The Hedge Fund Manager/CorrectNet Fund Administrator Survey

The fourth bi-annual survey of leading administrators spells good news for the industry: hedge funds' popularity shows no sign of waning and assets have almost doubled in the past year

Hedge fund assets have continued to soar over the past six months and are within touching distance of the US$2 trillion mark, 12 months after first breaking the US$1 trillion barrier.

The latest *Hedge Fund Manager*/CorrectNet Fund Administrator Survey shows total hedge fund assets have climbed by 22.96% in six months to US$1.92 trillion. Of this figure, 65.1% (or US$1.26 trillion) is invested in single hedge funds and 34.9% in funds of funds. Funds of funds have enjoyed stronger growth, with a six-month advance of 27.31% compared with 22.62% for single funds.

Phenomenal growth

The phenomenal growth of the hedge fund sector shows little sign of slowing. In November 2003 total hedge fund assets were around three-quarters of a trillion US dollars (US$745.24bn). In the space of 18 months this figure is closer to trebling than doubling. Of course, this strong sustained growth has encouraged the big game of the investment world to enter the hedge fund jungle. The survey illustrates a period of dramatic change in the landscape for administrators with yet more players losing their independence.

The increase in assets over the past six months has been due to increasing interest from institutions in the hedge fund space and improved underlying investment performance among other factors. Clare Flynn, president of Beauchamp Financial Technology, says increases in hedge fund assets over the past six months are more likely the result of additional institutional asset flows into hedge funds rather than pure performance improvements. She says one major trend over the past six months has been a shift to multi-strategy funds as the market matures.

While an increasing number of emerging market hedge funds have been launched, the US remains the dominant market for hedge funds. Three-fifths (59.5%) of hedge fund managers are located in the region, with a third (32.3%) in Europe and 8.2% elsewhere. This is based on the average split of manager locations, among the administrators taking

Administrator deals October 2004 – March 2005 part 1

BISYS acquires RK Consulting

BISYS acquired RK Consulting in December, taking its hedge funds and private-equity assets under administration to over US$180bn. RK Consulting contributed 27.1% to the total hedge fund assets of US$165.4bn reported by BISYS in our survey. In the past six months the former pre-deal BISYS and RK Consulting businesses reported hedge fund asset growth of 13.8% and 9.1% respectively.

RK Consulting was the investment fund administration affiliate of accounting firm Rothstein Kass and provides a full range of administration and outsourcing solutions to hedge funds, private equity funds, and funds of funds globally. Russ Fradin, president and chief executive of BISYS, believes the deal will allow his firm to leverage RK Consulting's fund of funds product offering and significant New York area presence.

Mellon/DPM

Mellon Financial Corporation completed the acquisition of DPM – the New Jersey-based administrator with 91 clients and US30bn of assets under administration – in February. The hedge fund administrator now operates as DPM Mellon within Mellon's Asset Servicing business.

Mellon believes transparency services, which enable institutions to see the positions of their hedge fund managers, have become increasingly important as the hedge fund industry becomes more institutionalised. James P Palermo, vice chairman of Mellon, says: æDPM Mellon strengthens Mellon's asset-servicing capabilities world-wide. We expect to work with DPM Mellon to establish a substantial hedge fund administration capability in Dublin to serve the European market, where we are seeing growing demand from international hedge fund managers."

Mellon has three hedge fund managers: Mellon HBV Alternative Strategies LLC (*see interview on page 44*), Mellon Global Alternative Investments and EACM.

William Keunen, director of fund services at Citco

part in our survey. In terms of hedge fund assets, 56.8% are based in the US and 34.2% in Europe – broadly in line with manager location. However, Asia (ex Japan) has a far greater share of assets (at 3.8%) than managers (at 2.1%).

An analysis of the largest administrator, Citco, shows 60% of single managers are located in the US, 30% in Europe, 8% in Asia and 2% in Japan. The asset split reveals a similar profile. Fortis' analysis shows its European heritage, with 35% of managers located in the US, 47% in Europe and 18% in Asia (ex Japan). Of assets, 41% are in the US, 40% in Europe and 18% in Asia (ex Japan).

The Caymans remains the domicile of choice for many hedge funds, but it is receiving increased competition from other offshore centres. A third of single funds are domiciled in the Caymans, with a surge in the number of hedge funds domiciled in the US, ahead of next year's registration requirements for hedge fund advisers (*see page 38*).

