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FINANCIAL SERVICES

Accessing hedge funds through managed accounts:

The future is now

November 2015

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EXECUTIVE SUMMARY

The hedge fund industry is in the midst of change, with institutional investors becoming an increasing proportion of assets under management. In a recent survey of managers, the majority of respondents believed that pension funds will be their primary source of capital by 2020. With this, the ways in which hedge fund investments are accessed is evolving significantly.

Key to this is a focus on improving transparency and customization. Investors require improved transparency to better their understanding of the investments made by hedge fund managers on their behalf, and to better assess their liquidity. Customization, both in investment mandate and commercial terms, is increasingly sought to ensure hedge fund allocations better complement investors' wider portfolios.

Managed accounts are key to this evolution within the hedge fund industry. They increase transparency and give investors more control, which allows better assessment of performance and liquidity. Such structures also enable investors to work with managers to develop more optimal, customized hedge fund solutions.

Operational costs (both setup and ongoing) are a key consideration in the use of managed accounts. Infrastructure providers are playing a key role in managing costs, as the industry evolves. These third-party service providers enable operational costs to be reduced and for a wider range of investors to access the benefits of managed accounts. As their offerings develop further, both investors and managers stand to increasingly benefit.

With the increasing prominence of institutional investors and their demand for customized solutions, we expect managed accounts to continue to increase in popularity and become a crucial component of the hedge fund industry.

Tom Brown

Global Head of Investment Management

MANAGED ACCOUNTS ARE THE FUTURE

The 2015 KPMG/AIMA/MFA Global Hedge Fund Survey highlights the material changes that the hedge fund industry is currently in the midst of. This includes improving operational effectiveness, increasing alignment of interests and delivering value to investors. Amongst this, the development of more customized products for investors is a key focus. This discussion paper considers if the use of managed accounts represents the future for hedge fund investing. Its focus is on how hedge fund investing is accessed. It does not seek to assess the future investment performance prospects for hedge funds, which is the topic of far-reaching debate elsewhere.

A managed account gives the investor transparency on the underlying portfolio of investments, and the ability to take control of the portfolio from the hedge fund manager should it be required. Further, the custom nature of managed accounts gives scope for the investor to negotiate both investment and commercial terms (e.g. investment guidelines and fees). Greater operational requirements are the flip side of the increased flexibility offered by managed accounts, with investors needing to address aspects such as account setup and appointment of third-party service providers.

This paper seeks to discuss the increasing use of managed accounts across the hedge fund industry in general. It is noted, for example, that not all hedge funds are opaque in terms of their underlying investments and that certain hedge fund managers will not offer investors managed accounts.

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Managers are moving towards customized product offerings with almost half (47 percent) of all fund managers reporting that they already offer a fund of one or managed account solution, and 21 percent saying they plan to offer these solutions within the next 5 years.

2015 KPMG/AIMA/MFA Global Hedge Fund Survey

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DEFINITION OF MANAGED ACCOUNTS

We define managed accounts as segregated accounts that are owned and controlled by the investor, with investment decision-making delegated to an appointed hedge fund manager — their structure is conceptually the same as a segregated portfolio within equity and bond investing. This paper focuses on managed accounts at the hedge fund level (i.e. where the underlying investments in instruments and securities are made). The term ‘managed account’ can also be featured at the portfolio of hedge funds level, where a fund of hedge funds manager constructs a custom portfolio (the managed account) of underlying hedge funds — commingled funds and/or managed accounts. While a number of the areas discussed in this paper are relevant to this type of managed account, it is not its primary consideration.

The paper also focuses on the use of managed accounts by investors on the ‘buy side’, where the investor drives the setup of the mandate and includes a discussion of operational support providers to institutional investors that utilize managed accounts. These ‘infrastructure providers’ are typically third-party firms who are agnostic to the hedge fund manager and the institutional investor, and they focus on supporting the operational needs of investors to effectively and efficiently run managed accounts within a diversified investment program.



THE DEVELOPMENT OF MANAGED ACCOUNTS

While managed accounts existed previously, they have risen in prominence following the 2008 financial crisis. This has been driven by investor demand, with their ability to address issues such as transparency and liquidity being key.

