The Stability of Wealth

Demystifying the Bank Platform Channel

The Understanding Allocators Series

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Jefferies

The Stability of Wealth

Flows to alternatives from retail are near an all-time high

Saying that the past 16 months have been volatile would be an understatement – in all arenas. Market performance, professional functionality and all of our emotional states have been on a rollercoaster ride since news of the pandemic broke in Q1 2020.

Many managers during Q2 2020 were concerned about redemptions and how to sustain their business. Allocators that were traditionally thought to be some of the more stable capital were particularly challenged during this time as universities might not open and elective surgeries were unlikely to continue for an undetermined length of time. Most groups had never priced in a non-revenue generating period and needed to think about the portfolio's fund requirements and liquidity needs. Looking back, the stickiest capital during this volatile time stemmed from wealth management and bank platforms that seemed to have more patience as they had long duration capital, could take more illiquidity or more free cash on hand.

At its broadest level, wealth management is an investment advisory service that addresses the financial needs of affluent clients. Wealth management businesses can include bank platforms, wealth advisory and RIA channels in addition to wire houses. In the industry, "bank platforms" and "wealth advisory channels" can be used interchangeably, but there are some nuanced differences we wanted to define at the beginning of this piece. For the purpose of this discussion, while both bank platforms and RIAs offer comprehensive wealth management, retirement and investment solutions to affluent and high net worth clients, we will define a bank platform as a sleeve of a private banking division which tends to have a brokerage structure whereas wealth advisory firms tend to be smaller, independent and boutique firms with financial planning and estate structuring as their primary focus with investment and asset management offerings, usually charging a flat fee on assets under advisement (AuA).

The wealth management channel is going to continue to be a source for alternatives allocations. Given the record number of mergers and acquisitions in the wealth management sector in 2020[1] combined with the steady capital base, **Jefferies believes the bank platform and wealth management channels are an important allocator vertical for managers to penetrate.** Wealth management continues to be a massive engine of economic growth for bank platforms. Bank platforms capital tends to be more-sticky given the time-consuming research, diligence and onboarding process, which incorporates multiple stakeholders. Additionally, the longer the relationship between the platform and the manager, the harder it can be for the relationship to be severed or replicate that distribution line.

> **Many managers have shied away from engaging with bank platforms due to its historical opacity. While Jefferies sees the benefit in partnering with all allocator verticals, in *The Stability of Wealth*, we wanted to demystify the bank platform allocator channel, discuss the key players in the ecosystems, address the incentives of each stakeholder, elucidate on what tends to be negotiated and highlight the benefits of partnering with wealth management channels.**

Jefferies has interviewed over 50 individuals throughout the bank platform ecosystem at over 20 bank platforms in addition to a number of marketers that have experience covering the bank platform channel to better understand this allocator vertical. We believe a better understanding of how bank platforms are structured and how stakeholders within are incentivized will provide managers with another tool to grow assets and better diversify their limited partnerships. *The Stability of Wealth* encourages managers to engage with bank platforms by offering some transparency into a traditionally complex and impervious allocator channel to navigate.

Not All Bank Platforms are Created Equally

A Short History of Wealth Management Channels

Most wealth management businesses started within banks as conduits for their own asset management platform and many have spun out to create smaller, more boutique and independent firms. The top 10 asset managers only account for 35% of market share, making it the most fragmented industry globally after capital goods.[2]

COMMON MISCONCEPTION #1 – Manager Selection

Many manager researchers were thought to simply be rubber stamping managers that were originated by trading desks, financial advisors and firm wide relationships. It was not about the "best" product per se, but instead the driving force was the bank relationship that determined what was approved and funded. While relationships within any organization can always be impactful or move the needle towards an investment, today, manager researchers are way more in control of sourcing, diligencing and approving managers based on investment opportunity and merit.

When bank platforms started launching wealth management channels, most firms created master feeder fund structures to grant alternatives access to their high-net-worth (HNW) clients who would not be able to invest otherwise due to high minimums.

Most platforms started with an equity and fixed income offerings and slowly diversified into alternatives including hedge funds, private equity, venture and eventually direct deal flow. Today, larger platforms will typically have over 50 hedge fund relationships across strategies while the smaller platforms tend to have more like 10 to 20 manager relationships. While hedge funds are the focus of our research, there tends to be more mutual funds and private funds on bank platforms given the transparency and lower minimums of mutual funds and the frequency of private approvals needed to accommodate demand and new raises given time sensitive closures. Diversification of products and client demand for alternatives have led to continued growth in the space.

What is the bank platform business model?

While banks offer a variety of ancillary services, we will be focusing on the investment and portfolio capabilities. Most bank platforms offer three primary lines of business including: an internal outsourced CIO (discretionary), an advisory business, and family office services that tends to be more focused on more off the radar deals and short "shot clock" investments.

Bank Platform Investment Services		
Outsourced CIO (Discretionary)	Menu Service (Advisory)	Deal Flow

Bank platforms tend to act as brokerage business that sometimes charge clients an advisory fee (flat or based on assets under advisement) and other times are commission based. Banks with more global HNW clients noted that European AuA tends to flow towards the holistic private banking model whereas in the US, clients are more transactional and focused on the advisory / menu model. While the scope of this piece is focused on the US, there are notably more independent advisors in the US than in Europe and Asia.

KEY TAKEAWAY #1
Unlike a family office, the challenge these platforms face is how to create a commercial business while providing customized services.

Like the family office vertical, bank platforms and wealth management channels are diverse and heterogeneous investors that have similar goals with nuanced structural differences. While bank platforms and wealth management firms are trying to leverage economies of scale to create one platform to fit all underlying clients' needs, they are still responding to individual customers that require unique needs at different investment time horizons. Unlike other institutional asset owners that are predominantly driven by finding the right investment product that achieves a specific investment objective, bank platforms must balance overall performance with the broader commerciality of their offering. **In other words, how can the manager research group, the distribution force (if applicable) and the financial advisors work together to create a funnel that is**

wide enough to include enough investment opportunities to fit all needs while also making it economical for the business to run?

