

Moody's Offers Glimpse Inside A Hedge Fund

Sorin-Run Vehicle Is the First To Be Publicly Graded Based On Firm's 'Operational Risks'

By SERENA NG

MOOODY'S INVESTORS Service today will publish its first public rating on an individual hedge fund's risk, in a closely watched move that could shed light on a fast-growing industry that traditionally has avoided outside scrutiny.

The lightly regulated hedge-fund industry manages more than \$1 trillion in assets. As it grows, demands are increasing among some money managers and individuals for closer scrutiny of the risks attached to their investments.

A fund run by Sorin Capital Management LLC, a New York firm that manages \$335 million in investor money, has been assigned a rating that places it near the highest category of Moody's newly developed ranking system. Sorin was founded in 2004 by Jim Higgins, a former Bear Stearns executive, and invests in debt products such as commercial mortgage-backed securities and asset-backed securities.

The rating marks a departure of sorts for the ratings service. Moody's, a subsidiary of Moody's Corp., and its chief competitor, Standard & Poor's, a unit of McGraw-Hill Cos., generally rate the quality of a company's debt based on the perceived likelihood of a default. Other services, such as Morningstar Inc., rate the track records of mutual funds based on returns.

In this case, Moody's is rating neither the hedge fund's debt nor its return. It is rating the "operational risk" of Sorin Capital, essentially, how well Sorin runs the nuts and bolts of its business, from its back-office systems to the controls it has in place to avoid experiencing sudden losses. Moody's also conducts background checks on managers.

These issues are of concern to investors in the wake of alleged frauds at firms such as Bayou Management LLC and Wood River Capital Management LLC.

Sorin's fund is one of a handful of hedge funds to have their inner workings scrutinized by big ratings services. Citadel Investment Group LLC of Chicago obtained public ratings on the debt and operational risk of two hedge funds in 2000 from Standard & Poor's and Fitch Ratings, a subsidiary of Fimalac SA of Paris. Citadel still maintains the ratings.

A handful of other hedge funds have sought credit ratings over the years, but have kept the ratings private. And Morningstar has acquired a hedge-fund database to increase its directory of funds to around 6,000.

Fund Watching

Moody's ratings address areas including the following:

- Back office and administration
- Regulatory compliance
- Risk reporting and control
- Legal and financial structure
- Human resources

Scale: OQ1-Excellent
OQ5-Poor

Source: Moody's

Moody's Rates Hedge Fund

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The slow adoption of hedge-fund ratings highlights the delicate balance these investment vehicles strike as they maneuver between the private and public realms. Hedge funds cater to wealthy individuals and large institutions and don't face the same regulatory scrutiny or disclosure requirements of institutions that cater to small investors.

While many hedge funds want to show their investors and lenders that they run quality businesses, they also don't want to reveal too much information about their strategies and internal operations to competitors or regulators. A recent federal-court ruling that hedge funds need not register with the Securities and Exchange Commission could give some funds reason to remain on the sidelines when it comes to public disclosure.

That could change as hedge funds attract more money from institutional investors, such as pension funds, endowments, and insurance companies. These conservative investment vehicles usually require checks to be performed on a fund before they invest their money.

The ratings companies believe they can profit from the growing desire for scrutiny.

They are staying away from analyzing hedge funds' investment strategies or the riskiness of their portfolios, in part because they see that as difficult to monitor and because many funds would be unwilling to share that information.

"There's definitely a strong desire from investors to understand and assess our operational quality," said Mr. Higgins, chief executive of Sorin Capital, who says he decided to obtain a rating after being approached by Moody's in April.

Mr. Higgins said some sensitive information came up during the ratings company's review, which took place over a few months and involved multiple meetings and conference calls. But he said he believed Moody's would be discrete about handling this information.

Moody's assigned a rating of OQ1-minus to Sorin's fund, one notch below its highest "operational quality" rating that has a scale of 1 to 5.

Moody's new ratings can be viewed on its Web site by "accredited" investors, generally defined as those with a

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net worth of at least \$1 million or at least \$200,000 in annual income.

Gary Witt, a Moody's managing director, said the firm is in talks with a few other hedge funds and expects to publish another public rating soon.

To persuade more funds to be rated, Moody's has been offering what it calls "indicative" ratings in which fund managers can get a preview of their rating before deciding whether to proceed.

Mr. Witt notes that this approach would allow funds with less-favorable reviews to avoid public scrutiny. That means there might not be many funds with low public ratings in the near future, "unless this becomes something of a market standard," he said.

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