NORTHERN TRUST EXECUTIVE TALKS TRANSPARENCY, "OPERATIONAL ALPHA"

As featured in FINalternatives, March 2014

"Transparency" has become a touchstone for investors in the post-Madoff world but, according to Carl Lingenfelter, chief administration officer at Northern Trust Hedge Fund Services, it's a concept that has evolved over the past five years from fraud protection to risk management to investment performance. Lingenfelter, whose organization provides integrated front-to-back office administration services to hedge funds, spoke to *FINalternatives* recently about the issue of transparency – why it's important, how it can be achieved and why it can be as beneficial to managers as investors.

Hedge funds always had a reputation for secrecy. Post-Madoff, how have fund managers' attitudes towards transparency evolved?

Hedge fund managers generally have risen to the occasion to counter many of the negative impressions left by the financial crisis. In addition, nearly all major managers have retained independent administrators, whose oversight helps guard against phantom investments and questionable valuations. Funds also have diversified their exposure to prime brokers and other counterparties, and most are willing to provide increased transparency to investors. Acceptance of managed accounts has grown significantly in the last five years, which gives investors the ability to track exposures as well as beneficial ownership of underlying assets.

Transparency is usually said to benefit investors, but a recent Northern Trust publication makes the case that it can also benefit managers and improve performance, can you discuss this?

Today's trading strategies place a premium on data quality. Advanced technology can give managers real-time transparency into their holdings, their exposures and how market events impact their portfolios. Strategy and attribution tagging help turn raw data into actionable information which in turn drives analytics for risk, compliance and performance, supporting a more efficient investment strategy. Together they help create what we call 'Operational Alpha'– the power of operations to help managers execute opportunistic trades with faster and more accurate valuation; the ability to optimize cash and collateral; and a reduction in operational friction from complex capital and legal structures that can impair a managers ability to execute investment ideas. The results add value to managers and investors alike.

Providing institutional investors with the data they now require is an expensive proposition. Can smaller funds compete with their larger peers? And if so, how?

The technology necessary to support transparency does come at a cost, and supporting it internally can be cost prohibitive for smaller funds. However, a third-party administrator has the scale to invest in that kind of technology, so the benefits substantially outweigh the relatively small increase in cost. We believe reporting and transparency should be part of any top-tier fund administration offering, and it's important for managers to select an administrator that can grow with them. Finally, we have seen that having a financially strong administrator with top talent and technology helps attract investors.

How important is infrastructure, as opposed to say, track record, to institutional investors?

It's not an either-or proposition. There are many, many managers with great talent and a good track record. Institutional investors want to know that those investment ideas will be executed responsibly with strong controls by a stable and independent third party. And managers who invest thoughtfully in infrastructure can build on quality data to enhance their performance.

Northern Trust

Q 55536 (3/14)