FERNANDO RESTOY'S DRAFT RESPONSE TO DISCUSSION QUESTION 1
TOPIC 4
HEDGE FUNDS

As the capital markets in mainland China become more developed, different investment opportunities and strategies, such as hedge funds and private equities, will become available. While the hedge fund sector offers the advantage of a larger range of product choices to investors, and the trading activities of hedge funds may add to market liquidity, there are concerns in the global marketplace about the impact of hedge fund participation on financial stability risk. How are regulators responding to the regulation of hedge funds? What are the lessons that the Mainland could learn from the more developed markets? **(Mr Fernando Restoy & Mr Howard Wetston)**

Response:

The regulators have been looking at the HFs since the crisis of LTCM in 1998. IOSCO issued some recommendations due to that event but recently as result of the recent financial crisis and Madoff, IOSCO drew up some high principles in June 2009 which have been used by the regulators all over the world. Most of them are related to mandatory registration, regulation of key aspects which include a general mention of prudential issues, mandatory reports to the regulators and cooperation.

The US and the EU have issued their regulation on the HF. In the EU the regulation was issued last June and it is coming into force in July 2013. I would like to focus on two aspects of the EU regulation: the adequate levels of information to investors and authorities and the role of the depositary.

The mandatory registration, the capital requirements, and other pieces of the regulation of HF are important but only an adequate level of disclosure to the investors of a Hedge Fund and to the regulators can contribute to foreseeing any future problems. Here, a good reporting system to HFs' clients and regulators can be used to detect in the early stages possible unbalanced situations. The sophisticated clients would be able to check the accuracy of the information reported by the HF. The regulator could use that information for checking alleged wrongdoings.

The second aspect of the EU regulation I would like to stress is the role of the Depositary. The experience in the UCITs' world in Europe shows that when a really implicated third party is risking its own neck in the game then risk controls work much better.

Personally, I foresee that the main challenges of the AIMFD are:

- Third country passport: the AIFMD introduces for the first time in European financial legislation a passport for non-European countries in order to market AIF to professional investors all around Europe. In this sense, in order to preserve investor protection, one of the main challenges of the AIFMD is to guarantee an adequate level of cooperation and exchange of information among the different involved

authorities. Currently, ESMA, according to its delegated powers, is working in a comprehensive MoU to address this issue.

- Types of AIFM: the AIFMD in its level 1 defines its scope by way of not including in it the UCITS. Therefore, it is of outmost importance to define the types of AIFM so as to be certain that the right kinds of vehicles and structures are included in the scope of the Directive, and in this way to achieve the ultimate objectives of the AIFMD of preventing systemic risk and preserving investor protection. Currently, ESMA, according to its delegated powers, is also working in this issue

Finally, I think that the Mainland could take advantage of the new EU and US regulation and more specifically reinforce the disclosure regime and the role of the Depositaries, as long as the other requirements like the compulsory registration and other are met. As in any other aspect of the securities regulation, disclosure and transparency are the key tools to reach a sound development in the securities industry.