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March 27, 2008

The Honorable Barney Frank
Chairman
Committee on Financial Services
House of Representatives

The Honorable Paul E. Kanjorski
Chairman
Subcommittee on Capital Markets, Insurance
and Government Sponsored Enterprises
House of Representatives

The Honorable Michael E. Capuano
House of Representatives

Re: *Hedge Funds: Regulators and Market Participants Are Taking Steps to Strengthen Market Discipline, but Continued Attention Is Needed*

Dear Honorable Representatives:

The CFA Institute Centre for Financial Market Integrity (the "Centre")[1] read with interest the report of the U.S. Government Accountability Office (the "GAO"), *Hedge Funds: Regulators and Market Participants Are Taking Steps to Strengthen Market Discipline, but Continued Attention Is Needed* (the "Report"). The growth of hedge funds has made such a review of the oversight mechanisms for this market sector an important exercise. Moreover, such a review is timely given the current disruptions in the global credit markets.

The Centre represents the views of investment professionals before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and the efficiency and integrity of global financial markets. As a part of this role, we have responded to regulatory proposals for hedge fund managers and regulators both in the United States and in foreign markets. In most cases, our responses called for greater transparency and ethical standards for hedge fund managers.

[1] The CFA Institute Centre for Financial Market Integrity is a part of CFA Institute. With headquarters in Charlottesville, Virginia, USA, and regional offices in London, Hong Kong, and New York, CFA Institute is a global, not-for-profit professional association of more than 94,000 financial analysts, portfolio managers, and other investment professionals in 133 countries and territories, of whom 82,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 56 countries and territories.

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In the paragraphs that follow, we discuss the issues raised by the Report that we feel are particularly important and relevant in the current market environment. Where applicable, we also will note where the Centre might be helpful to the Honorable Representatives as they consider the hedge fund sector and possible legislative and non-legislative actions to deal with potential systemic risks.

Improved Transparency

The GAO notes in the Report how hedge funds and their managers have improved their transparency in recent years. This, it states, was largely as a consequence of increased involvement of and demands from institutional investors such as pension funds. The Centre welcomes the improvement in the flow of such information but remains concerned. In particular, we are concerned about the level and timeliness of disclosures related to the level of current exposure to derivatives and other structured products, and whether proper valuations are being reported.

Investor Protections

The Report also notes the need for regulators to address investor protection issues as they relate to hedge funds and their principal counterparties. Clearly, investor protection issues are an important element of investor confidence in financial markets. As such, the Centre has called upon the hedge fund sector to take steps on its own to remedy the situation. In particular, the Centre created its *Asset Manager Code of Professional Conduct*[2] (the "AMC") to give hedge fund managers a code of ethics that addresses many of the issues discussed in the Report, including the need to provide regular, relevant, and accurate reports to their clients, to adhere to appropriate ethical standards, and to address investor protections. The AMC also calls on managers to put the interests of their clients first, and to act with loyalty, prudence, and care, to deal fairly, and to consider the suitability of investment strategies for their clients.

The Centre believes that such investor protection issues are an important omission from the various sets of industry sound practices and the code of conduct proposed by the Hedge Fund Working Group (the "HFWG") in the United Kingdom last autumn. These views were expressed in a letter delivered to the HFWG.[3]

The Centre has taken similar positions with regard to: how hedge funds value unique and illiquid investment instruments[4]; steps such funds must take before being permitted to sell their products

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[2] See *Asset Manager Code of Professional Conduct*

[3] See HFWG Proposed Code comment letter 12 Dec 2007.

[4] See 2007 - IOSCO on principles of valuation for hedge fund investment instruments

to less-sophisticated and/or less-financially secure investors[5]; and, how market regulators should monitor hedge fund activities.[6]

Conclusion

The Centre supports the Report's findings, and encourages continued vigilance by regulators over the hedge fund industry. To that end, the Centre is prepared to work with the Representatives in the future and provide the insights and experience concerning hedge funds and their oversight from its more than 94,000 professional members located in more than 130 countries. If you or any of your staff have any further questions, please feel free to contact Jon Stokes at 1.434.951.5314 (or jon.stokes@cfainstitute.org)

Sincerely,

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[5] See 2004 - SEC Registration of Hedge Fund Advisers under Advisers' Act.
[6] See 2005 - UK FSA Hedge Fund Risk and Regulation