



Financial Services Authority

# Hedge funds and the FSA: Feedback statement on DP16

March 2003



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**Annex 1:** List of non-confidential respondents to DP16

This Feedback Statement reports on the main issues arising from Discussion Paper 16 (DP16) *Hedge Funds and the FSA*

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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.**

# 1 Executive summary

- 1.1 We have carried out a review of our regulation of hedge fund managers to see whether any changes are needed to recognise the growing importance internationally of the hedge fund industry. We published Discussion Paper 16: *Hedge Funds and the FSA* (DP16) in August 2002 to stimulate debate and receive views.
- 1.2 This Feedback Statement (FS) summarises comments on issues raised by DP16 and our responses to them.
- 1.3 DP16 was concerned with two main questions:
  - The regulatory regime – London is a major location for hedge fund managers, but hedge funds themselves are ‘offshore’ and we do not regulate them. We asked whether the regulatory regime for managers was appropriate and whether the limits to our regime were understood.
  - Marketing and selling to retail consumers – Under the existing regulatory framework, hedge fund products may not be marketed and sold to retail consumers except in certain circumstances. For example, they can be recommended by an appropriately authorised financial adviser where they are considered suitable. However, in practice, individuals who do invest in hedge funds tend to be higher net worth individuals. Therefore, we asked whether the existing marketing and selling rules are still appropriate.
- 1.4 In addition, we asked whether hedge fund managers posed risks to our financial crime objective, which are not addressed by our current approach.
- 1.5 It is important that those who invest in hedge funds understand the nature of our regulatory regime and that it does not provide the same degree of consumer protection as it does for other products. Following some contacts with smaller institutional investors, we are proceeding on the basis that institutions making hedge fund investments are aware of our limited regulatory scope.

- 1.6 Our regulatory regime as applied to hedge fund managers is little different from that applied to other investment managers. In DP16 we asked whether that is appropriate. From the responses we received there was a general consensus that the rules applied to hedge fund managers are appropriate and workable. There was also a consensus that the supervisory regime applied is appropriate. So, we do not propose any changes to the rules to create a special regime for hedge fund managers, nor to the supervisory regime.
- 1.7 Hedge funds for the UK retail market could be structured in various ways, but the most obvious structures to use would use the regimes for listed investment companies or collective investment schemes. Either of these would enable the funds to be marketed to the general public, albeit in different ways. However, neither regime can, at the moment, accommodate individual ('single manager') hedge funds. Both regimes require a 'spread of risk' in a manner which hedge funds are unable to provide. 'Funds of hedge funds' that are investment companies can be admitted to listing in the UK and marketed through the publication of Listing Particulars. They can also be recommended to retail customers by authorised financial advisers who believe them to be a suitable investment for their customers.
- 1.8 Responses to DP16 have not suggested that there is a great desire on the part of product providers or retail investment advisers to produce and sell retail hedge fund products. Nor have respondents suggested that there is significant demand from retail investors for access to such products.
- 1.9 Hedge funds are quite unlike the investment products retail consumers are familiar with. Retail funds and, in particular, authorised collective investment schemes grew up to enable smaller investors to invest cost-effectively in a portfolio of underlying investments. The controls applied to investment products provide protections to retail investors. Hedge funds seek to provide rather more than an exposure to a diversified portfolio and make use of various investment management techniques, such as 'short selling' and 'leverage'. Such techniques are highly restricted in most retail investment funds. This means that hedge funds cannot be operated within the controls applied at present to listed investment companies or regulated collective investment schemes (i.e. unit trusts and ICVCs). Indeed, it would be difficult to define the term 'hedge fund' to allow authorised 'hedge funds' to become a category of authorised fund to sit alongside others. The term 'hedge fund' has no generally accepted definition and attempts to devise one would include a wide range of presently unauthorised schemes.
- 1.10 On the basis of the above analysis, we have decided not to take steps at this time to change our regime. However, we recognise that this situation needs to be kept under review, and we will continue to discuss the possibility of a new approach with market participants, which would allow for a broader range of funds to be brought into the regime for retail investment products.

