



Alternative Investment Management Association

**TESTIMONY
OF**

**W. TODD GROOME
CHAIRMAN**

**THE ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION
(AIMA)**

**For the Hearing on
“Perspectives on Hedge Fund Registration”**

**Before the

US HOUSE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES**

7 May 2009

The Alternative Investment Management Association Limited
167 Fleet Street, London, EC4A 2EA
Tel: +44 (0)20 7822 8380 Fax: +44 (0)20 7822 8381 E-mail: info@aima.org Internet:
<http://www.aima.org>



Alternative Investment Management Association

Introduction

The Alternative Investment Management Association (“AIMA”) is pleased to provide this statement in connection with the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises’ hearing “Perspectives on Hedge Fund Registration” to be held on 7 May 2009.

AIMA is the trade body for the hedge fund industry globally and submits this evidence on behalf of its global membership of hedge fund managers, fund of hedge funds managers, advisors and service providers. AIMA’s membership comprises 1,100 corporate bodies in 43 countries and its members manage approximately 75% of global hedge fund assets and over 70% of fund of hedge funds assets. AIMA has been active since its foundation in 1990 in working to enhance the regulatory framework in which its members operate and in seeking to promote sound practices within the industry although it is not a self-regulatory body, and appreciates the opportunity to express its views on the important topic of hedge fund registration.

Further information about AIMA is attached as [Appendix 1](#).

Committee’s specific questions

As detailed in the Financial Services Committee’s invitation, AIMA has been asked to address a number of specific questions; this written testimony is structured around answering these questions.

1. Your views on H.R. 711, the Hedge Fund Advisor Registration Act of 2009, and suggestions on how it can be improved.

AIMA understands that this Bill, sponsored by Representatives Michael Castle (Delaware) and Michael Capuano (Massachusetts) has been referred to the House Committee on Financial Services.

This Bill would amend the Investment Advisors Act of 1940 to repeal the exception to the registration requirement for any investment advisor who: (1) during the preceding twelve months has had fewer than 15 clients; and (2) neither holds himself or herself out generally to the public as an investment advisor, nor acts as an investment advisor to any registered investment company or any business development company. Therefore, AIMA understands that, in effect, this would lead to a compulsory registration regime for all US investment advisors (and non-US investment advisors, if they have US clients) under the Advisors Act.

AIMA supports the registration of investment managers, including hedge fund managers, with the appropriate national authorities in the country in which they are principally based, as envisaged above. On 24 February AIMA announced a policy platform which consisted of major proposals to increase transparency and to support the concept of manager-registration globally (see [Appendix 2](#) for a copy of the platform). Such a process of registration leads to a supervisory relationship between managers and the appropriate national supervisor, creates a relationship and dialogue which supports greater understanding of hedge fund activities and allows for increased oversight of markets more generally.

AIMA is aware of discussions taking place regarding a *de minimis* threshold for registration and/or reporting requirements; if this debate is being driven by considerations of the ability of



Alternative Investment Management Association

a manager to provide systemically relevant information and broad market insights, we would advocate that managers with \$500m of assets under management (AUM) or more be obliged to register. Indeed, as a practical matter, it may be very difficult to gather such information from so many firms and managers, and a larger figure (e.g. \$1bn or \$2bn minimum AUM), may be both more practical and still capture the majority of AUM in the industry.

This Bill would seem to put the US registration approach on substantially the same basis as that operating in the UK, which we have found to provide effective oversight and supervision. One important difference would remain however - the UK's current approach is not extra-territorial, and non-UK based investment managers who do not operate from a place of business in the UK are not registrable with the UK's Financial Services Authority (FSA), even if they have UK clients, whereas AIMA assumes that, pursuant to this Bill, any non-US investment managers with one or more US clients would be registrable under the Advisors Act even though they do not have a US presence. This raises the issue of dual registration - a process that is not endorsed by the G30, as can be seen in Recommendation 4 of the G30's January 2009 Report; and AIMA shares the view of the G30 in this respect.

Other countries with a significant hedge fund management industry presence (see [Appendix 3](#) for details) favour an approach which involves authorisation/licensing and/or registration of hedge fund managers, together with a continuing supervisory dialogue with a specialist supervisory team. These registration templates, together with ongoing supervisory dialogue, have assisted authorities to achieve their two main objectives of enhancing investor protection and monitoring issues concerning market integrity and financial stability. The details vary by country, but the essential components comprise some or all of the following:

- A fit-and-proper persons test, with a suitable business plan, providing for robust systems and controls.
- Notification/pre-approval of certain material changes (such as changes to ownership control).
- Periodic reporting of key firm, client and risk metrics.
- Cooperation in the conduct of ad hoc, themed supervisory visits to assess current market practices.

These requirements and ongoing controls help to ensure professionalism, soundness and qualification of the management company and foster market integrity and investor protection. A very important component to the success of such a registration and supervisory regime is the ongoing dialogue between the regulated manager and the supervisory authorities.

[Appendix 3](#) provides a global overview and comparison of hedge fund manager registration regimes in the UK, France, Sweden, Switzerland, Japan, Singapore, Hong Kong and Australia.

2. How you believe Congress can achieve the appropriate balance between providing appropriate regulation of the industry aimed at protecting investors without unduly inhibiting the benefits hedge funds provide investors and the market more broadly?

AIMA believes that a combination of manager registration and greater transparency is the most appropriate mechanism for achieving this balance.

As stated in Question 1, AIMA supports the registration of investment managers, including hedge fund managers, with the appropriate national authorities in the country in which they are principally based. There are clear and demonstrable benefits to this approach in those countries which already operate such a regime.



Alternative Investment Management Association

Whereas investor protection for hedge fund investors is perhaps best served by increased transparency and disclosure by managers (and there is much anecdotal evidence to suggest that this balance has recently shifted materially in favour of investors), it is possible that there may be inadequate risk data provision in the aggregate by larger, more systemically relevant managers to their national macro-prudential supervisors, and in turn there may be insufficient dialogue internationally between national supervisors to track composite activity. There may also be a gap that could be filled by confidential dialogue by the Senior Supervisors' Group, IOSCO and/or the Financial Stability Board if concentrated risk exposures are identified that may present a financial stability risk.

AIMA is promoting the concept of a Systemic Data Reporting Template (SDRT) which is explored in more detail in the answer to Question 4. This template would be shared by the main national regulators and would be completed by the managers with AUM in excess of a specified *de minimis* level.

Hedge funds, although not the cause of the current economic and market crisis, recognize that they, as mature market participants with a substantial investor base, have a role in bolstering financial stability and improving investor protection by enhancing transparency of their investment processes and market impact.

Achieving the appropriate balance is of course not unique to hedge fund managers and will apply equally to other market participants; a successful approach in this area may offer a way forward for other industry sectors.

3. The degree to which institutional investors and pension funds affect your industry, their recent demands for increased transparency, and their recent efforts at negotiating your fee structure.

