June 1, 2012

European Commission
B-1049 Brussels
Belgium

Via Email

Re: Managed Funds Association Response to the Commission’s Green Paper: Shadow Banking

Dear Sirs:

Managed Funds Association (“MFA”)¹ welcomes the opportunity to provide comments to the Commission in response to its Green Paper “Shadow Banking” (the “Green Paper”). MFA strongly supports the efforts to understand shadow banking and to explore potential measures for monitoring and addressing the systemic risks posed by shadow banking. MFA previously commented² on the Background Note “Shadow Banking: Scoping the Issues” published by the Financial Stability Board (the “FSB Note”) in May 2011.

MFA wishes to provide the Commission with information on the size of the hedge fund industry, the activities undertaken by credit hedge funds, the levels of leverage used, the relationships between hedge funds and their investors and counterparties and the regulatory framework within which hedge funds operate, in order to assist the Commission as it develops its thinking on the “shadow banking” sector.

Our detailed comments (which are included in Annex II below) are primarily focused on the definition of shadow banking (Questions a) and b) of the Green Paper) and the measures already taken at the EU and international level to regulate the shadow banking system. (Question

¹ The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

k) of the Green Paper). For ease of reference, we have also set out in Annex I an analysis of the key activities of shadow banks (as identified in the FSB Note and the Green Paper) in the context of the hedge fund industry.

As discussed in further detail below, MFA believes that hedge funds do not pose the types of systemic risks or regulatory arbitrage concerns raised in the Green Paper for the following reasons:

- **Relative size of the hedge fund industry** – The global hedge fund industry is relatively small compared to other financial industries, such as mutual funds and banks, and relatively small compared to financial markets.

- **Diversity / Concentration / Substitutability** – Hedge funds engage in a wide variety of investment strategies and invest in a variety of asset classes. There is also a wide dispersion of assets among different managers, demonstrating that there is not a concentration of risk among relatively few funds or asset managers. This dispersion of assets among a broad group of advisers and funds significantly reduces the risk that the failure of any one fund or manager would create systemic risk due to a lack of substitutes.

- **Asset-liability matching / Maturity or liquidity transformation** – There are two sources of funds for a hedge fund: its investors and its bank/broker counterparties. The financing from counterparties is secured by collateral and inherently limited both by regulation and by the sophisticated counterparties’ risk analysis. Most hedge funds also build strong liquidity protections into their contractual relationships with investors who are subject to a variety of restrictions. These measures are designed to more closely match the term or expected liquidity of the fund’s assets with the term of the fund’s financings and equity investors. As such, hedge funds generally do not engage in “maturity transformation” unlike banks and other financial institutions that have significant differences in the liquidity of their assets and liabilities.

- **Redemption rights / Liquidity protection / Potential for runs** – Hedge funds are subject to investor redemptions; however, because of the redemption restrictions agreed to between funds and their investors, hedge funds are not subject to “runs” the way other financial institutions that take demand deposit accounts. Hedge funds are launched and liquidated all the time and fund liquidations, including during the financial crisis, have not created systemic risk or required government intervention.

- **Leverage** – Because hedge funds post collateral and margin in connection with their borrowings, hedge fund leverage has been and continues to be modest compared to other financial institutions.
We would be very happy to discuss our comments or any of the other issues relating to shadow banking. If you have any comments or questions, please do not hesitate to contact Roger Hollingsworth or the undersigned at +1 (202) 730-2600.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO
### ANNEX 1

**ACTIVITIES OF THE SHADOW BANKING SYSTEM AND HEDGE FUNDS**

<table>
<thead>
<tr>
<th>Characteristics of shadow banks</th>
<th>Application to hedge funds</th>
<th>Analysis</th>
</tr>
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</table>
| Accepting funding with deposit-like characteristics | No | • Hedge funds rely on long-term financing in the form of equity investments by investors. Such investments do not have deposit-like characteristics. Hedge funds build strong liquidity protections into their contractual relationships with investors. In particular, investors in hedge funds are subject to a variety of restrictions on redemption (including limited periods of redemption, powers of the manager to impose restrictions, such as “gates” to manage outflows of funds and/or suspend redemptions).
• As such, unlike money market funds, hedge funds are not vulnerable to “runs” by investors. |
| Performing maturity and/or liquidity transformation | No | • Hedge funds do not rely on unsecured, short-term financing to support longer-term dated investing activities. Instead, hedge funds benefit from a stable equity base from investors.
• Hedge funds typically achieve leverage through secured borrowings (*i.e.*, by posting collateral) designed to closely match the term of expected liquidity of the financing.
• Only a very small proportion of hedge funds engage in direct lending (*e.g.*, to SMEs) and their share in the direct loan market is insignificant. Hedge funds that make direct loans do not typically perform maturity transformation because the liquidity profiles of such hedge funds are |

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3 As set out in the Commission Green Paper: “Shadow Banking”.
consistent with the medium-term nature of the lending strategy (i.e. investors are subject to multiple-year lockups on redemption).

<table>
<thead>
<tr>
<th>Undergoing credit risk transfer</th>
<th>No</th>
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<tbody>
<tr>
<td></td>
<td>• Hedge funds do not typically act as originators or sponsors of structured finance vehicles and do not provide liquidity or credit support to such structures.</td>
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<tr>
<td></td>
<td>• Hedge funds will, as a result of the EU AIFM Directive, be prohibited from investing in securitisation positions unless the originator, sponsor or original lender retains at least 5% of the securitisation. The U.S. Dodd-Frank Act also imposes a 5% risk retention requirement directly on originators. Accordingly, credit risk transfer without “skin in the game” will no longer be possible.</td>
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<tr>
<td></td>
<td>• Although some hedge funds engage in derivative transactions (such as total return swaps), the counterparties are typically required to post collateral which mitigates the credit risk to the hedge fund.</td>
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</table>

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<tr>
<th>Using direct or indirect financial leverage</th>
<th>Yes, but only to a limited extent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Hedge funds are significantly less leveraged than other financial market participants.</td>
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<td></td>
<td>• Hedge funds typically structure their borrowings to avoid a mismatch between their assets and their secured financing.</td>
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<td></td>
<td>• Hedge funds will also be subject to leverage reporting requirements under the AIFM Directive.</td>
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ANNEX 2
MANAGED FUNDS ASSOCIATION
POSITION PAPER RESPONDING TO THE COMMISSION’S GREEN PAPER
“SHADOW BANKING”
INTRODUCTION

