

European Commission
Directorate-General Internal Market and Services
B - 1049 Bruxelles/Brussels
Belgium

30th January 2009

**Working Document of the Commission Services (DG Internal Market) -
Consultation Paper on Hedge Funds**

The CFA Institute Centre for Financial Market Integrity (“CFA Institute Centre”) welcomes the opportunity to comment on the European Commission’s “Consultation Paper on Hedge Funds” (the “Consultation”).

The CFA Institute Centre¹ promotes fair, open, and transparent global capital markets, and advocates for investors’ protection. The efficient functioning of the market and the price formation process are driven in no small part by the activities of hedge funds. Given the systemic effects of the dysfunction in financial markets, and in view of the Commission’s review of the regulatory and supervisory framework for all financial market actors in the EU, we appreciate the efforts of the Commission to conduct a thorough examination of the issues relating to hedge funds.

EXECUTIVE SUMMARY

The Consultation broadly addresses the following issues: the impact of hedge funds on overall systemic risk, focusing on proper regulatory oversight of hedge funds; market integrity and efficiency issues related to hedge funds, focusing on short selling practices; risk management practices of hedge fund managers; and the level and transparency of hedge fund disclosures. These issues are central to the wider initiatives to review the financial regulatory architecture, both at the EU level (for example the work of the de Larosière High Level Expert Group) and at the international level through the G20. Our main observations are summarised as follows:

- With regard to systemic risk and prudential oversight, the CFA Institute Centre agrees that recent disruptions in financial markets merit a reassessment of the systemic relevance of hedge funds. Specifically, systemic risk is represented by the extent to which hedge funds employ leverage in their investment portfolios. The primary facilitator of hedge fund leverage is typically the prime broker. We believe that the ‘indirect approach’ of regulating and monitoring hedge fund exposures and aggregate leverage via the prudential oversight of and requirements on prime brokers and other

¹ 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, Global Investment Performance Standards (“GIPS[®]”), and the Asset Manager Code of Professional Conduct (“AMC”). 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.

hedge fund service providers can be effective. This would be preferred to an approach that would place new capital requirements on hedge funds. The imposition of capital requirements on hedge funds would be ineffective and costly from a supervisory perspective. Moreover, if such an initiative were to be adopted in Europe but not in wider international jurisdictions, it would likely result in regulatory arbitrage.

- More and clearer disclosures of hedge fund positions, both towards regulators and investors, would facilitate better monitoring of hedge fund activities, strengthen financial counterparties' due diligence, and thus reduce the potential for systemic risk. It should be incumbent upon hedge funds to produce timely (for example, monthly) net asset value calculations to assist regulators and financial counterparties to more accurately monitor hedge fund exposures. In particular, hedge funds should adopt transparency measures as part of a formal and workable self-regulatory code of conduct for the sector. Several industry efforts have fallen short with regard to investor concerns, opting instead for a cacophony of "pick-and choose" best practices. The industry should apply a consistent and verifiable code or face formal regulation, in our view. More broadly, transparency is a key component of investor protection. Clear, relevant, and timely disclosures are essential for investors to have sufficient information on which to base their decision-making process, and to maintain confidence in the hedge fund industry. Recent scandals only serve to highlight this fact.
- On market efficiency, the CFA Institute Centre firmly believes that short selling is a valuable investment activity that enables markets to quickly and accurately adjust securities prices to reflect investor opinions about valuations. Recent restrictions on short selling have limited some hedge funds' ability to execute their stated strategies, thereby reducing liquidity, and exacerbating market volatility. Accordingly, we remain opposed to measures designed to restrict short selling or specific controls to limit the activity of hedge funds. However, market efficiency could be improved through greater transparency regarding short selling activity. For example, if not already implemented in an EU jurisdiction, firms should identify short sales on trade tickets, and regulators should publish short interest data. Moreover, disclosure thresholds for short sales (for example, 0.25% of economic interest in some EU jurisdictions) are disproportionate relative to the claims and benefits of short and long positions of similar sizes. This asymmetry not only discriminates against the interests of short sellers, but also is detrimental to the efficiency of the price-formation process.
- The financial crisis has only reinforced the need for strong risk management on the part of all financial market actors. We are fully supportive of efforts to improve risk management processes and procedures for managing hedge fund assets, which would be best achieved through industry-wide adherence to an accepted code of conduct based on best market practices, such as the CFA Institute Centre's *Asset Manager Code of Professional Conduct*. Best practice would require adherence to firm-wide compliance policies and procedures to mitigate operational risks, robust investment selection processes, and risk measurement techniques based on statistical analyses such as stress tests.