The US$250bn administrator

Hedge fund administrators have again enjoyed six-month asset growth rates in double digits and the market shows no signs of slowing. Citco is the first administrator to reach the quarter-trillion dollar mark, sustaining a clear lead over its rivals.

William Keunen, director of fund services at Citco, says: "Citco had hedge fund assets under administration of US$250bn at the end of March, up from US$200bn in September and US$225bn in December. The continued growth has come from a number of sources. Broadly speaking, Citco offers three buckets of services: traditional fully-fledged fund administration services for both single-manager funds and funds of funds, and front-to-back services for single-manager funds.

"The funds of funds assets have been rising steadily, mainly driven by increases at existing larger clients rather than by new business. The biggest growth area over the past six months has been Citco's front-to-back offering for single managers, with significant gains from both new and existing funds. This offering – which has allowed Citco to prise clients away from other administrators as well as capture start-ups – comprises the Æxeo software that the investment manager uses to track positions and generate a real-time profit-and-loss analysis. Using one securities database, data flows through our front, middle- and back-office areas so that everyone in the organisation is looking at the same information. The appetite for this offering has been enormous: we've added around US$25bn in assets in that

Paul Smith, head of HSBC alternative fund services

Administrator deals October 2004 - March 2005 part 2

SS&C acquires Eisnerfast

SS&C acquired New York-based Eisnerfast and Achievement Technologies in February as the company continued to expand its offerings. Eisnerfast provides back-office accounting and administration services to hedge and private equity funds. Ward McGraw, senior vice-president at SS&C, says the deal is part of the company's plan to build the fund administration outsourcing business. McGraw says around one-quarter of SS&C's administration assets are derived from Eisnerfast, which he believes is a good example of an administrator that was already using SS&C technology, making the integration of the businesses easier.

He says SS&C has been providing fund administration for eight years and that among the diversified business' various 'silos', the alternative investments silo is the fastest-growing in the company. "The strong growth in the hedge fund market is one of the reasons that the alternatives silo has seen its proportion of total company revenue rise from 5% in 1998 to around 35% last year. A period during which total company revenues have risen. Most of the unit's revenues are earned in the US, with some offshore and Europe and Asia smaller still," he says.

Ward McGraw

Northern Trust acquires Barings' fund administration business

Northern Trust Corporation closed its acquisition of Baring Asset Management's Financial Services Group (FSG) from ING Group NV (The Netherlands) for £260m (US$500m) in March. Stephen N Potter, executive vice-president of Northern Trust, says Europe is a major driver of his firm's growth and expects this to continue. He believes the FSG business – with US$70bn of funds under administration, including US$4bn of hedge fund assets – complements Northern Trust's existing European fund services capabilities (in London, Dublin and Luxembourg) and the organisation's growing back- and middle-office outsourcing capabilities. He considers FSG's presence in Guernsey, Jersey, and the Isle of Man important and that the Barings name remains a good brand.

area alone in the past six months. Some of the largest start-up funds past year use the platform. An example is Eton Park, which was last year's largest start-up."

