



**Global
Custodian**

PRIME BROKERAGE

Merlin Makes Its Mark

Merlin prime brokerage is out to show mid-sized hedge funds that you do not have to be a mega fund to get great service and top-notch technology

VARIOUS estimates put hedge fund assets at \$1 trillion and the number of funds at 8,000—numbers that do not appear to be heading south anytime soon. Hedge funds not only continue to be attractive to money managers today, but they seem to be even more attractive in the future, according to the Cerulli Associates report “Hedge Funds: The Market for Absolute Return.” Admittedly on the bullish side, Cerulli says hedge fund assets could more than quadruple by the end of the decade.

Alternative investment managers will no doubt welcome the continued flood of new capital. But with SEC registration, and the threat of new regulation always on the horizon, hedge funds will be looking for partners to provide not just clearing, settlement, custody and stock loan—the traditional province of prime brokers—but also a degree of technology and reporting that before now was only available through third-party technology vendors and fund administrators.

Enter into the fray a new player in prime brokerage and risk and attribution services: Merlin Securities.

While the firm may be new, the names behind the operation are as old as prime brokerage itself. Running the show is Steve Vermut, who made a name for himself in prime brokerage first as a partner and managing director at Furman Selz and then as the founder of San Francisco-based Montgomery Securities, which was sold to NationsBank in 1997.

Vermut most definitely left his heart in San Francisco, choosing to stay there following NationsBank’s acquisition of Bank of America, as he built the prime brokerage business for the combined group. His head, though, has been decidedly fixed on the prime brokerage business through all of his career transitions. “Prime brokerage came about because people wanted one custodian so they could trade with the Street and have everything clear back to one place,” Vermut says. Hedge funds got more sophisticated and the prime brokerage industry developed along with them. “As hedge funds grew, the biggest firms went to a multi-prime set-up and the mid-size funds added a second prime,” he adds.

All of which created a problem for hedge

funds and ultimately their end investors: How do you consolidate the information from these multiple relationships, get the best execution and still maintain such essential services as stock loan? A problem for some, perhaps, but for Vermut it was a market need: a provider to connect these multiple prime brokerage relationships under one platform.

“What happens in a multi-prime world is that you need to consolidate your data,” he says. “If you manage \$8 or \$10 billion dollars you can do it yourself. However, at \$1 billion dollars you’ve got 30 or 40 people on your staff, and you’re paying rent and other expenses. Your cash flow may not allow for off-the-shelf technology and dedicated staffing.”

With the idea in hand, Vermut decided to come off the Napa golf course to get the old gang together to bring his idea to fruition and start the next wave of prime brokerage. The old gang included Rob Davis and other familiar faces such as Andy Lando, Chuck Brama, JP Muir, Eric Morgan, Gary Kniffin, Regina O’Neil, Denise Genovese, Brant Williams and Sammy Lo. The com-

mon thread running through all their careers was Montgomery Securities and Vermut's market-changing mantra back then.

Building the System

The Merlin team knew that there was a market need for a firm to provide performance attribution by consolidating the data that multiple prime brokerage relationships produce. To build this system, the Merlin team went to some potential clients to ask them what was going to matter to them. During these early visits, a common theme emerged: there was a decided lack of service from the established prime brokerage providers who allowed the arms race for the top 250 hedge funds to take them to the point where it was all about the size of the broker's balance sheet and less and less about client service and technological offerings.

"This focus on the top hedge funds just doesn't make sense to me," explains Vermut. "There is such a large, underserved market of mid-sized hedge funds that make very attractive clients to us. These are hedge funds utilizing single and multiple prime brokerage relationships that require more on the performance attribution and risk-analysis side."

However, the reality is that most major prime brokers are changing the way they do business, going after only the largest hedge funds clients. Vermut says this creates the aforementioned vacuum of prime brokers servicing the middle tier of hedge fund clients; which is a band that he says encompasses hedge funds from \$100 million in assets on the lower end to \$2 billion on the top end. It is in this band that he sees a market for a service offering of quality customer service and top-flight technology.

Make no mistake about it—Merlin does not suffer from delusions of grandeur. Rather than competing for all of a hedge fund's multi-prime brokerage business, Merlin likes to position itself as a complimentary piece to the overall service offering. Vermut and his team want to be the single source for performance attribution and risk analysis so that a

hedge fund can optimize their multi-prime relationships. This allows Merlin to shadow the other prime brokers, thus establishing itself as "the prime of primes," for reporting through its MerlinSHARP platform.

"Fund managers need attribution reporting, risk analysis and the ability to generate daily exact performance across multiple prime brokers. We have developed MerlinSHARP to address these issues and to allow the hedge fund manager to focus on what is important: managing money," explains Vermut. "We complement and overlay the other prime brokerage relationships and pick up the data analysis and reporting headaches that a lot of the hedge funds are demanding now."

Technology

While customer service is meant to differentiate Merlin, it is the technology that Merlin believes truly sets it apart from both the large and small prime brokerage providers.

To build the proverbial better mousetrap, Merlin tapped Amr Mohamed as its chief technology officer, where he is responsible for the firm's portfolio and risk reporting system. "The technology is very much the center of what we are all about," says Mohamed. "We differentiate ourselves from other prime brokers by delivering reports same day. We have eliminated the overnight process, so that once we get a file from our clients and match them with end-of-day pricing feeds, our reports are immediately available." Merlin hopes to have it reduced to true real-time by the end of the first quarter 2006.

Hedge funds today are having regulatory spotlights swept into their previously darkened corners, putting an onus of transparency on them that will put more emphasis on greater, more detailed reporting. Combined with the growing sophistication of their investor base, specifically the large institutions, hedge funds will have to provide greater performance and risk analysis. Merlin understands well the increased pressures that hedge funds are facing, as well

as their desire to provide data to their investors.

"Our technology serves a portfolio manager's many needs. We not only created a system that helps them better manage their portfolio, it also helps them manage and grow their business," says John Quartararo, who joined Merlin after serving as Montgomery Securities and Banc of America's marketing consultant in San Francisco. "Because of the depth of analysis and customized reporting features, a hedge fund manager can be more relevant to their limited partners and potential investors one minute and more relevant to their colleagues and strategic partners the next minute."

This new platform is not just about reporting; it is also meant to help the hedge fund manager better identify their sources of alpha, customized to their individual needs. "Managers want to see where they are making their money by different variables: They want to see the fund broken out by sector or by market cap; they want to see it broken out by analyst or by trader; they want to see it broken out by individual portfolio or on a consolidated basis," says Vermut. "And they want to be able to take the data, put it in different buckets and analyze each bucket."

Merlin is so confident in its technological prowess that it simply packages the system in with its prime brokerage product offering, with the idea that clients will be so impressed with it that they will be inclined to transfer more business to the prime broker. "Once the manager has the global view, they can run customized performance attribution and risk analysis on the whole portfolio," says Vermut. "If a traditional prime broker does 10 things, they do seven or eight of them really, really well, but we do two or three things better," he continues. "Hire us, and you can make your staff more productive, stop the growth of your infrastructure, get better performance numbers, service your investors better, enhance your marketing and compensate your people appropriately because now you know who is producing the results." **GC**