INSIGHTS

SUPPORTED BY: AQMETRICS

SEPTEMBER 2023

REGULATORY ROADMAP

THE HEDGE FUND COMPLIANCE LANDSCAPE IN 2024

EXECUTIVE SUMMARY

The regulatory environment has never been more complex to navigate for hedge fund operations and compliance professionals. Faced with a rising number of regulations, and with the SEC's Private Fund Adviser Rules likely to increase the reporting burden, teams must handle increasingly precious internal resources and make use of new technologies to master every detail. There is no margin for error.

The huge increase in the regulatory burden over the past five years means managers are outsourcing more than ever. There are more tools available, too, but CCOs know they cannot outsource the responsibility.

This report, supported by AQMetrics, canvasses the global hedge fund industry to gauge their regulatory priorities and concerns. Across North America, Europe and beyond, hedge fund operations professionals were asked how they are meeting these challenges, which tools are (or would be) most helpful, and how effectively their current reporting and compliance technology has been in supporting their efforts.

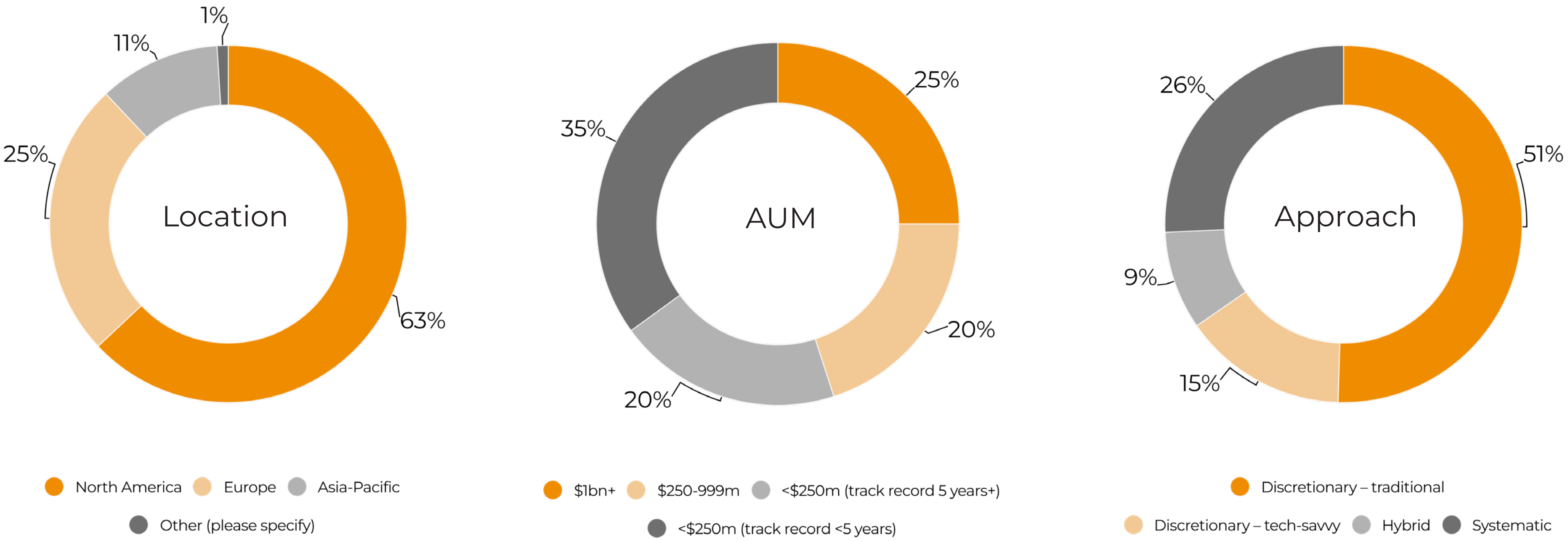
The conclusions drawn highlight just how much resource is now dedicated to regulatory compliance, with costs only rising. No wonder that more than half of firms with $1bn or more (60%) have an in-house compliance team. And the challenge is only set to increase.

But our research also shows how managers are innovating at every stage. By utilising the right tools and sources of information, hedge fund compliance teams are managing their reporting burdens. By combining these technologies with innovative working practices, their businesses are being prepared for further unknowns.

WILL WAINEWRIGHT
HEAD OF HEDGE FUND RESEARCH

CONTENTS

Breakdown of respondents to Hedgeweek's Q3 Hedge Fund Manager Survey by firm location, size, and approach:



METHODOLOGY

A key source of data in this report is the results of Hedgeweek's Q3 Hedge Fund Manager Survey conducted in August 2023. Of the 89 hedge fund firms that participated in the survey, 25% had AUM of $1bn or more, 20% had AUM between $1bn and $250m, and around 55% had AUM under $250m. By firm location, approximately 60% were based in North America, 25% in Europe and 10% in Asia-Pacific. Further insights in this report were gathered during interviews in August and September with named and unnamed hedge fund sources, and additional third-party research and intel.

KEY FINDINGS

1 Private Fund rules are top of the agenda

The SEC's Private Fund Adviser Rule proposals are the biggest regulatory concern for the global hedge fund industry, selected by 40% of respondents globally, rising to 50% in North America who ranked it as a top-three concern. Subject to a lawsuit from industry trade groups acting in coordination, the final application of the rules is as-yet unknown, but this report makes clear the industry is firmly preparing.

2 Complexity a particular concern in the US

Given the increase in the regulatory burden, it is perhaps no surprise that North American hedge fund operations and compliance professionals are more than twice as likely as their European peers to name the interpretation and understanding of complex regulatory requirements as their most significant regulatory challenge in terms of reporting and compliance. Two in five North American respondents (41%) highlighted this, compared to one in five European respondents (20%).

3 Outsourcing is now standard practice

'You can outsource the task but not the responsibility' is an often-heard phrase among hedge fund operations professionals – and this sentiment is increasingly applicable in the realm of compliance. Three-quarters of hedge fund managers use external compliance consultants/advisors to stay on top of regulatory developments. European firms (85%) are slightly more likely to than North American (78%), but it is now standard business practice globally.

4 US integrates regtech better than Europe

Asked to rate how effectively current compliance technology supports regulatory reporting and compliance efforts, 32% of North American managers awarded a top rating – 5 out of 5 – compared to just 10% in Europe. Our research suggests that European firms trail when it comes to integrating technological solutions for compliance, which was a top-three challenge for three times as many European respondents as North American respondents.

A RISING TIDE

There have been several landmark regulatory developments in recent months. US managers, however, face some particularly impactful changes – not least the SEC's proposed changes to the Private Fund Adviser Rules.

