

Hedge fund boards and the market for independent directors

Chris Clifford

Jesse Ellis

Will Gerken

Forthcoming in *Journal of Financial and Quantitative Analysis*

Hedge Fund Governance

- Over \$3 trillion invested in hedge funds by pensions, endowments, and the high net worth individuals.

Hedge Fund Governance

- Over \$3 trillion invested in hedge funds by pensions, endowments, and the high net worth individuals.
- Contracting environment for hedge funds
 - Limited regulation and disclosure, illiquid assets, illiquid hedge fund shares, increased use of leverage and derivatives

Hedge Fund Governance

- Over \$3 trillion invested in hedge funds by pensions, endowments, and the high net worth individuals.
- Contracting environment for hedge funds
 - Limited regulation and disclosure, illiquid assets, illiquid hedge fund shares, increased use of leverage and derivatives
 - Creates fertile ground for agency problems

Citi pays \$180 million to settle hedge fund fraud charges

by John Kell @johnnerkell AUGUST 17, 2015, 2:34 PM EDT

Ex-compliance chief avoids prison for \$500 million hedge fund fraud

By [Richard L. Cassin](#) | Tuesday, January 13, 2015 at 11:18AM

Hedge Fund Governance

- Over \$3 trillion invested in hedge funds by pensions, endowments, and the high net worth individuals.
- Contracting environment for hedge funds
 - Limited regulation and disclosure, illiquid assets, illiquid hedge fund shares, increased use of leverage and derivatives
 - Creates fertile ground for agency problems
- Has led to an increased call for more regulation and oversight of hedge funds (Dodd-Frank, Form-ADV, Form-PF)

Hedge Fund Governance

- What role do existing governance mechanisms play in shaping the contracting environment between investors and managers?
 - Board of Directors
 - $\frac{3}{4}$ of US funds are set up offshore as a corporation
 - Directors are hired by fund manager at inception

Life as a hedge fund director: a day at the beach

The New York Times

The Other Offshore Disaster

By **WILLIAM D. COHAN**

June 24, 2010

Financial Times

November 20, 2011 10:00 pm

Less is more for Cayman 'jumbo-directors'

By Sam Jones



FT FINANCIAL
TIMES

A call to fix hedge fund governance

By John Plender

May 6, 2012

The New York Times

JULY 1, 2012

In Caymans, It's Simple to Fill a Hedge Fund Board

By AZAM AHMED

Hedge fund board data

- We rely on Regulation D exemption disclosures to the SEC
 - Exemption allow companies to offer and sell securities without registering with SEC
 - Must file Form D electronically with SEC starting in 2009
 - Data on officers and directors of firm(fund)
 - Universe of hedge funds seeking to raise capital from U.S.-based investors from 2009-2013
 - For some analyses, we merge with Form ADV and commercial hedge fund return databases



Research Questions

- How are hedge fund boards structured?
 - Find evidence inconsistent with regulatory compliance-based or “rubber-stamping” explanations
 - “Busy” professional directors from directorship firms
 - Consistent with cost/benefit trade-offs
 - By serving many masters, a director is a slave to none.
- Does board composition matter to investors?
 - Investors respond to the structure (and changes in the structure) of the board
 - New funds with outside boards are larger
 - Funds lose AUM the quarter after outside director leaves
 - High quality boards associated with lower fraud rates and better use of discretionary liquidity restrictions
- How can hedge fund boards be effective?
 - Certification effect of outside directors
 - Reputation concerns in the market for directors

Implications

- While our study focuses specifically on the labor market for hedge fund directors
 - More generally, it raises an interesting question:
- Why don't we observe a similar market for professional *corporate* directors?
 - Anti-trust concerns
 - Advisory role of corporate directors
 - Heterogeneity of corporations vs. hedge funds