InfraHedge aims to steal a march on its competitors by reducing the risk of failure

State Street's infrastructure-only managed account arm is designed to encourage innovation

By Claire Makin

London-based InfraHedge has shot from nowhere to become the world's fourth largest managed account platform (MAP) since it was founded in January 2011 by Akshaya Bhargava and Bruce Keith.

A business that attracts $7.6 billion in assets during its first 18 months is bound to be based on a winning concept, and in InfraHedge's case it is the growing trend for large institutional investors to design their own dedicated hedge fund MAPs.

"We set up InfraHedge with the belief that increasing institutionalisation of the hedge fund industry would need a different kind of managed account model than existed at the time," says Bhargava, who is chief executive of InfraHedge and has a 32-year background in institutional financial services including hedge fund administration.

In October, InfraHedge was chosen by Japan's Nikko Asset Management for the launch of its Multi Manager Investment Trust for retail investors, which requires detailed reporting and disclosure including daily risk analytics.

InfraHedge's 'plug and play' approach to managed accounts leaves the choice of investment strategy, manager, domicile and legal structure entirely to the investor, while InfraHedge (supported by parent State Street Corporation) provides all the services required to establish and operate the structure including extensive analytics and highly customised reporting.

Bhargava believes that this infrastructure-only business model, where the client makes the asset management decisions and outsources operations, analytics, risk and compliance monitoring, is unique in its singular focus. It has a major advantage of providing a high degree of custom-tailoring at a relatively low cost because InfraHedge carries no asset management-related overheads costs.

This turns on its head the traditional model followed by the other big MAPs such as Deutsche Bank, Lyxor Asset Management and the FRM/Man Group.

Akshaya Bhargava

Their approach is distribution-driven, with providers competing to research and on-board high-quality managers in popular strategies, as well as offer them to investors in a managed account format. The exception is Deutsche Bank's dbSelect platform for accessing liquid trading strategies, where clients choose the managers (*InvestHedge*, October 2012).

The distribution model typically charges fees to managers as well as investors, whereas InfraHedge does not charge any fees to the managers.

Barely seven months after its launch, in July 2011, InfraHedge was snapped up by State Street. The giant financial services provider now runs InfraHedge as a product group within its alternative solutions group, which has more than $1 trillion of alternative assets under administration for institutional investors.

Bhargava says that he and Keith had realised early on that, since their business model was aimed at large institutional investors, it would need the sponsorship of a large, blue-chip institution. So they came up with a select list of potential acquirers that included custodian banks but excluded asset managers, investment banks or any other group where potential conflicts of interest might arise.

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Although InfraHedge was then just a tiny company, State Street clearly understood both the concept and its potential, according to Bhargava. InfraHedge's managed account operations are tightly integrated with State Street's risk analytics engine that currently services more than $1.5 trillion in assets under management. The InfraHedge team works with clients on developing an appropriate solution, making all the product and pricing decisions, and taking care of client relationships — with all of the support functions such as legal, compliance, finance and human resources provided by State Street.

InfraHedge does not have a very long list of clients, and is not at liberty to disclose details, but those that have signed up for its services are sophisticated investors who negotiate their own terms and guidelines with their chosen managers. This approach helps to explain InfraHedge's extraordinary growth, because each client has to commit substantial assets when setting up a dedicated MAP to make the project cost-effective.

The money committed to InfraHedge's platform is different from investment in a conventional MAP. It tends to be 'stickier' than conventional MAP assets, because the MAP is set up only on the request of the investor.

Excluding State Street employees, InfraHedge has a team of about 25 people split into two major groups. Global Client Solutions, run from London and New York, is headed by co-founder Keith, while the 18-strong operations and investment analytics team is based in Bangalore and run by Ravi Raman, chief operations officer.

Unlike an asset management-based platform, InfraHedge's MAP is driven by sophisticated technology-based processes. Its three key components are production, analytics and reporting.

Fund administrators send daily price feeds to InfraHedge's 'data warehouse'. The positions are then run through a range of risk analytics using State Street's 12-year-old risk engine — truView. In Bhargava's opinion, a MAP cannot be viable without sophisticated risk analytics. "It's the cost of entry," he says. Data management is a major priority and the final stage is customised reporting which clients access via their dedicated InfraHedge On-Line portal.

This is a crucial differentiating feature of InfraHedge's business model, and is based on detailed discussions between InfraHedge's client solutions team. The result is that each client is able to define its own precise requirements for disclosure, transparency and the way it wants information presented.