Managed Funds Association1 ("MFA") appreciates the opportunity to provide comments to the European Commission (the “Commission”) the Financial Stability Board (the “FSB”), and other regulators as they consider issues in connection with so-called shadow banking. MFA and its members seek to work constructively with policy makers and regulators in developing appropriate regulation of the hedge fund industry and financial markets in general. In that regard, MFA consistently has supported strengthening the regulatory framework and oversight of hedge fund managers in the United States, the European Union, and elsewhere. In particular, we have supported registration requirements for hedge fund managers, regulatory reporting on a confidential basis, and systemic risk regulation. MFA believes that the recent adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and the Alternative Investment Fund Manager Directive (the “AIFMD”) provide a robust regulatory framework for the hedge fund industry.

We understand the Commission and the FSB are analyzing the extent to which financial institutions other than banks are engaged in credit intermediation activities and whether there are regulatory gaps that need to be addressed with respect to such activities. While some refer to this type of financial activity as “shadow banking,” we believe this term creates misleading perceptions about non-bank financial institutions and activities. MFA notes that many of these financial institutions and activities can provide valuable services to financial markets and to the global economy. While financial institutions and activities should be subject to appropriate regulation, many of these institutions do operate within robust regulatory frameworks but are not banks and are not regulated as banks. Financial services regulation in many countries clearly contemplates separate regulatory frameworks for bank and non-bank entities and activities, a distinction that appropriately reflects important differences in the totality of activities engaged in by non-banking institutions as compared to banking institutions.

While regulators are considering a wide range of activities and institutions, our focus in this paper is on credit hedge funds. In looking at the activities of hedge funds in light of the following key policy issues, we believe it is clear that hedge funds are not engaged in bank-like activities, do not present systemic risk concerns, and are subject to robust regulation that is appropriately tailored to the investment fund business models.

- Existing regulatory oversight – The hedge fund industry is subject to a robust framework of existing regulations and will be subject to further regulation as pending regulatory reforms in the U.S. and the EU continue to be implemented going forward.

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1 The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.
• **Relative size of the hedge fund industry** – The global hedge fund industry is relatively small compared to other financial industries, such as mutual funds and banks, and relatively small compared to financial markets.

• **Diversity / Concentration / Substitutability** – Hedge funds engage in a wide variety of investment strategies and invest in a variety of asset classes. There is also a wide dispersion of assets among different managers, demonstrating that there is not a concentration of risk among relatively few funds or asset managers. This dispersion of assets among a broad group of managers and funds significantly reduces the risk that the failure of any one fund or manager would create systemic risk due to a lack of substitutes.

• **Asset-liability matching / Maturity or liquidity transformation** – There are two sources of funds for a hedge fund: its investors and its bank/broker counterparties. The financing from counterparties is secured by collateral and inherently limited both by regulation and by the sophisticated counterparties’ risk analysis. Most hedge funds also build strong liquidity protections into their contractual relationships with investors, who are subject to a variety of restrictions. These measures are designed to more closely match the term or expected liquidity of the fund’s assets with the terms of the fund’s financings and equity investors. As such, hedge funds generally do not engage in “maturity transformation,” unlike banks and other financial institutions that have significant differences in the liquidity of their assets and liabilities.

• **Redemption rights / Liquidity protection / Potential for runs** – Hedge funds are subject to investor redemptions; however, because of the redemption restrictions agreed to between funds and their investors, hedge funds are not subject to “runs” the way other financial institutions that take demand deposit accounts are. Across the industry, hedge funds are launched and liquidated regularly and fund liquidations over the past decade, including during the financial crisis, have not created systemic risk or required government intervention.

• **Leverage** – Because hedge funds post collateral and margin in connection with their borrowings, hedge fund leverage has been and continues to be modest compared to other financial institutions.

**Policy Goals Underlying Shadow Banking Regulation**

As noted in the FSB’s October 2011 report, Shadow Banking: Strengthening Oversight and Regulation -- Recommendations of the Financial Stability Board (the “FSB Report”), the G20 mandate to the FSB regarding shadow banking was to prepare, as necessary, additional regulatory measures to address the systemic risk and regulatory arbitrage concerns posed by the shadow banking system. The Commission’s Green Paper lists four potential risks associated with shadow banking: (1) deposit-like funding structures may lead to “runs;” (2) build-up of high, hidden leverage; (3) circumvention of rules and regulatory arbitrage; and (4) disorderly failures affecting the banking system. With respect to risks (1), (2) and (4), we believe the Commission should provide guidance that these risks will be considered from a systemic risk perspective. This approach is similar to the one taken in the FSB Report, which suggests that “authorities should narrow the focus for policy purposes to the subset of nonbank credit intermediation where there are (i) developments that increase systemic risk (in particular maturity/liquidity transformation, imperfect credit risk transfer and/or leverage), and/or (ii)
indications of regulatory arbitrage that is undermining the benefits of financial regulation.” The FSB Report provides further clarification regarding regulatory arbitrage, stating, “Parts of the shadow banking system perform credit intermediation similar to that provided by banks (i.e., combined with maturity/liquidity transformation and leverage) but are not subject to the same regulatory and supervisory constraints.”

We believe that systemic risk and regulatory arbitrage risks are the most appropriate focus for regulators and policy makers in considering whether additional regulation is necessary or appropriate with regard to shadow banking entities or activities. It also is important for regulators to consider the extent to which regulation designed to address these policy goals should focus on financial products and activities rather than focusing on entities. In considering the potential systemic implications of hedge funds, we believe that it is important that policy makers and regulators have a clear picture of the size, concentration, leverage and structure of hedge funds within the broader financial market. It is also vital that they consider the improvements made by hedge fund counterparties (banks and broker-dealers) over the last decade to risk management practices, as well as the new regulatory requirements mandated in the Dodd-Frank Act and the various EU directives and regulations that are being implemented, and which will impose further regulations for the hedge fund industry as well as further regulations on market activities.

