

FTfm Prime broking

Big players not so hefty post Lehman

Overview

Goldman Sachs and Morgan Stanley still hold sway, but new participants are building reputations, finds Sam Jones

There used to be little to argue about in the prime brokerage market. So much so that hedge fund managers tended to grade their brokers based on the quality of biscuit they served in their meeting rooms.

The point was that it did not really matter who had the best biscuits: Goldman Sachs and Morgan Stanley were the dominant players in prime brokerage and were the firms the average hedge fund manager sought access to.

In 2007, the two shared more than half of all business in the prime brokerage market.

Convulsed by the collapse of Lehman Brothers, however, prime brokerage has once again become an open playing field.

According to a survey conducted by the Tabb Group at the end of the year, close to 40 per cent of the hedge fund industry considered changing their principal prime broker in 2009, with a high proportion doing so.

"When Lehman Brothers collapsed, hedge funds scrambled for new relationships that would reduce the fear of waking up to a zombie provider," Tabb analysts noted in October.

"Even hedge funds that were less concerned about the imminent collapse of their current prime brokers felt it was a good opportunity to reassess existing relationships."

At the beginning of the year Goldman Sachs and Morgan Stanley were invariably named as the two with the most to lose in the coming months.

Indeed, in the darkest days of September and October 2008, both companies had come close to shuttering their prime brokerage operations altogether, fighting as they were for their survival. And in Global Custodian's annual prime brokerage survey, released during the summer, Goldman saw its ranking slip one place down to seventh, with a score of 5.52, while Morgan Stanley languished in eighth place.

Both firms have lost their lustre as a result of their intractable and often brusque handling of clients in the first few months of the year, according to one large London manager. The damage was done to Morgan Stanley's reputation by the company's chief executive, John Mack, making an inopportune attack on short-selling in September 2008.

Such gripes have not been enough to pull clients decisively away, however.



Michael Kirkham

In many cases, clients are forcing the pace of change. Funds with single prime brokerage relationships are finding themselves frozen out of new capital allocations from the largest players. Instead, institutional investors want to see funds with several prime brokerage relationships that can easily interchange with one another.

Many hedge fund managers recognise the problem.

"When Lehman went down we were caught out," the manager of one of the world's largest hedge funds told the Financial Times. "I had to sit down with our lawyers and go through all this stuff like rehypothecation that just hadn't been in my thinking before."

Rehypothecation – lending out clients' securities – remains something of a dirty word. Several hedge funds – including London's GLG Partners – are still fighting to regain control of assets held in prime brokerage accounts run by Lehman Brothers.

"It became apparent during the crisis that there wasn't as good an understanding of how contractual relationships worked as there should have been," says Anthony Byrne, the European co-head of prime finance at Deutsche Bank.

While rehypothecation remains central to the viability of many prime brokers' business models – particularly when margins are squeezed by lower volumes and little leverage – its prevalence is being challenged.

Deutsche Bank now offers the option of a separate custody account with BNY Mellon for clients' unencumbered assets.

HSBC, meanwhile, began to offer a limited range of "prime services" earlier this year in an effort to capitalise on its perceived strength and heft as an organisation.

Moving away from rehypothecation is less easy for traditional broker-dealer organisations, however, which can less afford lower margins on capital-intensive operations such as prime brokerage.

The biggest challenge ahead is likely to be on the availability of capital. The traditionally dominant broker-dealer banks have been able to retain share in 2009 while leverage is low, but as demands for leverage increase from clients not all will be able to meet the need.

"Several US banks spent 2009 reducing the number of managers they serviced, but kept those with higher assets under management as part of a general balance sheet clean-up," says the head of one large European prime brokerage operation. "But the issue now is how much room for expansion they'll have in the future."

Gone are the days when banks could leverage their balance sheets 30 times, and gone too are the days when a small number of institutions could corner and service the entire hedge fund industry.

While a prime brokerage account with Goldman or Morgan no longer carries quite the same cachet, many hedge funds say both firms' experience and technological edge remain unparalleled. In addition, the second-tier prime brokerage houses such as Credit Suisse, Deutsche, Citi and JPMorgan – which have topped the Global Custodian league for two years running – have gained mainly from the demise of Lehman and Bear Stearns, rather than the decline of Goldman and Morgan.