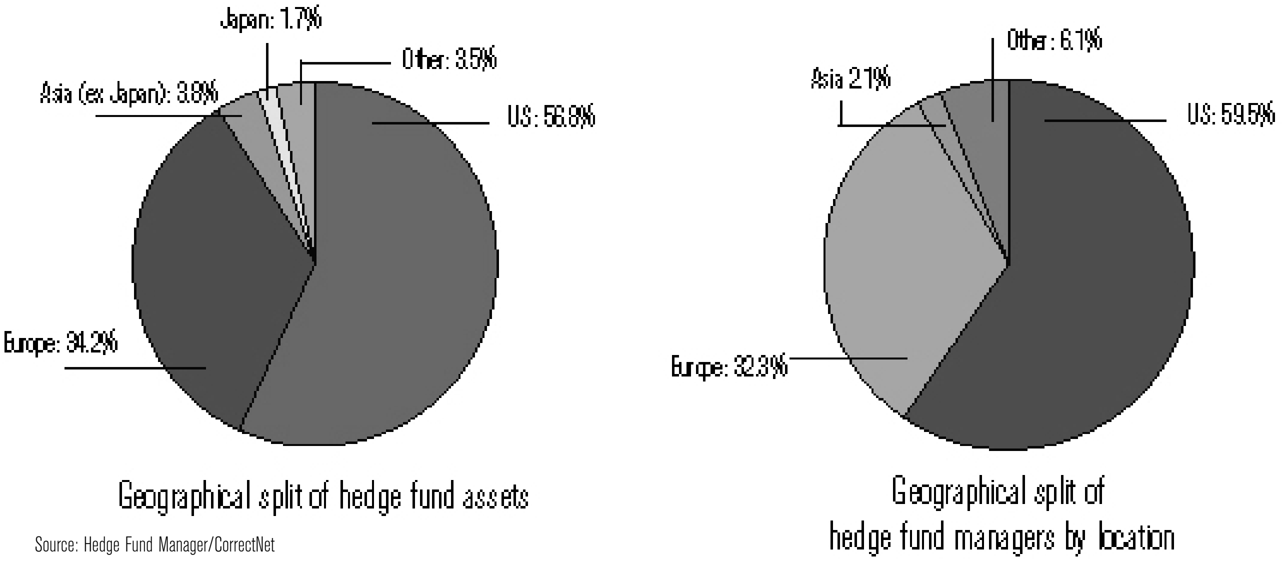
The move to multi-strategy

Keunen has seen a clear shift among start-up funds towards multi-strategy products. He says: "There is currently a terrific appetite for multi-strategy funds among start-ups. We've seen people leaving large institutions to establish multi-strategy funds. And what they're doing is reinventing an institution at the hedge fund, with the capability of investing across a range of strategies. The other source of growth is through existing hedge funds launching new funds. We have seen a continuing strong momentum of start-up funds – especially on the east coast of the US – and this shows little sign of slowing."

Keunen points out that of Citco's US$250bn of assets, "about 25% is invested in long/short equity strategies, 25% in funds of funds, 20% in a variety of arbitrage strategies, close to 20% in macro and multi-strategies, with the remaining assets dedicated to pure fixed income, private equity and emerging markets".

A geographical analysis shows three-fifths of Citco's assets under administration come out of the east coast of the US. Elsewhere, the UK market in particular has picked up market share and more than 25% of Citco's assets come out of

Graph 1: Global assets by geographical distribution



Source: Hedge Fund Manager/CorrectNet

Table 1: The largest fund administrators by assets under management as of May 2005

Company	Total AUM (US$bn)		Funds under admin		Average fund size
	Nov 04	May 05	Nov-04	May 05	per fund (US$m)
Citco Fund Services	200.00	250.00	1700	2000	125.00
Fortis Prime Fund Solutions	135.00	180.00	1400	1400	128.57
BISYS Alternative Investment Svcs (inc RK Consulting)	147.60	165.40	1432	1554	106.44
HSBC's Alternative Fund Services	134.20	165.00	1600	1829	90.21
IFS	130.00	150.00	600	700	214.29
Investors Bank and Trust	107.20	139.80	170	291	480.41
UBS Hedge Fund Services	73.00	86.00	485	529	162.57
Globe OP	67.00	82.30	536	673	122.29
Goldman Sachs (est)	78.00	78.00	268	268	291.04
SEI Investments	57.92	62.45	542	364	171.57
BoNY	46.70	55.60	242	267	208.24
Olympia Capital	44.00	52.00	350	350	148.57
SS&C Fund Services	26.00	50.00	340	530	94.34
PFPC*	39.00	45.00	476	556	80.94
Butterfield Fund Services	34.26	43.80	461	653	67.08
Crédit Agricole**	27.00	34.70	203	126	275.40
Euro-VL / SG GSSI	15.92	30.12	603	645	46.70
DAIWA	22.50	25.50	120	122	209.02
Dundee Leeds Management Services	16.00	18.00	116	120	150.00
BNP Paribas Securities Services	15.20	17.10	126	138	123.91
RBC	12.85	14.63	43	57	256.67
Admiral Administration Ltd (est)	14.50	14.50	155	175	82.86
Dexia Fund Services*	7.36	13.41	39	81	165.56
Trident Trust	11.00	13.00	186	186	69.89
Custom House Group	8.86	12.96	157	177	73.22
Citigroup Global Transaction Services	10.76	12.66	209	233	54.33
US Bancorp Fund Services	6.40	10.90	32	49	222.45
CIBC (est)	10.50	10.50	120	120	87.50
European Fund Administration (inc Kredietbank)*		10.39		89	116.74
Northern Trust (formerly Baring Fund Admin Svcs)	8.01	10.25	129	130	78.85
Spectrum Global Fund Administration	4.70	10.00	83	116	86.21
JPMorgan Tranaut Fund Administration	6.00	7.50	60	71	105.63
Caledonian (est)	6.75	6.75	125	160	42.19
BOISS	4.22	4.85	28	28	173.21
ATC Fund Services	3.22	3.62	21	29	124.83
Columbus Avenue Consulting		3.61		10	361.00
Apex Fund Services	0.39	0.51	16	25	20.40
AIB Fund Administrators	0.23	0.16	4	6	26.67
Total	1562.25	1920.97	13577	15257	126.04

