



MEDIA RELEASE

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HEDGE FUND CONSOLIDATION ON THE CARDS

Regulatory, governance and transparency issues demand more attention

South African hedge funds may suffer casualties if they come under continued pressure from cash-hungry investors looking to exit.

Carla de Waal, Portfolio Manager at Novare Investments and board member of the Alternative Investment Management Association (AIMA) South Africa National Group, said that while the domestic hedge fund industry survived 2008 in relatively good shape, further redemptions could leave some funds at risk.

“During 2008 many South African hedge funds had to contend with significant outflows, initially as offshore investors looked for liquidity in markets with favourable redemption terms amidst the growing credit crisis.

“With retirement funds being a large investor group in local hedge funds, but still restricted in terms of their maximum allocation to alternative investments, falling equity prices prompted portfolio rebalancing exercises that led to further outflows.”

This, she said, had increased the business risk for investors in these funds, as smaller managers especially could find themselves with insufficient assets to maintain business stability.

“In cases like these, affected funds should be as open as possible about the potential impact of forced selling on both redeeming and remaining investors with a view to finding a workable solution,” said de Waal.

However, she added that industry consolidation would not necessarily be a bad thing as the larger surviving hedge fund houses would be better equipped to deal with greater regulatory

demands and to better serve institutional investors.

Changes on the regulatory front have required hedge funds to shift the focus towards operational issues. For example, last year managers had to apply for special category financial services provider licences from the Financial Services Board (FSB) for the first time.

The FSB also has specific solvency requirements for licensed financial services providers including that assets should exceed liabilities at all times. For Category IIA licence holders (under which hedge fund managers fall) the specific requirements are that assets should exceed liabilities by at least R3 million, and that the business should always maintain liquid assets sufficient to cover the equivalent of 13 weeks' expenditure.

Until now, the South African hedge fund industry has been characterised by a high degree of self-regulation, with minimum standards set by investors like funds of funds. In adopting international best practice, domestic funds have tended to make use of independent administrators, prime brokers and custodians.

“With many banks and prime brokers facing difficulties on the back of the global credit crisis, this area might require even greater scrutiny in the year ahead. We also expect investors to push for greater transparency and more regular performance updates,” said de Waal.

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Notes to Editors:

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