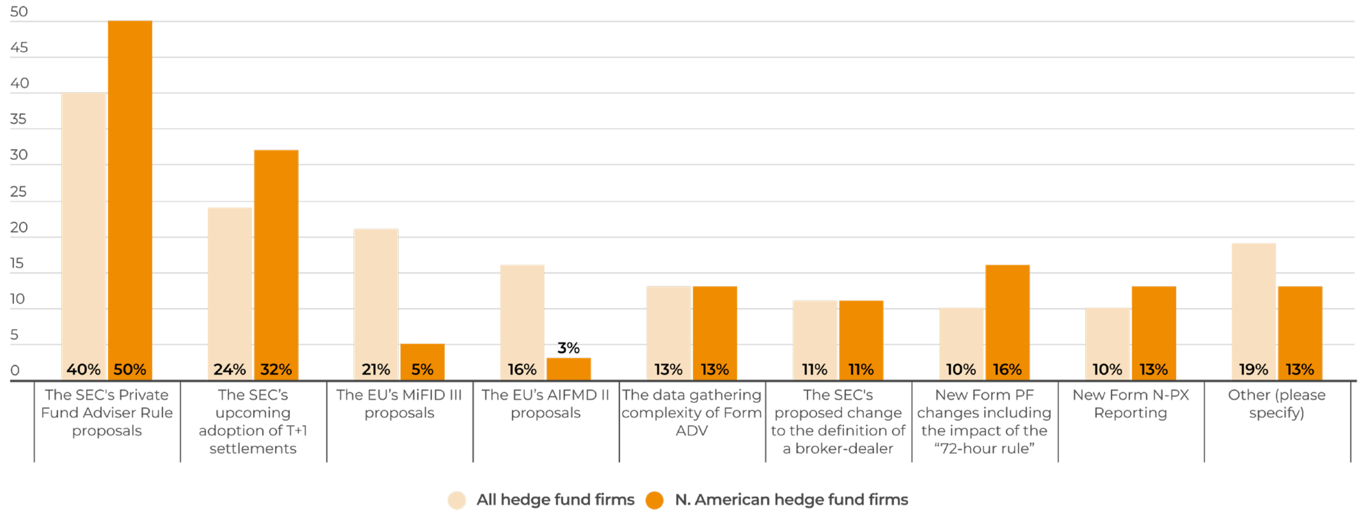
Hedge fund regulation is rarely headline news, but the SEC's decision to adopt new and impactful Private Fund Adviser (PFA) Rules has been a major talking point over the summer in hedge fund centres around the world.

The new rules will require fund managers to provide investors with quarterly statements detailing certain information regarding fund fees, expenses, and performance. All SEC-registered advisers must also obtain and distribute to investors an annual financial statement audit of each private fund it advises.

While the implications are still being absorbed, such changes have the potential to reshape the current fund manager/investor relationship across hedge funds and private markets.

Not without opposition. The MFA, AIMA, and three other industry groups have already announced plans to launch legal action against

Fig. 1.1 Top regulatory concerns for North American hedge fund firms



Analyst note: *Survey respondents were asked, 'Which of the following regulatory issues are you most focused on/concerned by at present?' (Please select up to three)*

Source: Hedgeweek Q3 Hedge Fund Manager Survey

the SEC to have the rules thrown out "on the grounds that they exceed the agency's statutory authority and are arbitrary, capricious, and otherwise unlawful," according to their announcement of the challenge.

In comment provided to Hedgeweek, Jennifer Han, MFA Executive Vice President, Chief Counsel, and Head of Global Regulatory Affairs, says the proposed rules would "undermine the ability of fund managers to raise capital and generate returns" and potentially drive small and emerging managers to "redeem their outside capital or shut down altogether".

She adds that the SEC has failed to conduct any cost-benefit analysis of the aggregate impact of its regulatory proposals on advisers, markets, investors, and companies raising capital.

"The SEC has undertaken the most aggressive rulemaking agenda targeting the alternative asset management industry since Dodd-Frank with over 20 rules impacting the industry that will fundamentally reshape the private fund business model," Han says.

Asked to highlight up to three regulatory priorities, 40% of all hedge fund firms surveyed by Hedgeweek during Q3 2023 picked the SEC's PFA proposals, including half of those based in North America (see Fig. 1.1).

Sean Cumiskey, Co-COO of Yiheng Capital Management, a San Francisco-headquartered long/short equity manager managing more than $1bn, says it is the main regulatory issue they are focused on currently.

"We are coordinating with our service providers as to how best to interpret and comply with the reporting regulations, which we believe will unfortunately lead to investor confusion."

New York-based Meteora Capital is one of many US managers working with outside counsel and external compliance specialists "to better develop an exact response", says Kevin Gahwyler, Managing Director and Head of Business Development.

Meteora has also "added a number of disclosures, reduced the recipients of our information and even changed some of the information we share," Gahwyler notes.

Such sentiment is widespread within the hedge fund industry, which will face the challenge

KEY FINDING

The SEC's proposed changes to the Private Fund Adviser Rules is the top compliance concern for US hedge fund firms

Top three regulatory concerns/priorities for North American hedge fund firms:

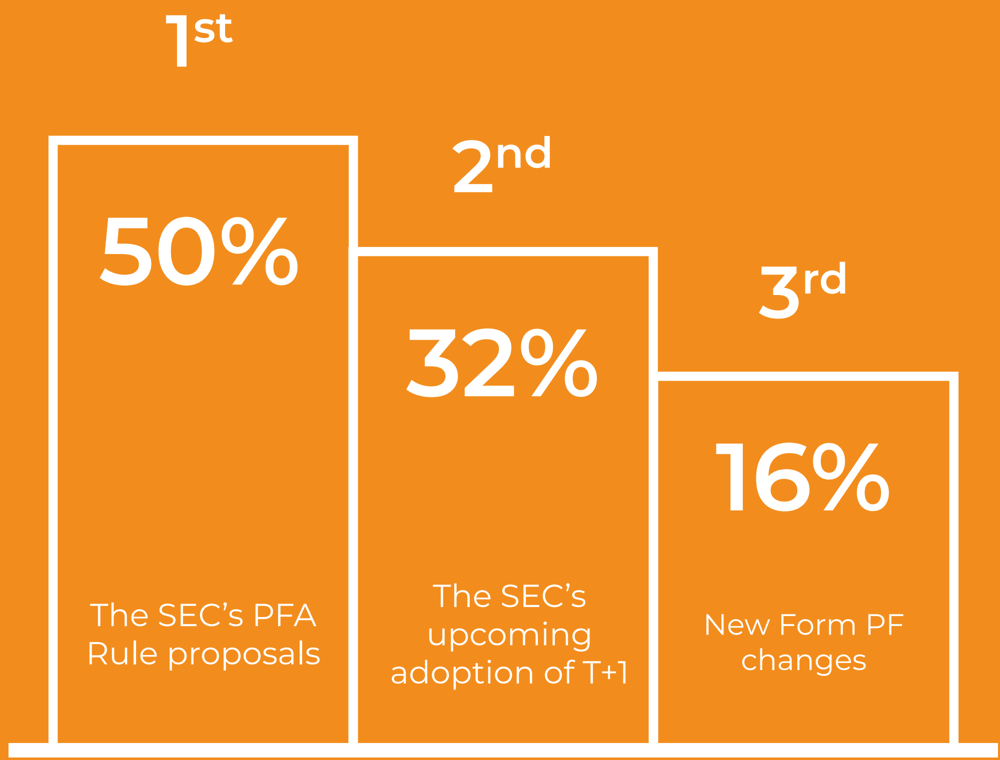
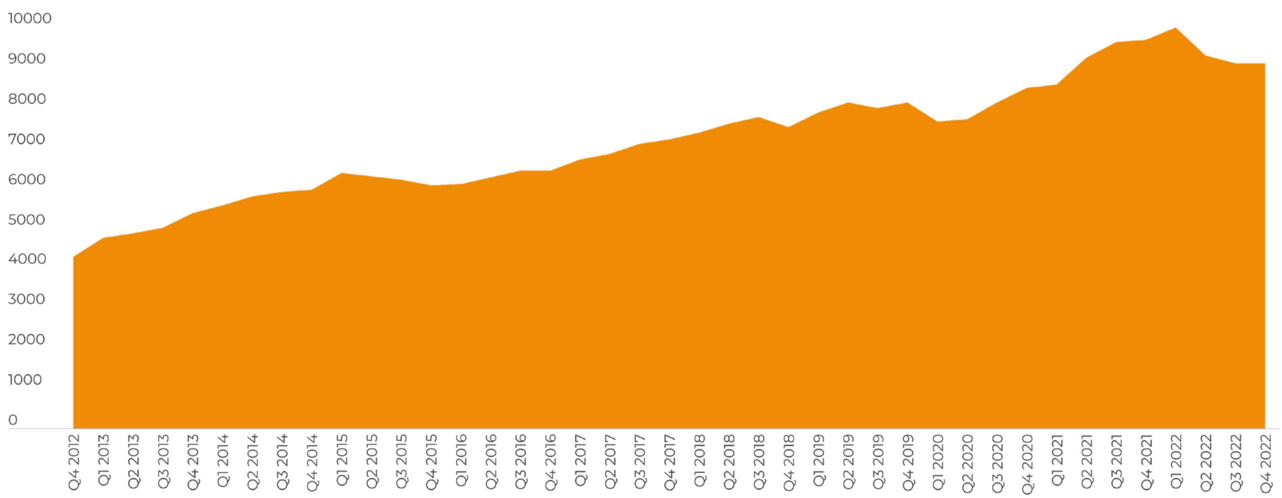