NB: Total figures include estimates for some non-participants in the latest survey that participated six months ago

Source: Hedge Fund Manager/CorrectNet

Europe. The remaining 15% includes assets managed out of the US west coast and Asia.

Regional trends

Paul Smith, head of alternative fund services at HSBC, is seeing strong growth in Asia but from a low base. He says: "Of our US$168bn of assets, US$90bn is in single-fund strategies, US$10bn in private equity, and US$68bn in funds of funds. Of our single-fund assets, the breakdown by strategy is fairly representative of the market. Around two-fifths of those assets would be in long/short equity, with the balance evenly spread among other strategies.

"We are seeing an increase in multi-strategy hedge funds, especially in Asia. In the Americas, the business we are picking up is more fixed-income arbitrage, relative-value credit, bank debt and the more highly specialised strategies.

"One of the things that occupies our time at the moment is the various differences in our regional markets – the Americas, Europe and Asia. In the US we cover a number of strategies and our clients are constantly pushing us into new spaces.

"Europe is very institutionally driven. Strategies tend to be plain vanilla across long/short, multi-strategy and several CTA funds. In Asia, it is a boutique market with limited institutional involvement and heavily weighted to long/short equity. Broadly speaking the US is a very mature market, Europe is mature and Asia is immature."

Alan Dudon, head of product, fund administration and middle-office outsourcing at BNP Paribas, says most of his client base is European and that the administrator has picked up its first hedge fund client in the German market in the past six months. The administrator has also picked up its first Italian fund of funds manager.

He says: "The aim in coming months is to cement BNP's European presence. We are also looking to introduce greater functionality to allow better analysis of fees.

"There is an increasing breadth of hedge fund instruments, with weather derivatives and the like 'hot' at the moment. There has also been much growth from traditional long/short strategies."

HSBC is also looking to the German and Italian markets for growth in Europe. Smith adds the the administrator is aiming to open an office in Italy this year to service growing demand in the region.

Fastest growers

Spectrum Global Fund Administration has outgunned everyone else over the past six months, to more than double its assets under administration. Its growth rate of 112.77% compares with an industry average of 23%. Spectrum illustrates both the opportunities being created by the outsourcing of more than basic fund administration and the growing complexity of the industry.

Spectrum started in 1998 and spent its first four years offering management and technology consulting.

Michael Griffin, chief executive at Spectrum and a former chief operating officer at Fenchurch Capital Management, explains: "This allowed us to build the proprietary technology platform on which we run our service model. Our technology is one of our key differentiators. The amount of resources dedicated to building this reflects the background of some of the principals, who ran hedge funds and lived inside the hedge fund community." Griffin says his aim was to build a full-service model that allows clients to pick a customised solution that suits their needs: from traditional fund administration to full, middle and back-office outsourcing.

Griffin remains upbeat that the past six months are not a flash in the pan and that the company can manage its exceptional growth.

"In November 2003 total hedge fund assets were around three-quarters of a trillion US dollars. In the space of 18 months this figure is closer to trebling than doubling"

He says: "I think Spectrum has the potential to grow much further, but our growth is going to be calculated and focused on providing a premier service. We will not compromise service for growth: reputations are sacred in this business. As we continue to build capacity and evolve our technology, we will be able to handle bigger clients and bigger volumes of business.

