KYD comments on SEC proposal regarding registration under the Advisers Act of certain hedge fund advisers – File Number S7-30-04

Based on the request by FEFSI, Turkish Institutional Investment Managers' Association (KYD), would also like to provide general comments on SEC proposal regarding the registration of certain hedge fund advisers. Investment Advisers Act of 1940 has been a comprehensive legislation to establish an efficient investment funds industry for many years. However with the evolution of new investment intruments throughout the world and with the addition of lots of new money managers using challenging investment strategies and styles, currently global investment industry needs better supervision and fair treatment by regulators.

The first priority of all investment fund advisers should be the management of clients' portfolios in the best interest of clients, but not in any prescribed manner which is the value added part of asset management business. The exemption for SEC registration for advisers may sometimes lack SEC the authority to conduct regular examinations of certain advisers. Although certain hedge funds are established by only a small number of clients many of whom are likely to be friends and family members, the size and the movement of client assets might have effects on the whole institutional investment industry. Hedge fund supervision is a sensitive issue because, hedge funds are perceived as liquidity instruments for market participants and as return maximization instruments for investors. They are originally designed to invest in equity securities and use leverage and short selling to 'hedge' the portfolios's exposure to movements of the equity markets.

Without the SEC supervision, hedge funds may charge unnecessary commisions, involve in fraudulent activities and may grossly overstate certain investment performances. Besides higher earning potentials, these practices may harm investors. It's no surprise that some advisers to hedge funds have previously been key participants in recent scandals. Another area of concern is the growing exposure of smaller investors, pensioners and other market participants to hedge funds. From SEC point of view, the new proposal may help the protection of investors and the suppression of fraud. But no action should encumber the independent operation and asset management activities of hedge funds since they heavily contribute to market efficiency and liquidity in the markets.

The best protection of hedge fund investors seem to be the transparent management of client portfolios. There should not be any overstatement of results regarding performance presentations to 'buy time' or to attract new investors. The crucial point in the new proposal regarding the registration of hedge fund advisers, is the fact that, there should be minimal burdens for registered advisers. The registration fees, asset management standards and record keeping practices should not create excessive costs to hedge funds.

If possible, a thorough cost-benefit analysis should be conducted before enforcing the mandatory SEC registration for hedge funds. If the additional aggregate cost of SEC registration of hedge funds is less than the aggregate investor losses created as a result of fraud in the industry, then the new proposal should be supported. On the other hand SEC registration might also have additional benefits for the industry such as, better compliance for code of ethics, decrease in fraudulent activities, ensuring symmetrical information and competition on the same basis.