Alternative Investment Management Association

By email to cp16@c-ebs.org

22nd February 2008

Dear Sirs

AIMA's Response to CEBS's Second Consultation Paper on its Technical Advice to the European Commission on the Review of Large Exposures

The Alternative Investment Management Association Limited ("AIMA") is – some 17 years after its establishment - the only professional trade association representing the hedge fund industry with worldwide membership. It is also the only such association which represents all practitioners in the alternative investment management industry – whether hedge fund managers, managers of futures or currency funds or those providing other specific services such as prime brokerage, administration, legal or accounting, auditing and tax advisory services.

The three 'pillars' of AIMA are:

- Education;
- Regulation; and
- Sound Practices.

AIMA's objectives are specifically:

- to provide an interactive and professional forum for our membership and act as a catalyst for the industry's future development;
- to be the pre-eminent voice of the industry to the wider financial community, institutional investors, the media, regulators, governments and other policy makers; and
- to offer a centralised source of information on the industry's activities and influence, and to secure its place in the investment management community.

AIMA is a not-for-profit educational and research body. Its membership is corporate and now comprises over 1,280 firms, in 47 different countries.

Within the UK, Eurohedge estimates that there are a total of about 320 single hedge fund manager firms. Of these, 188 are members of AIMA, along with a further 70 UK-based funds of hedge fund managers. With all professional advisers, brokers, exchanges, systems providers etc, the total of AIMA member firms in the UK is now 390. The number of hedge fund manager firms around the world who are AIMA members totals 507.

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AIMA's growth has been commensurate with the development of the hedge fund industry worldwide.

We are grateful for the opportunity to comment on CEBS's Second Consultation Paper on its review of the Large Exposures rules ('the CP'). We limit our comments to the following question set out in the CP:

Question 24: Do you agree with the proposal to invite the Commission to consider exempting investment managers from a future large exposures regime?

We strongly support this proposal for the reasons set out below.

AIMA represents regulated firms which raise funds for, and manage, hedge funds. Many of our members fall within the scope of MiFID and the CRD, in which case they invariably fall within CAD article 20(2), i.e., they do not carry on the MiFID activities of "dealing on own account" or "underwriting".

In our view, the policy aims of protecting depositors and ensuring continuing financial stability are not met by imposing large exposures requirements on this type of firm. We consider it inappropriate to apply such rules to hedge fund managers since these firms pose an entirely different set of policy considerations from those posed by credit institutions. Unlike a credit institution, a hedge fund manager will not be permitted to hold deposits, will not lend money to clients and will typically not deal on own account. The hedge fund manager does not invest using its own balance sheet (except where it makes the initial "cornerstone" investment to launch a fund), but rather invests the assets of the (normally unregulated) fund which it has raised from third party investors.

As noted in the CP, the assets held for third party investors are segregated from the hedge fund manager's own assets. Should the hedge fund manager become insolvent, there would be no impact on market participants, other than the administrative burden on the investors in appointing an alternative fund manager to manage their assets.

Leaving aside the large exposures regime, hedge fund managers ordinarily have a relatively low capital requirement. The impact of the large exposures regime is typically felt in relation to the payment of fees in arrears, in relation to which the hedge fund manager records an accrual. The current regime effectively caps the maximum value of accrued fees at 25% of the value of the firm's capital. This means that firms face an artificial barrier to growth because, as they become more successful and generate more fees, they are required to hold more capital against the risk that they may not be paid. In practice, since the hedge fund manager will have power to deduct the fees due to it from the value of the fund, there is, in reality, no exposure.

Thus, the regime as applied to hedge fund managers does not confer any benefit on either consumers or the market; it does, though, impose barriers to entry and to growth. These arguments apply equally to other types of firm which fall within CAD Article 20(2) and, as such, they support CEBS's proposal for reform.

We have had the benefit of sight of a draft of the Investment Management Association's response to

the CP and we note that they have reached similar conclusions for similar reasons.

Please do not hesitate to contact me with any queries on this response.

Yours sincerely,

Matthew Jones,
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