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3 Questions Reveal Whether Your Fund's Risk Management is Marketable To Institutional Investors

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(Excerpted from comments Sam Won made speaking at HedgeWorld's 2011 Fall Fund Services Conference on Oct. 26.)

If you are going to try to raise capital from institutional investors or seeders this year or next, you only get one chance to make your first impression. You need to meet the institutional-quality litmus test about risk management from the start. You won't get a second chance with these investors—there are no mulligans given today by investors to the funds that pitch them.

Is your firm's current risk management institutional-quality? Here are three questions about risk framework, risk measurement and risk management that will reveal the answer. Discuss this with your management team and see where you stand.

1. **Risk Framework**
Can your firm clearly state in writing its framework for and processes and controls around risk management, and explain how the risk management process is linked to and intertwined with the investment process?

It is critical to have well developed, written description of a risk framework that clearly delineates the fund's risk management processes and controls. This copy is a must-have for a fund's marketing materials. This copy does double duty because much of the information that describes a fund's risk framework is needed to answer DDQ questions from investors today. From my firm's experience funds that crafted a clearly stated risk management framework do a better job of articulating their risk management processes and controls to investors when pitching investors and managing investor relations with clients.

2. **Risk Measurement**
Does your firm have a formal process for measuring, monitoring and reporting its market and credit risks (e.g. VaR, Scenario Analysis and Stress Testing)?

Today, for a fund to be perceived to have an institutional-quality risk management program, it must be able to prove it has a formal program for measuring, monitoring and reporting its market and credit risks, to external constituents such as investors and regulators.

A fund must be able to demonstrate that it can identify, evaluate and monitor its major risk and performance drivers on both a quantitative and qualitative basis. Further, it needs to document that it reports these risks and trends to portfolio management team members, investors and regulators.

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3. **Risk Management**
Does your firm have clearly defined process for managing risks?

Prior to 2008, funds that could substantiate that they were able to measure and monitor their risk and performance drivers typically passed muster with institutional investors. Today, investors are expecting to see that their funds are able to manage investment risks through a formal risk management program that includes risk sizing positions, risk-based asset allocation and having a well thought out approach for defeasing risk through hedging. One of key differences pre- and post-2008 is that institutional investors are looking to see that funds can not only measure and report their market risks but also demonstrate that they can manage these risks, especially in times of volatility and crisis.

If you can't answer "yes" to the three questions posed here then you won't be able to pass the due diligence scrutiny from institutional investors and you're also bound to have difficulty attracting high net worth investors and family offices.

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