Traditionally, an investor would invest in the commingled fund set up by the hedge fund manager. This would either be a direct investment in the commingled fund, or an indirect investment with the investor first investing in a fund of hedge funds (FoHF) that then invests a proportion of its assets in the underlying commingled hedge funds. Both transparency and liquidity issues with this approach came to the fore in the fallout of the financial crisis. In addition, hedge fund investors were also exposed to the risk of the financial weaknesses or irrational redemption behavior of co-investors in commingled funds.

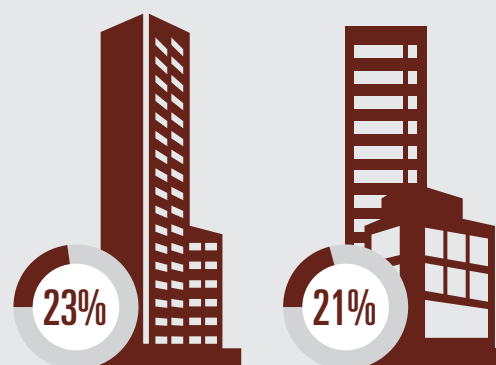
With stress across financial markets, investors experienced the drawbacks of limited transparency in the underlying holdings of hedge funds. This resulted in liquidity issues, which had knock-on effects throughout the hedge fund industry — from the underlying assets invested in, to the liquidity restrictions imposed at both the hedge fund and FoHF level (e.g. gates and side pockets). This was further compounded by a number of fraudulent acts that had been undertaken within hedge fund structures and were also exposed at the time — for example, Bernard Madoff.

Overall, this led to increased demand from investors for greater transparency, liquidity and asset segregation, in order for them to better understand the investments hedge funds were making. In addition, it also led institutional investors to demand greater control over their hedge fund investments and not be subject to the liquidity provisions and co-investor risk of commingled structures. This has been further supported by the increasing prominence of institutional investors in hedge funds (e.g. pension funds), which now account for around two-thirds of total hedge fund assets. These investors have increased demand for greater transparency and customized investment mandates, as well as putting pressure on fees.

Top box response among hedge fund managers, when asked to rank what will be the primary source of capital over the next 5 years

Corporate pension funds

Public pension funds



Source: 2015 KPMG/AIMA/MFA Global Hedge Fund Survey



MANAGED ACCOUNT STRUCTURES

Managed accounts are separate investment accounts over which the investor has ultimate control. The underlying assets are owned by the investor and registered in its name. Day-to-day management of the account however is delegated to the appointed hedge fund manager. In addition, the managed account will require certain third-party providers in order for it to be set up and function on an ongoing basis.

The hedge fund manager's sole link to the managed account is through an Investment Management Agreement (IMA). This outlines the terms upon which the manager is to make investments in the account and manage the resulting portfolio on behalf of the investor. Negotiation of the IMA is a key aspect of setting up the managed account as it contains the specific investment and commercial terms, as well as triggers (e.g. key man clauses), under which the manager is appointed. Should the investor wish to reallocate the assets or change manager, it only needs to amend or terminate

the IMA accordingly. The equivalent action in a commingled fund would require disinvesting from the fund, potentially incurring liquidity constraints (such as gates), a period of not being invested and then re-investing in another fund.

