

Alternative Asset Management

***Carlos Arenillas
Vice-Chairman***

***Comisión Nacional Mercado de Valores (CNMV)
Spain***

Brussels, October 2005

Index

1. Hedge funds: what are we talking about?
2. Remembering some facts
3. New regulatory initiatives with different approaches
4. Spain: the new regulatory framework
5. Concluding remarks

1. What are we talking about?

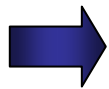
There is no formal definition of hedge funds

- Some try to identify what they have in common
- Others try to see the difference with mutual funds. For example:

“Like mutual funds, hedge funds pool investors' money and invest those funds in financial instruments in an effort to make a positive return. Many hedge funds seek to profit in all kinds of markets by pursuing leveraging and other speculative investment practices that may increase the risk of investment loss.

Unlike mutual funds, hedge funds are subject to very few regulatory controls. Because of that, hedge funds historically have generally been available solely to accredited investors and large institutions. Most hedge funds also have voluntarily restricted investment to wealthy investors through high investment minimums”

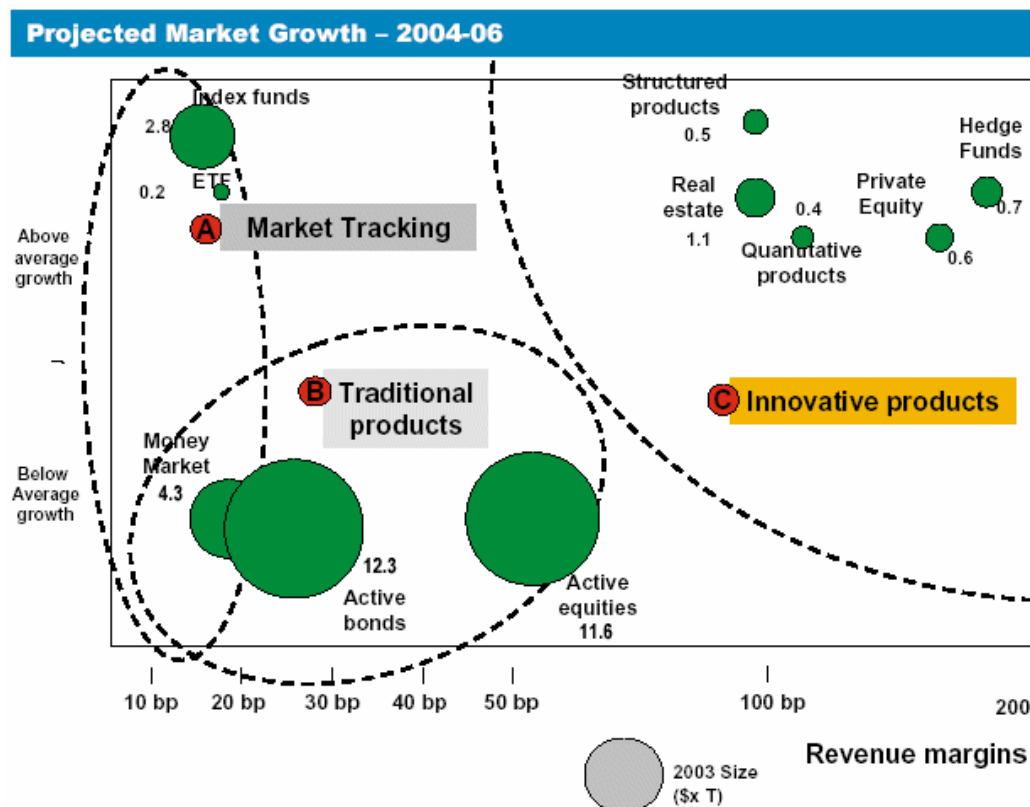
At the SEC 's web page



They are more related to a management style than to a new type of asset class

1. What are we talking about?

The border between traditional asset management and alternative asset management will fade away



Sources : National statistics, BCG analysis, Morgan Stanley Research. Projections 2004-2006

In Spain, we are going to denominate hedge funds as: *Fondos de Inversión Libre*, focusing on how they invest, rather than on, for example, their legal structure.

