

Content Includes:

Preqin Special Report: Hedge Fund Service Providers

February 2014

Managers Changing Service Providers

We examine key trends among managers that have changed service providers, including breakdowns by region.

Why Are Managers Changing Service Providers?

We explore the reasons behind hedge fund managers switching their service providers, including what service providers can do to keep relationships with their clients strong, as well as attract new business.

Preqin's Hedge Fund Services

Preqin's online services help thousands of professionals in the hedge fund industry create new relationships between service providers and hedge funds. We provide more information on how Preqin can help you with your business needs.





Changing Needs From Service Providers by Hedge Funds

Service providers, such as administrators, prime brokers, custodians, auditors and law firms, provide invaluable services to managers in the \$2.6tn hedge fund industry. In the wake of the credit crisis, and also following the fall out of the Lehman collapse and the Madoff scandal, the use of independent service providers has become indispensable and the industry has grown and innovated in the intervening five years.

However, fund managers often selectively change their existing group of service providers as their funds grow and their needs evolve. At the end of 2013, Preqin conducted interviews with over 100 fund managers to find out more about whether they had changed service providers and what had prompted the change.

Switching Service Providers

Fig. 1 shows the proportion of fund managers that have changed service providers split by the regional headquarters of the fund manager. In the past 12 months, a third of all fund managers have changed a service provider, with Europe- and North America-based fund managers being the most active in switching service providers in 2013. Over longer time frames, 41% of fund managers have reported that they have changed a service provider in the past five years (excluding the last 12 months). Europe-based fund managers showed a reduced need to change service providers over this longer period, as just 30% changed service providers in the five years preceding December 2013, compared to 55% of Asia-Pacific-based funds and 46% of North America-based funds.

When looking at the types of service provider that managers have changed over the two time frames (Fig. 2), it is fund administrators and prime brokers which are the most frequently changed by fund managers. In both time frames, over half of all fund managers which had reported they had changed a service provider had altered their outsourced administrator or prime broker. When looking at a regional level (Fig. 3), Europe-based fund managers

Fig. 2: Service Providers Changed by Hedge Fund Managers Within Each Time Frame

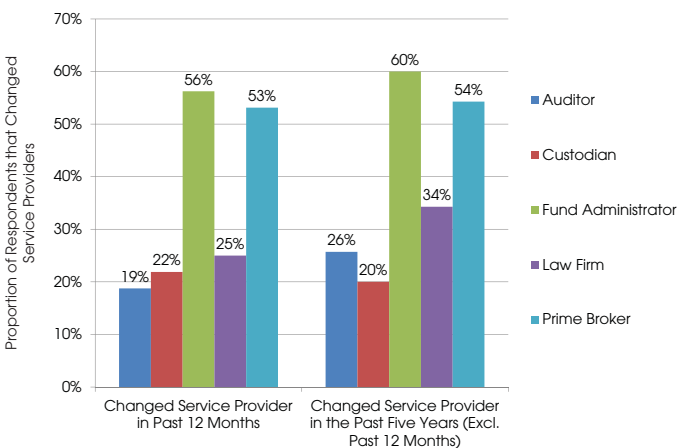
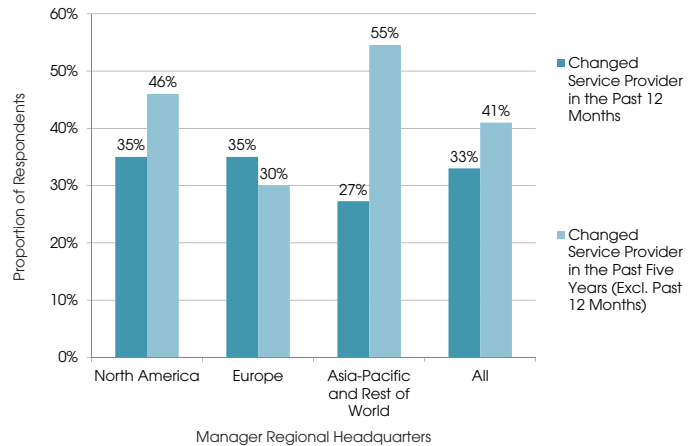


