Liquidity risk management and 2020 fund liquidity in light of COVID-19 related market conditions have been a key focus for AIMA members this year. Following up on a series of member discussions on these topics in July, SS&C, an AIMA sponsoring partner, was asked to reflect on these topics and the data they have access to as one of the largest global fund administrators and has prepared this white paper to provide their insights.

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WHITEPAPER

Managing fund liquidity in the time of COVID

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Introduction

Measuring and managing portfolio liquidity is a critical issue for alternative asset managers. Investors understand that fund managers typically have wide latitude in asset selection and that less liquid or illiquid assets can comprise significant percentages of the holdings. Moreover, these percentages can shift quickly and dramatically as managers anticipate and adapt to changing market conditions. Both managers and investors want to know the fund can meet liquidity demands without disruption to the portfolio strategy. Interest in liquidity, of course, is heightened in times of uncertainty and systemic stress, as is certainly the case today world-wide due to the outbreak of COVID-19.

This paper will analyze the impact of COVID-19 on alternative fund liquidity, drawing on SS&C's proprietary indices for redemptions, overall capital movements, and performance. Indices are compiled solely with actual client data collected across all SS&C clients, i.e., there is no bootstrapping or extrapolation of data and no selection or survivor bias. We will also detail how fund liquidity is presented to investors and other external parties, including regulators and risk aggregators.

Liquidity data in the age of COVID-19

Redemptions

Widespread recognition of the COVID-19 outbreak probably dates back to February 2020, when markets first began to reflect the shockingly rapid spread and health consequences of the virus. Therefore, we do not have even a single year of COVID-19 data behind us, so any analysis of the trends must include this caveat.

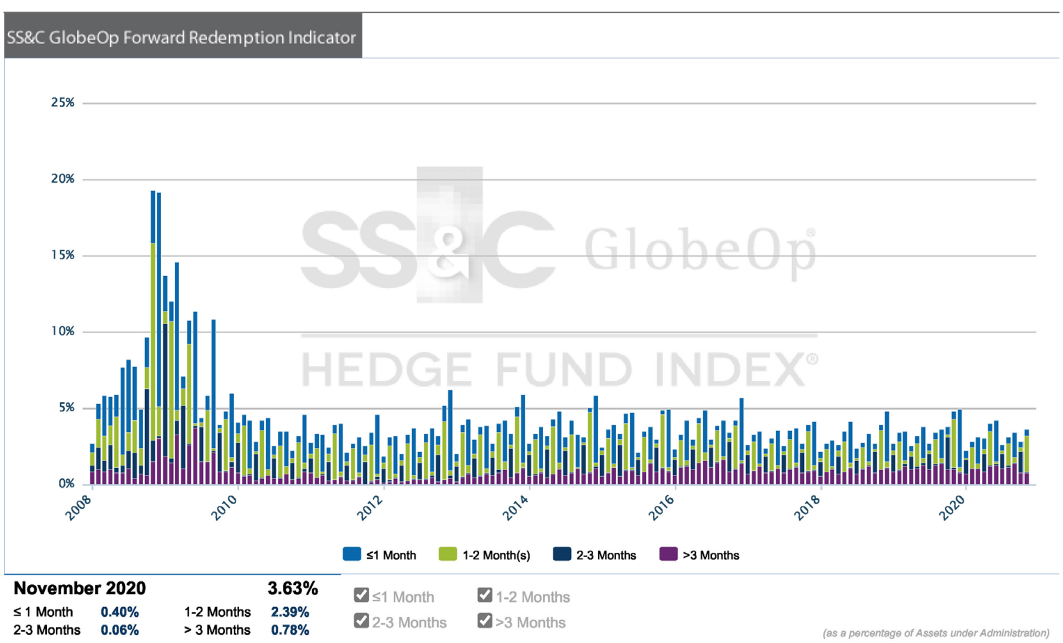
However, the data that has emerged thus far speaks quite clearly. Below is a graph of the time series of redemption notices received by SS&C fund administration clients dating back to the financial crisis of 2008-09. This data is encapsulated in SS&C's Forward Redemption Indicator, a monthly calculation of redemption notices as a percentage of assets under management.

https://www.globeopindex.com/home.go

Several points are clear from the graph:

1. Redemption notices throughout 2020 are running steadily in the low single digits. The most recent reading for November of 3.63% continues this trend.
2. The redemption experience in 2020 is entirely consistent with pre-outbreak levels from 2019 and other recent years.
3. As a corollary to these first two points, the 2020 redemption levels in no way resemble those of the last systemic crisis, the financial crisis of 2008-09, when redemptions approached 20%.