- 1.11 Our question on financial crime, included in DP16, did not yield many comments. Of those who did comment, most concluded that our current approach to the financial crime objective is appropriate. Hedge fund managers located in the UK must ensure that they have systems and controls in place for anti-money laundering purposes. This will often involve delegation of functions to overseas administrators. The act of delegation does not absolve the UK manager of his responsibilities for anti-money laundering.

### **Consumers**

We believe that Chapter 4 of this Feedback Statement will be of interest to retail consumers. We have decided it is not appropriate to change the regulatory regime to allow easier marketing of hedge funds to retail consumers because it would reduce the existing level of protection. Moreover, little interest has been noted on the part of retail investors.

# 2 Introduction

## Background

- 2.1 In August 2002, we published Discussion Paper 16: *Hedge Funds and the FSA* (DP16). It was intended to stimulate discussion on issues concerning hedge funds generally, but included as major themes:
- the regulation of UK-based hedge fund managers and the limits of our authority over hedge funds; and
  - the selling and marketing of hedge funds in the UK.
- 2.2 In October 2002, we published Discussion Paper 17: *Short Selling* (DP17). Although relevant to hedge funds, short selling is a distinct activity from hedge fund management and has been approached as such. This Feedback Statement will not touch on the issues raised in DP17. We will publish a further Feedback Statement on DP17 in late Spring.
- 2.3 Although London is a popular location for hedge fund managers, hedge funds themselves are not established in the UK. For tax reasons, the funds locate in offshore jurisdictions such as the Cayman Islands. Application of rules to the manager offers only limited scope to regulate the operation of the offshore hedge fund. The relationship between a hedge fund and its investment manager is one of firm (the London-based manager or adviser) and client (the offshore hedge fund). The fund itself will have its own governance arrangements, which will operate outside the UK.
- 2.4 It is important that those who invest in hedge funds understand that we do not, and are not able to, regulate the funds. We did not receive any DP16 responses on this point from investors. We therefore contacted a sample of smaller institutional investors, including pension funds, charities and friendly societies. From this we draw comfort that those making hedge fund investments are aware of our limited regulatory scope, and the lack of UK regulatory protection should an offshore fund encounter difficulties.

- 2.5 We explained in DP16 that other jurisdictions already permit the retail marketing of hedge funds. Hong Kong and Singapore have only recently changed their rules to allow this. The Hong Kong Securities and Futures Commission authorised three hedge funds in November 2002 and two of them have already launched in the Hong Kong market. The two funds have around US\$30 million under management. The Monetary Authority of Singapore made changes to their rules in December 2002, to set different minimum investment thresholds for investment into hedge funds, funds of hedge funds and capital protected/capital guaranteed hedge funds.
- 2.6 In December 2002 the Central Bank of Ireland announced the development of Funds of Unregulated Funds – authorised collective investment schemes with the ability to make substantial investment into other, unregulated, schemes. No fund has as yet applied for authorisation under these provisions.
- 2.7 In March 2003, the German authorities announced their intention that German institutions should be given greater access to hedge funds. In addition, the providers of funds of hedge funds products are to be allowed greater marketing opportunities to retail investors.
- 2.8 We will continue to monitor the work of other jurisdictions in their treatment of hedge funds. However, it is important to realise that the regulatory regime for retail investment products has developed in different ways in different countries. Before making any changes to the retail investment product regime a regulator must understand what retail investors want or expect by way of protection. Regulatory actions taken in one country may not be appropriate in others.
- 2.9 In CP164 *Investment companies (including investment trusts), Proposed changes to the Listing Rules and the Conduct of Business Rules, Changes to the Model Code* (published in January 2003) we proposed changes to our Listing Rules for investment companies. These proposals would require that listing documents should contain a prominent statement of the risk factors that are specific to the investment company. We already admit investment companies which invest in hedge funds ('funds of hedge funds') to official listing and several were officially listed in 2001. If the Listing Rules are changed to adopt the proposed new rules, the disclosure requirement will, of course, apply to funds of hedge funds investment companies.
- 2.10 The purpose of this Feedback Statement is to provide our conclusions from the discussion exercise. We recognise though that the 'hedge fund debate' will continue and we shall keep matters under review.

