ALGO FIRST FOR THE BUY SIDE

Qualitative database of external risk loss events

Algo FIRST is a uniquely designed research tool that helps hedge funds, asset managers, and pension funds understand, identify, and manage operational risk. Recognized by analysts and practitioners alike for its industry-leading coverage, the ever-expanding Algo FIRST database contains thousands of real-life case studies based on external risk loss events.

Algorithmics

Algo FIRST highlights operational risk events, control breakdowns, and management responses to help organizations prevent losses before they occur. Subscribers can proactively apply lessons learned from over 7,000 real-life case studies to help minimize their risk exposure and enhance internal controls. The Algo FIRST database is constantly expanding, and recent additions include a number of buy-side industry events, including: directed brokerage payments; hedge fund blow-ups; pension fund settlements related to corporate accounting; frauds; market timing; and mutual fund sales practices.

The industry's most respected external risk loss database

Buy-side organizations are complex entities that are ultimately responsible for managing the financial resources of others. As a result, they are at risk of losing their franchise if they are unable to preserve their good name. A worst possible scenario for a buy-side organization is one where its reputation is linked to lawsuits, news stories involving breach of fiduciary trust, or accusations involving the failure to deliver promised returns. History has proven that the failure to understand and manage these potential risks can lead to the ultimate consequence: a catastrophic loss in franchise value.

One important strategy for proactively managing risk is to learn from the failings of others. The Algo FIRST database contains unique, real-life case studies that provide the buy-side community with qualitative and quantitative analysis of large loss events. This content, which includes insight into key triggers, contributory factors, management responses, and associated control breakdowns, can help firms prevent similar mishaps from occurring within their own firm.

The industry's only research tool that puts real-life case studies within an operational risk framework, Algo FIRST is an ideal supplement to internal data for self assessment and scenario modeling. At-a-glance charts and graphs, free-text searching, in-depth case studies, and essential content for self-assessment programs ensure that Algo FIRST is an invaluable resource for any hedge fund, asset manager, or pension fund. Available on a subscription basis, the Algo FIRST database is accessed via the web, and does not require installed software.

KEY BENEFITS AND FEATURES

Improves understanding of potential exposures

Case studies can be easily shared between departments, providing valuable content for internal newsletters, management reports and discussions, self-assessment workshops, and scenario-based models. Easy-to-read charts and graphs allow for quick understanding of loss breakdowns, while the ASP-based subscription ensures that users across the organization can quickly access Algo FIRST without additional infrastructure cost.

Minimizes risk exposure

By proactively applying lessons learned, buy-side organizations can enhance internal controls, reduce investment risk, and improve new product research processes before losses or exposures occur.

Enhances trend analysis

Firms gain the ability to examine commonalities among a series of events and to track emerging patterns. By benchmarking internal loss history against the event experience of peers, organizations can use Algo FIRST to improve their competitive insights.

Reduces investment risk

Improve new product research processes by identifying potential risk exposure by product type, so the right controls can be put in place. Management can also reference Fitch ratings, linked to the timing of events, to see if there are contextual understandings of how events may have impacted the cost of capital.

Increases access to relevant insights

Algorithmics' operational risk research analysts have a background in financial analysis. This experience helps ensure they understand which loss event details are relevant to buy-side organizations – and that these insights are passed along to subscribers.

Easily export data

Use XML links to download direct feeds from the Algo FIRST database into internal or external operational risk, corporate governance, or other knowledge-based systems.

In-depth case studies

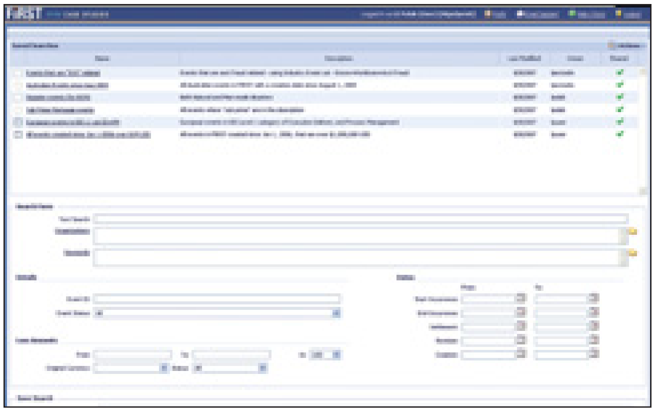
Loss events are detailed with analysis of key factors, including internal breakdowns, management responses to events, easy-to-read graphs and charts, and industry lessons learned. Special coverage is provided for catastrophic (fat tail) events, which are detailed with timelines to allow for day-by-day or hour-by-hour analysis of breakdowns that led to loss.