Figure 1: SS&C GlobeOp Forward Redemption Indicator Chart – November 2020



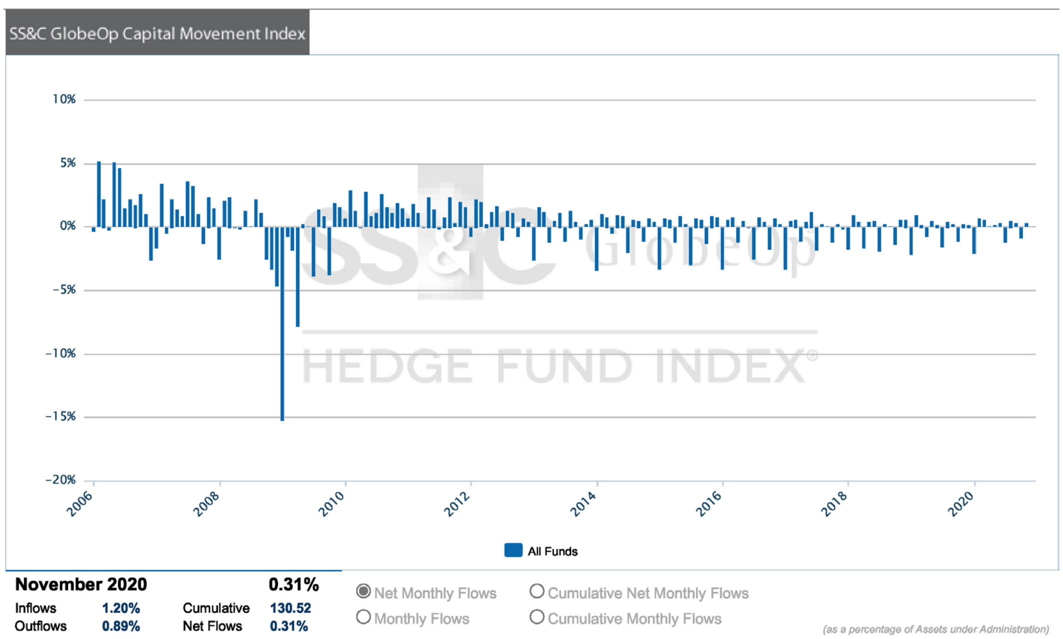
Capital movements

SS&C also calculates a Capital Movements Index, which measures the actual monthly change in capital by tracking inflows and outflows. These outflows differ from redemption notices in that the latter includes redemptions scheduled well into the future. Capital outflows, on the other hand, are amounts that have been withdrawn in the current month. The net inflows and outflows, without gains and losses from performance, are presented as percentages of assets under management.

The Capital Movements Index tells a similar story to the Forward Redemption Indicator discussed above.

1. Net flows of capital have remained remarkably steady in 2020 and are consistent with recent years' data.
2. The two individual components of this measure, inflows and outflows, are steady in their own right.
3. The current flows indicate nothing like the massive outflows that occurred in the financial crisis.