## **Structure of Feedback Statement**

- 2.11 The rest of this FS consists of:
- Chapter 3 summarising the responses we received to DP16, and providing feedback on the issues arising; and
  - Chapter 4 which discusses our approach to the regulation of retail hedge fund marketing in the UK.

## **Next steps**

- 2.12 We shall continue to keep the regulation of hedge funds under review. We have written to the Alternative Investment Management Association (AIMA) to see whether we can work with AIMA to help clarify the financial promotion regime for hedge fund managers. We shall continue an open dialogue with AIMA and with other interested parties.
- 2.13 We are already conducting a fundamental review of the FSA listing regime. And we shall soon be publishing a Consultation Paper to propose changes to the regime for authorised collective investment schemes. Any general changes we make to those regimes may have an effect on hedge funds structured as listed companies or as collective investment schemes.

# 3 Response to DP16

## General

- 3.1 We published DP16 in August 2002. We received 40 responses and we are very grateful for the comments received. These came mainly from firms already engaged in hedge fund management and those who wish to enter the market. We also received a response from the Financial Services Consumer Panel. Annex 1 lists the non-confidential respondents to DP16.
- 3.2 This chapter summarises those comments and sets out our responses to them. In DP16 we identified three areas for discussion, namely:
- The marketing and selling of hedge fund products to retail investors
  - The regulation of hedge fund managers
  - Financial crime

The questions we asked focused around those issues and we have structured this FS accordingly.

- 3.3 We have, where possible, given an indication of our current thinking in this FS, but this will continue to evolve in light of continuing developments in the regulation of the UK retail regime.

## The marketing and selling of hedge funds to retail investors

Q1: Do respondents agree that there is no strong case for reforming the regime for the marketing and selling of hedge funds to sophisticated investors?

- 3.4 All respondents agreed that there is no strong case to reform the system for the marketing and selling of hedge funds to sophisticated investors. However, many respondents asked for clarification and simplification of the financial promotion regime. Areas of concern include verification and certification

procedures for sophisticated investors and the scope of the exemptions. Some respondents also asked for a fewer rules to be applied to the distribution of products aimed at non-retail investors compared to those aimed at retail investors.

**Our response:** We have contacted the Alternative Investment Management Association (a relevant trade association) to see whether we can be of any assistance in clarifying the operation of the financial promotions regime. Our rules already recognise a distinction between retail and non-retail funds. For example, unregulated collective investment schemes are subject to substantially fewer regulatory requirements than schemes that can be marketed to the retail sector.

Q2: Do respondents believe that hedge funds, or certain types of hedge funds, can be suitable products to be marketed and sold to the retail sector?

- 3.5 The general consensus was that hedge funds can potentially be suitable products to be marketed and sold to the retail sector, although there were dissenters. However, almost all respondents expressed the need for safeguards to be introduced and particularly for products to be sold only if the investor is aware of the risks involved and the nature of hedge funds.

**Our response:** We agree with respondents that investor education and understanding are crucial issues if hedge fund providers were to have greater access to the retail market.

Q3: Is there significant demand from firms wanting to sell hedge funds to the retail sector? Would there be significant demand for hedge fund products from retail customers if we liberalised rules to allow them to be sold to the retail sector?

- 3.6 Most respondents said that there is no significant demand at the moment either from product providers, retail investment advisers or from retail customers. However, many respondents said that they anticipated demand increasing in the medium term, especially from investors, particularly if the rules were changed to allow marketing to the retail sector and if consumer understanding of hedge funds is increased. Some respondents said that adequate risk warnings are essential.

**Our response:** The responses received do not indicate any significant demand for immediate change to the present regime.