In light of the issues addressed by the Consultation, we believe the hedge fund industry's approaches to self-regulation, even those based on the principle of 'comply or explain,'

have failed to produce a common and consistently applied code of conduct. Therefore, we strongly urge the industry to adopt and apply a consistent and verifiable code or face formal regulation. Irrespective of the regulatory framework ultimately determined by the Commission, the CFA Institute Centre believes that the industry should demand of itself a higher level of ethics and professional standards to serve investors' best interests. In our view, adoption of the CFA Institute Centre's *Asset Manager Code of Professional Conduct* would help address these issues and restore much needed trust in the hedge fund industry.

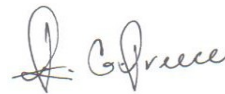
We attach our response that addresses the specific questions of the Consultation. Please do not hesitate to contact us should you wish to discuss any of the points raised.

Yours faithfully,



Charles Cronin, CFA
Head, CFA Institute Centre,
Europe, Middle East and Africa

+44 (0)20 7531 0762
charles.cronin@cfainstitute.org



Rhodri G. Preece, CFA
Policy Analyst, CFA Institute Centre,
Europe, Middle East and Africa

+44 (0)20 7531 0764
rhodri.preece@cfainstitute.org

The CFA Institute Centre is part of CFA Institute². 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 100,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 134 countries, of whom nearly 87,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

SPECIFIC COMMENTS

1. Scoping the Issues

Questions:

- (1) *Are the above considerations sufficient to distinguish hedge funds from other actors in financial markets (especially other leveraged institutions or funds)? If not, what other/additional elements should be taken into account? Do their distinct features justify a targeted assessment of their activities?*
- (2) *Given the international dimension of hedge fund activity, will a purely European response be effective?*

The Consultation distinguishes hedge funds by the following characteristics: a focus on absolute returns; investment strategies that employ a relatively high and systematic use of leverage; and an investor base typically confined to institutional or sophisticated investors.

The CFA Institute Centre concurs with these characteristics; however they are not sufficient to distinguish hedge funds from other financial market actors. Specifically, we suggest adding the following four elements to be the key distinguishing characteristics of hedge funds: investment objective, legal structure, fee structure, and the investment instruments used.

Hedge funds employ a plethora of investment strategies and as such may not be considered a homogeneous asset class. However, a common denominator, largely irrespective of investment strategy, is their objective to generate *absolute returns*. This feature distinguishes them from traditional collective investment schemes which focus on relative performance against set benchmarks.

The principal legal structures for hedge funds are limited partnerships, limited liability corporations, or offshore corporations. Hedge funds are established under these structures to enable them to avoid regulations that may restrict their investment parameters, such as restrictions on eligible assets and investment techniques. These legal structures therefore enable hedge funds to execute their objective of absolute returns whilst avoiding the taxation treatment that applies to more traditional collective investment schemes.

² CFA Institute is best known for developing and administering the Chartered Financial Analyst curriculum and examinations and issuing the CFA Charter.

The fee structure for hedge funds typically comprises a management fee (such as a percentage of net asset value) and an incentive fee (for example, 20% of realized profits). The fee structure may also include a “high water mark”, in which case any losses would have to be fully recouped before an incentive fee can be paid.

With regards to investment instruments, hedge funds may invest in over-the-counter derivatives, engage in short-selling techniques, and employ leverage. Typically, these instruments and techniques are outside the eligible investment parameters for traditional long-only collective investment schemes.

Regarding the supervisory issues related to hedge funds, the CFA Institute Centre considers that a ‘purely European response’ would not be effective. As the Consultation notes:

“...European hedge fund managers compete with other funds and managers from around the world, for the custom of international investors. [...] the commercial and regulatory geography of the hedge fund industry is complex”.

This raises two concerns. Firstly, efforts to introduce European-specific regulations would likely result in regulatory arbitrage, such that European markets would see an erosion of their client base as hedge fund investors divert their funds to other markets. Secondly, given the international nature of the hedge fund industry, European-specific supervisory arrangements would likely be ineffective, and difficult to enforce. The organisational structure of hedge funds is such that the fund itself may be domiciled offshore, but managed onshore, with an administrator and / or prime brokerage facility located in a separate jurisdiction. Accordingly, regulatory responsibility for the different functions, along with supervisory coordination, would need to be well defined and managed for a European-specific arrangement to be effective.