What marked 2009 out was the relative ease with which movements of clients between prime brokers was accomplished. The industry has skirted around widespread upheavals and has instead seen most clients settle with new principal prime brokers or else easily diversify the range they use.

"What people realised in 2009 was how seamless the shift was in the prime brokerage market from broker dealers to blue chip banks

as providers and how easily the newer players could handle the volume and needs of clients," says Roy Martins, the head of European prime services at Credit Suisse.

Credit Suisse has been one of the biggest beneficiaries in 2009. The bank has used the past 12 months to consolidate an already positive reputation. Credit Suisse has benefited not least thanks to an extremely prescient decision early in the year to bulk up its capital introductions team at a

time when banks elsewhere were downsizing theirs. As a result, Credit Suisse has been prime broker to 18 launches in 2009 in Europe alone.

As hedge funds emerge from months of painful redemptions, 2010 looks set to be a good year for the bank too. "[In 2010] funds' business models will depend on getting more capital – while other brokerages were scaling back their capital introduction teams we took a strategic decision to grow ours," says Mr Martins.

As such capital raising takes place. However, brokerages will have to contend with another set of challenges. Hedge fund clients, more than ever before, are asking for granular detail on the nature of funds' relationships and agreements – particularly with their prime brokerages.

Large fund of fund managers – the biggest single investors in hedge funds – have been among the first to demand information on funds' custodial and prime brokerage arrangements.

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FTfm – prime broking

Lenders reopen credit lines to hedge funds

Leverage

The bulk of large houses are back in the market though leverage limits are still down, writes **Chris Newlands**

A year ago today the hedge fund market was on its knees.

Average annual returns were touching -19 per cent, at least 150 European funds had been axed in the preceding 12 months, and hedge fund lending had dried up.

Twelve months on and the situation is much improved. According to figures from Credit Suisse/Tremont, annual returns have rebounded to 17.5 per cent – the best year-on-year figures since 1994 – fund openings rather than closures are once again the norm, and, importantly, prime brokers have reopened their credit lines.

“Lending to hedge funds has definitely returned,” confirms Andrew Shrimpton, a partner at hedge fund consultancy Kinetic Partners.

“The redemption surge is over and that, coupled with the state money that has been poured into the banking system, has meant there is more willingness to lend from prime brokers.”

The fall in volatility and how leverage limits are set have also played their part, Mr Shrimpton adds. “If lending targets are based around value-at-risk measurements, then a key component of that is volatility – and as this comes down, which it has, leverage limits go up.”

Bob Sloan is managing partner of S3 Partners, a prime brokerage risk manager. A year ago he declared it was impossible for the hedge fund community to get loans against many asset-backed securities and that a “time of deleveraging” had arrived.

Today, he is significantly more buoyant. “The balance sheet is still tight, but nowhere near as tight as it was,” he says.

“Clearly managers are more defensive. Clearly leverage limits are down, and clearly people are still dealing with some of the fallout of 2008 and early 2009.

“But we are seeing clients gathering assets once more and putting money back into the market. Maybe we have seen the bottom of deleveraging,” Mr Sloan says.

It is not surprising. Prime brokers were not long ago busy dealing with their own problems.

Liquidity was a genuine concern, and banks began calling in debts and halting lending in a bid to repair balance sheets.

That scenario looks to have changed with government handouts easing a lot of tensions. The bulk of lenders have consequently returned to the market but Mr Shrimpton knows of at least one large European prime broker – which he is

unwilling to name – that is still yet to return. “Nearly all of the large lenders are back but one of the big European prime brokers continues to stay clear. On the whole, those that were active before the Lehman collapse – other than Lehman itself – have returned but one is still absent,” he says.

Other sources were similarly either unwilling to name the absentee house or were unaware of the possibility.

“I haven’t noticed any of the large houses staying away,” says Magnus Ward, head of UK prime brokerage at SEB. “The big players, other than Lehman, all seem to be still active.”

He is quick to add, however, that he is not surprised some of the larger firms may have struggled. “Some firms were too aggressive in their lending prior to the crisis and had to cut back and impose greater haircuts.

