Managing Full Transparency in Multiple Account Portfolios

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Executive Summary

Monitoring portfolios of multiple accounts presents a number of challenges for risk managers and analysts. Recent developments in the financial services space have resulted in many more managers considering the daily examination of positions as part of their fiduciary duties. While this trend is overall important and timely, it also creates a number of issues for risk managers, analysts, and compliance officers. Some of the new challenges are technology issues, such as handling multiple data feeds from a variety of sources, aggregating and storing data. Others are more analytical in nature, such as providing meaningful reports to the investors.

In this paper we discuss the importance of having access to a system that combines position aggregation with reporting functionalities and thus allows risk managers and analysts to extract more value from position level transparency.

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1. New Paradigm for Transparency

Investment Monitoring

In the post-Madoff world, the availability of transparency from an investment manager has become one of the main factors to consider while making an asset allocation decision. After years of having very limited information on their existing investments in hedge funds, asset allocators now consider the daily examination of positions to be one of their key fiduciary responsibilities. Having full transparency to the portfolios of underlying managers allows risk managers and analysts to better understand each instrument in the context of the portfolio as a whole. Additionally, having position level transparency helps to improve the information flow within the firm and allows senior management to stay informed on the portfolios and make timely decisions when needed.

Investor Relations

On the other hand, many investment managers now feel that they need to provide their investors with increased transparency to their portfolios in order to be competitive.

Managed accounts have become increasingly popular, with a variety of managed accounts platform offering access to a multitude of hedge funds. Additionally, even investors who invest via a traditional direct investment in hedge funds are often able to negotiate position level transparency with their managers.

Regulation

Another critical factor in the battle for increased transparency is the legislative side. The Private Fund Investment Adviser Registration Act of 2009 was passed by the House Financial Services Committee. The proposed legislation would require all U.S. investment advisers to private investment funds and with more than $30 million under management to register with the SEC and provide it with certain records and reports, such as credit exposures, use of leverage, and trading positions on a regular basis.

2. Risk Monitoring Challenges

In the new environment of increased transparency, many asset managers who invest in multiple accounts are faced with a number of new challenges resulting from having full transparency to a number of different accounts. The issues are further magnified by the fact that accounts are often held at different prime brokers, administrators, or different managed account platforms.

We believe most issues associated with risk monitoring for can be broken down into the following categories:

- Technology
- Operational
- Analytical

We examine each of the issues below.

<u>Technology Challenges</u>

- Significant time and effort spent on data collection rather than risk analysis

  It takes a significant amount of an analyst's time to manually download each data feed separately from each prime broker or administrator. Also, most prime brokers require unique log in IDs, passwords, and secure tokens in order to access their websites. Therefore, there is usually a need for a back up for the analyst doing the monitoring.

- Time and effort spent on transcribing different data formats

  Different prime brokers and administrator provide position data in different formats. Some of the more popular options include csv, Excel, text, and pdf formats. The differences in formats make aggregating and storing data from different prime brokers a difficult task.

- Need for data storage and the ability to retrieve historical data

  Having a significant amount of daily data for multiple accounts requires a centralized storage database, since spreadsheets are not adequate data storage tools for a large amount of position level data. In addition to having large capacity, the database needs to be easily accessible in order to retrieve and analyze both historical and current data.

<u>Operational Challenges</u>

- Need for independent valuation of security marks

  Verifying security marks provided by prime brokers is not always straightforward. Our experience at Asset Alliance Corporation shows that marks on the same security provided by different prime brokers can vary by a significant margin. In such instances, independent pricing sources, like Bloomberg or Interactive Data, may prove to be more reliable.

- Challenges of reconciling values from different sources

  Reconciliation between security market values received from administrators, prime brokers, and underlying managers can be a very time consuming process. However, many asset management firms consider it to be a necessary step in achieving a level of comfort in the fact that the net asset values on a manager's financial statements are fairly stated.

<u>Analytical</u>

- Lack of supplemental information on positions

  Most prime brokers provide a very limited number of fields in their data feeds. Typically they do not include any descriptive information on underlying securities, such as industry, sector, country of origin, market cap, issue size, etc. All those additional fields may be very helpful to risk managers in evaluating firm-wide exposures.

- Unique reporting features required for multiple account portfolios

  Analyzing portfolios comprised of several accounts requires risk managers and analyst to be able to account for risk exposures on an account level as well as a firm-wide level. Having full transparency allows for an increased flexibility in reporting, so the security level data can be aggregated in a number of ways to monitor concentrations, exposures, leverage, and various limits.

- Different exposures and reporting needs for different strategies

  A portfolio of multiple accounts typically includes a variety of different strategies. Determining the risk factors specific to each strategy and creating reports to monitor those factors is a complicated process.