Historically, high net worth individuals and private banks accounted for most of the AUM in the hedge fund industry globally; however, in this decade institutional investors have steadily increased their investments with hedge funds and other alternative investment managers and, according to our research, now constitute an absolute majority of AUM within the alternative investment industry.

Chart 1 at [Appendix 4](#) depicts the growth of the hedge fund industry, and AIMA attributes this rapid growth from \$900bn to (at or even over) \$2 trillion to the significant growth and presence of institutional investors. Institutional investors have also increasingly been the source for new inflows to the industry, and during the past 5 -6 years are estimated to represent the vast majority of new capital (see Chart 2 at [Appendix 4](#)).

In the past year, it can very clearly be seen that investors are demanding - and receiving - greater transparency and disclosure; improved provisions related to liquidity; segregated or managed accounts; and a wider diversity of fee structures. In some cases this is resulting in lower fee levels, changing the mix between base fees and performance fees, and better aligning fees with expected investment or return durations, size of investments, and balance between hurdle rates and relative performance. As such, a much greater differentiation of fee structures is emerging, which tends to reflect an even greater alignment of interests between investors and managers. On a variety of operational issues, institutional investors are also demanding - and receiving - increased third-party services, such as independent administration, including NAV calculation and verification, as well as independent custody.



Alternative Investment Management Association

The benefits of hedge fund investment are increasingly recognised by many of the most demanding institutional investors. Hedge funds have repeatedly demonstrated that they provide the most attractive and consistent risk-adjusted returns.

4. What type of information you will voluntarily disclose to improve investor confidence and increase transparency - as well as any other self-imposed reforms the industry is considering and the consequences of not abiding by these policies?

AIMA believes, as a result of extensive consultation with its larger manager members globally, that the industry is not only ready but also willing to provide specific and regular transparency across a wide variety of investment and operational risk metrics to national supervisors (the regulator of the jurisdiction in which the manager is located and registered to operate), with the objective of contributing to an improved understanding of the hedge fund industry's activities and a broader contribution to a national and international analysis of financial stability related issues. To obtain a complete picture, the same information should be gathered from all bank and non-bank industry groups.

We would urge that due regard is paid to the wide variety of investment strategies deployed by hedge funds, and that definitions or measures used to monitor volatility, liquidity, leverage, counterparty exposures and risk concentrations are sufficiently flexible to avoid a one-size-fits-all approach. For example, there is a justifiable desire to understand the extent to which the hedge fund industry can amplify market movements as a result of the deployment of leverage but not only are there justifiably different definitions of leverage (see [Appendix 5](#) for examples), but leverage cannot usefully be tracked in isolation: for example, a relatively low degree of leverage in an illiquid or volatile portfolio may present concerns, whereas a more highly leveraged or repoed portfolio of short-dated government securities represents very little market risk.

AIMA is working with international policy makers and regulators to develop an appropriate risk reporting and increased transparency system, allowing regulators to better understand hedge fund and market activities, and thus be better able to prevent future events of potential market or financial instability. AIMA advocates that managers of larger hedge funds provide regular periodic reporting of systemically relevant information and risk exposures to their national supervisors.

'Increased transparency' in this context relates to what is deemed to be of systemic or broad market relevance, i.e., information that would contribute to an 'early warning system'. In practice, care will need to be taken to ensure that the information is relevant, proportionate and cost-effective to implement; AIMA has been at the forefront of constructing a template for systemic data reporting.

Full and plain disclosure of all relevant systemic data will not alone address the issue of better supervisory understanding of market activities and financial stability; it requires further analysis and qualitative understanding of the data. In the end, the desired result of better understanding of risks requires an informed dialogue, on an ongoing basis, between the regulated entities and their supervisors. Hedge fund managers have welcomed and continue to welcome such a dialogue with national and international authorities.

Harmonisation of sound practices

Over the last 10 years, the hedge fund industry has developed a vast body of work on sound practices. The importance of this work should not be underestimated, as it has not only been



Alternative Investment Management Association

developed by those with vast amounts of industry knowledge, but it has been endorsed by regulators around the world and serves as a very useful tool in enhancing regulation and helping managers adhere to sound practices.

Many of the core principles in existing sound practice guidelines are substantially similar, and in October 2008 AIMA, together with the International Organization of Securities Commissions (IOSCO), the Hedge Fund Standards Board (HFSB), the Managed Funds Association (MFA) and the Asset Managers' Committee of the US President's Working Group on Financial Markets (US PWG) created the Hedge Fund Matrix (www.hedgefundmatrix.com). The Hedge Fund Matrix, a website bringing together all the sound practice works by the aforementioned bodies and allowing users to compare the various guidelines side-by-side, was the first step towards harmonisation of existing sound practices on a global basis.

As referenced in the G20's recent Progress Report on the Washington Action Plan, AIMA has been proactively engaged with the Financial Stability Board and various national and regional authorities and, together with other aforementioned bodies, is working to put forward a common set of principles for the hedge fund industry, which will still allow for local interpretation of hedge fund standards and practices. AIMA is confident that harmonisation of these standards will represent a major step forward for the industry in terms of increased transparency.

5. Your views on the recently issued EU directive on the regulation of collective investment trusts (including hedge funds).

On 30 April 2009, the European Commission ("the Commission") published a proposal for a Directive on alternative investment fund managers ("AIFM"). This is a draft text which is aimed at further regulating the European alternative asset management industry as a whole and its reach goes well beyond hedge funds. The proposed Directive would apply to any AIFM established in an EU member state who provides management and administration services to one or more alternative investment funds (AIF). An AIF is defined as any collective investment undertaking, whether domiciled in or outside the EU, which is not a UCITS fund and thus includes not only hedge funds but also funds of hedge funds, private equity funds, real estate funds, infrastructure funds and long-only funds which are not collective investment undertakings under European legislation, referred to as UCITS funds.

Although the proposed Directive will apply to all AIFMs established in an EU member state which provides management and administration services to one or more AIF, it is our understanding that, as currently drafted, it may severely impact any non-EU, including US-based managers, (not just hedge funds and hedge fund managers, but many types of funds and fund managers as explained above) and may prevent them from accessing EU-based institutional and other professional investors, therefore raising possible issues of financial protectionism.

AIMA regrets that there has been no coordination between the Commission and the G20-ordered work in this area, particularly the IOSCO Task Force on Hedge Fund Oversight and the work being carried out by the Financial Stability Board, all seeking to identify and provide a globally consistent approach and appropriate solutions. Neither does the proposed Directive take into account the highly effective existing regulatory framework for European hedge fund managers. The proposed Directive draws on several other European Directives, primarily those regulating the UCITS products which are solely aimed at the retail sector. Therefore the proposed Directive does not logically or practically address the way many of the investment sectors covered by this proposal are structured, organised, or operate.



Alternative Investment Management Association

The proposed Directive will now undergo a complex consultation and negotiation process which could last many months.

A more detailed briefing note, based on a memorandum from AIMA's counsel, on some of the significant issues raised by the proposed Directive can be found in [Appendix 6](#).