Fig. 1.2 Hedge fund AUM captured through Form PF reporting, 2012–2022 ($bn)



Analyst note: *Gross figure, includes leverage*

Source: Federal Reserve

of compliance unless the legal challenge by industry trade groups succeeds. It will also be an expensive process, potentially adding billions to industry spend on compliance.

MOUNTING WORKLOAD

The backdrop to the SEC's PFA proposals has been a rising regulatory tide. Managers in the US and Canada agree the regulatory outlook and compliance workload has increased hugely for hedge funds in the last five years. Brandon Baer, COO and CCO at Polpo Capital Management, a small New York manager focused on CMBS investments, says they have seen this first hand.

"It really 'helps' the larger asset managers cost wise and manpower wise," he says, leaving smaller managers disadvantaged on a relative basis due to the compliance work now required.

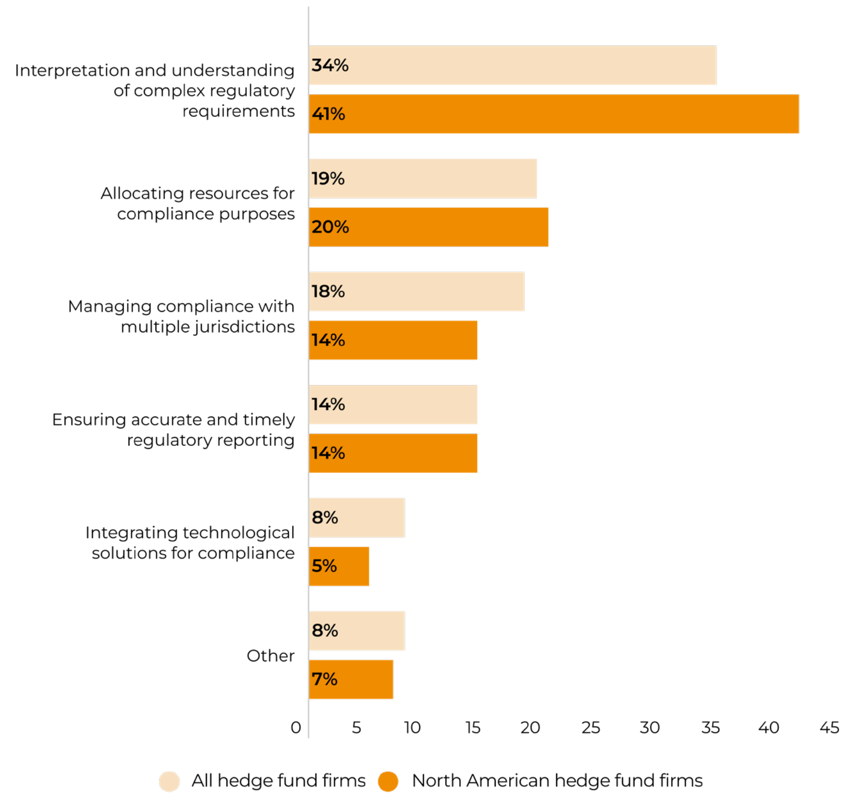
Meteora's Gahwyler says the regulatory outlook and compliance workload has "most definitely" increased for hedge funds in the last five years. "Clearly there are far more boxes to check and aspects of concern when sharing any level of information with current or prospective investors."

Not all agree on the extent. "It really depends on the fund, their trading/investment strategy, how they operate, etc," says a senior US hedge fund professional speaking anonymously about recent increases in the compliance burden. "If you are a very active trader, user of leverage, and operating across multiple jurisdictions, then yes, the workload and regulatory burden have increased [in the past five years]. But that is the 'cost' of doing business."

Baer's top three concerns from a regulatory perspective was the data gathering complexity of Form ADV, the SEC's upcoming adoption of T+1 settlements and new PFA Rules. How are they preparing?

"It will be more operationally, legal (third-party compliance providers and outside counsel) and accounting intensive," he says. "We have a good counsel and third-party compliance team along with our founding team."

Fig. 1.3 Top regulatory challenges for North American hedge fund firms



Analyst note: *Survey respondents were asked, 'What is the most significant regulatory challenge you face as a hedge fund manager when it comes to reporting and compliance?'*

Source: Hedgeweek Q3 Hedge Fund Manager Survey

Among Hedgeweek survey respondents, the SEC's upcoming adoption of T+1 settlements was the second biggest priority, with 32% of North American respondents concerned (compared to 24% worldwide). Designed to reduce risks in clearance and settlement, the SEC's final rules will shorten the process for settling securities transactions from two business days to one.

"In general, I do not think immediate, one-day settlement or T+1 is a good idea," said one senior US hedge fund professional. "It is too short of a time period, and there might be a few errors that can be resolved with a little bit more time. I don't see any tremendous gain by moving to T+1." The EU's AIFMD and MiFID II proposals are far down the priority list for North American managers – selected by just 3% and 5%, respectively.

The data gathering complexity of Form ADV is most on the radar for 13% of North American managers. As is the SEC's proposed change to the definition of a broker-dealer, selected by 11%.

AN 'EXISTENTIAL' IMPACT

Speaking on the Alternative Fund Insights (AFI) podcast in July, AIMA CEO Jack Inglis said there have been more than 30 new rules recently proposed by the SEC that AIMA has scrutinised and, in many cases, responded to.

One of the most significant from the industry's perspective is the proposed change to the definition of a broker-dealer, which has the

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The SEC has undertaken the most aggressive rulemaking agenda targeting the alternative asset management industry since Dodd-Frank

Jennifer Han
Chief Counsel and Head of Global Regulatory Affairs, MFA

potential to drag hedge funds and many other small asset managers, and even individuals, into the SEC's crosshairs.

"It is not an over-exaggeration to say its impact on the industry could be existential," Inglis said.

AIMA notes that the proposal to amend the rule doesn't include redefining a securities dealer in line with the argument the SEC is currently advancing in several court cases. The trade group is now supplying "amicus briefs" to various US courts that the SEC is using to sue people that it suddenly thinks are securities dealers.