“Consequently, and unsurprisingly, some funds have been upset by how they have been treated by some of the bigger players – and that has benefited smaller providers, which have been able to pick up

‘The lessons we, and others, have learned is that you need to know what is on the balance sheet’

a number of mandates,” he says.

In all bull markets, Mr Ward continues, firms tend to get more lax. “I wouldn’t say some of the bigger players got careless with their lending but you certainly saw them tighten things up pretty quickly over a short space of time.”

He adds that SEB is hiring people for its London office.

According to Credit Suisse/Tremont’s latest hedge fund performance figures, the broad index finished up 2.11 per cent for the month of November, bringing year-to-date figures up to 17.53 per cent.

Managed futures experienced its best month since October 2008, global macro was the second best-performing sector, while all sectors were positive for the month with the exception of dedicated short bias, which struggled amid rising global equity markets.

“The shakeout has been positive,” says Mr Shrimpton. “And for those funds that remain it means there are many more opportunities for them to make money. There is less competition and that is how it should be.”

Mr Ward adds: “Things may have improved but the lessons we, and others, have learned is that you need to know what is on the balance sheet. Some of the things you thought were liquid turned out not to be, so you really have to understand what you are dealing with before you lend.”



Deutsche Bank: one of the first to announce a new way of dealing with hedge funds’ assets

Reuters

Brokers adapt business model to new wariness

Rehypothecation

Since the Lehman collapse, brokers’ clients are being stricter about how their assets are used, writes **Sophia Grene**

Many hedge funds offer high returns based on leverage, making money from bets made with borrowed assets. They rely on being able to borrow those assets, usually from prime brokers, at rates they can afford.

The most common way to ensure this is to allow the prime brokers to use the assets they hold on behalf of the hedge funds to lend (or swap or otherwise use) to other clients. This “rehypothecation” of assets has been an essential part of both the hedge fund and prime brokerage business model for many years.

“Rehypothecation is essential if clients want cheap and reliable financing,” says Dougal Brech, managing director in Credit Suisse’s investment banking division, responsible for European client services. The alternative would be credit lines – borrowing directly from a bank – but although this seems more straightforward, and in the current low interest rate environment, perfectly affordable, it is vulnerable to change.

“If credit ratings change, or interest rates rise, those credit lines get pulled first,” says Mr Brech. So rehypothecation has been a common feature of the relationship between hedge fund and prime broker.

It works very well for all parties until a prime broker goes bust, as did Lehman Brothers, leaving hedge funds desperately trying to get back the assets the prime broker was holding on their behalf. The events of September 2008 and since have offered a salutary lesson to many hedge funds, who had not paid sufficient attention to the documentation of their transactions with prime brokers.

In an ideal situation, the docu-

mentation would be very detailed, stating clearly how the hedge fund’s level of indebtedness to the prime broker is calculated, precisely which of its assets can be used for rehypothecation and the financing terms the prime broker will offer in return.

The gold standard for rehypothecation agreements, says Mr Brech, include “daily transparency on what you have, what they are using, what they could use”.

In the US, regulations in place before the Lehman collapse limited rehypothecation to those assets a hedge fund held in a margin account, ie had not fully paid for. Assets it owned fully were held separately, usually in a cash account.

US regulation also limited the amount of leverage a hedge fund could avail itself of from a prime

‘Rehypothecation is still important, but rather than being the main source of funding, it is just a part of it’

broker, which, by implication, capped the amount that could be rehypothecated. This led to a large number of hedge funds looking for funding in Europe, particularly the UK, where such leverage was not generally capped.

However, when the unthinkable happened and a large prime broker did go out of business, it emerged that those funds using a European branch of Lehman not only had more assets lost in the labyrinthine relationships of a prime broker but they had less protection for them than in the US, where hedge fund assets were treated as separate from the assets of the bank.

Following this realisation, many hedge funds either stopped allowing rehypothecation or placed strict limits on what could be used. According to a report from the International Monetary Fund, the amount available for rehypothecation across the industry

plunged by \$1,774bn (£1,105bn, €1,235bn) in the year to December 2008, significantly changing the shape of the prime brokerage industry, and indeed the liquidity of the financial markets.

Since then, there has been a loosening up of attitudes to rehypothecation, but the landscape nevertheless looks very different.

