Understanding RAUM

How to interpret the SEC's new metric

Managed Funds Association
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Understanding RAUM

What is happening?

- On March 31 2012, newly available public records (Form ADV) will report Regulatory Assets Under Management (RAUM), a new SEC metric designed to calculate gross assets under management for regulatory purposes.

What is the concern?

- Because RAUM is a new metric, others outside the industry may misinterpret or misunderstand its meaning.

What is the takeaway?

- The SEC has created a new metric for regulatory purposes. It should not be confused with assets under management (AUM) or investor capital at risk.

Understanding RAUM

Form ADV (Part 1A) *page 9*

Regulatory Assets Under Management

F. (1) Do you provide continuous and regular supervisory or management services to securities portfolios? ☐ Yes ☐ No

(2) If yes, what is the amount of your regulatory assets under management and total number of accounts?

		U.S. Dollar Amount		Total Number of Accounts
Discretionary:	(a)	$__________.00	(d)	__________

<u>Potential for Misunderstanding and Confusion</u>

- RAUM may make funds appear “bigger” than they are
- People unfamiliar with the industry may attempt to make calculations (e.g., on leverage) that would be inaccurate
- Public confusion with traditionally reported AUM
- Different regulators will looking at different numbers (e.g., CFTC) furthering confusion

Understanding RAUM

Executive Summary

- For decades hedge fund managers have supplied investors and regulators with information measuring Assets Under Management (AUM) painting a clear picture of net investor capital at risk.
- RAUM is a new and separate measurement developed by the SEC. It is not intended to replace AUM and does not illustrate net investor capital at risk.
- The Commodity Futures Trading Commission (CFTC) does not use RAUM. It relies on the traditional calculation for determining investor capital at risk.
- RAUM will represent a manager's gross assets under management, rather than net assets under management.
- The industry will comply with the new SEC reporting requirements, however we will continue providing investors and regulators with AUM measurements that truly capture net investor capital at risk.

Contents

Understanding RAUM

SEC Introduces New Metric

- The calculation of "investor capital at risk" has been reported as assets under management (AUM). The AUMs of hedge funds are reported by a wide range of recognized industry service providers, such as Hedge Fund Research.
- In 2011, the Securities and Exchange Commission (SEC) changed how hedge fund managers should report the amount of assets they manage.
- They created **an entirely new concept,** based on a new gross calculation, called "**regulatory assets under management**" (RAUM).
- This new metric will be available through managers' public filings on Form ADV beginning in March 2012.

Understanding RAUM

SEC Introduces New Metric

- The SEC developed this new metric to have a consistent internal measurement implementing the new mandatory tiered registration of private investment advisers.
- However, other regulators, most notably the Commodity Futures Trading Commission (CFTC), **have chosen not to use RAUM** and will instead rely on the traditional calculation (AUM) for determining the net asset value of investor capital at risk.
- This presentation is designed to explain the difference between the two metrics and make clear the meaning of each.

What is RAUM?

- **RAUM is an indicator of our industry's capital markets participation. The size of the RAUM numbers collectively indicates how important we are as an industry to the capital markets and is one of the reasons we have advocated in support of fund manager registration and various forms of Dodd-Frank regulation. It is also one of the reasons why we continue to support measures that ensure fair, transparent and efficient capital markets, shareholder rights and investor focused regulation.**
- RAUM is <u>not</u> an accurate indicator of investor capital at risk
- RAUM is <u>not</u> an accurate indicator of leverage
- RAUM is <u>not</u> an accurate indicator of the riskiness of a particular fund, fund manager or the industry at large

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Additional Items Reported Under RAUM

The SEC now requires additional items to be reported as part of the RAUM calculation.

A manager's RAUM may be higher than its AUM because it includes:

- Hedging Techniques used to Offset Portfolio Risk
- Long and Short Positions (on a gross basis)
- Leverage
- Proprietary assets, assets managed without receiving compensation, or assets of foreign clients, all of which an adviser may currently exclude from its AUM
- The value of certain private funds that hold significant assets that are not securities and that can be illiquid and difficult to value
- Uncalled capital commitments (applies mostly to private equity)

Understanding RAUM

AUM: The Traditional Calculation

- Fund managers calculate their AUM on a net basis.
- Regulators required hedge fund managers to use this traditional calculation because it best represents the amount of investor capital at risk.
- AUM represents “investors’ equity” (like shareholders’ equity) and is an accurate representation of investors’ capital at risk (i.e., the amount of money that investors actually have invested in a manager’s fund(s)).

Understanding RAUM

What Makes RAUM Different?

