Up for the challenge

David Geffen tells SLT why he decided to look past BlackRock and go it alone with the launch of his new hedge fund consultancy firm, Geffen Advisors

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How was the decision made to start Geffen Advisors?

Shortly after my departure from BlackRock, I had the opportunity to work on a hedge fund launch as an advisor. That project took place while I was beginning to consider my options for my next professional challenge. The advisory role I took on was a very positive experience and led me to explore opportunities in hedge fund consulting, among other opportunities. The more I explored this market segment, the more I was convinced that areas where I wanted to focus (treasury management, counterparty credit risk management, hedge fund launches) were not currently overcrowded, and I perceived there was room for another capable firm in each area. I became very enthusiastic about the idea.

After exploring the possibility of joining existing hedge fund advisory firms, potentially to start a new practice area, I concluded that the best route for me was to set up and lead a completely new specialist firm. I expect the hedge fund industry to continue to be robust, and I expect that hedge fund managers will look more than ever to external parties for advice and the outsourcing of functions so that they can keep their staffs lean and focus on what they do best—investing. The initial areas where I am focused are areas where I believe I can add significant value, where I know very capable people who can join me to build the business as it grows, and where I will enjoy what I am doing.

Did your Wall Street experience help in the firm's creation?

While I have had roles over the years that had tremendous amounts of infrastructure support, I have also had roles where I built completely new business groups within established firms. For me, building a business from scratch is in many ways similar to building a new business group in an established firm so I am applying those experiences to my current launch In addition, my decade of marketing to clients and prospects at Citibank, which included hedge funds, was excellent relevant experience.

While at Citibank, I also had many opportunities to work with my client base to address business challenges they faced. My time at Goldman Sachs, overseeing hedge fund credit risk and working very closely with the prime brokerage and OTC businesses, also was extremely relevant to what I will be doing as I proceed. At Goldman Sachs I collaborated with many internal business units to solve problems they faced in growing their businesses, as well as to tackle important issues for clients of the firm.

How can hedge funds manage their prime brokerage activities effectively?

Prime brokerage is complex. No matter how much you think you know, there are always additional levels of complexity to be explored. One of the most significant challenges that many hedge funds face is identifying areas in which outside expertise would provide value to their organisation. While some of the largest hedge funds have hired full-time treasurers or portfolio finance teams to focus on these issues, the number of funds that have the capacity to do this comprise a very small percentage of the overall hedge fund industry.

One of the products that will be a key component of my firm's offerings is a diagnostic review service that is targeted to firms that use prime brokers but don't have an in-house expert. As the product name implies, this will involve visiting a hedge fund, looking at the way it currently operates in this space and making recommendations on areas where it may want to improve its practices. A second challenge, even for the more sophisticated firms, is putting in place the right technology to consolidate useful information and provide for better analytics and decision making around prime brokerage activities.

Five years ago, a hedge fund would have needed to build its own technology tools to obtain and use relevant information on their desktops with some regularity, to the extent such information was even available. Thankfully, today there are very capable providers that can provide excellent information on a daily basis at less cost than the cost of building and maintaining such technology in-house. I am working closely with one such provider, HazelTree, and they have some sophisticated technology available in this realm for hedge funds.

Did the collapse of Lehman Brothers, etc make hedge funds and prime brokers reassess their relationships?

One major impact resulting from these events was that many hedge funds started to rethink who they do business with and how much credit risk they are willing to accept to any single counterparty. Certainly Lehman Brothers and MF Global, as well as Peregrine and even Refco, are all recent reminders of the importance of focusing on mitigating the credit risk inherent in a hedge fund's prime brokerage and broader trading relationships. Beyond the impact I mentioned already, many hedge funds have taken steps to investigate a broad set of options available to them to reduce counterparty credit risk, and then made thoughtful decisions about which options to implement.

Some firms now set limits on how much credit exposure is acceptable for each counterparty, actively monitor these exposures as well as the creditworthiness of the counterparties, set internal policies governing who is responsible for the monitoring and the relevant decision making, and do a deep dive from time-to-time to ensure they really understand the credit risk inherent in the PB and clearing structures they are using.

However, most hedge funds are still only doing some of this important work, either because they do not recognise its value, or they lack the expertise or the funding to do it more completely. I'm optimistic that Geffen Advisors will be well positioned to assist firms in both identifying areas for improvement and filling the gaps for some firms on an ongoing basis.

Are you seeing much of an increase in 'prime custody'?

'Prime custody' is an important option for hedge funds to consider as they investigate ways to reduce their prime brokerage counterparty risk. I believe prime custody is here to stay, but I don't believe there is widespread use of 'prime custody' models or that there has been much increase in usage recently. Why? While prime custody can work effectively for some hedge fund strategies, it doesn't work for all strategies. Additionally, prime custody is expensive, it is operationally complex, and many people still believe that prime brokers continue to do a better job processing corporate actions than custody banks. Having said all that, where a hedge fund's strategy is conducive to a prime custody solution, I always encourage the fund to explore the option to understand what is available and to determine if it is an appropriate choice for them to reduce their fund's counterparty credit risk. **SLT**

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