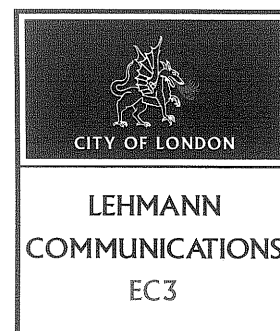


PRESS CUTTING

**Global Custodian  
October 2005 (pg1 of 2)**



**FSA Regulation Of UK Retail Investors In Hedge Funds On The Wrong Track,  
Says Jamie Stewart Of Eden Group**

This article was contributed by Jamie Stewart, Head of Institutional Marketing and Research at Independent Research Eden Financial Ltd.

As with most phenomena of human and natural worlds evolution is never finite: it spawns further development calling for refining, regulating and redesigning. This is the case in the Financial Services arena: it's unlikely the FSA ever saw itself as an example of evolutionary theory but undeniably it is.

As with most phenomena of human and natural worlds evolution is never finite: it spawns further development calling for refining, regulating and redesigning. This is the case in the Financial Services arena: it's unlikely the FSA ever saw itself as an example of evolutionary theory but undeniably it is.

The FSA's recent Discussion Papers, 'Hedge funds: A discussion of risk and regulatory engagement' and 'Wider-range Retail Investment Products', share financial DNA in terms of the evolutionary developments which they address, and of the FSA responsibilities which they seek to clarify, modify, define and, in the jargon of our caring age: 'share'.

The regulator has long recognised that the advent of hedge funds and sophisticated retail investment products (- far from the implications of their acronymic R.I.P.) is not only unstoppable, but ultimately welcome and constructive. New-fangled as they were ten years ago, these unfamiliar formations, like platypuses, have developed relentlessly and largely creatively.

It seems that the time is right to discuss compromise; not surrender so much as constructive means of permitting - encouraging, even - access for retail investors whilst ensuring the protection which all good overseers provide for their subjects.

Notwithstanding, the FSA is not only about red crosses, white flags, conventions and vigilance. The Treasury glowers, and some downstairs mandarin has underlined that fiscal revenues don't fall off trees. The FSA is part of the machine ensuring that capitalism and capitalization expand safely, and that capital invested continues to expand, ultimately providing the taxes desperately needed to alleviate the shortfalls along Revenue Row.

These discussion papers match in respect of diligent detail, definition and distinction. Their essence, however, is not so much about the 'leverage', 'volatility' and 'operational risk' which they explore as about the judicious balance between permissiveness and restrictiveness, about where to position responsibilities.

The FSA's style has become more consultative, less dictatorial; these DPs are paradigms of emergent rule by reason and referral rather than by rod. The questions exercising market denizens since June, when these two DPs were released, highlight the equitability and practicalities of the developing proposals for achieving objectives without creating tsunamis, freak hybrids and casualties meanwhile.

The natural historian would set out to ignore feathers and the braid in favour of identifying underlying principles and structures. The FSA, in these two DPs as well as other recent Consultation Papers and Policy Statements, are pursuing a policy of quietly transferring responsibility for vigilance and verification to the institutions, with detail depending on context. Their approach is aligned with a general tendency to impose duties to self-certify, self-assess, self-medicate, self-monitor. The expenses and hazards of traditional herding and husbandry have been recognised as deterrent;

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**Global Custodian  
October 2005 (pg2 of 2)**



transferring the onus of breeding model citizens on to the citizen himself, his family and his corner-shop solves many problems.

There is no abrogation of responsibility: proactive patrolling turns into 'enhanced regulatory oversight', whilst requirements for broader and deeper data-management, verification, recording, reporting, squeezing money-laundering and declaration replace traditional vigilante weaponry.

Recourses and sanctions remain, of course: reporting, random sampling, investigation and censorship have not gone away - whilst the FSA secures the added accolade of bidding a drawn-out farewell to nannyism.

The FSA can't treat retail investors like institutions. Whilst institutions must to comply, punters are free spirits and continue to run wild. Although they represent the key protégé under the FSA's microscope, they do not lend themselves to direct control, and shifting policy aims to ensure that they remain protected whilst the institution increasingly carries the can.

Hedge funds continue to proliferate: depending always on definition, there are 9,000 worldwide managing \$1.2 trillion in assets, close to total funds managed by Fidelity Investments, and close to Britons' aggregate personal debt. A number are exceptionally able, but some stumble and go the way of the Dodo: consider Bailey Coates, Bayou and Olea. It's the survival of the fittest all right, highlighting the characteristics of evolution: underperform, and asset becomes redemption.

What do their managers think about these developments? They vote with their front-door closed on the retail investor in his individual incarnation. Multi-managers spawned funds to meet the differing needs of both. Hedge funds prefer individuals who are expert investors with shedloads of money or standing behind family offices, private banks and SIPPs. Their asset inflows come from pension funds, A.I.-designated tranches of corporate, local authority and corporate funds, and fund-of-fund managers such as MAN Group and GAM. The closer they get to allowing punters one by one across the threshold, the more they attract the regulatory authority - so they prefer to keep them away, and court their funds as granular parts of bigger money.

Like the institutional inventors and distributors of UCITS, SPLITS and derivatives, hedge funds know full well that they are effectively being benevolently clobbered in the guise of smiling acceptance by the FSA. The HCF of reaction is to recognise higher hidden management costs looming, which they can ill afford: margins are already contracting. The reaction is to increase their PI cover, charge retail investors more if they service them, seek out the wealthiest if it isn't, and target pooled vehicles and institutional investors as clients. Intelligence bows thus to the inevitable: evolution with subcutaneous radar evolving beneath ruffled feathers.

And what of the retail investor himself? Few realise what is going on here. The expert investor, the HNW individual and a few others understand the survival and selection processes, recognising the responsibility of the deity to temper the wind to the shorn platypus. The UK punter has irreversibly developed US-rooted DNA of late: when the chips are down and the fat is in the fire, you name, shame, blame and claim, and you'll probably get some comfort and compensation, if not more. There is nothing novel and nothing disgraceful about this: Nell Gwyn discovered a long time ago that it is much more fun to have all the power and none of the responsibility than the other way round.

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