

**Keynote address** DAME AMELIA FAWCETT, CHAIRMAN OF THE HEDGE FUND STANDARDS BOARD

## Strong investors and hedge funds committing to best practice will complement regulation and build trust

In her keynote address, Dame Amelia Fawcett, who is chairman of the London-based Hedge Fund Standards Board, made a strong argument for best practice standards as a complement or alternative to 'blackline regulation' in the hedge fund industry.

Prescriptive regulation can be inflexible and may have unintended consequences, she said. By contrast, the standards developed by the HFSB represent the views of both hedge funds and prominent institutional investors, and keep pace with broader financial issues.

Increasing numbers of managers and investors have committed to the HFSB standards, in Asia and the US as well as in Europe, as proof that this approach is gaining acceptance on a global basis.

Dame Amelia organised her remarks under three main headings: the macro environment for hedge funds, the role of capital markets, and the role of hedge fund standards.

The well-known Chinese proverb warns us: May you be condemned to live in interesting times, she said. It is unfortunately relevant today, as it seems as though every paradigm we ever believed in has changed.

Economic power is moving East; the banking industry is in disrepute, about which Dame Amelia noted that: "It's as if the financial industry has lost its compass and forgotten where true North is." The Libor scandal has put regulators in the hot seat and governments want banks to finance growth at the same time as meeting high capital ratios, she said.

Among the questions that arise, one of the most pressing is "are we regulating for the problems of the past and potentially missing the problems of the future?" she asked.

Turning to the issue of capital markets, Dame Amelia noted how capital markets are replacing banks in financing growth, managing risk and ensuring efficient allocation of capital. The ratio of capital market to bank financing of the economy is now 50/50 in Europe yet it is 80/20 in the US. Dame Amelia queried whether the EU now would move more towards the US in that regard.

In this environment, strong investors are essential, and hedge funds have an important role to play despite their controversial presence.

Regulations are clearly essential in some cases, such as gaining authorisation to do business, she noted. But extraordinarily complicated regulations cannot always be the best response, given that many issues confronting the industry and regulators are cultural and behavioural. A legalistic approach also can

have unintended consequences, she warned.

"Rules are not the only way to deliver results," she pointed out.

Standards are a complement to, and not a replacement for, regulation, Dame Amelia pointed out. They are particularly effective in "less black and white areas" such as governance, risk management and transparency.

But in order to work, best practice standards must be developed by all the critical stakeholders, and this means "not just consultation but real engagement". Standards also need to be reviewed regularly so they remain effective.

The HFSB conforms to this approach, Dame Amelia said. Founded in 2007 by hedge fund managers, it now has more than 75 hedge fund signatories, and 60 major international investors have signed up to the Investor Chapter to drive adoption of the standards. In total these organisations manage about \$380 billion in assets.

The second milestone, in 2010, was to recognise the role of investors and make them partners in the HFSB's work and governance; now, investors have equal representation with hedge funds on the HFSB board. "To my mind the genius of the system is to bring together users and providers. Both believe they have a material stake in the standards," Dame Amelia said.

The third milestone, in early 2012, was to revise the standards so they could work anywhere in the world. The standards cover the areas of disclosure, valuation, risk management, fund governance and shareholder conduct. Managers conform with the standards on a "comply or explain" basis and make their disclosures available to investors.

Dame Amelia stressed again that the standards are intended to complement regulation in such areas as risk management and fee structure, which are not covered by 'blackline regulation'.

Standards can also usefully address issues that are not yet in the regulators' sights, such as the application of gates by hedge fund managers in 2008. The HFSB devised a standard within weeks, completing the process in a fraction of the time that the regulatory process takes and with the buy-in of investors and managers, she said, both of whom came together to develop the standard.

In late 2008, the UK Financial Services Authority endorsed the HFSB, saying that it took compliance with the standards into account when making supervisory judgements.

On the contentious issue of the AIFMD, Dame Amelia said that the HFSB arranged for a number of investors to have senior level



Dame Amelia Fawcett

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meetings in Brussels, and today is working hard to explain to the regulators globally why a restrictive approach is not in the interests of the investment community or society.

Investors and regulators in all three regions of the world are now asking managers to sign up to the HFSB standards. One US institution said "my board thinks hedge funds can be dangerous and should be avoided, so anything I can do to help people recognise that well-managed hedge funds add value and are responsible, I will do, and the HFSB is a critical part of that process". The HFSB has had the same response from other investors, Dame Amelia said.

As a demonstration that the standards are gaining traction outside the UK and Europe, so far this year 19 North American hedge funds have added their names to the list, including Bridgewater. In addition, three countries have asked the HFSB for help developing standards for their markets.

The HFSB is "in the vanguard of an unstoppable movement being led by some of the largest hedge funds and investors around the globe," Dame Amelia concluded.