

PRIME MOVERS

As a growing number of traditional prime brokers begin to focus solely on larger hedge funds, *HFMWeek* speaks to four industry experts about the ways in which small and mid-sized funds can benefit from boutique prime brokerage and why they believe this industry will continue to thrive in the future

HFMWeek: What are the key advantages of using a boutique prime broker over a larger prime broker? How do you compete with the more established operations?

Noel Kimmel (NK): In today's market environment, funds compete more than ever for prime brokerage resources. Bulge bracket primes underwent severe budget cut-backs in both capital expenditures and headcount as well as in terms of their extension of financing or credit. As a result, these firms closely scrutinise their allocation of resources to hedge fund clients. While boutiques by no means give these same resources away, they are often better positioned to make more thoughtful decisions around the client base they can impact the most. Cost structures and overhead assumptions can be significantly less at a boutique. At Cantor, a mid-sized hedge fund customer is likely to be already an important client, whether in Institutional Equities or Debt Capital Markets – therefore, it is an easy decision for us to allocate resources to that client across the firm. Cantor competes by virtue of having

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a team of talented and experienced professionals, powerful technology and various financing alternatives, all within the confines of a full-service investment bank.

Glen Dailey/Stuart Feldman (GD/SF): Today, the largest prime brokers are focused on the top 300 or 400 hedge funds and so, for a fund looking for access to the services of a prime broker, and also seeking a higher level of service, a firm like Jefferies can be ideal. Not only do we provide services to a number of accounts that larger primes may not have an interest in, but we are also a full-service prime broker – we have a large trading operation, research, investment banking, capital introduction and



GLEN DAILEY

joined Jefferies & Company in March 2006 as managing director and head of prime brokerage. He previously founded Banc of America Prime Brokerage in 1995 and led the business for 11 years. Prior to that, he was managing director and head of prime brokerage for 12 years at Furman Selz.



STUART FELDMAN

is senior vice-president of Jefferies & Company, and heads its East Coast Capital Introduction. Prior to that, Mr Feldman co-founded two healthcare hedge funds where he was chief operating officer. His duties included trading, risk management and marketing.



STEVE SIMMONS

is a managing director with Lighthouse Prime Services and manages the capital introduction programme. Simmons was a two-time winner of Opal Financial's Broker of the Year for Emerging Managers, and holds Series 7, 63 and 55 securities licences.



NOEL KIMMEL

is senior managing director and global head of prime services for Cantor Fitzgerald. He joined the company from JPMorgan where he served as North American head of sales and marketing for the Fixed Income Prime Brokerage division.

securities lending, and this allows us to both compete with the largest firms in the industry and differentiate ourselves from the so-called 'mini-primes'.

Steve Simmons (SS): We at Lighthouse Prime Services have a dedicated team able to provide the client with an efficient and comprehensive suite of services, which has been an important part of our continued success. Many of the clients that we tend to work with would simply not receive the same level of attention from a large prime broker, and they respect and appreciate the fact that they have, for example, a dedicated trader, someone dedicated to back-office services, someone else dedicated to capital introduction, and so forth. This would not be the case with a larger prime broker.

HFMWeek: What type of funds will use a boutique prime broker? Is there a focus on smaller/start-up funds?

SS: Five years ago, boutique prime brokers were considered by some to be the 'prime of last resort'. Today, however, it is very clear that this has changed. On the start-up and 'emerging' manager side, boutique prime brokers are able to provide full incubation-type set-ups for funds that are in the process of launching, while for the more established funds looking to branch out into a multi-prime set-up, the ability to provide and consolidate reporting among multiple prime brokers can help a boutique prime become a very attractive and viable option for funds looking to move to the next level.

NK: Smaller funds utilise boutiques as they are often denied access to larger firms' prime brokerage units. Historically, boutiques cater only to equity-based strategies,

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STEVE SIMMONS, MANAGING DIRECTOR OF LIGHTHOUSE PRIME SERVICES

offering clients 'plain-vanilla' financing, direct-market access and limited sell-side trading capabilities. Many of these funds have been start ups. Cantor's approach is more comprehensive in that we work with funds across the scope of strategies and asset classes, throughout their life cycle. Our multi-asset approach stems from Cantor's diverse, firm-wide capabilities and our anticipation is that as funds grow in size, they will add new asset classes/strategies which we, in turn, will be positioned to take advantage of.

GD/SF: There are three main tiers within the prime brokerage industry, with the larger firms on one tier, 'mini-primes' on another and Jefferies in the middle. While 'mini-primes' are typically focused on smaller hedge funds – that is, funds of \$20m [€13m] and below – Jefferies focuses primarily on mid-sized funds which range from around \$20m to £250m. That said, we do also work with those start-up funds that we believe have the potential to grow in the future.

HFMWeek: How can boutique prime brokers best fit into the multi-prime relationship now favoured by the majority of funds?

SS: It is vital that they ensure that reporting technology, and the consolidation of reporting, is fully established in order to ensure a smooth transition. What's more, to attract interest from a client already using another prime broker, boutique primes need to be able to demonstrate the added value that they offer the client, whether this be trade execution or our own speciality of capital introduction, for example. This, in turn, needs to sit well within the overall multi-prime structure and we at Lighthouse Prime have the back office in place to ensure that this is the case.