The Bank Platform Ecosystem

Who are the key players?

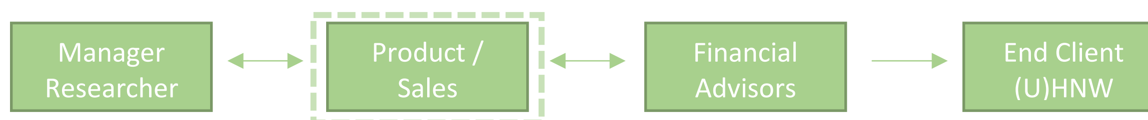
There are four primary players that typically exist in the bank platform ecosystem including the **manager researcher, the sales and product team, the financial advisors, and the high net worth end clients.** Navigating the four-legged stool that is these key decision makers throughout the manager approval process can be challenging as each group usually does not report into the same person or committee or have the same objectives.

The **manager research** team consists of a group of individuals within the organization responsible for sourcing and diligencing investments. Manager researchers can be generalists or have a product or strategy area of focus. Manager researchers are responsible for creating a tool kit or menu of products for the advisors to sell to their end clients.

The **product and sales team** help with distribution and liaises between the manager and financial advisors. This role's responsibilities vary the most firm-to-firm. There are a variety of names for this team including product origination, investment counselor or sales and distribution force. In any case, this team is focused on bridging the gap between the manager research team and the financial advisors by building product awareness to financial advisors and understanding the needs and commerciality of products to be sold to the end clients. This team can be responsible for some of the negotiating and structuring of funds once IDD and ODD have been completed. Depending on the organization, these teams can have a less active distribution role and more of a reactive product specialist role, responsible for knowing about the investment opportunities the bank offers as opposed to manager specific information.

Financial advisors (FAs) are responsible for managing the HNW relationships and knowing all of the bank's product offerings and how it may relate to the client, which can include legal, insurance, estate planning etc. There are a variety of names for the financial advisors across the different platforms, which can include banker, "FA" and field consultant.

The **end client** in most of these investment platforms are high net worth families and individuals. Almost all platforms defined high net worth individuals (HNW) as those with less than $20mm in investable AUM while ultra-high net worth (UHNW) is typically defined as over $20mm in AUM[3]. Some firms will also work with endowments, foundations and other institutions. For the purpose of this paper, we will refer to the end client as high net worth individuals



(HNW).

How do these functions work together?

Now that we have defined each of these roles, we will address how these key stakeholders work together as each of these groups are part of the same team, but also have different reporting lines and are therefore not always incentivized in the same way. It is important for managers to understand the nuances of each team members role in order to be as effective as possible.

Some platforms have a centralized product and sales force, sometimes referred to as a "home office" that acts as a unified point of contact, articulating the key bullets on strategies and new managers generated from the manager research team as well as conveying FAs strategy needs to the manager research team for new searches. Most of the time the manager researchers will execute on the sourcing in addition to the diligence and monitoring once approved, however ideas can also be sourced through the product team or financial advisors.

With platforms that have an internal sales team, once the manager has been approved, the fund's marketer shift focuses from selling and updating the manager researcher to educating the sales representatives and targeting the FAs with clients that have more active alternatives exposure. Whether it is from the manager researcher or the sales team, FAs are usually looking for a summary of the manager, performance, bullets on why to add that fund to the HNW portfolio, and how that fund fit with other managers on the platform. Most platforms ask for high level information (usually a pitchbook and fact sheet) and tend not to ask for position level or thematic trade information as they tend to be more performance driven. FAs have responsibilities outside of monitoring investments and so tend to rely heavily on the internal salesforce and manager research notes more than institutional investors to understand hedge funds and alternatives.

For platforms without distribution efforts, the manager research team and financial advisors tend to work more closely together, and manager researchers can act as the product specialist directly liaising directly with the HNW, spending almost 50% of their time educating FAs, creating pitch and marketing materials and interacting directly with the end client.

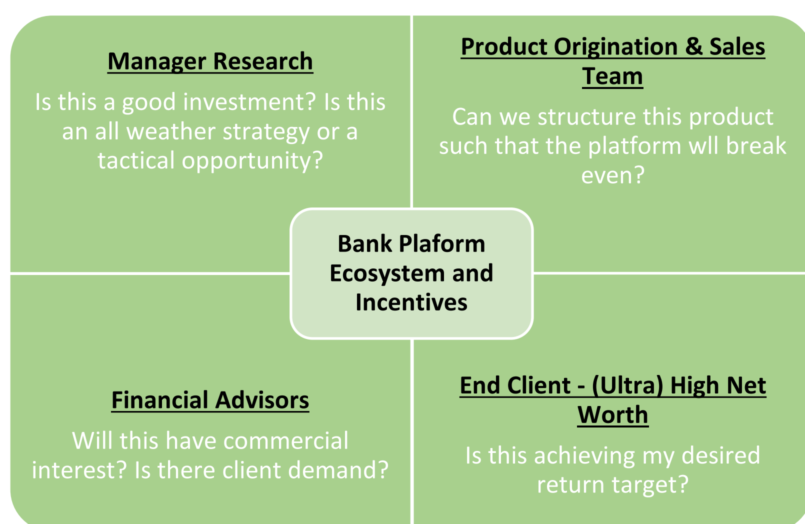
While the piece will not deeply explore a divergence in regions, it was worth noting that platforms with a non-US end client base consistently noted that financial advisors tended to guide more of the strategy decision making process through demand-based assessments.

No platform has a better process than another – they are just different. As such, understanding the key stakeholders, what each need is, and how to effectively communicate the needs of each party while optimizing everyone's time is critical for success.

Aligning the Bank Platform's Incentives

Each of the four stakeholders mentioned above have different incentives which can be at odds during the manager selection and funding process. Across most platforms, there was always collaboration between the manager research team and the financial advisors; however, it can be hard to disentangle what the manager research team believes is the best investment opportunity (what will make the most money) and why the FA wants to put the product on the platform (what will sell the easiest). Manager researchers are focused on finding the investment opportunity with the *best* risk adjusted returns whereas financial advisors are focused on products that are *good enough* investment opportunities that can be sold to end clients. In addition, the product sales and origination teams want to bridge the needs of the manager researchers and FAs, but also need to make sure it is structurally viable for the platform. Depending on the end clients' investment objects, HNW wants strong absolute or risk adjusted returning products.

