

Hedge Funds: A Credit Perspective

A two-day intensive workshop offering an in depth structured approach to the analysis of hedge funds and alternative investment strategies. The workshop takes a credit focus for bankers and analysts but is also appropriate for a wider audience who need to understand the key risk issues of the hedge fund industry.

TARGET AUDIENCE

The workshop is targeted at an intermediate level for credit analysts but is also appropriate for a wider audience of risk managers, bankers, regulators and other professionals who need to understand the key risk issues of the hedge fund industry. It is complementary to the one-day workshop: Regulated Funds & Fund Managers: A Credit Perspective. Participants may also be interested in attending Counterparty Credit Risk in Derivatives.

FitchTraining offers programmes at an intermediate level and advanced level of continuing education. Although there are no prerequisite courses or experience, working knowledge of investment markets and financial products is required.

COURSE OBJECTIVES

The workshop offers a structured analytic framework for the credit analysis of hedge and other unregulated funds.

Specifically participants will be equipped to:

- Distinguish the risk profile of a fund's investment strategy, structure, leverage and liquidity
- Apply financial analytic tools used to benchmark the performance and risk profile of a fund
- Identify the due diligence required for evaluating the fund manager's expertise, investment process, risk management and controls
- Evaluate the structural risks and rewards of exposures to funds.

CONTENT

INDUSTRY OVERVIEW

This section reviews the development of the hedge fund industry and the key legal, structural and jurisdictional features.

- History and growth of hedge funds
- Role of hedge funds in financial markets
- Investors - evolving investor base.
- Risks: orientation, strategy, financials and key parties.

Orientation

- Types of funds: hedge funds, managed accounts, certain closed ended funds, funds of funds, master feeders, etc.
- Hedge funds compared to private equity funds
- Legal status of funds: partnerships, companies, segregated accounts, etc.
- Jurisdiction: offshore registrations, listings, fund manager domicile
- Impact of recent and proposed regulation:-
 - Dodd-Frank Act in the US
 - Proposed Alternative Investment Fund Directive in the European Union
- Growth of the 'Newcits' Fund: increasing use of the UCITS framework in the European Union
- Open versus closed ended; notice periods and liquidity provisions
- Fee structures: upfront and performance; high water marks.

Goals

- Absolute versus benchmarked returns
- Alpha versus beta; portable alpha
- Minimising correlations.

STRATEGIES

The goal of this section is to differentiate the investment and trading practices and risk profile of different hedge fund strategies.

- Techniques to optimise risk adjusted returns: leverage, derivatives and short selling
- Fund policies, practices and restrictions
- Risk profile of different strategies

Directional Strategies

- Global macro
- Long / short equity
- Managed futures
- Dedicated short funds
- Emerging Markets

Relative value strategies

- Equity market neutral
- Fixed income arbitrage
- Convertible arbitrage

Other

- Event driven: distressed
- Event driven: risk arbitrage
- Multi-Strategy
- Fund of Funds

- *Exercises:* risk profiles of different fund strategies

FINANCIAL ANALYSIS

This section offers a structured approach to the financial analysis of hedge funds.

- "S": Size: reviewing size, diversification and market position of fund
- "M": Market risk: evaluating degree of market volatility
 - Is VAR a useful measure for hedge fund risk?
 - Appropriate limit & control structures for different strategies.
- "A": Asset quality: assessing the risks in the asset composition and using tools such as haircut analysis and NAV calculations
- "L": Leverage: measuring the degree of balance sheet and off balance sheet leverage; gross and net leverage calculations
- "L": Liquidity: redemption risk and benefits of capital locks, back up credit lines
- "P": Performance: bench marking performance against indices and evaluating past performance; measuring risk and performance – Sharpe and Sortino ratios; peak to trough drawdown.
- Importance and limitations of performance measures.
- *Exercises:* reviewing leverage, performance and asset quality measures
- *Case study:* financial analysis and risk rating of a hedge fund

FUND MANAGER

This section reviews the due diligence required for the fund manager and other parties involved in a hedge fund.

Overview

- Key parties involved in fund
- Prime broker
- Administrator / custodian.

Fund manager

- Key issues: experience levels, size, affiliation, regulation
- Due diligence: benchmarks for minimum disclosure
- Investment process
- Risk management
- Operational and credit risk
- *Case study*: financial analysis; overall performance; balance sheet and cash flow analysis of an alternative fund manager

Early warning signals

- Summary of major failures & causes
- Common themes of failure
- *Case study*: early warning signals of a leveraged hedge fund

TRANSACTION STRUCTURE

This section offers a systematic approach to the structuring of exposures to hedge funds.

Structured approach to analysis

- Using the purpose payback model to evaluate transactions: Who is the counterparty? What assets are being purchased?
- Risks and mitigants of example transactions: how will the transaction be settled or the debt repaid at maturity? Recommend how proposed transactions should be structured.
- Types of risk when dealing with funds: credit, market, operational, reputation
- Impact of prime brokerage relationships on the risk profile

Exposure profile:

- Assessing the appropriateness of the structure in terms of amount, maturity etc
- Ranking: establishing and maintaining a senior position
- Collateralisation of trading transactions:
 - Measuring exposure
 - Matching margining approach to risk
- Safeguards: collateral, unsecured thresholds, covenants, break clauses and other
- Market practices
- Managing the default process.
- *Exercises*: structuring exposures to hedge funds.

Learning Paths



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