FINANCIAL NEWS ONLINE US
Securities & investment banking
www.financialnews-us.com

Law firm advises using multiple prime brokers

Renée Schultes

08 Apr 2008

Hedge fund managers should appoint more than one prime broker to spread risk in case one of them fails, according to a prominent financial services law firm.

Schulte Roth & Zabel issued the advice after the near collapse of Bear Stearns last month led to a run on the bank's assets.

The law firm, which represents 2,200 hedge funds and 550 investment management firms with about $400bn (€255bn) in assets, said in a circular to clients: "Customers should consider establishing multiple prime broker accounts… both to spread risk and to facilitate rapid transfer of assets if one broker shows signs of an imminent failure."

Although the appointment of multiple prime brokers is standard practice among large hedge funds, guidance from a law firm is significant, according to industry specialists.

John Tavss, a partner in the investment management group of law firm Seward & Kissel in New York, said: "Hedge fund managers have a duty to be diligent in providing safe custody of their clients' assets.

"Managers should obtain information about how their prime brokers are structured, what their balance sheets look like and what insurance they have. But I do not believe having one prime broker is necessarily better or worse than having two or three."

Tavss said hedge funds had long addressed the issue of counterparty risk but his firm had received more questions from clients on the topic since the collapse and rescue of Bear Stearns and other financial crises.

Daniel Caplan, co-head of global prime finance for Europe at Deutsche Bank, said: "The industry has gone back to basics from a financing perspective.

"Hedge funds and their investors are much more focused on counterparty risk, leading to technical questions about how we fund ourselves."

Two pieces of US legislation, the Bankruptcy Code and the Securities Investor Protection Act, seek to protect customers of failed institutions but neither affords the customer the certainty of a 100% recovery.

Bear Stearns, which is a large prime broker to hedge funds, was bailed out by JP Morgan Chase last month.