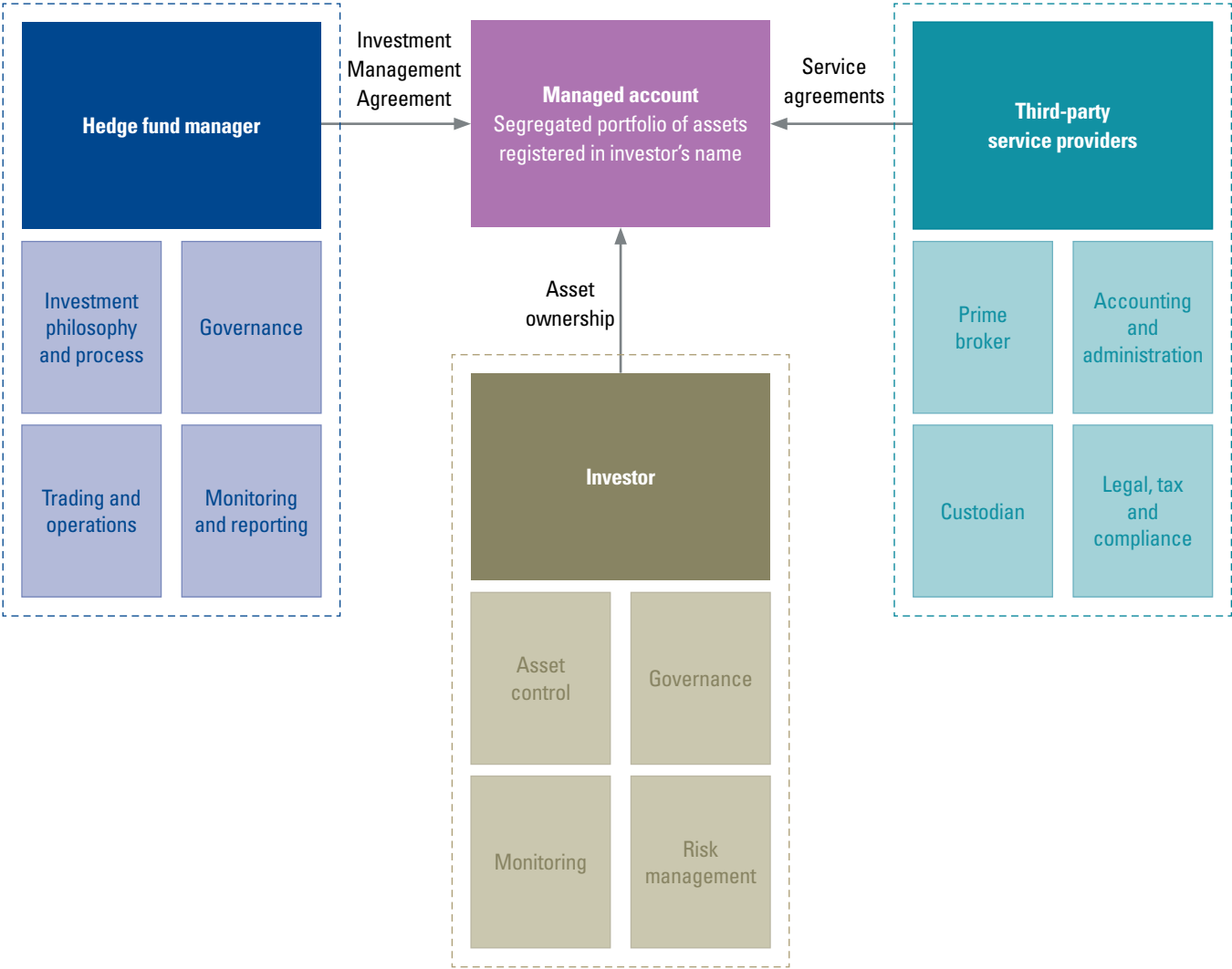
Unlike investment in a commingled fund however, the investor is also responsible for operational aspects of the managed account. This is most significant when the account is first set up. This will include the appointment of certain third-party service providers, such as prime brokers, administrators and custodians. Following the appointment of these providers, the input required by the investor will decline although ongoing costs will remain. Managed accounts structures require greater governance and are operationally more complex. Given this, managed accounts have typically been more appropriate for larger, institutional investors such as pension funds, endowment funds and FoHF managers.

Fund of one

A 'fund of one' structure lies between a commingled fund and a managed account. It is a fund structure that is set up specifically for, or by, the investor with the underlying assets owned by the fund. The investor is an indirect investor in the underlying assets as, formally, these are 'owned' by the fund. As the sole investor in the fund, however, this enables the investment mandate to be customized to their specific requirements.

The fund may be set up on behalf of the investor by the hedge fund manager using its third-party service providers, which reduces the operational burden on the investor. This structure does, however, have the potential drawback of the fund, to some extent, being interwoven with the manager due to its setup. This may limit the scope for the investor to take control of the underlying assets and/or replace the hedge fund manager (should it be required). This can be overcome by the investor setting up the fund themselves, although this approach requires a greater deal of governance from them — for example, in arranging the legal setup of the fund and appointing service providers. Alternatively, hedge fund infrastructure providers can offer the investor access to a fund of one structure making them more readily accessible.

