesting results. The largest managers, those with over \$500 million in assets under management, had the largest proportion of firms that had a managed account structure, as shown in Fig. 7.

When managers were asked why they established their managed accounts (Fig. 8), the top two responses were that they provide greater transparency (32%) and greater liquidity (25%), which are top investor concerns in 2010. Investor demand was the third most common response (18%). These reasons reflect that managed accounts are very much investor driven. Firms that have launched managed accounts to tap into the increased demand for such vehicles need to have strong

back office procedures in place to ensure legal and operation simplicity, scalability of strategy, risk control and low trading error. 10% of managers stated the main reason for establishing a managed account was the potential for customization, 4% stated improved risk management and 4% reported cash management as the main advantage. For example, a UK-based manager with \$2.3 billion in total AUM was attracted to the managed account as it meant greater control of assets and an improved strategic relationship with investors. The majority of managers questioned, 65%, either currently run a managed account structure or are considering it in the next 6-12 months, as shown in Fig. 9.

Managed accounts do not necessarily tick all the boxes for all managers and they carry some potentially significant drawbacks. These include possible liquidity mismatch, leverage restrictions and high operating costs. The managers surveyed by Preqin named seven main reasons for not running a managed account. As Fig. 10 shows, the two reasons that topped the list at 22% each were lack of investor demand and lack of infrastructure. A further 20% stated that managed accounts were not part of their strategic plan, and 18% said that they were not cost efficient. A large French fund of hedge funds manager with \$12 billion in assets under management stated that the reason for not running a managed account platform was that structurally they were unable to do so. A London-based manager with \$500 million in total assets stated it was simply due to not being big enough. Thus, for both large and small

Fig. 8:



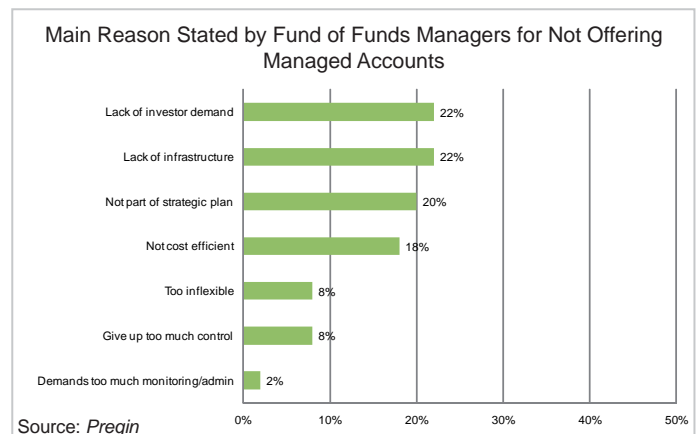
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Fig. 9:



Fig. 10:



managers, infrastructure can be a barrier to running a managed account structure. 8% of fund of funds managers stated that their main reason for not running managed accounts was that either they are too inflexible or they require giving up too much control. Lastly, 2% stated that managed accounts demand too much monitoring. One Japanese fund of hedge funds manager informed Preqin that clients have requested managed accounts, and as a result it is considering them; however, its long-term view is that its existing commingled style is more cost efficient. Several managers mentioned that they would set up a managed account if the ticket size was big enough. Others have ruled it out entirely, such as one \$50 billion British fund of hedge funds manager, which stated that managed accounts demand a great deal of monitoring and administrative hassle. Managed accounts are still evolving and, although not all strategies are well suited to them, they do offer solutions for mitigating hedge fund investment risks, especially liquidity, transparency and risk management. However, for some funds the cost and restrictions of these structures will always be a barrier.

Conclusion

Institutional investors have expressed a growing interest in managed accounts and we predict this trend will continue in 2010. The credit crunch, the Madoff investment scandal, and the gating of assets has led to investors demanding greater liquidity and transparency within their hedge fund portfolios. A shift to a managed account structure provides investors with

greater control over their investments, as well as the greater liquidity and transparency that they demand. More managers are accommodating investor demands by offering a managed account platform. It is predominantly larger managers that are able to do this; however, managed account structures are also increasingly being offered by small boutiques. Despite the rise of managed accounts, managers are unlikely to replace all existing pooled funds, as results from the survey showed most investors are still allocating to these funds. Managed accounts are not suited to all strategies, and they are still an evolving area of the hedge fund industry. For investors they are an attractive option, particularly as they offer solutions for mitigating hedge fund investment risks.

This survey was conducted with the help of Preqin's industry-leading product Hedge Investor Profiles.

For more information, or to register for a demo, please visit: www.preqin.com/hedge

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