

by Deirdre Brennan

One Size Doesn't Fit All



Searching for the *Perfect* Prime

While having the name Morgan Stanley or Goldman Sachs on a hedge fund offering memorandum

may lend credibility to a new fund, the big boys aren't the only game in town. In fact, as the major players go after the mammoth funds, smaller asset managers often feel left in the lurch. But according to a *FIN-alternatives* survey of service providers, small- and mid-sized hedge fund managers have more options than ever before when it comes to finding the perfect prime.

Mike Murray, a partner at Shoreline Trading Group, an introducing prime bro-

kerage that has been working with small- to mid-sized hedge fund managers for over a decade, says that asset managers don't realize that they have options.

"They go straight to Bear [Stearns] or Goldman," says Murray, who is based in the firm's New York office. "But what makes us different than the other mini-primes out there is that we are an introducing prime to multiple custodians including Bear and Goldman." A smaller firm—for example one with \$10 million in assets under management—will get customized service from Shoreline and still have the confidence that their trades are being cleared by a big-name brokerage.

"It wouldn't work if we didn't have Bear and Goldman behind us," he says.

Another prime brokerage backed by a "big guy"—in this case, Merrill Lynch—is Terra Nova Financial.

"We have a unique situation: Not only are we an introducing brokerage to Merrill Lynch, but we are also a self-clearing broker," says Steve Simmons, senior vice president of institutional sales and trading at Terra Nova.

"We have a good working relationship with Merrill Lynch, so when a fund comes in with \$100 million AUM and they are balance sheet-sensitive and very heavily reliant on a hard-to-borrow list, we can offer Terra Nova's trading platforms, service and support, as well as Merrill's balance sheet and hard-to-borrow list." For a fund that comes in with less than \$50 million, Simmons says it isn't economically feasible for them to clear through Merrill, so Terra Nova clears for them.

"It's the best of both worlds."

While Shoreline and Terra Nova cater to small- and mid-sized hedge funds, another prime broker is busy setting its sights exclusively on what it calls middle-market hedge funds—those with between \$100 million and \$2 billion in assets under management.

Merlin Securities, which was founded by industry veteran Steve Vermut, began signing its first client in early 2005 and has since grown at a rapid pace, gaining a strong reputation in the industry.

"The middle-market hedge funds are underserved," says Vermut, who in 1995 founded San Francisco-based Montgomery Prime Brokerage, which was sold to NationsBank in 1997 and is now known as Banc of America Prime Brokerage. "The largest prime brokers are all focusing on the top

couple of hundred hedge funds, because that is where the money is."

In addition to functioning as a full-service prime brokerage, Merlin also offers a technology platform that allows fund managers to aggregate their portfolio data from various prime brokers, allowing them to report their performance and provide transparency to investors.

"Merlin is a prime brokerage built around a need to satisfy a hedge fund marketplace that wants in-depth reporting on a multi-prime, global basis," he says, explaining that many hedge funds have more than one prime broker, and sometimes as many as eight or ten.

"The hedge funds in the middle-market can't build [the technology to aggregate their portfolio data] themselves. It's too expensive."

With the myriad of prime brokerages, it can be tough to differentiate among the players. At a recent roundtable discussion, George Lipsker, a director at IT consultancy Avanade, argued that prime brokerages are essentially becoming commoditized.

"It is a two-edged sword in that prime brokers want to lower the cost and complexity of on-boarding new clients, but by reducing complexity, they're facilitating the funds' ability to move and switch, creating essentially a commodity service office," says Lipsker.

Terra Nova's Simmons is quick to agree with him.

"Like many other aspects of our industry such as electronic trading, prime brokerage has become some-

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*Mike Murray
Shoreline Trading*



what commoditized to a degree,” says Simmons. “The differentiating factor is the support and service you can provide... and unfortunately, even that is something that becomes a cliché, but you really do have to be able to deliver on it.”

In fact, sometimes it is the advice hedge funds receive from their prime brokers that makes the difference between success and failure.

“The number one risk out there is business risk,” says Murray. “Fifty percent of hedge fund failures are the result of not being able to run a business; weak infrastructure and poor operational management.”

While Shoreline’s main service is facilitating trades, its team of 20 relishes getting to know each client and helping them overcome the

everyday obstacles that can lead to disaster.

“We’ve all been in the business for decades and have seen it all,” he says, adding that what makes Shoreline different is that it is run by former traders, not salesmen. And, as occasionally happens, when a firm grows large enough or demands specific services that Shoreline doesn’t offer—such as credit swaps—like proud parents the team will happily walk the manager down to Goldman.

“It’s actually a great day for us when that happens,” says Murray.

So what does the future hold for the Shorelines, Terra Novas and Merlins?

“There is enough business for everybody, and we are going to be successful as long as we can keep serving and supporting—providing cutting edge technology, capital introduction programs—doing everything that the big shops are doing,” Simmons says. “There is nothing saying that if you have less than \$50 million that you deserve lesser treatment. Smaller funds need to realize that they have a choice out there, and they deserve every component of prime brokerage services that are