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# The Current State of Play

A survey conducted by The Hedge Fund Journal and sponsored by KPMG

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## SUMMARY

In this survey we asked managers a series of questions under the following broad headings:

- Regulation
- Public image
- Investors
- Business specifics

The responses we received can be broadly summarised as follows:-

- Further regulation/supervision is welcome
- Yes, the industry has a poor public image but this image can be improved
- Due diligence is now far more thorough and onerous
- Yes, managers are cutting costs

It seems that as far as the manager community is concerned there is a general feeling that the UK regulatory regime has got things just about right. Manager authorisation works well in the UK and the manager authorisation process is an onerous one, were comments repeated on several occasions. That said, a number of managers seem to think that a proper short selling regime should be adopted but that there ought to be a common international reporting regime with component parts (dealing with aggregation, thresholds, frequency, timing etc.) that are common and agreed upon across all markets. On leverage levels a number of managers referred to the relatively low leverage levels deployed by their funds.

A number of managers suggested that the number of firms that are 'relationship managed' could usefully increase. The FSA has a specialist supervisory team that maintains strong relationships with the large hedge funds (in terms of size – say the top 30-40 funds) but it was felt that more regular dialogue with a greater number of managers on issues such as counterparty risk, leverage, crowded trades, short selling, compensation, redemption provisions, gates, suspension of NAVs, side pockets etc. could be very useful. A more formalised approach to direct supervision of all managers, not just the large ones, would be good, said some.

On the subject of public image, better communication with, and education of, the mainstream press (and even politicians) is the way to improve the industry's public image, say the managers we surveyed. Very few managers thought the parlous position beyond redemption and lots of managers expressed their view that a determined and concerted effort be made to deal with the image problem.

Investors are clearly displaying more rigour when it comes to due diligence. We got the impression that

this was a state of affairs that had existed for some considerable time. But certainly events post-Lehman had brought certain issues (counterparty risk, custody notably) under the microscope.

*NOTE: In conducting this survey we spoke to 20 managers who manage in aggregate circa US\$65 billion*

## REGULATION

### A sample of responses

- 80% of managers were supportive of more regulation and supervision. Those who were not supportive felt there was already adequate regulation and supervision
- Most managers believe further regulation is inevitable
- Most managers support targeted measures that improve market efficiency and reduce the ability of any participant to abuse the market in any way
- Some managers posed the question – does the regulator have sufficient well trained people to interpret the data they currently see, or put another way, do they understand what they are seeing?
- Some managers saw further regulation as just another sign of the maturing of the hedge fund industry; the current crisis has just hastened this process
- Increased regulation adds greater credibility and legitimacy to the industry and as such, if properly regulated, then more assets will flow into the industry
- It is crucial that the FSA avoid over-reaction to what may appear to be breaches of regulations; the idea of a 'grace period' would be helpful; also the FSA should try to form real industry partnerships to avoid a poacher/gamekeeper relationship

## PUBLIC IMAGE

### A sample of responses

- The industry has a poor public image
- Hedge funds are specialist operations within a very specific industry – an industry which is full of diversity, uniqueness and entrepreneurial spirit... this has raised the consciousness of the retail investor but not all investors should consider investments in hedge funds
- Improving processes and procedures will help
- A small number of managers felt the industry could

not improve its image and could probably not overcome the perception that short selling is bad – it's a cultural issue, said one manager, that is not well understood by the media, politicians or the public

- The mainstream media deliberately set out to permeate a poor image of the media, another sees a clear industry divide between European and Anglo-Saxon politicians
- Does it really matter if the industry has a poor public image?
- The industry is far too secretive. The industry needs to explain in relatively simple terms – what, how and why – it does
- The industry has done a poor job of communicating its message

## INVESTORS

### A sample of responses

- Assurances on liquidity management, risk management and operational management issues is key to attracting real sustainable fund flows
- Investors were very agitated in 2H of 08; they were less so in Q1 of 09.
- More reassurance required on all matters
- You have to be commercial and realistic and understand that whilst performance is still one of the key drivers, volatility of earnings is increasingly important
- There are lot more questions about client base, redemption levels and asset flows
- Lots more focus on risk management

### On UCITS and retailisation: -

- Let's innovate whilst accepting that care should be taken
- Retailisation is generally a good thing
- It is not clear that these products [UCITS] are suitable for retail investors
- Yes, due diligence has got much harder