The investor controls the managed account



Source: KPMG International 2015

ISSUES ADDRESSED BY MANAGED ACCOUNTS

Transparency and control

With hedge funds attracting an increasing proportion of assets from institutional investors, transparency is becoming an area of increasing focus. A large US hedge fund manager noted, “An increasing demand for transparency will drive demand for customized solutions such as a funds of one and managed accounts.” A managed account gives the investor transparency on the underlying portfolio holdings whenever it is required — accounts can typically be viewed on a ‘live’ basis. This can be contrasted with a commingled fund where the level of transparency is typically limited (e.g. only aggregate risk exposures or top 10 positions provided) and available on a weekly or monthly basis at best. Full transparency puts the investor in the best possible position to evaluate the hedge fund investment and its implications for their wider investment portfolio.

The asset segregation that a managed account provides gives the investor full ownership of the underlying assets and ultimate control, including authority on when to invest and disinvest. This removes the impact of other investors’ actions and the risk of the hedge fund manager suspending disinvestments (e.g. gates and side pockets), which has been a very apparent possibility for investors in commingled funds.

Further control is provided to the investor in that the manager is typically only afforded trading authority for the account. This gives the manager sufficient powers to manage the portfolio on a day-to-day basis, but limits wider authority such as the ability to move cash or securities. The greater oversight this provides contrasts markedly with a commingled fund where the manager has full control, with a typically more opaque structure.

In addition, the investor has the ability to take immediate control of the portfolio from the hedge fund manager should it be required — for example, in the event that the manager repeatedly breaches risk

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An increasing demand for transparency will drive demand for customized solutions such as a funds of one and managed accounts.

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Managed accounts offer improvements in key areas of hedge fund investing, including transparency and control, liquidity, customization, and ongoing monitoring and risk management.

guidelines. Ultimately, the investor has the scope to replace the manager and this can be done without upsetting the managed account structure and the underlying investment portfolio — i.e. by terminating the existing manager’s IMA and appointing a new manager through another IMA.

Finally, the benefits of transparency and control afforded to an institutional investor by managed accounts also allows the investor to manage the hedge fund investments as a portfolio themselves (or as a component of a broader investment portfolio) by adding overlay investments ‘on top of’ the hedge fund portfolio for purposes of hedging, adding incremental leverage, pursuing incremental alpha, etc. Utilizing commingled vehicles for hedge fund investing simply does not give the appropriate access, transparency or control of the underlying hedge fund portfolios to facilitate an extension of the investment process in this manner.

Liquidity

The transparency provided by a managed account, and clarity on the specific underlying investments, gives the investor improved understanding of the liquidity of its hedge fund investment. It also reduces the levels of liquidity that the investor must consider, with the sole concern being at the underlying asset level. In a commingled FoHF, for example, the investor must be cognizant of liquidity at the FoHF level, the underlying hedge fund level and their underlying investments. Under this approach, the investor can be impacted by the actions of other investors in the commingled fund — for example, when gates are imposed due to excessive disinvestment requests from investors.

The managed account may still contain illiquid assets as permitted by the investment mandate, and such assets will be affected by underlying liquidity conditions. The investor is, however, much better positioned to assess actual liquidity with fewer levels of liquidity to consider.

Customization

With the majority of hedge fund investments made in commingled funds, investors typically have to accept the investment characteristics of the respective fund. There are however increasing signs that the hedge fund industry is evolving to increasingly become a provider of 'solutions', rather than 'products' — i.e. an increasing focus on customization. A large UK fund manager noted, "Managed accounts provide a bespoke solution that enables pension funds to set guidelines and manage volatility."

A managed account gives the investor scope to set the hedge fund manager a specific investment mandate. With the ability to specify the exact investment targets, guidelines and restrictions, this enables the investor to develop a portfolio that is customized to its circumstances. For example, the investor may only want exposure to an equity long/short manager's expertise within a certain geography, whereas the commingled fund offered by the manager may permit it to invest globally.

The scope for customization extends beyond the investment terms with a managed account structure also enabling the investor to negotiate commercial terms with the hedge fund manager. This is particularly relevant within the hedge fund industry, where fees are widely publicized as being high relative to other asset classes, as well as the changing investor type in hedge funds — i.e. an increasing proportion of larger and more fee-conscious institutional investors. The scope to negotiate fees within a commingled fund is typically limited, and often constrained by most favored nation agreements.

Ongoing monitoring and risk management

The transparency given by a managed account directly improves the investor's ability to monitor the ongoing performance of the hedge fund manager. Such accounts can typically be viewed on a 'live' basis, with regular (e.g. daily) reporting. This greater

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Managed accounts provide a bespoke solution that enables pension funds to set guidelines and manage volatility.

