

Derivatives

STRATEGY

RISK MANAGEMENT, EXPLAINED

www.GlobeOp.com

A Back-Office ASP for Hedge Funds

One of the neglected but salient facts surrounding the Long-Term Capital Management saga is that there were a few things the troubled fund did right.

One of those was back-office processing. Remarkably, in the most frenetic days of the fund's implosion, when it was losing billions at a time and receiving margin calls at alarming rates, no payments to creditors were missed and it never had to restate its net asset value. That's not quite a silver lining, but it does speak to the fund's bulletproof back-office infrastructure, which performed well despite its flawed investment strategy.

Now, a group of LTCM alums are offering that back-office expertise to other hedge funds. Hans Hufschmid, a former partner at LTCM and co-head of its London office, left in May 1999 to form GlobeOp, an application service provider that bills itself as the most complete hedge fund accounting solution around.

Is there really a need for outsourced back-office support in the hedge fund world? Judging by the number of providers that have popped up over the past few years, the answer seems to be yes—particularly for newer hedge funds. "When people start hedge funds," says Hufschmid, "they tend to come out of broker-dealer shops, securities houses, banks or other hedge funds. They're familiar with managing money and risk, but they know very



GlobeOp's
Hufschmid:
Processing trades

little about the infrastructure of how to account for trades, how to process trades and generate an infrastructure that supports risk-taking."

That, says Hufschmid, is where GlobeOp comes in. The company provides all the necessary services to launch and operate a private investment entity. GlobeOp struck an ASP agreement with Reuters' Kondor+, a real-time trade-capture and risk management system. The system works as follows: A trader performs all of his pre-trade analytics on his own, and executes a trade

via Kondor+, which feeds the trade to GoTrade, GlobeOp's proprietary software. GoTrade then feeds the trade to the prime broker for reconciliation, and the trade is returned to GlobeOp and fed into the accounting engine, where the daily P&L, balance sheets and income statements are generated and updated.

GlobeOp also maintains the "security master," which houses all static data, and it takes care of the client's collateral management as well. "We take collateral agreements struck by clients, put them in our system and monitor them,"

says Hufschmid. "We interact daily with the counterparties to price the positions and initiate collateral movements. Clients then must validate the trade in order for it to be processed." GlobeOp also offers various types of risk management services, including value-at-risk, stress testing and interest rate analysis. And it takes care of the fund's relevant International Swaps and Derivatives Association documentation management as well.

GlobeOp is trying to separate itself from other hedge fund accounting firms by helping clients to process trades. While other firms offer accounting services, it performs daily reconciliations of the prime broker, the clients' positions in their systems, their cash balances, the income statement and the balance sheet. Ideally, at the end of every day, clients can go home knowing that everything is in sync.

Hufschmid is careful to point out that GlobeOp clients aren't merely buying the former LTCM's back-office processing power, impressive as it was. While the GlobeOp team draws from its experience at LTCM, it's been built using newer technology. The clients hook up to Kondor+ via a thin-client installation at their own work sites. All this takes is a PC and an Internet connection. The main servers and data centers are located in New York and London. The result: clients can access their positions at all times, and generate live P&L and NAV calculations. Smaller clients typically use standard Internet Service Providers to connect; bigger clients often choose to connect directly via a T-1 line.

Another of GlobeOp's benefits, says Hufschmid: counterparty and customer management. "At the client's request, we'll supply risk management and other

information to credit counterparties and investors. Counterparties who get this kind of information from an independent third party have a greater level of comfort, and therefore are willing to grant better credit lines to the hedge fund. That's a very valuable asset."

That kind of reporting should help funds reassure skittish investors nervous about the secrecy and mystery surrounding black-box operations associated with hedge funds. "Clients can't do their usual due diligence with hedge funds the way they can with other investments," says Hufschmid. "But we can provide them with information on a monthly, weekly or even daily basis."

Down the road, GlobeOp hopes to sell its services to mutual fund managers, insurance companies, family wealth offices and corporates.

—Robert Hunter