

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

1 June – 3 June 2010

Question: BET 88

Topic: European Commission – Hedge Funds

Hansard Page: E19-20 (03/06/2010)

Senator CAMERON asked:

Senator CAMERON—Can anyone explain to me the proposal that is before the EU Commission at the moment for a directive on alternative investment fund managers?

Mr Chapman—I doubt whether we can.

Senator CAMERON—Could you take that on notice?

Senator Sherry—We have the markets group coming next. They may well be able to give you more information. To the extent that hedge funds are used in prudentially regulated superannuation funds it is a subinvestment category. They have outlined the areas of interest here at APRA. The direct oversight of the hedge fund sector is something for ASIC but the markets group would have some information.

Mr Chapman—APRA were the overseers of much of these issues and—

Senator Sherry—Not of hedge funds specifically.

Senator CAMERON—No, I am not talking about hedge funds; I am talking about superannuation funds that are investing in hedge funds. This is where the link comes to APRA, from my perspective. APRA needs to have, I would think, some understanding of the risks that superannuation funds would take when they invest in hedge funds. Is that a proper analysis?

Mr Chapman—That is a fair statement, and we would need to understand the risks when they invest in infrastructure, equities, fixed interest, foreign investment, et cetera. We would not be looking specifically at what the proposals are around the world on how those hedge funds should be regulated.

Senator CAMERON—I am sure the market group is listening in so I am just letting people know that I will be raising this issue.

Mr Venkatramani—In addition to the issues of responsibility of ASIC and the market group, as far as we are concerned hedge funds are one sector into which our superannuation funds can invest. I go back to the statements made by Dr Laker and Mr Trowbridge: in assessing the capacity for regulated institutions to properly care for beneficiaries we first put that test on them. Do you understand what you are investing in? Can you tell me what can go wrong here and what you will do if it does, in terms of member balances, your ability to pay your members on time, sudden drops in value, simply not being able to get hold of information if that hedge fund is operated out of, say, Cayman Islands or British Virgin Islands?

Senator CAMERON—I accept that. I would expect that to happen. But in terms of hedge funds, this is a particular area where the European Commission are now saying

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that hedge funds were part of the problem in the global financial crisis, and that hedge funds are a significant area that requires regulation. That is what they are saying. If you do not know about it can I ask you to take it on notice? I do think it is important in the context of your supervision of superannuation funds that you have a look at the directive on alternative investment fund managers and advise this committee as to whether it has any implications for your prudential supervision of superannuation funds.

Dr Laker—We will take that on notice.

Answer:

During our on-going supervision work, APRA supervisors look at exposure to hedge funds and similar non-traditional assets on a case-by-case basis to understand whether the trustee's risk management is appropriate. Where this is not the case, our review findings would suggest/require remediation.

The attached article summarises APRA expectations in respect of hedge fund investments.



Expectations when
Investing in Hedge Fu

In addition, APRA leverages off the requirements of ASIC in relation to disclosure and market conduct.

Our experience has been that in nearly all cases the exposure of superannuation funds to hedge fund investments has not been such as to cause concern. If the level of exposure were to increase to levels that caused us concerns on an industry-wide basis, APRA would consider issuing further guidance.

In terms of the proposed EU Directive (Directive on Alternative Investment Fund Managers) APRA understands that the key provisions of this are to:

- ensure that all AIFM are subject to appropriate authorisation and registration requirements;
- improve risk management and organisational safeguards to mitigate micro-prudential risks;
- enhance investor protection;
- improve public accountability for AIFs holding controlling stakes in companies; and
- develop the single market for AIFM.

It is noteworthy that the AIFs include hedge funds, private equity funds, commodity funds, real estate funds and infrastructure funds, among others. From APRA's

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perspective the key issue is, as noted in the attached article, that superannuation fund trustees make properly informed and considered decisions about making any investments into hedge funds or other alternative forms of investment.