ICSA
INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

April 30, 2009

Greg Tanzer
Secretary General
IOSCO
C/ Oquendo 12
28006 Madrid
Spain

Re: Public Comment on the Hedge Fund Oversight: Consultation Report

Dear Greg,

We are writing to you on behalf of the members of the International Council of Securities Association (ICSA).[1] As you are aware, ICSA is composed of trade associations and self-regulatory organizations that represent and/or regulate securities firms active in all of the world's major capital markets as well as securities firms that operate on an international basis. ICSA members share a common interest in promoting efficient, well functioning securities markets and stable economic growth on a global basis.

ICSA's response to the paper is, inevitably, high level and some ICSA members may comment in more detail. We have restricted our comments to the portions of Chapter 3 that deal with hedge fund counterparties and hedge fund managers, with a focus on representing the views of the securities sector.

We welcome the IOSCO report (hereafter referred to as the "Report"), particularly in light of other overlapping initiatives in this area. Moreover, we strongly agree with the conclusion of the Report regarding the need for global standards that are applied in a consistent manner. We would note, however, that investors - for whose protection this work is being undertaken - remain local and therefore entitled to the protection of local laws. Therefore, we would emphasize that any global standards in this area need to be locally delivered.

[1] ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. More information about ICSA is available at: www.icsa.bz

Hedge Fund Counterparties

Regarding hedge fund counterparties, ICSA members agree that the information specified on page 32 of the Report should be obtained from banks and brokerages that serve as counterparties to hedge funds. ICSA members also support the call for strong risk management controls at those entities.

We would note that the information specified on page 32 of the IOSCO report is already being provided by the relevant counterparties in some jurisdictions.[2] Moreover, all ICSA members fully accept that as regulated and supervised entities, financial firms that serve as counterparties to hedge funds must cooperate with regulatory authorities in providing this type of information so that regulators in all jurisdictions can have a better sense of the possible systemic risk posed by hedge funds.

However, we would also suggest that any data derived from surveys of providers of capital should be supplemented with information from other regulated entities, including but not limited to the managers of hedge funds. In addition, ICSA members understand and share hedge fund managers' concerns that the data collected should remain confidential. Finally, we would note that the collection and standardization of such data is not a straightforward task, as the UK FSA has learned from the 'hedge funds as counterparties' survey. Moreover, the work of collecting such data imposes a significant and often duplicative burden on banks and brokers, at a time when risk management resources are under pressure. In short, collecting the relevant data from banks and brokerages regarding the exposures of hedge funds imposes costs on both regulators and the firms themselves.

Hedge Fund Managers

ICSA members agree that the direct regulation of hedge fund managers is the best approach to addressing investor protection and systemic risk concerns raised by hedge funds.[3] Prime brokers and other suppliers of finance capital to hedge funds are already regulated directly, of course.

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[2] In this respect we would point out that LIBA, a member of ICSA, has been working closely with the UK's FSA in developing the 'hedge funds as counterparties' survey of prime brokers and banks active in the sector.

[3] One ICSA member – the Association Française des Marchés Financiers (AMAFI) – disagrees with this statement. AMAFI believes that the regulation of fund managers alone is not sufficient to prevent systemic risk and instead believes that any funds likely to raise systemic risk should be registered with a prudential regulatory authority in order to allow that regulator the opportunity to access the "books and records" of those funds.

ICSA members believe that the proposal to regulate hedge fund managers directly is the best approach to addressing investor protection and systemic risk concerns raised by hedge funds for two reasons. First, any proposal directly to regulate hedge funds themselves must overcome the obstacle that, to date, there is no widely accepted, legally robust definition of a hedge fund. The business of managing funds is well understood and regulated throughout the world. Secondly, there are problems associated with the alternative approach, which is the indirect regulation of hedge funds through the regulation of prime brokerages. This indirect approach is problematic in part because there is an increasing trend for hedge funds to use multiple prime brokers. Since information concerning a hedge fund's positions held at each prime broker is held by that prime broker on a confidential basis, individual prime brokers will have access only to a limited picture of the exposures of their customer hedge funds in virtually all cases. This is particularly true for funds which are larger in size and therefore more likely to be of systemic importance. More importantly, positions held at other prime brokers or financing counterparties cannot be netted off, which may give a misleading impression of the aggregate risk in the system. Because an individual hedge fund's risk profile includes risks beyond leverage, such as liquidity risk, these risks may look very different to an individual prime broker than they would to the fund manager or a regulator in a position to see the fund's exposures on a consolidated basis.

This argument supports our view that data derived from surveys of providers of capital should be supplemented with information from other regulated entities, including but not limited to the managers of hedge funds.

ICSA members support the need for progress toward a consistent regulatory approach to hedge fund managers. We welcome IOSCO's support for industry initiatives, like those taken by the Hedge Fund Standards Board, the Managed Funds Association and the Alternative Investment Management Association. International standards, properly applied, set the framework for fair competition between managers to the benefit of investors.

ICSA members also agree that regulatory oversight should be risk-based and focused particularly on the systemically important and/or higher risk hedge fund managers with a de minimis cutoff. We would note, however, that it is not always easy to determine ex ante whether a hedge fund manager (or its underlying funds) is systemically important. We that think this is a judgment that will need to be made by supervisors based on the data that they have gathered from market participants, both routinely in the course of supervision and, when circumstances warrant, through special projects.

In closing, we would like to emphasize again our support for the recommendations contained in the Report. We would be pleased to meet with IOSCO members to discuss any of the matters set forth in this letter, or to assist in any other way that will be helpful for your consideration of the issues discussed in this letter.

Yours sincerely,

Jonathan Taylor, Chairman
International Council of Securities Associations (ICSA)

Duncan Fairweather, Chairman
ICSA Standing Committee on Regulatory Affairs