6. There is always a tension between market efficiency and market integrity. In the last few years, a good bit of the integrity disappeared. What steps has the industry taken, and what steps will it take, to restore this balance?

There are a number of industry-led initiatives which have either taken place or are due to take place that AIMA would like to bring to the attention of the Committee:

- In late February 2009, AIMA issued an important press release (see [Appendix 2](#)) stating its intention to work closely with regulatory supervisors and policymakers on universal templates for manager registration, systemic data transparency, reporting disclosure for short positions and the harmonisation of hedge fund practices.
- AIMA has developed, over many years, a substantial number of specific sound practice guides for the industry on hedge fund management, administration, valuation, business continuity, governance, anti-money laundering and due diligence for managers and service providers. Other important guidelines have been produced by IOSCO, the US President's Working Group on Financial Markets, the Managed Funds Association and the Hedge Fund Standards Board. This demonstrates both the amount of work already achieved in this area to date as well as the industry's continued focus on documenting and enhancing its practices. Additionally, in early May AIMA will be publishing the world's first guide to sound practices for funds of hedge funds managers.
- AIMA believes that investor education is as important as transparency from managers. Many of the world's leading investors have joined AIMA's global Investor Steering Committee and, in 2008, produced *AIMA's Roadmap to Hedge Funds* - the world's first collaborative educational guide for institutional hedge fund investors. The guide, which provides guidance on investing in hedge funds, also meets the Financial Stability Forum's Highly-Leveraged Report (2007) recommendation that industry and investors work more closely to develop positive initiatives.
- AIMA is working with industry participants to take forward the proposals of the G20 and the Financial Stability Board to develop a common set of principles for the hedge fund industry. As mentioned earlier in Question 4, AIMA and other industry groups are devoting a large amount of time and effort to developing these principles, which will be applicable to hedge fund managers globally.

7. Additionally, any other information or opinions you deem relevant to this hearing.

Global overview of the hedge fund industry

For the Committee's information, AIMA has provided at [Appendix 7](#) an overview of the global hedge fund industry.



Alternative Investment Management Association

“Systemic importance” vs. “systemic relevance”

AIMA does not believe that hedge funds pose a systemic risk to the capital markets in which they operate. To put matters in context, there are single banks, insurance companies and single traditional investment management houses, which are larger in terms of assets than the entire global hedge fund industry.

On the other hand, hedge funds are responsible for a number of positive features within the financial markets, such as enhancing pricing efficiencies and improved liquidity. Many issues affecting the capital markets are still, despite the undeniable evidence to the contrary, wrongly attributed to hedge funds alone, rather than being recognised as, in fact, symptomatic of a wider more complex system. If all hedge funds disappeared tomorrow, all these issues would still exist. One would, though, have lost an important contributor to market efficiency across numerous and important markets. During these very difficult times hedge funds should be seen as part of the solution for recovery and a return to properly functioning markets.

Most commentators accept, as mentioned above, that the current crisis has been caused by substantial failures in the regulated banking sector. Banks because of their size, leverage and concentrated positions, pose a systemic risk to the markets. Hedge funds are not banks or bank-like, and operate a completely different economic model.

AIMA accepts that hedge funds and other non-banks provide an increasingly important role to a variety of important financial markets and that some of these non-banks, including hedge funds, have become more systemically relevant. Therefore, it seems appropriate for supervisors and other national and international authorities to gather information and thereby develop a better understanding of non-bank activities. Likewise, all non-banks and hedge funds do not pursue the same strategies. However, rather than this being a threat, we believe this diversity of market behaviour is a positive feature for markets and acts to improve financial stability.

In contrast to those of banks, the risk management systems employed by hedge fund managers have better withstood many of the challenging problems of the past year, and where a wind-down of a hedge fund business has become necessary, bar a couple of examples, it has been orderly and successfully undertaken.

AIMA believes that it is entirely logical for increased regulatory attention to be paid to hedge fund managers given the role these managers play in many markets, as well as the desire to better understand broader market activity by developing a better understanding of hedge fund activity. However, it is wrong for hedge funds to be the sole, or even the main, focus of that attention. A reassessment of the systemic relevance of hedge funds is only of value if it is part of a wider review of the capital markets as a whole and that of all bank and non-bank participants. One must look at the market holistically in order to better monitor market and financial stability issues.

The need for global coordination

There is currently much national and international activity aimed at identifying and correcting regulatory deficiencies in financial services, including those of the hedge fund industry.

AIMA welcomes these initiatives, although we would have wished for much greater coordination between the various initiatives in this area. AIMA is working with numerous regulatory and



Alternative Investment Management Association

policy bodies in order to develop a regulatory landscape which is effective and capable of allowing the flexibility for innovation which hedge funds provide, and which has been so important for the development of the capital markets.

It is vital, given the number of different bodies examining these issues, that the findings which result are consistently aligned and therefore likely to produce reforms which will endure and promote long-term financial stability. An international perspective and approach are needed to handle what are global issues. If this is not the case it will lead to regulatory arbitrage and would cause harm to markets and undermine the confidence of investors.

The resulting reforms must be capable of being implemented internationally with relative speed. We support proportionate and well-judged rules, tightening up in those areas where shortcomings have been clearly identified, but resisting the urge to make change for change's sake in those areas where no problems have been encountered.

In the realm of industry-led initiatives, AIMA has been working with other global associations to develop a common set of principles for the hedge fund industry, which will still allow for local interpretation of hedge fund standards and practices.

Short selling

Short selling is a legitimate investment technique; its beneficial role in the efficient operation of markets is widely recognised by regulators. Short selling is a technique that is used by the wider asset management industry including, but not limited to, hedge funds in order to reduce risk to investors.

As a matter of principle, AIMA believes that new regulations should only be introduced if and when there is demonstrable evidence of market failure. In the case of short selling, there has been no such demonstration. The market is already well placed to regulate the level of short selling. The holders of long positions are best placed to be able to police whether short selling is permissible or not by their acceptance or refusal to lend stock.

AIMA believes that transparency and the timely provision of information to regulators should be the central feature of any global short selling regime and is developing a template for a global reporting regime - further details can be found at [Appendix 8](#).

In addition to AIMA's template, AIMA would like to highlight the following reporting considerations:

- AIMA believes that it is quality of information, rather than quantity, that should drive disclosure to regulators.
- Disclosure of positions should be made privately to the regulator and kept confidential. Cross border exchange of information should be subject to appropriate controls in order to ensure confidentiality. Also, the amount and nature of information exchanged should be proportionate to the purpose of the exchange. Any information provided to the market on short positions should be provided on an aggregate basis.
- The cost, quality and utility of the information requested by regulators should be very carefully considered - AIMA highlights the situation in Canada where the local regulator has, in fact, attempted to discontinue the twice-monthly position report due to issues associated with its cost, usefulness and accuracy.