While both stakeholders have fiduciary responsibilities to put the best investment on the platform, "best" is a relative term and what is good for one FA and her clients might not make sense for all.



Most platforms pay financial advisors based on assets under advisement (AuA) regardless of asset class, however, some firms pay FAs an incentive fee based on the performance of their investment choices[4]. While FAs do not have apparent incentives to put a client in one asset class versus another, there are reoccurring revenues associated with longer locked capital. Given recent perceived outperformance of privates, HNW have been putting more capital to work within private equity as part of their alternatives' asset allocation. However, one could argue that FAs are incentivized to stay more liquid as hedge funds pay annually or quarterly while private equity pays at the end of the lifecycle of the fund.

Now that we have covered the key stakeholders, how they each work together and how they are incentivized we will shift gears to better understanding how a manager gets sourced to getting approved and ultimately a successful allocation.

Three Step Approach to Platform Approval

Every platform has a unique manager **sourcing, diligence, and onboarding** process, but there are similarities across those three steps to getting an allocation.

Sourcing – How do you find them?

As previously discussed, sourcing new investment opportunities can come through a variety of channels including the manager research team, the product origination team and the financial advisors and HNW clients themselves. The most traditional channel is through the manager researchers whose primary responsibility is to identify unique and high risk adjusted returning investment opportunities and begin the bottom-up quantitative and qualitative research on each manager. However, the product origination and distribution team as well as financial advisors can also act as a sourcing engine for idea generation and help to identify key trends and themes or manager specific suggestions to the manager research team that may be more commercial for sale to the end client.

While a manager's pedigree and past performance does not guarantee future returns, performance does sell. The manager research team must balance researching and approving the best investment opportunity with what can be sold to and funded by the end client.

KEY TAKEAWAY #2
The manager research team must balance researching and approving the best investment opportunity with what can be sold to and funded by the end client.

Diligencing – How do you get them to take notice?

The manager research team is solely responsible for the investment due diligence (IDD) which can take 6 -18 months (if not more). Like many LPs, diligence consists of qualitative and quantitative analysis, meeting with investment and non-investment professionals at the GP through on-site meetings and virtual calls, in addition to reference calls. Some platforms have dedicated operational due diligence (ODD) teams in house, but a number of platforms and many wealth advisory channels outsource that function or have the investment team run it as well. Both the IDD and ODD are critical parts of the investment process and must occur sequentially or simultaneously in order for a manager to be considered for approval and funding.

Once the IDD and ODD have been completed, a member of the manager research team presents the fund to an investment committee to be approved. The investment committee is usually comprised of a variety of business and strategy heads throughout the bank. Throughout the process, there tends to be continuous dialogue between the manager research analysts and the investment committee in order to better leverage the team's time and understand not just whether the manager and strategy is a fit, but also how to size it, capacity needs, and investment structure. **The more transparent a platform was about the process, the better the relationship with the manager seemed overtime.** Not all investments that are presented to the committee get approved and even once approved the onboarding and funding process is a whole other progression.

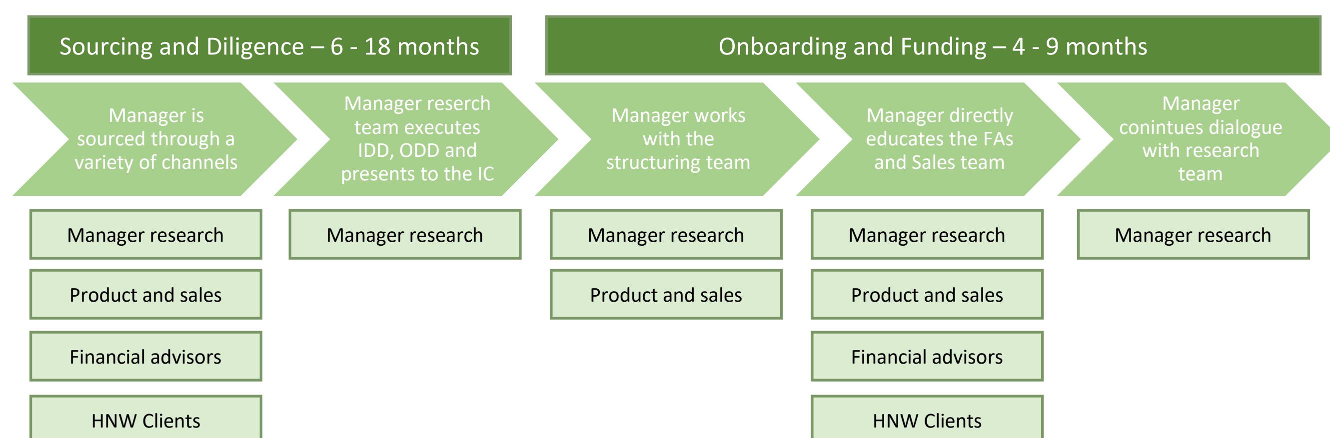
Setting Funding Expectations

To the Bank Platforms: In order to garner more interest from managers, bank platforms should be more transparent about the process (IDD, ODD, and funding), setting expectations around timeline and roadblocks in addition to more clearly emphasizing key touch points along the way.

To Managers: Given the complexity of the onboarding process, managers should ask the platform questions like:
- What other funds are coming to market around the same time?
- Will there be other funds (public or private) that will also be getting funded at the same time that may compete with capital that could go to our fund?
- What does the next 6-12 funding calendar look like?

During the diligence process most IDD groups will proactively address the touchpoints that must be negotiated (usually fees and capacity with minimum ticket sizes are the biggest areas of focus especially for the wealth advisory businesses with smaller average client sizes). Like many other LPs, the ODD team will enter into the diligence process mid-way through the IDD process. Usually, a separate operations team will execute the fund structuring and negotiations in conjunction with someone on the distribution team after the IDD and ODD has been completed. **This part of the timeline is important to note as a manager can go through IDD and ODD be approved, but if the structuring was not discussed, the manager may not be able to onboard to the platform**.

