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Insider View: Bob Guilbert, Eze Castle Integration

Transparency for fund managers is ideal for investors

The impact of the U.S. Court of Appeals striking down the Securities and Exchange Commission registration requirement for hedge fund firm advisers in June continues to ripple through the industry, causing firms to debate the benefits of registration versus non-registration.

The SEC estimates that hedge funds have around $1.2 trillion under management. Such rapid growth has brought the hedge fund industry under intense scrutiny and debate and has garnered much media attention. The growth and scrutiny has also driven these investment firms to strengthen their business operations and internal controls.

The public collapse of Connecticut-based hedge fund Amaranth Advisors, which lost $6 billion dollars in energy trading, has re-energized discussions around registration and regulation within the investment community. The entire debate focuses on investment firms' need for transparency and compliance plan.

Two trends are emerging for investment managers with regards to transparency and compliance. First, new startup hedge funds and investment firms are increasingly considering SEC registration to attract investors, including institutional investors, who require or prefer some form of registration. Registration provides these new firms credibility and gives investors confidence that the firm is following best practices.

Prospective investors are increasingly evaluating transparency and compliance plans as part of the due diligence process. In fact, some investors withhold allocations until a hedge fund firm can demonstrate they have an actionable business continuity plan in place. Today's hedge fund regulation is more investor driven now than ever because they want to see the complete picture of their returns.

On the flip side, more established funds with extensive assets under management are weighing the pros and cons of registration and regularly selecting to deregister since the U.S. Court of Appeals ruling. Traditionally, hedge funds have not disclosed information because many managers fear they would be giving away their trade secrets and lose their competitive advantage. Industry analysts report that investment firms were more concerned about the cost involved with registering, citing the time and opportunity costs that can occur if something happens such as an SEC audit or investor due diligence.

Regardless of the route, any investment advisor should maintain an industry-standard infrastructure because it delivers immediate operational efficiencies and reinforces investors' confidence in the firm's stability. Additionally, maintaining best practices can help minimize costs should registration again become needed.

The hedge fund market is maturing and becoming more institutionalized every day. Larger funds are being created and the need for transparency and compliance is not lost on new fund managers. Even if investment firms are not registered, many of them are leaning towards creating a compliance infrastructure to demonstrate that they have a sound business operation in place.

Today’s investment decision-makers base their choices on large amounts of data and information, so implementing new technologies to maintain transparency has become a crucial component and market differentiator for fund managers and investment firms. If a critical system goes down, firms and their investors are susceptible to losing thousands of dollars per minute or hour, depending on the investment strategies in play.

Many fund managers recognize and understand that the key to compliance is transparency, internal auditing systems and a disaster recovery plan. Investors are more open to working with a fund if they understand and recognize that the firm is working on a thorough contingency plan, complete with technology monitoring, automated data replication and an off-site archive, and fast and secure remote connectivity to your information.

The upside to regulation is that it encourages a holistic approach to infrastructure and systems management. That said, registration or not, hedge fund firms are increasingly being proactive about implementing safeguards, such as disaster recovery and compliance plans, to protect their investors and help ensure sound business operations. Just as you can expect the hedge fund market to remain in the media spotlight, you can also expect the industry to mature and replicate business best practices established by large financial institutions.

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