Alternative Investment Management Association

- There is potential for moral hazard, with regulators seeking information from the market which they may lack the means or expertise to interpret fully. This is a regulatory risk but also poses the danger of giving false comfort to the market, namely that the regulator is happy that the market is functioning properly or condones existing practices.
- AIMA's members do not, in the main, undertake 'naked' short selling to any significant extent. However, members pursuing certain investment strategies (e.g., statistical arbitrage) legitimately make use of short selling without locate/pre-borrowing activity and it should be noted that it is settlement failure, rather than 'naked' short selling per se, that is a risk to orderly markets.
- Furthermore, any attempt to ban 'naked' short selling requires a clear and consistent definition of what is a 'naked' short sale, something that, in practice, would be very difficult to achieve. AIMA, therefore, believes that a better approach is to regulate the settlement side of short selling. Penalties should not be applied to those who can demonstrate that they have taken all reasonable steps to provide for settlement (e.g., if the locate counterparty fails to deliver resulting in settlement failure).
- AIMA broadly supports greater transparency by alternative investment managers to regulators. However, thought should be given by regulators as to what information they require to achieve their aims, and to select the least costly and / or disruptive means for obtaining it.
- Ultimately, AIMA would wish to see convertibles / warrants / rights included in the denominator in the net short position calculation (subject to this information or calculation being workable on a global basis) but it is assumed that, initially, the denominator would be the current issued equity share capital (since information providing a diluted denominator is not yet widely available).
- AIMA believes that a globally agreed and adopted approach to short selling disclosure is required.



Alternative Investment Management Association

APPENDIX 1

About AIMA

AIMA is the not-for-profit trade association which represents the hedge fund industry globally. Its membership comprises 1,100 corporate bodies in 43 countries and is drawn from all constituencies which make up the hedge fund sector – including hedge fund managers, fund of hedge funds managers, prime brokers, administrators, accountants and lawyers.

AIMA's members manage approximately 75% of global hedge fund assets and over 70% of fund of funds assets. Membership is corporate and, within these firms, AIMA services in excess of 4,800 individual contacts worldwide. AIMA is not a self-regulatory body. New members are vetted for their bona fides; manager members must be supervised by a recognised regulator in order to qualify for membership.

AIMA's member profile is as follows:

- Hedge fund managers - 44%
- Fund of hedge funds managers - 21%
- Investors - 2%
- Advisers/service providers - 33%

Members in the Europe/ Middle East/ Africa region account for 55% of the association's membership, those in the Americas 23% and those in the Asia-Pacific region 22%. They all benefit from AIMA's active influence in policy development, its leadership in industry initiatives, including education and sound practice guidelines and its excellent reputation with regulators worldwide.

Since its establishment in 1990, AIMA has worked with the aim of enhancing the regulatory framework in which its members operate. AIMA has a central tenet that good regulation makes for good business. Over the years AIMA has developed contacts with 144 separate regulatory or policy-making organisations in 62 countries.

AIMA has produced, over many years, a number of specific and detailed sound practice guides which have been widely used across the industry; these include guides on hedge fund management, administration, valuation, business continuity, governance, anti-money laundering and comprehensive due diligence of managers and service providers.

AIMA has worked closely with its counterpart the Managed Funds Association ("MFA") in the United States, as well as with the UK Hedge Fund Standards Board and the US President's Working Group on Financial Markets' Asset Managers Committee. AIMA is currently involved with the work on unification of best practice standards as requested by the G20 and is working closely with the Financial Stability Board towards achieving this important objective.

AIMA has a history of working closely with institutional investors and recently published the world's first collaborative educational guide for institutional hedge fund investors, *AIMA's Roadmap to Hedge Funds*.

AIMA is committed to developing industry skills and education standards and is the co-founder of the Chartered Alternative Investment Analyst designation (CAIA) based in Massachusetts – the industry's first and only not-for-profit specialised educational standard for alternative investment specialists. Over 10,000 industry professionals have enlisted in this programme since its launch in January 2003.



Alternative Investment Management Association

APPENDIX 2

AIMA's policy platform press release

AIMA LAUNCHES MAJOR TRANSPARENCY INITIATIVE

London, 24th February 2009: The Alternative Investment Management Association (“AIMA”), the trade body for the global hedge fund industry, has announced a major new transparency initiative. AIMA says that it will support the principle of full transparency and supervisory disclosure of systemically significant positions and risk exposures by hedge fund managers to their national regulators (the regulator of the jurisdiction in which the manager is authorised and registered to operate).

The initiative is one of a series of policy positions in the association's new platform. Other key new strands of the platform include an aggregated short position disclosure regime to national regulators, support for new policies to reduce settlement failure (including in the area of naked short selling), and a global manager-authorisation and supervision template based on the model of the UK's FSA and a call for unified global standards for the industry.

AIMA's members manage approximately 75% of hedge fund assets globally and the association has over 1,100 member firms in 43 countries. Members include leading hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms and fund administrators.

The association is representing the global hedge fund industry in on-going international discussions about the future regulatory framework for the industry, notably with the organisations tasked by the G-20 to address the issue, such as IOSCO and the Financial Stability Forum. AIMA supports these efforts to achieve global consensus, and is providing active cooperation and leadership on behalf of the industry. It is also working closely with leading national regulators regarding the supervision of hedge fund managers.

The policies in AIMA's new platform are:

- 1) support for regular reporting and increased transparency of systemically significant positions and risk exposures by managers of large hedge funds to their national regulators (the regulator of the jurisdiction in which the manager is authorised and registered to operate);
- 2) support for an aggregated short position disclosure regime to national regulators;
- 3) support for new policies to reduce settlement failure (including in the area of naked short selling);
- 4) support for a global manager-authorisation and supervision template based on the UK's FSA model; and
- 5) a call for a common set of principles and standards for the hedge fund industry, based on the existing industry standards work, such as that authored by AIMA, HFSB, IOSCO, PWG and MFA.

Andrew Baker, Chief Executive of AIMA, said, “We want to dispel once and for all this misconception that the hedge fund industry is opaque and uncooperative. That's why we are declaring our support for the principle of full transparency of systemically significant positions and risk exposures by hedge fund managers to their national regulators through a regular reporting framework. We are confident that our members recognise that it is in everyone's best interests if we cooperate fully in the important on-going international efforts to examine and improve the supervisory framework of the future.”



APPENDIX 3

Hedge fund manager authorisation regimes - a global overview

	UK	France	Sweden	Switz ¹	Japan ²	Singapore ³	HK	Australia ⁴
1. Firm structure and core information requirements								
Disclosure of core firm details (e.g. place of business, staff details, legal status of firm)	•	•	•				•	•
Disclosure of changes to core firm details	•	•	•				•	•
Requirement for particular legal form							• ⁵	• ⁶
2. Firm details								
a. Business experience								
Disclosure of background to firm (previous experience, business strategy, shareholding structure etc.)	•	•	•				•	•
Disclosure of any previous sanctions, or offences committed by the firm	•							•

¹ At present hedge fund managers in Switzerland are only subject to anti-money laundering requirements and are not otherwise regulated (although fund of hedge fund managers are bound by UCITS regulation if they manage assets in such a vehicle).

