Feedback Statement on Consultation Paper (CP1/2009):

Hedge Fund Redemptions

1. Overview

The HFSB has invited comments on Consultation Paper 1/2009 (CP1/2009)[1]. This paper summarises the consultation feedback received and presents the amendments to the Hedge Fund Standards[2]. The last section details the process for implementing these amendments.

CP 1/2009 relates to the handling of redemptions and in particular, issues arising when significant redemption pressure occurs, as experienced in the second half of 2008 and early 2009. The proposed 'Standards and Guidance' seeks to address potentially damaging externalities that can develop in such situations, keeping in mind the principle of fair treatment of investors.

The HFSB would like to thank those who took the trouble to respond to the Consultation Paper and offered their feedback to us. The HFSB would also like to give special thanks to Tim West at Herbert Smith and Iain Cullen at Simmons & Simmons for their advice on the final drafting.

[1] The original consultation document is available at http://www.hfsb.org/?page=11296
[2] The Hedge Fund Standards can be found at http://www.hfsb.org/?section=10564

2. Feedback Received

This section summarises the feedback received in the course of the consultation. The individual responses are also available online at www.hfsb.org .

1.) Do you Agree with the Analysis of Systemic Concerns?

Most respondents broadly agreed with the assessment, although some felt that these concerns did not refer to the systemic issues.

Additional Points Raised by Respondents:	**HFSB Perspective:**
The manager has no legal role in determining whether or not to impose gates or suspend redemptions. It is a matter for the Board of Directors of a company.	The HFSB agrees. However, it is important to acknowledge the important role played by managers in enabling and encouraging appropriate governance arrangements to be put in place. More broadly, the Standards also reflect the role of managers in enabling and encouraging fund governing bodies to achieve the various outcomes required by the Standards where such outcomes are ultimately within the control of fund governing bodies rather than the managers.

2.) Do you Agree with the Best Practice Implications Highlighted in the Three Hypotheses (Perverse Incentives for Manager Behaviour, "Bottom of the Barrel Risk", Pre-Emptive Redemptions)?

Most respondents broadly agreed. Some of the additional comments are summarised in the table below. A controversial item for some is the proposed disclosure of redemption penalties when redemption requests are revoked.

Additional Points Raised by Respondents:	**HFSB Perspective:**
There should be no fees on redemptions.	The proposed amendment does not suggest that there should be a fee on all redemptions. The way the Standard/Guidance works is that the circumstances in which redemption requests can be revoked (e.g. redemption requests may be irrevocable, except when permitted by the Fund Governing Body), should be disclosed to investors, and there should also be disclosure if there are any fees or penalties involved. So, the approach is disclosure based, rather than prescribing a specific mechanism or a mandatory fee.
A revocation fee is a good idea and will be accepted by investors.	
It is excessive to state that if there is no cost	Avoiding abuse is exactly what the HFSB seeks to

Additional Points Raised by Respondents:	HFSB Perspective:
associated with the option to redeem, this "destroys" the ability of the manager to properly manage the fund. We agree however with imposing a fee as an optional measure when there is a risk of abuse.	achieve.
Side pocketing should not be a tool to manage liquidity towards investors but a mechanism to ring fence a specific asset or limited set of assets that would be impaired.	Side pocketing is indeed a mechanism to ring fence illiquid assets, and by doing so, it allows for fund subscriptions and redemptions to continue on the liquid (non side-pocketed) portion of the portfolio.

3.) Do you Agree that Issues in Relation to Redemptions should be Addressed by the HFSB Standards?

Respondents felt that it is adequate to address these issues in the Standards. One respondent felt that this is an issue that should also be addressed by the regulators.

4.) Do you Agree that the Disclosure Mechanism is the Best Way to Address such Issues?

Most respondents agreed.

5.) Do you Agree with the Proposed Amendments to the Standards?

Most respondents agreed with the proposed amendments. Some comments are summarised below.

