

Hedge Fund Regulation Doesn't Matter: An Artificial Operational Due Diligence Floor

It is official - hedge funds are going to be re-regulated in one form or another. The exact tools of this regulation are still being determined. At the forefront of this regulatory charge was U.S. Senators Grassley and Levin via the introduction of the *Hedge Fund Transparency Act*. Now, a host of government personalities have joined the bandwagon and are jockeying for the hedge fund regulatory reigns. The most vocal of the group have been the Treasury's Timothy F. Geitner and newly minted SEC Chairman Mary L. Shapiro. A number of industry groups such as the Managed Funds Association have also indicated that they support regulation in one form or another. Hedge fund regulation is a good thing however, taken in the context of due diligence, these proposed regulations will do little to promote a higher standard of operational due diligence. Furthermore, they will likely create an extremely dangerous false sense of confidence among many hedge fund investors – the very same confidence that led to the current Ponzimonium. Specifically, the proposed regulations are a missed opportunity to raise the standards of operational due diligence on two primary fronts:

A higher standard of diligence will not be required for fund of funds of hedge funds and consultants

Many hedge fund investors who lost money with fraudsters like Madoff were introduced to these funds via “professional” money managers such as fund of hedge funds or feeder-funds. These entities were supposed to be performing a certain level of operational due diligence. The new proposed regulations will not place increased responsibility or liability on these professionals to perform a minimum level of operational risk reviews.

Disclosure requirements will not provide sufficient operational transparency

The proposed hedge fund regulations, regardless of which plan is ultimately implemented, essentially turn back the clock on hedge fund operational information disclosure requirements to the time when hedge funds were previously required to be SEC registered. A few new bells and whistles are added depending on which plan you look at, yet all of these proposals set the operational information disclosure bar very low. For example, the *Hedge Fund Transparency Act* will require hedge funds to disclose the name of a fund's accountant and broker. If a hedge fund will not disclose this information any responsible investor would never allocate to the fund, regardless of whether such a disclosure is a regulatory requirement or not.

Conclusion

Hedge fund regulation is not a replacement for investor operational due diligence. U.S. based hedge funds will likely be required to produce a uniform minimum amount regulatory documentation. This base level is far below the minimum amount of operational risk information that any responsible investor should require as part of the operational due diligence process. Investor's should not expect to rely on the regulators to properly vet the operational risks associated with hedge fund investing. As it has in the past, hedge fund regulation will only create an artificial operational informational floor which some hedge funds may continue to attempt to hide beneath.

For More Information

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