



CORGENTUM

Hedge Fund Operational Due Diligence - Understanding Your Hedge Fund's Approach To Prime Brokerage

Hedge funds interact with a number of different service providers and trading counterparties during the course of their daily operations. One of the most important of such service providers are prime brokers. Entering into relationships with one or multiple prime brokers presents a hedge fund with the opportunity to make a number of key operational decisions. These choices can have long lasting ramifications on both the operational efficiency and overall profitability of the entire hedge fund organization. In addition to the complexities of the actual prime brokerage agreements which a hedge fund will enter into, there are a number of other operational considerations related to prime brokerage which investors should inquire about during the operational due diligence process including:

Utilizing Multiple Prime Brokers:

Many hedge funds have sought to dilute their exposure to any single prime broker by diversifying their counterparty risk via multiple primes. Utilizing multiple prime brokers can also mitigate funding liquidity risk and create backup capabilities for processing items such as corporate actions. A multiple prime brokerage environment can also present a series of unique operational challenges for hedge funds including:

- How has the hedge fund revised its trade allocation policies and procedures for a multi-prime environment?
- Has the hedge fund been pro-active in sharing information among primes or rely on hearsay reporting?
- Are the fund's systems adept at receiving, aggregating and sharing fund data from multiple prime brokers?

Introducing Prime Brokers:

- Does a hedge fund work directly with a larger prime broker or are they working through any intermediary parties such as introducing prime brokers?
- Is the use of introducing prime brokers economically efficient for the hedge fund? What are the fee structures in place between the hedge fund, introducing prime broker and the ultimate clearing broker?
- Is the hedge fund clearing any trades through an introducing prime broker who might self-clear as well? If so, how is this relationship monitored for any potential conflicts of interest which might arise?

Bundled Services:

- Does the prime broker offer any other so-called "bundled" services? If Yes, do these services include:
 - Capital introduction
 - Stock borrow
 - Risk reporting capabilities
 - General business consulting services
 - Investment research
- Does the hedge fund pay any additional fees for these services or are they built into existing fees?
- If a hedge fund begins giving less business to any one prime, will any complimentary services no longer be available? Has the hedge fund become reliant on these services? If so, how will the hedge fund adapt?

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