A growing number of hedge funds are following the example of such canny peers as Brevan Howard, which stated in its annual management review “we limit the rights of prime brokers to rehypothecate our securities. We move our cash balances away from our prime brokers to segregated custody accounts at third parties.”

So widespread is this attitude becoming that some prime brokers are starting to offer this facility, or something like it, without being asked. Deutsche Bank recently announced it would offer clients a hybrid custody version of prime brokerage, named DB Integrated Prime Custody.

This “allows funds to hold unencumbered assets that were typically held within their prime brokerage in a separate custody account held at BNY Mellon”, according to a press release.

While hedge funds may be keeping a closer eye on what exactly their prime brokers are doing with their assets, rehypothecation nevertheless remains an important part of the business model for both parties.

“Nowadays rehypothecation is still important, but rather than being the main source of funding, it is just a part of it,” says Mr Brech. “Clients are almost putting pressure on us to use more of their assets.”

In general, the more illiquid the asset available for rehypothecation, the better the financing terms the prime broker offers.

Although this makes it more desirable, for the hedge fund, to allow the prime broker to re-use illiquid assets, the very reason for the improved deal is the increased risk that in an insolvency event, it would be impossible to get back the asset.

FTfm – Prime broking

A very brisk business with mouths to feed

Capital introduction

Demand for the service is high amid investor caution and elusive capital, writes **Suchita Nayar**

Capital introduction events became star-studded during 2009. Hedge fund luminaries mingled with investors over breakfasts or cocktails in New York, Geneva, London and elsewhere, to raise new capital. This was telling because for years these heavy-hitters did not have to raise a dime as all of their fund capacity was already spoken for.

That changed after industry assets dropped about 40 per cent from a mid-2008 peak of \$1,900bn (£1,189bn, €1,324bn), prompting a scramble for replacement capital. So, capital introduction groups got busy promoting even companies such as Brevan Howard Asset Management, Millennium Management, Paulson & Co, and Tudor Investment. Some of these marquee names have topped up and are starting to close once again.

During the go-go years, the industry was so flush

with capital that these groups were just another tool to raise money. Now, with investors more cautious and capital more elusive, managers see them as a material avenue for fresh inflows. "Capital introduction services have never been in such demand," says Alessandra Tocco, global head of the introductions unit at JPMorgan's prime brokerage.

However, as capital introduction does not generate any direct revenue for the parent bank, its own ranks were among the first to go amid the credit crisis. Most prime brokers pared these teams as new funds slowed to a trickle and existing managers could barely keep pace with redemptions during the first half of 2009.

By the summer, however, most banks resumed staffing, anticipating slowing outflows through the summer amid early signs of renewed interest from institutions, pensions, endowments and family offices. Increasingly, capital introduction groups are customising services for such allocators. UBS's capital introduction group, for instance, takes into account positioning and branding of its key clients and serves their specific needs, says global prime brokerage head Stu Hendel.



Cocktails and capital: there's been a rise in events for investors and fund managers

Corbis

'Almost all our hedge fund clients are considering Ucits products'

**Dominic Freemantle
Morgan Stanley**

Prime brokers all say the new fund pipeline for early 2010 is robust, of course to varying degrees. But a start of several hundreds of millions still remains a tall order; the majority of funds are setting out with under \$50m from friends and family.

Demand has ramped up significantly, says Robert Leonard, Credit Suisse's global chief operating officer for capital services. "We expect this to be a very active year."

For now, investors are being choosy in sensibly seeking a measure of safety by sticking with liquid strat-

egies. A recent Morgan Stanley survey of 76 investors around the globe showed that 68 per cent were looking to increase their exposure to equity long/short.

In Europe, meanwhile, Ucits III hedge funds are gathering steam. Over the next 12-24 months, players expect a rash of launches under this regulated, transparent and liquid structure. Dominic Freemantle, Morgan Stanley's European head of capital introduction, says: "Almost all our hedge fund clients are considering Ucits products."

Additionally, some sophisticated investors are tapping into distressed and other esoteric strategies, but only where fee concessions compensate for multi-year lock-ups.

In general, investors, particularly European funds of funds, prefer liquid investments at easy terms.