Given the international dimension of the hedge fund industry and the associated complexities of supervisory arrangements, we consider self-regulation based on an industry-wide accepted code of conduct to be most effective. To this end, the CFA Institute Centre has published its own code of conduct, entitled, “*Asset Manager Code of Professional Conduct*”³ (the “Code”). The goal of the Code is to set forth a framework for asset managers (including hedge fund managers) to provide services in a fair and professional manner and to fully disclose key elements of these services to clients.

2. Systemic Risks

Questions:

- (3) Does recent experience require a reassessment of the systemic relevance of hedge funds?*
- (4) Is the ‘indirect regulation’ of hedge fund leverage through prudential requirements on prime brokers still sufficient to insulate the banking system*

³ See CFA Institute Centre for Financial Market Integrity, “*Asset Manager Code of Professional Conduct*”, at <http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2004.n4.4008>. A revised version of the Code is due to be published in forthcoming months.

from the risks of hedge fund failure? Do we need alternative approaches?

- (5) *Do prudential authorities have the tools to monitor effectively exposures of the core financial system to hedge funds, or the contribution of hedge funds to asset price movements? If not, what types of information about hedge funds do prudential authorities need and how can it be provided?*

Recent experience merits a reassessment of the systemic relevance of hedge funds. As the Consultation points out, these funds have traditionally been considered not to pose a significant systemic risk, to the extent that losses are borne principally by their investors and immediate counterparties. However, in light of the significant value and volume of trading activity demonstrated by some hedge funds, the often complex or illiquid nature of their investments, and the pro-cyclical effects stemming from large redemptions, there may be greater potential for the impact of fund losses (or fund failure) to go beyond the confines of fund investors.

Specifically, the systemic relevance of hedge funds is primarily determined by leverage. The extent to which hedge funds leverage their operations is dependent upon the extent to which credit is extended to them from the prime broker or other bank lender. The relationship between the hedge fund and the prime broker acts as the primary transmission mechanism for the pass-through of risk from hedge funds to the financial system. Therefore, the greater the degree of leverage extended to hedge funds, the greater the counterparty risk borne by the prime broker, and hence the greater the potential for systemic risk. For example, the combination of a hedge fund leveraged to several multiples of capital and declining asset values (corresponding with large redemption requests) may expose the prime broker to large losses. These losses may then be transmitted to the wider financial system as the prime brokerage contracts the supply of credit to other financial institutions. It follows that the key to mitigating systemic risk is to control the extent to which the prime broker extends leverage to the hedge fund.

Question (4) asks whether 'indirect regulation' of hedge fund leverage through prudential requirements on prime brokers is sufficient to mitigate systemic risks, or whether alternative approaches are needed. As implied above, we consider the 'indirect' approach to be most appropriate. Alternative approaches are likely to be ineffective and conducive to regulatory arbitrage.

Specifically, we interpret "alternative approaches" to mean direct capital requirements for hedge funds (as recommended by the Rasmussen report⁴). In our view, it would be more effective to improve the prudential supervision of prime brokers, as opposed to introducing a further layer of capital requirements on hedge funds themselves. Suggested ideas would be incentives to encourage exclusive prime broker/hedge fund relationships, and sharing of information between prime brokers so as to more closely monitor individual hedge fund liability exposure. An additional layer of capital requirements may be both unnecessary and costly from a supervisory perspective. Moreover, if such a requirement were to be imposed in Europe but not in wider international jurisdictions, it would likely result in regulatory arbitrage, to the detriment of the European funds industry.

⁴ Report of the European Parliament with recommendations to the Commission on hedge funds and private equity (A6-0338/2008). See <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A6-2008-0338+0+DOC+PDF+V0//EN>

The proposed revisions to the Capital Requirements Directive, notably in the area of “large exposures” (which limit inter-bank exposures to 25% of own funds), serve as a useful basis for improving prudential requirements for prime brokers. Moreover, systemic risk can be reduced through separating the inter-relationships between the prime broker and the funds to which it extends credit. These inter-relationships arise through the use of cross-collateralisation and the commingling of fund assets with other assets of the prime broker, which may then be re-hypothecated.