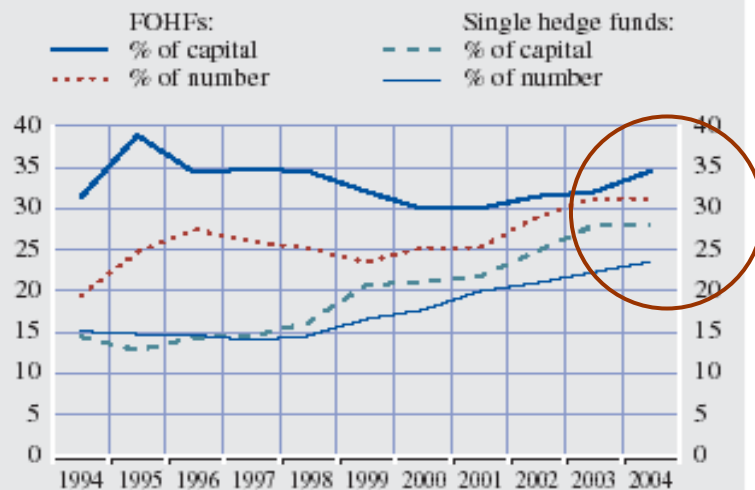
2. Remembering some facts

The European share of the market is still reduced, but it has been growing over the last few years.



Chart 9 Market share of EU hedge funds

(% of total; end-of-year data)



In addition, hedge funds are growing in importance in terms of their contribution to financial markets.