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clarity allows a better understanding of exactly how returns are being generated and most crucially offers full insight from a risk management perspective (e.g. early detection of style drift). This enables the investor to build a knowledge of how the manager runs the portfolio, which puts it in a better position to challenge the decisions made as well as understand periods of underperformance.

The benefits of this to the investor are not limited to the hedge fund investment. It will also have a beneficial impact in the monitoring and risk management of the investor's wider portfolio that the hedge fund investment is part of. This is because it allows the underlying positions and exposures of the hedge fund portfolio, which typically have to be estimated in a commingled fund, to be aggregated with those of the other asset classes invested in. This enables more accurate assessment of the overall risks in the investor's total portfolio, aiding more comprehensive risk management.

The managed account structure also affords improved risk management from an operational perspective. With operational weaknesses often the source of frauds related to hedge funds, operational due diligence is often a key area of focus by investors prior to investing in a hedge fund — this entails the research of areas such as fund structure (e.g. jurisdiction) and third-party service providers (e.g. auditors and custodian), which are decided by the manager. This risk is limited, or arguably transferred, within managed accounts with the investor responsible for setting up the operational structure and appointing third-party service providers.



of hedge fund managers see increasing demand for customized solutions

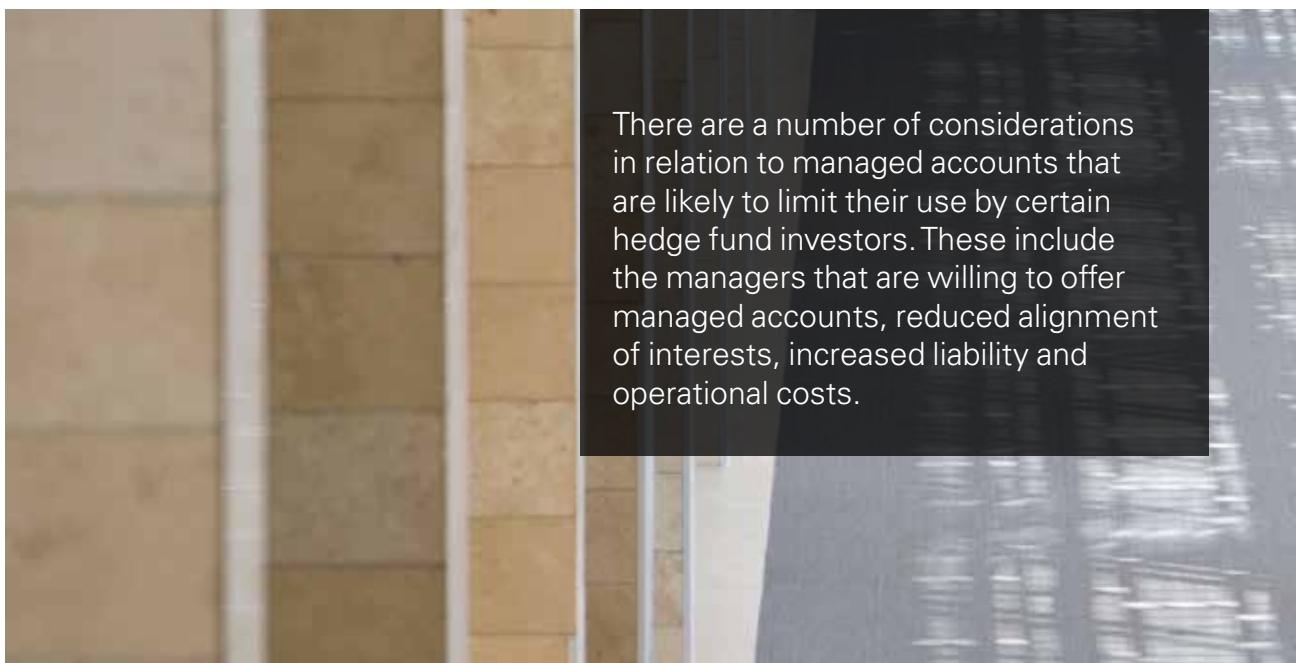
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Many hedge fund managers suggest that the pressure to develop more customized solutions is already heating up. Almost two-thirds (64 percent) of respondents said they were already witnessing increased demand for 'solutions' such as managed accounts and funds of one from their investors. Forty-four percent say they already offer customized solutions to their investors with a further 22 percent saying that they are preparing to do so.

