

GlobeOp hosts ‘Insights for Investors’ managed accounts seminar – speech highlights

Conference draws industry attendees representing \$260 billion in assets under management (AUM)

NEW YORK, LONDON – 28 September 2009 -- The challenges and best practices of managed account relationships drew a capacity audience of hedge fund investors and managers, representing approximately \$260 billion in assets under management (AUM), to a recent GlobeOp-hosted seminar in New York City.

A panel of established experts from a cross-section of the industry addressed the key considerations of manager selection, legal requirements, middle-back office services, controls and monitoring.

Speakers representing Lighthouse Investment Partners, Lyxor Asset Management, Waterstone Capital Management, Bracewell & Giuliani, Newedge Group and GlobeOp offered the following insights:

Sean McGould, president and co-chief investment officer, Lighthouse Partners

“We transitioned to managed accounts over the last five years for the added benefits of transparency, flexibility, and control. Full transparency allows for a deeper focus than has traditionally been the case, especially during the manager selection process. For prospective managers, there are three primary considerations. First, does the manager offer real diversification or do they merely compound existing risks? This can only be accurately measured by layering a prospect’s daily position level data into the portfolio and conducting a deep statistical analysis. Second, is the portfolio highly correlated to the most widely held names or other dominant themes within the hedge fund universe? Having the ability to confirm the uniqueness of a prospect’s portfolio is of great benefit and increases the level of overall diversification. Finally, if the manager meets these tests, is there a willingness to commit the resources necessary to make a managed account feasible and the on-boarding process as seamless as possible? ...Flexibility is key to remaining opportunistic and taking advantage of market dislocations. ...The benefit of control speaks for itself after a year like 2008.

Nathanael Benzaken, managing director, Lyxor Asset Management

“The two main risks for investors are market risk and operations risk – one to manage and the other to mitigate... The challenge with transparency is how to exploit it. To understand risk, investors need robust software, experienced risk managers, and an appropriate risk methodology. Only scenario and stress test models can help assess tail risk in dislocated markets. VaR is not appropriate, unless perhaps for manager-level portfolio construction... The managed account’s segregation facilitates operational risk management. This is the most important risk to eliminate because it creates a short put equivalent position for investors – it’s the ‘dark side’.... All managed accounts and platforms are not equal. Some are ‘Madoff-able,’ some are ‘Amaranth-able.’ For full transparency and to identify risk and/or style drift early, in-depth and regular due diligence should be done on the underlying managers, the platform structure and infrastructure – at inception and throughout the life of the relationships.

Risk monitoring is nothing, what really matters is risk management. The goal is not to second-guess or intervene in portfolio management, but to understand and take clear action when it's necessary – for instance in the case of mitigating counterparty risk or when confidence in the manager is lost (e.g. breach of mandate).”

Martin Kalish, chief operating officer, chief financial officer, Waterstone Capital Management

“Managed accounts are not for everyone - does it fit your business plan? The manager seeks a long-term investor; the investor requires assurance of the manager's experience in running a managed account. Consider whether the investor will understand and be responsible for the portfolio information they receive -- is more support time needed than for other fund investors? ...The mandate is also key – its definitions can significantly impact asset allocation, concentrations, leverage, liquidity, operations and risk management compared to the flagship fund.

Cost and resources also matter. Managed accounts are about data management. Operational systems are needed to create reporting transparency. Is there sufficient operational staff for trade allocation, valuation and settlement, portfolio accounting and programming? ...It's very difficult to run multiple funds without investing in technology. Trade allocations should be automated to mitigate manual intervention. ... Investors also need resources to execute managed accounts - it requires two-three months, including the key challenges of the legal aspects and establishing prime broker accounts.”

John Brunjes, partner, Bracewell & Giuliani

“The structure and terms an investor prefers in the managed account involve a fully-negotiated process. For the investment advisor, a managed account is a separate client under the Investment Advisors act. At the level of 15 clients, the advisor must become SEC-registered and operate in a registered environment – a new challenge for some. For the investor, the arrangement gives power of attorney to the manager to trade the account, subject to restrictions the investor defines. It is a fee-for-service arrangement as opposed to the two-and-twenty structure traditional in pooled capital. Many investors, in consultation with their managers, create a special purpose vehicle, usually a limited liability company. To avoid project execution risk, investors should ensure the manager has already strategically decided to undertake managed account arrangements and is prepared for what it entails.

The mandate or operating agreement defines the type of trading authorizations and restrictions governing the manager, including sector, concentrations or company specifics. As the direct owner of the securities, the investor also assumes liability and compliance responsibilities.

Investors increasingly specify independent administrators to provide checks and balances on managers, including asset and portfolio valuation, daily position and risk reporting, etc. The registered environment also stipulates administrative, infrastructure and reporting requirements. Independent involvement in providing transparency, checks and balances to various managed account components can offer more comfort to investors, which is why these vehicles are increasingly attractive.”

Cary Goldstein, associate director, Newedge USA, Prime Brokerage Group

“A managed account platform will have more than one hedge fund manager trading for multiple vehicles, multiple prime broker relationships and a single administrator across all accounts. From a trading perspective, the most significant implication for

each fund manager is the need for a trade allocation process to split trades appropriately between the managed accounts and the flagship fund. For liquid, listed instruments, this is fairly straight-forward. But it can be more complex for OTC and illiquid instruments - distinct trades may be needed for each managed account and flagship fund, with good monitoring to mitigate tracking errors... In a managed account, investors view the ability to control of the amount of leverage utilized to be an advantage.

Managed account middle- and back-office requirements impact the investor, fund manager and prime broker as each managed account requires its own daily position, trade and cash reconciliations.... The investor may also be involved in selecting prime brokers and counterparty risk management.”

Vernon Barback, president, chief operating officer, GlobeOp Financial Services
“Administration for managed accounts should focus on what the investor wants and needs. Best practice requires a very deep level of service. Helping the investor manage and mitigate risk across all portfolios is key; reducing overall operational risk is the greatest value-add. The investor should approach the administrator in a demanding and thoughtful manner, as a partner who helps to mitigate operational risks and provide transparency so the investor can ensure that the manager is adhering to the agreed investment principles.

Due diligence is not a “tick the box” exercise. Rather, it needs to be an ongoing and in-depth process. There are seven administration areas where an investor should conduct deep due diligence. Is technology a source of innovation and target of continuous investment? Are processes subject to a control environment and is real-time transparency accessible to investors and administrator management? Is domain experience and scale being developed in the human resource pool? Visit off-shore teams and operations to ensure they are integral and adding value to operations. Ask for a personal presentation of the SAS 70 to ensure it is a single document whose scope covers all services & controls the managed account requires, in all offices. Reconciliations should be run daily, with breaks corrected with the manager, and root causes should be investigated to prevent repetition. As the devil is in the detail of the security master, verify that customized risk reports can be run by the administration organization keeping the managed account’s books & records.”

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