Fireside Friday with...

Mark Aldoroty of BNY Mellon's Pershing

With the global pandemic radically changing the way hedge funds operate, combined with the high profile collapse of Archegos Capital, Mark Aldoroty of BNY Mellon's Pershing explains how prime brokers will have to stay on top.

Over the past year, hedge funds and prime brokers have had to dramatically alter the way they operate, establishing new communication lines and workflows in order to keep on top of volatile markets and increased margin calls. Hedge funds have also had to rapidly adapt to a virtual environment when raising capital for new strategies.

Yet what has most notably grabbed headlines this year has been the collapse of the US family office Archegos Capital, and the knock-on effect it has had on the prime brokerage industry.

Mark Aldoroty, head of prime services at BNY Mellon's Pershing, outlines how prime brokers have stayed on top to ensure the smooth running of operations, and whether recent market events will cause the industry will review their risk and financing processes.

GC: What were some of the biggest workflow changes between hedge funds and prime brokers last year, and will they continue throughout 2021?

MA: The biggest change we saw was transition from the office to WFH that certainly could have been different. We were lucky to have everyone up and running, with securities financing and trading up. For clients it depended on their ability and flexibility to transition – whether it was new for them, if they had to change their communication mechanisms, and we saw hedge funds rely on their prime brokers more for information and data. That will continue for the foreseeable future, depending on how quickly they return to their main office, is it full time or flexible, and we also seen some funds relocate from New York to other parts of the country.

What also occurred in 2020 is with industry people no longer getting together at events, obtaining market intelligence is very different, and some hedge funds relied on their prime brokers differently to get broader view. Furthermore, we have seen capital introduction take on a new form – with due diligence between investors and fund managers historically carried out at the office, this is not always true anymore, so a prime broker can facilitate that and answer questions on how the hedge fund operates for investors. In addition, market volatility has continued, with an increased need to understand portfolio liquidity. This has prompted some hedge funds to connect with their prime brokers differently.

GC: What new strategies are hedge funds looking to target and how are they looking to raise capital?

MA: We carry out a cap intro flash poll survey, and our research has shown equity long/short remains the most popular strategy. However, we have seen SPACs and ESG continue to be popular, with a huge push from both people who had historically traded SPACs and those that are new to it. With capital raising – while networking is gone for the time being – funds have had to shift fundraising in a different way through intermediaries and cap intro teams of prime brokers. We have held virtual events and set up high quality meetings for targeted clients. It has taken a bit of time for people to get comfortable with the virtual format, and we have tried to be mindful to not engage clients with meetings that are not suited for them.

GC: With more demand from allocators for their hedge funds to expand into private markets and adopt hybrid structures, how can prime brokers support these moves?

MA: We have seen hedge funds enter the private equity space, while also mutual funds launching more of a hedge fund structure, and vice versa. Over time, structures have evolved and our goal is to keep pace with that. As investors take different ways to allocate, we need to stay in step with that and grow along with it.

While prime brokers are usually focused on public markets, being owned by BNY Mellon, which has a large fund admin and custody business that caters for the private equity side, allows clients to use both Pershing and BNY to cover both sides of their strategy. It is also another place for the cap intro teams to be helpful, where we are speaking with investors that have that view into the private markets expanding the remit of our cap intro team. That may continue.Historically, the liquidity and funding of public market is different to private, one could argue SPACs are somewhere in the middle. For us, it is working with our counterparts within BNY Mellon Asset Servicing that are active in this space, and where we can help raise capital for new and existing funds.

GC: What was your reaction to the collapse of Archegos and do you foresee any long-term implications on the prime brokerage industry?

MA: There have been market events in the past that has caused people to review their businesses and their risk profile/client base. Recent market events have caused prime brokers to do this once again, and while some are comfortable with the business, others are reviewing this. Any large-scale event that changes the way people operate will have a lasting effect. We may see regulatory changes regarding risk disclosures and reporting, while firms may look to improve their risk tools and transparency with clients.

It is also understandable that we may see changes in the amount of risk a prime broker takes on, but that should be an ongoing process. It has not stopped for us in any way – we feel very comfortable with our clients and our risk profile, and we are not looking to make any dramatic shifts.

GC: How will prime brokers further look to safeguard their business for the future?

MA: Some will have to change who they are lending to and to develop a greater understanding of the risk in those portfolios. The industry may need to recalibrate their risk/reward ratio. However, I think the core of the prime brokerage model will stay the same – different firms may take different views and will review the right position for them going forward.