- Distribution of reports needs to be efficient and automatic

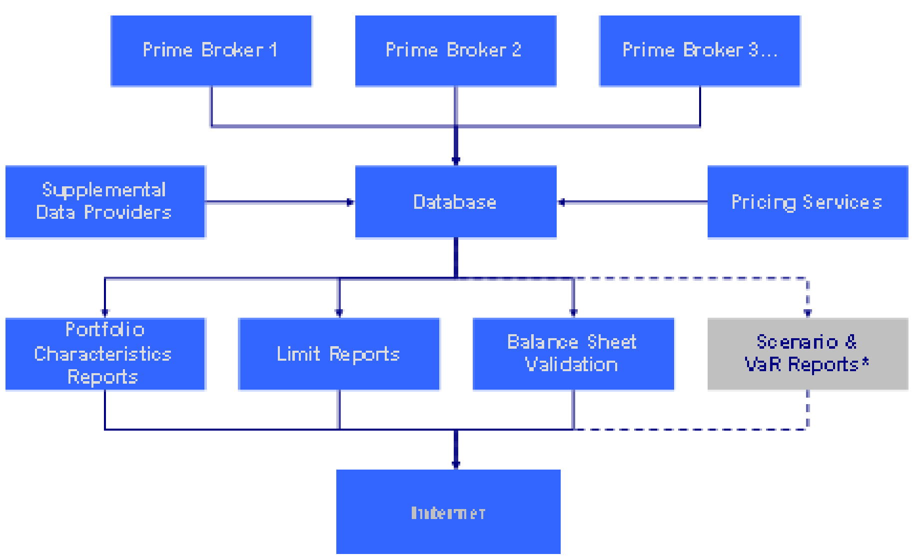
  The reports produced have to be made available to the end users. The internal users may include internal risk managers, fund analysts, and compliance officers. Certain reports need to be sent to external clients as well.

3. Risk System That Works with Full Transparency

With all challenges named above, risk managers working with position level transparency need a system that would link various aspects of risk monitoring for multiple accounts on a firm-wide basis. Such a system would help to decrease the amount of analyst time spent on downloading and formatting data by a significant margin. This would allow analysts to concentrate on the analytical aspects of risk monitoring process.

We believe a system that would help risk managers and analysts to optimize the process should have the following components.

System Components



The daily risk monitoring process can be described as follows:

- Position level data is automatically downloaded from a number of prime brokers.
- The feeds are formatted to meet the criteria of the centralized internal database.
- Additional descriptive information is obtained from supplemental data providers based on security identifiers received from the prime brokers.
- Independent pricing information is obtained from independent pricing services if needed.
- A variety of reports is produced from a centralized database. The top level groups of reports may include the following:
    - Portfolio characteristics reports
    - Limit reports
    - Balance sheet validation reports
- Scenario analysis and VAR reports may produced for further in0depth analysis
- Reports are published on a secure Internet website, or a company internal network for the analysts to review.

We believe a comprehensive risk system similar to the one described above will prove to be a valuable tool in the firm-wide risk monitoring and management process. The system can help analyst identify important early warning signs, such as portfolio trends inconsistent with a manager's strategy. The system will also allow risk analysts to stay informed on various aspects of the underlying portfolios and keep both senior management and outside investors updated on any changes on a timely basis.

About Asset Alliance Corporation and Prospect 33 Joint Venture

Asset Alliance Corporation, a New York and London based Investment Management Company entered a joint venture with Prospect 33, a New York and London based Information Technology Consulting practice, to co-market and offer to interested parties Asset Alliance's internally developed risk transparency software called PARS – Position Aggregation and Reporting System.

Having successfully developed and used PARS internally for several years, Asset Alliance is now making it available to other investment management firms as a product that works with position level transparency to portfolios of multiple accounts. The system allows users to download, on a daily basis, portfolio holdings from multiple prime broker accounts and produces a variety of user friendly reports designed to better understand and monitor risk exposures on an account and firm-wide basis.

Prospect 33 will provide technical support to the users of PARS and will offer a high level of customization of the system to meet each client's unique portfolio monitoring needs. Prospect 33 is a leading provider of information technology and consulting services to the investment management firms.

About Asset Alliance:
Asset Alliance Corporation, founded in 1996 and headquartered in New York is an investment management holding company that assists and invests in diversified alternative asset management firms, and provides specialized alternative investment products and services to institutions and high-net-worth individuals. Through its New York-based subsidiary, Hedge Harbor Inc., its London-based subsidiary, Hedge Harbor, Ltd., as well as its Dubai-based subsidiary, Capintro Partners Ltd. the company provides joint venture opportunities and distribution of specialized products throughout Europe, Asia and the Middle East. For more information please visit assetalliance.com or hedgeharbor.com.

About Prospect 33:
Prospect 33 is a New York and London based Information Technology Consulting practice delivering services to the Investment Management community. Prospect 33 clients trade a wide range of asset classes and derivatives and utilize a significant cross section of technological platforms. Prospect 33's distinct emphasis on onshore service centers enables us to eliminate many of the complex communicative issues that occur when dealing with disconnected global service centers. For more information please visit prospect33.com.

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