Private Eye is Watching You
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How private investigators dissect the backgrounds of hedge fund managers—and help potential investors get both sides of the story.

Robert Seiden got a call one day from one of his clients, a fund that was considering an investment with a South American businessman. Someone at the fund had seen a news story about a gentleman of the same name being involved with a major South American drug ring. The fund's managers wanted to know if Mr. Seiden's company, **Fortress Global** Investigations & Security, would check it out—just as a precaution.

Wouldn't you know it, it was the same man.

"He was a very wealthy guy who owned a mansion in a South American country," says Mr. Seiden, president and chief executive of Fortress. Not surprisingly, the fund opted not to invest with the individual. "We were able to save the client a lot of money and aggravation with the information we disclosed," Mr. Seiden says.

Fortress provides background screening of hedge fund managers, a service that is growing in popularity as funds of funds, institutions and high-net-worth individuals place greater worth on due diligence in an age where scandal and fraud are widespread.

The fact that the hedge fund industry is not formally regulated lends itself to these types of investigations. Over the last three years, Mr. Seiden says he's seen the demand for hedge fund manager background screening grow "dramatically," which he says is a good thing: "The industry needs these checks and balances in place, because the government and regulators aren't doing this."

Jeff Brenner, principal of Intelysis Corp., estimates that approximately one-third of his company's business now comprises hedge fund manager investigations; over the past five years, he says he's seen a tenfold increase in such cases. The largest percentage of that work is done for funds of funds, he says, followed by wealth management offices and venture capital and private equity firms.

"The rules of the game have changed," says Michael Fellner, senior managing director and Chicago office head for Kroll, which conducts investigations into the backgrounds of hedge fund managers from more than 60 offices around the globe.

In the past, institutions and investors may have relied on their own contacts and experiences to vet a hedge fund manager, but those methods don't usually uncover lawsuits, regulatory action and criminal histories.

Mr. Fellner offers the examples of Bayou Management LLC, where an accounting firm controlled by the fund was used to hide losses until its demise in 2005, and Integral Investment Management LP, the Dallas hedge fund firm that lost most of a $22.5 million investment from the Art Institute of Chicago in 2001. In both instances, he says, a background screening could have turned up information that might have made investors think twice before allocating.

The Permanent Record

The first step of a background screening is verifying the educational and employment history on a manager's resume, and looking for related litigation or regulatory action at the federal and state levels. Criminal records are checked at the manager's current and past places of residence, along with bankruptcies, tax and civil court issues, Uniform Commercial Code filings, personal and professional affiliations, membership and donations to political parties, and ownership of real estate, vehicles, boats and aircraft.

This involves a lot of document-pulling and database searching, and traveling is sometimes required. In the case of "media searches" done at Fortress, investigators might find themselves in the local library—if a manager lived in Stamford, Conn., Fortress investigators use databases like Factiva and Lexis-Nexis to search local newspapers dating back 20 years, and if it's not available online, someone is sent to look at the microfiche in person.

Researching legal action is similar. "With lawsuits we don't rely on what's online, we go down to the courthouse and pull out the copy and see what the story is," Mr. Seiden says. "Oftentimes in this industry, when there are lawsuits, they're often settled out of court, and then we try to find out the nature of that settlement, which requires a bit of guile on our part."

Context is crucial—a pile of documents is one thing, Mr. Fellner says, but a complete picture of someone's track record comes to light "tangentially."

"We look for the issues that surround them—for example, the person may not have been named in any litigation, but maybe they were the central figure in a problem involving the company where they worked. We'd check out the companies they've been involved in and their past business partners," he says. "This type of secondary check is what most people don't do."

That's where tough questions can arise. Does a manager's spouse have a material role in the firm? If so, she must be vetted as well. Does the manager pay bills on time, or has he had a foreclosure on a mortgage? If he can't keep his personal finances in order, Mr. Fellner says, a client may question whether he's fit to manage finances professionally—or if there is a temptation to commit fraud.

"We're not looking for dirt, just a complete picture," Mr. Fellner says. "Hedge funds pride themselves on creative investing… you have to look at them creatively."

Then there's a good old-fashioned Google search. Intelysis has proprietary methods of combing the internet, looking for blogs, bulletin boards or podcasts that may involve the interview subject or mention him in some way. According to Mr. Brenner, it may reveal what is thought of a manager's trading habits, views on his reputation or a glimpse of his social life.