GD/SF: As previously stated, Jefferies is a full-service prime broker and our securities lending, self-clearing

and capital introduction efforts make us a very good match as a second prime broker for funds which are moving towards the multi-prime model. That said, funds would normally have to reach a certain level – around the \$200m mark – before they start considering a multi-prime relationship.

NK: It is increasingly difficult for large firms to satisfy the rising demand of hedge fund clients of all sizes for a multi-prime environment, given the resource constraints previously mentioned. Boutiques enhance their relevance to the degree that they can be more flexible in how they earn revenues and the various services they can offer. Cantor recognises that many of our clients may have relationships with other primes. Our experienced client service representatives and innovative technology help to make the multi-prime experience a more seamless and positive one. Cantor will succeed by listening to our customers, which is why we have developed this prime services business.

HFMWeek: What can boutique prime offer in terms of capital introduction services, and how does this differ from the service offered by larger prime brokers?

GD/SF: While other firms rely on a revenue-based model, we at Jefferies endeavour to make all our clients capital introduction eligible across numerous platforms. Our approach is to look towards the investor to find out what strategies they are seeking and then cross these with our managers on the platform. What's more, in contrast to some of the larger primes, we spend a lot of time teaching our clients how to market – marketers and portfolio managers are given the opportunity to hear how to put their marketing materials together and best present them to investor from industry expects, with investors also participating in a roundtable discussion on the same topics.

NK: Most boutiques have capital introduction in some form, but it is typically less developed and, in many cases, less effective. Ideally, boutiques' capital introduction should not be any different than that of a larger firm. At Cantor, by virtue of the scale and scope of the business we envision, we will ensure our ability to appropriately staff the capital introduction team. Differentiating factors for boutiques might include a more consultative, hands-on approach with clients as well as a broader network of investors given the client base.

SS: Lighthouse Prime has had a fantastic year in terms of capital introduction through a unique set-up of manager-investor events and by delivering some excellent clients to the institutional investor audience. Being recognised for our capital introduction services at the *HFMWeek* Service Provider Awards has not only benefited us in terms of credibility but also in terms of attracting more established hedge funds. This, in turn, has benefited our smaller clients as we are now able to attract more investors and so, are able to present them to investors who they might not otherwise have been introduced to.

HFMWeek: How important is it to establish relationships with other hedge fund service providers? How does this benefit the fund in question?

SS: I see it as a core tenet of having a successful boutique prime brokerage. Too many people are trying to be too many things at once – I think that it is important to recognise what your key strengths are. Moreover, it is important to have a consultative approach – if a fund, especially a new or start-up fund, approaches us want-



ing advice on audit, administrative or legal services, we need to be confident that we have several service providers that we are happy to recommend.

GD/SF: The friendly environment that exists between services providers, such as accountants, lawyers and administrators, as well as prime brokers, has certainly made it easier for managers of small or start-up funds to find their way through the myriad service providers available to them. Not only do we at Jefferies advise our clients to go out and interview a number of different service providers before making their choice, but we also help them compile a list of possible prospects as some do not, at that stage, have the wherewithal to know who they should be looking at.

NK: A thorough understanding of the specific product offering and capabilities of the various service providers – and Cantor's ability to work effectively alongside them – provide our clients with a strong support network to help manage their business.

HFMWeek: How does the US boutique prime brokerage market compare with that of Europe? Do you anticipate this changing in the future?

NK: The boutique model has gained little popularity in Europe. Most boutique primes relying solely on the introduced model have predominantly domestic (US) client bases. That may change in the near term, but for now it does not appear that clearing banks are actively pursuing non-US based boutique prime brokers, as the business model just does not exist in any meaningful sense today.

GD/SF: Due to the regulation in Europe, the funds there tend to be larger upon start-up which is, naturally, more conducive to the larger prime broker market – as such, there are relatively few boutique prime brokers in the region. In comparison, the US hedge fund market is far more conducive to smaller boutique prime brokers and as a result, the boutique prime market exceeds that of Europe.

SS: While the US boutique prime brokerage market is currently more evolved than the Europe market, I firmly

anticipate a bigger presence by US boutique firms in Europe. The model is very clearly proven to work here and this, alongside the overall growth in the industry, reinforces my belief that there is still a big call for the service model overseas – especially for the overseas fund which are trading in the US.

HFMWeek: Looking forward, how do you expect the boutique prime broker market to evolve in the future?

SS: I strongly predict a lot of consolidation within the industry. While the general consensus is that there is plenty of business to go around, it is clear that the stronger boutique primes are going to flourish. Looking ahead to 2010-11, I expect that we will see a lot more start-up funds and as such, there will be many opportunities to service a number of these funds. However, that said, as boutique primes continue to evolve in terms of service provision, it is going to be increasingly cost-intensive, and with funds becoming more and more sophisticated, those without the sufficient backing to really build out their offering and keep it competitive are simply not going to be able to survive.

NK: One can make the case for consolidation in the sector. While there seems to be a large increase this year in terms of new entrants into the space, it is not clear how all can survive and prosper. Those that will see their businesses thrive, will at a minimum need to add or enhance capabilities, including: multi-asset capability across a range of investment strategies; a broad array of financing, custody and execution solutions; and bespoke technology and customised, high-touch client service.

GD/SF: There are currently somewhere between 20 and 25 boutique prime brokers operating in the US and as this is likely to be more than is needed in the market, we anticipate that there will be some consolidation in this area. Nevertheless, there is still certainly a market for boutique prime brokers that provide outstanding service and these will be the firms that will continue to operate and that will prosper in the future. ■