

# Choosing your next Prime Broker

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October 21, 2019*

Choosing your prime broker (PB) or futures clearer (FCM). Sometimes you know who to use – there is a preexisting relationship, perhaps spinning out from your existing shop, and the decision is simple. Other times, you may be unsatisfied with your existing prime, you’re launching a new product, or you may be structuring a product for multiple underlying managers and looking to house them all at one PB for cross margining or other efficiencies.

For any new or existing hedge fund this can often be a daunting task. How do you go about looking around the street? How do you make the right decisions? Steps below are a helpful guide on how to frame that discussion.

## **1. Know Thyself - Determine what you are looking for and why**

First step is to have a clear understanding of what your needs are. Perform a Self-Assessment. Manager must sit down and clearly articulate the strategy, trading needs and objectives. For instance (portfolio composition, sectors, turnover, use of leverage, shorts, technology, reporting, etc.). This will largely be driven by the type of strategy you are running. For instance, an equity long short manager will need a PB with a strong balance sheet and short borrow sourcing, who can provide competitive rates on longs and shorts. A CTA strategy will need a strong FCM that can provide competitive clearing commissions, access to exchanges, and also has good

execution. For all of these, other factors also come into play, do you need a PB/FCM that provides other good bundled services such as Cap Intro, Advisory, Research, etc.

## **2. Identify internal stakeholders and determine what is important to them**

As part of step 1 above, it is important to involve internal stakeholders from different groups (traders, ops, legal, risk and compliance). A wholistic approach should be taken when selecting a provider.

## **3. Approach candidates to advise and see what information is relevant to them**

Develop a list of potential providers and begin discussions. At this stage, this is pre-RFP. Get a sense as to how they view you, what services they can provide, and what information will be relevant to them to get you a proper RFP response and pricing. What they will need will depend on products in scope:

- Equity PB: Financing needs, gross/net leverage, execution volumes
- Futures: Trade volumes/turnover + Execution (open to executing with FCM if not already doing so; if so, in what portion)
- OTC Derivatives: Notional Amounts

In all cases they will need your marketing deck, a sample portfolio, an understanding of the turnover, and where/how you intend to execute. It's crucial to have a strong and clear marketing deck so that the PBs understand your strategy well. It is also vital to tell a good story so that even if you are not that important to the PB in terms of revenue, the PB will believe in your growth potential and seek to grow alongside you. A PB will be more likely to support a manager in such cases.

#### **4. Prepare RFP questionnaire**

You can start with the AIMA standard DDQ (most PBs will already have these ready to send to you), and then add questions which are specific to your needs.

#### **5. Send RFP. Provide clear deadline.**

Simple enough – be very clear on the deadlines. Make sure to provide enough time. Try to send all information at the outset so as to not send things later and risk needing to provide an extension.

Many PBs will also offer (or should offer) to come make a presentation to your offices. Depending on how you run the RFP, you could use this for the top providers. You should also visit the finalist PB onsite to meet the team who will be covering your account.

#### **6. Create Grid for key points in decision making**

Now, we are starting to get to the fun part. This grid will serve you well to rank and sort between providers as information starts coming in. Here are some suggested categories (Services Required, Pricing, Operations,

Onboarding, Creditworthiness, Legal Terms and Relationship Management)

Some additional points to be factored into your decision:

##### **a. Relationship with PB. It's a partnership.**

Not to be underestimated, but it is crucial that there be solid relationship and foundation with you PB. This is a core service provider. It is important to build relationships across organization (senior management, sales, client services, risk). Does the PB understand the business of the manager and their objectives. Does the PB value the partnership. There is no sense in going to a big name prime broker if they will not give you the care and attention you need. A strong relationship will be crucial in times of market stress.

##### **b. Diversification. Multi-Prime.**

Using more than one Prime Broker is important from a counterparty risk and business continuity perspective. However, this will depend on the size of manager. Splitting revenues across PBs is not ideal when the wallet is small - this could create a barrier to getting a solid PB. In selecting your PB, it is important for them to understand if you will be multi-prime and if so, how you will share the wallet. This is a discussion that should be had early in the process.

#### **7. Review RFP responses and rank service providers**

RFP is now closed, and you should be drowning in information. Take time to review and start ranking/scoring based on the categories. This summary table

will be critical when looking at it all together.

Circulate information internally to stakeholders. Suggest holding one initial meeting to go through high level, and then a second meeting where decisions is made. At the first meeting, additional questions or concerns will likely be raised, so leave time to then go back to PBs.

## **8. Make decision and advise all candidates**

The fun and the hard part. All candidates selected will be over the moon. Those which are not retained however will be

disappointed and it is crucial to advise them in a professional and thoughtful way. A phone call in advance of an e-mail is highly recommended where you can provide them with helpful feedback. They will be interested in knowing why they were not retained and how they compared. Where they were strong and where they were weak vis-à-vis the competition. Make sure to thank them, again, for all their time and effort (because they probably spent a number of days/weeks on this). It is crucial to maintain those relationships even with those not selected as the street is a small place and you may work with those people or institutions in the future.

## Contact

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