² Fund managers operating in Japan are typically located overseas and so are not authorised by the Japanese regulator. Firms appoint Japanese investment advisers, who are authorised in Japan to provide investment advice. The fund manager then takes discretionary decisions based on this advice. The requirements set out in this matrix are based on obtaining authorisation to provide investment advice in Japan. Authorisation to make discretionary investment management decisions in Japan is more onerous and time-consuming to obtain.

³ No authorisation is required in Singapore for an investment manager which undertakes fund management for not more than 30 'qualified investors' and has a substantial presence in Singapore. Hedge fund managers in Singapore commonly rely on this exemption and this matrix sets out the position for a fund manager falling within this exemption.

⁴ Some overseas hedge fund managers may not require any authorisation from the Australian regulator (e.g. where it is authorised by another regulatory body).

⁵ The firm must be a company incorporated in Hong Kong, or an overseas company with a company registry in Hong Kong.

⁶ The 'responsible entity' must be a public company.



Alternative Investment Management Association

	UK	France	Sweden	Switz ¹	Japan ²	Singapore ³	HK	Australia ⁴
b. Scope of firm authorisation								
Authorisation limited to certain activities (advising, dealing, managing etc.), certain securities (shares, debentures, options etc.) and certain clients (retail, professional etc.)	•	•	•				•	• ⁷
Requirement for pre-approval for certain changes in activity, assets or customers	•	•	•				•	•
c. Financial resources								
<i>Initial requirements</i>								
Complete financial resources questionnaire including regulatory capital and liquidity calculations	•	•	•				•	
<i>Ongoing requirements</i>								
Maintenance of required capital and liquidity levels	•	•	•				•	•
Notification of inability to maintain required capital and liquidity levels	•	•	•				•	•
d. Compliance arrangements								
Requirement for internal risk management/compliance system	•	•	•			• ⁸	• ⁹	•
Requirement for anti-money laundering system	•	•	•	•		•		
Requirement for anti-market abuse system	•	•	•					

⁷ The firm, as the 'responsible entity', is the authorised person

⁸ Exempt fund managers in Singapore are still required to comply with various securities and finance regulations e.g. the Securities and Futures Act.

⁹ Appropriate to size and nature of firm.



Alternative Investment Management Association

	UK	France	Sweden	Switz ¹	Japan ²	Singapore ³	HK	Australia ⁴
3. Key firm personnel (directors, partners etc.)								
Relevant experience and/or qualification requirement	•	•	•		• ¹⁰		•	• ¹¹
Evidence of fitness for role e.g. disclosure of any previous improper conduct	•	•	•		•	• ¹²	•	•
Authorisation requirement for commencement of role and function	•	•	•		• ¹³		• ¹⁴	
Authorisation requirement for change in role and/or function	•	•	•				•	
4. Key owners and influencers								
Notification of details of substantial owners/controllers of firm and respective holdings	•	•	•			•	•	•
Evidence that substantial owners/controllers are fit and proper persons	•	•	•			•	•	
Ongoing notification and/or pre-approval requirement for changes to substantial owners/controllers	• ¹⁵	•	•				•	•
5. Appointed representatives								
Notification of any representatives appointed by the firm	•		•					

¹⁰ At least 4 suitably experienced individuals must be employed in providing the investment advice

¹¹ The firm must demonstrate it has “responsible managers” who meet certain professional standards, although these individuals are not directly authorised.

¹² An exempt manager is still required to ensure it employs fit and proper persons for fund management roles.

¹³ As described at footnote 2 above, obtaining authorisation to provide investment advice in Japan is less onerous and time-consuming than obtaining authorisation to provide investment management services in Japan.

¹⁴ Two “responsible officers” are required for each regulated activity carried on by the firm, one of whom must be resident in Hong Kong.

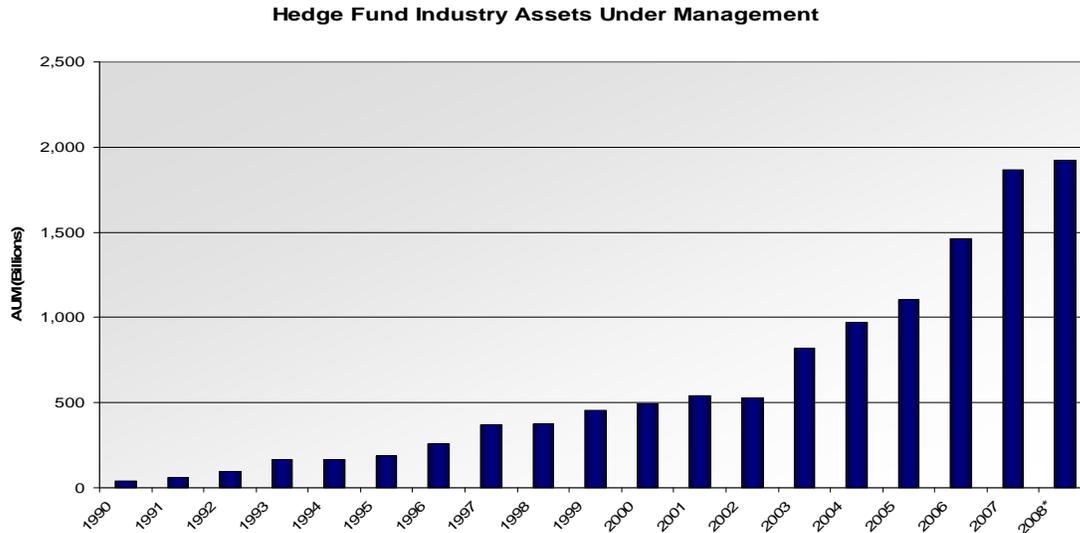
¹⁵ Extensive pre-approval requirements exist for changes in control



Alternative Investment Management Association

APPENDIX 4

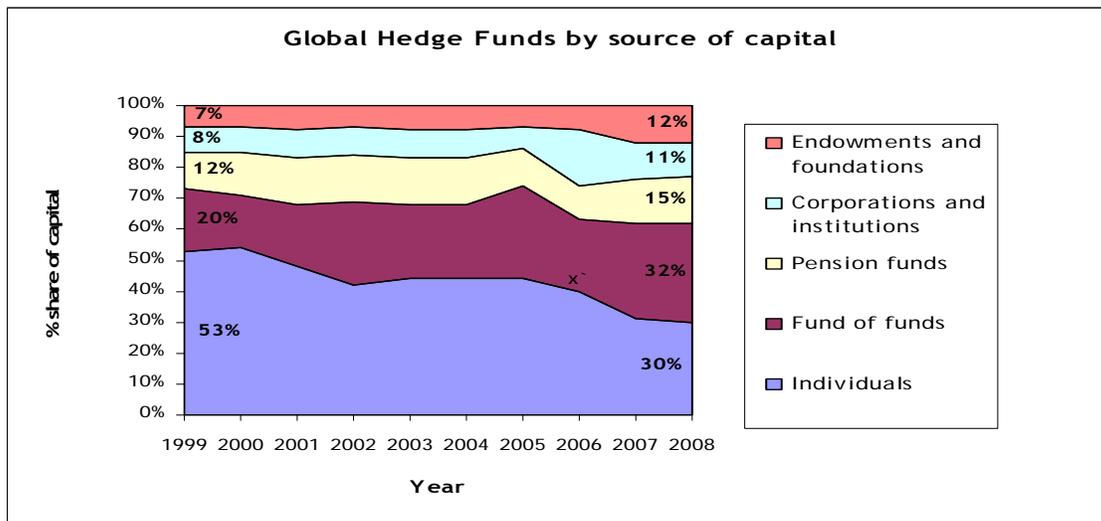
Chart 1: Growth of the global hedge fund industry



