



Hedge Fund Operational Due Diligence – Analyzing Hedge Fund Valuation Practices

When beginning the hedge fund operational due diligence process, one of the foremost topics which tends to receive a great deal of attention, and rightly so, is valuation. The approach a hedge fund takes towards valuation can be crucial not only to the worth of the actual portfolio, but also to the level of confidence that investors and counterparties maintain in a manager. A hedge fund's policies and procedures related to valuation should undergo careful scrutiny as part of the investor due diligence process. Corgentum's proprietary approach to hedge fund operational due diligence encompasses a multifaceted review of a hedge fund's valuation procedures. This analysis leverages Corgentum's focused operational risk expertise to determine how a hedge fund approaches the valuation process. Additionally, Corgentum's review process also evaluates what checks and balances, if any, are in place to ensure consistency and independence in determining valuations. As part of the evaluation process of a hedge fund's valuation procedures some key questions investors should consider include:

- What steps has the hedge fund implemented to ensure independence in the pricing process?
- Where do the majority of pricing inputs come from? (i.e. – Bloomberg, Reuters or via broker quotes)
- How is an appropriate price determined if a discrepancy exists among pricing inputs? Is an average taken? Are the highest and/or lowest price discarded? Who makes these determinations?
- How does the hedge fund mark private or illiquid securities for which only a thinly traded market may exist?
- Does the fund maintain an internal pricing committee?
- What role does the administrator play in the pricing process?
- Is the administrator, independently of the hedge fund manager, corresponding with a hedge fund's prime brokers and trading counterparties? If so, what data is shared among these organizations?
- What percentage of the portfolio can a hedge fund's administrator independently verify?
- For items which cannot be independently verified, how does the administrator become comfortable with manager provided prices?
- Are any other parties involved the valuation process such as third-party valuation consultants?
- Are third-party valuation consultants providing actual values, ranges of values, positive assurance of values, negative assurance?

For More Information Jason Scharfman, Managing Partner
Scharfman@corgentum.com
Corgentum.com
20 Fleet Street, Jersey City, NJ 07306
Tel. 201-360-2430