



**POSITION PAPER  
ON THE REPORT ON HEDGE FUNDS  
ISSUED  
BY THE ALTERNATIVE INVESTMENT  
EXPERT GROUP IN JULY 2006**

**20 September 2006**

ALFI would like to congratulate the Expert Group for the excellent report (the “Report”) it produced on managing, servicing and marketing Hedge Funds in Europe. ALFI also salutes the European Commission for having set up the Expert Group and facilitated its discussions. The Report gives a complete overview of the challenges, identifies areas for possible improvement and addresses preconceived notions about the hedge fund industry. ALFI welcomes the opportunity to comment on this important paper.

ALFI is the representative body of the 1.6 trillion euro Luxembourg fund industry. It counts among its members promoters and managers from various horizons and a large variety of service providers. As one of the main gateways to the European and global markets, Luxembourg is well positioned as fund domicile and servicing centre for hedge funds.

ALFI fully supports the set of eleven targeted and practical recommendations issued by the Expert Group which we believe are important for the continued successful development of the hedge fund industry in Europe.

## **1. GENERAL REMARKS**

ALFI has analyzed the following two key areas pointed out by the Expert Group:

- 1) Freeing up access to investors in other member States by removing unproductive, inefficient and unjustified legal or regulatory impediments; and
- 2) Removing and not creating barriers to the free provision of services between Member States, which impede access to “best of breed” service providers for essential support services such as fund administration, custody and prime brokerage.

## **2. FREEING UP ACCESS TO CROSS-BORDER INVESTORS**

### **a) Retail Access to Hedge Funds**

ALFI welcomes the idea of the Expert Group to not control sales and distribution through product regulation or registration but, instead, to fix conditions under which retail access to hedge fund-based investments could be contemplated.

ALFI supports the suggestion made by the Expert Group to introduce, as a minimum threshold of 50 000 euro as condition to prevent access to hedge funds by investors for whom such investments are not suitable.

**b) Quantitative restrictions**

ALFI approves the Expert Group's position regarding the arbitrary and/or regulatory quantitative restrictions on hedge funds investments. ALFI is of the opinion that no quantitative restrictions should be imposed on hedge fund investments whether they are made by institutional investors or retail investors. Even if Member States justify the settlement of such quantitative restrictions with legitimate arguments, in practice the effects of such restrictions are negative for the hedge fund's business (e.g. legal uncertainty, high costs), and are limiting the investment strategies of hedge fund managers. Furthermore they are ineffective in terms of investor protection.

**c) Extension of UCITS Directive's scope**

In line with the majority of the Expert Group's view, ALFI considers that it should not be envisaged to broaden investment rules and other provisions of the UCITS Directive to allow funds of hedge funds to be authorised as UCITS compliant funds.

We are of the opinion that the provisions of the UCITS Directive (e.g. provisions on valuation, risk diversification, investment restrictions, eligibility of assets) are too restrictive to apply to the hedge fund industry.

**d) Mutual recognition of national hedge fund**

Following the Expert Group's recommendation, ALFI encourages the European institutions and national authorities to take all steps needed to give effect to the mutual recognition of nationally regulated hedge fund products.

**e) Harmonised private placement regime for hedge funds**

It would be worthwhile considering to establish an alternative regime to the current regime of hedge funds analysed by the Expert Group (Private placement hedge funds regime based on a 50.000 euro threshold) and to the UCITS regime. Indeed, the regime proposed by the Expert Group does not only recognize that offshore hedge funds can be distributed on a private placement basis in Europe but that the creation of a European harmonised regime should also be accompanied by more flexible rules in terms of marketing European harmonised hedge funds.

Such alternative regime could be based on minimum European standard requirements (e.g. local administrator, disclosure requirements reputation and experience of managers) which, when fulfilled, would allow the offering of hedge funds by means of advertisements though only up to 50.000 euro minimum investment. This solution should be in line with the Prospectus

Directive in terms of disclosure in prospectuses and with the idea of a European harmonized regime.

### **3. CONCLUSION**

ALFI welcomes the Expert Group's publication of its Report which we believe will contribute to further reflections on the development of the policy framework for a successful European asset management business and to draw attention to areas for potential improvement in the European operating environment for hedge funds and funds of hedge funds. ALFI appreciates the quality of this document and is of the view that it addresses many critical concerns for hedge fund practitioners.

ALFI will support and be happy to contribute to any further effort initiated by the European Commission with a view to develop the hedge fund's business in Europe.