Source: Hedge Fund Research

The increase in hedge funds assets (“AUM”) since 2002 has been mostly driven by substantial allocations from institutional investors. The individual investors’ share has dropped from 53% in 1999 to 30% in 2008. As shown in Chart 2 below, pension funds and fund of funds have significantly increased their hedge fund market share during this time - they now account for approximately 47% of all hedge fund AUM. Additionally, pension funds are forecast to be the greatest source of asset flows between now and 2013.¹

Chart 2: Institutional investors involvement in hedge funds



Source: Hennessee Group LLC

¹ Bank of New York Mellon, Casey Quirk, “The Hedge Fund of Tomorrow, Building an Enduring Firm”.



Alternative Investment Management Association

APPENDIX 5

Examples of leverage measures

Type of measure	Definition	Observations
Financial statement/asset based (classic)	<ul style="list-style-type: none"> ▪ Gross assets/equity ▪ Gross debt/equity 	<ul style="list-style-type: none"> ▪ Does not incorporate on-balance sheet hedges and off-balance sheet instruments
	<ul style="list-style-type: none"> ▪ Net assets/equity ▪ Net debt/equity 	<ul style="list-style-type: none"> ▪ Does incorporate on-balance sheet hedges (therefore “net”), but does not include off-balance sheet instruments
Risk based	<ul style="list-style-type: none"> ▪ Portfolio volatility/equity ▪ VAR/equity ▪ Stress loss/equity ▪ Other loss measure/equity 	<ul style="list-style-type: none"> ▪ Usually incorporates all (on- and off-balance sheet) hedge positions ▪ But does not account for mitigating measures by manager in times of distress

Source: Hedge Fund Standards Board, Final Report



APPENDIX 6

Commission publishes proposal for a Directive on alternative investment fund managers

The European Commission published on 30 April 2009 the final text of a draft proposed European Directive on alternative investment fund managers (AIFM). The proposed Directive would apply to any AIFM established in an EU member state which provides management and administration services to one or more alternative investment funds (AIF). An AIF is defined as any collective investment undertaking, whether domiciled in or outside the EU, which is not a UCITS fund and thus includes not only hedge funds but also funds of hedge funds, private equity funds, real estate funds, infrastructure funds and long-only funds which are not UCITS funds.

The proposal has not been subject to the usual consultation process and introduces unwarranted and inappropriate changes to the way in which AIFMs operate and, indirectly, to the structure of the AIF industry itself not only inside but also outside the EU. The draft also prejudices the outcome of the work being undertaken by IOSCO and the G20 in relation to the regulation of hedge funds and other alternative investment funds on a global basis.

Significant issues raised by the draft proposed Directive for AIFM which are managers of hedge funds include the following:

Which AIFM are covered

The proposed Directive will apply to AIFM with assets under management in excess of €100 million (about US\$ 130 million), irrespective of the number of AIF which they manage. The €100 million threshold is phrased as "assets under management, including any assets acquired through the use of leverage" and it is not clear whether this means net or gross assets. The official press release announcing the proposal indicates that this threshold has been chosen so as to exclude AIFM for whom the requirements would be disproportionate and that as a result approximately 30 per cent of hedge fund managers, managing 90 per cent of EU domiciled hedge funds, will be covered by the proposed Directive. AIMA estimates that the Directive will in fact cover approximately 87 per cent of all assets under the management of EU hedge fund managers in EU and non-EU domiciled hedge funds.

Marketing passport for non-EU AIF delayed until 2014

Although AIFM established and authorised in an EU member state under the provisions of the Proposed Directive will be granted a passport to market the AIF which they manage to professional investors (as defined in Annex II of the MiFID Directive) throughout the EU, AIFM will only be permitted under the same passport to market in the EU AIFs which are domiciled outside the EU, including US hedge funds, subject to certain conditions, including a requirement that each EU member state in which such an AIF is to be marketed has entered into an agreement with the country in which the AIF is domiciled to share information on tax matters complying fully with the standards laid down in the OECD Model Tax Convention. This requirement has nothing to do with the regulatory objective of the Proposed Directive but rather, as the Commission admits in the Explanatory Memorandum accompanying the draft, it is designed to ensure that tax authorities in the EU may obtain such information from the tax authorities in the country in which an AIF is domiciled as is necessary to enable them to tax investors in the AIF. We believe it is inappropriate to use a directive on investment funds to achieve a tax objective.



Alternative Investment Management Association

The passport to market AIF domiciled outside the EU will, however, only become available three years after the rest of the proposed Directive has come into force, and until then an AIFM domiciled in one member state will be permitted to continue to market AIF domiciled outside the EU in the other member states under the existing domestic private placement rules currently in force in those member states. During this three year period, AIFs domiciled outside the EU will be at a competitive disadvantage when compared to AIFs domiciled in the EU, particularly in countries such as France and Italy which do not currently allow AIFs domiciled outside the EU to be marketed even on a private placement basis.

No level playing field

The proposed Directive will not apply to EU credit institutions which provide management services to AIFs, so long as they do so through a division and not through a separate company. This carve-out appears to have been included in the draft at the last moment, presumably as a result of lobbying by large continental European banks. Given the objective of the proposed Directive, AIMA questions why it should not apply to such institutions.

It also appears that entities which are authorised in an EU member state to market but not to provide management services to AIF, as well as AIFMs established in an EU member state which do not provide management services to EU domiciled AIFs nor market AIFs in the EU, are not covered by the proposed Directive.

Non-EU AIFs may be denied marketing access to the EU

AIFMs or other entities which are not established in an EU member state (such as all US and Asian hedge fund managers and marketers) will be prohibited from marketing AIFs in the EU, even under the existing domestic private placement rules of the member states. In theory, such non-EU established managers may apply to a member state to become authorised to market their AIFs to professional investors in the EU, but in practice it may be impossible for the requirements for authorisation to be satisfied. These requirements include a determination having been taken by the Commission (rather than the relevant member state) that the legislation of the non-EU country in which the AIFM is established in relation to prudential regulation and ongoing supervision is equivalent to the provisions of the proposed Directive, that AIFMs established in the EU are granted comparable effective market access to professional investors in that non-EU country and that, as described above, the non-EU country has entered into an agreement on sharing information in tax matters with each EU member state in which the AIF is to be marketed. As regards the market access condition, it is notable that regulators in the EU and the US have been endeavouring without success for over 30 years to agree reciprocal access for UCITS funds and their US equivalent. The above requirements do not, however, apply to AIFMs established in an EU member state, and therefore non-EU hedge fund managers wishing to continue to market their AIFs in the EU will be forced to establish a place of business in the EU and become authorised under the proposed Directive.