2015 KPMG/AIMA/MFA Global Hedge Fund Survey

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CHALLENGES FOR MANAGED ACCOUNTS



There are a number of considerations in relation to managed accounts that are likely to limit their use by certain hedge fund investors. These include the managers that are willing to offer managed accounts, reduced alignment of interests, increased liability and operational costs.

Managers offering managed accounts

A key reason for managers to offer investors managed accounts is the potential commercial benefits to them — i.e. increased investor base and assets under management. Certain, well-established managers will not, however, need to offer managed accounts as they already have sufficient investor demand and may even be closed to new investors. In addition, offering investors managed accounts will potentially increase costs for the manager both from an investment and operations perspective with the management of more, potentially quite different portfolios. The increased cost and complexity to hedge fund managers (and investors, for that matter) who offer managed accounts is a reason why the industry of infrastructure providers has arisen in the past several years. Such providers have made the offering of managed accounts more palatable to hedge fund managers and investors because of their ability to handle most of the operations as an outsourced managed service.

There will also be certain hedge fund strategies where managed accounts are not suitable. While the traditional lack of transparency associated with hedge funds has declined materially over the past

decade, some managers continue to view their underlying positions as key intellectual property and want to limit the opportunity for position replication and trade crowding by others (e.g. within event-driven strategies).

These factors will limit the range of hedge fund managers willing to offer investors managed accounts, which could lead to an adverse selection bias if investment is predicated on a managed account being available.

Reduced alignment of interests

A key feature of commingled hedge funds is the ability of the manager to invest in the fund alongside their investors. Given that the manager would not be able to invest in a managed account, there is a risk that the alignment of interests between the investor and the manager would be negatively impacted. This can however be mitigated by structuring fees in favor of incentive fees (with the accompanying moral hazard noted). It would be further mitigated to some extent by the likelihood that the managed account would follow broadly similar strategies, and make some of the same investments, as the manager's commingled fund.



Increased liability

Certain hedge fund strategies utilize instruments, such as derivatives, that have the potential to magnify losses (as well as gains). This could result in an investment losing more than the initial capital allocated to it. While this is mitigated in commingled funds by their structure such that the amount invested is the maximum that could be lost, in managed accounts the ultimate liability lies with the investor as owner of the underlying assets. This risk can be managed by appropriate structuring of the IMA (e.g. prohibiting the use of certain instruments), as well as a greater focus on monitoring of the account with appropriate risk controls in place.

Operational costs

With there only being a single participant in a managed account, all accompanying costs are borne solely by the investor — these include, for example, the time required by the investor and the costs

incurred with third-party service providers. There is limited scope for the economies of scale that come from commingled funds by sharing such costs with other investors, although it is likely that investors considering managed accounts will already have certain service providers in place (e.g. custodians), which could reduce costs. As noted previously, these costs include both initial setup costs and ongoing costs. This is typically a key obstacle to smaller investors using managed accounts, and for those where it is not, the investor needs to be comfortable with the transfer of operational responsibilities to them. Another advantage of the aforementioned 'infrastructure providers' is the ability for these providers to focus on operational efficiency, thereby potentially making the operational processing of managed accounts more efficient for a wider range of investors. This is a primary reason for the growth of the 'infrastructure provider' industry.

COST CONSIDERATIONS FOR MANAGED ACCOUNTS



The types of costs associated with managed accounts are similar to those of commingled funds, with both investment management and operational costs. They tend to differ, however, in the split between these two categories, with scope to negotiate management fees and the clearer breakdown of operational costs.

Investment management costs

The 2015 KPMG/AIMA/MFA Global Hedge Fund Survey found that two-thirds of respondents expect that offering specialized fee structures will be a key growth strategy to attract investors over the next 5 years.

A managed account gives the investor more scope to negotiate the hedge fund manager's fees. Within commingled funds, these fees typically consist of a base fee and a performance-related fee. The standard hedge fund fee structure of 'two and twenty' (i.e. a 2 percent p.a. base fee with a performance fee of 20 percent p.a.) is well publicized, and while there is evidence of these fees coming down, in general, the scope for investors to negotiate specific terms within commingled fund is limited — for example, due to the existence of most favored nations agreements.

