

Technology

Hedge Funds Using Technology to Control Access to Fund Data

By Jennifer Banzaca

Hedge fund data – including performance information, portfolio holdings, transactions and the identity of underlying investors – typically is well-guarded and not available for public consumption. However, with hedge fund performance down sharply this year – 2.69% in November and 18.44% year to date, according to the Hennessee Hedge Fund Index – investors are clamoring for more transparency.

With declining performance, the pendulum of bargaining power has swung back in favor of investors. Investors have demanded more information, and managers have obliged. Notably, some managers have taken pen to paper and drafted monthly or quarterly investment letters, offering investors commentary and color not available in basic performance data. However, as these letters have been leaked to the press and possibly competing fund managers, managers have been looking for ways to restrict the circulation of their fund information while still satisfying investor demands for the data.

“You want to give clients access to information beyond a paper statement once a month but you have to decide what to give them access to,” noted George Michaels, principal at G2 Systems and former chief technology officer at Carlson Capital. “You then need to figure out how you make that data available and not open the hedge fund up to general security breaches.”

Leaked investor letters are not the only concern for fund managers. Hedge funds also have to contend with staff

changes and employees with virtual private networks (VPN) that can access fund databases remotely through laptop and handheld devices which can be lost or stolen.

Just as technology has created a wider range of issues relating to information management, it has also provided solutions. In particular, digital rights management programs enable fund managers to restrict the circulation of and control access to fund information.

Digital Rights Technology

Enterprise rights management (ERM) is the application of digital rights management (DRM) technology to the control of access to fund documents, e-mails and intranet web pages. ERM is typically used to prevent the unauthorized use of proprietary documents. Protected documents can include spreadsheets and financial statements, policy and procedure manuals, research data, customer data, project data, personnel files, intranet pages and other sensitive information.

The technology can limit document access to specific computers, place expiration dates on access rights, and prevent people from saving, printing and cutting and pasting documents. Each time users try to access a protected document they have to go through an authentication process to prove they have the right to view it.

According to Ed Gaudet, senior vice president of corporate development and marketing at Liquid Machines, which

provides ERM technology programs to hedge funds and other financial institutions, the technology allows fund managers to define and manage the rights of their documents within a dedicated policy server. Managers can set very strict “read-only” controls for confidential information, while allowing less sensitive documents to be read, printed or forwarded.

“Hedge funds use the technology to protect their most valuable asset, which is the proprietary fund information like transaction and portfolio data and also the models that run their business,” Gaudet said. “There’s so much value in their models and portfolio information that this control protection is critical.”

Gaudet said the software can also audit the protected data and the reports can let fund managers know when someone has tried to access a file to which they did not have rights. “It’s that level of control and visibility into how data is being used within the organization which has been very important,” Gaudet added.

Aside from Liquid Machines ERM programs, other similar technologies include Microsoft Office SharePoint, EMC’s Documentum IRM Client and SealedMedia.

Gaudet said programs such as Liquid Machines ERM technology can cost a hedge fund approximately \$30,000 per year.

Limitations and Alternatives

Not all hedge funds are using ERM programs to control access to fund information.

G2’s Michaels said the problem with ERM software is that it can restrict the use of data that some investors, such as funds of funds, are requesting to run risk management programs. According to Michaels, some institutional investors want to take the holdings of one hedge fund and combine them with the holdings of another to run risk metrics on the aggregate holdings.

“If you’ve pinned ERM on the holdings files, that means you can’t do anything with the data other than look at it,” Michaels said. “If you can only look at it then you can’t put it into a spreadsheet or into some type of risk control system. If I’m a fund of funds and I’m trying to get the positions out of one of the hedge funds, I want to take the positions across all of them and do actual processing of that data. The whole thing with ERM is it’s meant to be read only.”

Michaels suggested that funds use Citrix Systems, which offers software and services specializing in virtualization and remote access software for delivering applications over a network and the Internet. Within a Citrix system, users can only cut and paste within the system and could allow investors looking to run risk metrics programs to do so.