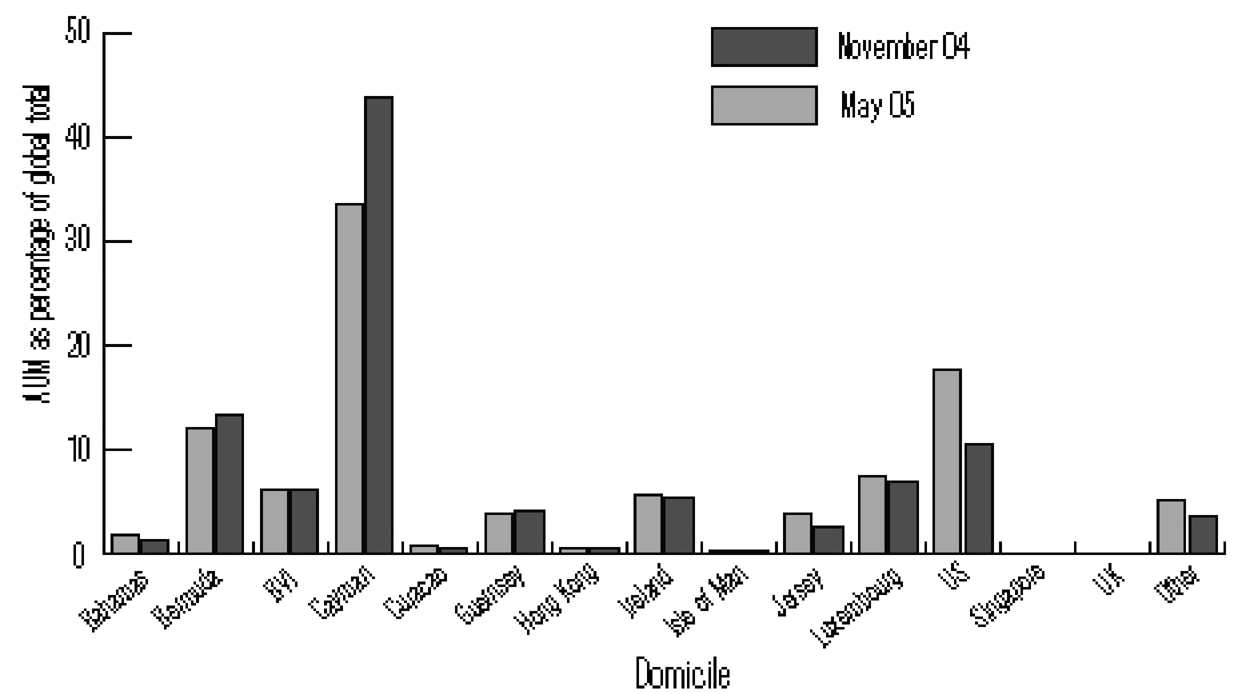
"Our last few wins have been US$1bn-plus hedge fund launches. We are able to handle many of the esoteric hedge fund strategies, having as we do competent staff who understand the nuances of the clearing and settlement issues of such instruments and having the systems to allow them to be reported accurately." He stresses that much of the company's growth is new business rather than stealing share from competitors.

Acquisitions

Increasingly hedge funds are being offered the choice between independent, niche administrators and those that are part of a larger financial conglomerate. Indeed, the growing number of strategies being run by hedge fund businesses and increasing willingness to outsource administration is creating some multi-administrator arrangements at funds.

The acquisition of Barings by Northern Trust and DPM by Mellon in the past six months are among deals that are reshaping the industry (and the survey's analysis). Griffin says: "The hedge fund industry is growing so rapidly that it creates a venue