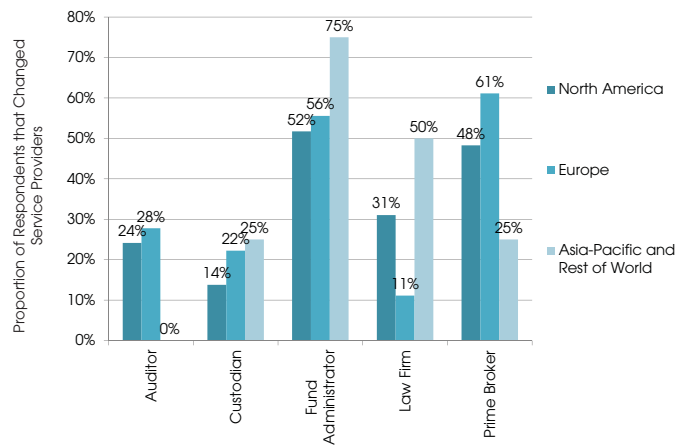
Fig. 1: Proportion of Fund Managers Which Have Changed Service Providers by Regional Headquarters



have been the most active in changing prime brokers over all time frames, with funds based in Asia-Pacific and Rest of World the least likely to change these service providers; 61% and 25% of respondents based in Europe, and Asia-Pacific and Rest of World respectively changed their brokers. With the large choice of prime brokerage houses in Europe, funds in the region have more options to switch to a provider that can better fulfil their needs, compared to those fund managers in Asia and Rest of World, which have more limited options available to them. On the other hand, Asia-Pacific and Rest of World-based fund managers are the most likely to change fund administrator; three-quarters of all the fund managers in the region have switched their administrator.

Overall, fund managers are least likely to change service providers that provide custody or auditing services, particularly in the shorter term. In the longer term, approximately a third of all fund managers that reported they had changed a service provider had changed the firm that provides legal services for their funds. Asia-Pacific

Fig. 3: Service Providers Changed by Hedge Fund Managers by Regional Headquarters in the Past Five Years





and Rest of World-based fund managers in particular are more likely to switch law firms (Fig. 3) – half of all the Asia-Pacific and Rest of World-based managers that responded they had changed their service provider specified they had switched law firms.

Why Change Service Providers?

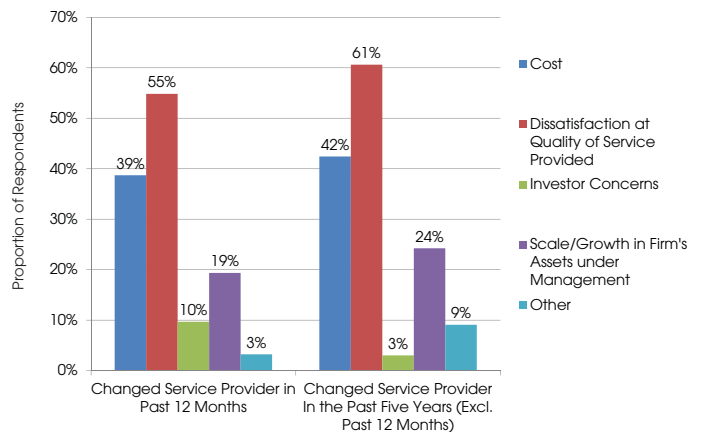
Over each time frame shown in Fig. 4, dissatisfaction with the quality of the service offered by a service provider is the leading reason behind fund managers changing their service provider. Although fewer fund managers gave this as the reason they changed service providers in the short term, indicating managers have seen some improvement, there is still clearly a long way to go for many service providers in keeping hedge fund managers satisfied with the quality of service they receive. Asia-Pacific and Rest of World-based fund managers in particular reported dissatisfaction with the service offered by their service providers; 86% stated this as a reason for changing one of their providers (Fig. 5). As these emerging regions for hedge funds continue to grow in prominence, service providers will need to re-evaluate their services in each region and ensure they are able to offer the same quality and reach of fund services as they do in the established European and North American markets.

Next to dissatisfaction with the quality of the service they received, cost is the next leading cause for fund managers to switch their service provider. In the current environment, fund managers are being squeezed between investors looking for lower fees and rising costs as a result of investor demands, increased technology demands and the new cost of compliance. As a result, fund managers are becoming ever more conscious of looking for value for money when assessing the service providers that work on their funds. In North America, concerns around cost are less frequently cited as a reason for them to switch service providers (Fig. 5). For these North America-based fund managers, the changing size of the fund/issues around scale are the greatest concern, with this being the only region where fund managers expressed this as a reason for switching service provider. North America-based funds have had the greatest success in fundraising over recent years, and as their funds grow, many funds have switched to service providers that are better able to cope with their larger capacity.

The changing make-up of a fund's investors can lead to a change in service providers they use; a third of all funds which reported an increase in the amount of capital coming from institutional investors in the past 12 months stated that they had changed service providers in the past year, and a significant 70% of those funds that had seen a reduction in the amount of institutional capital in the past 12 months had switched service provider. Differing groups of investors have different needs and requirements from fund managers and also differing levels of information requirements from the service providers that work with these groups. Therefore, as funds move from managing predominantly capital from private wealth to institutional capital (and vice versa), it is often necessary to switch service providers to one that is better able to cater to these investors.