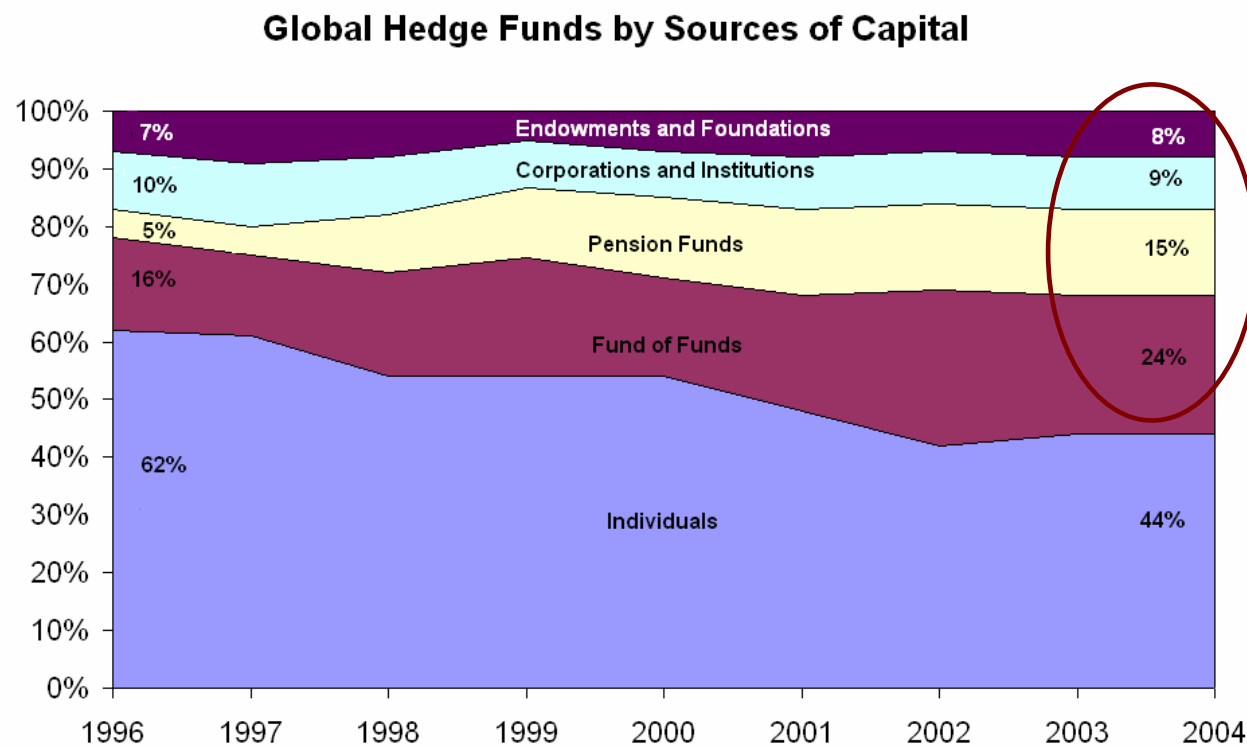


Due to the active role played by hedge funds in the markets, they are more important than what one could think because of their size.

While it is estimated that they only account for less 5% of total assets under management worldwide, they are estimated to account for between a third and a half of daily activity on the NYSE or LSE

2. Remembering some facts

The breakdown of the type of investors is changing:



- Institutional (pension funds)
- Retail investors (mainly using funds of hedge funds)

3. New regulatory initiatives...

All around the world, including Europe, several national regulatory initiatives have been taken over recent years.

But all with different regulatory approaches, even within Europe.

Some European jurisdictions focus on products, others more on the fund manager and others on the distribution of the fund.



3. New regulatory initiatives...

The lack of regulation leads to:

- Less transparency and lack of disclosure → Potential fraud and conflicts of interests
Absence of investor protection
Threat to credit institutions
- Absence of controls → Could increase the risk of market abuse, operational risks, valuation weakness...

The lack of harmonization leads to:

- Fragmentation of the market → Inefficiency
- Regulatory arbitrage and unfair competition on a cross-border country and between regulated and non regulated investment products
- Absence of an international mechanism to exchange information
→ Increase systemic risk

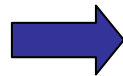
4. Spain: the new regulatory framework

The goals of the new regulatory framework for Spanish collective investment¹ are:

- Improve the protection for retail investors
- Achieve a more flexible regulation
- Reduce the bureaucracy on registration process

With these core principles in mind, the Spanish Government has set up the regulation that implements the new IIC Law, which now includes hedge funds². The CNMV is, currently, drafting a *circular* regarding hedge funds.

With the following
objectives



To provide a legal framework for the establishment of domestic single hedge funds and funds of hedge funds

To assure adequate governance of hedge funds (focusing on the asset management company)

