



# Caveat Emptor – The Elusive Definition of Hedge Fund Due Diligence

The term *due diligence* is used frequently these days in a hedge fund context. Yet the exact definition in practice seems quite elusive. One need only examine a cross section of due diligence providers to see that a wide range of services are classified, sometimes misleadingly so, by this term. So what exactly are investors buying when they purchase hedge fund due diligence services?

## Is it background investigation work?

In recent years a slew of companies have sprung up that refer to the background investigation work they perform on a hedge fund management company, its employees and perhaps even board members as due diligence. From pre-employment screening firms looking to reinvent themselves to ex-CIA agents looking to capitalize on a trend, and everywhere in between, the depth and coverage of these services range from very basic public records database searches to extensive reputational reviews and independent reference checks. Savvy hedge fund investors can often obtain virtually the same background information at a deep discount when purchasing the work from more traditional background investigation vendors rather than providers of this same information repackaged as due diligence.

## How about compliance reviews?

Hedge fund compliance consultants and law firms also have begun to offer services under the heading due diligence. These reviews are typically limited to analyzing a hedge fund's compliance programs and legal documentation. Sometimes background investigation work such as searches for regulatory violations and public record searches are also performed by these firms.

## What about investment strategy reviews?

Groups that advise investors regarding which hedge funds to allocate capital to, such as consultants and fund of hedge funds, often term the research they perform on a hedge fund's investment capabilities as investment due diligence. These same groups may also perform operational due diligence reviews (see below).

## Is it a review of operational risks?

Consultants, funds of hedge funds and specialized outsourced operational due diligence providers typically refer to the reviews they perform on a hedge fund's operational risks (aka: non-investment risks) as operational due diligence. Each of these firm's have different approaches and some only cover certain limited areas (i.e. – accounting) while other firms have more comprehensive approaches.

## Conclusion

What exactly an investor receives when purchasing hedge fund due diligence services clearly depends upon who they purchase the service from. Cautious investors should perform detailed due diligence on the sellers of such services to ensure that they understand that not all hedge fund due diligence services provide the same level or depth of coverage.

## For More Information

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