The Impact of Dodd-Frank on Hedge Fund Operational Due Diligence

The broad impact of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act has a number of implications for the hedge fund industry. While, the full impact of this legislation is still unfolding, Dodd-Frank has a number of ramifications which will directly influence operational due diligence on both US based hedge fund managers and those managers which have a presence in, and interact with US markets. Subsequently, investors will need to revise their approaches towards operational due diligence in order to determine if a hedge fund manager has reacted effectively to this landmark legislation. Specifically, one area that will be most readily affected is a hedge fund's approach towards compliance. Investors must also consider Dodd-Frank in the context of other recently passed rules such as the SEC's amendments to Rule 206(4)-2 of the Investment Advisors Act of 1940 (the so-called Custody Rule). Other key areas which may be affected include information technology requirements, fund reporting, recordkeeping and transparency. Some key questions investors should consider during the operational due diligence process in the new Dodd-Frank environment include:

- What changes has a hedge fund manager made in anticipation of Dodd-Frank passage?
- Has a hedge fund appropriately budgeted for the increased costs of compliance associated with Dodd-Frank?
- With the increased focus on compliance has a hedge fund spoken to the appropriate service providers (i.e. - legal counsel, compliance consultants etc.) to ensure that quality individuals and adequate services are dedicated to the hedge fund's account?
- What changes in compliance policies and procedures has a hedge fund undertaken? How have these changes been communicated to staff? How have changes been documented in the firm's compliance manual? If changes have not been made yet, when will they be made?
- If a hedge fund manager was not registered with the US SEC relying previously on an exemption such as Section 203(b)(3) of the Investment Advisers Act, what is their plan for registration?
- If a hedge fund is already registered will they fall into the category of manager that may need to potentially de-register? If so, are they prepared to do with local state registration requirements? For example, do they fall into a New York or Wyoming Blue Sky threshold exemptions?
- Has a hedge fund developed an reporting and technology infrastructure to meet new requirements?

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