To achieve maximum level of transparency

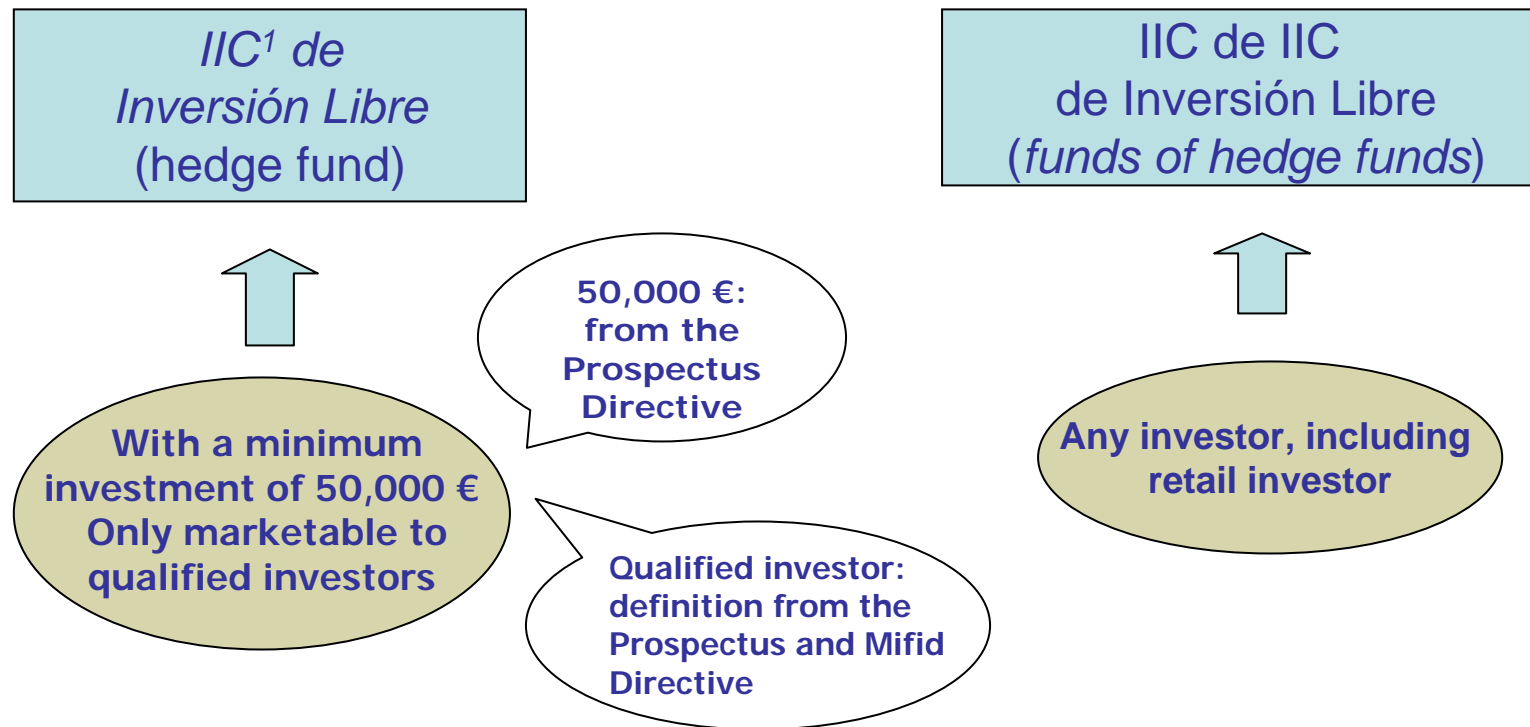
To improve retail investors protection

¹ *Collective Investment Scheme Law 35/2003, dated 4 November*

² *To be approved in the following weeks*

4. Spain: the new regulatory framework

The regulation has established two different products:



It will allow public distribution of funds of hedge funds to retail investors. Meanwhile, single hedge funds will only be marketable to qualified investors.

¹IIC: Colective Investments Schemes: funds or open securities investment companies

4. Spain: the new regulatory framework

IIC de Inversión Libre (*hedge fund*)

- Minimum investment of 50,000 €
- Limited marketability: only to qualified investors
- Flexible investment regime (principle of risk diversification)
- Calculation of net asset value could be quarterly or even, in some cases,
 - half-yearly
- No limits on fees, but transparency
- Transparency and disclosure requirements on the prospectus



Registration at the CNMV



Establishment of specific requirements to the asset management company (licence by CNMV)

4. Spain: the new regulatory framework

IIC de IIC de Inversión Libre (fund of hedge funds)

- Without minimum investment, no restrictions on marketability
- Investment policy: at least 60% on hedge funds registered in Spain, in a OECD country or managed by a management company registered in a OECD country. And no more than 10% in the same hedge fund.
- Calculation of net asset value could be quarterly or even, in some cases, half-yearly
- No limits on fees, but transparency
- Transparency and disclosure requirements on the prospectus



Registration at the CNMV

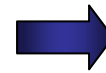


Establishment of specific requirements to the asset management company (licence by CNMV)

5. Concluding remarks:

Regarding the questions in the green paper:

Is there a need for a common regulatory approach?



An increased regulation is considered as inevitable and it has to be done in a coordinated way.

Are there risks which might warrant special attention?



Impact on financial system, operational risk, potential conflicts of interests, valuation weakness and lack of investor protection.

Could a common private placement regime help?



Current investors are primarily institutional but we must take into account the increasing interest of retail investors towards this kind of investments.

Alternative Asset Management

***Carlos Arenillas
Vice-Chairman***

***Comisión Nacional Mercado de Valores (CNMV)
Spain***

Brussels, October 2005