Graph 2: Domicile size by percentage of global assets



Source: Hedge Fund Manager/CorrectNet

Table 2: Growth in assets from November 2004 to May 2005

Company	Total Assets May 05 US$bn	Six-month asset growth %	Single fund assets May 05 US$bn	Single fund growth %	FoF assets May 05 US$bn	FoF fund growth %
Spectrum Global Fund Admininistration	10.00	112.77	6.40	106.45	3.60	125.00
SS&C Fund Services	50.00	92.31	40.00	73.91	10.00	233.33
Euro-VL / SG GSSI	30.12	89.20	10.12	48.60	20.00	119.30
Dexia Fund Services	13.41	82.20	4.60	52.82	8.81	102.53
US Bancorp Fund Services	10.90	70.31	10.50	69.35	0.40	2224.00
Custom House Group	12.96	46.28	10.56	35.73	2.40	122.22
Fortis Prime Fund Services	180.00	33.33	72.00	33.33	108.00	33.33
Apex Fund Services	0.51	30.77	0.30	36.36	0.21	23.53
Investors Bank and Trust	139.80	30.41	130.40	27.72	9.40	84.31
Crédit Agricole**	34.70	28.52	4.80	-4.00	29.90	35.91
Northern Trust (form. Baring Fund Admin. Services)	10.25	27.97	6.22	43.32	4.03	9.81
Butterfield Fund Services	43.80	27.85	26.28	16.28	17.52	50.26
Citco Fund Services	250.00	25.00	175.00	34.62	75.00	7.14
JPMorgan Tranaut Fund Administration	7.50	25.00	7.20	25.00	0.30	25.00
HSBC's Alternative Fund Services	165.00	22.95	101.00	20.67	64.00	20.75
Globe OP	82.30	22.84	65.84	23.07	16.46	21.93
BoNY	55.60	19.06	48.30	19.05	7.30	19.09
Olympia Capital	52.00	18.18	28.60	18.18	23.40	18.18
Trident Trust	13.00	18.18	9.10	18.18	3.90	18.18
UBS Hedge Fund Services	86.00	17.81	37.00	12.12	49.00	22.50
Citigroup Global Transaction Services	12.66	17.66	9.24	13.51	3.42	30.53
IFS	150.00	15.38	100.00	9.89	50.00	28.21
PFPC*	45.00	15.38	25.40	15.45	19.60	15.29
BOISS	4.85	14.93	3.81	13.06	1.04	22.35
RBC	14.63	13.85	1.77	227.78	12.86	4.47
DAIWA	25.50	13.33	19.38	13.33	6.12	13.33
BNP Paribas Securities Services	17.10	12.50	2.54	12.39	14.56	12.52
Dundee Leeds	18.00	12.50	16.00	14.29	2.00	0.00
ATC Fund Services	3.62	12.42	1.05	23.53	2.57	7.98
BISYS Alternative Investment Svcs (inc RK Consulting)	165.40	12.06	130.10	11.87	35.30	12.78
SEI Investments	62.45	7.82	29.80	6.28	32.65	9.27
Admiral Administration Ltd (est)	14.50	0.00	13.00	-	1.50	-
Caledonian (est)	6.75	0.00	4.81	0.00	1.94	0.00
CIBC (est)	10.50	0.00	2.10	0.00	8.40	0.00
Goldman Sachs (est)	78.00	0.00	78.00	0.00	0.00	-
AIB Fund Administrators	0.16	-30.43	0.16	-30.43	0	-
Columbus Avenue Consulting	3.61		3.60	-	0.01	-
European Fund Administration (inc Kredietbank)*	10.39		3.91	-	6.48	-
Total	1920.97	22.96	504.38	22.62	655.08	26.52

Source: Hedge Fund Manager/CorrectNet

NB: Total figures include estimates for some non-participants in the latest survey that participated six months ago

for a whole range of service providers to enter the industry. However, recent acquisitions of administrators have come at a high price. Acquisitions by the likes of State Street, Mellon and HSBC of administration businesses illustrate the premium on the nature of the business, growth of the business and the types of revenue flows being offered by administrators."

Keunen argues the industry is evolving rather than consolidating. He says: "We are the largest administrator with around a 20% market share. When people talk about consolidation in the industry – through HSBC with Bank of Bermuda or BISYS with Hemisphere and RK Consulting for example – there is not so much consolidation, but rather acquisitions by non-administrators. There may be further acquisitions but Citco is determined to remain independent.

"We are always watching for new entrants into the administration business. Unquestionably new entrants could change the nature of the business and raise the competitive bar. However, we believe prime brokers raise conflicts of interest by carrying out prime brokerage and administration."

Griffin warns: "The large institutions have to be careful that the servicing and administration of the long-only side does not necessarily transcend automatically to the hedge fund space. Hedge fund managers tend to be more entrepreneurial and demand excellence, priority and timely service. An institutional approach doesn't necessarily work well in that environment."

As more traditional asset managers dabble in alternatives, HSBC's Smith believes recent deals presage the emergence of a new order. He says: "In five or six years' time I would expect a group to emerge that will be running products across the alternative and traditional spectrum and using one service provider to provide the back-office support for these funds. That is what the activities of Mellon, Citigroup, HSBC and other large investment houses moving into this business is focused on. At the same time, there will be space for more independent and niche players to emerge."

Pressure on fees

Typically, hedge funds pay fees at 10 basis points on assets under administration for core fund administration services, and perhaps double that for the more added value offerings. So an industry with essentially US$2 trillion of assets, is generating at least US$2bn of annual administration fees.