While bank platforms try to garner indications of interest from the FAs during the diligence and onboarding processes, **nothing is ever a guarantee**. When bank platforms make allocations to a hedge fund manager, that LP has not pre-emptively raised the assets that will fund a manager in advance (unlike a private equity investment with a closing date). Most platforms hope to raise a base amount of capital within a certain period of time. Most bank platforms were looking to raise at least $100mm within the first 12 to 18 months with an ideal size of $250mm by 3 years.[5]



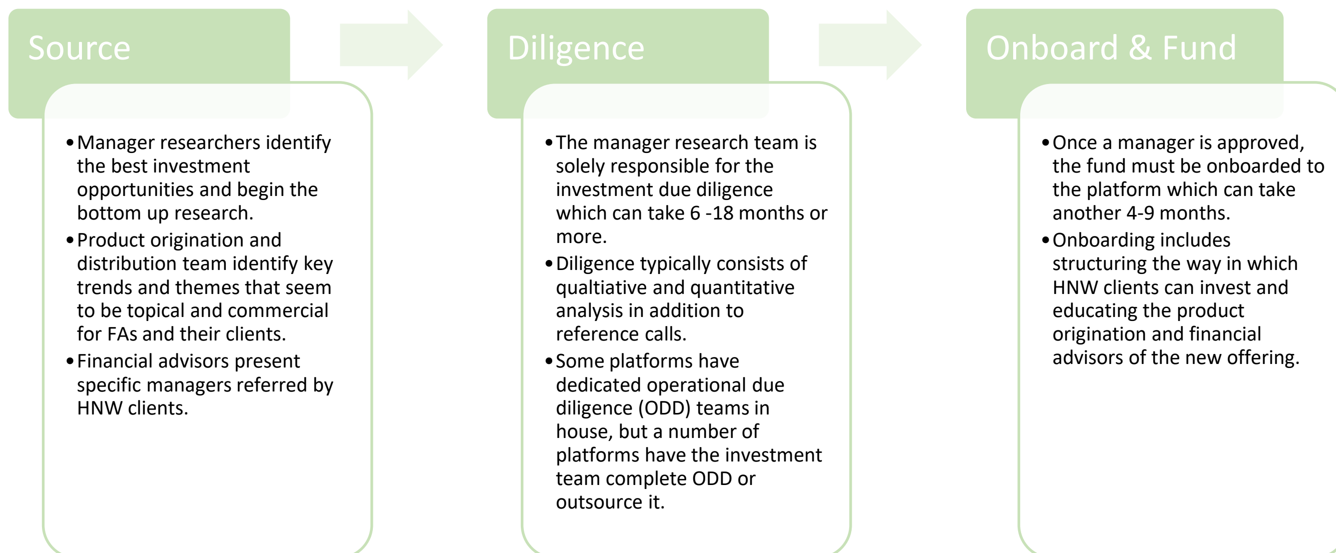
While all platforms hope to hit that capacity within a specific period, most groups will not end a relationship with a manager once approved if the fund does not hit asset raising targets assuming the strategy and other due diligence assumptions are still in place. Moreover, most platforms will not close the account unless having the open account is running at a deficit. **Structurally, this is why bank platform capital tends to be so sticky and stable.** Because banks have a time consuming and laborious onboarding process, these platforms tend to be more patient compared to an institution.

Unlike institutional LPs that approve an investment and immediately fund, bank platforms tend to have a gap between the investment committee approval and the date of funding, which can take 4 to 9 months on average. Once an investment committee gives the stamp of approval to fund a manager, two things need to happen: 1) the onboarding team must create and open the appropriate fund structure that allows for HNW clients to make investments and 2) the manager research team must educate the distribution team and financial advisors of the new offering.

KEY TAKEAWAY #3
Bank platforms capital tends to be very sticky and stable given the time-consuming research, diligence and onboarding process, which incorporates multiple stakeholders.

Onboarding – So you're approved…now what?

When a fund is newly onboarded, there is always a product education call with the "home office" for the benefit of the FAs. These calls are followed up with materials that cover the FAQs and key talking points about the manager's strategy investment. There can be more frequent calls after the initial launch for continued education on products available to clients. Many FAs seemed to be focused on the importance of direct relationships with marketers and access to the CIO than the investment itself. Specifically, FAs seemed to like to have annual access to the CIO via update call and then the marketer could lead any other update calls.



Are Bank Platforms the Right Fit for Me?

Not at all bank platforms are created equal

Managers are increasingly waking up to the benefits of a bank platform partnership as manager think more about business diversification and capital base stability. Now that we have given you an overview of the bank platform ecosystem and the approval process, we wanted to pause and give the manager a moment to assess whether a partnership with a bank platform could make sense for them.

Most marketers understand that while wealth management platforms are all created differently, each has benefits and disadvantages. There are numerous gate keepers that can make it challenging to get onto the platform and unlike other LPs, once on the platform, there are more hurdle to unlock that capital source as time still needs to be spent selling to the FAs. However, once unlocked, that capital is sticky and usually there to stay.

KEY TAKEAWAY #4
It's a two-sided partnership…While the bank platform is interviewing the manager, the manager should be interviewing the platform as well.

Like many manager to LP relationships, when assessing wealth management partnerships, the team should focus on creating a partnership – understanding the firm's investment philosophy and firm culture and communication style. When engaging with platforms, **the three biggest concerns for managers tend to be fees, fund structuring and sales effort needed.**

Do we want to share fees? Managers should think about whether the firm wants to share fees at all (and if so, will having that arrangement violate other MFNs). Managers should not be put off by "fee sharing" as a concept simply because the manager needs to give up some of the firm's fees. These fees are used to compensate the FAs and the operational set up to the platform can be costly. For example, when you break down the economics, if a platform says it typically invests $100mm with a 50/50 split on a 1.5% / 20% shareclass (platform gets 75bps), that is effectively $750k to the manager in management fee revenue. As such, the manager can think of that one platform investment as paying for the cost of a senior marketer's annual salary. Managers and platforms tend to be more willing to engage when the manager already has a shareclass with a low enough management fees to add a basis points to the fund's management fee. The HNW clients could always invest directly into the fund, but most cannot write large enough checks; as such, the trade-off for the HNW is higher fees for lower minimums.