- The RAUM calculation requires managers to report assets managed without deduction of any offsetting liabilities.
- RAUM will represent all of the assets managed by a single manager, including assets of separate accounts and separate private funds.
- It is important to remember that hedge funds are legally separate entities, often have different investors and can engage in distinct trading activities in different assets and markets.
- Any losses of one fund are borne exclusively by the investors in and counterparties to that fund, and do not subject other funds managed by the same adviser to losses.
- *NOTE: These changes will apply to managers' public filings on* ***Form ADV*** *beginning in March 2012.*

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What RAUM Does Not Consider

- RAUM does not take a fund’s strategy into consideration
- It may not be an accurate indication of a private fund’s leverage.
  - For example, a manager’s RAUM may not take into account certain hedging techniques which reduce overall risk to the portfolio.
  - The combination of both “long” and “short” positions on the balance sheet of a hedge fund results in a “gross” exposure figure that exceeds the true “net” assets under management.
- Positions held that limit exposure to a particular asset may not be represented in such a manner for purposes of the manager’s RAUM.

Understanding RAUM

<u>Questions and Answers</u>
What is RAUM?

- *In 2011, the SEC created an entirely new regulatory measurement – Regulatory Assets Under Management (RAUM) – directing how hedge fund managers should report the amount of assets they manage.*
- *RAUM is distinct from any existing measurement.*
- *It does not replace the industry standard AUM measurement, and does not depict the true net value of investor capital at risk.*
- *RAUM will apply to fund managers' public filings on Form ADV beginning in 2012*
- *RAUM is an indicator of our industry's capital markets participation. The size of the RAUM numbers collectively indicates how important we are as an industry to the capital markets and is one of the reasons we have advocated in support of fund manager registration and various forms of Dodd-Frank regulation. It is also one of the reasons why we continue to support measures that ensure fair, transparent and efficient capital markets, shareholder rights and investor focused regulation.*
- *RAUM is <u>not</u> an accurate indicator of investor capital at risk*
- *RAUM is <u>not</u> an accurate indicator of leverage*
- *RAUM is <u>not</u> an accurate indicator of the riskiness of a particular fund, fund manager or the industry at large*

Understanding RAUM

<u>Questions and Answers</u>

How does the SEC define RAUM?

- *The SEC proposes to require all advisers to include in their regulatory assets under management securities portfolios for which they provide continuous and regular supervisory or management services, regardless of whether these assets are proprietary assets, assets managed without receiving compensation, or assets of foreign clients, all of which an adviser may currently exclude.*

- *Advisers would not be permitted to subtract outstanding indebtedness in determining regulatory assets under management.*

- *All advisers would be required to use the current market value (or fair value of private fund assets) rather than their cost in determining regulatory assets under management.*

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Questions and Answers

How is RAUM different that the AUM #'s that the industry has used in the past?

- *RAUM is an entirely new, separate measure from traditional AUM.*
- *It does not replace AUM and does not measure net investor capital at risk, rather it's an indication of a fund's overall capital market participation.*
- *Instead, RAUM requires managers to report assets managed without deduction of any offsetting liabilities.*
- *As a result, RAUM will represent a manager's gross assets under management, rather than net assets under management.*

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<u>Questions and Answers</u>

Is this a more accurate metric for regulators and investors to use when viewing the industry's systemic risk and leverage?

- *No, it is simply a different metric.*
- *Keep in mind that a manager's RAUM may not take into account certain hedging techniques which reduce overall risk to the portfolio*
- *Also, The Commodity Futures Trading Commission (CFTC) does not use RAUM. It relies on the traditional calculation for determining investor capital at risk.*

Understanding RAUM

Questions and Answers

If a firm's gross RAUM number is now much larger – does that mean they are highly levered or have risky long / short bets on?

No. RAUM now requires managers to include the following additional assets in their calculation:

- *Assets held in family accounts*
- *Proprietary accounts of the manager*
- *Accounts for which the manager receives no compensation*
- *Accounts of non-U.S. persons*
- *The value of certain private funds that hold significant assets that are not securities*
- *The amount of any uncalled capital commitments to a private fund*

RAUM represents all of the assets managed by a single manager, including assets of separate accounts and separate private funds.

Hedge funds are legally separate entities, often have different investors and can engage in distinct trading activities in different assets and markets.

Any losses of one fund are borne exclusively by the investors in and counterparties to that fund, and do not subject other funds managed by the same adviser to losses.

Understanding RAUM

Questions and Answers

Are mutual funds subject to this same disclosure?

Yes. All registered investment advisers must file Form ADV.

How often are these numbers updated and required to be filed with the regulators?

Fund managers are required to file Form ADV with the SEC on an annual basis. Managers are required to calculate current market value of securities investments 90 days prior to the date on which they file Form ADV.

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