

Hedge Fund Integration - The Challenge

Elliott Ross Associates was invited to pitch for a high profile banking project. The project's internal sponsor was the Board Member for Investment banking who requested a proposal detailing the statement of qualification, track record and approach in supporting the bank initiate and build-out a bank internal hedge fund. This was a flag ship project for the bank.

Following the proposal and selection process, Elliott Ross Associates was retained to identify a buy-side credit business which could sit alongside a sell-side bank credit franchise. The aim was to implement an internal bank hedge fund program. The initial strategy was to be credit L/S.

Given the buy-side emphasis to the search, ERA engaged its alternatives strategic partner, Corbiere to assist in both the research and the execution of the mandate.

Elliott-Ross Associates embrace the challenge

The buy-side market was duly researched, providing the client with an overview of credit proprietary desks and hedge funds both in terms of historical returns and business/individual profiles. The research and review of the businesses led to a document which illustrated a number of key facts. For each business reviewed, ERA detailed the following;

- *Strategy insight;*
- *Track record/absolute USD returns;*
- *Risk adjusted returns – VaR driven for bank proprietary businesses and volatility/Sharpe ratio driven for hedge funds;*
- *Professional overviews by team member;*
- *Professional motivations by team (capital driven, pay-out driven).*

The output was a document detailing each business, compiling the relative merits. The bank duly reduced the long list of target businesses to a short list of preferred teams. In parallel, at the time of the sell-side ERA search, Corbiere was advising a hedge fund in terms of growth opportunities. The fund alpha comprised five portfolio managers and analysts located in the US and UK with additional analytical support situated in India.

This fund, a credit long/short alternatives platform with AUM in the region of USD200Mio was experiencing a period of investor redemption despite strategy-relative upper quartile returns. The redemptions followed the parent company corporate action – a protracted MBO. Investors do not appreciate corporate uncertainty.

Corbiere's review of the buy-side credit strategy sector suggested that there were multiple opportunities. These opportunities comprised (i) drawing down start-up, seed capital from institutional investors, (ii) forming the UK 'beach head' strategy for a large US multi-strategy fund and (iii) absorption into a traditional asset management firm looking to launch an alternatives business.

Before further researching the market opportunities and embarking on a business marketing process on behalf of the team, Corbiere had undertaken a detailed review and due diligence of the existing fund and its team members: It is essential that the

*business offering is both clearly understood and the value proposition is consistent with the presentation made by the fund manager;
To this end, the following areas were researched and documented;*

- *Investment Philosophy;*
- *Investment process;*
- *Risk management;*
- *Operational efficacy;*
- *Returns track record;*
- *Personal references and testimonials.*

The results of the review were fed back to the fund manager who incorporated the analysis into the proposition pitch book – produced as part of the business marketing program.

At this point in the process, Corbiere introduced the hedge fund to its strategic partner, Elliott Ross Associates, thus allowing the fund to investigate the sell-side opportunity.

Elliott-Ross Associates Delivers Cost Effective Alpha

The due diligence undertaken by Corbiere coupled with ERA's understanding of client requirements led to fast track discussions - culminating in a structured offer for the hedge fund team.

The bank secured a business with;

- *Proven, auditable track record;*
- *High profile fund managers;*
- *Pay-outs net of costs (fully loaded seat and funding);*
- *Pay-out triggers – upside and down-side. With accompanying knock-outs based on minimal expected performance;*
- *An option on investment allocation/capacity on any future spin-out.*

The bank secured a business without;

- *Having to guarantee long term bonuses;*
- *To overhaul the operational support – this was a 'plug and play' business;*

In turn, the hedge fund team were offered the equivalent of;

- *USD500Mio hard capital equivalent;*
- *Sayanora clause – allowing the business to spin-out of the bank at a later date;*
- *Hard pay-out formulae;*
- *Leverage agreements (by product);*
- *Financing agreements;*
- *AUM growth targets (by performance).*

The transaction was duly completed. Within, one year the fund was able to build the business to around USD2.5BN.