

Alts Pros Face More Prying Eyes in Background Checks

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Hedge fund and private equity professionals are facing deeper levels of scrutiny from current and prospective investors, who are pushing for executives to cough up social security numbers, credit reports, and disclosures of past transgressions.

Panelists at a Financial Research Associates conference last week in New York described a slew of records that institutional investors are seeking during background checks of top alts shop officers, part of a larger emphasis on beefing up due diligence of operations at these firms. And speakers across several different panels at the event said some fund manager professionals don't like the fresh attention.

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**Christopher Addy
Castle Hall Alternatives**

"Many fund managers feel that [background checks are] somewhat irrelevant," said panelist Robert Strang, CEO of Investigative Management Group, a corporate security consultant. "They feel that their private life is their private life. They don't expect to have former FBI, DEA, Secret Service [agents] digging into their private life and looking through all the things that should be important for the investor."

Managers resist such requests at their own peril, however.

"If a manager doesn't want to provide us with a social security number... a signature or credit [information] or any other documentation that's needed – passport information, motor vehicle information – the investor will go in another direction," Strang said. "[Investors are] not so much interested in whether or not this individual is going to make me money next year. What they're worried about is reputational risk."

A recent survey from Corgentum Consulting, an investigations and due diligence firm, suggests more such background dives might be in the offing, with more than a third of investors and operational due diligence analysts saying they don't yet do background checks on hedge fund managers. The survey found 86% of respondents saying they "should be doing" more, especially with regard to research on criminal backgrounds, litigation, and tax liens.

Investigative consultants cast their nets widely seeking information on fund manager backgrounds, Strang said, scouring credit reports, news coverage, social media, and criminal, civil, and bankruptcy court records. Those searches aren't just for investment and financial data but also for other items that can point to personal behavior and judgment, including the details of driving under the influence, domestic violence, sexual harassment, and divorce cases.

Another panelist, who requested anonymity, said some investors inquire about personal financial matters as well, including whether a fund management professional is paying for children's college tuition or is facing distress from big debts or expenses. Such searches would extend to portfolio managers of the fund in question, professionals who control cash, and all C-level executives, the panelist said.

The intensity of background checks may not be the same for all managers, however, said panelist Christopher Addy, CEO and president of Castle Hall Alternatives, a due diligence specialist. The differences could stem in some cases just from investor preferences, he said.

"Investors have different degrees of sensitivity, different pressure points, and different budgets," Addy said.

Background reviews also may differ based on the asset manager's own profile, he added.

"I would be very watchful about imposing an utterly dogmatic principle... for an investor to say 'Under no circumstances will I ever invest with a manager who does not allow me to conduct a credit check,'" he said. "If I was investing in Bridgewater [Associates], I wouldn't be too worried about Ray Dalio's credit, for example. On the other hand, if I'm looking at a small manager, then that could be something that is much more pertinent."

Some of the most surprising revelations come from what may seem like routine information, several panelists noted. For instance, an emerging manager who had been thoroughly vetted and came out clean at the start of an investing relationship might be worth regular follow-up visits, Addy said. "Making some money does strange things to people's personalities, and interesting stuff can come out a little bit further down the road," he said.

Similarly, a \$60 fine for a misdemeanor may look harmless on the surface, but the case could turn out to involve more serious criminal activity, the anonymous panelist said. Many felony criminal cases end up with misdemeanor convictions because the individuals were able to enter plea agreements to avoid stiffer penalties.

In some cases, background checks simply uncover dishonesty, such as the fund manager who claimed to have won an Olympic bronze medal but had made up the tale, Addy said. That alone is enough to trouble investors.

Strang recounted the background check of a manager with an impressive and valid track record who nevertheless turned out to have made up key points on his résumé – including false claims of being an Ivy League law school graduate, a certified public accountant, and a rabbi.

"Ultimately it comes down to a discussion in these gray areas... with the manager," Addy said. "Is there anything I'm going to find here? Tell me before I find it."

The reluctance by individuals to give up personal data about themselves in an era of widespread identity theft and cybercrime is understandable, Strang noted. However, investors often believe the security of their assets and reputations trumps that concern.

Moreover, a thorough investigation often can clear up unfair characterizations and untrue information about an individual that might already be available online or in other sources, Strang said.

"You really have to do the homework," he said. "You can't base a decision on just purely what's [online]. It's not fair to anybody."