MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

December 1, 2009

The Honorable Barney Frank
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Re: Managed Funds Association Views on Systemic Risk and Resolution Authority Proposals

Dear Chairman Frank:

On behalf of the Managed Funds Association ("MFA"),[1] I write to express our views concerning the draft systemic risk and resolution authority legislation, and our serious concerns about the proposed industry assessment to create a new Systemic Resolution Fund (the "Resolution Fund") contained in the Financial Stability Improvement Act of 2009 (the "Bill").

In considering the scope of the Bill, it is important to note that the hedge fund industry's relatively modest size, compared to other industries (such as the U.S. banking, brokerage, insurance and mutual fund industries), and low leverage, coupled with the expertise of hedge fund firms at managing financial risk, means we have not been the cause of the difficulties experienced by the average investor or the recipients of any taxpayer bailout funds. To the contrary, hedge funds were an essential provider of capital during this recent market crisis, consistent with the beneficial role hedge funds have played in our financial markets historically. We agree with recent statements by Chairman Bernanke that it is unlikely that any individual hedge fund is systemically relevant. We note that the Financial Times recently reported that the Financial Stability Board created a list of thirty financial institutions that will be subject to cross-border supervision exercises by regulators because of their potential to pose systemic risks globally.[2] Consistent with Chairman Bernanke's statement that no individual hedge fund is likely systemically relevant, the Financial Stability Board's list does not include any

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies.

[2] *See,* http://www.ft.com/cms/s/df7c3f24-dd19-11de-ad60-00144feabdc0.html.

hedge funds or hedge fund advisers. Nonetheless, we believe that the hedge fund industry should play a constructive role as policy makers develop a smart framework for systemic risk regulation and resolution authority.

The objectives of systemic risk regulation are best met by developing a framework that adopts a tailored approach to address the different risk concerns of the various business models and activities of different financial institutions. For example, if firms post collateral when they borrow from counterparties, as hedge funds customarily do, the potential risks associated with that borrowing are greatly reduced; a factor that should be considered in determining which prudential rules should apply to various market participants. The magnitude of leverage employed is also an essential risk characteristic that must be taken into account. Many hedge funds incur no or only a modest amount of leverage, and therefore potential losses are borne solely by the funds' investors – with no systemic risk implications.

With respect to the Resolution Fund, we believe that those entities that receive the benefits of the resolution authority should bear the responsibility for paying the costs associated with that authority. Systemically relevant firms are the entities that will benefit from this framework (*e.g.*, through lower borrowing costs as a result of potential government support), and we believe that these firms should be responsible for payment of the assessment. Firms that are not systemically relevant and do not receive competitive benefits such as implicit or explicit government guarantees or access to the Fed's discount window, should not be required to subsidize those firms that do receive these benefits.

Accordingly, we are extremely troubled by the punitive hedge fund "carve in" language added during the Thursday, November 19, 2009 markup of the Bill as part of the amendment offered by Rep. Brad Sherman. Far from recognizing that hedge funds had no adverse impact on the financial crisis, the Bill now perversely singles out hedge funds for more onerous treatment without any articulated policy rationale, thereby compelling them to unfairly shoulder a disproportionate share of the proposed assessment.

The Sherman amendment raises the asset threshold for those financial institutions required to contribute to the Resolution Fund from $10 billion to $50 billion, presumably based upon the view that firms of smaller size do not pose systemic risks and are not likely to be bailed out in the future by the Resolution Fund. However, the amendment specifically "carves in" hedge funds with assets under management on a consolidated basis of more than $10 billion, rendering them the only market participants with either assets or assets under management of less than $50 billion that will be required to pay an assessment. We are troubled by this singular treatment and the lack of supporting rationale or evidence behind it. As we have noted, the relatively modest size and historically low leverage of hedge funds would indicate that this measure is misguided. Indeed, no hedge fund has received any taxpayer bailout funds and it is not expected that any individual one would be deemed systemically relevant.

MFA urges you to reconsider the structure and funding of the Resolution Fund and the inequity caused by the Sherman amendment and restore a level playing field to the Financial Stability Improvement Act of 2009 before it is considered by the full House of Representatives.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO

Cc: The Honorable Spencer Bachus