May 2017

McLagan Announces New Prime Services Offering

Rumours of the death of prime brokerage are exaggerated. An industry whose entire business model was brought into question by the introduction of the Basel III capital adequacy regime – and the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) in particular – has not just survived the rising cost of capital but is thriving in spite of the constraints.

According to data analysed by McLagan, eight leading prime brokers had collective revenue of $16 billion in 2015, and direct margins that averaged 85%. But within those aggregates and averages, there is a wide disparity in terms of performance. The biggest prime broker has 4.5 times the revenue of the smallest, and the most profitable prime broker enjoys margins 15% above those of the least profitable.

Of course, the LCR and the NSFR have not left the hedge fund clients of the prime brokers untouched either. In particular, investment strategies that rely on the financing of short positions and copious amounts of leverage consume more of the balance sheet of a prime broker, rendering them less profitable after capital is taken into account.

In the last few years, all of the leading prime brokers have reshuffled their client portfolios and re-focused their business on the clients that offer them the highest returns. The prime brokers that have managed this transition successfully are now outperforming their competitors in terms of both revenues and profits – and by wide margins.

It is to explain these wide disparities in performance that McLagan has today launched a new service aimed at prime brokers and their clients, which integrates four different data sets.

The first is ten years of **financial data**, right down to cost centre level, collected directly from the general ledgers of the leading prime brokers. This offers users penetrating insights into how revenue, expenses and productivity vary between firms, and where investment should be increased or reduced.

The second is **compensation data**, collected directly from human resources departments of the leading prime brokers. This enables users to compare headcount numbers, compensation, roles and levels across every function in prime services, providing vital data on market pay and staff mix.

The third is **hedge fund revenue and expense data**, drawn from an annual survey completed by hedge fund management companies. This enables hedge fund managers to compare what they are earning and spending – on staff, prime brokers, administrators, lawyers, auditors, data vendors and others – with their peers.

The fourth is a pair of **customer satisfaction surveys**, in which hedge funds assess the services of their prime brokers, and the findings are matched with self-assessments by the prime brokers. This allows prime brokers to find out what their clients like and do not like about the services, and empowers hedge fund managers to compare the level of service they receive with their peers.

There is no charge to take part in the surveys – there is no pay-to-play– but the data operates to a give-to-get model.

Importantly, every hedge fund manager that completes a questionnaire will receive a complimentary report that benchmarks their views of their prime brokers with those of other users of the same firms.

Every one of these services is also available on a stand-alone basis, though McLagan insists that the real value lies in integrating the four sets of data.

“For prime brokers, our aim is to provide fresh insights into the strengths of their hedge fund franchise and competitive position,” explains Keith Amos, co-lead of McLagan Investment Services. “The best way for us to do that is by integrating information about revenues and operating, capital and liquidity costs, with what employees are paid, and what customers think of the products and services they receive – and what products and services they would like to receive in the future.”

Dominic Hobson, co-lead of McLagan Investment Services, points to the benefits for hedge fund managers. “Managers are able to benchmark their revenues and costs against a peer group, and assess the level of service they receive from their prime brokers relative to other managers using the same firm,” he says. “At bottom, managers are competing for assets to manage, and one way in which they can compete more successfully is by managing their service providers and their costs of doing business better than their rivals.”

Steven Sanchez, a director in McLagan Banking & Capital Markets, agrees. “There are compelling reasons for hedge fund managers to support this initiative,” he says. “Not only will they be able to compare their cost and revenue structures with their peers. They will find out if they are being super-served by their prime brokers, or under-served by them. We think both of those things are worth knowing.”

Shelley Eisenhandler, a partner in the Asset Management practice at McLagan, adds that interest in the annual hedge fund expense, staffing and productivity survey has never been higher. “Our data enables managers to compare expenses at the level of the fund as well as the management company,” she says. “In an increasingly cost-conscious and transparent environment for the industry, the ability not just to manage risks and costs, and manage them downwards, but also to show that you are doing the job better than your peers, is an important tool in securing institutional allocations.”

Ready to learn more? Contact our team today to receive an overview and survey access.

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