In one case, this method revealed that a certain manager was a very avid sailor, registered for regattas all over the world. While not necessarily negative, Mr. Brenner says that fact was reported to the client: "How often is [the manager] going to be at the trading desk? It's something that would be of interest."

At Fortress, after the documents are collected, the information is passed onto a group of retired Federal Bureau of Investigation and Central Intelligence Agency agents, who have past experience investigating the backgrounds of cabinet and federal judge nominees, as well as candidates for employment in federal offices.

The next step is interviewing those who have worked with the manager in various capacities, as well as former investors or those who have been on the other side of a lawsuit against the manager. This approach can reveal information that isn't part of a paper trail. Mr. Fellner notes that, in the white collar world, most wrongdoers aren't arrested, fired or sued in open court—they're quietly shown the door.

Mr. Fellner says he does these interviews in person as often as possible: "There's no substitute for body language and being able to look the person in the eye across the table," he says.

That factor comes into play with another key source—the hedge fund manager himself. All of the firms spoken to for this story offer clients the option of conducting an investigation in secret, but most prefer to include the manager in the process.

With the manager's signature on a disclosure and consent form, Mr. Seiden explains, the investigator has the right to check his credit report, regulator filings, and whether he's worked previously in other areas, such as the National Association of Securities Dealers.

There are, however, advantages to conducting an investigation anonymously. The firm can act as a barrier for the potential investor, asking not-so-nice questions so the client doesn't have to. "Con men succeed in part because they make it uncomfortable for people to check them out," Mr. Fellner says. "They ingratiate themselves and make people feel uncomfortable openly investigating or asking questions."

Then again, if the right question comes up, the client may have no trouble taking the concern straight to the manager. Kroll once investigated an individual who began to look as though he may have engaged in insider trading; when the client, a hedge fund, was alerted, the fund's principals decided to ask the individual about it themselves.

Mr. Brenner says it's rare to find a manager who balks at being personally interviewed. Intelysis recently investigated one fund manager who refused to sign a consent form, and as a result, the client refused to do business with that fund. "In this marketplace, I just can't see any manager, whether at a hedge fund or private equity fund, refusing to do a background check," he says.

Mr. Fellner agrees. "Anybody that's serious in this business hasn't objected," he says. Even when investigating subjects who seem highly suspect, Mr. Fellner has found them more than willing to sit for an interview. "They figure they can talk their way out of anything," he says.

The Verdict

In general, a domestic investigation takes anywhere from one to three weeks, depending on the availability of information and interviewees, and can cost between $1,000 and $2,000. Usually, clients have companies like Fortress, Intelysis and Kroll on retainer, and submit investigation candidates as they come along. Single cases are taken as well, though they tend to be less common.

The time frame and price can increase significantly when the subject has lived or done business overseas. Many private investigation firms, if they don't have an office in a particular country, will contract with a local investigator, which can help to keep costs down. But conducting background screenings abroad is always limited by the country's laws regarding investigations.

In China, for instance, private investigation is prohibited as a matter of law. It's still possible to get information legally and investigations do go on, but "it's not cheap," according to Mr. Seiden, whose company retains a Harvard MBA in China to facilitate such practices.

Europe is better, Mr. Brenner says, but much information is not publicly available, so in many cases investigators must schedule in-person meetings to obtain information that would be available via database in the United States—to access an individual's criminal record in Germany, for example, that individual must request it in person. In England, Mr. Fellner says, litigation is not indexed, and one needs to know the details of a case in order to find a copy of the lawsuit.

That said, "If the person is any kind of player at all, he should have a track record in the U.S.," according to Mr. Fellner. In fact, "if you can't find a track record, that's a huge red flag."

Lawsuits, bankruptcies, tax liens and civil litigation are other issues that give pause to potential investors. Most of the time, Mr. Seiden says, such issues aren't necessarily dealbreakers, but they do need to be explained further, and often can lead to changes in the terms of the investment.

Occasionally, an investigation will turn up a criminal conviction. Mr. Seiden recalls one subject who was found to have a driving under the influence conviction on his record in the United Kingdom, where he had been a student. That offense might be reasonably passed off as youthful indiscretion, but what to make of a recent Intelysis investigation, which uncovered a three-year-old shoplifting charge against a very wealthy hedge fund manager?

Different clients have different comfort thresholds, of course. But if you're a private investigator, after awhile, it's hard to be shocked anymore.

"We disclose everything we learn, and how [the clients] use it is up to them," Mr. Seiden says. "They're paying us good money to discover information about people… we don't make the judgments."

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