Institutional Investor's
alpha
The Definitive Source for Everything Hedge Funds

Top Accounting Firms

RANK	COMPANY
1	EisnerAmper
2	Ernst & Young
3	Deloitte Touche Tohmatsu
4	PricewaterhouseCoopers
5	KPMG
6	Rothstein Kass
7	McGladrey
8	Grant Thornton International
9	BDO

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ALPHA AWARDS: **ACCOUNTANTS**

CUSTOM NEEDS

NOBODY KNOWS hedge fund returns better than accounting firms — the folks tasked with auditing the funds — and in recent years those returns have been mediocre at best. The HFR Fund Weighted Composite Index, published by Chicago-based data provider Hedge Fund Research, was up just 3.33 percent in 2014, marking four years since the popular benchmark last delivered a double-digit return. (In three of those four years, the HFR Composite trailed the S&P 500 stock index by double digits.) Nicholas Tsafos, audit partner at New York–based advisory and accounting firm EisnerAmper, believes the U.S. Federal Reserve is partly to blame for the paltry returns.

"The Fed's easy-money policies since the financial crisis have really made it difficult for hedge fund managers to outperform the market," says Tsafos, who specializes in working with hedge funds, private equity funds and broker-dealers.

The Federal Reserve began its controversial $3.5 trillion bond-buying program, known as quantitative easing, in December 2008 to jump-start the U.S. economy during the financial crisis. In the wake of QE, which came to a well-telegraphed end last fall, hedge fund managers are looking to snap up investors' capital and recapture their place in the market. "Investment advisers need to develop investment strategies and infrastructure so they can differentiate themselves and give reasons to investors to allocate with them, because [the market]'s beating them up," Tsafos explains.

The best way to reach new investors and win assets from existing clients is for managers to cater to their needs, either by launching additional strategies, expanding current options or creating bespoke funds-of-one tailored to individual investor preferences. This approach has been successful so far but does not come without difficulties. Hedge fund managers must plow lots of resources into researching and forming new funds in different regions with different regulations. The upshot is a maturation of the hedge fund industry and a deeper need for the assistance of hedge fund service providers, especially those with a global reach.

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> *Nicholas Tsafos, EisnerAmper*

"It wouldn't surprise me to see a good percentage of my clients delving into different types of structures or different types of financial products to enhance returns," says Michael Laveman, a tax partner at EisnerAmper.

For the first time, EisnerAmper takes the top spot in the Alpha Awards ranking of the leading hedge fund service providers, besting its Big Four competitors: Deloitte Touche Tohmatsu, Ernst & Young, KPMG and PricewaterhouseCoopers. EY, last year's champion, sinks to second place while Deloitte, the largest global accounting firm, with $34.2 billion in revenue, leaps three spots to third.

PwC and KPMG fall from their respective second- and third-place standings to No. 4 and No. 5 this year. Sneaking in at No. 6 is Rothstein Kass, a New Jersey–based accounting firm with a well-developed hedge fund practice, acquired by KPMG in July 2014. BDO, the world's fifth-largest accounting firm, with $7.02 billion in revenue, and a longtime favorite on this survey, drops from No. 5 to No. 9 this year.

To determine the Alpha Awards, we surveyed more than 625 hedge fund firms, asking them to rate the quality of service they received from their accounting firms over the past year in five categories: Audit, Client Service, Hedge Fund Expertise, Regulatory & Compliance, and Tax.

The trend of hedge funds moving into complex products outside the traditional model has translated into an uptick in business for accounting firms. Managers turn to them for advice on when, where and how to cost-effectively launch unfamiliar vehicles, ranging from private equity–like funds and managed accounts to registered products, such as liquid alternatives in the U.S. and undertakings for collective investment in transferable securities (UCITS) in Europe.

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Natalie Deak Jaros, partner and co-head of the hedge fund services group at EY, sees this as an opportunity for service providers to flex their international muscles. The New York–based accountant is able to leverage the EY network, spanning more than 150 countries across six continents, to share the firm's expertise on regional investor interests as well as regulations for start-ups.

London-based PwC, the second-largest global accounting firm, with $34 billion in revenue and nearly 760 offices across 157 countries, has noted a concentrated rise in income from its clients in Europe, where demand for new products has been particularly high: In 2014, Central and Eastern Europe revenue grew 3 percent and revenue in Western Europe increased by 4 percent.