For the reasons discussed below, we believe that hedge funds, including credit hedge funds, do not pose these types of risks. In the context of systemic risk, hedge funds do not have deposit-like funding structures, do not present a risk of high, hidden leverage and hedge fund failures do not present the risk of affecting the banking system. Further, hedge funds are not structured similarly to, and are not engaged in similar activities, as banks. The hedge fund industry is well regulated in light of the business models in the industry and the policy issues relevant to the activities of private investment funds and their managers and do not, therefore, present the risk of regulatory arbitrage. Accordingly, we believe that the current regulatory framework for the hedge fund industry, in addition to those regulations in the process of being implemented appropriately address the regulatory and policy goals concerning hedge funds and that bank-like regulation of these funds is not necessary from a policy perspective. Further, bank-like regulation of hedge funds likely would have the unintended consequence of placing unnecessary restrictions on the activities of hedge funds, unduly limiting the benefits these investment funds provide to investors, including pension plans, and to a stable and efficient financial system, which benefits investors and companies that need access to private capital.

**REGULATORY FRAMEWORK FOR HEDGE FUNDS**

**U.S. Adviser Registration**

In the U.S., the Dodd Frank Act requires all hedge fund managers with at least $150 million in assets under management (“AUM”) to register with the U.S. Securities and Exchange Commission (the “SEC”) under the Investment Advisers Act of 1940 (the “Advisers Act”). Hedge fund managers with less than $100 million in AUM generally will be required to register with state securities regulators under state law. The AUM thresholds are based on a manager’s “regulatory assets under management,” which includes assets acquired through various financing methodologies. As a result, all large hedge fund managers are now registered with the SEC.

Registration with the SEC requires hedge fund managers to, among other things, maintain books and records, be subject to examination and inspection by SEC staff, maintain written
compliance programs designed to prevent violations of the U.S. securities laws, and have a chief compliance officer responsible for implementing the compliance program. The SEC also has enhanced substantially its reporting requirements under the Advisers Act for hedge fund managers. Those enhancements include:

- An expanded Form ADV, the registration and public reporting form for investment advisers, including hedge fund managers.
- Adoption of Form PF jointly with the Commodity Futures Trading Commission (the “CFTC”), which requires hedge fund managers to report substantial information to the SEC and the CFTC on a confidential basis. The information reported on Form PF will also be made available to the Financial Stability Oversight Council, which has responsibility in the U.S. for monitoring systemic risk.

The CFTC also has increased oversight of managers to funds investing in commodity futures and swaps.

In addition to increased commodity pool and commodity trading advisor oversight, the CFTC, together with the SEC, is implementing Title VII of the Dodd-Frank Act, which establishes a new regulatory framework for the over-the-counter (“OTC”) derivatives market. Title VII establishes rules for central clearing of many derivatives, segregation of customer collateral, margin and collateral requirements, and enhanced transparency. While Title VII of the Dodd-Frank Act is not specifically targeted at hedge funds, its market-wide reforms will impact hedge funds as market participants. For example, many market participants, including hedge funds, will be subject to new margin and collateral requirements, which will help ensure that market participants do not become overly leveraged through the use of derivatives. Further, to the extent market participants accumulate outsized derivatives positions and become “major swap participants” or “swap dealers,” they will become subject to additional capital, margin, and other requirements. Title VII also will make the derivatives market safer and more transparent through the creation of central clearing and reporting requirements.

**U.S. Systemic Risk Regulation**

The Dodd Frank Act established the Financial Stability Oversight Council (the “FSOC”) to collect and analyze data for the purpose of examining systemic risk. As noted above, hedge fund managers will be providing extensive information to the SEC and the CFTC on Form PF, which the SEC will provide to the FSOC. The Office of Financial Research (“OFR”) will analyze the data on behalf of the FSOC. The FSOC will use the data analyzed by OFR to determine which financial institutions are systemically important (“SIFIs”). These SIFIs will be subject to enhanced prudential regulation by the Board of Governors of the Federal Reserve System (the “Fed”). Under the Dodd-Frank Act, the Fed has authority to impose a wide variety of prudential regulations on entities that have been designated as SIFIs, appropriately tailored based on the type of business and risks posed by an entity designated as a SIFI. Those prudential regulations may include capital requirements or other regulations that limit leverage, limits on

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2 Form ADV is available on the SEC’s website at: [http://sec.gov/about/forms/formadv.pdf](http://sec.gov/about/forms/formadv.pdf).
3 Form PF is available on the SEC’s website at: [http://sec.gov/about/forms/formpf.pdf](http://sec.gov/about/forms/formpf.pdf).
4 Non-U.S. regulators, including the UK Financial Services Authority and the Hong Kong Securities and Futures Commission, also collect significant amounts of data from hedge fund managers.
5 The FSOC is also tasked with facilitating information sharing and regulatory coordination among U.S. regulatory agencies.
risk exposures to counterparties, and regulatory authority to require SIFIs to take corrective action to reduce risk. We note that, according to Doug Elliott from the Brookings Institution, no hedge funds presently qualify as SIFIs, as hedge funds are a financial sector that tends to “generate quite low systemic risk per dollar of assets” and does not “have enough assets for their absolute risk to come close to systemically important levels.”6 And while Elliott acknowledges this could change in the future, the FSOC has a framework in place to address any such eventuality.

In addition to the Fed’s regulation of SIFIs, Section 619 of the Dodd-Frank Act established the so-called “Volcker Rule,” which substantially limits the authority of banks to own hedge funds and other private investment funds.7 The implementation of the Volcker Rule also places limits on the authority of banks to sponsor hedge funds and imposes restrictions on lending and financing arrangements between banks and hedge funds they do sponsor or otherwise control. The restrictions established by the Volcker Rule are designed to address regulators’ concerns about bank exposures to hedge funds. As discussed above, changes to the derivatives market under the Dodd-Frank Act, including central clearing of swaps, will further reduce bank exposures to hedge funds.