Thanks to the recent uptick in M&A activity, event-driven and merger arbitrage are increasingly drawing investors' attention. And money is chasing emerging markets once again. A number of pension funds and endowments are on the prowl for funds targeting Asia and Brazil, market sources note.

In the last three months or so, Asia, most notably Hong Kong and Singapore, has seen a spate of new launches from managers and traders spinning out from large fund houses and banks. Deutsche's recent research shows Asia had the most new funds, although their average assets were under \$25m apiece. 2010 looks promising, too.

Look for more sponsors to emerge for pedigreed newer managers worldwide, says Emma Sugarman, the global unit head at BNP Paribas. "A large number of pension

funds and other institutions are investing earlier in new funds. Family offices are also doing seed deals," she says.

One unexpected development is that, contrary to dire predictions of a pension fund exodus from hedge funds following the problems of 2008, institutional investors stayed put. Some even raised their allocations to compensate for larger losses on the long-only side.

When will overall inflows perk up? In the past six months, things have turned around. For most investors, the realisation has been that missing lucrative investment opportunities is just as bad as losing capital, says Dick Del Bello, senior partner at Conifer Securities. But inflows will remain measured and will come with more strings attached. As allocations rise, so will investors' need for asset control and transparency.

Nonetheless, while investors certainly are not abandoning start-ups, they will continue to place greater emphasis on established players, says Anita Nemes, global chief of Bank of America Merrill's cap intro unit.

Of course, managers' quest for "sticky capital" also continues unabated. "Big funds will continue to raise capital just like they did last year. A few have closed again but most are open for the right type of capital," says Ms Nemes.

Finally, for managers looking to launch solo ventures, Deutsche's global cap intro head Sean Capstick has this advice: "Timing is everything in this business. Nine months ago, I'd have probably said it's too early to launch, let's wait."

"Today, to those with a proven track record and the right infrastructure, I'd say let's talk. But think long and hard because it is still difficult to raise capital."

Smaller prime broker sector to keep growing in 2010

Trends

Mini primes are expected to play a larger role, writes **Suchita Nayar**

Between the one-two punch of high investor withdrawals and tanking markets, hedge fund assets fell precipitously between September 2008 and March 2009. Simultaneously, the banking crisis roiled large prime brokers, which in turn cut off funds with under \$500m (£312m, €347m) of assets. The smaller prime brokers took this as their cue to seek market share.

Significant shifts followed amid this churn. For instance, Jefferies & Co's prime broker client roster jumped to 350 from 200 during 2009 and assets more than doubled.

"Business grew nicely last year," says Glen Dailey, the prime brokerage head at Jefferies, the only mid-size full service firm.

The surge is likely to continue in 2010. A large number of new funds, either spin-offs from existing managers or debut funds of proprietary traders, are teed up for the next few months.

Most will soft-launch with under \$50m and work for a year to amass a track record. Smaller firms, often

known as mini primes, will lure these new entrants with lower fees and a boutique feel. They will keep their fees low by availing of wholesale rates from bulge bracket firms.

"The first quarter's heavily weighted toward new funds," says Ron Suber, global sales and marketing chief at Merlin Securities,

'It will take a substantial commitment of time and capital for the boutiques to survive'

which has some 450 clients, including 192 new ones from last year. "The pipeline's very strong."

This business segment is likely to also benefit from the trend toward "multi prime" – a number of brokers working on the same fund. Due to counterparty risks exposed following the collapse of Lehman Brothers, managers are increasingly using more than one prime apiece.

"With the continued growth of multi-prime relationships, mini primes will definitely play a larger role," notes Jack McDonald, chief executive of Conifer Securities, which established its prime brokerage business last year. On

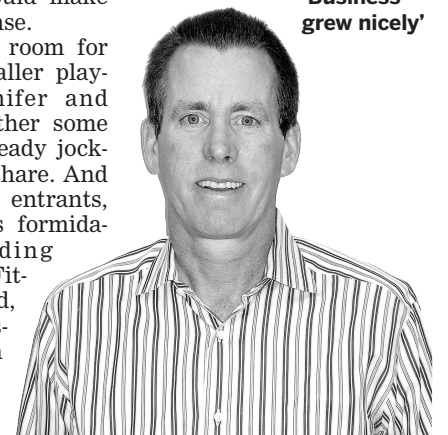
smaller accounts of around \$200m-\$300m, having two-three larger players working together is unlikely. In such instances, coupling a bulge bracket firm and a smaller prime would make more business sense.