How do we structure the deal? Managers can structure a deal with a bank platform through feeder funds, a new shareclass or direct investment. Bank channels can give access to HNW clients by launching master feeder structure

(while more costly for the platform, it puts the operational burden of reporting on the manger). Pending the structure of the deal, the manager may need to hire additional employees or inquire about an outsourced relationship to handle the added operational intensity.

Fees	Structuring	Sales Force
• Am I open to sharing fees? If not, can the platform charge a fee on top? • If so, how far can I lower the fees (assuming a certain capacity) to make it worth the discount? • Do I have an MFN in place that could be a challenge? • Are there other poinsto be negotited to make up for lowering the fees?	• Would the platform prefer a master feeder fund structure or new share class? Or does the platform need to invest directly? • Is there a maximum capacity I am willing to give the platform?	• If I am willing to split fees with the platform, what additional distution help will I be getting? • Will adding the platform require an additional resource to be hire? If not, how much time will manging this relationship take away from other prospecting and investor relations functions? • If we are onboarded, what other managers are in line to get funded and who else does the platform plan to bring to market in the next 6 months?

How much blocking and tackling will need to be done? The manager should consider how much time the marketer is going to spend with FAs once the fund is approved. When the platform has a distribution team, there is less day-to-day and hand-to-hand combat needed with FAs. Education of some level will be required whether directed at the sales force or the FAs and can range from an overview manager's strategy to general information on alternatives and their purpose in a portfolio. Marketers will need to triangulate which FAs have HNW clients that are more active alternatives investors. More time will need to be spent going to regional bank offices and presenting to FAs than marketing to institutional investors. Understanding the right FAs to spend time with requires more sales hustle and less product specialist communication.

It is hard to penetrate the FA community within any bank platform given the sheer volume of FAs at most banks (there could be 10 FAs at some of the boutique firms and 17,000 FAs at some of the larger bank platforms). Managers need to be strategic about coverage given the differences in financial advisors' footprint.[6] For example, some wholesalers have enough representation to focus on specific counties or zip codes in the US. Mutual funds are a scale game whereas hedge funds need to be more strategic. Many FAs prefer to recommend privates over hedge funds as they noted that they do not need to "deal with mark to market returns and its locked up capital"; however, selling hedge funds are more liquid, but typically commands a more sophisticated investor base.

FAs are going to sell what is easiest to sell (based on performance, ability to articulate the strategy, ease and access to information etc.…), so the most successful marketers are those that are frequently in front of FAs and provide simple clear and digestible datapoints for the fund's competitive advantages.

Penetrating the Smaller Wealth Advisor and RIA Communities

The wealth management space is very fragmented and hard to sell to, specifically the boutique and independent RIA space as each firm conducts business so differently. While the bulk of this paper will not cover the boutique RIAs, marketers should be asking:

- How are they running their investment business?
- Does the firm use alternatives? Do they actually use hedge funds?

If your strategy is one that is core to most portfolios, it can be worth spending the time to educate a platform on the benefits of hedge funds because if the manager is there day 1 when a platform begins using alternatives, that manager tends to benefit from being a first mover.

Is a bank platform partnership worth it?...Maybe

Managers that had positive experiences with platforms noted that their success occurred when the onboarding timeline, internal incentives and fund performance were all aligned. These are the key questions a manager should ask when assessing whether or not to pursue the bank platform and wealth management channel.

- **Is this the best return on time?** Managers should think about the economics and ask themselves how much time needs to be spent to add 10 LPs (assume average $10mm to $25mm tickets) and will it be less cumbersome that one platform or wealth management channel that targets $100mm?

- **What resources will need to be dedicated to this channel?** Most managers interviewed felt that that number depended on the platform. Either a dedicated resource should be added or about 50% of the marketer's time would need to be dedicated to that channel to triage with the platform through the FAs and distribution teams as well as with external service providers like a fund administrator.

- **If a manager partners with bank platform, what is the ideal number of relationships?** While most managers did not feel like there was an optimal number of wealth management partners, all agreed that it was dependent on who the partner is and what the needs of that platform are. That would also dictate the manager's staffing needs.

- **Are there other allocator channels that are similar and worth engaging?** Managers compared the merits of pursuing the consultant channel to the bank platforms. While there is not one channel that is better or more fruitful than another, many managers felt that consultants' approval processes were faster and easier to navigate than bank platforms, but those LPs also tended to redeem faster as institutional capital seems less patient than HNW clients. There is a need for diversification of underlying LPs and there is room to raise capital from both allocator verticals.

So, you think you made it?... Guess Again

A marketer's guide to getting funded

As previously discussed, managers cannot just walk into a bank platform and get an allocation. Getting approved to a platform does not mean you will open the floodgates. The approval process takes time, requires the corralling of multiple gate keepers, and some luck in timing strong fund performance and a commercial need within the organization. Once the IDD and ODD are approved, there are still structural and distribution hurdles to overcome.

Marketers must understand the leverage points of a platform and know how to influence those structures and teams. These partnerships should be a win-win. There are two primary ways to engage a platform once approved: 1) educate internal sales force on the product and general use of hedge funds within a client's platform and 2) engage with FAs directly that have alternatives exposure.

The quality of people on the research and distribution side is crucial (it is all about aligning interests). The amount of time and resources the manager research team invests up front helps with the stability of capital long term. If the marketer is going to do much of the heavy lifting themselves engaging the FAs, the manager needs to have personnel that want to aid the marketer in the distribution process and disseminate relevant information to keep underlying investors engaged and informed. For the platforms that have more active distribution teams, many marketers would liken the LP coverage to that of any institutional investor.

