



The full picture

David Blair of the Custom House Group explains how his company has grown this past year and the issues that will affect the hedge fund industry in the coming months

Reflecting to a large extent the growth levels across the hedge fund industry in Ireland as a whole, business throughout 2004 has been quite exceptional for Custom House. We have grown from around US\$5bn assets under administration as of 31 December 2003 to in excess of US\$11.5bn at the end of December 2004.

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We, of course, consider this to be encouraging and almost remarkable, but when we stand back we realise that many other administrators have seen similar growth, particularly those who, like ourselves, specialise in hedge funds.

The main drivers behind that growth have been the increased interest in the markets from all sectors – not just institutions, although they have been very influential. The only area that we have not seen growth in is the small retail investor – although it should be noted that what was previously seen as a high-net worth investor investing US\$100,000 is now often considered to be retail, or that awful phrase ‘the mass affluent’.

Within our funds we have also seen good performance, which has increased assets under administration for us. This has led to a substantial increase in subscriptions from new shareholders or existing shareholders increasing their positions.

Many of our managers have launched new funds during the year and we have also been successful in attracting new fund-establishing clients. In addition, several new clients have joined us from other administrators.

INSTITUTIONAL INFLUENCE

As large institutions enter the market and create their own funds, it seems likely they will be limited in the style of hedge funds they can produce and most of them will probably introduce fund of funds. This is purely a reflection on the capacity constraints of most hedge fund strategies.

THE IMPORTANCE OF TECHNOLOGY

David Blair provides an overview of the role technology plays at Custom House

PFS PAXUS, our fund accounting system to which we have recently introduced several enhancements and CHARIOT (Custom House Accessible Reporting In Open Technology), our secure web-reporting platform introduced in April 2003, have been bedded down very successfully.

It is always an interesting paradox as to who an administrator's client is. In the case of a fund, we have responsibility and consider our ultimate client to be the investor; however, on matters such as transparency our client is obviously the manager and we comply with what the manager says, providing it is within the terms of the offering documentation.

Thus any investor demands for transparency are subject to the manager's willingness to expose his positions and, providing that his wishes comply with the offering document then we will act on those wishes in this regard.

Having said that, the CHARIOT platform enables us to give full or partial transparency to any investors as the manager may wish. One of the huge advantages of CHARIOT is that a manager or investor can download the information into an Excel spreadsheet and then manipulate the numbers within their own back-office or portfolio management programmes.

Finally, although by no means of least importance, CHARIOT represents a huge resource for the auditors of the fund and we have found this has substantially increased our efficiency in that particular area.

As to addressing other clients' needs, the PAXUS system has definitely enabled us to be more efficient, which means we are able to address many client needs with regard to speedy and efficient calculation of the NAV, including the equalisation process.

Therefore, with the exception of some futures, currency funds and large-cap, liquid market long/short funds, it is likely that the majority of institutional investment will be through multi-manager funds or fund of funds.

The attitude people have toward multi-manager funds, funds of funds and indices is reminiscent of the videotape wars between Betamax and VCR. Although VCR won, it has now been replaced by DVD and one wonders what will replace indices, hedge funds or the multi-manager funds when the time comes.

Be that as it may, I believe the main effect the large institutions will have on the market will be to partially knock-down fees but also to increase the demand for managers as existing managers' capacity is soaked up.

The real question, of course, is whether the huge influx of money we have seen in the past 12 to 18 months will increase on a geometric rather than an arithmetic basis over the next five years and will eliminate the inefficiencies and therefore some investment opportunities in these markets, particularly arbitrage strategies. If they do, other opportunities will come to the fore and it will be interesting to see what they are.

INCREASING EFFICIENCY

Service providers will cope with the growth in assets and the demands placed on them by increasing efficiency. This is probably only going to be possible by introducing better technology, and we have already begun this at Custom House by implementing Pacific Fund Systems' PAXUS fund accounting system and CHARIOT, our secure web-reporting platform.

There will also be pressure relating to staffing issues and finding the right talent pool, and we are beginning to see those pressures reflected in the market in Ireland. No doubt this will continue worldwide.

Certainly auditors are finding staffing a major problem, with qualified personnel difficult to come by, but then they have not only the growth in the market to contend with but also the increase in regulation, such as the Sarbanes-Oxley Act and other new protocols.

MALTA AND THE EU

Our plans are to continue expanding and hopefully increase our market share. We see a substantial future in two areas of the market that we will be looking to exploit. However, I would expect Dublin to consolidate its position as one of the two leading fund centres in Europe and also as the leader, between itself and Luxembourg, with regard to hedge funds.

Luxembourg has made a noticeable play for the hedge fund market and I suspect

that is partially a reaction to the potential havoc the European Savings Tax Directive could wreak with the popularity among Belgian dentists of the Luxembourg fixed-income and money market funds.

Although many people may think this far-fetched, we believe the biggest threat to both Dublin and Luxembourg in the context of hedge funds will be Malta, which has a regulatory structure for professional hedge funds a little stronger but similar to the Cayman Islands.

The main advantage Malta has over the Caribbean and the threat it represents to Dublin and Luxembourg is the fact it is itself an onshore European jurisdiction, having joined the EU on 1 May last year.

One of the problems Dublin-based administrators are going to have to face in 2005 will be complying with the European Savings Tax Directive, if it ever comes to fruition. Generally the continued advance of regulation will continue to cause problems for administrators.

These problems are not a reflection of the difficulty of compliance but of the costs involved and it is likely the plethora of new regulations we have seen over the past several years, including more aggressive anti-money laundering regulations, the US New Issues (formally Hot Issues) regulations, the European Savings Tax Directive as referred to above, and of course the obligation to meet German tax reporting requirements, are all liable to add not only to the administrative burden but, in the longer run, the administrative cost which will eventually be passed on to investors.



David Blair has been managing director of the Custom House Group of Companies since 1996.

After returning to the UK and Ireland from Bermuda in 1990, he established the fund administration and custody operations of Barings in Dublin. From 1990 to 1994, he was a director of International Fund Managers (Ireland) Limited, the Barings fund administration company, and then was appointed a director of Barings (Ireland) Ltd, the Barings entity providing custody services to investment funds.