

Intralinks: Seeking a common approach to fund transparency

**How to bridge the
LP-GP information
disconnect**

**Reporting needs
to be standardised
and electronic**

**Using operational
alpha to gain a
competitive edge**

An abstract background featuring concentric circles in various colors (green, blue, orange, red) and two large arrows pointing towards the center. The overall style is painterly and textured.

Fund transparency and the information disconnect between GPs and LPs

By James Williams

When it comes to communication between managers and investors it is still akin to talking to each other down a long-distance phone line crackling with interference. Things are improving, that is for sure, but there's a long way to go to address the transparency demands that now infiltrate the alternative funds industry.

Put simply, there remains a clear disconnect between GPs and LPs. The former are sensitive about giving away too

much information. The latter don't feel they are getting enough information.

In a revealing survey compiled by Intralinks in collaboration with Opalesque called *Let's Be Clear*, in which over 100 institutional, family office and UHNW investors from 16 different countries were interviewed, some 66 per cent of hedge fund and 45 per cent of private equity investors said that transparency had improved over the last three years. Revealingly, however, only

approximately half of these investors felt that the level of transparency they received was sufficient.

Andre Boreas is the Director of Alternative Investments at Intralinks Inc. More than 100,000 allocators globally log on to Intralinks Fundspace to access information on their alternative allocations such as fund statements, capital calls etc. At the same time, managers utilise the system to securely share information with investors to aid their capital raising campaigns.

When it comes to understanding the push and pull effect on managers and investors Boreas is ideally placed having been both a portfolio manager for a fund of hedge funds as well as the CIO and head of research for an USD800m family office.

"I've shared the pain on both sides. We know investors want more transparency but nobody has ever asked why they want this information. On an informal basis we get together with a number of high profile GPs and LPs to talk about industry developments.

"What was apparent was that the GPs have got their investor relations team running around, answering lots of different questions, presenting data in different formats without really knowing what their LPs want it for. What is the purpose of having all this data?" says Boreas.

At the same time, LPs are not being clear enough with their managers as to why they want the data in the first place. LPs need to state up front what they expect from the GP so that from day one both parties are clear on what the communication and reporting requirements will be.

Clearly, there's a clear grey area that exists where the two parties are standing on either side of the line and not necessarily willing to concede and as Boreas says: "I can relate to that experience directly as a former practitioner.

"What we wanted to do with the Let's Be Clear survey was bring some analysis into this conversation."

Managers are under the microscope

One of the key findings in the report is that 89 per cent of hedge fund investors (and 71 per cent of private equity and real estate investors) said that they didn't invest in new funds due to transparency concerns.



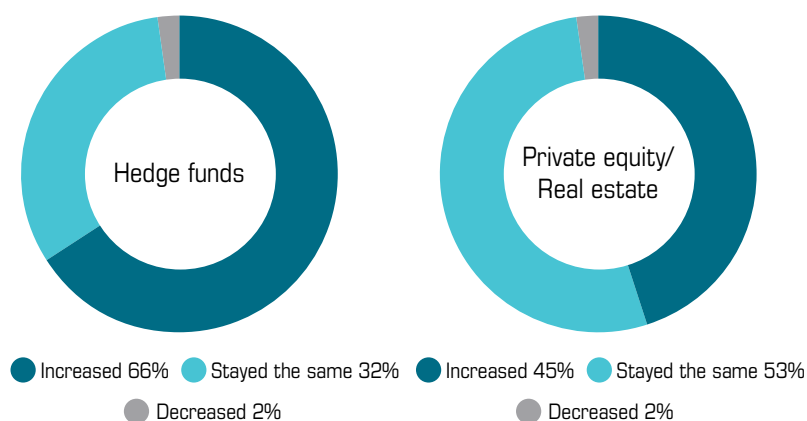
Andre Boreas, Director of Alternative Investments at Intralinks Inc

That's a significant figure. What it shows is that investors still exercise an inherent bias towards managers that can demonstrate a first-class operational infrastructure. A manager might launch with USD500m and be the next rising star but if they don't have the processes, procedures and communication skills in place to report to LPs and offer sufficient transparency they won't grow their asset base.

"I was slightly surprised by the 89 per cent figure. If we'd asked that question two years ago it would probably have been lower. Transparency has become a greater requirement when making that initial allocation, especially considering hedge fund performance has been average. We are in a high market beta cycle right now but that will change," says Boreas.

Indeed, in such an environment investors are more forensic than ever at the pre-allocation stage when it comes to understanding how a manager makes returns in the fund. What percentage of the returns is just market beta? How much risk and leverage is being employed? These are key questions that investors want answers to. The dialogue has become much more quantitative and necessarily so given the fees involved.

How has transparency changed over the past 3 years?