Depositaries, prime brokers and liability issues

An AIFM will be obliged to ensure that each AIF that it manages appoints an EU credit institution as a depositary of its cash and other assets (the concept of a depositary is borrowed from the UCITS Directive and indicates a custody function with additional regulatory responsibilities beyond those normally attaching to mere custodians). The proposed Directive provides that the depositary may delegate its tasks to other depositaries (presumably acting as sub-depositaries/sub-custodians) but while it is silent as to whether such other depositaries must also be EU credit institutions, that appears to be the position, except in the case of the depositary of a non-EU domiciled AIF which will be permitted to delegate to a depositary



Alternative Investment Management Association

established in the same domicile subject to certain conditions. Since currently only two of the principal prime brokers are EU credit institutions or have such an institution in their group, and none of the principal prime brokers are established in any of the non-EU domiciles in which AIFs are usually established, these restrictions will clearly make it difficult, if not impossible, for an AIF to appoint or continue the appointment of the prime broker(s) of its choice. If US hedge fund managers are forced to establish a place of business in the EU as an AIFM and become authorised under the proposed Directive in order to market their AIFs in the EU, their prime brokerage arrangements will also need to be changed to comply with the proposed Directive.

The obligation to appoint a depositary will also extend to AIFs which are US or other limited partnerships. The structure of a limited partnership, which is managed for the benefit of its investors who are limited partners by a general partner that will usually be the AIFM itself or an affiliate thereof, does not lend itself well to the concept of appointing a depositary. It seems likely that, when faced with compliance with this obligation, many US hedge fund managers who have delegated responsibility for the investment management of an AIF to an AIFM which is a UK or other EU affiliate will consider closing that affiliate down.

Independent valuation agent required

An AIFM will also be obliged to ensure that each AIF that it manages appoints an independent valuation agent and, if the registered office of the valuation agent is outside the EU, the European Commission must first have determined that the valuation rules and standards used by valuation agents in the relevant third country are equivalent to those applicable in the EU (which assumes that there are EU rules and standards). Although IOSCO, AIMA and the Hedge Fund Standards Board recommend that an independent valuation agent be appointed, they all recognise that circumstances can exist where it is not always appropriate, and it is not yet a generally recognised practice among US hedge fund managers. The proposed Directive will have the effect that UK AIFMs which are affiliates of US hedge fund managers will not be able to comply with the requirements for authorisation, unless each AIF in respect of which they have been appointed as sub-adviser by their US parent has appointed an independent valuation agent.

Leverage

The proposed Directive contains provisions relating to AIFMs which manage one or more AIFs “employing high levels of leverage on a systematic basis”. It is notable that this test differs from that expressed by IOSCO, the G20 and the Turner Report, which refers to hedge funds which are “systemically important”. Under the Proposed Directive, the test will be deemed to be met by any AIF which employs leverage exceeding the “value of [its] equity capital”, in which case certain disclosures to investors and regulators will have to be made. The level at which the test has been set will result in virtually all hedge funds being deemed to have met it (AIMA recently calculated that the average level of leverage employed by hedge funds is 1 times net assets and this was recognised in the FAQs issued by the European Commission when officially announcing the proposal for the proposed Directive).

The proposed Directive also contains a provision which requires that the European Commission, in order to ensure the stability and integrity of the financial system, adopt measures setting limits to the level of leverage which AIFMs can employ taking into account the type of AIF, their strategies and their sources of leverage. The proposed Directive suggests that such limits could either consist of a threshold that should not be breached at any time or a limit on average leverage employed during a given period (such as monthly or quarterly). This provision represents an undue interference by the European Commission in the commercial sphere.



Alternative Investment Management Association

Master-feeder structures and prime brokerage not addressed

The proposed Directive does not recognise that the majority of hedge funds operate through a master feeder structure, and it is not therefore clear how a number of its provisions will apply in practice. This is despite the fact that the UCITS Directive itself is currently being amended to cater for master-feeder structures. The proposed Directive does not recognise the concept of prime brokerage, and refers only to the concept of a depositary.

Timing and process

The proposed Directive will now be sent to the European Parliament and the European Council, where according to the European Commission itself "it is expected to be the object of intense political discussion and negotiation". Interested parties will also have an opportunity to influence such discussions and negotiation, both directly and through AIMA and other trade associations. It is hoped that this will result in a final text of the proposed Directive which is more proportionate and less protectionist, as well as being more sensitive to the differences between the structures employed by hedge funds and other AIFs and avoiding wholesale modifications to the structure of the asset management industry, including hedge funds. If political approval of the proposal is reached by the end of 2009, the proposed Directive could come into force in 2011. AIFM operating in the EU at that time will have a further year in which to obtain authorisation under the Directive.

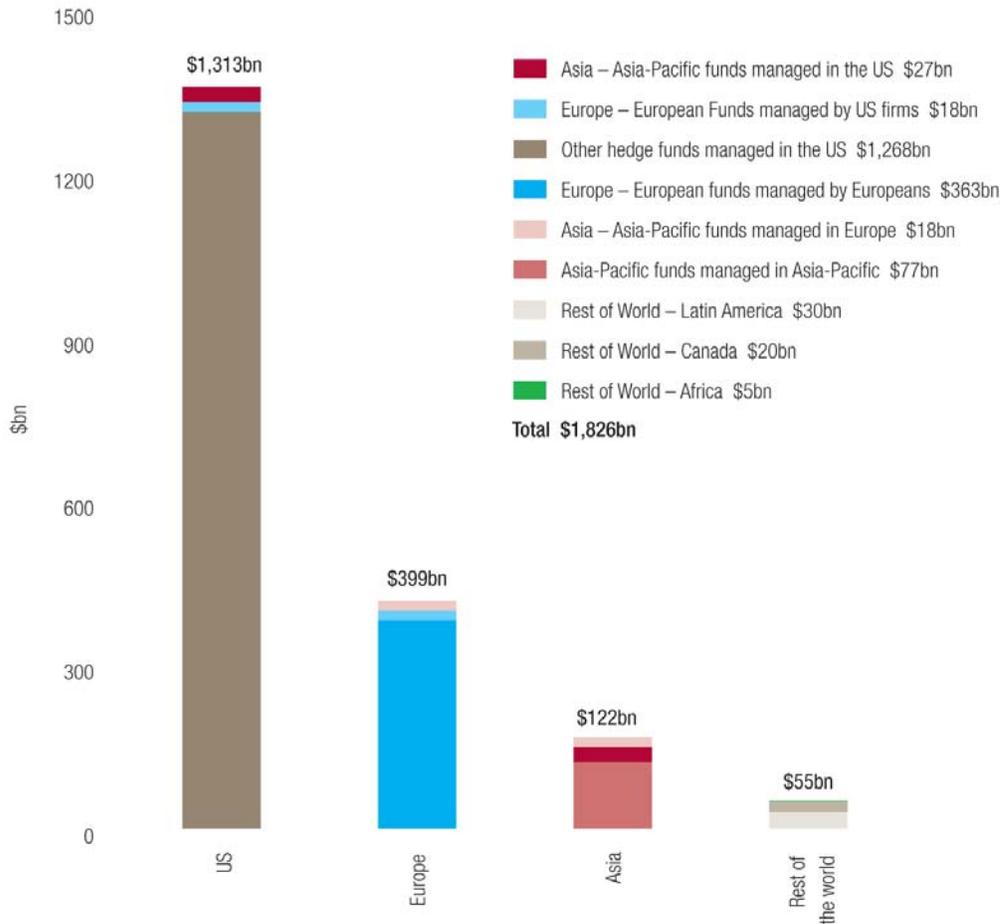
The above list of issues is not intended to be exhaustive and there are numerous additional areas where the drafting of the proposed Directive could and indeed will need to be improved.