## BUSINESS SPECIFIC

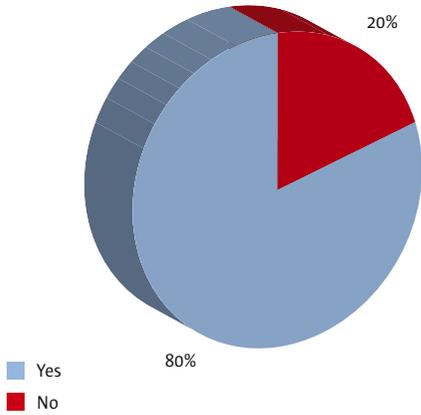
### A sample of responses

- We are doing more business risk assessment
- All of these items are subject to ongoing development and focus and so no change as a result of recent events **THFJ**

## Section I: Regulation

### Question 1

Consensus would suggest that further regulation or supervision of the industry is inevitable. Do you support the idea of further regulation or supervision? Yes/no. If no, why not?



Those who answered 'No' to this question said they considered there was already adequate regulation and supervision

### Question 2

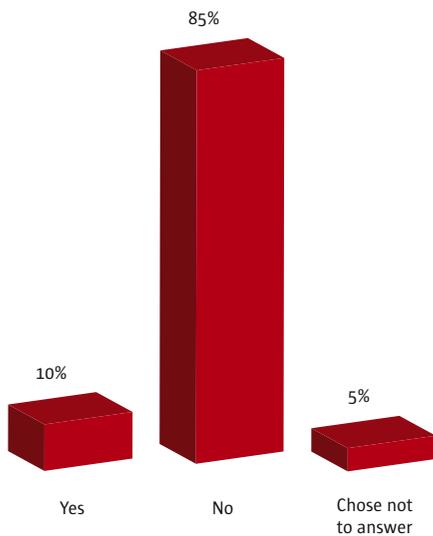
What new or further regulation do you think would be helpful?

#### SAMPLE ANSWERS

- "Relationship manage more firms – and smaller firms"*
- "Control/monitor leverage level"*
- "Reporting of positions in aggregate, not at individual level"*
- "Introduce rules for hard to value assets"*
- "Control style drift which has become abundant in the quest for returns"*
- "More intensive reporting"*
- "Proper short selling regime"*
- "The ability to run a low-risk industry under a UK regulatory umbrella and so dispense with Cayman"*

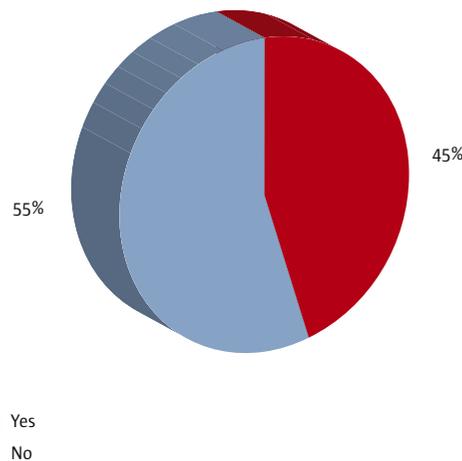
### Question 3

Is your firm doing anything differently to reassure the FSA/regulator?



### Question 4

Have you signed up to the HFS/PWG Standards? Yes/no. If not, do you intend to do so? Yes/no. If not, why not?

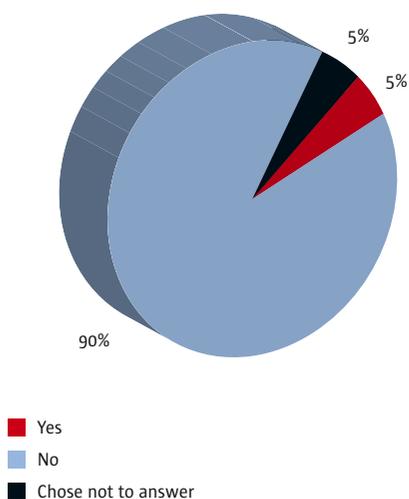


#### Sample answers from those who have not signed-up

- "Monitoring and may do so in time but waiting to see where it is all going"*
- "May do so in the future"*
- "Whilst we believe we meet and indeed exceed all these standards we currently do not see any commercial or other benefit from signing up"*
- "We are FSA regulated so why would we need to?"*