"Each one of our clients' portals looks completely different," Bhargava says. What is more, he adds, "we are not concerned if the name InfraHedge doesn't appear on the portal. After all, it's their platform and we are only building and operating the platform for them."

Because InfraHedge's concern is with providing infrastructure, it is completely agnostic about strategies and managers, and whether or not they have broad appeal. As a result, the managers it has on-boarded (numbers are not disclosed) range across a wide variety of strategies around the world.

One client, Singapore-based Milltrust International, chose InfraHedge for its emerging markets managed account platform, which launched in August with three sub-funds investing in Brazil, Latin America and Greater China. The platform is packaged as a Dublin-based UCITS umbrella fund.

Many other clients are looking for platforms to be set up as Cayman Islands, Luxembourg, Dublin or onshore US structures, according to Bhargava, who says that demand is growing for onshore regulated structures, basically UCITS in Europe and 1940 Act Regulated Investment Companies in the US (*InvestHedge*, December 2012/January 2013).

The reason is that no-one wants to be wrong-footed by regulation. "So much regulatory change is taking place that regulated on-shore structures represent lower levels of uncertainty," he points out.

InfraHedge clients can choose which custodian and administrator they use, although the obvious choice for a new managed account set-up is State Street, because "all the pipes are in place", Bhargava says. Some clients need more flexibility, however, and InfraHedge's open architecture model provides that.

One large FoHF, for instance, wanted to change its underlying fund investments to managed accounts. "You can't convince 40 managers to convert to a single administrator, even one as high-quality as State Street," Bhargava points out. In such a case, InfraHedge takes an open-architecture approach, which is essential despite the increased level of complexity it creates, he notes.

As Bhargava sees it, the biggest challenge for MAPs going forward is not technology, although this is developing at a phenomenal pace to the point where customised risk reports can be delivered to multiple mobile devices including smart phones, for instance.

Instead, he believes that the key challenge for InfraHedge and its competitors lies in being able to present the reams of data they collect from administrators and process in their risk analytics engines in a way that that highlights exactly what information is most useful for a client.

This differs from client to client. "You need someone to be constantly watching what you consider important metrics and analytical indicators on your behalf, so that you can decide what is critical and what is irrelevant," he says. It is not easy to do this completely in-house and investors who set up internal teams to interpret the data themselves are increasingly rare, he notes.

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There are other challenges, too, based on fundamental shifts in the way institutions are investing in hedge funds. Bhargava and his colleagues have clearly thought-out ideas about the way the business is developing, and intend to keep InfraHedge at the cusp of these trends.

"The world is changing. I really think the future of hedge fund investing will be based on much more proactive portfolio management," he says. In his opinion, offering daily position-level transparency and the ability to aggregate intelligently across all exposures — such as InfraHedge provides — has to be the starting point.

Transparency, rather than liquidity, is taking over as the main story for institutional investors because the ability to 'look through' to illiquid positions and aggregate risk exposures allows institutional investors to apply overlay or tail-risk hedging, he points out.

Competition in this space is heating up. Other MAPs are upgrading their risk analytics and reporting, and scrambling to build up dedicated platform business for their larger clients. This raises questions about whether their cost structures are set up to deal with the lower margins provided by this business.

From the numbers, it looks as if InfraHedge is grabbing market share from its rivals. Many other MAPs (apart from dbSelect) have shrunk or experienced sluggish growth over the past year, leading to a debate about whether institutional demand for managed accounts is falling.

But MAP assets are not entirely representative of the managed account industry as a whole, as Bhargava points out, because large numbers of institutional investors of all types now have bilateral managed account relationships with hedge funds.

With so much business to play for, there is plenty of room for both traditional and newer types of MAPs, he believes. "There will always be a market for distribution platforms, but we will help create a parallel market for infrastructure platforms," he says.

He has no doubt that managed accounts are the best way for institutional investors to access hedge funds, but points out that low barriers to usage are essential to attract institutions.

Switching from funds to managed accounts can be a costly and uncertain process for them, which is why InfraHedge aims to make the conversion faster, cheaper and provide a more predictable outcome while maintaining high-quality operations and overall control, according to Bhargava.

The end result will be to give institutions access to hedge fund risk exposures with the right level of oversight, control and flexibility that allows them to include hedge funds in their mainstream portfolios.

"Our role in the industry is to help our investor clients be more innovative. The best way we can do this is to reduce the risk of failure. If the cost of failure is low, it will encourage greater innovation," he says.

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