Q4: Are there any other options not considered in this paper that respondents think we should consider in relation to the marketing and selling of hedge funds in the UK?

3.7 Around half of the respondents said there were no other options. Others suggested as options:

- training for advisers on hedge funds;
- allowing hedge fund marketing through insurance contracts or pension schemes;
- allowing hedge funds to be sold subject to a capital guaranteed wrapper;
- the constraints imposed by the taxation regime;
- avoidance of using the term ‘hedge fund’;
- regulation of the adviser and not the product; and
- a review of marketing restrictions on hedge funds.

**Our response:** This question yielded many diverse comments. We agree that the training of retail investment advisers is clearly vital to any wider retail marketing of hedge fund products. However, most of the comments on investment restrictions are outside our control. And we agree that the term ‘hedge fund’ is not meaningful in regulatory terms because it has no universally accepted definition.

Q5: Do you think that hedge funds would wish to comply with the current regulatory regime for authorised CISs, if the categories of authorised funds were extended to cover certain types of hedge fund strategy? If not, what aspect of that regime would need to be changed and in what manner to suit particular types of hedge funds?

Q6: Which types of hedge fund strategy do respondents think we should consider in our forthcoming fundamental review of the CIS Sourcebook?

3.8 Many respondents commented that, before hedge funds could use the authorised CIS regime, many of the rules would have to be amended, including those on:

- performance fees;
- disclosure;
- borrowing restrictions;
- investment restrictions; and
- redemptions and frequency of valuations.

Several respondents expressed concern that amending the regime to allow hedge funds may weaken the protections offered by the existing regime. Some respondents said that allowing funds of hedge funds into the regime might be appropriate, provided the rules were adjusted appropriately. Others said that

other routes (such as amending the listing regime or adapting the current financial promotion regime) were more appropriate if hedge funds were to be offered more widely.

- 3.9 A small majority of respondents said that funds of hedge funds, long/short equity and equity market neutral funds would be appropriate retail investments. However, several respondents said that either identifying strategies would not be useful or appropriate, or that the regulator should not deem certain strategies to be more appropriate than others. Problems with defining strategies were also raised, although one respondent thought that adopting standard definitions might allay some concerns with hedge funds. Some respondents suggested that focus should be concentrated on appropriate disclosure and suitability tests.

**Our response:** We recognise that the existing regime for authorised collective investment schemes does not accommodate hedge funds. We explain more fully in Chapter 4 that including hedge funds in that regime would significantly change the nature of the regime for authorised schemes. We note also that this would reduce significant protections offered by the existing regime.

Q7: If we were to authorise certain hedge fund strategies as described above, what strategies should we and/or the industry adopt to provide retail consumers with appropriate information about the risk profile of hedge funds?

- 3.10 There was an overwhelming consensus that education of both investors and IFAs is the key issue here, along with the use of risk warnings, and the appropriate disclosure of the risks associated with hedge funds and the investment strategies that they might employ. Many said that we would need to play a leading role in this education process, along with product providers. One respondent suggested that we should include information about hedge funds, including comparative tables, on our website, while another said that we should be responsible for ensuring that information disclosed on hedge funds is up to date. Several respondents suggested that IFAs wishing to advise on hedge funds should be required to pass a 'hedge fund examination'.

**Our response:** We have a statutory objective to promote public awareness of the financial system and we announced in our Plan and Budget for 2003/4 proposals for a major step change in consumer education. However, our resources for consumer awareness are limited and we would expect product providers to make resources available for investor education as part of their development of a retail sector presence.

Q8: Would there be significant demand for shares in hedge funds if we introduced new Listing Rules to allow them to list?

Q9: What safeguards would we need to build into our Listing Rules, both in terms of eligibility for listing and additional disclosure requirements, if we were to consider such a change? Should we consider setting a high minimum share denomination at issuance?

