

# 05/4 *newsletter*



This newsletter provides a summary of DP05/4. Please see 'Who should read this paper?' below to see if DP05/4 is relevant to you.

Financial Services Authority

## Hedge funds: A discussion of risk and regulatory engagement

### Why are we issuing this Discussion Paper?

In 2002 we published Discussion Paper (DP) 16, Hedge Funds and the FSA. It encouraged a discussion of how UK-based hedge fund managers were regulated and the limitations of our authority over their activities. In addition, it touched on the impact of hedge funds on our market confidence and financial crime objectives.

We now feel it is appropriate to publish a further paper on this topic.

### Who should read this paper?

This paper is addressed to investment managers and advisors, hedge fund counterparties (including prime brokers) and institutional investors, commentators and analysts. It is not addressed to UK retail investors. Retail access issues are covered by our DP A wider range of retail investment products: consumer protection in a rapidly changing world, which we are publishing at the same time as this paper.

## Why are we analysing the risks in the hedge fund sector?

We believe that hedge funds are playing an increasingly important role in financial markets, significantly enhancing market liquidity and market efficiency. They also offer more diversification options for investors. This positive contribution to market dynamics is anticipated to increase over time as the sector continues to grow and mature. It is in this context that we have analysed the risks inherent in the sector and the appropriate regulatory response.

Against this backdrop, we have sought to identify specific risks and appropriate risk mitigation actions. A number of initiatives are already in place, both domestically and globally, to mitigate hedge fund related risks. In this DP, we outline a number of potential additional risk mitigation actions for consideration. These potential actions are consistent with our current risk-based approach to supervision and would support the enhanced application of our current supervisory approach.

## How is the paper set out?

In the DP, we consider the potential risks associated with hedge funds in relation to:

- financial stability and market confidence;
- market cleanliness;
- our financial crime objective; and
- our consumer protection objective.

## Which firms will this affect?

This paper addresses issues of relevance to hedge fund managers, their counterparties (including prime brokers) and institutional investors in hedge funds.

## What happens next?

We are now embarking upon a period of consultation, during which we invite views from interested parties that will help us to reach a conclusion on:

- whether we have correctly identified the risks; and
- which of the potential additional risk mitigation actions merit further analysis.

We intend to review these comments and issue a Feedback Statement in early 2006.

The Financial Services Authority invites comments on this Discussion Paper. Please send us your comments to reach us by 28 October 2005.

Comments may be sent by electronic submission using the form on the FSA's website at ([www.fsa.gov.uk/pubs/discussion/dp05\\_04\\_response.html](http://www.fsa.gov.uk/pubs/discussion/dp05_04_response.html)).

Alternatively, please send comments in writing to:

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**It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure.**

## How can I get the full paper?

You can download the full Discussion Paper from:

[www.fsa.gov.uk/pages/Library/Policy/DP/2005/05\\_04.shtml](http://www.fsa.gov.uk/pages/Library/Policy/DP/2005/05_04.shtml)

Or you can order hard copies of the paper:

Phone our helpline on 0845 608 2372, quoting reference DP05/4

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