Among all Hedgeweek survey respondents, 10% selected new Form N-PX reporting as a priority/concern, as they did the new Form PF changes, including the impact of the "72-hour rule". The recently finalised Form PF proposals require "timely" reporting to the SEC of significant events, ranging from extraordinary investment losses to material changes in prime brokerage relationships or margin, as well as any significant operational issues or redemptions.

Speaking with AIF, Inglis said the most significant aspect is the need to report changes to the SEC no longer than 72 hours after the events happen. "72 hours is not a huge amount of time if there is a weekend in between and a bank holiday attached to that. The possibility of not meeting that deadline is very real."

The extent of the increase in the SEC's regulatory reach and industry growth is revealed by the fact that gross assets of hedge fund managers filing Form PF with the SEC has more than doubled in the last decade: from $4.25tn in the last quarter of 2012 to $9.09tn in the last decade of 2022 (see Fig. 1.2).

Given the increase in the regulatory burden, it is perhaps no surprise that North American hedge fund firms surveyed by Hedgeweek chose 'interpretation and understanding of complex regulatory requirements' as their top regulatory challenge, with over twice as many votes as the second-placed selection (see Fig. 1.3).

Furthermore, two in five North American respondents highlighted the challenge around regulatory complexity compared to one in five in Europe. But then European managers face a different set of challenges – as explored in this report's next section. ■

KEY TAKEAWAY

The SEC's Private Fund Adviser Rule proposals are the biggest regulatory concern for the global hedge fund industry, selected by 40% of respondents globally, rising to 50% in North America who ranked it as a top-three concern. Subject to a lawsuit from industry trade groups acting in coordination, the final application of the rules is as-yet unknown, but this report makes clear the industry is firmly preparing.

GERALDINE GIBSON

CEO

AQMetrics

Proposed rules set out the removal of side letters and preferential rights. This means that new funds may no longer be able to offer preferential redemption rights; leaving seed investors without preferential right to redeem at the end of a seeding period in turn hampers fund launches.

The prohibitive activities rule as it currently stands will likely discourage advisers from taking sound risks and will also increase up-front costs.

The prohibitive activities rule also makes the setting of fees quite rigid and bars the charging of fees or expenses associated with examinations, investigations, or compliance matters, even if disclosed and agreed by investors. The disincentive to invest in compliance will have long term governance, risk and compliance implications for hedge fund businesses and may ultimately weaken compliance controls across the firms. This is of course not in the best interest of the investors the rules serve to protect nor the hedge funds themselves in terms of resilience.

To stay on top of these rules hedge funds can lean on their service providers. Service providers are constantly tracking the SEC updates for any change and are continually updating their materials on the subject in line with the ever-evolving regulatory landscape for hedge funds.

TRANSATLANTIC CONCERNS

There has been a relative lack of drama – so far – around updates to the EU's AIFMD and MiFID regulations. For European managers, the challenge is maintaining focus on multiple fronts.

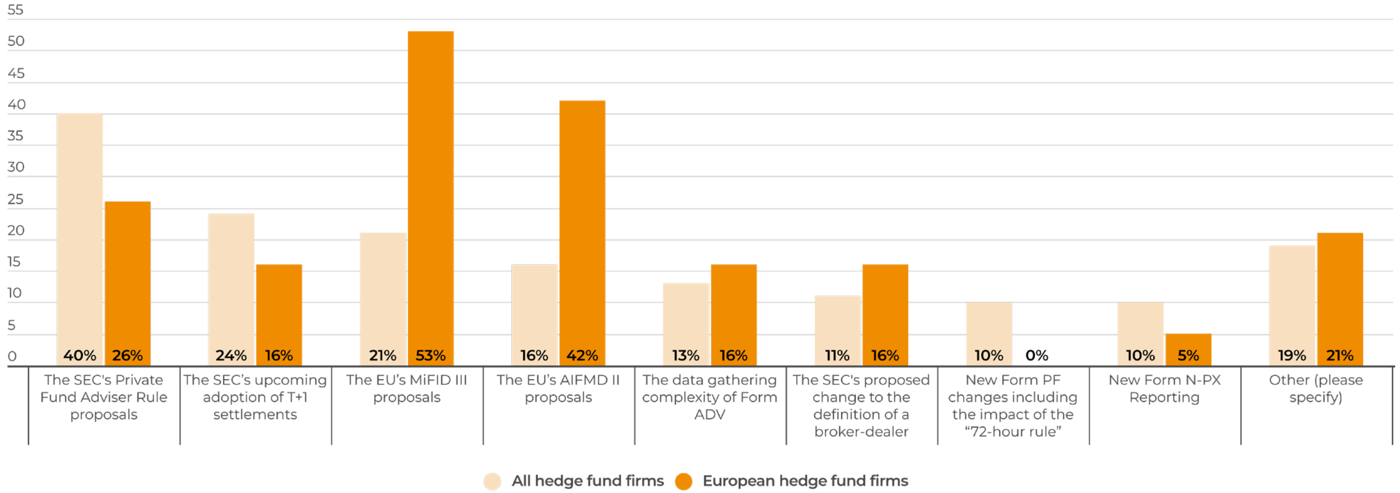
In the years after the Global Financial Crisis, the EU was the main source of new regulation affecting the industry in Europe and indeed globally, most notably with the controversial Alternative Investment Fund Managers Directive (AIFMD).

"By contrast, the US was pretty quiet on new regulatory rules being presented to the market," says AIMA's Jack Inglis, speaking on a recent industry podcast. "That all changed when chairman [Gary] Gensler came into the SEC. Since then, we have seen an extraordinary number of new proposals being made to the market and to the industry which we have had to respond to."

Given the global nature of the industry, the impact of all those rules and proposals is felt by hedge fund management firms in Europe just as much as the US.

However, of the six US-focused regulatory options presented to Hedgeweek survey respondents, only one was selected as a top regulatory challenge by more than a quarter of Europe-based respondents – the SEC's Private Fund Adviser (PFA) Rule proposals (see Figure 2.1).

Fig. 2.1 Top regulatory concerns for European hedge fund firms



Analyst note: *Survey respondents were asked, 'Which of the following regulatory issues are you most focused on/concerned by at present?' (Please select up to three)*

Source: Hedgeweek Q3 Hedge Fund Manager Survey

AIFMD II AND MIFID III

Unsurprisingly, the top two concerns for European respondents stemmed from Brussels: EU proposals covering the Markets in Financial Instruments Directive (MiFID) III and AIFMD II, selected by 53% and 42%, respectively.

The provisional changes to the current AIFMD regime aim for hedge funds to disclose further information especially regarding investments with private funds in non-EU countries like the UK.

Another proposed amendment in the drafting stages was a limit on the amount of leverage in private fund vehicles. While seeking to limit stress within financial markets, this may have an impact on managers employing arbitrage strategies.

AIMA has responded positively to the AIFMD proposals, reiterating that managers can still delegate portfolio and risk management to third parties, however this means managers may have to provide further data on these relationships to regulatory authorities.

Many smaller firms outsource AIFMD reporting to a consultant/third party, but this can cost in the region of $10,000 per report, according to industry observers.

The MiFID proposals crack down further on the ban on inducements especially regarding non-advised sales. Interestingly, MiFID III looks to reduce the wealth requirement of professional investors to €250k, which may widen the pool of potential investors.