It is important not only to look forward to pending regulatory changes regarding systemic risk regulation, but also to distinguish among financial institutions that receive government support, such as government insured bank deposits or access to government subsidized lending from central banks, and those financial institutions that do not receive such support. It is also important to consider the extent to which certain types of financial institutions received government support in the 2008 financial crisis. In addition to banking entities that receive regular support from taxpayers, money market funds received support from the U.S. government during the financial crisis, and arguably continue to have an implicit government backing. Hedge funds (including Long Term Capital Management in 1998) have never been bailed out by any government and no hedge fund is large enough to be considered “too big to fail” such that a government bailout would be an option. Hedge funds also do not have access to subsidized financing from central banks and hedge fund investors do not have access to government insurance. Financial institutions that do not have explicit or implicit government assistance do not pose the same potential systemic risk concerns as institutions that do have such government support.

**U.S. Market Regulations**

Hedge funds and their managers, like all other investors and asset managers, are subject to a variety of market based regulations in the United States, including:

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6 Testimony of Doug Elliott, Brookings Institution, before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit, May 16, 2012: “In my view, there are currently no true SIFIs in most of the financial sectors, including: private equity, venture capital, hedge funds, property-casualty insurance, and mutual funds management, with the possible exception of money market funds. This is not a matter of principle, but rather due to the fact that these are sectors which tend to generate quite low systemic risk per dollar of assets and none of them have enough assets for their absolute risk to come close to systemically important levels. It is possible that one or more of these sectors could develop SIFIs over time, particularly in the hedge fund sector where there is a wide range of business models. Therefore, as noted earlier, a blanket exception by class of institution is inappropriate.” (available at [http://financialservices.house.gov/UploadedFiles/HHRG-112-BA15-WState-DElliott-20120516.pdf](http://financialservices.house.gov/UploadedFiles/HHRG-112-BA15-WState-DElliott-20120516.pdf))

7 The Volcker Rule also generally prohibits banks from engaging in proprietary trading, subject to certain exceptions.
• Reporting requirements under Section 13(d) of the Securities Exchange Act of 1934 for positions of 5% or greater of public company equity securities;
• Requirements for institutional investment managers that manage at least $100 million to report holdings of public company equity securities on a quarterly basis;
• Prohibitions against insider trading and other fraudulent conduct in connection with the sale or purchase of securities; and
• Regulatory reporting requirements from various agencies, including the Department of the Treasury, the CFTC, the Fed, and the Bureau of Economic Analysis for investors with large positions in various financial instruments.

European Union Regulation

Similar to the U.S. regulatory reform efforts following enactment of the Dodd-Frank Act, the EU also is in the process of implementing regulatory reforms that will impose a robust and comprehensive regulatory framework for the hedge fund industry. Of primary relevance to hedge funds, the AIFMD will be implemented on 22 July 2013 throughout EU Member States. From that date, hedge fund managers will be subject to registration and oversight and regular reporting requirements to EU Member State regulators. The EU also is in the process of implementing market reforms, including an update to the Markets in Financial Instruments Directive (“MiFID”) and the European Market Infrastructure Regulation (“EMIR”). While MiFID and EMIR are not specifically targeted at hedge funds, their market-wide reforms will impact hedge funds as market participants. For example, many market participants, including hedge funds, will be subject to new margin and collateral requirements, which will help ensure that market participants do not become overly leveraged through the use of derivatives. These new EU regulations will impose an EU-wide regulatory framework for the hedge fund industry that appropriately focuses on the business models and policy issues relevant to private investment funds and their asset managers. This framework is separate and distinct from banking regulation, appropriately reflecting the differences in activities and structures between banks and hedge funds.

SIZE AND STRUCTURE OF THE INDUSTRY

In considering the potential for hedge funds to create systemic risks, it is important to consider not only the existing regulatory framework (discussed above), but also the size and structure of the hedge fund industry, which is smaller than many assume. Although the hedge fund industry is important to capital markets and the financial system, it is relatively small in size when considered in the context of the broader financial markets. As demonstrated in the table below, the global hedge fund industry has approximately U.S. $2.08 trillion in net assets. By comparison, the global mutual fund industry has approximately U.S. $23.1 trillion in net assets. The top 50 U.S. bank holding companies have approximately U.S. $14.4 trillion in assets. The FSB Report estimates the global shadow banking industry at U.S. $60 trillion. When looking at the hedge fund industry in the context of other financial market participants and financial

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8 Our comments are intended only to provide perspective regarding the size and concentration of the hedge fund industry; we are not commenting on the systemic significance of other financial market participants or industries.
markets in general, it is clear that the hedge fund industry is a relatively small part of the larger financial system.

Estimated size of the hedge fund industry by strategy

Source: Hedge Fund Research, Inc (“HFR”) (excerpts from various Industry Reports)

The hedge fund industry is not only relatively small when compared to financial markets, the industry also is not concentrated. Absolute Return magazine reported that, in 2011, in the U.S., 220 firms managed assets of U.S. $1 billion or more and in the UK, 63 firms managed assets of U.S. $1 billion or more. This dispersion of assets among different managers demonstrates that there is not a concentration of risk among relatively few funds or asset managers, rather hedge fund assets are distributed across a number of different funds, managers and investors.

This dispersion of assets among firms is of particularly importance because of the wide variety of investment strategies and assets that hedge funds invest in. Hedge funds engage in various strategies that are not necessarily correlated to each other and are often counter-cyclical. The chart below demonstrates the wide variety of strategies used by hedge funds and the lack of concentration in any particular investment strategy.
In addition to the relatively small size and lack of concentration in the hedge fund industry, it is important to consider the structure of hedge funds. We believe that the structure of hedge funds helps ensure that any losses that hedge funds incur are almost exclusively borne by their investors, not their creditors, counterparties, the general financial system, or taxpayers.

The structure and business model of hedge funds distinguishes them from banks or other bank-like entities. Hedge funds do not accept retail investors; they are limited to sophisticated investors. They do not provide demand deposit accounts like banks or instant liquidity funds like money market or other mutual funds. Hedge funds do not receive government-backed deposit insurance and do not have access to central banks’ discount windows.