The challenge facing administrators is to maximise fee revenues as assets soar, while protecting their reputation. Keunen says: "The main challenges for administrators are related to the increased complexity of hedge funds and the fact that expectations constantly evolve. While investors demand transparency, timeliness and accuracy in reporting, the regulatory environment is also becoming more intense.

"The result is a greater emphasis on a fund's operational performance, not just its trading performance. And as the aggregator of fund information, the focus on the role of the administrator continues to increase. Administrators will continue their support role through the checks and balances we carry out – reconciling the fund's records to those of the manager and the street, validating portfolio positions, cash balances and the value of the fund.

"The other factor that has a big bearing on our business is the increasing complexity of some of the structures and strategies being employed by hedge fund managers. The majority of funds are using 'exotic' over-the-counter derivatives. Tracking this activity is more convoluted given the nature of the instruments used and the fact they are being executed with multiple counterparties.

"And pricing these positions is a significant challenge. In any event we believe valuations currently represent a key debating point in the industry. Investors are undoubtedly reassured if the portfolio is priced or validated independently. For this reason we are devoting significant resources to our pricing capabilities."

Griffin points out there are opportunities for additional fees through offering back-office and other added-value products. However, he warns, fee margins fall as assets grow: "We can offer adjusted profit and loss reports and position reports. Clearly this is a more concentrated effort that requires more staffing to support it. The service is not just a month-end NAV calculation.We have a matrix of service levels that we ask clients to choose from and fee levels are based on this. However, fee levels will scale down as assets grow."

being able to provide the appropriate level of infrastructure and find multiple administrative opportunities. Large hedge funds are unlikely to face the same issue.

"Given the challenges, administrators have to be more careful in terms of who they work with. But there are more administrators setting up, so a hedge fund will always be able to find an administrator that suits them, although sometimes they will be limited in those they can employ.

Table 3: Top-five administrators' six- and 12-month growth rates

Company	Assets US$bn	6-month growth (%)	12-month growth (%)
Citco Fund Services	250	25.00	56.25
Fortis Prime Fund Services	180	33.33	36.36
BISYS Alt Investment Svcs (inc RK Consulting)	165.4	12.06	40.23
HSBC's Alternative Fund Services	165	22.95	64.34
IFS	150	15.38	50.00
Total	**1920.97**	**22.96**	**76.67**

Source: Hedge Fund Manager/CorrectNet

Ward McGraw, senior vice-president of SS&C, says there has always been pressure on fee levels. "We are noticing increased interest in added-value propositions with more clients looking for execution and IT solutions along with core administration."

Bob Miller, chief executive and founding principal at global data delivery and reporting provider CorrectNet, sponsor of the administrator survey, agrees that hedge funds are expecting far more from their administrators than simple NAVs.

He says: "Investor and manager web reporting is now a 'must' offering. There is a growing belief that fund administration must go beyond NAVs to become a provider of technology and other services. Among funds of funds, manager reporting is vital (with strategies for consolidating and reporting on diverse performance, risk and strategy) and there is a growing focus on due-diligence support."

Flynn agrees there has been significantly more demand from hedge funds for software that can cope with a variety of strategies, fixed-income in particular. However, she warns, many IT systems have traditionally been equity-based.

Back to the future

Looking forward, Keunen expects the market to become tougher for smaller administrators and smaller hedge funds. He says: "The bar for the industry as a whole has been raised and one of the implications of this is that small- to medium-size hedge funds will be squeezed in terms of

"Given the challenges, administrators have to be more careful in terms of who they work with"
William Keunen

"Citco works closely with hedge fund managers to ensure there is a fit in terms of the partnership between us, the manager and the investors, so that the offering we provide works for everyone. If there isn't a good fit then it's probably best for them to work with another administrator. However, we have no minimum size of funds or other barriers to entry, and our existing clients have a wide range of sizes of hedge fund. We pitch for clients with fees that we feel comfortable with in terms of providing a quality service."

Smith agrees it is getting harder for administrators to try and satisfy the whole industry.

He says: "We've always had a horror of being overly selective when considering new business and we want to be there for the market. However, it is becoming increasingly difficult to sustain that proposition. The biggest challenge is trying to recruit and train staff for the continued hectic pace of the alternative world. This is a global issue. Staffing issues are prevalent in Europe, the Americas – particularly in New York – and in Asia."