

Are you Making Yourself a Target to Regulators?

It is impossible over the last couple of years for members of the Hedge Fund Industry not to feel like a target. The presidential candidates all termed the Hedge Funds as the “Fat Cats” who brought our economy to the brink of destruction. The general public jumped on the bandwagon citing the egregious pay packages received by many of the top hedge fund managers and portfolio managers. In turn the regulators smarting from not doing their job (to ensure the proper running of our financial services industry) determined the only way to save face and their jobs would be to target public enemy number one (the “Wall Street Fat Cats”).

It is now public knowledge that the Hedge Funds had very little to do with the financial crisis, in fact the hedge funds actually provided critical liquidity to the marketplace at critical moments. However, we now are living in a new era of regulators who have to prove their worth. We also have politicians who know that they can capitalize and win elections on simply going after Wall Street. Therefore, we must all accept that in one form or another, the hedge fund industry has become the target of multiple groups.

We came up with our tagline, “Don’t be a Target” based on a series of conversations with General Counsels, Chief Compliance Officers, CFO’s and COO’s of our clients. In those conversations we heard a common theme which was that they did not want to be surprised by regulators, investor inquiries or any other information request. They also stated that at points in time they felt targeted by these groups for various reasons.

Of course there are always external events that regardless of a funds particular actions will require effort (e.g. requirement for SEC registration), but in most cases the reason for what our client’s fear most (a surprise visit from a regulator or subpoena) is generated by issues within the organization. Whether it be a lack enforcement of strong policy and procedures, as we saw with Societe Generale leading to a “rogue trader” costing them €4 million in fines. Or a matter of not staying on top of your exposure to key counterparties like the issues many firms experienced related to the Lehman crisis. While these events are extreme examples, we all know that every day in business far less significant but equally potentially damaging incidents can occur when we lack the proper infrastructure to properly support your business. In most cases it is only a matter of time before the issues in your operations bubble to the surface and are noticed by regulators or turn into critical market exposure.

So with all this happening in the industry what are the largest and most complex hedge funds doing to prepare? Most of our clients in reaction to SEC registration decided to undertake SAS 70 Type II testing exercises. While this is certainly a good idea, in reality this step really does nothing to address the real issue within your infrastructure. It is like examining the portion of the iceberg that is above the water, by doing this you may feel better but you have missed the majority of the issue that lies well below the surface of the exam.

We as a firm are always surprised by the fact that the best funds in the industry have less than stellar infrastructures (systems and business processes) supporting their businesses. The key to not being a target, is to ensure that you have setup the best possible infrastructure given your own unique set of requirements. The last part of this point is the most critical. Hedge Funds by their very nature are complex and unique organizations that require complex systems and



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processes to support them. Therefore, the majority of Hedge Funds with over \$1 billion in AUM cannot be supported by a Third Party Administrator for timely reporting or management of their business. Instead it requires that the fund build its own infrastructure to support their business from; Portfolio Management, Risk Management to Financial Management.

Without making this investment you are making yourself a giant bull's-eye for the regulators and politicians who are looking for the opportunity to show they are doing their jobs. So, "Don't be a Target" really means taking the necessary steps to setup the proper infrastructure in your business to know that your day to day operations are well maintained and if the regulators or even your investors do come knocking you will be well prepared with all the information they require at your fingertips.

About FinServ Consulting

FinServ Consulting is an independent experienced provider of business consulting, systems development and integration services to alternative asset managers and their service providers. Founded in 2005, FinServ delivers customized world-class business and IT consulting services for the front, middle and back office, providing managers with optimal and first-class operating environments to support all investment styles and future asset growth. The FinServ team brings a wealth of experience from working with the largest and most complex alternative asset management firms in the world.