



Enterprise. Strength. Collaboration.



Thinking from IntraLinks

Best Practices  
for Hedge Fund  
Managers

Establishing  
transparency  
and meeting  
regulatory  
mandates

**AIMA's guide to sound practices for European hedge fund managers**

AIMA deals with the main functions typically carried out by hedge fund administrators, and outlines how they contribute to the overall management and administration of a hedge fund.

**MFA's sound practices for hedge funds**

The MFA works with other industry organizations to create unified best practices principles for the global hedge fund industry.

**Hedge fund regulatory environment**

The hedge fund industry is facing increased pressure for more oversight and regulation

## Introduction: The current landscape for hedge fund managers

Global financial markets have experienced significant volatility while the hedge fund community has been plagued by several high profile scandals. As a result, policy-makers and regulators around the globe have proposed that fund managers register with the appropriate regulatory body and report on their funds to not only regulators, but investors as well.

For example, the Dodd Frank Act has extensive reporting and document retention requirements. In Europe, the Directive on Alternative Investment Fund Managers will change the regulatory landscape for funds. Both proposals, as well as guidelines published by the Managed Fund Association (MFA), International Organization of Securities Commissions (IOSCO) and Alternative Investment Management Association (AIMA), propose that funds establish greater transparency between themselves, their investors and prospects.

To prepare for these impending global changes, hedge funds can take proactive steps now in their day-to-day business to lay the foundation for what's to come. These 'Sound Practices' are outlined in the following eBook.

## New challenges of sharing critical information

Hedge funds that don't frequently and uniformly communicate with investors in a secure manner will struggle to retain and attract investors. Additionally, once registered, an investment advisor may be subject to periodic regulatory audits. Funds must be able to manage documents and data in a way that helps them pass regulatory examinations and prevent insider trading violations.

### Investor communications

Hedge fund managers currently provide investors with performance data, investor letters and risk reports. However, the frequency of and detail in the reports are left to the discretion of each fund manager. The proposed hedge fund regulations, along with the MFA and AIMA guidelines, attempt to bring consistency to how a fund should communicate with its investors, outlining the type of information fund managers should share and how frequently. While increasing the frequency and breadth of information fund managers share with investors enhances their relationship, it can also threaten the fund's reputation in the market should the information fall into the hands of unauthorized parties.

**BUSINESS GOAL:** Execute an investor reporting program that establishes the level of transparency essential to retaining and attracting institutional investors.

### Prospect communications

Another challenge faced by hedge fund managers is securely communicating with prospects. If material fund information that is approved by compliance and legal is altered and different prospects are provided with different information the fund could be subject to a selective disclosure violation.

**BUSINESS GOAL:** Share information consistently and equally with all accredited prospects.

**Auditor requests for information**

In the U.S., once a hedge fund is required to register as an investment advisor, it is subject to periodic audits by the SEC. Similarly in Europe, hedge funds may be subject to audits by a regulatory body in country or one designated by the European Union (EU). Regulators will expect funds to quickly retrieve *complete* records of all the information related to a specific trade, investment idea or thesis. Funds that have not implemented a structured process for saving, cataloging and retrieving their material information will struggle to satisfy the requests of regulatory examiners. If a fund manager cannot easily and quickly produce basic documents, such as their current Form ADV, it becomes a red flag to the auditor to take a closer look at the fund manager’s records.

**BUSINESS GOAL:** Effectively manage all of the fund’s material information and quickly retrieve any document an auditor requests.

**Eliminating the hazards of e-mail: Solutions for safeguarding corporate information**

E-mail is the most important electronic communications tool in today’s world, and as a result, exposes companies to a wide variety of risks.

**Current communication practices leave funds exposed**

The current communications practices of hedge funds may not be ideal to meet their business goals and looming regulations. Many funds lack sufficient staff and IT resources to facilitate the proposed communication practices outlined by the MFA and AIMA.

Current methods of communication including e-mail, overnight delivery and password protected web sites do not give funds control over what investors and other parties do with their confidential information — once the fund manager releases that information it can be freely shared with anyone. For example, password protected web sites only protect access to the documents. Once the user is authenticated and enters the site, there is little to no control over what happens to that confidential information; it can be printed, e-mailed, saved to desktops, faxed, etc. Similarly, documents shared through e-mail can be forwarded to other people whether they are authorized to view that information or not. In the case of overnight delivery, not only is there a lack of control over documents once they reach their destination, but the process is inefficient and creates an additional administrative burden on the fund’s staff.

