

technical platforms for multi-prime brokers

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edge fund managers are finding that they need to retain more than one prime broker. "Their accountants and other advisers are telling them if they don't have a multi-prime broker setup, they should go out and get it," says Peter Salvage, global head of hedge fund middle-office services at Citi. According to a Merrill Lynch report released earlier this year, nearly 35 percent of funds in excess of \$1 billion in assets have four or more prime brokers. The largest funds might retain as many as a dozen.

In the wake of the Bear Stearns collapse, even smaller funds, which previously preferred the simplicity of using a single prime broker, are under pressure to retain at least two prime brokers as a hedge against counterparty risk. The global credit crunch has overturned the traditional consensus that hedge funds are the riskier party in the relationship between a hedge fund and its prime broker.

"A few years ago, the banks worried about hedge funds blowing up; now hedge fund managers worry about the banks blowing up," says Dougal Brech, European head of client services at Credit Suisse. In addition, much of the demand for using numerous prime brokers comes from institutional clients seeking streamlined reporting systems and portfolio accounting, independent valuations and enhanced risk analysis, along with frequent reporting and

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detailed net asset value calculations. Fund managers are increasingly relying on prime brokers for trade execution, cash and collateral management; leveraged financing; securities lending; and in some cases, capital introduction. In addition, more fund managers are expanding into emerging markets in search of investment opportunities, and their prime brokers must demonstrate an ability to support these markets. With a need for so many complex functions, the managers are seeking a range of prime brokers, each with its own specialties.

When a fund uses more than one prime broker, it must also have software that can incorporate data from all of the brokers on one seamless platform. Technical platforms are growing in importance for the emerging hedge fund industry in Asia. Consolidation of data is important to Japanese funds that do their trading in Singapore, due to the expense of registering in Japan, as well as to the large global hedge funds that have Asian offices and need real-time exchange of data with their main offices in London, New York or elsewhere.

“From a global perspective,” says Stuart Farr, chief executive of Beauchamp Hedge Fund Solutions at Linedata Services, a third-party



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on third-party service providers, such as fund administrators, for middle- and back-office support and prime brokers for technology and infrastructure. While more large prime brokers are offering platforms that can incorporate data and services from other brokers, the independence of a third-party provider is preferable to some funds. Not surprisingly, there is a growing field of third-party integrators – including Paladyne Systems, Linedata, Investment Technology Group (ITG) and Portware – offering diversified platform functions to hedge funds.

To a certain extent, third-party integrators are competing with major prime brokers in offering technology platforms that consolidate a fund’s trading data, risk management, accounting and administrative functions. A third-party integrator’s technology also makes it easier for smaller funds to use multi-prime brokers without having to spend time and money on developing their own technical platforms. “With our technology, a prime broker will not hold a hedge fund captive,” says Paladyne CEO Sameer Shalaby.

ITG also provides an alternative to a prime broker’s bundled services, offering independent third-party research, trading execution, compliance guidance and client support. ITG’s services include a full suite of automated strategies that enable fund managers to tap into hidden liquidity while keeping their trading activity invisible to the market, thereby lowering market impact costs.

At the same time, there is a growing trend to partnerships between third-party integrators and prime brokers. Two years ago, Paladyne announced a technology partnership with Credit Suisse to offer their hedge fund clients an integrated and independently-hosted, multi-prime technology platform, thus helping clients with the

integrator that provides technical platforms for hedge funds, “it is of paramount importance that the funds have capability that is region-specific, such as tax lots and stock financing methodology.” Technical platforms have to accommodate standard trading practices in every country where a fund invests.

A recent study by the third-party integrator Paladyne Systems notes that as an alternative to building costly technology to exhibit operational control, hedge fund managers increasingly rely on prime brokers for bundled front- to back-office technology. Prime brokers have invested heavily in recent years in an effort to offer such systems to their customers.

Third-Party Integrators

According to Paladyne’s research, Goldman Sachs and Morgan Stanley have emerged as market leaders among prime brokers due in large part to offering integrated, full-service capabilities. Their services include a large pool of investment products, access to large balance sheets and strong credit ratings, capital introduction, trade ideas and research, and comprehensive technology platforms and support.

A hedge fund manager must choose between spending hefty sums on infrastructure and technology or reliance

GOING MULTI-PRIME

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ability to take on competing prime brokers. Now, says Farr, “We see prime brokers offering software to their clients as a trend that has been and still is becoming more prevalent.”

Consolidating Trades

Brech says the big issue, when it comes to competition, is not over technology from third-party integrators or the services of other prime brokers. Instead, clients want to know that Credit Suisse can make it easy for them to consolidate the daily trades made through a group of prime brokers. “Going multi-prime is always difficult,” says Brech. “Through our partnership with Paladyne, we can help create a technology solution to facilitate this step and, most importantly, ensure that what is promised is delivered. We know that every prime broker has a



different client profile, and we tend to work with the larger hedge funds. We know that the larger hedge funds have to diversify counterparty risk and have multi-prime brokers, so we advocate open access and open architecture. We act as the main prime broker and help our clients set up their own technology platform to support their workflow processes and allow them to go multi-prime. We help to reduce the technology dependencies

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*Sameer Shalaby
Paladyne Systems*

clients have on their prime broker so that prime broker business is competitive and not captive.”

