

Automation's Potential in the Alternatives Sector

By Peter Sanchez of Northern Trust – Automation is key for managing alternative funds, particularly when it comes to decreasing data security risk, working with a fund administrator and managing cash and collateral needs. Alternative asset managers know how to thrive despite the volatility that is inherent in the market – sometimes even leveraging low volatility to generate alpha (1). Still, any manager would jump at the opportunity to cut down on certain aspects of operational uncertainty for the sake of decreasing risk and increasing efficiency.

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As many alternatives managers have already grasped, automation and other technology have great potential to help them achieve just that – and meet many of their top goals in the process. According to Northern Trust's Driving Growth in Asset Management report, for which 300 asset managers were surveyed, 64% of asset managers plan to leverage new technology to achieve their priorities in the next two years.

Security Risk

Automation can help alternatives managers tackle security risk on a couple of different fronts. First, consider automation's role from a data protection perspective. Managers house huge amounts of sensitive data, such as investor banking information, trading strategies or private equity deal details, making data breach a huge and intimidating risk. Reputation fallout has always been a consequence of data breach, but now as concrete data privacy policies are emerging worldwide (GDPR in Europe, PDPO in Hong Kong, PDPA in Singapore, CCPA in California, etc.), managers have a legal obligation to take steps to protect the data they hold.

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Automation helps enable safer data sharing for alternatives managers by ensuring the administrator or manager isn't sending sensitive information to the wrong recipient or committing an error when manually transcribing a piece of data. A secure platform for report sharing, for example, should utilize automation to require the whitelisting of the recipient's IP address and employ automatic keyword searches for concerning terms (such as other clients' names) to avoid report mix-ups, all while encrypting the reports sent within it.

Automation can also help managers mitigate security risk from the perspective of fraudulent trading. Since many managers oversee a large number of funds and a large number of trades/investments occurring within each fund, it can be challenging to notice suspicious trading activity, especially to the naked human eye. This can particularly be the case for high-frequency trading hedge funds. Automation is able to call out concerning changes in typical trade volume over a custom period of time, potentially pointing out fraudulent trading activity.

Workflow Between Fund Administrator and Alternatives Manager

Fund administrators handle a high volume of work on managers' behalf, especially in times of increased volatility, and automation is a key technology in creating a productive relationship.

Particularly in the private capital space, automation holds strong potential to help administrators and managers improve the quality of many reports and investor communications – like financial statements, valuation documents, waterfall distributions and investor records – which both parties spend time analyzing regularly. On this front, data APIs will see growing adoption in the manager-administrator relationship for both private capital and hedge funds in the coming months and years. APIs enable automation's full potential for data standardization and automate the flow of data between organizations. They also reduce the manual error rate and potential client losses as they increase the manager's and administrator's ability to focus on data interpretation and other high-value-add tasks versus mechanical work.

Centralized reporting streamlines the sharing of new report versions between an administrator's team and the manager, ensuring better controls and higher quality documents. Adding an automation-powered workflow tool into the mix provides the manager with even better insight, including a view into the administrator's deliverables in real time. This offers more transparency into the administrator's deliverables status – what's in progress, what is the corresponding exposure, what needs to be done, etc. Building up reporting and workflows with the help of automation empowers the administrator to be the true strategic extension of the client and enhances the resolution of breaks by offering frictionless communication between the administrator teams and the managers.

Ultimately, automation's potential within the fund administrator/alternative manager relationship enhances the client experience on the manager's side and service excellence on the administrator's side. The technology mitigates the need for reworked deliverables and associated delays, making way for a stronger relationship between the two parties.



Cash and Collateral

Automation plays a necessary role in de-risking alternative funds' treasury operations. Cash management and, in particular, collateral management can have very complex requirements. Large hedge funds often work across many different prime brokers with only one collateral manager running the operation.

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Collateral calls are frequent and fluid, and it is extremely important to stay abreast of the information flow. If the window for posting collateral is missed, funds will see their trades close and still be on the hook to make the payment to the broker. Placing cash and collateral needs in an automated system takes the heavy burden of administrative work away from a cash and collateral manager. They can then focus on answering the cash needs and collateral calls without having to worry about manually creating the back-end accounting entries for the comings and goings of a fund's payments.

Automated cash and collateral operations are even more crucial in times of volatility. During the

initial market turbulence that accompanied the COVID-19 global outbreak in March 2020, Northern Trust Alternative Fund Services experienced a 86% increase in margin calls for bilateral repurchase agreements and OTC agreements versus just two months prior (2).

When volatility spikes as it did in Q1 2020, automation helps to remove the risk of unfulfilled cash obligations and empowers human teams to act more efficiently through stressed markets.

What's Next for Automation in Alternatives?

The benefits of automation closely align with managers' top goals for the next two years as noted in our survey - focusing on risk/compliance (86% of asset managers), enhancing quality and accuracy (74% of asset managers), creating greater efficiency (66% of asset managers). As a result, we'll continue to see adoption of the technology, particularly in the alternatives sector where decreased risk and increased efficiency can be challenging to wrangle thanks to high volatility.

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Automation offers many benefits for alternatives managers, and it will continue to evolve. Data management presents the biggest potential for increased use. Automation can help managers and administrators harness funds' unstructured data to provide the manager with a more sharply defined real-time view into the many metrics and data sources of their funds. Simultaneously, newly adopted automation functions will continue moving to the cloud, increasing the ability for real-time metrics.

Ultimately, the data shows that alternatives managers are ready and willing to turn to technology in order to achieve their risk management, accuracy and efficiency goals over the next two years. Automation holds the key to mastering some of the pain points unique to the alternatives world, and the managers who set out to tackle their digital transformation goals fastest will reap the greatest benefits.

(1) Northern Trust Asset Management, Leveraging Volatility to Create Alpha, June 2020.

(2) Northern Trust and Hazeltree, Weathering the 2020 Storm: Market Volatility, Location Disruption, Cyber Threats, and Record Volumes", July 2020.

The article is a guest contribution by Peter Sanchez, Global Head of Northern Trust Alternative Fund and Omnim Business Services and featured in HedgeNordic's September 2020 special report on "Hedge Funds and Technology,"