As noted, managers in Europe were far more likely to rank AIFMD and MiFID II as one of their top three key concerns compared to North American managers. There was proportionally more concern among Asian firms, explaining the higher figure for global respondents who put either in their top three – 21% for MiFID III and 16% for AIFMD II.

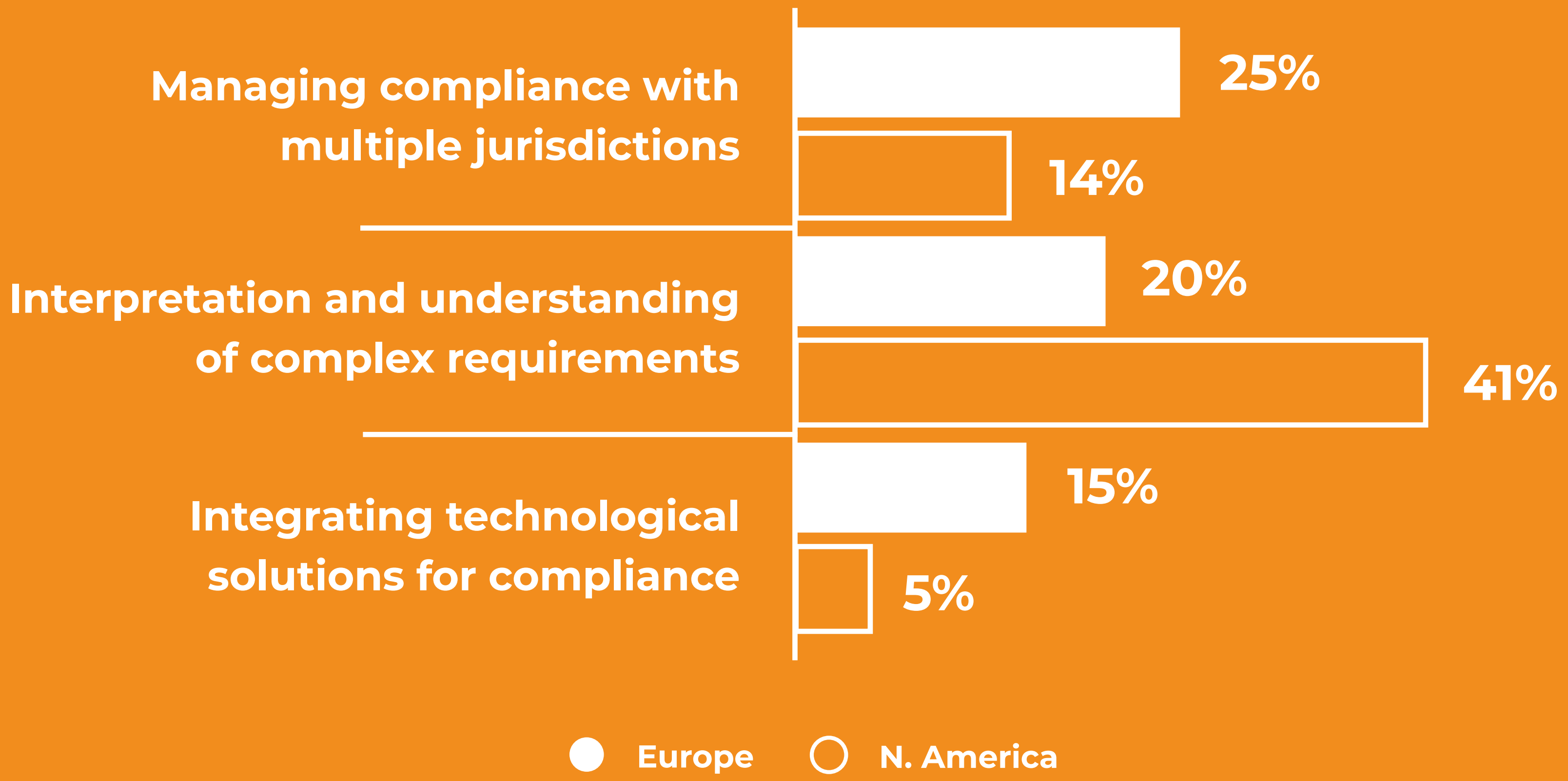
FROM ACROSS THE POND

Hedgeweek research suggests – and confirming the conclusion drawn by Inglis – that European

KEY FINDING

European hedge fund firms are less concerned by complexity, more by multiple jurisdictions

Selected regulatory challenges considered 'significant' by European and North American hedge fund firms:



INSIGHTS

hedge fund managers are far more concerned with SEC-proposed regulations, than vice versa. The PFA amendments drew the most concern from 26% of surveyed European managers. The global figure was 40%.

The PFA proposals have drawn ire from hedge fund managers over, for example, the Restrictive Activities rule, which for US private fund clients, bars the adviser from engaging in specified activities such as borrowing securities or implementing a credit line unless certain covenants are satisfied.

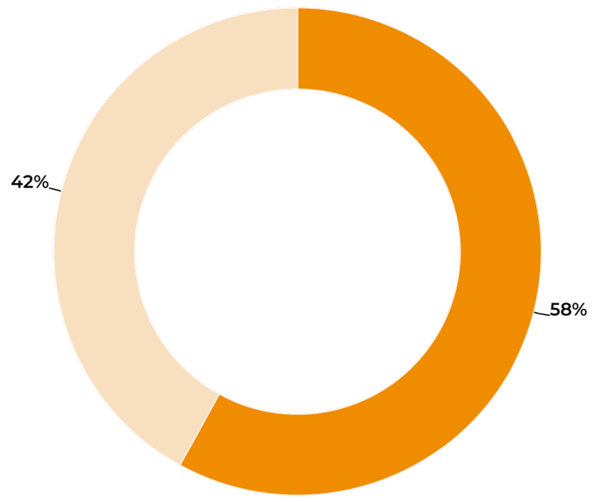
Among US developments, the PFA rules drew most concern among European managers, but 16% also selected the SEC's upcoming adoption of T+1 settlements, rather than T+2, within their top three (against 24% globally).

The SEC's proposed redefinition of a broker-dealer under the PDA rules appears to have more European managers concerned compared to the global aggregate, showing how more of the non-US, and typically smaller, industry may well be drawn into their regulatory net. European managers registered a concern for the rule at 17%, higher than the North America and global figures, both 14%.

US law firm Morgan Lewis warns that firms using covered technologies (broadly any form of technology that is used for client interaction, including potentially financial models) may face increased capital expenditure to be compliant (for more, see the boxout in Section 3).