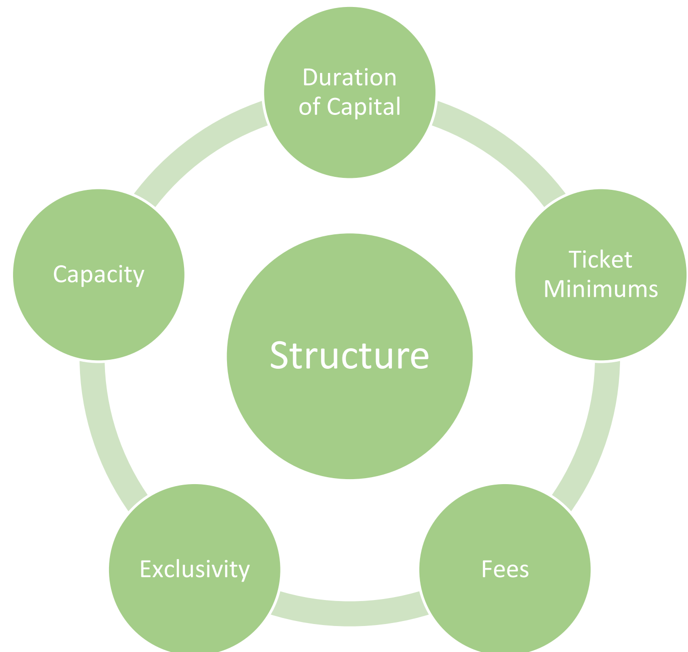
In order to have a successful raise, marketers should be aware of a platform's "product launch schedule". Many platforms have dedicated time periods of focus on what products are raised and when funds are launched (usually forward looking for 6 to 12 months). When a new fund is onboarded, the manager should ask the platform what other products are already approved are similar or complimentary and try to negotiate an exclusivity period of a marketing push by the FAs or distribution team to the HNW clients so as not to compete with client capital available (at onboard or during future periods).

Everything is Negotiable

Whether or not the negotiation is easy is another thing

Now that we have addressed how a platform is structured, understand the manager approval processes and have a better idea as to whether bank platforms could be a fit for your business, we wanted to shift gears and spend some time focusing on what can be negotiated when engaging with a bank platform.

When coming to the table on any negotiation it is important to understand how the other side is incentivized to better find common ground and align interests between parties. As former US Secretary of State to Truman said, "Negotiation in the classic diplomatic sense assumes parties more anxious to agree than to disagree".



There are 6 primary toggles that tend to be negotiated including capacity, duration of capital, exclusivity, ticket minimum, fees and structure. While every deal is different even within a platform, there are certain points that are more heavily negotiated, and it is important to understand each side's incentives.

What's in a structure?

Usually when an allocator thinks about how to structure an investment, they are referring to a comingled or separately managed account. When bank platforms speak about structuring, it is in reference to the construction of the account and the payment arrangement that the platform's operations team requires in order for the HNW clients to make investments. As such, bank platforms typically structure deals in two ways: fee sharing agreements (sometimes referred to as rebates or retrocessions) or through a selling agreement whereby the bank platform simply adds an additional fee on top of the manager's management fee.

> **COMMON MISCONCEPTION #2 - Rebates**
>
> The "rebate" unnecessarily deters managers from engaging bank platforms.
>
> Many believe platforms struggle with adverse selection bias; some higher performing funds think that the only way to engage with platforms is through fees sharing or discounts. **This is not the case.**
>
> Bank platforms are frequently willing to compress fees or find mutually beneficial structures to ensure "the best" managers on the platform.

When the origination team has to create a master/feeder fund, there are costs that the platform incurs for set up (platforms try to cap the fee given the expense, which tends to break even around $50mm). As such, platforms need a minimum level of demand in order to make launching a feeder fund worthwhile. Structuring a feeder fund creates more of a logistical burden on the manager (removing it from the bank platform) as the manager will need to produce K1s for reach investor among other operational requirements. Not all platforms can set up a master feeder structure given the operational intensity and expense. If a platform does not have the capability internally, some will try to outsource the infrastructure instead of building the function internally. While most platforms would not disclose the exact percentage of management that each required, numbers seemed to range from 50bps to 100bps (or 50% of the management fee) with each platform having a floor of what they need to accept.

When negotiating rebates, the platforms ideally try to split the manager's management fee 50/50 and usually leaves the incentive fee as is. Most FAs charge underlying clients less than 100bs on assets invested and the idea would be for most of the split to cover the FA and operational fees. If the average hedge fund charges a 2% management

fee and the platform splits the fees with the manager evenly, that gets to the 100bps (or less) that is paid to the platform and FAs.

Some platforms do not have big enough businesses to handle the logistics associated with setting up a master feeder structure so a direct investment can make more sense for an underlying HNW if the platform can negotiate an appropriate minimum ticket size. When creating a new shareclass, platforms typically ask the manager to open a new shareclass with newly agreed upon terms[7]. The shareclass looks like any other shareclass the manager offers and is usually available to other investors in the fund in addition to the platform. For example, if the platform is charging HNW 75bps on AuA and the manager's standard shareclass is 1.5% / 20%, the platform would create a new shareclass of 2.25% / 20%. The manager will collect that additional 75bps and then write a check to the manager on a quarterly basis – it can be as frequent as monthly or as infrequently as annually.

Structuring Considerations	Manager		Investor	
	Benefit	**Challenge**	**Benefit**	**Challenge**
Master/Feeder Fund	Economies of scale – one LP relationship can bring in a large ticket	More operational burden as managers must handle all of the K1s / individual reporting for each HNW client	Easier for underlying clients to access	Costly to set up the structure and must negotiate the rebate percentage
New Shareclass	Operationally consistent with other LPs	Charging LP lower fees on the new shareclass and small fee associated with opening a new shareclass	Lower fees for HNW with larger minimums and easier operational set up and acts like all other LPs	Must charge higher price to HNW than manager's list price
Direct Investment	No actions required – platform treated the same as other LPs	Many underlying FAs and HNWs instead of one institutional point of contact	Lower fees for HNW with larger minimums and easier operational set up and acts like all other LPs	Must charge higher price to HNW than manager's list price

Once the structure is negotiated, what's next?