There is ample room for Jefferies, and smaller players Merlin, Conifer and BTIG. But altogether some 40 players are already jockeying for market-share. And at least five new entrants, by most accounts formidable ones including Fidelity, Cantor Fitzgerald and Lazard, are coming. Industry players reckon there is only room for 15 or so.

"It will take a

substantial commitment of time and capital for the boutiques to survive," he said.

**Glen Dailey:
'Business
grew nicely'**



European banks' ascent marks altered landscape

Competition

New loyalties have been forged and the old duopoly is being challenged, says **Suchita Nayar**

In prime brokerage rankings wars, Credit Suisse had long run a distant fourth or lower, behind Goldman Sachs, Morgan Stanley and others. However, following a strong resurgence over the past 18 months, most industry estimates pitch it at or near the top of the heap even as incumbents have rallied and regained some market share.

The Swiss bank's turning point ironically came amid the depths of the financial crisis when, following Lehman Brothers' collapse in September 2008, hedge funds feared a "bank run" next on Morgan Stanley and Goldman Sachs. A lot was up for grabs. Still, Credit Suisse selectively took in only some 70 additional clients, taking its total tally to 470.

In 2008 and 2009, "the previously sleepy prime brokerage business woke up to some new realities", says Philip Vasani, Credit Suisse's unit head.

Under his stewardship since 2003, Credit Suisse has pursued a "hand-picked client base" that placed a premium on quality and safety, compared with other

banks that took a more "mass market" approach, he says.

Deutsche Bank's prime brokerage business has been another beneficiary of the market turmoil. Its hedge fund market share has surged over 18 months, according to its unit co-heads Barry Bausano and Jonathan Hitchon.

"The business environment is tremendous. 2009 was our best year ever despite a fall in industry-wide aggregate revenues," says Mr Bausano. Deutsche continues to make headway in 2010 by playing more of a volume game that takes advantage of its strategic strengths, including the strong balance sheet of its parent bank and a broad global franchise, he adds.

The ascent of these European banks has rocked the prime brokerage landscape and upended the duopoly of Goldman Sachs and Morgan Stanley that dates back to the early 2000s. But as the markets have stabilised Goldman and Morgan are on the offense again.

For example Morgan's average client balances rose 10 per cent and 14 per cent during the second and third quarters of 2009 respectively. A number of key franchise clients have returned. "This is an environment that plays to our strong heritage and continued clients' rankings as one of the leading global prime brokerage providers," says Alex Ehrlich, Morgan Stanley's global

head of prime brokerage. As unprecedented market forces largely drove the shift in favour of the European banks, it is only logical to question whether the duopoly will reassert itself once the dust settles. Will the change stick?

The expectation is that it will, and here is why: prime brokerage is a relationship business and some new loyalties were forged during the crisis that will not disappear as the financial system recovers. Additionally, the overall prime brokerage business has become increasingly fragmented

'There's plenty up for grabs as hedge fund clients of large brokers diversify their assets'

post Lehman as hedge funds are no longer comfortable having massive counterparty exposure to just one or two prime brokers.

Over the next few years, look for hedge fund assets to continually be spread out among multiple brokerages and custody banks. "The multi-prime trend is here to stay," says Stu Hendel, head of prime brokerage at UBS. He adds: "There's plenty of business up for grabs as hedge fund clients diversify their assets."

Research analyst Matt

Simon of the Tabb Group says hedge funds with more than \$3bn (£1.9bn, €2bn) now have 4.8 prime broker relationships apiece, compared with 3.7 in 2008. While this has opened doors for new entrants to gain market share, there is also more competition to get the business and make money on it, says Mr Simon. Not surprisingly, AllianceBernstein analyst Brad Hintz expects a 52 per cent drop in prime broker earnings. And due to a host of reasons, the cost of running prime brokerage has gone up.

That means each broker must work harder on building client loyalty and selling enhanced services. All told, prime brokers are expanding their product range, their geographic reach and their sales capability, notably in Asia. Goldman and Morgan are pressing ahead to further solidify their dominance in equities, and both Credit Suisse and Deutsche are touting more diversified platforms.