- 3.11 There were mixed responses on this issue. Of those who believed that listing would increase demand, some said that allowing open-ended hedge funds to list would increase demand. Others thought that a London listing might increase the marketability of hedge funds and regulatory comfort in them. Some respondents thought that listing might increase disclosure and transparency, although one felt otherwise. Some respondents said that demand from listing would only increase if rules on taxation and redemption changed and if education increased.
- 3.12 Of those who opposed listing, many said that a UK listing was not necessary as other listing routes are available and are often cheaper than the UK. Some respondents said that listing would not have a beneficial effect for retail investors, as its primary role was to open up the market and not to achieve investor protection.
- 3.13 On the question of safeguards, the majority of respondents said that the use of risk warnings was the most important safeguard. Comprehensive disclosure requirements were also suggested. Other suggestions include gearing and maximum position size limits, assessment of manager's infrastructure to handle retail clients, liquidity and risk spread requirements. A small number of respondents questioned the need to change the current regime, with one suggesting that additional disclosure requirements would make listing unattractive for some hedge funds.
- 3.14 On the question of high minimum share denominations, the majority of respondents said that they weren't necessary or useful as they may decrease liquidity and limit hedge funds to those who are wealthy but not necessarily sophisticated. Secondary dealing might also render them irrelevant. Those who supported it said that it would be useful to restrict retail investors from investing in hedge funds.

**Our response:** We explain in Chapter 4 why we do not believe it is appropriate to provide for the official listing of hedge funds at the present time. Funds of hedge funds may be listed under our present rules and we do not propose changing this. Recent proposed changes to the Listing Rules will require greater disclosure of risks to investors in investment companies.

## The regulation of hedge fund managers

Q10: Do you consider our regulatory approach towards UK hedge fund managers to be appropriate? Are there any changes we should consider making, within the constraints set down under the Act?

3.15 The vast majority of respondents said that our regulatory approach was appropriate. Some suggested that:

- we should simplify rules and encourage dialogue with the hedge fund industry on trends
- additional rules might be required if products are made available in the retail market; and
- we should provide guidance on what constitute appropriate risk control and valuation systems.

Several respondents expressed the view that the burden of regulation should not increase, as it would be damaging to the UK hedge fund management industry.

**Our response:** We have no plans at present to introduce rules specifically to regulate hedge fund management. In particular, the rules in our Handbook module, “Senior Management Arrangements, System and Controls” apply to hedge fund managers as much as to any other firm. These rules include a requirement that a firm “must take reasonable care to establish and maintain such systems and controls as are appropriate to its business”.<sup>1</sup> Any hedge fund manager failing to meet this standard would therefore be in breach of our rules. We pointed out in DP16 that hedge fund managers are assessed as low impact firms under our risk-based approach to regulation. We are certainly open to engage with the hedge fund industry on trends.

Q11: Is our approach to monitoring the overall hedge fund market appropriate? Are there additional actions we should consider taking with respect to hedge funds that would improve confidence in the UK's financial markets?

3.16 Some suggested that we should focus on:

- monitoring credit and market risks;
- additional disclosure and monitoring requirements regarding shorting; and
- increasing investor and IFA education.

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1 SYSC 3.1.1R

One respondent said that the lack of direct supervisory control of hedge fund managers (because they are often classified as low risk by the FSA) raises the risk of undetected regulatory failings occurring in those firms.

**Our response:** As regards supervision, supervision visits are only one tool available to us. We also make use where appropriate of desk based supervision, based on reports received from firms. Any firm, including any hedge fund manager may be included in our 'thematic' visits. We shall carry out some specific work to assess the adequacy of hedge fund managers' risk management systems and controls. Of course, this will not amount to a review of the fund's own systems and controls – we are unable to regulate the offshore investment vehicle.

## Financial crime

Q12: Is our approach to implementing our financial crime objective appropriate for hedge fund managers? Is there multilateral action to which we should contribute through international fora?

3.17 Only around half of the respondents answered this question. Almost all agreed that our approach is appropriate, as is our involvement in international fora. However, some suggested that:

- proactive work needs to be done through international fora on money laundering, 'know your customer' and account opening procedures;
- we should investigate problems that have arisen in countries where external custodianship is not mandatory;
- anti-money laundering measures need to be as robust for hedge funds as other products; and
- UK and US money laundering requirements should not conflict with one another. One respondent expressed the view that we would gain greater comfort if funds were regulated onshore and so subject to increased money laundering reporting requirements.