A managed account allows the negotiation of fee structures that are specific to the customized investment mandate. This can include altering the split between base and performance fee, a flat fee only or a performance fee only. Other terms such as

lock-ins and fees based on performance over longer periods (e.g. rolling 3 years), as well as performance fee hurdles and claw backs, can also be incorporated to further negotiate fee structures. This flexibility also enables the management fee to be adapted to reflect the level of risk that the manager is being asked to take in the portfolio (fee per unit of risk) — for example, if a managed account has a volatility target lower than the equivalent commingled fund, it would have a lower management fee.

For these reasons, it is expected that managed accounts will contribute towards the downward pressure on management fees, as well as their customization for investors.

Operational costs

The operational requirements associated with a managed account have been noted. The accompanying operational costs relate to the third-party service providers to the managed account, including custody, administration and legal. These explicit costs are the equivalent to the additional expenses contained in commingled funds (which are in addition to management fees), although they



may be lower (e.g. due to lower administration requirements in preparing Net Asset Values). Operational costs are much clearer in a managed account as the investor sees the individual costs incurred by each service provider. However, as the economies achieved in a commingled fund are not present, overall operational costs are expected to be higher for a managed account.

Cost savings can potentially be achieved by using specialist providers of hedge fund services, where there is scope to bundle together the required services. Alternatively, intermediaries such as banks and FoHFs offer platforms where managed accounts can be set up. While a platform fee will typically be charged and/or the provider will look to sell investors other services (e.g. bridging finance facilities or manager research), the scale of the investor base can be leveraged to reduce operational costs. The use of such platforms may (depending on the structure and agreed-upon terms) forego some degree of control and asset segregation. In addition, there may be limitations to the range of managers available on a particular platform resulting in limited choice. For larger investors seeking to have

a number of managed accounts, it may be viable for them to set up their own platform. With increasing demand for managed accounts overall, operational costs would be expected to decline.

While a managed account offers scope for a fully customized investment mandate, most will follow strategies that are similar to the manager's equivalent commingled fund. The opportunity cost that may arise from any performance difference between the managed account and the commingled fund is known as slippage. This additional 'cost' may be intended (e.g. due to the intended differences in the strategies followed) or unintended (e.g. due to the commingled fund having access to a bridge finance facility, enabling more efficient portfolio management, while the managed account does not).

The existence of operational costs is a key consideration for investors in managed accounts. Sufficient size and scale or access to providers of hedge fund services is required to ensure that the approach is viable.

CONCLUSIONS

With the increasing prominence of institutional investors set to endure, the way in which hedge fund investing is accessed will continue to evolve.

We expect managed accounts to be key to this development. They address, head on, the issues faced by investors in the aftermath of the 2008 financial crisis — namely, transparency, control and liquidity.

The segregation provided by managed accounts enables the investor to have full transparency, as well as ultimate control of the underlying hedge fund investments. This allows improved understanding of both the liquidity and the management of the hedge fund investment, which enables it to be considered more effectively in the context of the investor's wider portfolio (for example, in terms of overall risk management). Further, as institutional investors increasingly look for investment solutions rather than products, the customization afforded by managed accounts is crucial. This is equally true from the perspective of the investment mandate and the commercial terms.

While investors and managers are already adapting to the changing environment by increasing the use of managed accounts, we believe that there remains material scope for further growth, and at a greater pace. Infrastructure providers will be key to supporting this development. They are already allowing both investors and managers to overcome the operational costs and complexities of managed accounts. As their offering evolves further, the benefits of managed accounts will only become more accessible, to a wider range of investors.

We expect managed accounts to continue to increase in popularity and become a crucial component of the hedge fund industry.



With such increasing importance, we conclude with some key considerations for both investors and managers.

Investors

- What degree of transparency do you have over your hedge fund investment; do you know what the underlying assets actually are; and do you have enough transparency to understand how the portfolio is being managed?
- Do you own your hedge fund investments directly; how much control do you have over them; and is it balanced in your favor or the manager's?
- What is the actual liquidity of your hedge fund investment; is it affected by different layers of liquidity (for example, the underlying investments and the commingled fund); and how would it be affected in a stressed market environment?
- Can your hedge fund investment benefit from greater customization; would a more bespoke investment mandate improve its contribution to your wider portfolio; and would bespoke commercial terms improve the alignment of interests?

