Premium Alternatives News
OPALESQUE

Opalesque Exclusive: With or without additional hedge fund industry regulation, managers and investors have increased focus on risk management

From Kirsten Bischoff, Opalesque New York:

Regulation in both the US and Europe may not wind up being as Draconian as was originally expected. This past week US officials reached out to assure the hedge fund community that regulations will not be a hindrance to industry growth (Source), and in Europe there have been signs that some portions of the draft directive on alternative investment managers will be eased (Source). However, investor demand for increased transparency, and manager focus on risk management has been driving industry-wide change without formal regulation.

“We know that our clients are focusing more than ever on risk and operational issues,” Paul Compton, Head of Product Management for Alternative Investments at SunGard, told Opalesque.

Survey results released by 7city Learning (Source) showed that 35% of respondents polled (a mix of both quants and risk professionals randomly selected from alumni from 7city’s Certificate in Quantitative Finance course) replied that risk management was taking up a greater portion of their job. Additionally, 55% said they were being consulted more often on risk management issues and 35% of these said consultation on risk management issues had increased inordinately.

Such is the growing demand for risk management tools as well as the technologies to pass such information on to investors and potential investors that SunGard, which services several hundred hedge funds, private equity managers, and other alternatives business, has invested in several of them.

“ Greater demand for transparency is one reason why SunGard has invested in flexible reporting technology for its Alternative Investments back-office solutions. Of course managers and owners of investment firms also need to know that their exposures are well understood and reported, which we offer through technology such as SunGard’s APT buy-side risk solution,” said Compton.

The change also signals a significant shift in culture within the hedge fund industry. Prior to 2008, when funds flowed into managers at record-breaking pace, with many funds closing due to oversubscription, investors did not have the leverage to make demands for additional strategy information. Quant firms especially were notoriously secretive about divulging too much information on the trade programs and other proprietary information they used for investing. However, the pendulum now swings in favor of investors who will eventually be reallocating to hedge funds starved for assets. These investors, still shell shocked from combination of market turmoil and fraud of 2008 have made it very clear that they will not invest in strategies they can not understand, or with managers who cannot explain them.

7city survey respondents revealed that many (61%) saw an increase in information requests made with the purpose of validating and understanding investment techniques. “I think the survey results point toward the need for quantitative finance professionals to make sure they have an applicable understanding of risk management, rather than a theoretical one,” said portfolio manager Steve Young in a statement released with the survey results.

Such transparency has served one quant firm well in the 8 years they have been investing. New York-based Systematic Alpha Management has been fairly transparent from its start in 2001, but even the team at that firm has seen an increase of investor requests for even more information.

“We have tried to make our fund as transparent as possible,” Alexei Chekhlov, PhD Head of Research and Portfolio Manager at Systematic Alpha Management. The high frequency strategy available as a fund vehicle as well as through managed accounts trades 24 hours, 6 days a week. The firm engages risk metrics for the purpose of monitoring risk.

“The key point of transparency is the risk. Not just the strategy and when you buy or sell, but: How is the risk changing as a function of time? What is the meaning of risk? What is the marginal risk? What are the tail properties of the risk?”

Related July-09 article: **Opalesque Exclusive: Hedge fund managers concerns are focused on real and familiar pain of counterparty and volatility risk, not regulation**
As it turns out, regulation is not the biggest fear for hedge fund managers. Volatility and counterparty risk are the biggest concerns according to the preliminary results of the Risk Governance Survey performed by PRIMA and Capital Market Risk Advisors…Full article: Source