Unless hedge funds, specifically startup funds, can find a low cost technology and service provider solution and provide best of breed operational and compliance support, the below article indicates what is imminent.

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Financial Times - FT.com

Small hedge funds hit by closures **By Ruth Sullivan** **November 4, 2012**

A rising number of small hedge funds are shutting their doors, with houses run by former investment bank proprietary traders being particularly badly hit by rising costs and difficulty in attracting assets.

The mounting burden of regulatory compliance is proving particularly damaging to smaller hedge funds, said Paula Smith, head of asset management at PwC in the UK, and previously PwC's alternatives investments assurance leader in the US.

"People just can't afford to keep going if they don't have a certain level of assets. The SEC [Securities and Exchange Commission] forces hedge funds to have a chief compliance officer and lawyers and internal staff they may not have had in the past," she said.

Without the necessary infrastructure and assets, "the future in the US is the big guys will get bigger and the small guys...are really going to find it difficult to continue to bear the cost of technology [and personnel]," Ms Smith added.

Figures from Preqin, the alternatives data provider, show that 50 per cent of hedge funds that closed globally since January 2011 had less than $49m of assets under management.

Overall, the number of hedge fund closures reached 232 in the first three months of this year, the highest quarterly figure since the first three months of 2010, although the rate of liquidations eased to 192 in the second quarter, according to data from Hedge Fund Research.

"Investors are concerned about small and medium-sized firms that have small operations, and are not willing to invest," said Kenneth Heinz, president of HFR. "Larger ones are more capable of handling regulatory requirements. They have an established department for compliance [and although] it is an increased cost they can handle it."

A dramatic shift in the industry's investor base has also made it harder for smaller hedge funds to raise assets, said Chris Topple, head of prime clearing services at Newedge, a consultancy and brokerage.

In the past decade retail investors have moved away from hedge funds, particularly in Europe, while the proportion of institutional investors has increased. The latter prefer to allocate to large hedge funds, Mr Topple added.

David Butler, a founding member of Kinetic Partners, a consultancy, said: "small managers can't raise enough capital and their performance is not good enough," a problem compounded by the fact that many former bank prop traders are struggling to come to terms with operating outside a "cossetted" environment, he argued. "When you set up a business, you have to take over the operational aspects of running a business. [At investment banks] everything was done for prop traders. Their skill is trading."

The 2010 Volcker rule, part of the US Dodd-Frank Act, under which banks are barred from proprietary trading and owning private equity and hedge funds, prompted many traders to set up their own shops.

In spite of the difficulties, Mr Heinz expected the flow of former prop desk traders to continue. "Although it's challenging for prop desk traders to set up, I expect to see more people leaving prop desks and starting up hedge funds as regulation [further] impacts investment banks," he said.

Mr Butler is less optimistic. EU plans to regulate the hedge fund and private equity industries through the Alternative Investment Fund Managers directive, due to come into force in July 2013, will "add to hedge funds' regulatory burden with more likely to close," he said.