Additional Points Raised by Respondents:	HFSB Perspective:
In Hedge Funds managed by non-US managers, there is rarely a standalone power to suspend redemptions; rather there is power to suspend calculation of NAV in certain specified circumstances, which, in turn, automatically leads to suspension of redemptions given that there is then no price at which such redemptions can be effected.	This observation relates to an illustration in the consultation document. The observation is correct, but does not affect the actual Standard/Guidance.
Fees on side pockets are reduced by way of a reduction on the percentage fee rate, not by way of a rebate.	This is correct, and the respective guidance has been amended.
In relation to redemption penalties, it is not possible to reset a high watermark where a redemption request has been revoked. If such a request is revoked, the investor in question	The observation is correct, and the Standard has been amended as proposed: Redemption requests are irrevocable, except when permitted

Additional Points Raised by Respondents:	**HFSB Perspective:**
retains its shares. Since all shares in the same class must have the same high watermark, the only way to implement the standard would be to cause the investor compulsorily to exchange its shares for the shares of another class which would constitute the redemption of the shares of the old class and the subscription for shares of a new class.	by the Fund Governing Body.
We do not agree with measures to enhance liquidity. The current restrictions on transfers should be maintained and we do not consider that they should be relaxed merely because redemption restrictions are in place.	Some investors have voiced interest in enabling such transfers at times when redemption restrictions have been imposed, and it would clearly add to the completeness of markets. The HFSB is aware that issues can arise in relation to investor eligibility requirements in terms of fund transfers. However, it is important to remember that the proposed guidance requires disclosure, if such mechanisms may be considered, when redemptions are suspended or restricted. So rather than prescribing a specific approach, this relies on disclosure.

3. Amendments to the Standards

Proposed New Disclosure Standards and Guidance

[2] Commercial Terms Disclosure	
• **A hedge fund manager should do what it reasonably can to enable and encourage the fund governing body to disclose the commercial terms applicable to a particular hedge fund in sufficient detail and with sufficient prominence (taking into account the identity and sophistication of potential investors) in the fund's offering documents.**	(as is)
○ fees and expenses (...)	(as is)
○ termination rights (...)	(as is)
○ exit terms (in the case of open ended funds) ▪ the period of notice investors are required to give to redeem their investment in the fund; ▪ <u>the circumstances in which redemption requests can be revoked (e.g. redemption requests may be irrevocable except with consent of the fund governing body)</u> ▪ details of any redemption <u>penalties (including, if relevant, any fee or penalty applicable where redemption requests are revoked);</u> ▪ <u>details of</u> any "lock-up" periods during which the investor will be unable to redeem its investment in the fund and any limits on the	(enhanced)

extent of redemptions on any redemption date (i.e. redemption "gates"); and ▪ an indication of circumstances in which normal redemption mechanics might not apply or may be suspended, if any – these could include, amongst other things: • a significant reduction in the liquidity of the fund's underlying assets; and • distress of one or more of the fund's counterparties (including its prime broker(s)) leading to uncertainty as to the value of OTC contracts or access to / ownership of rehypothecated assets. ▪ Details of any other measures which may be considered by the fund governing body in circumstances where normal redemption mechanics might not apply or may be suspended – for example: • fund level gating, investor level gating, lock-ups, suspension of redemptions, penalties for revoking redemption requests *(to the extent that the fund's constitutional documents/offering documents do not already provide for such mechanisms)* • side pocketing • restructuring the fund to incentivise investors to accept, or switch to an alternative share class offering reduced liquidity (for example in exchange for lower fees) ▪ if relevant, an indication of any circumstances in which any changes to redemption terms may be made without shareholder consent; ▪ whether measures to enhance liquidity at the fund level may be considered when redemptions are suspended/restricted (eg facilitating transfers of shares/units in the fund subject to ensuring that investors satisfy investor eligibility requirements).	
• **A hedge fund manager should do what it reasonably can to enable and encourage the fund governing body to disclose any material changes to such commercial terms to investors.**	(as is)
(...)	(as is)

4. Process for Incorporating these Standards

The existing HFSB signatories will need to revisit and adapt their Disclosure Statements to accommodate the amendments, if relevant and appropriate. The HFSB will grant 5 months to the signatories to incorporate the changes. Thereby, these amendments will be effective as of 01 August 2010.