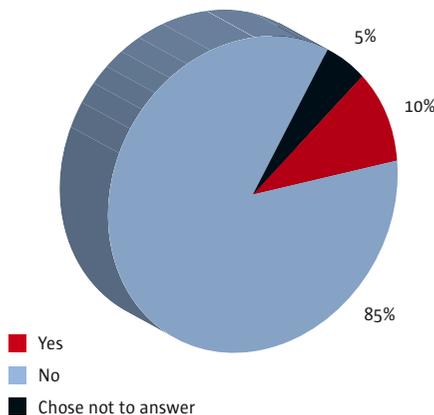
### Question 5

Has your relationship with the FSA/regulator changed in any way over the last six months?



### Question 6

Is there any data or information that you would not be in favour of the FSA/regulator seeing? If so, what?



Those who answered 'Yes' to this question said they would not be happy to supply actual positions

### Question 7

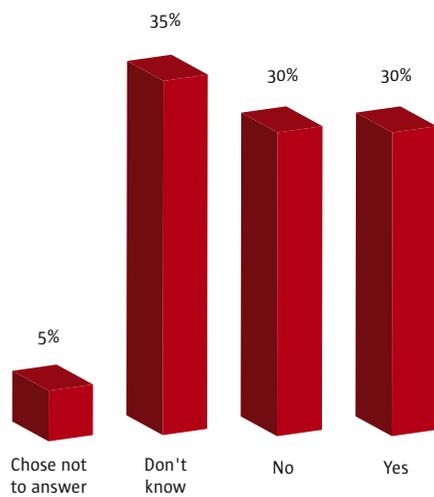
What data, if any, should hedge fund managers be required to supply to the FSA/regulator?

#### SAMPLE ANSWERS

- "Full disclosure of substantial positions"*
- "Short positions and complex derivative structures"*
- "Short position data for the FSA to aggregate and send back to the market"*
- "Internal audit and risk management reports"*
- "Transparency on outstanding"*
- "Details of all fee sharing arrangements"*
- "Whatever they require to ensure appropriate enforcement"*

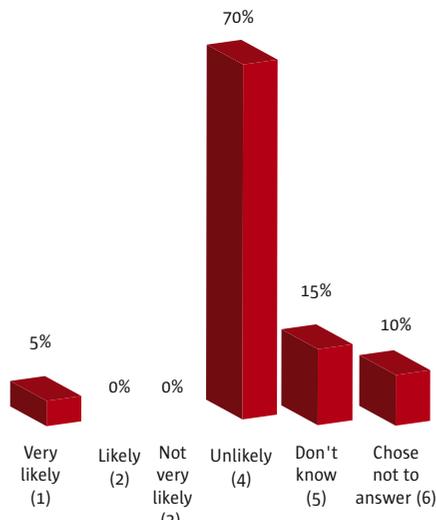
**Question 8**

Does/can the FSA/regulator get enough data/information from prime brokers in order to adequately supervise the industry? Yes/no



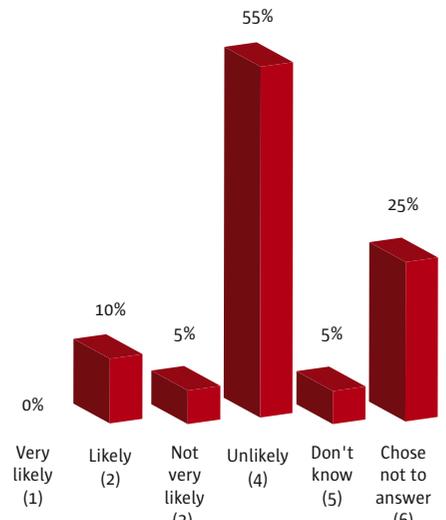
**Question 9**

On a scale of 1 to 5, how likely is your business to move overseas as a result of changes in regulation or supervision?



**Question 10**

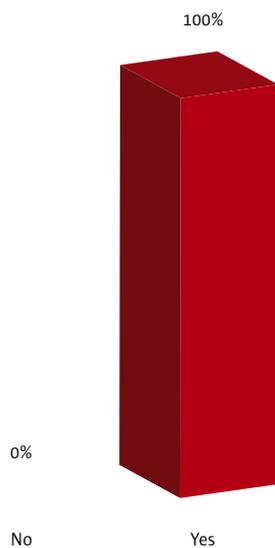
On a scale of 1 to 5, how likely is your business to move overseas as a result of changes in taxation?