Hedge funds build strong liquidity protections into their contractual relationships with investors. Hedge fund investors are subject to limited periods of redemption (sometimes monthly, but more often quarterly, annual, or longer), often with a notice requirement. Hedge fund managers also typically have the right to employ other techniques, such as “gates,” “lock-ups,” and “side-pockets” to prevent forced asset sales. Hedge funds typically structure their redemption and lock-up requirements to complement the levels of liquidity and leverage the fund expects to use. The UK Financial Services Authority (the “UK FSA”) noted in its February 2012 Hedge Fund Survey (the “FSA HFS” or “FSA Survey”) that, since its Hedge Funds Survey has been running (since 2005), the results demonstrate that hedge funds’ portfolios can be liquidated more quickly than their liabilities fall due.11 As such, hedge funds generally do not engage in

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“liquidity transformation” or “maturity transformation,” unlike banks and other financial institutions that have significant differences in the liquidity of their assets and liabilities.

Chart 9: Asset/liability mismatch – Cumulative liquidity profile of assets & liabilities, March 2011

Source: FSA HFS
Similar to the structuring of investor redemption rights, hedge funds structure their financing arrangements in light of their investment strategy and the liquidity of the assets they hold. Unlike many other financial market participants, hedge funds do not rely on unsecured, short term financing to support their investing activities. Instead, hedge funds rely on secured borrowings, which are designed to more closely match the term or expected liquidity of the asset and the financing which funds it. Indeed, banks do not provide uncollateralized loans to hedge funds. This practice is also true with respect to derivatives transactions. Hedge funds pay initial margin and exchange variation margin with their derivative counterparties, a market practice that is also a key component of derivatives regulation in the U.S. under Title VII of the Dodd-Frank Act and in the EU under EMIR.

Because of the size and structure of the hedge fund industry, hedge fund liquidations over the past decade, including during the financial crisis, have not led to systemic risk. The financial crisis saw “runs” on repos as well as on other entities which were dependent on short term financing (but which held longer term assets) – notably, asset-backed commercial paper conduits (“ABCP”) and structured investment vehicles (“SIVs”). There was also a run on money market mutual funds. Money market funds were exposed to ABCP, SIVs and other financial institutions (principally banks), so investors in money market funds which had such investments assets withdrew their funds (and deposited them in money market funds which invested only in government securities). Hedge funds also faced investor redemptions during the financial crisis; however, because of the redemption restrictions agreed to between funds and their investors, hedge funds were not subject to “runs” the way other financial institutions were. As
demonstrated on the following chart, many hedge funds liquidated during the financial crisis, but hedge fund liquidations did not create systemic risk or require government intervention.

**Hedge Fund Launches and Liquidations**

Source: HFR
LEVERAGE

As noted above, hedge funds are required to post collateral and margin to secure their credit exposures to banks. Because hedge funds post collateral and margin in connection with their borrowings, hedge fund leverage is modest compared to other financial institutions. A Columbia University study showed that the leverage ratio for the hedge fund industry was 1.5 as of October 2009, with an average ratio of 2.1 from December 2004 to October 2009 and a high of 2.6. The findings of the Columbia University study with respect to the leverage ratio of the hedge fund industry are consistent with other studies, which generally report leverage ratios below 3.0 for an extended period of time. The UK FSA’s Hedge Fund Survey has conducted several studies on the hedge fund industry, and has consistently found leverage ratios for the industry of less than 3.5. A 2009 study by Lord Adair Turner, then Chairman of the FSA, found that the leverage ratio of the hedge fund industry since 2000 has been two- or three-to-one. By comparison, the Columbia University study found that the leverage ratio of investment banks during the period from December 2004 to October 2009 was 14.2, with a peak of 40.7 for investment banks in 2009, and the leverage ratio of the entire financial sector during that period was 9.4. These studies all demonstrate that hedge funds, despite popular misperceptions, are not highly leveraged entities, particularly when compared to other parts of the financial market.

We recognize, of course, that the risks associated with leverage vary depending on the investment strategy and the nature of the assets involved. The FSA Survey includes information about the use of leverage within specific fund strategies, in addition to aggregate leverage information for the industry. Hedge Fund Research (“HFR”), a hedge fund data and research company, also provides information about the use of leverage across the industry and by investment strategy. FSA and HFR leverage data are provided in the charts on the following pages. The HFR data charts show leverage use by the industry as a whole as well as leverage by funds engaged in event-drive and relative value strategies, two key strategies for credit hedge funds (as discussed in more detail in the section “Credit Hedge Funds” below). While the use of leverage does vary across investment strategies, most investment strategies use low levels of leverage, similar to the industry-wide numbers. Even fixed-income arbitrage strategies, which the FSA Survey shows use relatively higher amounts of leverage compared to other investment strategies, use significantly less leverage than many banks, which range as high as 44.1 (see the chart on page 17 with leverage ratios for a number of large banks). As noted in the chart on bank leverage, for the fourth quarter 2011, bank leverage for major banks ranged between 10.38 and 44.10, and for the fourth quarter 2008, bank leverage for the same group ranged between 13.21 and 50.82. Importantly, hedge funds will be subject to regular reporting requirements under the Dodd-Frank Act and the AIFMD, which will ensure that regulators have ongoing access to

13 FSA Surveys, Assessing possible sources of systemic risk from hedge funds, available at: http://www.fsa.gov.uk/library/other_publications/miscellaneous. The FSA Surveys consider multiple ways that leverage can be calculated. In the February 2012 Survey that reported gross leverage of 3.5, the FSA notes that the method uses to calculate this ratio may overstate leverage as netting arrangements that reduce a fund’s exposure may not be reflected in the calculation.
15 Hedge Fund Leverage study.
information about the amount and type of leverage being used by hedge funds so that they can perform their monitoring and oversight functions.

