Hedgeweek exclusive: Open Protocol set to revolutionise risk reporting using standardised template

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Hedgeweek writes: ***While most industry folk were enjoying their summer holidays last month, a potential game changing development occurred within the hedge fund industry. On 9 August, a working group of leading hedge fund managers, investors, prime brokers and administrators launched OPERA 'Open Protocol Enabling Risk Aggregation' to help hedge funds report risk information in a standardised fashion. In so doing, providing investors with the ability to aggregate information and do more with it.***

As compliance seeps into the industry in response to tightening regulation, the pressure on fund managers to deliver timely, accurate risk reports is enormous. The problem is that investors are asking for this information in different forms, made possible by the fact that a number of different templates exist (FSA, SEC, ESMA all have their own). All of which ask vague questions without providing details on how to accurately fill them out.

Open Protocol is the proposed solution and already it's being greeted with open arms by fund managers and investors, not to mention the regulators, according to the working group's co-chairman Simon Ruddick (pictured) of Albourne Partners, who spoke to Hedgeweek last week.

'Open Protocol is an attempt to align with these different templates and come up with a technically detailed solution', says Ruddick. It has been developed, he says, to give managers a set of detailed assumptions which they can use to fill in general questions.

It all started back in 2006 when the FSA were developing their template to assess the systemic risk hedge funds posed to financial markets. Given that Albourne Partners does the same thing to a far lesser extent, that is assessing risk for clients on a portfolio by portfolio basis, it already had a survey of questions. It therefore knew all the different ways questions were asked to managers and the ways they were willing to be answered. 'We then asked ourselves: From this morass can we produce a standard template? That is to say, a definitive list of questions', explains Ruddick.

The FSA agreed to the formation of a working group provided there was no commercial agenda and everything would be shared in the public domain. Ruddick delivered his first iteration to the group (which includes the likes of Lansdowne Partners Ltd, Thomson Reuters, Utah Retirement Systems) last December. After debating what should and shouldn't be included, a second iteration evolved. It then went through a consultative phase between 15 July and 9 August, at which point the third iteration was released on the internet, free for anyone to use.

As Ruddick comments: 'We're gifting the detail to the world. We've had a great dialogue with a wide number of regulators and central banks. They like it because it's a detailed solution to a challenge that they're facing and because investors have been involved in its creation.'

It's easy to understand why. If the authorities know there's something that investors can use to get a gauge on market risk, they're bound to support it. It's a form of leverage, a way to help them shoulder responsibility. 'It's like the wisdom of the crowd', adds Ruddick. In today's age of risk management, the more people there are looking at it, the safer the world might be.

Anything that makes life simpler yet enhances operational risk and due diligence has to be applauded. Using ten different templates for reporting risk is laughably inefficient. People will look back in ten years' time and wonder why it took so long to standardise things.

The OP is essentially a taxonomy, a language. What sets it apart from other templates, crucially, is that it provides three layers of granularity. That's the secret sauce. Grade one provides summarised information. Grade three provides the most detailed granular information.

Not all funds are in a position to provide granular detail and as Ruddick explains: 'The key thing with the grades is making sure the summarised information has been built on exactly the same foundation as the detailed information. That way, if you're an investor and half your portfolio is granular, the other summarised, you can still get an aggregate position at the summarised level.'

Using a trading analogy, it's a little like bottom-up stock picking. If a fund can provide granular detail, great. If it can't, summarised details are still coming from the same source. It means that investors won't necessarily be dissuaded from investing in great funds. 'It creates an alibi for them to stay invested because they're able to say they've got a grip on the overall market risk. It's a pragmatic solution,' adds Ruddick.

'We feel OPERA will be a significant benefit to both hedge fund managers and investors alike. The success of this program will be in its participation. If the managers and investors catch the vision of this program and implement it into their reporting, it will only enhance the transparency needed in this area', comments Bruce Cundick, CIO Utah Retirement Systems.

Administrators are already showing a keen interest and willingness to use OP according to Ruddick, although the real catalyst for seeing pervasive industry-wide adoption will be the risk software firms. To have a blueprint telling them what to build for their clients is like manna from heaven because they now have the technical detail.

Only the hedge fund industry, a complex and multi-faceted beast, could have created a solution like this. It would never have come from the traditional fund world. Nevertheless, Ruddick sees OP as having a broader application across asset management at large. 'Investors have always been able to get a lot of information from US mutual funds but they've struggled to know what to do with it.'

Open Protocol represents a potential paradigm shift, one in which investors, fund managers and regulators could all benefit.

Ruddick concludes: 'It's not rocket science. The beauty is in the simplicity not the complexity.'