**Section II: Public Image**

**Question 1**

Do you think the industry has a poor public image? Yes/no. If yes, why do you think this is?

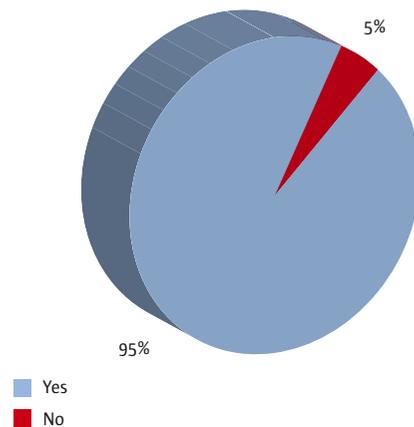


**Sample of reasons given for why the industry has a poor public image**

- "Made scapegoats by politicians"*
- "Very high earnings of many managers and the public perception that this is not deserved"*
- "We are not allowed to advertise. Consequently we are thought to be secretive"*
- "Made scapegoats by the press"*
- "Lack of understanding by those outside the industry"*
- "Sensationalist mainstream media reporting"*
- "Far too secretive"*
- "Flaunting of wealth"*
- "Inability to promote"*

**Question 2**

Do you think the industry can improve its public image? Yes/no. If so, how?

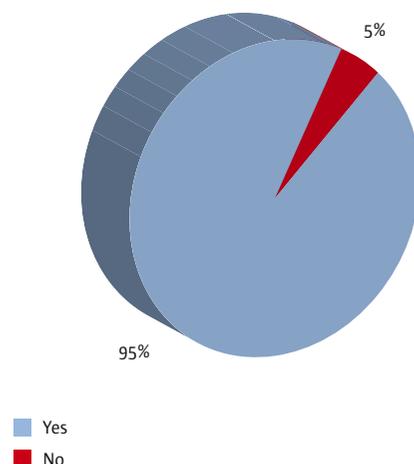


**Sample of suggested ways to improve the industry's public image**

- "More education of the press"*
- "Responsible reporting"*
- "Engage with government, embrace and encourage sensible regulation and demonstrate that it does have something to offer the country"*
- "Journalists need to work with communicative managers"*
- "More transparency"*
- "Engagement with press"*

**Question 3**

Can the industry recover from the public criticism/perception of short-selling? Yes/no. If yes, how can the industry restore confidence in this core business practice?



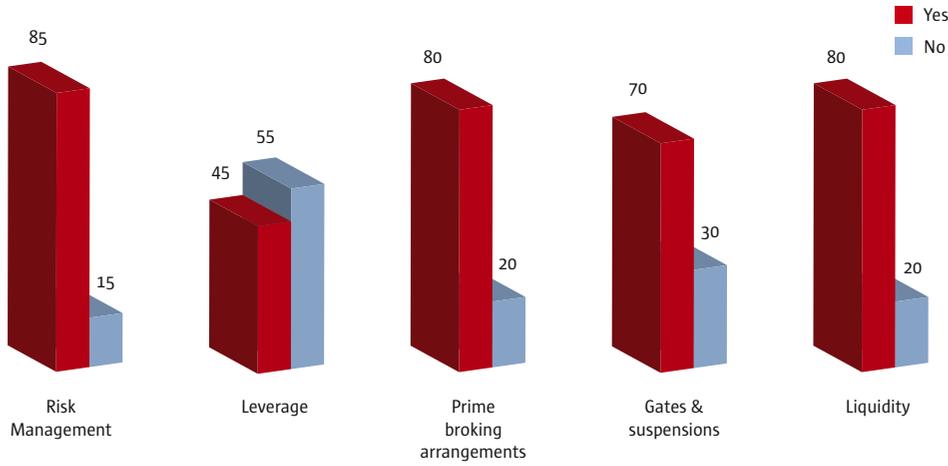
**Sample of suggested ways to overcome public criticism of short selling**

- "More education of the press, politicians and the public"*
- "Better communication"*
- "It's perception not reality, so explain/communicate this"*

**Section III: Investors**

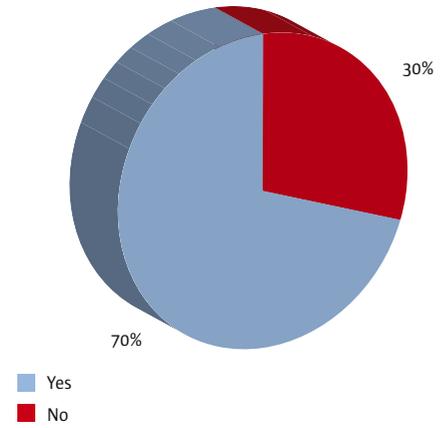
**Question 1**

In light of recent events, are your investors asking for assurance in any of the following areas? a) risk management b) leverage c) prime broking arrangements d) gates and suspensions e) liquidity f) other?



