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Prisma sees hedge funds as key to bank revival

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By Joseph A. Giannone

NEW YORK (Reuters) - Hedge funds, vilified in the past year for roiling markets and driving brokerages into the ground, are poised to play a key role in leading the banking system's revival, Prisma Capital Chief Executive Girish Reddy said on Tuesday.

The hedge fund industry is in retreat after a disastrous 2008, when the average fund posted losses and investors yanked out a record \$155 billion. Bankers and regulators blamed short-selling funds for fueling panic and driving firms like Lehman Brothers out of business.

Yet this same industry is now being courted by the Obama administration, Reddy said. Treasury Secretary Tim Geithner has offered to make hundreds of billions of dollars available to fund managers who snap up toxic assets from the nation's downtrodden banks.

"Hedge funds will become a much more integral part of our capital structure," said Reddy, speaking at the Reuters Private Equity and Hedge Funds Summit in New York. "We need new players to step in and we are already seeing that."

Private investors are poring over the proposals announced on Monday by Geithner, who wants to revive markets for mortgage and other debt securities by providing financing and agreeing to absorb some losses. Hedge funds, though not the only source of capital, could help draw in money from a broader audience.

"They will be the conduits for the pension funds and insurance money," Reddy said.

Reddy, a former head of equity derivatives trading at Goldman Sachs Group (GS.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)), and two partners formed Prisma in 2003. The firm, which formed a joint venture with Dutch insurance giant Aegon (AEGN.AS: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)), has \$4 billion invested in other hedge funds.

He said the Treasury's plan appears to be a step in the right direction. But based on conversations with hedge fund managers, Reddy said it is too early to determine if hedge funds will embrace the plan.

"The details are in very early stages. There are documentation issues. Qualifying is still unclear. There are still a lot of details to be worked out," he said. "If they get resolved, I would see (hedge funds) participating."

The challenge is balancing the needs of the government, investment banks and investors so that no one party is put at a disadvantage.

One big concern among funds considering an investment is that if distressed assets generate big gains, it may inspire resentment among lawmakers.

"They may say, 'That's way too much,'" Reddy said. "There is some uncertainty related to that."

Hedge funds alone don't have the capital needed to clean up the banking system, he added. Pensions, endowments, private equity firms and insurance companies will also be needed.

Reddy said one of his biggest worries is what happens if the government's latest, sweeping array of rescue plans does not solve the problem. "If not, what are the alternatives? How many arrows do we have in the quiver?"

(Editing by John Wallace)

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