

The challenge of de-coupling investment risk from technology needs

Risk management, compliance and administration become more important as investor interests become more complex. But unwinding a middle and back office contract can take months or even years, jeopardising the whole portfolio in the process. *Caroline Allen* talks to SRL Global, which offers an 'outsourced, in-house' solution to technology demands

The daily deluge of data is becoming an increasing burden for managers overseeing all but the simplest portfolios. Data accuracy, security and manipulation is an integral part of any investment management, without effective handling it threatens to stall and/or distort the process, but if properly controlled it can be a very powerful commercial advantage.

Alex Lowe, now managing director at SRL Global was a former director at Man Group. He ran 50 managed accounts, receiving perhaps 35,000 pieces of data on the portfolio per day. Files arrived in different formats, from many time zones and with varying degrees of completeness. The next day the business received another round of data, some of which replaced the previous information, some not.

"For many businesses it has become completely unmanageable, and there is little they can do about it. They just have to keep going with what they have. Any serious governance is hard to achieve unless you have proper control over the data, but for the moment very few do," said Lowe.

Every time an asset manager makes a decision based on incomplete data and information, it is less relevant and potentially even dangerous. SRL Global's Nexus system, improves oversight through timely data and an audit trail of investment activity, exposures, returns, and compliance failures.

"Knowing your managers and knowing what they are

Managers need to build an accurate picture from the bottom up, and from a multi-dimensional aspect rather than relying on a single statistic like VaR, or Value at Risk.

As an example, Lowe noted that in early 2008 many investors were long commodities and short financials. "It is reasonable to say almost everyone had that bet in one form or other, whatever strategy they were in. Then there were huge moves that caught many people out. At the underlying fund level, it was not unreasonable, but collectively across a portfolio of managers it substantially increased risk as expected diversification evaporated."

The financial crisis prompted many investors to consider how they can control both the flow of data and the management of managers better. "You have to step right back and take an overview of the whole process portfolio and what it is trying to achieve," said Puri.

Investment risk is generally well addressed by most investors' underlying fund managers, but at a portfolio level

the risk readings are rarely accurate because simply adding two identical pieces of risk information does not mean the result is double the factor. Furthermore, operational risk, which is just as great, is hardly addressed at all.

Disillusionment

The effect these errant factors have on the numbers can be seen from the increasing number of unaccountable events

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managing director,
SRL Global**



Neil Puri

Like other institutional investors, family offices and endowment funds are increasingly intolerant of layers of fees and seek a direct, clean, hands-on solution which is not reliant on third parties

for critical elements of the business such as due diligence, accessing quality managers and risk management.

"Recent history has questioned the fund of fund model," said Puri. "Many well known fund of funds were invested with Bernard Madoff, the question of privileged access has now been turned on its head. Investors are keen to cut out the middlemen and manage direct access to the underlying asset managers."

There is a realisation that risk management means the security of having control of your own process with direct access to your own data. Taking this level of control is a significant undertaking however, and it is important that asset managers secure suitable partners. The code SRL uses to administer its systems sits in escrow, which means the owner can have their data at any time. When it is retrieved it can go into any data base format that is required.

Undoing relationships

To undo any existing relationship can be a prolonged process and a monumental undertaking to untangle everything and move in. So many do not, although they recognise the shortcomings and increasing risk.

Lowe said SRL aims to de-couple the investment process from the technology needs, so families can concentrate on investment risk. In an interconnected world, security means owning and being able to manipulate your own data. "We hire mathematicians, rocket scientists and software engineers to devise and manage the system so the client doesn't have to," explained Puri.

SRL's technology systems do not involve any new investment process. They are delivered through private (not hired) computer clouds. The firm is based in the UK but can operate the cloud anywhere, as long as the servers are properly supported. All data is encrypted to the equivalent of central bank level security. There is ISO27001 certification which entails palm prints, passport details and weigh-ins before any sort of access.

The added value for the manager is what Puri calls the "GUI dashboard" – the analytics to enable the manager

to "look through", manipulate and model the information once it is clean, reconciled and enriched and produced in a standardised format.

He believes investment decisions should not be influenced by the technological process. "We don't even need the entire portfolio – just what the client is comfortable with. We don't hold any of the assets, we just manage the technology and the data so it is in-house, but outsourced."

The system also holds legal documents, due diligence, correspondence, media encounters, communications and notes, all tagged with an audit trail. The client can interact and give sharing permission at any level, while the underlying data is secure and protected.

Installation and maintenance costs are contingent on a number of factors, such as the number of data sources, the number of funds, assets or instruments, the storage capacity required, frequency of reconciliation, the number of users and security levels, and the number and location of sites.

"We don't link costs to assets under management or client profits," explained Lowe. "The costs are to do with our cost base and margin, not the client's business."

Because systems are often bespoke, or have customised elements, the solution is most appropriate for portfolios of \$1bn-plus. Clients are also locked in for an initial three to five years. "They are comfortable with that. They understand the industrial architecture, the scale of what we are trying to achieve," added Puri. High conviction managers might want systems built around a specific indicator – Value at Risk, giving a 'future proof' contract moulded to the client's investment style.

The firm itself is highly focused on its area of expertise. Owned by its employees, some former board members of the Man Group and Rothschild Investment Trust, it spends several million a year on research and development. There is no 'sales force' as such. "This model and business does not lend itself to a vanilla sales force because the client has to 'get it' to understand what we do. It is a

strategic decision that is highly sensitive and confidential. That means connecting with someone at chief operating officer level)." •

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**Neil Puri,
chief executive,
SRL Global**

Useful links

SRL Global: www.srlglobal.com

SRL Global's Nexus system: www.srlglobal.com/nexus