Second, the changes, which target practices where the firm put their interests ahead of their

Fig. 2.2 Proportion of AIF AUM domiciled in Ireland and Luxembourg



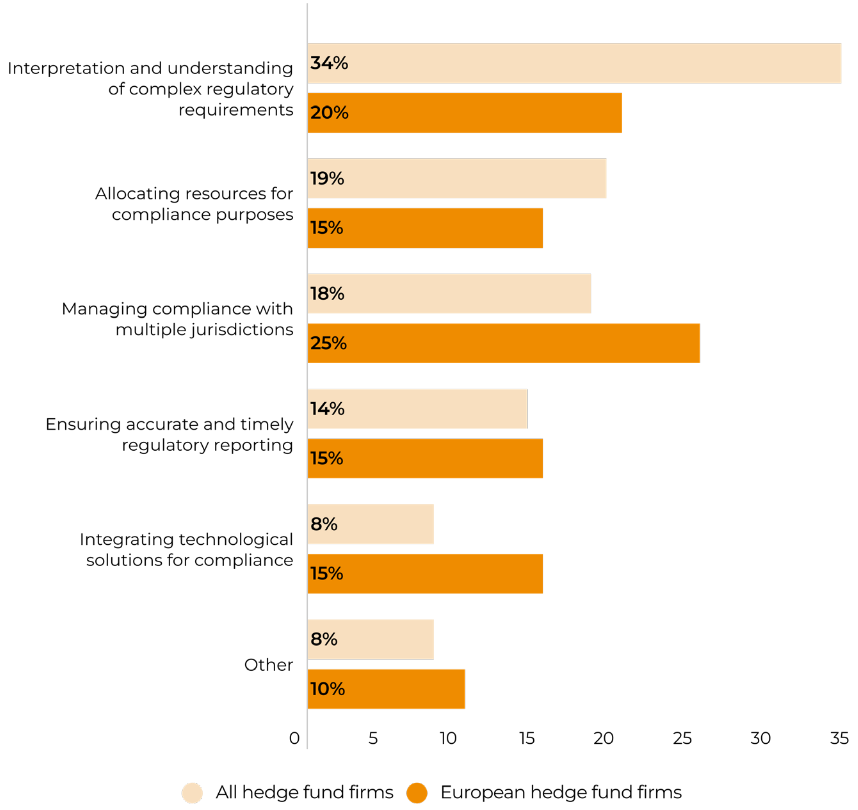
Analyst note: *NAV of HFs of AIF managed and/or marketed by authorised AIFMs and sub-threshold managers registered only in national jurisdictions. Data for the EEA30.*

Sources: AIFMD database, National Competent Authorities, ESMA.

> “We have seen an extraordinary number of new proposals being made to the market and to the industry

Jack Inglis
CEO, AIMA

Fig. 2.3 Top regulatory challenges for European hedge fund firms



Analyst note: *Survey respondents were asked, 'What is the most significant regulatory challenge you face as a hedge fund manager when it comes to reporting and compliance?'*

Source: Hedgeweek Q3 Hedge Fund Manager Survey

client, could theoretically impact any European manager who has a US Private Fund client invested in any of their vehicles.

When breaking down the figures, European discretionary managers were more likely to be concerned by this redefinition than systematic managers. In contrast, changes to Form N-PX, regarding proxy voting records, and changes to the SEC's Form PF attracted the least concern of European managers (6% and zero respectively).

Figures from the European Securities and Markets Authority (ESMA) show how much the European hedge fund market, within the European Economic Area of 30 countries, is dominated by Luxembourg and Ireland. The first reading since Brexit occurred at the end of 2020 shows the two countries account for 58% of industry NAV (see Figure 2.2).

MULTI-JURISDICTIONAL CHALLENGES

In this fluctuating regulatory environment, the survey also examined how challenged European hedge fund managers were when meeting their compliance and reporting requirements.

Overall, there was one overriding concern for Europe-based managers: 'managing compliance with multiple jurisdictions', selected by 25% of European survey respondents (see Figure 2.3).

This figure was notably higher than the 18% of global firms which selected this, suggesting that European firms are more burdened on this

Burden heaviest on smaller firms

The impact of the raft of new SEC rules is being felt not just in the US but across the world, including in Europe. Smaller firms are exempt from reporting in the US, so saved from varying amounts of this burden, but still disproportionately impacted by having to deal with new rules on cost grounds.

It is more difficult to justify the spend on personnel for smaller firms and more use of outsourced services is likely. "[It is] just much harder for smaller investment managers like ourselves," says Brandon Baer, COO and CCO at US-based Polpo Capital Management. Phillip Chapple, COO at UK-based Monterone Partners, a sub-billion dollar long/short equity firm, coined the phrase "compliance fear" when managers fret about compliance to upcoming proposals.

He suggested that until some proposals are closer to final adoption and are more fully interpreted and better understood, it is preferable for smaller managers to look at how larger managers are responding to draft regulations and then act accordingly.

Many in the industry share this opinion, with much regulation spending a lot of time in draft phase before being implemented. There is a balance to be struck between being prepared and only reacting to rules once they are about to take effect, saving a lot of time and effort in the meantime – resources which can be in short supply for smaller firms.

> "There is a balance to be struck between being prepared and only reacting to rules once they are about to take effect

front than their North American peers, and likely speaks to the large number of European firms that have to provide additional fund intelligence to the SEC as well as their domestic regulator.

Beyond this, European managers' second top concern was the "Interpretation and understanding of complex regulatory requirements" on 20%, albeit well below the global average of 34%. After this, there are there options tied on 15%.

Integrating technological solutions for compliance was a top challenge for 6% of respondents, against 4% globally and 3% in North America, indicating that firms in Europe find it more of a struggle. The tech angle of compliance will be explored in the next chapter, but this finding suggests European firms are missing a trick and could do better in using technology to transform their handling of the compliance burden. ■

KEY TAKEAWAY

Given the increase in the regulatory burden, it is perhaps no surprise that North American hedge fund operations and compliance professionals are more than twice as likely as their European peers to name the interpretation and understanding of complex regulatory requirements as their most significant regulatory challenge in terms of reporting and compliance.

REFRESHING THE ROADMAP

Whether it's managing a compliance team or staying informed on regulatory developments, CCOs and COOs need all the help they can get. Here are the methods and solutions proving popular.

Given the sheer scale of existing and planned rules and regulations covering hedge funds, dissected in the previous two sections, operations and compliance staff face a huge challenge. Navigating the complex regulatory environment has never been more arduous.

The challenge of allocating enough internal resource to the task, means it is perhaps no surprise that 80% of respondents to Hedgeweek's hedge fund manager survey said they make use of external compliance consultants/advisors to stay on top of developments (see Fig. 3.1).

Larger firms make more use of outsourced compliance support than smaller ones, again speaking to how hard it is for emerging managers to dedicate enough resource – whether internal or external – to the challenge (see Fig. 3.2). And European firms were more likely to do so than North American firms (85% versus 78%).

The other three options for staying informed – in-house team, subscription services, and industry events – all received a similar share of survey responses, around 40%. But again, much depends on size and location.

For example, North American managers are less likely than European managers to use industry conferences to stay on top of compliance developments and more likely to use an in-house compliance team. This is likely considered a better way to manage the challenge of 'interpreting and understanding complex regulatory requirements', which, as previously shown, is a concern for a greater proportion of North American managers.

Smaller managers are, unsurprisingly, less likely to dedicate resources to an in-house compliance team than larger managers: one quarter of firms with AUM <$250m stay informed this way, rising to 53% among managers with AUM of $250-999m and 60% at managers with AUM of more than $1bn.

