Former officials tell hedge funds: Be ready for the regulators

By: By Svea Herbst-Bayliss – January 23, 2013

U. S. securities regulators are watching hedge funds more closely than ever, and former Securities and Exchange Commission officials and industry experts are urging managers to be ready when federal examiners come knocking.

For roughly a year now, once-secretive hedge funds have been forced to open up about how much money they manage, the kind of clients they have and how they plan to make money.

While many managers may have hoped that the requirement to register with the SEC, part of the Dodd-Frank financial reform act, would go away, experts say the new rules are here to stay and may even get tougher.

"The election only affirmed Dodd-Frank," said Mark Calabria, director of financial regulation studies at the CATO Institute, a think tank. "The government can now move from a posture of defense."

Indeed, many managers are now worried about a possible "witch hunt" from regulators ready to make an example of a fund that has been sloppy in enforcing the new rules.

"The SEC is starting to make surprise visits, they want to make their presence felt," said Deborah Prutzman, CEO of Regulatory Fundamentals Group, which guides managers on facing these exams.

Managers worry even more about the government's ongoing insider trading probe, which has seen prosecutors and federal agents knocking on doors and actually arresting people.

Their efforts have circled in on prominent funds, including Steven A. Cohen's SAC Capital Advisors, in an effort to see whether these funds rely on illegally obtained information to gain an edge. Neither Cohen nor SAC have been accused of any wrongdoing.

Some 40 percent of the SEC's current cases revolve around insider trading.

"They want to string someone up by the yardarm," Paul Atkins, a former SEC commissioner who now runs Patomak Global Partners, said. "I don't see that happening, though," he added.

Still, government examiners will come knocking, and experts urge managers to be ready to answer all questions.

"Hedge fund managers need to understand that they need to stay ahead of the information that the SEC already has on them," said David Thelander, a former SEC enforcement lawyer who is now a managing director at regulatory advisory consulting group Promontory. This means having data available on how funds traded around releases of key corporate releases and having a handle on how their analysts used expert networks, for example.

David Kotz, a former SEC inspector general and now director at Berkeley Research Group, told managers to welcome the SEC.

"Interact with them more," he urged. "The more you schmooze them the better it will be."