“Investors will look at the fund – how long and short is it? What’s the gross and net exposure? Then they’ll look at position-level details. What percentage of the portfolio is Apple? If it’s 25 per cent, that’s a problem!”

“When evaluating a fund, under the ‘very important’ category, performance came out on top with 87 per cent in the survey. Next was leverage exposure, with 81 per cent,” confirms Boreas.

Use operational alpha to gain a competitive edge

For start-up managers in particular, this is something to be mindful of. The culture of secrecy has all but disappeared from the alternative funds space. The reality is that a long/short equity manager is not unique. They are literally thousands of managers all running such strategies.

Those that grasp what kind of information investors want from day one, and how they can best deliver that information, will go at least some way to remaining on investor short-lists. In effect, it’s setting up the business to deliver ‘operational alpha’.

“I’ve seen every type of equity long/short manager you can think of, I’ve heard every kind of pitch presentation. A manager might be at USD250m and they’re trying to get to USD500m so what’s going to make the difference?”

“How can you make that extra dollar of capital work more effectively than your competitors? By being more transparent, more communicative, by explaining what you do. When you interview and speak with managers, the range of answers is

phenomenal. I asked one manager why he decided to set up a hedge fund his response was that it cost less and was easier to do than to set up a mutual fund. What I want to hear is their passion; their short selling expertise.

“That’s why so many hedge funds go out of business every year,” states Boreas.

The point is, transparency is not solely about reporting in a granular way, on a frequent basis, to satisfy the LPs. It’s also intrinsically linked to communication. Picking up the phone on a proactive basis, not waiting for investors to call, and keeping them in the loop. No more important is this than during a down cycle in the fund. Investors are increasingly institutional and have a long-term outlook. It doesn’t matter if the fund falls -10 per cent in a month provided the portfolio manager explains why it happened and what is being done to remedy the situation.

This is a crucial part of the transparency narrative.

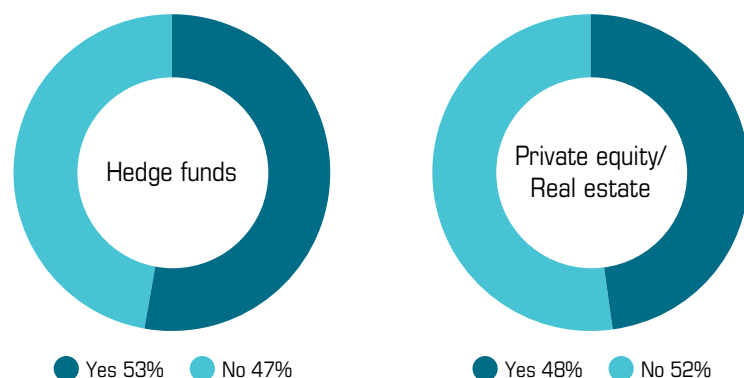
“When something goes wrong in the portfolio the last place an LP will want to hear about it is in the press. It is not a time to hide but to get on the phone and call every LP in the fund. If I, as an LP, were to find out in the press, that manager would never get another dime from me,” says Boreas.

Reporting needs to be standardised and electronic

With respect to how GPs share fund information, the Let’s Be Clear survey found that only 55 per cent of respondents said they received it in a data download format. Of the other 45 per cent that did not, 85 per cent said it would aid due diligence and monitoring. For managers that still complain about how hard capital raising is, even bringing their reporting execution into the 21st Century would go some way to alleviating that pressure.

“There’s room for improvement on both sides but the way that information is being delivered is still archaic. In the long-only world you get all your positions split across separate accounts, everything is pretty much apples for apples and the portfolio data can be sliced and diced a thousand different ways,” says Boreas.

Do you receive the correct amount of transparency from the majority of your managers?



In the hedge fund world, unfortunately, reporting remains a heterogeneous mess.

“Take a FoHF manager. An investor might ask them: ‘How much exposure do you have to healthcare?’ They look at the risk reports for each manager in the portfolio but Manager X does not refer to it as ‘Healthcare’. They separate it out to biotechnology and medical services. Manager Y separates out pharmaceuticals. It’s all apples and oranges.

“The data has to be manually massaged and reconstructed to understand the risk exposure to healthcare: a straightforward question that requires a huge amount of effort. It’s ridiculous that it should be that complex,” comments Boreas.

This lack of consistency is a real issue when one considers that institutions are increasingly using alternative strategies within their overall portfolio i.e. long/short equity and event-driven managers in their equity bucket, fixed income arbitrage managers in their fixed income bucket.

Point being, alternatives as a distinct asset class is dissolving. Investors, especially those with managed accounts, want the same consistency of reporting across the book.

“This is a natural progression as the industry becomes more institutionalised,” says Boreas.

