

HEDGE FUND DARWINISM

ISSUE

When the tech bubble burst in the early part of this decade, only the strongest dot-coms and tech start-ups survived. When the financial implosion hit last year, hedge funds were the ones fighting for their lives.

IMPACT

Many funds didn't make it.

- A record 778 funds liquidated in Q4 2008, representing \$152 billion in assets
- Almost 200 funds of hedge funds (FOFs) closed in Q1 2009, many on the heels of significant losses and many due to exposure to the Bernie Madoff fraud (this represented 8% of all FOFs)
- Since mid-2008, almost 1,200 funds have disappeared (*Hedge Fund Research*)

The secrets to survival included prudent risk management and quick, smart strategic moves. Many of these survivors have trimmed management fees as an olive branch to investors. Hedge funds have also pumped money into lobbying efforts as the Obama administration proceeds with financial system reforms, hoping that their industry will be spared an onerous regulatory overhaul that could demand transparency of all trades and investment management fees. Over \$6 million was spent by the industry in

Washington in 2008, up from \$4.2 million in 2007. (*Center for Responsive Politics*)

Last but not least, many hedge funds have come to see the value of insurance protection. Professional Liability (D&O and E&O) and Crime (Fidelity) insurance are fast becoming a critical risk management tool for the hedge fund industry.

ACTION

Any firm currently purchasing D&O, E&O and Crime coverage lines should benchmark their limits and retentions based on the size of their operations and full, detailed assessment of their evolving exposures. An experienced broker partner can help lead this undertaking.

Any fund without insurance in any of these lines should explore the marketplace options. Not only do these insurance products protect the fund and the individuals running the business, but the coverage also provides comfort to those investors that entrust their invested assets to hedge funds. Work with a partner that knows what policy language is required and can help you obtain optimal protection.

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