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Investors Seek Hedge Fund Red Flags

Steve McMenamin

Compliance and corporate governance issues are among the red flags that investors can and should be looking for before putting their money into hedge funds, according to **Steve McMenamin**, executive director of the **Greenwich Roundtable**, a non-profit research and education group. Investors are conducting a healthy level of due diligence, McMenamin said, but "it's just not noticed by the outside world." Hedge funds are happy to open their doors to potential investors conducting research, he added. "If they want the money they're going to do it."

Compliance and corporate governance issues are among the red flags that investors can and should be looking for, McMenamin said. Investors need to look at the financial instruments in hedge fund portfolios and ask whether the manager has met the necessary regulatory requirements. For example, if a fund manager is trading in German credit default swaps the investor should ask whether it has registered with the German authorities, if that is a requirement for operating in the market. Investors should also check whether there are any lawsuits or regulatory actions pending against the fund's managers.

According to a guide published by Greenwich Roundtable last week, hedge fund investors should also be looking for red flags such as:

- Inadequate back-office and operational infrastructure.
- A lack of separation between trading and settlement functions.
- A lack of independent pricing by an outside administrator.
- Illiquid assets combined with excessively generous redemption terms.