**Our response:** We are grateful for confirmation that our approach to our financial crime objective is generally well supported. We shall continue to engage in international fora wherever we feel it would be of benefit.

The importance of anti-money laundering regulation has become a major international issue since the terrorist events of September 2001. We share the concerns of other jurisdictions that all appropriate steps must be taken by authorised persons to prevent the financial system from being used as a vehicle for money laundering.

Hedge fund managers in the UK must ensure that their anti-money laundering systems and controls reach the required standard, and if they are in any doubt about that they

should take appropriate advice. In practice, many UK based hedge fund managers will need to rely on the systems and controls of their administrator, who may not be located in the UK. In making such reliance, the UK manager does not absolve himself of responsibility for compliance with the Money Laundering Sourcebook.

# 4 Policy considerations concerning greater access for hedge funds to the retail market

- 4.1 Most of the interest generated by DP16 arose from the suggestion that we might permit product providers to have greater ability to market to retail investors. DP16 itself did not express any views on the desirability or otherwise of such marketing.
- 4.2 We suggested in DP16 that there are two particular ways to bring hedge funds to the retail market:
- We could officially list hedge funds for trading on the London Stock Exchange.
  - We could create a regime for hedge funds to be authorised when structured as collective investment schemes (as either unit trusts or investment companies with variable capital).
- 4.3 Respondents to DP16 did not suggest that there is significant desire on the part of product providers or retail investment advisers to get immediate access to the retail market. Similarly, it was not generally suggested that retail investors are demanding access to retail hedge funds. We note also that the present regime does allow for hedge funds to be marketed and sold to retail investors, although only in limited circumstances. In particular, appropriately authorised intermediaries are able to recommend hedge fund products to retail customers for whom they are considered suitable.
- 4.4 As several respondents to DP16 noted, it would be difficult to create a definition of the term ‘hedge fund’ for regulatory purposes. Most industry commentators would seek to define a hedge fund by reference to a series of characteristics. As we said in DP16, the funds:
- use a wide variety of trading strategies involving position-taking in a range of markets;
  - employ an assortment of trading techniques and instruments, often including short-selling, derivatives and leverage; and
  - pay performance fees to their managers.

- 4.5 A definition incorporating these features would include a substantial number of funds, some of which might not even be considered to be hedge funds. The true distinction between a hedge fund and a conventional fund is the extent to which a hedge fund manager is able to use a wider range of portfolio management techniques.
- 4.6 Many respondents to DP16 suggested that some, but not all, hedge funds should be available for retail marketing. Respondents frequently suggested that some types of long/short hedge fund (and some others) effectively begin where the current range of authorised collective investment schemes ends. So, respondents suggest that allowing these types of activity to be carried on in authorised schemes would amount to a nudging of the present boundary between authorised and unauthorised schemes, rather than a significant change. Unfortunately, the difficulty of distinguishing between types of hedge fund would make it very difficult to limit the funds that we would need to be prepared to authorise.
- 4.7 We explained in DP16 that in the UK we do not generally admit hedge funds to official listing for trading on the London Stock Exchange because they are unable to offer an adequate spread of risk. Permitting them to list would require a significant change to the listing regime for investment companies. Funds of hedge funds are, however, another matter and we do list investment companies that invest in underlying hedge funds.
- 4.8 These companies do comply with the requirement to offer an adequate spread of risk. Their shares are marketable in the UK in the same way as any other company's. Where the shares are first offered to the public they can be marketed through Listing Particulars. Furthermore, suitably authorised investment advisers can recommend investment in the shares to retail consumers for whom they are considered suitable.
- 4.9 We have concluded that we should not, at the present time, officially list hedge funds for trading on the London Stock Exchange. This does not apply to funds of hedge funds that may continue to be admitted to the Official List. We are presently conducting a fundamental review of the listing regime in the UK and that includes the regime for investment companies. Any general changes we might make to that regime may have an effect on the official listing of hedge funds, along with other investment companies. Any such changes will of course be subject to consultation.
- 4.10 The UK authorisation of collective investment schemes operates on a predominantly 'top-down' basis, meaning that the structure and operation of authorised schemes must comply with strict rules. None of the scheme types allow for hedge fund strategies to be operated. The 'top down' approach would effectively oblige us to define the term 'hedge fund' to create a type of specific authorised scheme for them. If we did this, however, the imprecision