Deloitte is the largest global professional services firm, with a deep consulting practice that it has chosen not to spin off, unlike its biggest competitors. "We're in a category of one," says Ted Dougherty, head of Deloitte's U.S. hedge fund practice. The firm combines its accounting and consulting businesses, when necessary and appropriate, to assist clients. "We've worked very hard to engineer that consulting engine into our hedge fund delivery" by providing business insight to managers, adds Cary Stier, head of Deloitte's global investment management business. The firm's bird's-eye view of the industry helps managers become more innovative and cost-efficient and think about the best ways to install an optimal operating model.

Deloitte is facing greater competition from the other Big Four firms, however, as they rebuild their consulting units. PwC, for instance, bought Booz & Co. (renamed Strategy&) in April 2014 to strengthen its consulting business, which had been spun off and sold to IBM Corp. in 2002. The accounting practice still brings in about two thirds of PwC's revenue.

No. 5 KPMG bought Rothstein Kass to bolster its hedge fund expertise at a time when demand for auditors is particularly high. Rothstein Kass's hedge fund practice really took off in 2012, when the firm counseled 20 percent of all new hedge fund launches, busting the Big Four's grip. The purpose of the merger is to improve KPMG's ability to service hedge funds; indeed, hedge fund managers position Rothstein Kass as a top five hedge fund expert in the 2015 Alpha Awards. But a Rothstein Kass client fears client service will go downhill after the merger. Another noted a decline in responsiveness from KPMG during the transition but hopes the problem is only temporary.

Though top-ranked EisnerAmper is primarily North America–facing, with offices in California, New Jersey, New York, Pennsylvania and the Cayman Islands, the accounting firm is able to assist clients opening funds overseas through its international network, EisnerAmper Global. The firm works with member companies to provide services in the jurisdictions where its clients want to structure funds, and it has developed relationships with law firms and other service providers in the European Union to help make introductions for clients. EisnerAmper regularly sends partners abroad to meet clients face-to-face and help them understand different regions. The firm is launching a Dublin office this year.

"Hedge fund expertise is absolutely vital in today's environment," says one happy client. "We are in regular contact with EisnerAmper on the various nuances of this field." The firm takes the crown in all five of the key aspects of service for accounting firms.

EisnerAmper's New York–based Laveman has advised and continues to have conversations with the firm's more than 1,200 hedge fund clients about introducing new products and adding strategies. Many of the fund documents are written very broadly to allow managers discretion to invest in a wide variety of instruments, the tax lawyer says. Some of the more common products and approaches include master limited partnership investments and lending strategies.

For Deloitte's Stier the managers that were most successful in 2014 focused on customization rather than fund diversification. He says managers must be more responsive to institutional investors, which are becoming increasingly sophisticated and aware of what they want. Instead of allocating into the flagship fund, they may want a slight variation on the strategy — a geographic concentration, a customized fee structure or customized liquidity — and better terms for longer lock-ups.

Bespoke funds primarily come in the form of managed accounts and funds-of-one, though sometimes customized funds are offered in a commingled structure. As firms think about how to attract investors from different marketplaces and geographies, they've got to figure out how to design those products around jurisdictional distinctions, notes Stier. A U.S. fund may not look the same, or it may not appeal in the same way to investors, if it is placed in Europe. Deloitte's team of asset management professionals helps managers consider how to take a successful U.S.-based fund and market it abroad. Part of this is navigating the regulatory terrain and thinking about the different market environments. "The stronger players understand what distribution is all about and how to entice existing customers to continue to invest and attract new investors to allocate to them," Stier says.

The result is a rebranding of hedge funds, according to EY's Deak Jaros. Managers are looking to develop a reputation for being able to meet very specific terms, for the right ticket size, so that institutional investors know to come to them rather than to their competitors. EY, which topped all the accounting categories in the 2014 Alpha Awards, is No. 2 in Audit, Hedge Fund Expertise and

Top Firms by Aspects of Service

RANK	COMPANY
Audit	
1	EisnerAmper
2	Ernst & Young
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5	Rothstein Kass
Client Service	
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Hedge Fund Expertise	
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Regulatory & Compliance this year and drops to third in Client Service and Tax.