Pricing is more of an art rather than a science. Fee compression across the industry has challenged some platforms. In general, most managers are familiar with allocators negotiating lower fees for longer duration and additional capacity rights. Many managers will accept the trade-off of lower fees for longer duration capital.

Bank platforms have a different incentive than most allocators when it comes to fees, which is why it tends to be the biggest sticking point. While all LPs want to negotiate fees lower, there is an imperative for platforms to get as low a fee as possible given the additional layer of fees needs to operate the business, pay financial advisors and the desire to treat HNW fairly and charge the same fee as the manager's standard shareclass (as the client could invest directly into the fund and the platform would lose the fee). The platforms that charge higher fees than the manager's standard manager shareclass are those with HNW clients with minimums that would be too small to access the fund without it.

What do platforms pay managers?

On average, most platforms seemed to pay somewhere around **1.55% management fee and 16% incentive fee** for hedge funds products. For platforms with multi-PM or macro strategies, the average was higher as those products tend to be more expensive and were less willing to make fee concessions.

Capacity rights is the dollar amount of capital that is earmarked for the investor at a certain price; the investor will usually invest a smaller size check initially and have the option (not the obligation) to invest additional capital

overtime. There is usually a time limit on capacity and if that capacity is not met, it can be given to other prospective or current investors at all full fees. Thinking about capacity from the manager's point of view, funds can negotiate the capacity maximum of an LP as a percentage of the fund as it thinks about diversifying its LP base (many managers will try to keep a single LP to 15% to 20% of total AUM).

In addition to capacity rights, platforms may negotiate exclusivity with a manager. This restricts the GP from marketing to other platforms or potentially LPs for a specific period of time. This negotiation point can beneficial to FAs that are originating new HNW clients that want access to new launches or hard to access funds. Additionally, it can create a sense of impetus for hedge funds that do not typically have a close date like private equity. Lastly, there were a few one-off points of negotiation that we wanted to acknowledge in order to be thorough including side letters and placement agreements, but they were only presented in a couple conversations.

Negotiation	Definition	Considerations
Capacity	The guaranteed amount of capital an LP ensures access to. After doing months of work, LPs can be concerned about getting enough access to a manager. As such, the LP will negotiate a minimum amount of capital that it can guarantee access to the GP. Usually this negotiated with duration of capital.	Usually about $100mm to $250mm
Duration of Capital	The amount of time an LP has to raise a pre-determined amount of capital.	12 to 18 months
Exclusivity	A few platforms will restrict the GP from marketing to other LPs or specifically to other platforms for a period of time. This negotiation point is meant to create a sense of impetus can invest can help FAs originate new business.	1 to 2 years
Fees	Many investors will negotiate both the management and incentive fees. Given compensation structure of the FAs, platforms typically prefer to negotiate a lower management fee.	Management: 50bps to 2% Incentive: 15% to 20%
Minimum Ticket	The minimum check size an individual client within the platform can directly invest. Negotiating the minimum check size an individual client within the platform can directly invest is important depending on the average size of the underlying HNW client and the structure set in place.	Lower the better but usually around $100k to $250k
Structure	The way in which underlying clients will be able to access an investment in the fund. Most platforms will structure investments in one of three ways: create a master / feeder fund, launch a new shareclass, or have underlying HNW invest directly in the fund.	Master / Feeder New Shareclass Direct Investment

Retail Flows Post-COVID

While hedge funds generally outperformed markets during the sharp sell-off in March 2020, industry assets fell below $3tr for first time since 2016 as many investors redeemed from managers that had already been on watchlists due to underperformance and style drift.[8] Over the next few months, hedge funds held up fairly well compared to markets and other asset classes, incurring half the losses of the broader market industry in March and then quickly improving over the next 6 months. During that recovery period, investors generally stuck with their existing managers, reviewed funds that were launching new products, and revisited funds that allocators had previously met in person. Allocators have been deploying capital to longer biased equity managers, specific sectors and strategies, including Asia, TMT and healthcare as well as dislocation opportunities in the credit space in order to take advantage of market inefficiencies. Today, hedge fund industry assets have now surpassed $3.8tr.[9]

Post COVID, bank platforms are seeing more invested capital into alternatives.

The value of advice has never been higher and there is a lot of money on the sidelines (within the bank platforms and more generally across the market). Bank platforms are starting to see inflows from new client relationship, but more capital has come in from current clients that were sitting in cash.

Larger brokers are finding more retail capital coming into the markets and not just because people have been at home during COVID. Some people have entered the market as part time day traders given free time, but others have become more interested given the sell off, investment opportunity and ease of investing due to new technology. A lot of client portfolio reallocation seems to be more about fundamentals of the economy and less about consumer taste. As such, there has been a significant increase in allocations to the alternatives space through wealth management acquisitions or new teams being built internally. Not only are alternatives like hedge funds under more regulatory scrutiny by they are reaching product maturity in their lifestyle, further institutionalizing and becoming more accessible through platforms like iCapital and CAIS.

Additionally, there has been innovation in communication style between FAs and HNW clients as well between manager researchers and managers. While many agree that physically meeting with clients especially in the wealth management space is in the cornerstone of trust and relationship building, technology has impacted the future of wealth management. Bank platforms and wealth management businesses have to think about how to communicate and with what frequency, what kind of data security and privacy should be implemented, as well as how to source new clients externally and talent internally.

Now that employees can work from a variety of cities, many wealth management channels are seeing this as an opportunity to have more global platforms. The platforms that have been most successful are those who didn't have a disruption of service due to technological or disaster recovery limitations. Moreover, those with digital presence and brand increased asset growth compared to word of mouth and in person networking events given the macro limitations and zoom fatigue. Many FAs have moved from current employers to those with better technology as they cannot monetize some of their relationships because the user interface and risk / reporting technology is painful slow and antiquated limiting factor.