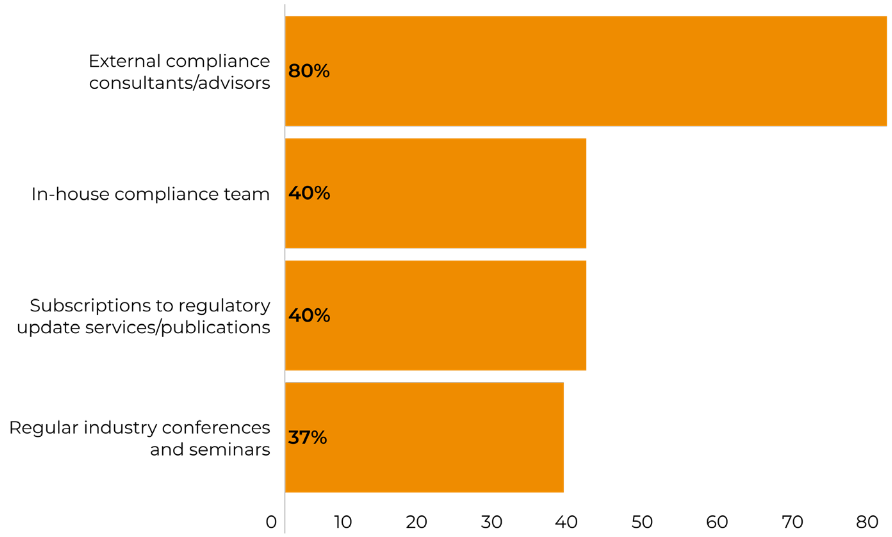
However, there were similar levels of uptake across the AUM spectrum for consultants, conferences, and subscriptions.

ASSOCIATIONS AND SEMINARS

"We stay up to date on the regulatory landscape via our membership in the Managed Funds Association," says Sean Cumiskey, Co-COO of Yiheng Capital Management, a San Francisco-headquartered long/short equity manager with over $1bn under management. "The MFA does an excellent job of communicating ongoing regulatory developments in addition to serving as an effective advocate for the private funds industry."

One UK boutique hedge fund co-founder interviewed by Hedgeweek described how

Fig. 3.1 Top ways hedge fund firms stay informed about regulatory changes



Analyst note: *Survey respondents were asked, 'How do you manage and stay up-to-date with the evolving regulatory landscape?' (Select all that apply)*

Source: Hedgeweek Q3 Hedge Fund Manager Survey

KEY FINDING

Hedge fund firms ramp up in-house compliance resources as AUM passes $250m

Proportion of hedge fund firms surveyed that manage their regulatory requirements through an in-house compliance team:

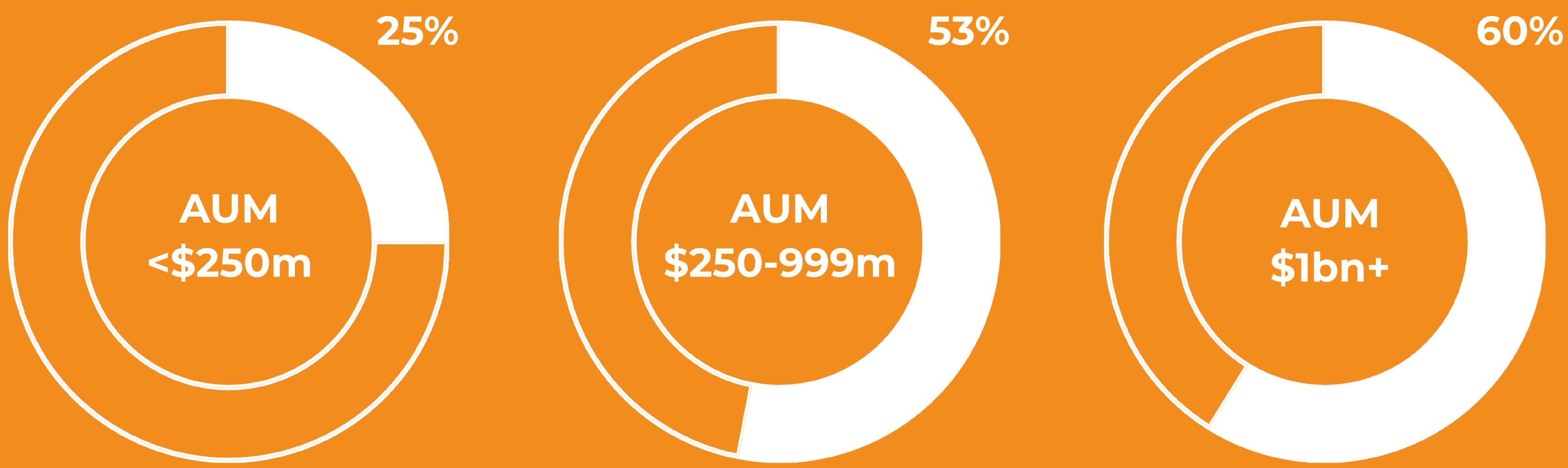
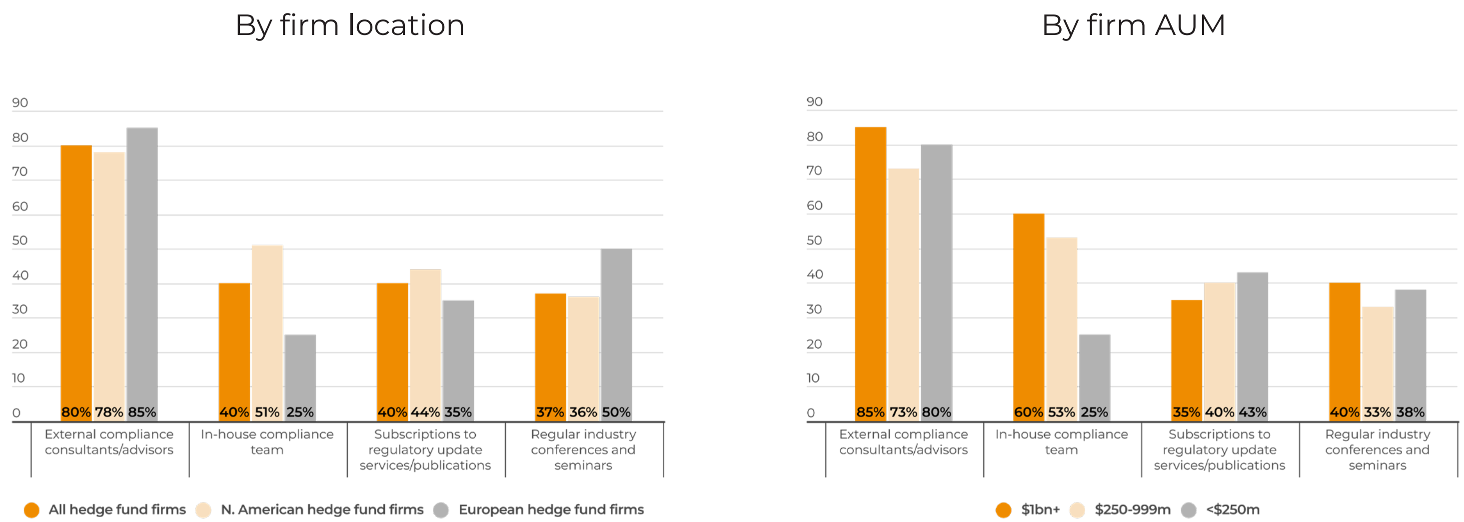


Fig. 3.2 Top ways hedge fund firms stay informed about regulatory changes – by respondent firm location and AUM



Analyst note: *Survey respondents were asked, 'How do you manage and stay up-to-date with the evolving regulatory landscape?' (Select all that apply)*

Source: Hedgeweek Q3 Hedge Fund Manager Survey

seminars were useful to verify whether the information provided by consultants was up to date.

Adam Knowles, deputy COO at Systematica Investments, a European quant manager running more than $15bn, says the main ways to keep up to date are via service providers such as brokers, legal firms, consultants, and direct regulator contact.

"What's missing is a tailored exec summary that you can filter by fund types, products traded, regions traded, investor base by country," he adds. "The detail we can always find, but that scan of the market for relevant points is painful."

