

By Martin Steward in New York, Financial Times
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A solution to the need for consolidating information

Large hedge funds are likely to have four or five core prime brokers, plus satellite providers. So what is the most efficient way of dealing with so many disparate sources of vital information?

The bigger funds can afford to buy or develop the software to consolidate it all and hire the staff to bring it into a spreadsheet. But for those running less than about \$2bn – most of the industry – one answer might be: prime of primes.

That may be one reason Merlin Securities, which provides a prime-of-primes solution in the form of its MerlinSharp platform, was named by the Global Custodian 2007 Prime Brokerage Survey as number one prime broker in North America for single strategy funds and for funds under \$100m, and the favorite prime broker for firms with less than \$1bn in Alpha Magazine's 2007 Small Firms' Favorites Awards.

"As times have gone by managers have found additional reasons to go multi-prime, but the hurdle is the complexity," says Stephan Vermut, co-founder and managing partner of Merlin Securities. "The concept of prime of primes is that in a multi-prime world there is difficulty in bringing all of a hedge fund's positions, performance data and transactions back together into one system so the manager can use it, in the form of shadow reporting, for risk management and attribution."

Merlin, founded in 2004, saw profits and revenue rise by more than 100 per cent in 2005 and 2006 and recently sold a \$20m stake to Sequoia Capital as it continues to expand. Its MerlinPrime product suite provides a single prime broker package of advanced reporting, trading and operational services, including risk and performance attribution analysis. But it is the MerlinSharp platform that sets Merlin apart from the competition.

A fund manager authorizes MerlinSharp's proprietary technology to produce a shadow report for every transaction with each of a fund's prime brokers, taking in granular data showing all the underlying long and short positions, and loading them on to its system on a tax-lot basis so the system gets not only the trades for each day but all the interest dividends and other bookkeeping entries that apply to the portfolio.

This enables the fund manager to create customized baskets of data that can then be used to produce targeted performance reports aggregated across the fund's custody and prime broker relationships.

"If the fund manager has multiple baskets, it is more of a challenge to do that internally, and no custodian or prime can do it for the assets held with another custodian," Mr. Vermut says.

It also preserves the confidentiality hedge fund managers crave for their positions – a main drive towards the multi-prime model – because, unlike the investment banks housing most prime brokers, Merlin Securities is independent and has no prop trading accounts: orders are executed on an agency basis.

The aggregation of data should facilitate much more rigorous and comprehensive risk-analysis.

“We’ve seen interest growing every day but for different reasons,” says John Quartararo, head of sales and marketing. “Portfolio managers want a better sense of where their risks are and they are not necessarily able to do that with five different prime-broker reports. And the more sophisticated investors want to know whether or not their managers are drifting on strategy and they don’t want to get apples and oranges reporting to figure all that out.” But the clearer picture of performance attribution might also help with the bottom line.

“I think what it does is it frees the manager from having one prime and gives him options to go out and shop for product and price elsewhere,” Mr. Vermut says. “He can take advantage of the full resources of the Street to better manage the product he’s receiving and the price he’s paying for it.”