



Centre for
Financial
Market
Integrity

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Hedge Fund Standards: Consultation Paper

From the Hedge Funds Working Group

A response by

CFA Institute Centre for Financial Market Integrity - EMEA

Dear Mr. Deinet,

The CFA Institute Centre for Financial Market Integrity ("CFA Institute Centre")¹ is pleased to submit its response to the Hedge Funds Working Group's Consultation Paper (the "Consultation"). The CFA Institute Centre is part of CFA Institute which is best known for developing and administering the CFA curriculum and examinations and issuing the CFA charter. CFA Institute's mission is to lead the investment profession globally by setting the highest standards of ethics, education and professional excellence.

The CFA Institute Centre develops, promulgates, and maintains the highest ethical standards for the investment community, including the CFA Institute Code of Ethics and Standards of Professional Conduct. It represents the views of investment professionals and investors 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 transparency and integrity of global financial markets.

In addition to this letter, you will receive a more comprehensive response from the local CFA society, specifically the advocacy committee of CFA Society of the UK, chaired by Geoff Lindey, FSIP. We offer our support to their response generally. In addition to the comments of the UK Society, we wish to offer some additional comments to the Consultation for your consideration.

¹ The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With headquarters in Charlottesville, VA, and regional offices in New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 95,300 investment analysts, portfolio managers, investment advisors, and other investment professionals in 133 countries, of whom more than 79,800 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 56 countries and territories.

First, we wish to acknowledge our appreciation for the efforts of the Hedge Fund Working Group (HFWG) in seeking to develop a self-regulatory template for the hedge fund industry. We all recognize the importance of the industry stepping up to this challenge. In our earlier letter of the 2nd August to the HFWG and Sir Andrew Large we encouraged that any such process include adequate consideration for investor protections and professional conduct. As we noted then, we believe that a working group composed exclusively of hedge fund managers, without other stakeholders input, may not adequately address these important areas. Our organization, which has developed a set of standards in this regard, remains concerned that the views of other stakeholders were not fully addressed in the Consultation.

In particular, we believe that the Consultation reflects too strongly the commercial interests of the group while paying less attention to professional and ethical purpose than we think is needed. In discussing the hedge fund industry with our global membership and other regulatory authorities, the hedge fund business is viewed very critically. Issues include non-transparent processes, market exposures and operations. Investor and regulator communications are viewed as weak and the potentially high business and market risks create a concern about the potential for systemic shocks to markets. Increasingly, concerns are expressed about the significant potential for conflicts of interest due to fee structures and prime brokerage support. In this context, we believe the Consultation is lacking and should pay particular heed to higher standards of professional care in each of these areas. Central to this needed focus is the duty to put the interests of investors before those of the firm and its employees.

An example of such higher professional standards were developed by the CFA Institute Centre and published as the Asset Manager Code of Professional Conduct (the "Code" see, www.cfapubs.org/toc/ccb/2004/2004/4). This is a firm-wide Code that evolved from CFA Institute's Code of Ethics and Standards of Professional Conduct, which are annually reaffirmed by its members. We hold this document out to the HFWG as a set of global principles of professional conduct that could augment the ethical direction of the Consultation.

A second concern of ours rests with the notion of a comply-or-explain regime. Investors are concerned with the ability of a firm to adopt some or even a small portion of the HFWG approach, depending on what is in such firm's commercial interest, and still represent itself as compliant. The Consultation process presents an opportunity that should not be missed for both the UK market and the HFWG participants, who represent leaders in this industry, to aim for a higher standard. We encourage the group to consider a more global approach to hedge fund oversight. In this regard, we feel the Consultation's dependence on a 'comply-or-explain' regime falls short of being adequately rigorous or comparable across managers and markets.

The approach reflected in our Asset Management Code requires full adherence to its principles to claim compliance. The ability of a hedge fund firm to 'cherry pick' from the variety of provisions in the Consultation or from one or more of the other "Hedge Fund Codes" that are now emerging from this sector, creates confusion and no standard basis of comparison. We would encourage the HFWG to join others in working toward a single 'global' standard, free from commercial bias and reflecting consistent adherence to a full set of professional and ethical principles.

As one important example of this, the Consultation does make reference to the CFA Institute Centre's Global Investment Performance Standards (GIPS), which stand in



contrast to the comply-or-explain regime. Managers can claim GIPS compliance only by fully conforming to its provisions. Consequently, GIPS is now recognised as the industry standard in 28 countries including the UK precisely because it is rigorous, requires full adoption, and provides a consistent benchmark of comparison. The GIPS have become globally endorsed by the investment management business and its stakeholders.

Thank you again for your efforts. We appreciate the opportunity to respond to the HFWG's Report and would be happy to meet with the HFWG to further discuss our suggestions. If you need additional information or would like to schedule a meeting, please contact Alan or I by telephone or email at the contact details below.

Yours sincerely,

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