All of these methods leave hedge funds open to security breaches, with both offline and online methods facilitating the sharing of information to unauthorized recipients.

	EASY TO ADMINISTER?	ABILITY TO MANAGE DOCUMENT ACCESS?	ABILITY TO CONTROL DOCUMENT SHARING?	PROVIDES AUDIT TRAIL?
<b>Web</b>	Dependent on system or vendor	YES	NO	NO
<b>E-mail</b>	YES	NO	NO	NO
<b>Overnight Delivery</b>	NO	NO	NO	NO

New methods for secure, online communication are available to help hedge funds prepare for the regulatory changes ahead. New technology, such as investor portals delivered via Software-as-a-Service (SaaS), offer ease of use, control and security that is superior to password protected web sites, e-mail and overnight mail.

Cost-effective document management solutions for business critical processes

Today's increasingly turbulent global and competitive business environment is fueling the need for a new, more efficient and effective exchange of information and ideas across enterprises.

## Sound practices for hedge fund communications

### Sound practice 1: Control what authorized users can do with your confidential information

Somewhat surprisingly, unauthorized people often receive a fund's confidential information from authorized users, such as investors. Therefore, simply restricting access to a fund's confidential information via a password protected website is not enough. A fund must restrict access to confidential documents and control what a user can do with those documents in order to protect its reputation and retain and attract investors.

Fund managers also should utilize Digital Rights Management (DRM) technology to control what users can do with reports they receive from the fund and ensure that performance data or investor letters are not published on the Internet. DRM prevents the printing, saving and forwarding of critical documents — those created in Word, Excel and PowerPoint as well as PDFs. In addition, to mitigate the risk that someone might print and disseminate confidential materials, documents can be further protected by "watermarking" them. This adds an indelible digital fingerprint, which can include the user's name and the date the document was viewed or printed, as well as warning language such as "Confidential" or "For Internal Client Use Only."

### Sound practice 2: Centralize and secure material information to prevent insider trading violations and enable quick retrieval for auditors

Confidential information in the hands of the wrong *employee* can do irreparable harm to the fund. Galleon was brought down when an Intel employee faxed confidential sales and pricing information to the fund — an insider trading violation. To protect their investors and livelihood, fund managers must:

- Restrict access to material information by individuals inside the fund
- Control what each individual can do with the information
- Generate an audit trail identifying what information an employee viewed and when they viewed it

Since the investment process is a collaborative effort appropriate access and barriers to information must be established. Fund managers can accomplish this by creating different groups (analysts, traders, administrative staff) that can only access documents appropriate to their role, fund they support or investment idea.

To prevent information leakage, such as the Intel employee faxing confidential data to Galleon, fund managers need to control what authorized employees can do with each document they access. For instance, a fund manager may want to allow a spreadsheet to be updated but restrict it from being printed. Alternatively, they may want to allow their meeting notes to be read while protecting them from being forwarded or printed.

To respond effectively to auditors, a fund manager should retain all their material information in a central repository that enables them to quickly and precisely retrieve any document an auditor might request.

### Sound practice 3: Prevent selective disclosure violations by documenting fund's communication with investors

Funds using an online platform can provide a detailed, complete and accurate record of who has seen what information and when, enabling funds to maintain an auditable record of disclosure for legal and/or compliance purposes. This audit trail documents that a fund manager adhered to selective disclosure requirements by sharing material information equally and simultaneously with all investors.

**Sound practice 4:** Retain control and execution of your investor communications program

The timeliness of a manager's reporting can determine whether investors consider the fund to be sufficiently transparent and impact redemptions. This makes sharing performance data, investor letters and risk reports a core competency of the fund that the manager should control. Given the lean organizational structure of firms and the lack of in-house IT support, this requires a SaaS based solution that non-technical staff can use to execute a communication program that meets investors' expectations. The platform must be intuitive enough that non-technical people can control and execute the fund's investor communication program.