![Chart 8: Aggregate fund leverage: gross exposure as a multiple of NAV](chart.png)

**Excludes interest rate derivatives, commodity derivatives and FX**

Source: FSA, Assessing the possible sources of systemic risk from hedge funds, February 2012, chart 8 (“FSA Study”).
Leverage by Number of Funds – Industry Wide

Source: HFR (excerpts from various Industry Reports)

Leverage by AUM of Funds – Industry Wide

Source: HFR (excerpts from various Industry Reports)
Event-driven strategies are discussed in more detail in the section “Credit Hedge Funds” below.
Relative value strategies are discussed in more detail in the section “Credit Hedge Funds” below.
# Bank Leverage

<table>
<thead>
<tr>
<th>Name</th>
<th>Tier 1 Capital Ratio Q4 '11</th>
<th>Tangible Common Equity Ratio Q4 '11</th>
<th>Net Debt to Shareholder Equity Q4 '11</th>
<th>Financial Leverage Q4 '11</th>
<th>Financial Leverage Q4 '08</th>
<th>Last Reporting Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMMERZBANK AG</td>
<td>11.1</td>
<td>2.79</td>
<td>506.99</td>
<td>44.10</td>
<td>50.71</td>
<td></td>
</tr>
<tr>
<td>CREDIT AGRICOLE SA</td>
<td>11.2</td>
<td>1.20</td>
<td>783.63</td>
<td>40.09</td>
<td>43.01</td>
<td></td>
</tr>
<tr>
<td>DEUTSCHE BANK AG-REGISTERED</td>
<td>12.9</td>
<td>1.75</td>
<td>115.60</td>
<td>39.81</td>
<td>65.09</td>
<td></td>
</tr>
<tr>
<td>CREDIT SUISSE GROUP AG-REG</td>
<td>15.2</td>
<td>2.38</td>
<td>(294.24)</td>
<td>30.12</td>
<td>35.95</td>
<td></td>
</tr>
<tr>
<td>BNP PARIBAS</td>
<td>11.6</td>
<td>2.78</td>
<td>1,152.88</td>
<td>29.42</td>
<td>45.35</td>
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</tr>
<tr>
<td>BARCLAYS PLC</td>
<td>12.9</td>
<td>3.07</td>
<td>137.39</td>
<td>28.68</td>
<td>58.03</td>
<td></td>
</tr>
<tr>
<td>SOCIETE GENERALE</td>
<td>10.7</td>
<td>2.83</td>
<td>970.83</td>
<td>28.33</td>
<td>36.08</td>
<td></td>
</tr>
<tr>
<td>UBS AG-REG</td>
<td>15.9</td>
<td>3.10</td>
<td>392.90</td>
<td>27.29</td>
<td>50.82</td>
<td></td>
</tr>
<tr>
<td>HSBC HOLDINGS PLC</td>
<td>11.5</td>
<td>5.03</td>
<td>(26.89)</td>
<td>16.65</td>
<td>23.02</td>
<td></td>
</tr>
<tr>
<td>BANCO SANTANDER SA</td>
<td>11.0</td>
<td>3.95</td>
<td>249.81</td>
<td>16.30</td>
<td>18.59</td>
<td></td>
</tr>
<tr>
<td>BANCO BILBAO VIZCAYA ARGENTIA</td>
<td>10.3</td>
<td>5.01</td>
<td>351.20</td>
<td>15.53</td>
<td>20.61</td>
<td></td>
</tr>
<tr>
<td>MORGAN STANLEY</td>
<td>16.6</td>
<td>6.71</td>
<td>549.25</td>
<td>14.40</td>
<td>24.81</td>
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<tr>
<td>GOLDMAN SACHS GROUP INC</td>
<td>13.8</td>
<td>6.74</td>
<td>648.55</td>
<td>13.32</td>
<td>21.75</td>
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<tr>
<td>JPMORGAN CHASE &amp; CO</td>
<td>12.3</td>
<td>5.62</td>
<td>161.43</td>
<td>12.74</td>
<td>16.24</td>
<td></td>
</tr>
<tr>
<td>CITIGROUP INC</td>
<td>13.6</td>
<td>7.90</td>
<td>353.07</td>
<td>11.12</td>
<td>23.52</td>
<td></td>
</tr>
<tr>
<td>WELLS FARGO &amp; CO</td>
<td>11.3</td>
<td>7.40</td>
<td>78.09</td>
<td>10.43</td>
<td>16.93</td>
<td></td>
</tr>
<tr>
<td>BANK OF AMERICA CORP</td>
<td>12.4</td>
<td>6.52</td>
<td>141.70</td>
<td>10.38</td>
<td>13.21</td>
<td></td>
</tr>
<tr>
<td>MERRILL LYNCH &amp; CO INC</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>37.51</td>
</tr>
<tr>
<td>LEHMAN BROTHERS HOLDINGS INC</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>34.66</td>
</tr>
<tr>
<td>BEAR STEARNS COS LLC/THE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>34.56</td>
</tr>
</tbody>
</table>

Source: Bloomberg

- Tier 1 Capital Ratio -- Tier 1 Capital (Common equity plus qualifying perpetual preferred equity plus minority interests in subsidiaries, less goodwill) divided by Risk Weighted Assets (Basel capital driven; OECD sovereigns get zero risk weight).
- Tangible Common Equity Ratio -- Tangible equity divided by tangible assets
- Financial Leverage -- Average Total Assets divided by Average Total Common Equity
- Net Debt to Shareholder Equity -- Net debt divided by total equity
CREDIT HEDGE FUNDS

As discussed above, hedge funds invest in a wide variety of assets and use a wide variety of investment strategies to generate positive risk-adjusted returns for investors. In the context of the regulatory review of shadow banking, the discussion regarding hedge funds has focused on a subset of the hedge fund industry, so-called credit hedge funds. Credit hedge funds typically buy and sell credit securities and derivatives in the secondary credit market, including asset-backed securities and corporate or government bonds. In this context, credit funds are no different from other investors in financial instruments. Some credit hedge funds make direct commercial loans to small and medium-sized enterprises (“SMEs”); however, industry sources indicate that credit hedge funds constitute a very small percentage of the direct loan market. As indicated on the chart below, banks, not hedge funds originate the overwhelming majority of direct loans.