In June 2007, Credit Suisse unveiled Advanced PrimeSM, a prime services offering that includes all of the traditional prime brokerage services coupled with a multi-prime technology platform offered through its Paladyne partnership, and complete middle- and back-office operations support through Viteos Capital Market Services, an Indian provider of administration and outsourcing services. Advanced PrimeSM also incorporates expert consulting and implementation services, process automation and business continuity through these and other strategic relationships with best of breed vendors.

Citi is now in a partnership with Linedata Services' Beauchamp Hedge Fund Solutions to give hedge fund clients a technology platform called Open Prime, which is designed for multicurrency, multiasset and multistrategy investing. Linedata also has partnerships with Scotia Capital in Canada and Investec in South Africa.

“The technology is broker agnostic and works across all geographies,” says Salvage. The Open Prime system incorporates Beauchamp's software but also includes proprietary connections with major electronic execution avenues and broker trading algorithms. At the end of each trading day, the hedge fund manager can send relevant data to each prime broker for reconciliation. Citi functions as host for the system and takes care of maintenance and disaster recovery. Prime brokers are increasingly using integrated, open-source technology platforms as a competitive strategy. “We view this as part of what sets us apart from the other prime brokers,” says Salvage. “We've been doing this a little over a year and have 25 clients signed up. The interest from clients has surpassed our expectations.” ●

ISSUES

faced by managers with multiple prime broker relationships:

• ADMINISTRATIVE •

Multiple primes translate to increased counterparty monitoring for the additional accounts and points of contact.

• FRONT-OFFICE •

Multiple prime brokers may require managers to utilize multiple execution platforms for direct market access. Since most prime broker execution platforms are single prime offerings, managers will need supplemental trading applications and order management capability.

• MIDDLE-OFFICE •

Multiple prime brokers create the need for aggregated portfolio reporting, accounting, and risk management. This need is most significant because it requires the manager to consider building infrastructure or outsourcing services to a third party.

• BACK-OFFICE •

Multiple prime brokers require more complicated trade allocation and reconciliation processes which result in higher error rates and more resource requirements. Managers are again forced to add staff or leverage outsourced service organizations.

Source: Paladyne Systems

Highly Controlled Operational Environment A Key to Attracting Institutional Investors



Peter Salvage
Global Head of Citi's
Hedge Fund Middle
Office Services

To serve institutional investors effectively, hedge fund managers are deploying "industrial-strength" middle and back office solutions, according to Peter Salvage, director, global head of Citi's Hedge Fund Middle Office Services.

"Compared with high-net-worth individual investors, institutions require more formal procedures and controls, including more frequent and detailed reporting," says Salvage, who directs Citi's OpenPrime™ and Hedge Fund Middle Office Services.

"As part of a due diligence analysis, institutions may bring in an analytical team to examine the operating systems and procedures, pricing policies, disaster recovery plan and other factors before approving an investment in the fund," Salvage adds. "Therefore, if a fund manager wants to attract more institutional money, it makes sense to take a proactive approach to their operations platform rather than scrambling to catch up."

Putting a robust middle and back office platform in place enables hedge fund managers to quickly and easily track their positions across regions, markets, asset classes and currencies. Managers can get a consolidated view of actions across an entire portfolio with real-time reporting capabilities. "When an institutional investor asks, 'What's your current exposure to the X, Y and Z sectors?' the information is right at your fingertips," says Salvage.

Installing a highly controlled operational environment offers managers other significant benefits as well. "It gives hedge fund managers the ability to focus their time and energy on investing, rather than worrying about the back office," says Salvage.

Today's fund managers also need powerful analytic, tracking and reporting tools when dealing with the increased complexity of the global investment arena. For example, the proliferation of over-the-counter (OTC) derivatives, can pose difficult settlement issues, collateral requirements and valuation challenges.

Another trend adding to overall market complexity is the growing use of multiple prime brokers. "It is a daunting task to try to assemble the daily reports from several prime brokers," says Salvage. "Reconciling the data and creating an accurate picture of the fund's aggregate positions, cash balance and risk profile is difficult."

Other changes in the hedge fund landscape include the growth of multi-strategy funds and the growing popularity of 130/30 strategies. In both cases, fund managers often need to become familiar with new asset classes, new trading styles and new reporting requirements.

In such a complicated investment environment, many hedge fund managers are turning toward a new breed of software and services designed to address the complex issues of multi-prime brokers, multi-asset classes and improved operational processes and controls. "We find a modular approach to the challenges works well - using a mix of Citi's best of breed industry solutions with what clients already have in place," said Salvage. For example, Citi's OpenPrime solution is open architecture and provides secure multi-prime capabilities, including trade order and portfolio management. Adaptable for funds of all sizes, OpenPrime provides a direct window to Citi's integrated Hedge Fund Services, which include prime brokerage, comprehensive fund administration and capital raising.

Citi launched OpenPrime in third-quarter 2006, quickly established a global footprint, and has since attracted over 25 hedge fund clients in North America, Europe and Asia.

Name: Peter Salvage
Address: 388 Greenwich Street, New York, NY
Phone: 212-816-0267
Email: peter.salvage@citi.com
Web: www.transactionservices.citi.com



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