MANAGED FUNDS ASSOCIATION

ORAL STATEMENT

OF

ADAM C. COOPER

CHAIRMAN, MANAGED FUNDS ASSOCIATION

BEFORE THE COMMITTEE

ON BANKING, HOUSING AND URBAN AFFAIRS

OF THE

UNITED STATES SENATE

July 15, 2004

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FOR THE HEARING ON
REGULATION OF THE HEDGE FUND INDUSTRY

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INTRODUCTION

Mr. Chairman, thank you for inviting me to testify before your Committee today. My name is Adam Cooper, and I appear as Chairman of Managed Funds Association, which is the voice of the hedge fund industry in Washington. I am also Senior Managing Director and General Counsel of Citadel Investment Group, a hedge fund manager based in Chicago.

I would like to thank you for organizing this special hearing on regulation of the hedge fund industry.

I. HEDGE FUNDS PLAY A SPECIAL ROLE IN THE CAPITAL MARKETS

Hedge funds play a critical and special role in our capital markets and are enormously important to helping institutional investors diversify their investment portfolios and meet their future funding needs.

The liquidity hedge funds provide to the marketplace in the form of risk capital creates more stable and efficient markets and reduces systemic risk. Simply stated, hedge funds act as "risk absorbers" in markets by serving as ready counterparties to those wishing to hedge risk, even when markets are volatile. In addition their active trading and research contribute to greater pricing efficiencies in our financial markets.

Because the returns hedge funds provide tend to be uncorrelated to traditional stock and bond investments, they have proven key to helping university endowments, foundations, and other institutional investors achieve enhanced returns at lower volatility than would otherwise be the case, thereby helping them meet their funding needs.

II. THE CURRENT REGULATORY FRAMEWORK

The success and growth of the hedge fund industry and the general satisfaction of its investors testify to the fact that the current regulatory regime works extremely well. This framework reflects a long-standing recognition by Congress and federal regulators that government resources should be devoted to protecting investors that require protection, rather than those that can look out for themselves. This regime is consistent with those governing other institutional marketplaces, such as the markets for private placements, private equity, venture capital and over-the-counter derivatives.

As detailed in MFA's written statement, which is being submitted for the record, hedge fund managers today are subject to a wide variety of direct and indirect regulation, whether they are registered or not. Many hedge funds are voluntarily registered with the SEC or the CFTC (or both) and yet, even for those that are not registered, unregistered does not mean unregulated. The SEC's anti-fraud, anti-manipulation and insider trading rules apply fully to hedge funds, irrespective of their registration status. In addition comprehensive market conduct rules govern hedge fund trading activities, and pending anti-money laundering rules will apply to hedge funds as well.

III. WHAT WE CAN DO NOW

Even though the industry has prospered under the current legal framework, MFA believes it is fair and appropriate to re-examine the regulatory regime governing an evolving industry to be sure that it remains suitable. In this regard MFA believes that a number of the issues raised by the SEC staff should be addressed, and MFA embraces the opportunity to work with the SEC and other relevant agencies on these matters.

For example, the SEC staff has expressed concern over the increased number of investors qualifying for certain hedge fund investments under current "accredited investor" standards. MFA believes that this concern should be addressed directly by at least doubling accredited investor standards. In so doing the minimum eligibility standards applicable to hedge fund investors would be increased to at least $2 million in net worth (from current level of $1 million) and minimum annual individual income of $400,000 (rather than $200,000).

The SEC staff also state that registration would permit the SEC to collect information about hedge fund managers and their trading activities. MFA submits that current reporting obligations already provide significant sources of information about hedge funds to a wide range of regulators. MFA has compiled an extensive list of over 46 different reporting requirements potentially applicable to hedge funds. The solution here is for government agencies to coordinate the use and sharing of the vast amounts of industry information that they currently have at their disposal.

IV. VIEWS OF OTHERS REGARDING REGISTRATION

I wish to share with the Committee the views of Chairman Greenspan, SEC Commissioners Cynthia Glassman and Paul Atkins and the General Accounting Office on the subject of mandatory registration of hedge fund managers.

On June 15, Chairman Greenspan testified before this Committee that he continued to oppose mandating the registration of hedge fund managers. He specifically stated "so long as their source of funds, equity funds, are professional or large investors with net worth, say, exceeding a million dollars or more, I see no purpose in regulation and I see very significant potential loss in doing so."

On February 17, SEC Commissioner Glassman stated, "I have been very vocal about my concerns about such a proposal… I don't doubt that there are aspects of hedge fund activity that would benefit from scrutiny. But it is not clear to me that registration and the concomitant inspection process is the way to do it."

SEC Commissioner Atkins maintains that the findings in the SEC staff's report on the hedge fund industry do not justify mandatory registration. On May 18, Commissioner Atkins stated, "My principal concern is whether we need to dedicate the SEC's limited resources to protect a small number of investors that presumably have the wherewithal to look out for themselves … I remain concerned that this is not where we should be placing our troops in this battle to protect investors."

Finally, the General Accounting Office testified on April 20 that the SEC does not have sufficient resources to effectively regulate hedge fund managers. Further, their report noted that the SEC's examination process has not been effective in detecting fraud in the recent cases involving mutual funds for various reasons. "According to SEC staff," the GAO's report stated, "many of the cases involved fraud and collusion among personnel and such activity is very hard to detect in a routine examination."

V. NEXT STEPS

MFA is concerned that the SEC's proposed rules will adversely impact an industry that makes significant contributions to the strength, liquidity and efficiency of our capital markets. In addition, MFA believes that any changes to the current regulatory scheme must be carefully crafted to avoid duplication of regulation to which managers are already subject and other unnecessary burdens.

MFA looks forward to working with this Committee, the SEC, the CFTC and other relevant policymakers and agencies on the subject of hedge fund industry regulation and other matters of importance to our industry. Thank you.