Information Overload Red Flags – When a hedge fund doesn't know when to say when to due diligence information requests

In the current environment investors are increasingly allocating more resources to hedge fund due diligence. Necessarily, hedge funds are similarly required to dedicate commensurate increased resources towards responding to these due diligence requests. Accompanying these increased resource allocations, there seems to be a new willingness on the part of the hedge funds to demonstrate transparency – particularly in regards to operations. Investors typically turn to a hedge fund's documentation to demonstrate this. While data collection, review and analysis is a core part of any operational due diligence review, there is often a dangerous misconception at times during the due diligence process that the more documentation an investor collects, the more robust the due diligence. This broad assumption tends to sacrifices information quality for total page count. Hedge fund's themselves may also fall prey to this notion by attempting to drown investors in documents, not all of which may be relevant to the investor due diligence process. When a hedge fund doesn't know when to say when to information requests, in some cases this can be representative of operational risks of equal weight to those imputed to a fund which does not provide such a detailed level of transparency to being with. Some key questions to consider during the due diligence documentation collection process include:

Are response requests pro-active or reactive?

Does a hedge fund provide a predetermined set of documents to begin the due diligence process? (i.e. – due diligence questionnaire, marketing presentation etc.) Or instead, is the hedge fund reactive and only provide documentation when it is specifically requested?

Coordination or too many moving parts?

Investors should consider who or which departments within a hedge fund are managing the investor due diligence documentation request process? If different groups (i.e. – compliance, investor relations, information technology) as well as service providers (i.e. – administrator, legal counsel) are involved in providing documentation, is this process coordinated or must investors perform the bulk of the leg work to obtain due diligence documentation?

How is investor information protected?

If a hedge fund manager does not demonstrate competence in responding to investor documentation requests, how can investors be sure that any personal information they have provided to a hedge fund is being protected? The types of documents which contain investor information which a hedge fund might accidently send to other investors include historical private placement memorandum, marketing presentations, subscription documents etc. When a tight lid is not kept on the document dissemination process unintended cracks often begin to emerge and investor information may leak out in the process.

Lack of process increases operational risk concerns

Hedge funds, particularly those which are registered with regulatory bodies, should take steps to ensure that different investors performing due diligence are provided with the same core information. So for example, multiple investors should not be receiving documents which conflict with other documents, contain stale information or are simply incorrect. When this happens the hedge fund may be opening the door to liability, regulatory action and general disinformation. Understanding the compliance and process controls surrounding due diligence documentation distribution are crucial to diagnosing this sub-set of operational risk.

For More Information

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