<table>
<thead>
<tr>
<th>Bank Holding Company</th>
<th>Bookrunner Volume</th>
<th># of Deals</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of America Merrill Lynch</td>
<td>98,916,605,941</td>
<td>525</td>
<td>18%</td>
</tr>
<tr>
<td>JP Morgan</td>
<td>70,084,961,518</td>
<td>297</td>
<td>12%</td>
</tr>
<tr>
<td>Wells Fargo &amp; Company</td>
<td>54,627,467,800</td>
<td>373</td>
<td>10%</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>46,684,860,138</td>
<td>128</td>
<td>8%</td>
</tr>
<tr>
<td>Citi</td>
<td>35,327,780,198</td>
<td>110</td>
<td>6%</td>
</tr>
<tr>
<td>Barclays Bank Plc</td>
<td>34,777,298,560</td>
<td>131</td>
<td>6%</td>
</tr>
<tr>
<td>Deutsche Bank</td>
<td>29,050,716,801</td>
<td>118</td>
<td>5%</td>
</tr>
<tr>
<td>Goldman Sachs &amp; Company</td>
<td>23,323,577,908</td>
<td>64</td>
<td>4%</td>
</tr>
<tr>
<td>General Electric Capital Corporation</td>
<td>21,186,047,333</td>
<td>209</td>
<td>4%</td>
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<tr>
<td>Morgan Stanley</td>
<td>20,327,192,400</td>
<td>59</td>
<td>4%</td>
</tr>
<tr>
<td>RBC Capital Markets</td>
<td>12,655,874,406</td>
<td>68</td>
<td>2%</td>
</tr>
<tr>
<td>BNP Paribas SA</td>
<td>12,567,073,414</td>
<td>65</td>
<td>2%</td>
</tr>
<tr>
<td>SunTrust Bank</td>
<td>11,755,192,755</td>
<td>122</td>
<td>2%</td>
</tr>
<tr>
<td>UBS AG</td>
<td>9,853,292,008</td>
<td>49</td>
<td>2%</td>
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<tr>
<td>BMO Capital Markets</td>
<td>8,197,331,537</td>
<td>93</td>
<td>1%</td>
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<tr>
<td>RBS</td>
<td>7,348,557,520</td>
<td>49</td>
<td>1%</td>
</tr>
<tr>
<td>U.S. Bancorp</td>
<td>6,655,751,668</td>
<td>72</td>
<td>1%</td>
</tr>
<tr>
<td>KeyBank</td>
<td>6,282,231,727</td>
<td>60</td>
<td>1%</td>
</tr>
<tr>
<td>Jefferies Finance LLC</td>
<td>5,340,750,300</td>
<td>34</td>
<td>1%</td>
</tr>
<tr>
<td>PNC Bank</td>
<td>4,831,641,429</td>
<td>63</td>
<td>1%</td>
</tr>
<tr>
<td>Credit Agricole Corporate and</td>
<td>3,824,036,690</td>
<td>17</td>
<td>1%</td>
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<tr>
<td>Investment Bank S.A.</td>
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<td></td>
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</tr>
<tr>
<td>Mitsubishi UFJ Financial Group</td>
<td>3,052,090,084</td>
<td>18</td>
<td>1%</td>
</tr>
<tr>
<td>HSBC Banking Group</td>
<td>2,890,696,399</td>
<td>9</td>
<td>1%</td>
</tr>
<tr>
<td>Scotia Capital</td>
<td>2,630,702,381</td>
<td>9</td>
<td>0%</td>
</tr>
<tr>
<td>Madison Capital Funding LLC</td>
<td>2,450,220,500</td>
<td>61</td>
<td>0%</td>
</tr>
<tr>
<td>TD Securities</td>
<td>2,248,329,694</td>
<td>20</td>
<td>0%</td>
</tr>
<tr>
<td>Fifth Third Bank</td>
<td>2,202,966,666</td>
<td>29</td>
<td>0%</td>
</tr>
<tr>
<td>Rabobank</td>
<td>1,976,733,787</td>
<td>12</td>
<td>0%</td>
</tr>
<tr>
<td>Regions Bank</td>
<td>1,920,941,667</td>
<td>26</td>
<td>0%</td>
</tr>
<tr>
<td>Golub Capital</td>
<td>1,561,549,998</td>
<td>32</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: The Loan Syndications and Trading Association (LSTA)

In looking at the size of credit hedge funds compared to the size of the leveraged loan markets, it is clear that credit hedge funds are a relatively small portion of the total market. As discussed in more detail in the section on credit hedge fund strategies below, credit hedge fund
strategies generally include the following, with the estimated percentage of the hedge fund industry’s AUM noted: 18

- Fixed Income Corporate – 4.49%
- Fixed Income Asset Backed – 2.04%
- Credit Arbitrage – 0.31%
- Distressed/Restructuring – 6.27%
- Private Issue/Regulation D – 0.33%

In total, credit hedge funds comprise an estimate 13.44% of total hedge fund AUM, or approximately U.S. $325 billion in AUM. By comparison, the leveraged loan market has been estimated at: 19

- US market – U.S. $1,200 billion
- Western Europe – €450 billion

In considering the scope of activities of credit hedge funds, it is important to recognize that these funds are a small portion of the overall market. Further, very few credit hedge funds provide direct loans as part of their investment strategy. Credit hedge funds instead typically buy and sell credit instruments on secondary markets along with other investors, which is significantly different than acting as a direct lender, which is more akin to bank-like activity.

**Credit hedge fund strategies**

While there is no uniform definition for hedge fund investment strategies, set out below are descriptions of key credit hedge fund strategies, prepared by Hedge Fund Research. These strategy descriptions correspond to data points in the above charts that are sourced to HFR.

**Event Driven:** Asset managers who maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities. Event Driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company-specific developments. Investment theses are typically predicated on fundamental characteristics (as opposed to quantitative), with the realization of the thesis predicated on a specific development exogenous to the existing capital structure. Event Driven is further subdivided into three sub-categories.

- **ED:** Credit Arbitrage Strategies employ an investment process designed to isolate attractive opportunities in corporate fixed income securities; these include both senior and subordinated claims as well as bank debt and other outstanding obligations, structuring positions with little or no broad credit market exposure. These may also contain a limited exposure to government, sovereign, equity, convertible or other obligations but the focus of the strategy is primarily on fixed corporate obligations and other securities are held as components of positions within these structures. Managers typically employ fundamental credit analysis to evaluate the

18 Source: HFR, Credit Suisse

19 Source: Credit Suisse Leveraged Finance Market Update, March 9, 2012
likelihood of an improvement in the issuer's creditworthiness, in most cases securities trade in liquid markets and managers are only infrequently or indirectly involved with company management. Fixed Income: Corporate strategies differ from Event Driven: Credit Arbitrage strategies in that the former more typically involve more general market hedges which may vary in the degree to which they limit fixed income market exposure, while the latter typically involve arbitrage positions with little or no net credit market exposure, but are predicated on specific, anticipated idiosyncratic developments.

