



Ten Questions Every Investor Should Ask Their Hedge Fund Manager: Operational Risk

In the post-Madoff environment many hedge fund investors, both institutional and ultra-high net worth, are taking an increased responsibility for overseeing their own due diligence. During the course of the due diligence process often times investors tend to overlook certain non-investment related (aka: operational) aspects. Reasons for this can include organizational biases towards placing more weight on certain operational factors while ignoring others, deficient operational due diligence resources and a lack of requisite knowledge necessary to review a particular operational risk area. Operational risks in hedge funds are multi-disciplinary. As such, during the operational due diligence process investors should seek to touch on a variety of different topics (i.e. – legal, accounting, technology etc.) to gauge whether a hedge fund manager has appropriately mitigated risk across the firm's entire operational risk landscape in an even manner, or has weighted the deck against its investors by focusing heavily on certain operational issues while ignoring others. Almost more important than the particular answers to these questions, is whether or not a hedge fund manager can explain why they made certain operational choices which led to these answers.

10 Questions Every Investor Should Ask

- **1. Administration** – When was the last time the hedge fund negotiated its administration agreement? If so, what changed during the most recent negotiation?
- **2. ISDA Collateral** – If the hedge fund has entered into ISDA's, is there a requirement that collateral be held in a separate account? Why or why not?
- **3. Board of Directors** – For offshore funds, how many members are there on the Board of Directors? How many are affiliated versus unaffiliated? How many different boards does each member serve on? Has the board size ever changed?
- **4. Insurance** – Does the hedge fund manager have key person insurance? If so, to whom are the policies payable? (i.e.- the management company or the fund)
- **5. Documentation** – When was the last time the legal documentation (i.e. - offering memorandum, subscription documents etc.) for each fund was updated?
- **6. Employee Status** – Does the firm employ any part-time employees? If so, how does the firm prevent information loss and key person risk? Does the firm anticipate hiring these individual on a full-time basis? If so, when?
- **7. Office space** – When does the hedge fund manager's lease expire? Will they renew or are they looking for new space? Is any space sub-leased to others?
- **8. Valuation** – If the hedge fund manager values any portion of the portfolio themselves how often are these valuations revised? (i.e. – quarterly or when a valuation event occurs)
- **9. Audit** – If the funds have an audit holdback, how long does it take to pay? Is this the same for all funds? Has this time-frame changed since fund inception?
- **10. Open-ended** – Is there anything else I should know?

For More Information

Jason Scharfman, Managing Partner
scharfman@corgentum.com
corgentum.com



CORGENTUM

Tel. 201-360-2430