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INVESTMENT FUNDS GROUP

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The President's Working Group on Financial Markets Issues Guidelines for the Oversight of Hedge Funds and Private Equity Funds

By Timothy Spangler

On February 22, 2007, the President's Working Group on Financial Markets (the "Working Group") issued guidelines for the oversight of hedge funds, private equity funds and other private pools of capital, entitled "*Agreement Among PWG and U.S. Agency Principals on Principles and Guidelines Regarding Private Pools of Capital*". The Working Group consists of representatives from the Treasury, the Federal Reserve, the Securities and Exchange Commission and the Futures Trading Commission. The Working Group was formed in 1988 to further the goals of enhancing the integrity, efficiency, orderliness, and competitiveness of financial markets and maintaining investor confidence.

The guidelines will guide U.S. financial regulators as they address public policy issues associated with the rapid growth of private pools of capital, including hedge funds, and serve as a framework for evaluating market developments, specifically concentrating on investor protection and systemic risk concerns. The Working Group has designed the guidelines to provide a flexible principles-based approach to address the issues presented by the growth and dynamism of these investment funds. They are intended to reinforce the significant progress that has been made since the Working Group last issued a report on hedge funds in 1999 after the collapse of Long Term Capital Management.

In summary, the guidelines lay out certain responsibilities that various participants should bear in mind when addressing the issues that currently face private pools in the financial markets:

- **Funds should** maintain and enhance information, valuation, and risk management systems to provide market participants with accurate, sufficient and timely information.
- **Investors should** consider the suitability of investments in a private pool in light of investment objectives, risk tolerances, and the principle of portfolio diversification.
- **Counterparties and creditors should** commit sufficient resources to maintain and enhance risk management practices.
- **Regulators and supervisors should** work together to communicate and use authority to ensure that supervisory expectations regarding counterparty risk management practices and market integrity are met.

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The guidelines stress the importance of market mechanisms in addressing the challenges presented by the rapid growth of hedge funds and private equity funds, both to market participants and policy makers. Importantly, the Working Group made no call for new laws or regulations to be adopted, recognising that the current regulatory approach is sufficient to protect investors and the overall stability of the financial system. The focus instead will remain with the funds themselves, as well as their principal counterparties, such as prime brokers, to adhere to certain non-binding principles. Many of these principles will represent "best practices" for leading hedge funds and experienced investors.

A copy of the guidelines may be found at
http://www.ustreas.gov/press/releases/reports/hp272_principles.pdf.

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