For a fund to provide access to investors, Michaels also suggested creating a warehoused copy of the data to be placed on a separate section of the fund’s network server and protected by firewall from the main section of the server, which contains core fund information.

“You do not want to open up your core information to the client so you make a copy of what you do want them to see,” Michaels explained. “You allow them to log in to a web portal to access the information they are requesting. This is a secure way of controlling what information a client or

investor has access to. And, the information is unidirectional, so data can only flow one way.”

Andrew Rogers, president of Gemini Fund Services, said his firm and clients have been using Archway Technology Partners ATWeb solution to provide a client portal where the fund manager can control what reports investors can run and at what frequency there are available. According to Rogers, ATWeb allows user provisioning by module, thereby allowing some users to only view financial information, portfolio detail or just run reports.

“We let them go to a website and we put out information and they view it online,” Rogers explained. “We don’t e-mail any information. It’s on the website so we can control who can access the information, for how long and what they can do with it. We have different levels of access. For the advisors, we may give them access to all the various different investors and we may break them up based upon different distribution channels. Then we decide what levels of reporting the individual investors should have. We can limit the investor to only their account and only certain reports.”

The ATWeb system and similar web portal can cost about \$100,000 per year.

How Technology Can Aid Compliance

Compliance rules often require funds to store information in a secure fashion, so that it can be retrieved, analyzed and subject to other forensic analysis. With ERM software, any action a user takes with protected information, such as printing or moving via the clipboard, can be audited. Reports are available and e-mail alerts can be configured to support

specific company objectives. ERM also helps fund managers prepare documents for regulatory approval. It also prevents employees from unwittingly (or purposefully) releasing information to the public.

Gaudet explained that ERM software allows fund managers to manage the communication and distribution of fund documents appropriately, and to make sure that only authorized people are granted access. This can enhance compliance not only with the firm’s own policies, but also with NASD and SEC regulations. Because ERM programs can manage distribution of fund documents, such programs can be used to set up information walls between various groups within a fund manager.

The ERM software can also prevent any personally identifiable information from being disclosed, in accordance with data security laws that are currently in effect in 48 states, Michaels said. “What it really comes down to is making sure that there are proper controls on the data to prevent unauthorized access to the data and then being able to prove that you actually protected the data in accordance with the regulations,” Michaels added.

Rogers said that much like ERM technology, data portals also could be configured to reflect the firm’s business requirements and goals. The configurable options can be tailored to suit its compliance policies and procedures. “The technology can only enhance a fund’s compliance program,” Rogers suggested. “The fact that all systems are now automated does allow for a greater integration with compliance programs and allow for a more timely reporting of compliance exceptions.”

Interaction with the Traditional Role of the Fund Administrator

Gemini's Rogers noted that data control technology has altered the distribution of responsibility for certain tasks between the manager and administrator, in many cases expanding the role of the administrator. For example, the technology has allowed administrators to produce statements that go out to investors, handle subscription activity and perform e-mail compliance for managers.

According to Rogers, such technologies often offer integrated accounting and administration platforms that enable investors to log in and access their statements and other investor reports.

Gaudet agreed that data management technology has aided fund administrators. Administrators can control the access to any material, non-public information as well as ensure public information is released only when it is ready for public consumption.

"It really gives administrators as much control over the data as required for their business processes," Gaudet explains. "This is really good for controlling access to proprietary data and product strategy documents."

Investor Reactions

Rogers said that despite the fact that hedge funds are using various technologies to restrict access to and distribution of fund information, investors have been very receptive.

"In my experience, providing a client login helps build investor confidence as they will have visibility into the fund performance and their performance returns, but their information cannot be accessed or leaked to outsiders," Rogers noted. "Additionally, having a client portal as a direct extension of the administration platform provides the confidence that the financials of the funds are kept in a controlled fashion and can be readily available if needed."

Michaels also said that investors have been accepting of technological controls on data. Overall, investors just want access to their personal investment information and performance data. If the information requires a password or has some distribution restrictions, investors are not so concerned as long as their needs are being met by the hedge fund, Michaels concluded.