Additionally, ancillary services, including those that allow verification and safe holding of assets, have been on the radar screens of all bulge bracket firms, following the events of 2008. That is the thinking that led Credit Suisse not to use client cash to fund anything. "With hedge fund investors in mind, we run this place as a conservative investment portfolio," Mr Vasani says. Both Goldman



Morgan Stanley HQ in New York. With Goldman Sachs, the group dominated the scene from the early 2000s Bloomberg

and Morgan have established "bankruptcy remote" group custodian structures for client cash and securities.

Each prime broker is vying for a large piece of the new fund business that is going live by this spring. Mr Vasani says his firm is involved in virtually all of the "major launches" of 2010. Goldman's involvement is on "80-90 per cent of relevant" new funds, says John Willian, who leads the prime brokerage unit with James Paradise.

Separately, Deutsche

recently launched its emerging managers platform that allows it to cross-sell various services to start-ups.

Looking forward, Goldman's Mr Willian says: "One of the big changes over the next five years will be towards OTC clearing." Brokers will look for a way to integrate OTC and futures products clearing with the broader prime brokerage business, he adds.

The prime brokerage business remains material and profitable for Goldman, Mr Willian says.

DE Shaw's launch nods to hedge fund worries

Profile

The company's new fund will be more liquid and less opaque, writes **Suchita Nayar**

Hedge fund management heavyweight DE Shaw is preparing to launch a new fund that will be more liquid and transparent than its widely followed flagship macro-oriented fund.

The DE Shaw Heliant fund, the planned entity, is expected to set sail during the first quarter amid markets that, in Shaw's view, are conducive to global macro strategies and invest-

ment styles that meld discretionary and systematic approaches.

Heliant will utilise many of the macro elements employed by DE Shaw Oculus, its largest multi-strategy fund. Since its inception in 2004, Oculus has delivered impressive 19.3 per cent annualised gains, net of fees, and is up more than 10 per cent this year.

Last year was rough, however. Amid the market meltdown in late 2008, numerous Oculus investors headed for the exits, notwithstanding its respectable 7 per cent annual gain. Like many other hedge fund managers, DE Shaw invoked the gate provision to stagger withdrawals,

which it is still operating.

The new fund will target typical liquid macro fare such as commodities, currencies, equity indices and interest rates, along with related fixed income and futures.

Unlike Oculus, however, this fund will abstain from equity arbitrage, asset-backed securities and energy-related strategies that can constrain liquidity. This fund will take a relative value exposure, with limited directional bets.

The \$28bn (£17bn, €19bn) company, known to be super-secretive, is proposing a few concessions to investors, in keeping with the industry's shift away from illiquidity and opacity – two factors that have

repelled a large number of hedge fund investors since late 2008.

For starters, Heliant's fees, at 2 per cent of assets and 20 per cent of gains, are lower than Oculus, which charges 2.5 and 25. The gate provision has been removed and Heliant will permit monthly withdrawals, compared with once every three months for Oculus.

Nevertheless, each Heli-

DE Shaw is attempting to lift the shroud of secrecy surrounding its operations

ant investor will be allowed to redeem only a 1/12th of their previous capital contribution, and that must follow a 30-day notice period. Its proposed minimum investment threshold is \$10m.

DE Shaw is attempting to lift the shroud of secrecy surrounding its operations, but only partially. For instance, it will use Citco Fund Services, a third-party administrator, to provide monthly verification of the fund's positions and their pricing, cash and counterparty balances and also investors' capital.

Additionally, it will work with Credit Suisse Asset Management to create a month-end analytics report for investors, based on daily

position information it will provide to Credit Suisse. Credit Suisse, however, will not independently verify or confirm the accuracy of DE Shaw's data.

Once each quarter, DE Shaw will provide investors with an operational update that, among other things, will include a breakdown of assets according to FAS 157 fair-value accounting rule.

David E. Shaw, a Stanford University-trained computer scientist and a former Columbia University professor, established the eponymous company in 1988.

Alongside Oculus, he runs three funds and a long/short 130/30 investment programme. The company has 1,600 employees, including some 140 PhDs.