of the definition suggests that we would be allowing within the regulatory framework for authorised schemes a substantial number of presently unauthorised schemes. This has implications for retail consumers who are familiar with currently authorised products that carry a high degree of product regulation. We are presently reviewing the collective investment schemes regime and will soon be publishing a Consultation Paper including proposed changes to the regime. Any general changes we propose to that regime may have an effect on hedge funds, along with other presently unregulated schemes.

- 4.11 As mentioned above, funds of hedge funds may be listed as investment companies. In theory, it would be possible for us to create an authorised fund of funds vehicle for hedge funds as collective investment schemes. We note, however, that at the moment authorised collective investment schemes are only able to invest significantly in listed securities or other authorised collective investment schemes. These underlying investments are therefore themselves subject to regulation. It would amount to a significant change for the authorised schemes regime to create a retail authorised scheme for investment in unregulated hedge funds. Protections provided by that regime would be removed.
- 4.12 We conclude that bringing hedge funds into the present regime for authorised retail collective investment schemes would require a radical rethink of the authorisation regime for retail schemes generally. Other jurisdictions operate authorisation regimes using a predominantly ‘bottom up’ approach, i.e. they set broader criteria for the schemes to be authorised, but much more responsibility is placed on the promoter to explain in adequate detail through the prospectus how the specific scheme will operate. This allows a greater variety of schemes to obtain authorisation, and makes it easier to allow for retail hedge funds. In such a regime, there would be no need to define the term ‘hedge fund’ as a matter of regulation. Unless the description were positively misleading any fund would be able to call itself a hedge fund.
- 4.13 We have concluded that we should not at the present time create an authorisation mechanism for hedge funds or funds of hedge funds in the retail authorised collective investment scheme regime.
- 4.14 Respondents to DP16 did not suggest that there is a great desire on the part of product providers or retail investment advisers to provide or sell such retail products. Nor have respondents suggested that there is significant demand from retail investors. In addition, such a regime would undermine the protections currently applied for authorised funds.
- 4.15 However, we recognise that the regulatory status of presently unregulated schemes needs to be kept under review. We will continue to discuss the possibility of a new approach with market participants. This new approach would allow for a broader range of funds to be brought into the regime for retail investment products.



# List of respondents to DP16

(excluding those who asked for their responses to remain confidential)

ACP Partners LLP

AGS Capital

APCIMS

AXA Investment Managers Ltd

The Actuarial Profession

The Alternative Investment Management Association (AIMA)

American Financial Services Association

Association of Independent Financial Advisers (AIFA)

Association for Investment Management and Research (AIMR)

The Association of Investment Trust Companies (AITC)

Aviva

Barclays Capital

Barclays Global Investors

Cadogan Financial

Castle Investment Consultants

Close Brothers Securities

Close Fund Management

Deutsche Asset Management

Financial Services Consumer Panel

Fitzrovia International plc

Goldman Sachs International

Henderson Global Investors  
Investment Management Association (IMA)  
Jupiter Asset Management  
The Law Society  
London Investment Banking Association (LIBA)  
McKinsey Investment Office (Europe) Ltd  
MAN Investment Products  
Matrix Money Management  
Park Caledonia Associates Ltd  
Patience Clarke Burrowes Begg Financial Services  
Premier Independent Advisers Ltd  
Schroders Investment Management Ltd  
Tee Kaihong

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