CalPERS

Executive Office
P.O. Box 942701
Sacramento, CA 94229-2701
Telecommunications Device for the Deaf: (916) 326-3829
(916) 326-3987, FAX (916) 326-3410

Opening Remarks to the Senate Committee on Banking, Housing and Urban Affairs

Mark Anson
CIO, CalPERS
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Mr. Chairman, Ranking Member Sarbanes and members of the Committee, I am Mark Anson, Chief Investment Officer for the California Public Employees Retirement System and I very much appreciate the opportunity to present CalPERS' views on the important matter of the regulation of hedge funds.

Introduction

Currently CalPERS has $165 billion in net assets invested in every asset class around the globe. The CalPERS Board of Administration has allocated $1 billion to its Absolute Return Strategies Program (the Program). Of this $1 billion, approximately $750 million has been invested with 16 hedge fund managers over the past two years. The current market value of the Program is $877 million. In total dollars this is a considerable sum of money. However, as a percentage of total assets, the Program is less than 1% of the total CalPERS Fund.

CalPERS invests with hedge fund managers that purse long and short equity strategies, convertible arbitrage strategies, merger arbitrage, fixed income arbitrage, and statistical/quantitative equity arbitrage. These strategies are selected to diversify CalPERS' exposure to any one type of hedge fund strategy as well as to diversify CalPERS' portfolio across a number of hedge fund managers.

Comments on Regulation

As the Chief Investment Officer, I believe that some level of regulation is necessary in the hedge fund industry. Previously, at a Roundtable Discussion hosted by the Securities and Exchange Commission in May of 2003, I advocated the registration of hedge fund managers as Registered Investment Advisers under the Investment Advisers Act of 1940. I believe that there are two distinct advantages to registration.

1. <u>A Starting Point of Information</u>

Form ADV is the standard disclosure form that must be filed annually by every registered investment adviser. Form ADV becomes effective 45 days after the filing with the SEC, provided that it is properly completed.

I believe that Form ADV would give every investor an initial point of reference for due diligence. This would benefit investors in that it would ensure some amount of uniform disclosure required of hedge fund managers. Please note that many hedge fund managers have chosen to register as investment advisers for just this reason. In fact, of the 16 hedge fund managers with whom CalPERS invests, 9 are Registered Investment Advisers.

Form ADV, however, is not a panacea. It does not provide all of the necessary information that must be acquired as part of the due diligence process in selecting a hedge fund manager. Naïve investors should not rely on Form ADV for all of the necessary disclosures in a due diligence process. It is a starting point. Intelligent and probing questions must still be asked by the investor before deciding whether to invest with a hedge fund manager.

2. Determine the Size of the Hedge Fund Industry

The size of the hedge fund industry is estimated anywhere from $600 billion to over $1 trillion. However, the true size of the hedge fund industry is not known.

Several academic studies have identified the lack of a comprehensive database for hedge fund managers. While there are many hedge fund index providers and hedge fund databases in existence, each is incomplete. Some hedge fund managers report only to one index provider or only to one database. Still other hedge fund managers fail to report their return data to any database or index provider. As a result, no one knows for certain the total size of this industry.

Registration of hedge funds within the United States would help determine the size of the hedge fund marketplace. Also, it would allow investors, academics, and regulators to monitor the growth of the industry. Last, it would help index and database providers to construct more complete indexes and databases for the economic analysis of the benefits from hedge fund investing.

Conclusion

While some form of regulation or registration may be appropriate, there must be a balance. Part of the keen interest in hedge funds has been their unregulated nature that allowed hedge fund managers to seek economic returns from non-traditional investment strategies. Burdensome regulation could have two adverse consequences.

First, it might reduce the returns that can be earned by hedge fund managers by overly restricting their investment strategy. This would make the industry less desirable to investors.

Second, hedge fund managers may move their funds “Off-Shore” away from United States investors in an attempt to reduce their regulatory burden. This would reduce the investment opportunity set for United States investors, and may result in a lower return expectation for pension funds and other investors based in the United States.

Mr. Chairman, this concludes my prepared remarks and I would be pleased to answer questions from members of the Committee.