Technology has played an increasingly important role in hedge fund compliance over the past ten years, and, though there is room for further improvement and evolution, most hedge fund firms are generally satisfied with their solutions: among Hedgeweek's survey sample, when asked to rank on a scale of one to five how effective their technology currently deals with regulatory compliance is, more than half provided a rating of 4 or 5 out of 5 (see Fig. 3.3)

But again, there were notable differences by size and location. Over one quarter of smaller managers (AUM <$250m) awarded a score of 5 out of 5 compared to 16% of larger managers (AUM $1bn+). Furthermore, the top rating was far more common in North America (32%) than Europe (10%) – perhaps evidence that Europe is behind the curve when it comes to integrating regulatory technology.

Long/short equity managers were more likely to view their regtech favourably than digital assets firms, with 60% of the former rating it as a 4 or 5 out of 5 compared to 29% for the latter – an opportunity for digital asset specialist providers to step up or step in.

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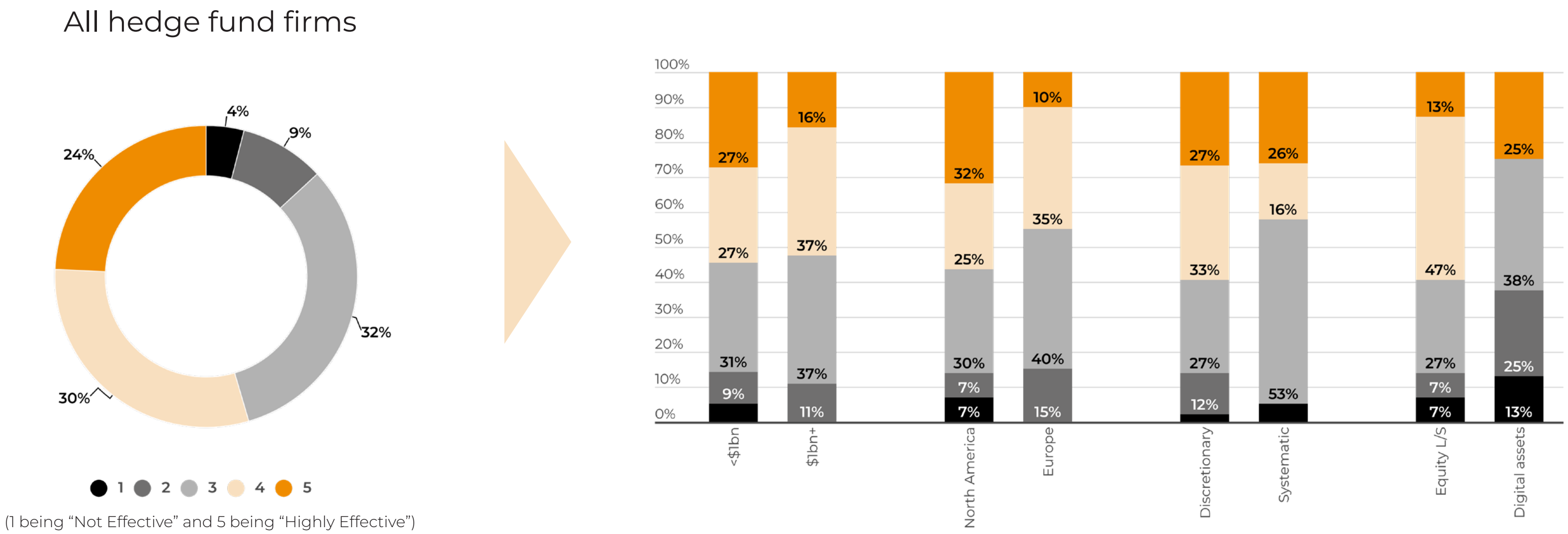
The detail we can always find, but that scan of the market for relevant points is painful

Adam Knowles
Deputy COO, Systematica Investments

Fig. 3.3 Effectiveness of compliance technology, according to hedge fund firms



Analyst note: *Survey respondents were asked, 'How effectively does your current compliance technology support your regulatory reporting and compliance efforts?' (Rate on a scale from 1 to 5, with 1 being "Not Effective" and 5 being "Highly Effective")*

Source: Hedgeweek Q3 Hedge Fund Manager Survey

A similar pattern – albeit more muted – can be observed by manager trading style, with 60% of discretionary managers rating their regtech's effectiveness as 4 or 5 compared to 42% of systematic managers – perhaps suggesting that the regulatory technology ecosystem has more work to do when it comes to the compliance burden faced by quants.

WHERE TO IMPROVE?

As part of our research, hedge fund interviewees were also asked to identify the specific features or improvements they would like to see in compliance technology to enhance the regulatory reporting processes.

"This is a hard one to answer," admits Brandon Baer, COO and CCO at Polpo Capital Management. "It becomes plug and play once you get the first few done," he says, noting the many reporting requirements in the US beyond Form ADV. Ultimately, you just need a good process in place, he adds.

At Yiheng Capital Management, where AUM is over $1bn, Cumiskey says compliance technology and potential improvements to enhance the regulatory reporting processes is "an area of continual discussion". "Our experience so far is that there is no one-size-fits-all solution here, at least in relation to our firm."

> Technology has played an increasingly important role in hedge fund compliance

For firms with more modest requirements, it is a case of identifying when additional features or new tech are necessary. For example, many COOs, including Phillip Chapple at UK-based Monterone, a concentrated equities manager, use models and spreadsheets to harvest the necessary data for regulatory reporting.

Kevin Gahwyler, managing director and head of business development at New York-based Meteora Capital, says his firm has "not added any technology at this point".

The results of Hedgweek's survey and the spread of sentiment from operational leaders shows there is clear need among hedge funds for new tools to improve regulatory reporting and compliance – but maybe not the understanding of how technology can help.

If there is agreement among hedge fund managers – a group with increasingly varied requirements – it is that regtech solutions could be better streamlined, where possible, and that multiple providers and systems are adding complexity at a time when there is a real need to reduce complexity, not compound it. ■

KEY TAKEAWAY

Asked to rate how effectively current compliance technology supports regulatory reporting and compliance efforts, 32% of North American managers awarded a top rating – 5 out of 5 – compared to just 10% in Europe. Our research suggests that European firms trail when it comes to integrating technological solutions for compliance, which was a top-three challenge for three times as many European respondents as North American respondents.

New rules to increase reporting and compliance tech spend

Even the SEC admits its new Private Fund Adviser Rules will likely add hundreds of millions – and probably billions – to the global industry's spend on compliance. The huge increase in the reporting and compliance burden over recent years has transformed the budget required by hedge funds.

The US watchdog has estimated the new rules covering audit statements and quarterly performance reports will cost the industry an extra $961m every year, according to the FT. And the rules on unequal treatment of investors, plus extra costs linked to new fund expense disclosures are estimated at another $938m.

The reality will likely be higher, given the entire industry will be clamouring for these new services at the same time, and follow the raft of other new recently introduced or planned measures on the SEC agenda.

Higher spend on compliance and reporting technology is inevitable, as well as a rush to beef up headcount in operations at the largest firms. Lawyers on the sell-side will become prime targets as big firms add support for their general counsels, and ops and compliance teams.

The burden will fall heaviest on the smaller managers with less resources. But given the high satisfaction with regtech's effectiveness among these firms, there is a clear appetite for innovation.

HEDGEWEEK

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