

## Hedge Funds: Managing legal risk amidst market turmoil

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Hedge funds and their managers are struggling to cope with a ‘tsunami’ of redemption requests, coinciding with poor investment liquidity. On top of this, certain funds have been impacted by the business dislocation caused by Lehman’s collapse, the ban on short selling, and a more risk averse approach by prime brokers. Legal risk permeates all of these issues. Mayer Brown’s cross-practice team of lawyers can assist funds and their managers in evaluating and reducing the relevant risks, developing proposals for investors and successfully implementing them.

### EVALUATION

Proactive dialogue by funds and their managers with investors can be key to avoiding or surviving a redemption crisis. Credible dialogue must be based on a proper understanding of the legal risk inherent in existing relations with investors, with brokers and other service providers, and with investment counterparties. For example, collateral and rehypothecation arrangements pursuant to prime brokerage agreements have been poorly understood by funds and their managers, leading to unfortunate results in these times of market stress. Many of the complex instruments invested in by hedge funds are based on equally complex legal agreements, which when tested do not always operate in the way intended by the draftsman or understood by the investor. Cross jurisdictional issues add to the complexity.

### MITIGATION

Proper understanding of the legal risks points the way to effective mitigation proposals for submission to investors. Mitigation proposals may include:

- restructuring underlying assets (such as SIVs);
- restructuring the fund, such as by hiving off problem assets and their revenue streams into segregated pockets (“side pockets”) for disposal;
- renegotiating or amending key operational agreements in particular prime broking, administration, custodian and stock lending arrangements;
- amending investment objectives and restrictions, NAV calculation methodology, redemption gates, management fees and high water marks, and bringing side letters in line;
- enhancing transparency; and
- keeping at bay threatened or actual litigation by investors and creditors.

“Commended for Client service in FT Innovative Lawyers 2008 - the only firm to be ranked for helping clients respond to the dislocation in the credit markets”

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### INDUSTRY EXPERTISE

Mayer Brown has an extensive hedge fund practice involving lawyers from across practice areas in its 21 offices worldwide. Our clients range from small groups of individuals who join together to sponsor and operate a hedge fund to some of the largest financial institutions in the world, including full service broker-dealer and investment banking firms that establish large hedge funds with complex structures designed to meet the needs of the most sophisticated investors. We offer a comprehensive set of services that can assist hedge fund managers and funds to protect their positions in the current climate. Our cross practice team comprises leading lawyers expert in fund structures, operational and investment agreements, financial services regulation, litigation, finance, restructuring and insolvency. Our market leading restructuring team is actively engaged in a number of hedge fund industry assignments including restructuring transactions for SIVs.

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0184 fin October 2008