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Greenwich Roundtable Tackles Due Diligence

By Chris Clair, Reporter | Tuesday, July 12, 2005

GREENWICH, Conn. (HedgeWorld.com)—No one will accuse the Greenwich Roundtable of fielding a softball in its first exercise to build a portfolio of best practices publications.

The group of managers from the Roundtable's research council and investors from a new education committee teamed up to produce a guide to hedge fund due diligence. Stephen McMenamin, executive director of the Greenwich Roundtable, said it may the first collaboration of its kind between managers and investors. The guide is the initial installment of a planned series of "best practices in hedge funds" publications.

It is an ambitious first step. It examines what "due diligence" for equity-based hedge funds should include by breaking the process down into 10 broad topics: strategy, investment process and market opportunity; team and organization; fee structure and terms; risk management; management company, fund structure and asset base; quantitative review; operations and transparency; third parties; intuition, judgment and expertise; and documents.

Within each of these are a number of questions to ask. For instance, under "Fee Structure and Terms," questions to ask include, "What expenses are charged to the fund, in addition to management and performance fees." Additionally, the guide offers commentary on how to interpret the answers. "Standard fees usually include items like administration, audit, and other professional expenses. However, a manager sometimes will expense the firm's overhead, including T&E, rent, salaries, and bonuses to the fund. If this is the case, get an understanding of what the percentage charge to the fund has been in prior years. Is it in line with industry standards? Are you willing to accept this?"

Mr. McMenamin said the best-practices series was a new venture for the Greenwich Roundtable, which, since it started 10 years ago, has specialized in attracting well-known industry leaders to participate in symposia.

"We looked around and said, 'we've got a great group of members here, let's do more,'" Mr. McMenamin said. "We started an education committee. It came back and suggested we should probably undertake a best-practices exercise; coming forth with our own best practices for our own usage."

That led to Mark A. Pearl, managing member at Henderson Capital Management in Wellesley, Mass., conducting a literature review of best-practices documents. He reviewed more than 2,000 pages, cataloging each document. He found a couple of interesting things. None of the papers was written from the investor's point of view, and almost none of them dealt with assessing the people running the hedge funds.

The latter seemed to the committee to be a particularly problematic oversight since hedge fund investors, as Mr. McMenamin put it, are not buying stocks or bonds. "We're buying people."

It was decided to tackle due diligence first. As the committee examined the issue, it became clear that one best-practices document for due diligence wouldn't cut it. The topic was too complex, with different strategy-specific issues that needed to be addressed. So this first guide deals solely with equity-oriented hedge funds. Subsequent guides will delve into global macro and commodity trading advisers.

After that, the committee will vote on what to consider next. Once the best-practices guides for due diligence are through, the Greenwich Roundtable will tackle manager monitoring and portfolio construction.

In the meantime, investors who want a copy of the guide either have to pay US$395, or join the Roundtable. Membership costs $350 annually for plan sponsors or $650 a year for funds of funds or investors who manage other people's money, Mr. McMenamin said.

"Our experience has been positive with hedge funds," Mr. McMenamin said. "Whenever we've spoken out before, it's been largely off the record. Now we feel we should go on the record, both with our best practices but also with trying to demystify hedge fund investing."