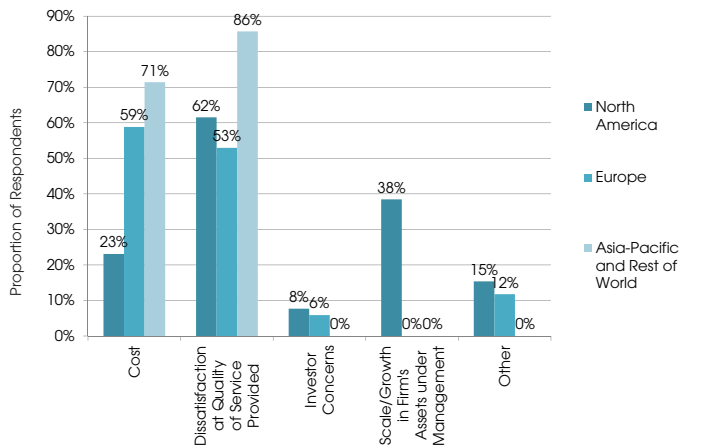
Significantly larger numbers of fund managers reported that they had changed their services providers in the past 12 months as a result of investor concerns, as compared to the equivalent fund

Fig. 4: Reasons Why Fund Managers Have Changed Service Providers Over Each Time Frame



Source: Preqin Fund Manager Interviews, December 2013

Fig. 5: Reasons Why Fund Managers Have Changed Service Providers by Regional Headquarters



Source: Preqin Fund Manager Interviews, December 2013

managers that had changed service providers in the four years previous to that. Fund managers are continuing to pay attention to investors' demands and concerns in the current competitive fundraising environment. Although changing service providers can be costly and time consuming, managers that can satisfy investor needs and calm their concerns by switching service provider will likely be the ones to gain and retain investor capital. Other reasons why fund managers changed service providers included risk diversification post-2008, fund restructuring, or that the service provider no longer offered services in their geographic region.

Outlook

Our study of fund managers shows that many hedge funds change their service providers; 45% of the respondents indicated that they had switched service provider at least once since their fund's inception. Some fund managers change service providers regularly, as their needs change, as their investors change, and as they strive to keep fund management economical.

Fund managers switch service providers for a variety of reasons, and fund managers in different regions have differing needs which lead to changes in the service providers they use. Dissatisfaction



with the quality of the service they receive is a common concern across all fund managers, and is clearly an area where groups that provide services to funds can improve. This is a particular problem in emerging regions for hedge fund management, Asia-Pacific and Rest of World, where the service provider sector may be less developed, or has little local presence. There is certainly an opportunity for groups that can provide consistent, good service on a local level to appeal to this growing group of managers in Asia-Pacific and Rest of World.

Fund managers are also conscious of cost and scale when looking at service providers. For Europe- and Asia-Pacific and Rest of World-based managers, cost is a particular concern. Funds in Asia-Pacific and Rest of World are typically smaller and newer than their counterparts in Europe and North America and there is a need to keep costs low, particularly when trying to keep fees at a competitive level. For Europe-based managers it has been a challenging few years in terms of fundraising and the new regulations in the region have made it more costly to run hedge funds; these managers are conscious of the need for service providers to provide good value for money.

On the other side of the Atlantic, North America-based fund managers find the need to switch service providers as their funds grow to those that are better able to cope with their scale. As a result, there is a clear opportunity for different types of service provider, particularly in the administrator and prime brokerage sectors, which can provide services to funds of different sizes, or are specialized in providing services for funds of a particular size. It is also important for service providers to offer good value for money, particularly in an environment where the overall costs of running a hedge fund are increasing and investors are making calls for fees to be cut.

The data in this report is sourced from interviews with a selection of the 5,285 fund managers profiled on Preqin's [Hedge Fund Analyst](#). Details include their relationship with the 273 fund administrators, 134 prime brokers, 196 custodians and 352 law firms tracked by Preqin.

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- ▶ **Target** new business opportunities using our full contact details data.

Hedge funds are using Preqin to:

- ▶ **View** profiles of over 1,100 fund administrators, custodians, prime brokers, auditors and law firms working with hedge funds.
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- ▶ **Reach out** to new service providers using our full contact information.

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Source new investors for funds

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Identify potential investment opportunities

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Find active fund managers in hedge funds

Search for firms operating hedge funds. View information on key contacts, assets under management, performance history, key investment preferences, known investors, and more.

Benchmark performance

Identify which fund managers have the best track records with fully customizable performance benchmarks and view performance details on individual named funds and share classes.

Examine fund terms and conditions

Access fund-by-fund and industry level fund terms and conditions data for individual hedge funds, which provide a market overview, enabling you to see the current trends for specific strategies, structures, sizes, and more.

View detailed profiles of service providers

Search for active administrators, custodians, prime brokers, auditors and law firms by type and location of funds and managers serviced. Customize league tables of service providers by type, location of headquarters, and total known number of funds serviced.

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