Managers

- Are you effectively positioned to benefit from the ongoing evolution of the hedge fund industry; are you sufficiently attractive to institutional investors; and can you meet their more stringent demands?
- Do you offer investors managed accounts; does your investment process lend itself to their use; and what is the commercial cost/benefit of doing so?
- Are you positioned to effectively run managed accounts; do you have sufficient investment resources; and is the operational structure in place?
- Are you benefiting effectively from managed account infrastructure providers; does it make you more accessible to investors; and what are the commercial benefits to you?

GLOSSARY

Administrator — Third-party party provider that carries out a set of activities (e.g. calculating the NAV, paying expenses, preparation and filing of accounts) to support the running of a fund or account.

AIMA — Alternative Investment Management Association.

Base Fee — A fixed percentage that is charged based on the level of assets under management.

Bridging finance facilities — Short-term loan to aid cash management and enable more efficient portfolio management.

Claw backs — Provision to allow investors to claw back performance fees charged in previous periods if performance reverses.

Commingled fund — A fund consisting of assets from several investors that are blended together and invested in underlying securities. Investors have a direct investment in the fund and an indirect investment in the underlying securities.

Crowding of trades — A security or an investment theme that has attracted an unusually large number of participants such that the opportunity diminishes.

Custodian — An organization that is charged with safekeeping the securities and other assets of an investor.

Derivatives — A contract whose value depends on the value of one or more other assets.

Event-driven — A hedge fund strategy that involves exploiting price inefficiencies caused by a corporate event, for example, a merger or acquisition.

Fund of Hedge Funds — A commingled fund which invests in hedge funds rather than directly in underlying securities.

Gate — A restriction that limits the amount of withdrawals from the fund during a redemption period. Typically initiated if a large number of withdrawals, as a proportion of the fund's total assets, are requested.

Infrastructure providers — Third-party firms who provide operational support services to investors and managers enabling them to efficiently and effectively run managed accounts.

Investment guidelines — The general rules which an investment manager should adhere to when managing a fund or account, such as risk/return objectives and specific limits and constraints on asset allocation, risk tolerances and liquidity. They are usually included in the IMA.

Investment Management Agreement (IMA) — Legal document that defines the relationship between an investor and investment manager. It usually incorporates both the investment and commercial terms of the mandate.

Key man — An individual investment manager that is responsible for the majority of the investment decisions, and whose departure would be expected to materially detriment the investment process.

Liquidity — The degree to which an asset or fund can be bought or sold.

Lock-in — Period in which investors are not allowed to disinvest.

Long/short equity — An investment strategy that involves buying equities that are expected to increase in value (long) and selling equities that are expected to decrease in value (short).

MFA — Managed Funds Association.

Most Favored Nation Agreement — A guarantee that any terms an investor agrees to with an investment manager will be no less favorable than any other investor.

Net Asset Values (NAV) — Calculated as the total market value of assets minus total liabilities and expenses.

Operations — Activities that are non-investment related, for example, valuation policies and processes, legal and regulatory compliance, business continuity planning/disaster recovery, back-office and trade operations.

Operational due diligence — An investigation into the operational (i.e. non-investment related) activities of a fund.

Performance fee — A fee that is charged based on the increase in the NAV of the fund. It is typically in addition to the base fee.

Performance fee hurdle — The return above which the manager earns a performance incentive fee.

Platform — An investment arrangement that gives investors access to the capabilities of certain investment managers on the platform. It will typically utilize its scale to achieve economies in both investment and operational costs.

Position replication — When one investor mimics the investment trade of another, which can lead to crowding of trades if done on a sufficient scale.

Prime broker — Bundled package of services offered by investment banks to hedge funds, generally including securities lending, trade executions and cash management.

Risk management — The forecasting and evaluation of financial risks together with the identification of procedures to avoid or minimize their impact.

Segregated account — Investment portfolio that is owned by a single investor, with the underlying assets separately identifiable and registered in the name of the investor. An investment manager is typically appointed to manage the underlying assets.

Side pocket — An account used by hedge funds to separate illiquid assets from more liquid assets. Only investors in the hedge fund at the side pocket's inception will be entitled to a share of it.

Style drift — When an investment manager diverges from its stated investment style or objective.

Transparency — The degree to which information is able to be provided to investors, for example, underlying investment and leverage exposure.

Volatility — A measure of the amount of fluctuation in the value of an asset (or market). Typically expressed as the standard deviation of annual returns.

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