Kevin Beauregard and Wendy Goetz from Get The Net discuss what a start-up hedge fund needs to consider when developing its compliance programme

Made to measure

Get the Net is a consulting firm that provides compliance and operational risk management services to the alternative investment community.

The firm was founded in October 2005 by Kevin Beauregard and Wendy Goetz, two former managing directors responsible for overseeing Banc of America Securities Global Equities Division in a business management and compliance capacity, which included cash equities, derivatives, prime brokerage and capital markets.

Get The Net tailors its recommendations to the size and strategies of its clients. It designs creative solutions with the understanding compliance is not a 'one size fits all' programme. Product mix, seniority of staff and cost constraints are all factors to be considered in the design and implementation of a compliance programme.

HFM: What differentiates Get The Net from other consulting firms?

Wendy Goetz (WG): Our practical experience in working with traders allows us to implement procedures that squarely meet or exceed all regulatory requirements and at the same time do not overburden the client.

"A typical Get the Net client has solid trading experience and understands risk management"

Get The Net operates at a granular level which enables it to deliver thoughtful and creative control recommendations.

Kevin Beauregard (KB): When a client engages Get The Net, we not only facilitate setting up their compliance programme, but can also assist with managing the process of setting up the rest of the fund's infrastructure. This enables the fund's management to focus its effort on developing its business plan and pursuing capital raising initiatives. We have strategic partners that offer expertise in areas such as corporate real estate, legal, accounting, model development, prime brokerage, fund administration and trading floor build outs. A typical Get The Net client has solid trading expertise and understands risk management; however, they often lack the knowledge and underestimate the work required to build out the necessary support infrastructure.

HFM: What is the first step for a new fund in developing a compliance programme?

WG: A compliance programme should be done part and parcel of building the business. The only way people will utilise the tools and create an efficient compliance structure is if it is simple and integrated within the flow of the business. This can be accomplished by addressing compliance needs in the technology architecture at its early stage of development.

The fund's business plan must be consistent with the fund's legal documentation in all respects. This data will form the basis for the compliance policies and procedure manual. From this information, a compliance checklist is developed to serve as a management tool to ensure the relevant oversight functions have been identified and addressed. Once a thorough compliance programme has been developed, staff training and acceptance by the fund manager is critical to ensure management's message of a 'compliant environment' is understood.

In this new era of regulation, it is critical that compliance programmes address the specific needs of a fund manager's operations. Off-the-shelf solutions, which may have been acceptable in the past, are no longer satisfactory, as they may fail to address the unique components of the fund.

A major component of the SEC's review process involves testing for discrepancies between a manager's policies and procedure manual and the actual operation of the manager.

Examples of various aspects of a hedge fund manager's compliance programme include:
- Code of ethics
- Policy and procedure manual
- AML procedures
- Business continuity plan
- Privacy notices
- Employee trading review
- Identification of conflicts and remediation through disclosure and/or monitoring
- Handling confidential/non-public information
- Operational reviews of errors processing and daily trade break reviews
- Valuation of positions
- Interaction with the fund administrator and prime broker
- Best execution policy addressing how to evaluate broker dealers
- Develop a system for tracking soft dollars
- Review of marketing material and calculation of performance
- Partnering with risk management
- Annual compliance review including forensic testing.

Kevin Beauregard has over 20 years' experience having held various positions as business manager for equity, derivatives, prime brokerage and fixed income divisions.

Wendy Goetz has 28 years' experience in the compliance field, most recently as compliance manager for prime brokerage, equities, capital markets and derivatives for Banc of America Securities.

HFM: What should a new fund manager be concerned with when assigning the role of chief compliance officer (CCO)?

WG: Separation of officers' duties is an important aspect of compliance. The role of CCO comes with a significant amount of responsibility including interfacing with the SEC during audits. The CCO must be knowledgeable in all aspects of compliance, as well as the general operations of the business, and must have the full trust and support of senior management.

Many start-up funds delay hiring a CCO, or may not hire one at all, for expense reasons and opt instead to rely on other senior officers of the fund to perform this function in addition to their primary roles. This can lead to poor execution and even neglect, as it is normal human behaviour to gravitate to what one knows how to do best. In these instances, there is risk that some issue(s) (for example compliance operations) may 'fall by the wayside' putting the fund manager at unnecessary risk.

Get The Net can create a programme where the required functions are identified in a checklist and the reports can be easily accessed. Another option pursued by some funds is outsourcing the role of CCO. It should be noted that, while outsourcing this function is not strictly forbidden by regulation or policy, it is certainly not something expressly encouraged by regulators.

The expectation of the SEC is that the CCO is entrenched within the business and has the ear of top management – this is difficult to accomplish if one is an outsider. Get The Net prepares the fund manager to assume the CCO responsibility while working behind the scenes to ensure the fund manager's success.

HFM: What other factors should fund managers be thinking about when starting a new fund?

KB: One of the challenges new fund managers face is determining how much time and capital to invest in building their support infrastructure. Smaller managers need to use their capital efficiently and judiciously. If they overspend, they may not be able to provide the returns that their investors expect. If they invest too little, they may not be able to support the business efficiently and may run afoul of the regulatory authorities. We work with our clients to find the appropriate balance to sufficiently meet their current needs with a look towards the future.

Investors have multiple investment choices. They are looking for the fund manager to differentiate itself by its strategy, trading personnel and controls. Sound compliance practices and appropriate operational risk infrastructure are differentiating attributes and can serve as excellent marketing tools.

HFM: There has been a lot of controversy about SEC registration. Should a new hedge fund manager consider voluntary registration?

WG: Obviously, that's an individual decision driven by a variety of factors. However, in my experience, many investors will not consider investing with a fund manager that is not registered. As a consequence, a fund manager may be unnecessarily cutting itself off from a significant source of investment capital in an effort to manage costs and minimise oversight.

If a registered fund manager has set itself up appropriately, it should not fear an audit from the SEC. The decision to register with the SEC should not be driven by cost saving considerations as a sound infrastructure will eventually pay for itself. Get The Net can help prepare for a regulatory examination.

HFM: Could you give a couple of examples of issues that might get overlooked by new fund managers?

KB: There have been several instances where fund managers have over-relied on the support provided to them by the fund administrators; thus, leading to major problems for the manager and its funds. Fund managers must accept and be held accountable for the accuracy of their books and records. A sound infrastructure must be put in place with the appropriate technological tools to enable the support staff to perform their necessary functions.

The SEC frequently mentions conflicts of interest in its speeches, which are an inherent part of the business, but are sometimes overlooked. It is important to identify conflicts so that they may be disclosed to investors and properly managed.

Obvious conflicts are segregation of duties between trading and operations, treatment of material non-public information in a fund that trades public securities, the fund's fee structure, best execution and the use of soft dollars. Get the Net can help new managers with this important process of identifying, managing and resolving conflicts.

HFM: Any closing remarks?

KB: Fund managers work extremely hard to generate revenue. At the same time, they owe it to their investors and employees to put in place a sound infrastructure that meets its strategy and that protects this revenue.

Get The Net's personnel bring to its clients more than 48 years of high-level compliance and business management experience. We can succeed in easing the compliance burden for the manager's principals and let them pursue what they do best.