APPENDIX 7

Overview of the global hedge fund industry

Chart 1: The \$1.8 trillion hedge fund management industry and where it is located



Source: HedgeFund Intelligence (31 December 2008)

Chart 1 (above) shows that hedge funds are very much a global industry. The US is by far the leading location accounting for approximately 72% of the total of net AUM. Europe and Asia also provide significant offerings. These statistics represent single-manager hedge funds only. (To avoid double counting, fund of hedge funds are not included in these numbers.)

Hedge fund managers invest in a variety of strategies from equity related, plain vanilla to more sophisticated type strategies. Larger hedge fund management groups typically have a presence in multiple geographic regions.



Alternative Investment Management Association

Table 1: Assets under management by firms managing in excess of \$1 billion

Hedge Fund Firms Greater than \$1 bn AUM				
Date	Firms with >\$1bn	Asset size Billion Dollar Club (\$bn)	Total of hedge fund global assets (\$bn)	% of billion dollar club
Dec-08	311	1455	1826	79.7%
Jun-08	395	2161	2697	80.1%
Dec-07	391	2083	2646	78.7%
Jun-07	381	1892	2482	76.2%
Dec-06	351	1564	2079	75.2%

Source: Hedge Fund Intelligence

As at 31 December 2008, there were 311 hedge fund manager firms globally that managed \$1 billion hedge fund AUM or greater (together they managed over \$1.4 trillion in hedge fund AUM. 70% of these firms are US based and 23% European, mostly London based.

New York remains the biggest location for hedge funds with over 123 firms that manage 46.2% of the total hedge fund AUM, thereafter followed by London with over 65 firms that manage 17% of the total of hedge fund AUM.

Global estimated number of hedge funds

As at the end of Q1 2009, Hedge Fund Research (“HFR”) estimated that there were approximately 8,860 hedge funds and fund of funds operating worldwide. Of this, approximately 75% (or 6,644 funds) were single manager hedge funds while the remainder 25% (or 2,216 funds) being funds of hedge funds.

Global Regional Breakdown of Hedge Fund Industry

As per Chart 1, AUM for the US hedge fund industry accounts for approximately \$1.313 trillion. Tables 2 and 3 below provide an overview of the European and Asian hedge fund industry AUM.



Alternative Investment Management Association

Table 2: Total European hedge fund assets by location

Country	Funds	AUM (\$ millions)	% of Universe by AUM
UK	957	317,313.95	79.61%
Switzerland	153	13,747.67	3.45%
France	127	13,324.43	3.34%
Sweden	67	12,245.85	3.07%
Netherlands	25	9,798.67	2.46%
USA	41	9,462.35	2.37%
Norway	36	4,082.64	1.02%
Cyprus	10	2,767.16	0.69%
Ireland	24	1,841.82	0.46%
Italy	18	1,714.93	0.43%
Russia	19	1,592.46	0.40%
Spain	18	1,538.01	0.39%
Denmark	13	1,056.99	0.27%
Austria	18	1,053.14	0.26%
Finland	18	1,021.11	0.26%
Other	94	6,014.57	1.51%
Total	1638	398,575.75	100.00%

Source: Eurohedge

The UK accounts for approximately 80% of the total of hedge fund AUM managed in Europe. Other key locations for hedge fund managers in Europe include France, Switzerland and Sweden. Growth of the UK and European hedge fund industry has also primarily been driven by increased investment from institutional investors.

Table 3: Total Asia-Pacific hedge fund assets by location

Country	No of Funds	AUM (\$billion)	% of Universe by AUM
UK	104	17.3	14.13%
USA	136	27.39	22.37%
Australia	145	27.05	22.09%
Japan	69	8.52	6.96%
Hong Kong	245	22.18	18.12%
China	9	0.62	0.51%
Singapore	150	15.93	13.01%
Other	70	3.44	2.81%
Total	928	122.43	100.00%

Source: Asiahedge

The Asia Pacific region is also increasingly important, both as a source of capital and location for managers. Both the UK and the US are leading locations for management of Asian hedge fund assets' making up for approximately 36% of Asian hedge fund AUM.



Alternative Investment Management Association

APPENDIX 8

AIMA's template for a global short selling reporting regime

Confidentiality requirement

Disclosure of positions should be made privately to the regulator and kept confidential.

Aggregation requirement

Any information provided to the market on short positions should be provided on an aggregate basis.

Position reporting requirement

Reporting should be on the basis of net short positions rather than on a trade marking basis, at manager rather than investor level (where practicable). A short position is deemed to arise at the time it is opened (i.e., time contract, not time of settlement).

Threshold reporting requirement

Net short positions above 1% of the issued share capital of the relevant stock should be reported.

Banding reporting requirement

An additional report should be made when a net short position increases by every 0.25% over 1%.

'Home state' nomination requirement

Each issuer should nominate a 'home state' to determine the destination and timing of reports (assumed to be the location of the primary listing for dual-listed securities).

Single report requirement

A single report should be made to the 'home state' regulator. (Arrangements should be made among regulators for appropriate sharing of reports, for example, where securities are dual listed. Sharing requirements already exist for sharing of some reports among EU regulators.)

Timing requirement

The aggregate net position should be calculated at midnight on the day on which the short position was opened (i.e., time of contract), referenced to the time-zone in which the 'home state' regulator is located. The report should be made within 48 hours of that time.

Language requirement

Reports may be made in English or the local language of the 'home state' regulator, at the option of the disclosing party.

Scope requirement

The reporting regime should apply to all 'listed' equities (with each regulator to produce a list of recognised exchanges) with a carve-out for baskets / indices / ETFs (subject to certain exceptions e.g., if a relevant stock makes up at least 1% of the class in issue and 20% or more of basket). Investments relating to un-issued equities would also be caught. In principle, derivatives will also be included on a delta-adjusted basis, although we appreciate that substantial complexities will need to be addressed to make derivative reporting workable and meaningful⁴.