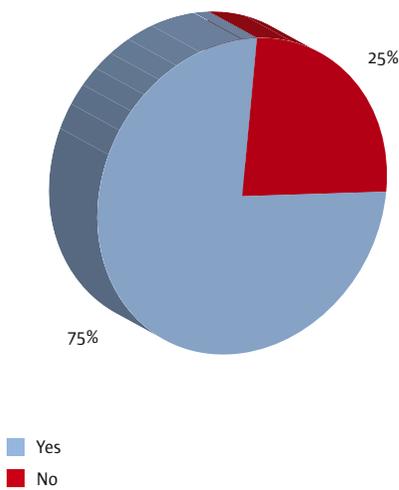
**Question 2**

Institutional investors in hedge funds are now in the majority. Do you believe this brings new assurance responsibilities and risk management obligations for the industry? Yes/no. If yes, what do you think they are?



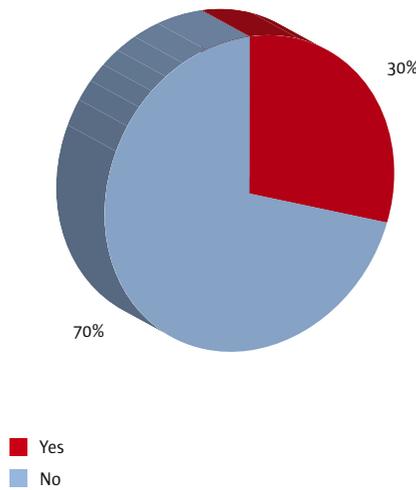
**Question 3**

The UCITS III framework allows retail investors to invest in funds that deploy leverage. Do you welcome this? Yes/no



**Question 4**

Should the industry pull-back from retailisation? Yes/no



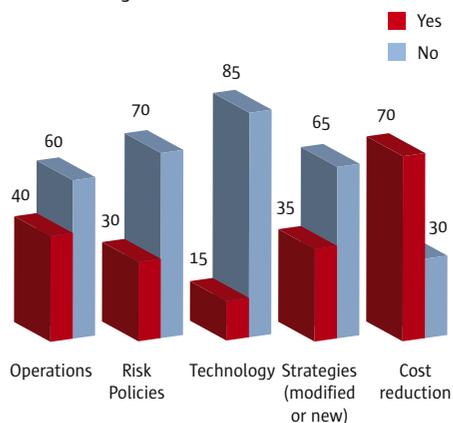
**Sample of what these new obligations are**

- “We have to provide more information, become their partners in knowledge growth and value generation”
- “We have to set clearly defined parameters and stay within”
- “In the last 6 months due diligence has become more sophisticated and focused on operations, custody and where the cash is. We are up another level”
- “DD has got much harder but to be honest their tick charts have got longer”
- “You have to do what you say on the tin – so no style drift”
- “The industry needs to provide institutional quality support and reporting to these clients”

**Section IV: Business Specific**

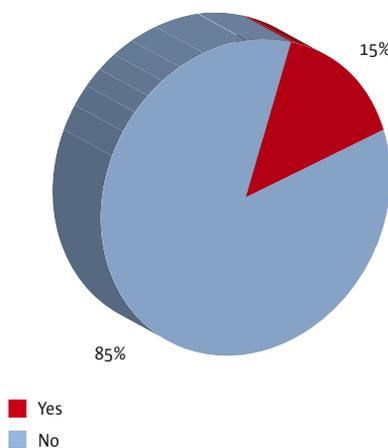
**Question 1**

As a result of the current financial turmoil are you making changes to your business, or have you made changes to your business, in any of the following areas?



**Question 2**

Are any of your funds gated at present? Yes/no



**Question 3**

Are any of your funds likely to be wound up within the next 12 months? Yes/no