It can be challenging for anyone to stay invested in markets during moments of volatility, especially when there is a split in performance between the market and one's own portfolio managed by a wealth advisor. If a wealth manager has failed to protect capital or unable to keep up with the market, many financial advisors report that HNW clients can act emotionally, questioning their advisory relationship after that event. As HNW individuals shop around for potential new advisors after the market stabilizes, more wealth tends to transfer 6-12 months post a market event, and 2020 - 2021 is no exception especially with the lift from technology. Not only is there movement of wealth by the HNW clients, but also movement of FAs across firms due to increased competition.

Post-COVID Changes to Bank Platforms

Industry Structure	Technology	Areas of Interest
• More wealth management M&A • Build out of alternatives teams to accommodate the capital chasing similar exposure	• Increased client communication • Easier and more efficient reporting • Hiring talent / remote work	• Blockchain - cryptocurrency and private companies • Credit • ESG - investment framework, investable universe

In order to accommodate the uptick in demand for alternatives, we believe we will continue to see a pickup in M&A in the wealth advisory space accelerating into 2022. Not only are RIAs buying competitors and building out

alternatives offerings, but the larger bank platforms and wire houses are also hiring some of those financial advisors in-house as they grow their platforms and offer better incentives due to economies of scale and a consistent and continued investment in technology.[10] The winners in the space will be those with culture (they know what they are) and funding (spending ability).

Strategy Demand During and Post-COVID

During COVID, most platforms raised capital through credit dislocation funds and explored the block chain space.

Throughout COVID, the two innovative areas that have been explored were around credit dislocation funds and block chain-oriented funds. Like many other LPs, bank platforms tried to take advantage of the credit dislocation not only from an investment perspective, but as a way to raise assets from current HNW clients. Many groups quickly created internal 3-5-year locked products around that theme, investing in all kinds of sovereign or corporate only managers, structured and private credit-oriented funds as well as distressed strategies playing the COVID recovery theme.

KEY TAKEAWAY #5
Most investors, including bank platforms, are rethinking how to define its investment objectives, what products exist to achieve those goals, and where that asset class should reside.

Many bank platforms and wealth management firms also have been spending time exploring the blockchain space looking at more liquid cryptocurrency focused products and more illiquid fintech opportunities that are focused on disintermediation of financial services spaces through the block chain technology. Given the short tenure of the technology, speculative nature of the "currency" and nascent stage of institutional products, many bank platforms have not made investments in the space even with the merits around security of custodians, exchanges and the functionality of decentralized ledgers. **This has led many LP verticals (not just bank platforms) to rethink what an asset is, but where it should reside within a portfolio.**

In 2021, most platforms seem to be focused on private equity raises, long only equity funds, and ESG oriented mandates across asset classes.

Financial advisors tend to push strategies based on performance that will sell. Over the past 10 years, that has been more equity centric funds whereas many of the manager researchers interviewed have been spending time on the relative value and uncorrelated hedge fund space. More recently, many FAs agree that there has been more demand in alternatives broadly, and more specifically noted that private equity flows have been stronger than hedge funds.

In terms of strategy demand within equities, most platforms have seen an uptick in demand for long only equity and biotechnology funds given the perceived potential for alpha opportunities. While lower net equity strategies are less interesting for clients given the lower returns, most manager research teams are spending time in the equity market neutral and relative value spaces as they see benefit to investments in funds that are focused on isolating market exposure if and when there is another drawdown. Platforms wanted to make sure they have capacity if and when there is a sell off as many of the blue chip, established products are hard closed to new capital.

Lastly, like many other allocators that see the benefits (performance and moral), bank platforms and wealth advisory channels are keen to build out their ESG and D&I offerings. About 50% of all respondents either had a dedicated resource to sourcing managers or had a committee focused on increasing exposure to the space. Usually teams had an individual selected by asset class responsible part time or one dedicated resource whose sole focus was to look at ESG and D&I across asset classes.

How Can Jefferies Help

Jefferies is a global investment bank with a variety of offerings across investment banking, capital markets, research, and now wealth management. Like the Jefferies prime brokerage and capital intelligence businesses, Jefferies wealth management has spent a great deal of time investing in the human capital and infrastructure of the business.

The Jefferies Wealth Management team now has 45 wealth managers with an average of 23 years of experience managing over $13bn in AUM which is over double the size of where we were 5 years ago.[11] Like many of the bank platforms discussed above, Jefferies financial advisors offer a variety of facilities across family office services, performance reporting, financial advisory, and investment management. Jefferies financial advisors help clients define an investment strategy tailored to their goals and assists them in making informed investment choices. The team delivers solutions cross every market and asset class including alternative investments.

Please reach out to Laurie Goodman for any Jefferies Wealth Management related questions or to your capital intelligence coverage person for more details on the wealth management or prime brokerage offerings.

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[1] FT Article: M&A in 2021: asset management primed for consolidation: https://www.ft.com/content/4d38b100-07de-400e-95b4-3199837ea044
[2] FT Article: M&A in 2021: asset management primed for consolidation: https://www.ft.com/content/4d38b100-07de-400e-95b4-3199837ea044
[3] Many HNW individuals are not QPs or may not have dedicated hedge fund exposure given their ticket size or risk appetite. Much of the hedge fund exposure within these bank platforms falls on the UHNW channel.
[4] These organizations tended to have better financial advisor retention (>15 years) whereas many other platforms noted that FAs were frequently moving their businesses to other platforms looking for better payouts.
[5] This number could be significantly higher depending on the length of duration and capacity of the strategy. Some bank platforms reported over $1bn with one manager.
[6] A hedge fund will rarely have enough marketers to effectively cover all of the financial advisors the way wire houses do (and we would not recommend a manager to build out a large enough team to do so).
[7] While the new shareclass could have a different duration of capital, ticket minimum, or redemption period, it is usually a focus on fees.
[8] HFR Q1 2021 Industry Report
[9] HFR Q1 2021 Industry Report
[10] FT Article: M&A in 2021: asset management primed for consolidation: https://www.ft.com/content/4d38b100-07de-400e-95b4-3199837ea044
[11] Jefferies Wealth Management numbers as of October 2020. Total Assets figure is inclusive of both Brokerage and Investment Advisory Assets.