## Summary

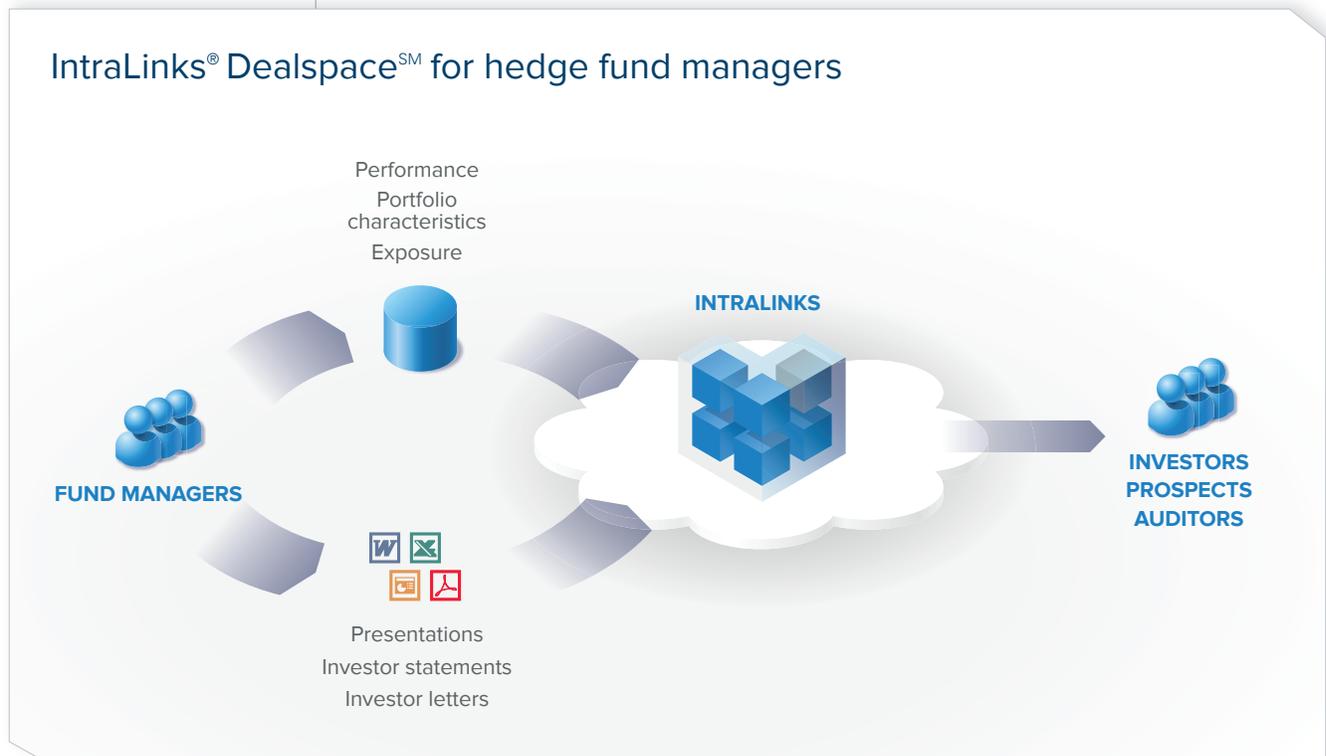
Hedge fund regulation appears inevitable due to the volatility and uncertainty of the global financial markets. To prepare for these new regulations, hedge fund managers should follow industry best practices for establishing transparency with their investors, prospects and regulators.

Using a SaaS platform for critical information exchange will give funds the ability to instantly share material information in a timely and consistent manner while protecting it from falling into the hands of unauthorized parties — a breach that can damage a firm's relationship with investors and reputation in the market. In addition, the solution can enhance the ability of fund managers to manage their operations, satisfy responsibilities to investors, comply with applicable regulations, and address unexpected market events.

## Appendix

### Implement a secure document exchange platform for sharing and managing material information

SaaS critical information exchange solutions (also referred to as cloud computing solutions) enable secure information sharing capabilities, allowing hedge funds to easily grant access to users inside and outside the company firewall — from anywhere, at any time. The functionality available within a critical information exchange solution typically includes the ability to securely share, track, organize and manage documents. Audit trails indicate who accesses and views which documents and when, further helping funds to establish transparency. For these reasons, SaaS critical information exchange platforms are emerging as an alternative to traditional document-sharing methods like e-mail, fax, overnight mail and unprotected websites.







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