

Small is beautiful

By Dermot Butler

Given the flurry of acquisitions that have taken place in Dublin's hedge fund administration market over the past few years, as leading international banks have added administration of alternative assets to their custody and long-only fund servicing businesses, you might be forgiven for thinking that the industry was now dominated by global behemoths and that smaller niche providers had been squeezed out.

It's true that the acquisition of specialist hedge fund administrators such as Hemisphere, Bank of Bermuda and Tranaut by leading traditional service providers including Bisys, HSBC and JP Morgan has certainly brought institutions into the business in a big way. However, reports of the death of the independent administrator have definitely been exaggerated.

It's easy to see why acquisition is an attractive route into the market for global financial services groups. Clearly they have come to the conclusion that hedge fund administration involves a different mindset and range of skills from traditional mutual fund administration, with its huge volumes and much more straightforward asset valuation processes.

There's a stark contrast to hedge funds, with their complex transactions and fee structures, administration issues such as performance fee equalisation, and valuation procedures that may involve seeking prices from three or four brokers for particularly sophisticated and exotic instruments. Not surprisingly, the big institutions have decided that it would be more economic in the long run to acquire the expertise of a firm that's been in the business for a long time, along with its book of business, than to develop their own operation from scratch.

But one consequence of hedge fund administrators becoming part of much bigger institutions is that these larger groups do not understand, and are not interested in, what



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they deem to be small, or relatively small, accounts. Their business models are not designed to accommodate them – and their idea of a small account is a fund with assets of \$100m, while a relatively small account is \$200m.

However, authoritative sources estimate that some 70 per cent of all hedge funds in the world have less than \$100m in assets. The result in Dublin is that as some of the big players get bigger, the relatively small independents such as Custom House, Olympia Capital and a couple of others are seeing their business grow rapidly on the back of surging business from small funds and especially start-ups, which would otherwise find servicing hard to obtain at an affordable price.

Not only are larger administrators less attuned to the needs of smaller funds and especially start-ups, but inevitably these acquisitions and mergers lead to teething problems in areas such as IT integration. But there are often cultural issues too at companies that were happy to exist as independents in their own right, but now have become a small part of a huge global institution.

There is plenty of anecdotal evidence in Dublin that these cultural questions can be an issue, not only for staff of what were formerly entrepreneurial independent firms, but also for their customers, who are used to enjoying a close relationship with a smaller team that knows their business well.

They are also likely to become disillusioned if the merged entity starts to suffer from higher staff turnover. In an environment where skilled and experienced hedge fund administrators are very much in demand, an appreciable movement of staff away from the big firms has been evident – another reason to believe that their smaller rivals can continue to look forward to a successful future. ■