There are two main concerns arising from these inter-relationships. Firstly, re-hypothecation can transmit systemic risk. For example, suppose that the prime broker lends capital to a fund (“fund A”) that has been raised from a third party using as collateral the assets of another fund (“fund B”). Failure of fund A could negatively impact on the prime broker’s solvency, which in turn would have a detrimental impact on fund B. In its July 2006 report to the European Commission⁵, the Alternative Investments Expert Group recommends against imposing any regulatory restrictions on re-hypothecation limits, instead favouring the fund and prime broker to negotiate specific commercial terms. In light of the systemic risks identified (and most notably exemplified in the case of Lehman Brothers in Europe), and the implications for investor protection, we recommend that the Commission give due consideration to whether a harmonised ceiling on re-hypothecation would be appropriate. Such a ceiling would be measured by the level of the fund’s indebtedness to the prime broker.

Secondly, the commingling of the fund’s assets with the assets of the prime broker increases the potential for systemic risk and fraud. As per the above scenario, should the prime broker suffer losses through exposure to another of its counterparties, it may be difficult for the hedge fund in question to secure the assets held in its custody account if those assets have been commingled and cross-collateralised (the extent of this risk may vary according to prevailing laws in different jurisdictions). Therefore, it may be prudent to limit the extent to which assets held in custody can be commingled by the prime broker. It follows that the most prudent approach would be to ring-fence the assets held in custody at the prime broker, or, preferably, to outsource the safe-keeping of assets to a third party custodian. In practice, the benefits of limiting commingling, in addition to re-hypothecation ceilings, would need to be weighed against the associated costs. However, in light of the potential for systemic risks and the need to protect investors we urge the Commission to carefully consider the appropriateness of the above recommendations.

Most importantly, greater transparency is needed to improve prudential supervision. Limited disclosures by hedge funds have made it difficult for lenders to assess the true degree of leverage. Whilst prime brokers can monitor individual levels of indebtedness, the absence of timely, transparent disclosures on assets, coupled with a lack of detailed disclosures on the extent of relationships with other brokers, has made it difficult to properly measure hedge fund leverage. Moreover, the commingling of hedge fund assets with those of the prime broker further obfuscates the monitoring of fund investments and their performance. Consequently, prudential authorities are likely to have lacked the ability to effectively monitor the exposure of hedge funds to the financial system.

⁵ See http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/hedgefunds_en.pdf

In response to question (5), it is therefore clear that the level of transparency towards regulators could be improved. Specifically, regulators (in addition to investors and lenders) need access to timely data on net asset value calculations. For example, funds should provide monthly balance sheets based on standardised valuation methodologies, in addition to annual audited financial statements. This would enable supervisors to monitor movements in fund values and calculate simple leverage ratios, so that they can identify the build-up of risk.

Moreover, regular due diligence should be conducted by the prime broker on its counterparties. Ultimately, this is the most effective method to monitor the build-up of risk. Indeed, regulated entities such as prime brokers are likely to collect most of the information that the prudential authorities need. Accordingly, it may be efficient for the regulator to obtain this information directly from the prime broker and / or other regulated financial counterparties.

For example, should the relevant prudential authority wish to verify hedge fund positions and valuations, it could look to relevant financial counterparties for over-the-counter derivatives contracts, contracts for difference, or listed securities. It could also look to the central counterparties of derivatives exchanges for exchange-traded derivative contracts.

3. Market Efficiency and Integrity

Questions:

- (6) Has the recent reduction in hedge fund trading (due to reduced assets and leverage, and short-selling restrictions), affected the efficiency of financial markets? Has it led to better/worse price formation and trading conditions?*
- (7) Are there situations where short-selling can lead to distorted price signals and where restrictions on short-selling might be warranted?*
- (8) Are there circumstances in which short-selling can threaten the integrity or stability of financial markets? In combating these practices, does it make sense to tighten controls on hedge funds, in particular, as opposed to general tightening of market abuse disciplines?*

Hedge funds' trading activities deepen market liquidity, and help contribute to better price discovery. In part, this stems from their ability to engage in short selling. The CFA Institute Centre believes that short selling is a valuable investment activity, which enables markets to quickly and accurately adjust securities prices to reflect investor opinions about valuations. Accordingly, restrictions on short selling (coupled with large investor redemption requests) have limited the extent to which hedge funds can participate in financial markets, reducing liquidity, and exacerbating market volatility. As a consequence, the efficiency of the price-formation process has been compromised. However, we recognise that short selling restrictions are not the primary cause of the unprecedented market turbulence in recent months, which is more a function of a lack of confidence and heightened investor uncertainty.