“We need one standardised reporting solution. Whether it’s the OPERA protocol (Open Protocol Enabling Risk Aggregation), the Hedge Fund Standards Board (HFSB) or some other standard; we just need one. Let’s at least agree on the basics of how

hedge funds should be reported – let’s call an apple an apple.”

Is too much transparency a hindrance to GPs?

One of the inevitable consequences of sharing more data with investors is that managers become pressured into changing the way the portfolio is managed. They also fear that sharing too much data will give away their secret sauce. A large investor might, for example, feel uncomfortable with a fund’s net exposure and lean on the team to reduce it.

The other problem that managers face is not knowing why investors want the information in the first place.

Too often, an investor who wants to interrogate a long/short equity manager running 150 positions will also seek to get the same position-level data from a systematic manager running thousands of positions.

“It becomes a box ticking exercise. What are they going to do with position-level data from such a fund? I’m not sure it’s a problem of demanding too much information. I think it’s more a case of LPs not knowing what to ask for. They read somewhere in the media that it’s important for LPs to understand position-level data in funds and so they follow suit. They assume that it’s the right thing to do.

“But the LPs are getting better. The GPs are getting better. At Intralinks, it’s our job to better educate managers. To show them what other industries are doing, how things like cloud platforms, mobile technology (and other forms of technology) can benefit both them and their LPs.

“As I say time and time again, a happy LP is a happy GP,” concludes Boreas.

Download the report for further details:

<http://offers.intralinks.com/LP=337>

A GP’s perspective

Speaking with *Hedgeweek*, a London-based private equity firm with a focus on deal opportunities in the upstream oil and gas industry in Europe, the Middle East and Africa shared some thoughts on transparency but asked not to be identified as the firm is currently in capital raising mode. The firm has around 10 investors

What types of information from your hedge fund managers is important to you?

	Very important	Important	Somewhat important	Not important
Performance	87%	13%	0%	0%
Geography breakdown	31%	34%	28%	8%
Industry breakdown	34%	32%	33%	2%
Leverage/exposure	81%	15%	1%	3%
Holdings	40%	30%	29%	2%
Underlying managers (fund-of-funds)	53%	28%	18%	0%

including an Australian pension fund, a large European institution and a number of large US family offices.

Being a first-time fund means that there are a lot of background calls and meetings with investors in what is a highly detailed due diligence process. To that end, using technology and addressing the transparency needs of its investors has been important from the get-go.

"Investors are going in to far more detail than they did a few years ago, especially with new funds that don't have long track records. In the due diligence process investors want to go through the firm's build-out, governance and reporting processes and understand how we are going to apply governance not just to the fund but to the companies we invest in," says a spokesperson.

In the Let's Be Clear report, 40 per cent of private equity managers said that they provide monthly portfolio updates to their LPs. In that regard, this manager is no different.

"With each of our investors we have a pre-agreed timing of reporting. We have a quarterly call with our LPs and a monthly update on the fund that we send out. We also hold one-on-one calls with investors if they have specific questions on these monthly updates," confirms the spokesperson.

These reports are sent to investors electronically in a PDF format. In addition, the manager uses a Jersey-based fund administrator to send documentation if there are certain legal requirements that need to be executed. The spokesperson confirms

that the administrator has an in-house investor log-in that investors can use to access certain data but adds: "That's not something that we've needed to use yet because we don't have enough investors to warrant doing so."

Nevertheless, having that functionality is helping the wider private equity and hedge fund community put their investors more in control of data and reporting. They can access data when they want it, rather than having to wait and rely on the manager.

In this manager's view, transparency is more nuanced when discussing hedge funds and private equity.

"Private equity investors are more concerned about governance, procedures, making sure investment processes and committees are in place to ensure that the proper investments are chosen. I wouldn't expect them to have as much of a need for data and transparency (as compared to hedge funds)."

Currently, the firm is in fundraising mode for its second deal. The firm uses Intralinks for this purpose.

"Where we are speaking with potential investors we use Intralinks to share a lot of background information on the team etc to help with their due diligence process. We hope to complete the next deal in a couple of months, which we estimate will be around USD200m, at which point we will determine whether or not to launch a fund structure or allocate on a deal-by-deal basis.

Some of our investors like the family offices prefer to invest deal by deal," explains the spokesperson.

When asked whether there is a risk that providing too much transparency could lead to managers giving away their secret sauce, the spokesperson confirms that there has been a degree of pushback on investors because some of the firm's data is proprietary and highly sensitive:

"We want to make sure that our strategy is under full control for us to execute it properly. Hedge funds have metrics on a daily or monthly basis that can be measured (and shared with LPs) but in private equity these are long-term investments. It's a case of saying to our investors, 'Trust us, you've done your due diligence on us as a team and we'll deliver on the strategy'." ■