



Hedge Fund Investors Discover External Leverage

By Martin de SaPinto, Senior Financial Correspondent

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ZURICH, Switzerland (HedgeWorld.com)—**An increasing number of private banking clients are leveraging their hedge fund investments in order to expand their portfolios and enhance their returns**, according to a number of industry watchers. They are also borrowing against their hedge fund portfolios when liquidity needs arise, rather than liquidating the investments themselves in order to meet these needs.

"Private clients will often find that they need liquidity but don't want to redeem any of their portfolios for a variety of reasons," said Edmund Wandeler, client relationship manager at Zurich-based portfolio and risk management adviser AlphaSwiss. But the lack of liquidity inherent in certain hedge fund strategies such as distressed debt or merger arbitrage means that redemption may not be an appropriate solution for clients needing liquidity in the near term.

"Redemption can require from three months to two years," explained Wandeler. "Some clients may not want to wait that long, they may need immediate liquidity. Or they may not even want to liquidate the investment at all, especially if it is a closed fund which they could not get back into once they had liquidated their position."

But the problem with borrowing against the assets in an illiquid portfolio is the obvious one: **How can a lender make an accurate evaluation of those assets, and what lending ratios should be applied?**

Nowadays more and more private clients are using their hedge fund portfolios as collateral against their loans. However, unless the portfolios can be accurately evaluated in terms of both NAV and risk, lending ratios are going to be somewhat arbitrary. **This was a question that the private banking unit of one of the largest U.S. financial institutions put to AlphaSwiss.**

The adviser came up with a risk management platform that, Wandeler said, "uses a qualitative and quantitative score framework, as well as proprietary style and risk premium analysis" to achieve the task. AlphaSwiss will, for example, create a table of fund administrators and apply a scoring framework to be used when evaluating a fund. **The 120 factors** considered to generate the lending ratio also **include the background of key personnel, the service providers used, the fund's risk/reward profile** and so on.

"When a lending ratio has been assigned to a fund, we will conduct monitoring reports and provide monthly updates," said Wandeler. "If there is a style shift or strategy change within the fund, we will ask for an explanation and the lending ratio will be modified according to the input provided." Furthermore, he added, while a fund's exposure to factors such as foreign exchange, inflation or interest rates may change over time, sensitivity shouldn't change much if the manager is true to the strategy.

Wandeler noted that banks **and insurance companies are using the framework to calculate their lending ratios**. He said his company has been approached by both Swiss and overseas entities seeking help in evaluating and monitoring their alternative asset credit risk exposure.

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