- ED: Distressed Restructuring Strategies which employ an investment process focused on corporate fixed income instruments, primarily on corporate credit instruments of companies trading at significant discounts to their value at issuance or obliged (par value) at maturity as a result of either formal bankruptcy proceeding or financial market perception of near term proceedings. Managers are typically actively involved with the management of these companies, frequently involved on creditors' committees in negotiating the exchange of securities for alternative obligations, either swaps of debt, equity or hybrid securities. Managers employ fundamental credit processes focused on valuation and asset coverage of securities of distressed firms; in most cases portfolio exposures are concentrated in instruments which are publicly traded, in some cases actively and in others under reduced liquidity but in general for which a reasonable public market exists. In contrast to Special Situations, Distressed Strategies employ primarily debt (greater than 60%) but also may maintain related equity exposure.

- ED: Private Issue/Regulation D strategies which employ an investment process primarily focused on opportunities in equity and equity-related instruments of companies which are primarily private and illiquid in nature. These most frequently involve realizing an investment premium for holding private obligations or securities for which a reasonably liquid market does not readily exist until such time as a catalyst such as new security issuance or emergence from bankruptcy proceedings occurs. Managers employ fundamental valuation processes focused on asset coverage of securities of issuer firms, and would expect over a given market cycle to maintain greater than 50% of the portfolio in private securities, including Regulation D or private investment in public equity (“PIPE”) transactions.

Relative Value: Asset managers who maintain positions in which the investment thesis is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed income, derivative or other security types. Fixed income strategies are typically quantitatively driven to measure the existing relationship between instruments and, in some cases, identify attractive positions in which the risk adjusted spread between these instruments represents an attractive opportunity for the investment manager. Relative Value position may be involved in corporate transactions also, but as opposed to Event Driven exposures, the investment thesis is predicated on realization of a pricing discrepancy between related securities, as opposed to the outcome of the corporate transaction. Relative Value is further subdivided into six sub-strategies:

- RV: Fixed Income - Asset Backed includes strategies in which the investment thesis is predicated on realization of a spread between related instruments in which one or multiple components of the spread is a fixed income instrument backed by physical
collateral or other financial obligations (loans, credit cards) other than those of a specific corporation. Strategies employ an investment process designed to isolate attractive opportunities between a variety of fixed income instruments specifically securitized by collateral commitments which frequently include loans, pools and portfolios of loans, receivables, real estate, machinery or other tangible financial commitments. Investment theses may be predicated on an attractive spread given the nature and quality of the collateral, the liquidity characteristics of the underlying instruments and on issuance and trends in collateralized fixed income instruments, broadly speaking. In many cases, investment managers hedge, limit or offset interest rate exposure in the interest of isolating the risk of the position to include only the yield disparity of the instrument relative to the lower risk instruments.

- **RV: Fixed Income - Convertible Arbitrage** includes strategies in which the investment thesis is predicated on realization of a spread between related instruments in which one or multiple components of the spread is a convertible fixed income instrument. Strategies employ an investment process designed to isolate attractive opportunities between the price of a convertible security and the price of a non-convertible security, typically of the same issuer. Convertible arbitrage positions maintain characteristic sensitivities to credit quality of the issuer, implied and realized volatility of the underlying instruments, levels of interest rates and the valuation of the issuer's equity, among other more general market and idiosyncratic sensitivities.

- **RV: Fixed Income - Corporate** includes strategies in which the investment thesis is predicated on realization of a spread between related instruments in which one or multiple components of the spread is a corporate fixed income instrument. Strategies employ an investment process designed to isolate attractive opportunities between a variety of fixed income instruments, typically realizing an attractive spread between multiple corporate bonds or between a corporate and risk-free government bond. Fixed Income - Corporate strategies differ from Event Driven: Credit Arbitrage strategies in that the former more typically involve more general market hedges which may vary in the degree to which they limit fixed income market exposure, while the latter typically involve arbitrage positions with little or no net credit market exposure, but are predicated on specific, anticipated idiosyncratic developments.

- **Relative Value: Multi-Strategies** employ an investment thesis that is predicated on realization of a spread between related yield instruments in which one or multiple components of the spread contains a fixed income, derivative, equity, real estate, Master Limited Partnership, or combination of these or other instruments. Strategies are typically quantitatively driven to measure the existing relationship between instruments and, in some cases, identify attractive positions in which the risk-adjusted spread between these instruments represents an attractive opportunity for the investment manager. In many cases these strategies may exist as distinct strategies across which a vehicle which allocates directly, or may exist as related strategies over which a single individual or decision making process manages. Multi-strategy is not intended to provide broadest-based mass market investor appeal, but is most frequently distinguished from others arbitrage strategies in that it is expected to maintain greater than 30% of portfolio exposure in two or more strategies meaningfully distinct from each other that are expected to respond to diverse market influences.
CONCLUSION

MFA appreciates the opportunity to provide comments to the Commission, the FSB and other regulators as they consider issues in connection with so-called shadow banking or parallel banking. We believe that systemic risk and regulatory arbitrage risks are the most appropriate focus for regulators and policy makers in considering whether additional regulation is necessary or appropriate with respect to these issues. For the reasons discussed above, we believe that hedge funds do not pose systemic risk. Hedge funds also do not present the risk of regulatory arbitrage, as they are well regulated as investment funds and are not engaged in bank-like activities. As part of that regulatory framework, hedge funds are subject to regular reporting requirements, which will ensure that regulators will have ongoing access to information about the industry and individual firms. As such, we believe that the current (including regulations in the process of being implemented) regulatory framework for hedge funds appropriately addresses the regulatory and policy goals concerning hedge funds and that bank-like regulation of hedge funds would unduly limit the benefits these investment funds provide to investors, including pension plans, and to a stable and efficient financial system, which benefits investors and companies that need access to private capital.