



RYANEYES

CASE STUDY - Handling the Management of Side Pockets with RyanEyes

Leading Fund Automates and Streamlines the Accounting of Side Pockets, Saving 52 hours of Manual Work per Month

The Exploding Growth of Side Pockets & The Impact on Accounting and Fund Administration

Introduction

Side pocket accounts have a long history in the hedge fund industry, yet the use of side pockets is expanding dramatically to the chagrin of fund administrators who have to manage the complex accounts. Briefly, a side pocket is a type of account utilized in hedge funds to segregate riskier or illiquid assets from more liquid investments like equities and bonds.

The illiquid assets in these side pocket accounts include investments such as real estate, antiques, over-the-counter (OTC) stocks, stocks with extremely low trading volume, stocks delisted from exchanges, and private equity investments.

The assets of a side pocket account are recorded on a fund's books, but they are tracked separately. Their accounting and valuation calculations are shared with investors but are often complicated and valuations may change dramatically depending on the asset and market conditions. Recently, funds are not only increasingly adding side pockets to the fund, but they are also taking out loans against the assets to increase leverage, thus creating a massive challenge for accounting and fund administrators.

Side pockets can have hundreds of investors and if each investor starts a month with 20 side pockets and 20 new side pockets are added in a month; and there is a loan against each side pocket the number of ledger entries explodes by the thousands each month and compounds exponentially going forward.

The Challenge

Typically, all of the assets a fund owns is commingled into one portfolio and investors simply own a percentage interest in the whole fund. While management fees and incentive structures may vary participant-by-participant in a hedge fund, the general fund accounting is simplified by everything else being commingled.

Side pockets are the exceptions to the commingling process. When securities are illiquid or hard to value and constitute some significant part of a fund's assets side pockets are created. Hedge funds and private equity funds have been investing in an increasing number of illiquid investments for a variety of reasons and using the assets as a means to borrow additional funds.

This has become a nightmare for accounting and fund administrator teams who must value the illiquid asset, track its value for the fund's monthly NAV and manage the loan against the asset.

Real World Example

A leading Hedge Fund has hundreds of investors with approximately 20 sidepockets created per month. For accounting, the increase in the use of side pockets has led to an increase in 20,000 new capital entries per month. Side pockets can have hundreds of investors and if each investor starts a month with 20 side pockets and 20 new side pockets are added in a month - and there is a loan against each side pocket the number of ledger entries explodes by the thousands each month and compounds exponentially going forward.

Side pockets were often managed manually through spreadsheets and updated by creating new sheets and cutting and pasting existing formulas from the previous month's sheet. It was a painstaking, time-consuming task that in one account absorbed two high-level employees for three days. However, now, with thousands of additional entries and subsequent calculations spreadsheets have grown to over 150MB in size, become corrupted. Further, calculations have copied incorrectly or changed over time making the valuations incorrect.

When a fund manager decides to create a side pocket, existing shareholders are allocated shares in the new side pocket account on a pro-rated basis. These shares cannot be redeemed until either the fund manager realizes a portion or all of the side pocket investment creating additional challenges for accounting and fund administrators.

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Start Date: 3/4/2020 Fund: RBTS_LP, RBTS_OS, RBTS_INT, RB1
 End Date: 6/30/2021 Investor: I000100001 / Ryan Capital Partners
 Report Type: Sidepocket Tran Type: ASSIGN_FULL_IN, ASSIGN_FULL_C
 Collapse Activity: (Select All) Main Sidepocket

Ryan Capital Partners

Capital Orders Summary By Investor / Date / TranType							
IA Code	Date	Tran Type	Inflow	Transfers	Outflows	SP Funding	Credit Borrow
Report Period: 3/4/2020 - 6/30/2021							
Ryan Capital Partners Onshore L.P.			8,263,437.50	0.00	0.00	0.00	0.00
I000200001 Andrew Taylor SLP Lot#: 1			96,875.00	0.00	0.00	0.00	0.00
SP001			12,500.00	0.00	0.00	0.00	0.00
I000200001-SLP-SP001-001	1/1/2021	SP_CAP_IN	12,500.00	0.00	0.00	0.00	0.00
SP002			25,000.00	0.00	0.00	0.00	0.00
I000200001-SLP-SP002-001	1/1/2021	SP_CAP_IN	25,000.00	0.00	0.00	0.00	0.00
SP003			37,500.00	0.00	0.00	0.00	0.00
I000200001-SLP-SP003-001	1/1/2021	SP_CAP_IN	37,500.00	0.00	0.00	0.00	0.00
SP004			12,500.00	0.00	0.00	0.00	0.00
I000200001-SLP-SP004-001	1/1/2021	SP_CAP_IN	12,500.00	0.00	0.00	0.00	0.00
SP005			9,375.00	0.00	0.00	0.00	0.00
I000200001-SLP-SP005-001	1/1/2021	SP_CAP_IN	9,375.00	0.00	0.00	0.00	0.00

Side Pocket Reporting in RyanEyes

Integrating RyanEyes Delivers Ongoing Value

The fund is now processing 20 to 30 sidepockets on the first day of the month which are committed to preliminary estimate and final estimate for NAV calculations. Estimates are sent on the first business day of the month. Reprocessing updated files from the Fund Admin is seamless as the automation in RyanEyes takes care of reprocessing. RyanEyes handles side pockets by owner, investment allocation, pro rata calculations and income generated by the asset.

RyanEyes monitors these illiquid side pockets so that if they grow as a percentage of the total fund, managers and administrators will understand when the asset exceeds prescribed limits. Finally, when the fund's side pocket is deemed liquid again, it can be reintegrated into the general fund at its current known value.

As the number of side pockets grow RyanEyes has the ability to handle, not only the automation of entries and calculations, but also the impact they have on NAV, the General Ledger, and Investor Returns.

RyanEyes Automates the Management and Calculations of Side Pockets

RyanEyes has the ability to automate the calculations and the tracking of each side pocket and the loans against the asset. Further, the software tracks custom fee structures and liquidity terms in each side pocket account. In addition, for monthly or periodic valuation, RyanEyes will process the sidepockets so that they are properly tracked and reported.

In this case, the transition from spreadsheets to RyanEyes software saved the firm's fund administrators 3-4 days of manually extracting and reconciling each side pocket's data and calculations. In addition, new private equity investments were handled with RyanEyes automating the entering and processing of additional side pocket entries saving an addition 1-2 days.

RyanEyes saved Fund Administrators 52 hours of manual entering, calculating, and reconciling spreadsheets on a monthly basis. In addition, reporting became a seamless process as part of the NAV calculation within RyanEyes providing additional value.

RYANEYES | TECHNOLOGY SOLUTIONS FOR ASSET MANAGERS ***RyanEyes is a second set of eyes for your financial services organization***

RyanEyes delivers intelligent software and consulting solutions for Hedge Fund and Private Equity organizations. Our solutions provide visibility and automation across business processes and operations by connecting and communicating with your front, middle, and back-office data solutions.