Extensive search functions

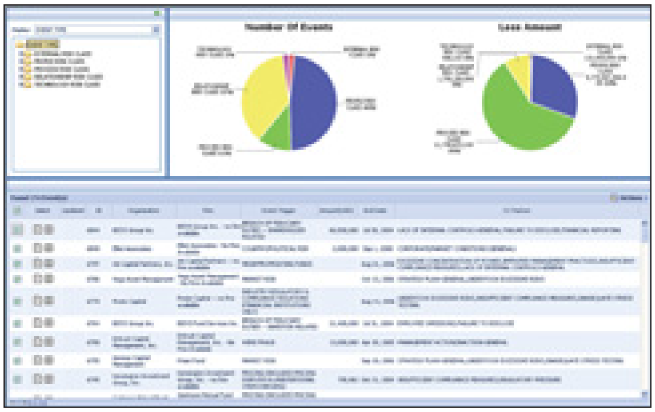
Free-text searching allows for easy identification of events by natural language. Algo FIRST's powerful search engine allows users to combine search concepts, or search by a variety of factors, including product type, loss type, event trigger, and control breakdowns. Keyword-indexed case studies (including Basel II categorizations) also support advanced search functionality.

Access to online newsletter

Database subscribers gain access to the Algo FIRST Newsletter. The online newsletter is designed to raise awareness of topical issues that can impact day-to-day business operations and provides excerpts from relevant case studies.



Algo FIRST homepage.



Algo FIRST query results.

Algo FIRST Database Sample Case Study

PaineWebber (excerpt of event #1358)

In a high profile and landmark derivatives case, one of PaineWebber's "safe" mutual funds suffered significant losses in 1994. The fund was billed as a low-risk fixed income investment, but carried derivative "kickers" that exploded when interest rates moved in an unanticipated upward direction in 1994. PaineWebber's total bailout of the fund, which constituted one of the largest in the mutual fund industry at the time, came to $268,500,000, which included an SEC fine levied in 1997. This amount also includes the firm's decision to spend $180 million in July 1994 in order to shore up the fund and an expenditure of $88 million in June 1994. Of the $88 million, the firm allocated $33 million directly to investors in settlement of a lawsuit, and $55 million in order to purchase derivatives from the fund in an attempt to increase its value.

The PaineWebber Short-Term U.S. Government Securities Fund had been extremely popular because it promised the stability of a money market fund, but delivered higher returns than competitors. The fund, which was founded in May 1993, had $2 billion in assets. It was billed as a safe fixed income investment. But in order to earn better than average returns, the fund's manager invested in structured notes. After the Federal Reserve began raising interest rates in February 1994, the strategy backfired and the fund suffered significant losses as a result of investments that tracked the movement of interest rates.

PaineWebber's decision to invest in the structured notes came at a time when interest rates were very low and it was difficult to achieve returns from fixed income investments. The mutual fund industry was under a great deal of pressure and large managers were struggling to distinguish themselves from each other. PaineWebber heavily marketed its fund as a safe investment that earned a few extra percentage returns above its competitors. The fund also advertised that it had waved commission fees associated with a certain class of investments in the government securities fund. The waving of the commission fees and associated additional costs meant that the fund, which was growing rapidly in terms of investor assets, needed to come up with a more aggressive strategy in order to be profitable.

As long as interest rates continued to fall, PaineWebber found a way to increase profits and cover the commission costs that it was essentially giving up to the market. PaineWebber's strategy did not necessarily consider what would happen if interest rates moved upwards and the fund lost money. Morningstar publisher Don Phillips commented that PaineWebber had "taken marketing considerations and put them right in the middle of the investment process, which mucks up the works." This appears to have happened as a result of the intense competition in the industry.

When the Federal Reserve started raising interest rates in February 1994, the short-term government fund started realizing losses. By July 1994 the fund was down 7% for the year, which was unusually high for a fixed income fund at the time. This led to a flight of investors and the firm's decision to invest its own capital in the mutual fund in order to halt the outward flow of funds.

PaineWebber was under no obligation to bail-out the government bond fund. The firm, however, decided to do so in order to protect its mutual fund franchise and retain its client base. The $258 million investment in its own funds was one of the largest that the industry had experienced to date. The firm faced a reputational crisis at the time with the New York Times publishing stories entitled "Yet another round of greed vs. prudence."

This case served as a reputational embarrassment for a firm that took pride in the quality of its relationships with its retail clients, and harmed the image of Mitchell Hutchins, PaineWebber's investment advisory and mutual fund division. Mitchell Hutchins, which at one time was one of the most highly respected investment advisory firms on Wall Street, had a difficult time recovering its reputation after this incident. The reputational issues were acknowledged by the head of the fund group at the brokerage when he was questioned after the announcement that the firm was shoring up the fund: "It sounds corny, but that mutual fund had the PaineWebber name on it, and our reputation is important to us," said Thomas F. Eggers.

About Algorithmics

Algorithmics is the world's leading provider of enterprise risk solutions. Financial organizations from around the world use Algorithmics' software, analytics, and advisory services to help them make risk-aware business decisions, maximize shareholder value, and meet regulatory requirements. Supported by a global team of risk experts based in all major financial centers, Algorithmics offers proven, award-winning solutions for market, credit and operational risk, as well as collateral and capital management. Algorithmics is a member of the Fitch Group.

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