Customized funds add a degree of complexity that hedge fund executives must be prepared to navigate and that their resources must be equipped to support. "A lot of managers will move into new products without being fully aware of the impact it may have on their margins and on their business," Deak Jaros explains.

EY's global team of more than 15,000 asset management professionals makes sure hedge fund clients are prepared, not just from an infrastructure standpoint but from an overall business operations perspective. "Have they built something that's scalable as they move into new products?" she asks. "Have they really leveraged across the product?" Customized funds also tend to be more highly regulated products, so there are significant setup and legal costs that accompany them, and their lower fee structures or fee caps reduce managers' income, placing further strains on margins.

"As a firm, at Deloitte we've found that there are a lot of needs to be innovative to help the hedge fund managers be more innovative," Stier observes. Deloitte helps hedge fund managers navigate new terrain through its Next Generation CFO Academy and CFO Transition Lab programs, which help CFOs think about how to become strategists and stewards for their organizations.

The challenges associated with implementing new products differ depending on the size of the hedge fund managers. EY's Deak Jaros notes that the biggest hurdle for larger funds is making sure they have the in-house talent and infrastructure to support the new products. For smaller managers the biggest obstacle to offering new strategies may be raising capital.

"It's not going to make sense for funds with less than $2 billion or $3 billion under management to offer too many different types of products because the cost of maintaining infrastructure is going to be too prohibitive," says Michael Serota, EY's New York–based global hedge fund services co-leader. The third-largest accounting firm in the world, with $27.4 billion in revenue, EY services 70 of the 100 biggest hedge fund organizations.

Investors tend to turn to the larger funds, with brand names and reputations they can trust, giving those firms a competitive advantage over midsize and smaller managers. Hedge fund managers feel the same way about the service providers they use. Though EisnerAmper takes the top spot in the Alpha Awards, the Big Four continue to dominate the hedge fund industry, servicing 82 percent of all single-manager hedge funds in 2014, according to London-based data provider Preqin's latest global hedge fund report. The July acquisition of Rothstein Kass vaults KPMG, which pulled in a record $24.8 billion in revenue last year, over EY as the largest auditor of hedge funds in the world. KPMG serviced 27 percent of hedge fund managers last year, compared with 22 percent for PwC, 21 percent for EY and 12 percent for Deloitte. EisnerAmper services just 3 percent of the hedge fund market, according to the same survey, as do BDO and No. 8 Grant Thornton International. KPMG also takes the cake for servicing the most hedge fund launches in 2014: About 29 percent of new hedge funds chose the Big Four firm.

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> *Michael Serota, Ernst & Young*

EisnerAmper makes up for its relatively small size — $285 million in revenue and 250 professionals across its asset management division — by soaring above the rest when it comes to attending to clients. "EisnerAmper is impeccable in terms of their client service," attests one New York–based manager. "They return phone calls, answer questions and generally act like a partner in your business and not like a service provider." Others praise the firm for its proficient and timely turnarounds on audits and tax filings.

As hedge fund managers endeavor to grow by distinguishing themselves from their peers, the result is a more developed industry. Over the next few years, EY's Deak Jaros expects to see the continued globalization and institutionalization of the industry in terms of product expansion and diversification. Some of that may drive M&A activity and consolidation across hedge funds. "Let's say a hedge fund manager wants to move into a '40 Act Fund," Deak Jaros explains. "They can either build their own or they can buy it."

Within the next five to 15 years, there will be fewer large pure-play hedge funds and more of a continuum between very liquid hedge funds and very illiquid private equity funds, predicts EY's Serota. Hedge funds will have longer lock-ups, side pockets and different types of liquidity arrangements based on the assets being traded.

"Looking down the road, some of the largest hedge funds and the largest private equity funds globally are going to be multiproduct, multidimensional asset managers instead of pure-play managers, based upon what their original core offering was," Serota says. It's the need to diversify and grow, but it's also what investors want. That's going to be a sea change. a

— *Georgina Hurst*

Order of Importance to Clients

RANK	ASPECT
1	Audit
2	Hedge Fund Expertise
3	Tax
4	Client Service
5	Regulatory & Compliance