Nevertheless, in the view of CFA Institute Centre, short selling does not generally lead to distorted price signals. It is more likely that restrictions on short selling would distort price signals by restricting legitimate investment activity and hence weakening the price-discovery process. However, in some circumstances we recognise that naked short selling⁶ could worsen trading conditions. Specifically, by selling stock that has not first been borrowed or sourced, settlement of the transaction in a timely fashion may be jeopardised. Additionally, in some circumstances, up-tick rules may be a useful tool to limit scope for market abuse and thus preserve the efficiency of price discovery. In many global markets, up-tick rules may be useful in preventing abusive market behaviour without disrupting the legitimate short selling activities of the majority of investors.

In response to question 8, we do not consider short selling to threaten the stability of financial markets. Accordingly, controls targeted at hedge funds (or other market participants) would be inappropriate. However, market conditions could still be improved in respect of short selling transparency. Coordinated efforts by regulators should focus on collecting and publishing short interest data by company rather than by individual short seller. This would enhance investor understanding of the forces affecting securities prices while, ultimately, removing the current disincentives for short sellers to participate in the markets. Additionally, transparency towards regulators would be improved by firms noting on trade tickets transactions that involve short selling (where this is not already standard practice within European jurisdictions). For example, this could be achieved by the addition of a suffix on a consolidated tape, such as 'SO' or 'SC' (short open or short close), to provide market participants with real-time data on short positions throughout the trading day. This would aid regulators in assessing the extent of securities lending by specific financial institutions, and assist regulators in understanding the degree of systemic risk present in the market at any point in time.

A further consideration to reduce market disruption is to shorten the settlement timeframe for short selling (indeed for all securities transactions). This would likely discourage naked shorting through the trading day and would also likely deter some forms of market abuse, such as front-running. It should, however, be up to the financial counterparties to make such decisions, as they are the entities directly exposed to risk.

4. Management of Micro-Prudential Risks

Questions:

- (9) *How should the internal processes of hedge funds be improved, particularly with respect to risk management? How should an appropriate regulatory initiative be designed to complement and reinforce industry codes to address risk management and administration?*

A transparent, robust framework for managing risks is of key importance to protect investors' interests and maintain confidence in the hedge fund industry. Recent financial market turbulence has only highlighted the importance of the risk management function. As the Consultation notes, it is important that risk management processes and

⁶ By "naked" short selling, we mean the sale of a security prior to the seller sourcing a sufficient quantity of the stock on loan from a financial counterparty.

administrative functions evolve to meet the growing complexity of the market, and thus avoid exposing investors to undue operational risks.

The Consultation identifies the management of liquidity risk as an area of concern, notably in light of large scale investor redemption requests. The ability to meet withdrawal obligations is dependent upon the ability to liquidate portfolio holdings; hence the manager should give due consideration to the liquidity of the assets held in the portfolio on a continuous basis. In the case of funds of hedge funds, the manager should manage the liquidity of the Fund to an extent that is commensurate with the level of liquidity in the underlying hedge funds.

Liquidity risk management could be improved in respect of redemption policies. In circumstances where the liquidity of the fund deteriorates to the extent that fund withdrawal obligations may be compromised, the hedge fund manager may implement limited redemption arrangements⁷. In the interests of investor protection, we believe that such facilities should only be implemented in exceptional circumstances, for a limited period, and provided that investors are made aware of this facility prior to subscription via clear and prominent disclosures in the prospectus.

We also recommend that appropriate consideration be given to the nature of any agreements entered into between hedge funds and any specific classes of investors. Such agreements could, in some circumstances, present a conflict of interests with regards to the liquidity considerations of the Fund, thus exposing the investor to undue risk. To this end, it would be in investors' best interests if the manager disclosed, where possible, the nature of these arrangements and the conclusions drawn thereon regarding their potential impact on the Fund. Disclosure of conflicts of interests protects investors by providing them with the information they need to evaluate the objectivity of their manager's actions, and by giving them the information to make their own determination regarding the circumstances, motives, or possible bias of the manager's decisions.

The Consultation also cites the counterparty, custodian, and settlement risks that could arise in the event of failure of important prime brokers and other market counterparties. To manage such exposures, it is imperative the manager and its financial counterparties conduct regular and thorough due diligence on each other.