Figure 2: SS&C GlobeOp Capital Movement Index Chart- November 2020

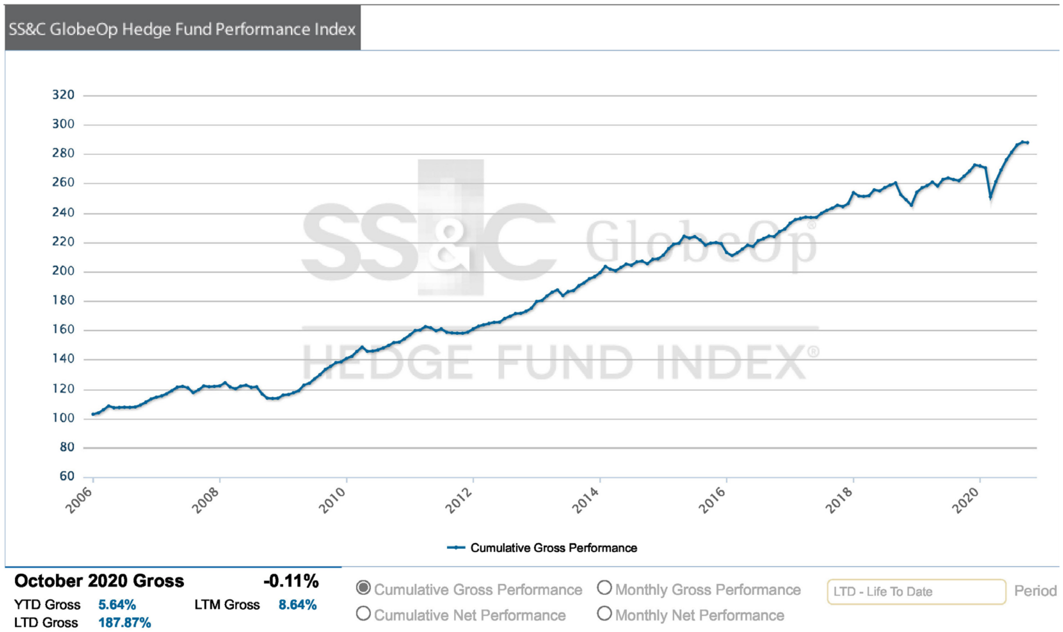


Performance and other factors influencing liquidity

If liquidity demands are a function of market disruption, what accounts for the steady trend lines in redemptions and capital movements? The starting point for this answer is performance.

The graphic below presents SS&C aggregated alternative asset fund performance. Investors allocate capital to alternatives to improve their risk-reward position and the performance record for 2020 indicates that managers are fulfilling this mission.

Figure 3: SS&C GlobeOp Hedge Fund Performance Chart – October 2020



Yet, it must be noted that the prospect of this strong performance was not immediately obvious when COVID-19 first roiled markets earlier in 2020. We believe additional factors explain the confidence that investors showed in alternative managers during those turbulent months.

1. The return of volatility to the markets was seen as playing into alternative managers' strengths, both in terms of available long/short strategies and proficiency in active trading.
2. The macro-policy reactions to the COVID-19 crisis were swift and decisive for both fiscal and monetary policy.
3. These speedy reactions helped keep an emerging public health crisis from becoming an immediate market crisis so that markets never "seized up" the way they had in 2008-09
4. Many investors of 2020 had lived through the 2008-09 crisis, understood the implications of policy responses and remembered the V-shaped recovery of that crisis. Panic selling took place, but not on the scale of 2008-09.

The relative calm in redemptions has created opportunities, as well. For example, several fund launches have focused on deep credit and distressed assets, strategies that naturally encompass less liquid assets. These funds can move forward more confidently, given the considerations discussed.

Again, we are only partway through the COVID-19 outbreak and the news is filled with new surges and hopeful signs for developing effective therapies and vaccines. Therefore, markets remain volatile, but with confidence seeming to remain high in alternative asset managers' ability to create attractive risk-adjusted returns, liquidity demands are running in line with pre-COVID-19 levels.

Liquidity reporting

SS&C provides liquidity in days to clients on its Algorithmics risk platform for a variety of reporting uses. These include:

1. Internal reporting for portfolio managers, risk managers and compliance officers
2. The regulatory requirements of Form PF, AIFMD, UCITS
3. Investor reporting, including The Open Protocol Enabling Risk Aggregation

These applications are supported by rules-based calculations that sub-aggregate the portfolio into bands of days to liquefy and calculate average liquidity for the portfolio.

These rules afford managers a standard set of metrics, but clients can adapt the rules to their unique circumstances. This capability is particularly important in the alternative space because the unique strategies and sometimes less liquid asset mix require experienced traders' judgment. The role SS&C fulfills, as a fund administrator, is to provide the data and tools to perform the calculations necessary to meet the needs of the various constituencies that monitor fund liquidity.

Conclusion

Alternative asset funds have proven remarkably resilient and effective in navigating the financial impact of the COVID-19 crisis, and, to date, investors have shown strong confidence in their ability to continue to do so in the aggregate. Still, the market turbulence has reminded all investment stakeholders of the importance of measuring, monitoring, and managing liquidity risk. SS&C, as a fund administrator and risk service provider, is seeing a marked increase in interest in liquidity data and reporting. We expect this will continue to be the foreseeable case future among managers, investors and regulators.

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