

**Dermot S L Butler** of Custom House Administration & Corporate Services outlines the selection process and provides advice for choosing your hedge fund administrator

# The correct choice

**B**efore you can select a hedge fund administrator, you must have an absolutely clear understanding of your requirements – what you want, or, more to the point, what you need. This comes down to ‘what to look for’ and ‘what to ask’. However, before you can make any decision on these, you must carry out your own due diligence.

Let me be quite categorical – due diligence is absolutely essential when choosing an administrator and there are many administrators to choose from – there are about 50 in Dublin alone.

Therefore, the first thing you should do is eliminate as many as possible and you can do this by asking the candidates to complete a detailed questionnaire or RFP (request for proposal).

## Illustrative questionnaires

The sound practices committee of the Alternative Investment and Management Association (AIMA) has written a series of illustrative questionnaires, including one for the due diligence of hedge fund administrators, which are available at no charge to institutional investors and AIMA member companies. Visit [www.aima.org](http://www.aima.org).

The questionnaire, designed for a manager seeking an administrator, which is currently being revised, has several sections under many headings.

These include: details of the administrator; ownership and management; documentation; size of group; client relationship management; auditors; operations; equalisation; compliance oversight and anti-money laundering; regulatory body/authorisation; payment and signatory procedures; NAV calculation;

valuations; reconciliations; fund accounting; reporting; fund systems; fees; business continuity and general – staff.

## Perform further checks

Although designed to find out as much information as possible and I believe these questionnaires are very valuable tools, the results will not tell you whom you should select, but they will definitely indicate whom you should not select and that is the first, and a very important, stage in the process of elimination.

If, having reviewed the questionnaires, you decide that a potential candidate is still in the running, you then need to carry out many further checks and assessments including, inter alia: take out references from existing clients and, particularly, from clients using the same services, operating in the same manner and trading in the same instruments as you.

**"The questionnaires will not tell you whom you should select but they will definitely indicate whom you should not select"**

Ask your prospective prime broker all about your prospective administrator (and vice versa), including checking that they can communicate electronically; and check with the administrator's regulator (if there is one) that they are in good standing and check how diligent the regulation process is.

When you get references, be clear about what the references say – and what they do not say which may be more useful.

Sadly I have to say that almost every reference you get will probably say



Dermot S L Butler is chairman of Custom House Administration & Corporate Services, which specialises in advising and assisting clients on the structure and the incorporation of offshore funds and, once established, providing a full administrative service.

that the referee does not accept responsibility for what it says. In fact, I believe that it is often better to call the referees, because they may say something 'off the record' they would not commit to writing.

## Perform further checks

Next, 'check the market' when selecting an administrator – for example, look at more than one administrator and hold a 'beauty parade' to find out what they offer, and how they can add value to your product. Visit their offices and see what they do and how they do it. Speak to the actual people on the floor who will be providing the service – do not rely on the sales person. Make your IT systems guru to talk to their IT systems guru. Does the administrator have web access account reporting for both the manager and investors? Is it flexible?

At this stage, you should have a pretty clear idea whether the candidate is able to offer a personal service and whether you are going to be allocated one named person as your account executive (preferably backed up by another named person), or whether you will be an anonymous account.

Remember, if you have a query, you need know you only have to ring up 'Sam' to get a quick answer – and not find yourself, wandering from extension to extension, ending up with someone saying: 'I can't help you, because the person you spoke to last week has gone fishing'. Basically you have to find out if you will be treated as a person or as a number.

You should then ask the administrator how many clients it has in total and, more importantly, how many clients invest in the same asset classes, sectors or disciplines as you do.

Review the administrator's standard agreement and get an example of a detailed fund specific procedures manual to explain exactly what the administrator is going to do and who is responsible, in which office, for each task.

You should check the administrator's anti-money laundering policy. Find out what are the qualifications of the administrators' staff – how many professionals do they have? What is the



previous employment history? What is the turnover of the administrator's staff?

Find out if they are capable of carrying out esoteric valuations, if required. If they cannot do this in-house, do they have effective outsourcing arrangements?

## Risk analysis questionnaires

Similar questions about risk analysis should be asked. The administrator has responsibilities with regard to ensuring compliance, by the fund and the board of directors, with relevant regulations. Find out how they handle this. They may also have similar responsibilities (depending on the agreement), with regard to the investment restrictions. Clarify this point.

Can the administrator handle equalisation? If so, what methodologies can they support, and is it automated or calculated on a dreaded spreadsheet?

Does the administrator have an independent electronic price feed from the data/price services, such as Bloomberg and Reuters? I stress 'independent' to ensure that the administrator is cross-checking the price of the investments, without relying entirely on the broker. Is the administrator domiciled in a jurisdiction with reliable telecommunications?

There is no point in having an electronic feed from the brokers and data services, if the telephone lines are down. How advanced is the administrator's system? Is it integrated and automated?

What facilities and procedures does the administrator have in the area of shareholder services? What is the administrator's response time to an investor or potential investor? Remember the administrator is the interface between the manager and your client – the investor – and an incommunicative administrator can alienate that investor just as quickly as poor performance. In fact, they can alienate the investor even if performance is good.

What is your deadline for the NAV? Can the administrator meet that deadline, whether it is monthly, weekly or daily?

What is the administrator's business continuity plan, including disaster recovery – obtain a full rundown.

One final word on the selection process – when you have done all of this do not choose the cheapest option, go for best value.

Remember, an administrator should add value to a fund, and the more you want your administrator to do, then the more it will cost.

Even in today's high-tech environment, administration is still a labour intensive business and everywhere that administrators operate, labour costs are high.

There is a great tendency to assume that administration is a simple book-keeping task and that the administrator that can do it cheapest is the one you want. Be assured that this would almost inevitably turn out to be a totally false economy.