More generally, it is necessary for hedge fund managers to have documented and traceable procedures, in addition to detailed compliance policies. The CFA Institute Centre's Code reinforces the importance of having appropriate resources and procedures. Specifically, section D.5 states that managers must *"Employ qualified staff and sufficient human and technological resources to thoroughly investigate, analyze, implement, and monitor investment decisions and actions."*

The forthcoming Addendum to the Code specifically addresses risk management. Under Section D "Compliance and Support", it is proposed that Managers must:

⁷ Examples of limited redemption arrangements include redemption gates, redemption deferrals, and side pockets. We also wish to draw attention to the concept of a redemption sub-fund for illiquid assets (that is, a carve-out of illiquid holdings from the fund into a sub-fund). Under such arrangements, the manager should provide full disclosure of the nature of the redemption sub-fund to investors, so that they can determine whether the fee structure for this portion of the Fund's assets is acceptable.

“Establish a risk management process that identifies, monitors, and analyzes the risk position of the Manager and its investments, including the sources, nature, and degree of risk exposure.”

For example, Managers following best practice should consider performing stress tests, scenario tests, and back-tests as part of developing risk models that comprehensively capture a full range of actual and contingent exposures.

As indicated throughout our response, we believe that best practice is based upon industry-wide adherence to an accepted code of conduct. Any regulatory initiative to complement industry codes should be based upon the publication of best market practices, principally through the International Organization of Securities Commissions (IOSCO). IOSCO, through its standing committees and task forces (for example the task force on unregulated financial entities) continues to provide best market practice guidance for issues related to hedge funds. We support these efforts.

5. Transparency towards Investors and Investor Protection

Questions:

- (10) *Do investors receive sufficient information from hedge funds on a pre-contractual and ongoing basis to make sound investment decisions? If not, where do the deficiencies lie? What regulatory response if any is needed to complement industry codes to make a significant contribution to the transparency of hedge fund activities to their investors?*
- (11) *In light of recent developments, do you consider it a positive development to facilitate the access of retail investors, subject to appropriate controls, to hedge fund exposures?*

Disclosure of key investor information, both prior to investment and during the holding period, is important to protect investors. Presently, investors may lack sufficient information to enable them to conduct thorough due diligence. Transparency of the hedge fund is essential for investors to be able to make a proper assessment of the suitability of a given fund. Specifically, the appropriate information that investors need to make sound investment decisions includes (but is not limited to):

- the strategies used by the hedge fund (and the associated risks);
- fund performance information (both absolute and relative);
- the background and experience of the hedge fund manager;
- a list of portfolio holdings at regular intervals;
- valuation methods and relevant assumptions applied to those portfolio holdings; and
- audited financial statements, in addition to details on the auditor itself.

Additionally, in evaluating the methodology used to calculate fund performance, we recommend that the Manager adheres to the Global Investment Performance Standards⁸

⁸ CFA Institute created and administers the GIPS standards and partners with local country sponsors around the world to promote the GIPS standards. For more information, visit <http://www.gipsstandards.org/>

(GIPS®). GIPS® is a set of standardised, industry-wide ethical principles that provide investment firms with guidance on how to calculate and report their investment results to prospective clients. Adherence to GIPS increases the transparency of performance reporting and thus improves investor confidence in the veracity of the reported information.

The importance of transparent disclosures is further emphasized in the CFA Institute Centre's *Asset Manager Code*. Paragraph 2 of section F of the Code, "Disclosures", states that Managers must *"Ensure that disclosures are truthful, accurate, complete, and understandable and are presented in a format that communicates the information effectively."*

As indicated in our response to question 9, any regulatory response to complement industry codes of conduct would be best addressed through IOSCO. We view this channel as the most appropriate and effective from a regulatory perspective.

Finally, in response to question 11, strong safeguards must be in place if retail investors are to have access to hedge funds. Generally, the CFA Institute Centre's view is that hedge funds are unsuitable investment vehicles for unsophisticated investors. They are inappropriate because unsophisticated investors lack the expertise to understand the risks inherent in these types of investments. Typically, they do not possess the necessary financial resources to hire the expertise needed, weather volatile performance, or endure financial losses. Furthermore, these investment vehicles still have limited transparency about investment strategies, instruments, and risks. Accordingly, these vehicles should remain the principle domain of institutional or sophisticated investors.

30th January 2009.