

Hedge Fund Operational Due Diligence Questionnaire – To Use or Not To Use?

One of the most common documents investors will likely receive when performing due diligence on a hedge fund is the due diligence questionnaire (“DDQ”). DDQ’s are essentially the highlights of the firm’s most frequently asked questions – or that is to say the ones the hedge fund wants to answer. What many investors fail to realize is that DDQ’s, just like pitchbooks, are marketing documents. A competent hedge fund manager will most likely attempt to present the information in the DDQ in the most positive light possible. In an attempt to legitimize their DDQ’s many hedge funds will utilize a standard question format. A popular one in the hedge fund industry is one prepared by the Alternative Investment Management Association (“AIMA”). In many cases a hedge fund manager will utilize the AIMA format even if the answer to several questions ostensibly is not applicable, as determined by the manager. Despite some fallbacks, these manager provided DDQ’s are often good starting points for the due diligence process. Regardless of the format employed, many investors often raise the question of whether they should require a hedge fund to complete their own DDQ, sometimes called a request for proposal (“RFP”). In regards to the operational aspect of due diligence, there has been a trend in recent years to not require a manager to complete a bespoke operational DDQ. At Corgentum we never ask a hedge fund manager to complete a form DDQ. We utilize a time-tested proprietary approach to create an operational risk profile of a hedge fund from the ground up. Before asking a hedge fund manager to complete a DDQ or RFP investors should bear in mind the following issues:

Key Questions:

- What is the goal in having the manager complete your particular DDQ or RFP?
- How will you follow up with a manager who responds vaguely or to a different question than the one that one presented in the DDQ? Will you require new responses in writing?
- Will you accept a previously prepared DDQ in lieu of your specific format? How will you determine when a manager provided DDQ meets this standard?
- How will you incorporate the information from the DDQ into your larger due diligence process?
- How often do you anticipate having the manager update the DDQ?

Other considerations:

- A template canned investor questionnaire often results in similarly generic responses
- When investors require custom DDQ completion the element of surprise during the due diligence process is often lost as investors are effectively showing their hand by revealing questions in advance
- Many investors have a tendency to use the DDQ as a crutch and to supplant completion of this document in place of extensive operational due diligence
- The opportunity for the give-and-take of an in-depth operational due diligence process is often lost when due diligence is conducted primarily via DDQ’s or RFP’s

For More Information

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